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KBC Group
Risk Report 2012

KBC

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Introduction: highlights in 2012 and disclosure policy

KBC is an integrated bank-insurance group, whose main focus is on retail clients, small and medium-sized enterprises and private banking clientele. We occupy leading positions on our home markets of Belgium and Central and Eastern Europe, where we specialise in retail bank-insurance and asset management activities. Elsewhere around the globe, the group has established a presence in selected countries and regions.

Highlights

Firmly embedding risk management

At the start of 2013, the risk governance model was strategically updated to take account of the most recent changes in the organisational structure of KBC. Our core strategy is focussed on bank-insurance in Belgium and a selection of countries in Central and Eastern Europe (Czech Republic, Slovakia, Hungary and Bulgaria). In line with our strategic plan, we have almost completed the sale or rundown of a number of (non-core) activities. More information on the new risk governance model can be found in the 'Risk management governance' section of this report.

KBC Group Solvency

In 2008 and 2009, a number of capital-strengthening measures were taken, whereby non-voting core-capital securities were issued to the Belgian State and the Flemish Region, and a guarantee agreement signed with the Belgian State for CDO risks. During 2012:

- We reimbursed 3.5 billion euros (and paid a 15% penalty) to the Belgian State. As a result, the remaining core-capital securities totalled 3.5 billion euros at the end of 2012.
- We issued 1.25 billion euros' worth of new shares by means of a capital increase in December 2012 and contingent capital notes worth approximately 0.75 billion euros were successfully placed in January 2013.
- We successfully sold our treasury shares for 350 million euros in October 2012.
- We concluded a number of divestments, including KBL EPB, WARTA and Kredyt Bank, which had a positive impact on our solvency ratios.

For more information in this regard, see the sections on 'Capital adequacy' and 'Liquidity Risk Management' in this report.

Regulatory challenges

- In 2012, KBC received the green light from the regulator to allow its main group entities to shift from using the IRB Foundation approach to using the IRB Advanced approach. Other entities are scheduled to follow suit in 2013.
- Basel III will introduce new and more stringent capital requirements for financial institutions as well as impose minimum liquidity requirements in terms of LCR and NSFR ratios. At present, our strategic aim over the next few years is to further strengthen our Basel III LCR and NSFR ratios.
- The Solvency II ratio – based on the most recent draft of the Solvency II regulations – of the KBC Insurance Group in 2012 amply exceeded the minimum requirement. Furthermore, KBC invested in a Solvency II reporting system that will allow it to follow up the key metrics of all the insurance entities on a regular basis.

De-risking structured credits

- In 2012, there was a total notional reduction of 3.3 billion euros in our CDO and ABS exposure due mainly to the collapse of two CDOs.

More information can be found in the 'Structured credit products' section of this report, as well as in the 'Value and risk management' section of the 2012 annual report of KBC Group NV (see *www.kbc.com*).

Further reduction of sovereign exposure in GIIPS countries

KBC holds a significant portfolio of government bonds and much progress has been made in reducing its exposure to GIIPS countries. We have maintained the concentration on our home countries, primarily as a result of our considerable excess liquidity position and for the reinvestment of insurance reserves into fixed instruments. More information on sovereign exposure can be found in the 'Credit risk management' section of this report, as well as in the 'Value and risk management' section of the 2012 annual report of KBC Group NV (see *www.kbc.com*).

Credit portfolios under stress

As a result of the economic slowdown in 2012, the quality of the credit portfolio remains under stress. Due to the specific situation on the Irish and Hungarian markets, information on the credit and investment portfolios there is provided separately in the 'Value and risk management' section of the 2012 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 2012 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. Going forward, 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. Basel III will come gradually into effect, most likely from 2014 onwards, while Solvency II was intended to come into effect at the end of 2012, but the European authorities postponed the official entry into force to 1 January 2014. However, because of delays in the development and adoption of the new regulatory, it is not inconceivable that this date could be further postponed until 2015 or even 2016.

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.
Since the end of 2011, CRD III has also required the disclosure of information on the remuneration policy of financial institutions. More information can be found in the 'Corporate governance' section of the 2012 annual report of KBC Group NV and at *www.kbc.com*.

To ensure that a comprehensive view is provided, the credit risk inherent in 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) and non-financial risks have been drawn up to include detailed information at KBC group level (banking and insurance combined). Liquidity risk is managed at bank level. 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).

Remark:

Please note that, unless otherwise stated, KBL EPB, Fidea and WARTA in 2011, and Absolut Bank, KBC Banka, Antwerp Diamond Bank, KBC Bank Deutschland (and the minority shareholding in Nova Ljubljanska banka) in 2012, which have all been recognised as 'disposal groups' under IFRS 5, have been excluded from the various tables in order to maintain consistency with their treatment in the balance sheet. We have provided summary information for these entities separately in the footnotes under these tables.

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.

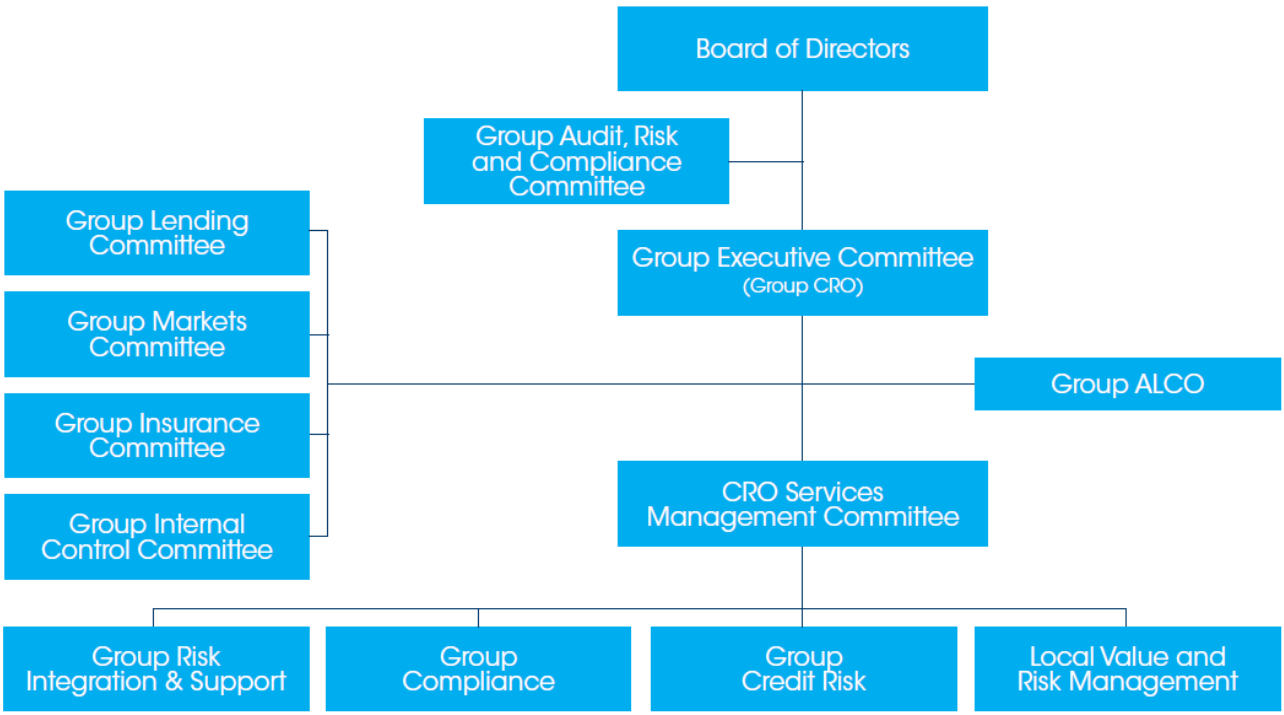
This risk report is available in English on the KBC website and is updated on a yearly basis. KBC's next update is scheduled for the beginning of April 2014. Depending on market requirements, KBC may however decide to provide more frequent updates.

Risk management governance

In financial year 2012, our risk governance model was characterised primarily by:

- the Board of Directors (assisted by the Audit, Risk and Compliance Committee (ARC Committee)) which sets the risk appetite each year, monitors risks and proposes action, where necessary. More information on the Board of Directors and the ARC Committee can be found in the section entitled 'Corporate governance statement'.
- integrated architecture centred around the Executive Committee 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 within the overall strategic choices and risk appetite of the group.
- the Group Risk and Capital Oversight Committee (GRCOC), the activity-based Asset/Liability Management Committee (ALCO), the Group Risk Management Committee and activity-based risk subcommittees that leverage the time of the Executive Committee.
- a single, independent, group-wide risk function that comprises the Group Chief Risk Officer (CRO), local CROs, and group and local risk functions.
- risk-aware business people, who act as the first line of defence for conducting sound risk management in the group. The Risk and Compliance functions act as the second line of defence, while Internal Audit is the third line.

As of 2013, a new risk governance model will be put in place to take account of changes in the organisational structure of KBC.



This new model will be characterised primarily by:

- the Board of Directors (assisted by the ARC Committee) which sets the risk appetite each year, monitors risks and proposes action, where necessary.
- integrated architecture centred around the Executive Committee that links risk appetite, strategy and performance goal setting.
- the CRO Services Management Committee and activity-based risk committees mandated by the Group Executive Committee.
- risk-aware business people, who act as the first line of defence for conducting sound risk management in the group.
- a single, independent risk function that comprises the Group Chief Risk Officer (CRO), local CROs, local risk functions and the group risk function. The risk function (together with the compliance function) acts as the second line of defence, while Internal Audit is the third line.

Relevant risk management bodies and control functions:

- Group Executive Committee:
  - Makes proposals to the Board of Directors about risk and capital strategy, risk appetite, and the general concept of the KBC Risk Management Framework.
  - Decides on the non-strategy-related building blocks of the KBC Risk Management Framework and monitors its implementation throughout the group.
  - Allocates capital to activities in order to maximise the risk-adjusted return.
  - Acts as the leading risk committee, covering material issues that are channelled via the specific risk committees or the Group Asset/Liability Management Committee (Group ALCO).
  - Monitors the group's major risk exposure to ensure conformity with the risk appetite.
- Group ALCO:
  - Is a business committee that assists the Group Executive Committee in the domain of (integrated) balance sheet management at group level. It handles matters related to ALM and liquidity risk.
- Risk committees:
  - The CRO Services Management Committee supports the Group Executive Committee in assessing the adequacy of, and compliance with, the KBC Risk Management Framework and defines and implements the vision, mission and strategy for the CRO Services of the KBC group.
  - The Group Lending Committee (GLC) supports the Group Executive Committee in setting, monitoring and following up limits for lending activities (funding, liquidity and ALM issues related to lending activities remain the responsibility of the Group Executive Commitee/Group ALCO).
  - The Group Markets Committee (GMC) supports the Group Executive Committee in in setting, monitoring and following up limits for markets activities (trading activity, where there is not only market risk, but also operational and counterparty credit risks).
  - The Group Insurance Committee (GIC) supports the Group Executive Committee in in setting, monitoring and following up limits for insurance activities at group level.
  - The Group Internal Control Committee (GICC) supports the Group Executive Committee in monitoring and strengthening the quality and effectiveness of KBC's internal control system.
- Local Chief Risk Officers (LCROs) are situated 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.
- Group Risk Integration & Support and Group Credit Risk (known collectively as 'the Group risk function') have a number of responsibilities, including monitoring risks at an overarching group-wide level, developing risk and capital models (while business models are developed by business), performing independent validations of all risk and capital models, developing risk frameworks and advising/reporting on issues handled by the Group Executive Committee and the risk committees.

The overall conceptual structure of the KBC Risk Management Framework was defined in 2011. The design phase for all frameworks was concluded in 2012. Performance is assessed on a yearly basis as part of the Internal Control Statement.

Please note that all the processes described in the rest of this section refer to the risk governance model that was in place during 2012.

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, we use a multi-dimensional approach where the capital situation is assessed and set off against minimum targets at group and local entity level

- 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 macroeconomic and business conditions: likely scenarios (including base case scenario), recession scenario (which can be one of the likely scenarios) 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. 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. In the future, this process will be further expanded with the Own Risk and Solvency Assessment (ORSA), as required under pillar 2 of the Solvency II regime for the insurance activities of the KBC group.

The outcome of the ICAAP is discussed by KBC's Group Executive Committee, its Audit Risk and Compliance Committee and its Board of Directors. ICAAP as such is also subject to regulatory examination by the National Bank of Belgium, which has resulted in a Supervisory Review and Evaluation Process (SREP).

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 material 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 section, a distinction is made between regulatory solvency disclosures – linked to pillar 1 of Basel II – and economic capital disclosures – linked to pillar 2 of Basel II. A brief reference is also made to the expected impact of regulatory adjustments.

Regulatory solvency disclosures

Scope of solvency disclosures

The capital profile is disclosed for the 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 material 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 2012, group overview

For group solvency, we use the so-called 'building block' method. This entails comparing group regulatory capital (i.e. parent shareholders' equity adjusted for a number of items (see table)), with the sum of the separate minimum regulatory solvency requirements for KBC Bank and the holding company (after deduction of intercompany transactions between these entities) and KBC Insurance. The total risk-weighted volume of insurance companies is calculated as the required solvency margin under Solvency I divided by 8%.

The scope of consolidation used in the solvency calculation is identical to the scope used in the financial statements, as determined by IFRS rules.

Regulatory minimum solvency targets were amply exceeded in 2012, not only at year-end, but also throughout the entire year. At 31 December 2012, the tier-1 ratio amounted to 13.8%.

Solvency at group level (consolidated; under Basel II) (in millions of EUR)	31-12-2011	31-12-2012
Total regulatory capital, after profit appropriation	19 687	16 113
Tier-1 capital[1]	15 523	14 062
Parent shareholders' equity	9 756	12 099
Non-voting core-capital securities	6 500	3 500
Intangible fixed assets (-)	-446	-356
Goodwill on consolidation (-)	-1 804	-987
Innovative hybrid tier-1 instruments	420	419
Non-innovative hybrid tier-1 instruments	1 690	1 692
Direct and indirect funding of investments in own shares	-	-250
Minority interests	145	-5
Equity guarantee (Belgian State)	564	276
Revaluation reserve, available-for-sale assets (-)	117	-1 263
Hedging reserve, cashflow hedges (-)	594	834
Valuation differences in financial liabilities at fair value – own credit risk (-)	-550	-22
Minority interests in available-for-sale reserve and hedging reserve, cashflow hedges (-)	-3	0
Equalisation reserves (-)	-139	-111
Dividend payout (-)[2]	-598	-960
IRB provision shortfall (50%) (-)[3]	0	0
Limitation of deferred tax assets	-384	-227
Items to be deducted (-)[4]	-338	-577
Tier-2 and tier-3 capital	4 164	2 051
Perpetuals (including hybrid tier-1 instruments not used in tier-1 capital)	30	0
Revaluation reserve, available-for-sale shares (at 90%)	246	185
Minority interests in revaluation reserve, available-for-sale shares (at 90%)	0	0
IRB provision shortfall (50%) (-)[3]	0	0
IRB provision excess (+)[3]	403	130
Subordinated liabilities	3 778	2 268
Tier-3 capital	45	44
Items to be deducted (-)[4]	-338	-577
Total weighted risks	126 333	102 148
Banking	110 355	89 532
Insurance[5]	15 791	12 386
Holding-company activities	286	304
Elimination of intercompany transactions between banking and holding-company activities	-100	-74
Solvency ratios		
Tier-1 ratio	12.3%	13.8%
Core tier-1 ratio	10.6%	11.7%
CAD ratio	15.6%	15.8%

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 (at year-end 2012, mainly the minority shareholding in Bank Zachodni in Poland).
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).

In October 2012, KBC Group NV sold its treasury shares, in line with the strategic plan that was approved by the European Commission in November 2009, for a total of 350 million euros. In December 2012, it also strengthened its capital base via the issue of 1.25 billion euros in new shares by means of an Accelerated Book Build and announced a contingent capital note issue of approximately 0.75 billion euros, which was carried out in January 2013.
Besides 'Parent shareholders' equity', the major component of the tier-1 capital of the group is non-voting core-capital securities. These originated from the capital-strengthening 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 exposure to CDOs (see the 'Additional information' section in the 2012 annual report of KBC Group NV for more details). On 2 January 2012, KBC reimbursed 0.5 billion euros (and paid a 15% penalty) to the Belgian State. This had already been taken into account in the balance sheet and hence also in the solvency calculation at year-end 2011. On 17 December 2012, an additional 3 billion euros of Belgian State support (and a 15% penalty) was repaid, leaving 3.5 billion euros of Flemish Regional Government support outstanding. KBC has expressed its intention to repay 1.17 billion euros of the latter amount (and to pay a penalty of 50%) in the first half of 2013, subject to the customary approval from the National Bank of Belgium.

The tier-1 capital of the KBC group also incorporates hybrid instruments. As these are all issued by KBC Bank, more details are provided under 'Solvency, KBC Bank (consolidated)'.

The total weighted risks of KBC group declined substantially throughout 2012, falling from 126.3 billion euros at year-end 2011 to 102.1 billion euros at year-end 2012, on the back of divestments (including WARTA, KBL EPB and Kredyt Bank), selective sales of assets, de-risking of the portfolios and the adoption of the IRB Advanced approach.

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. In June 2012, KBC Bank, CBC Banque, KBC Lease, KBC Finance Ireland, KBC Credit Investments and KBC Real Estate received regulatory approval to implement the IRB Advanced approach. ČSOB (Czech Republic) received its approval in September 2012. As a consequence, Basel II IRB Advanced has become the primary approach for calculating risk weighted assets within KBC (used for 63.8% of the total weighted credit risks). The remaining weighted credit risks are calculated according to the Basel II IRB Foundation approach (23.2%) and the Standardised method (13.1%).

Solvency, KBC Bank (consolidated) (in millions of EUR)	31-12-2011 Basel II	31-12-2012 Basel II
Total regulatory capital, after profit appropriation	16 364	14 390
Tier-1 capital	12 346	12 235
Parent shareholders' equity	11 117	11 255
Intangible fixed assets (-)	-95	-89
Goodwill on consolidation (-)	-1 449	-969
Innovative hybrid tier-1 instruments	420	419
Non-innovative hybrid tier-1 instruments	1 690	1 692
Direct and indirect funding of investments in own shares	-	-250
Minority interests	606	351
Equity guarantee (Belgian State)	443	240
Revaluation reserve available-for-sale assets (-)	413	-335
Hedging reserve, cashflow hedges (-)	612	863
Valuation differences in financial liabilities at fair value own credit risk (-)	-550	-22
Minority interest in AFS reserve & hedging reserve, cashflow hedges (-)	-5	-1
Dividend payout (-)	-120	0
IRB provision shortfall (50%) (-)	0	0
Limitation of deferred tax assets	-466	-342
Items to be deducted (-)	-271	-577
Tier-2 and tier-3 capital	4 019	2 154
Perpetuals (including hybrid tier-1 instruments not used in tier-1 capital)	250	250
Revaluation reserve, available-for-sale shares (at 90%)	27	39
Minority interests in revaluation reserve, available-for-sale shares (at 90%)	1	0
IRB provision shortfall (50%) (-)	0	0
IRB provision excess (+)	403	130
Subordinated liabilities	3 565	2 268
Tier-3 capital	45	44
Items to be deducted (-)	-271	-577
Total weighted risks[1]	106 256	88 927
Credit risk	85 786	69 149
Market risk	9 727	8 733
Operational risk	10 744	11 045
Solvency ratios		
Tier-1 ratio	11.6%	13.8%
Core tier-1 ratio	9.6%	11.4%
CAD ratio	15.4%	16.2%

The regulatory minimum under Basel II for the CAD ratio amounts to 8%. However, the regulatory floor of 80% is still applicable, which means that the capital required under Basel II should not be less than 80% of the capital required under Basel I. If 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 slightly above 80% of Basel I.

In Belgium, banks may issue both innovative and non-innovative hybrid capital instruments which qualify for a maximum 35% 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.

In fact, on 31 December 2010, new rules entered into effect with respect to the characteristics and proportion of hybrid instruments that may be included in pillar I tier-1 capital ('CRD II'). The instruments issued by KBC are not yet fully compliant with these new requirements. The European Directive and Belgian regulations allow for a transition period, during which instruments that are no longer compliant may still be included in tier-1 capital. During the first ten years, there would be no additional cap on these grandfathered instruments. However, implementation of the Basel III regime will affect this grandfathering regime. Non-compliant government-subscribed instruments will be fully grandfathered in an initial phase. As from 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 2013 to 0% of the outstanding amount in 2022.

As announced in December 2012, KBC Bank NV placed 1 billion US dollars'(approximately 750 million euros) worth of tier-2 contingent capital notes in January 2013 as an extra capital cushion. The notes were placed with a wide range of institutional and high-net-worth investors in Asia and Europe. They carry a coupon of 8% per annum and have a maturity of 10 years, with an optional call in year 5. Furthermore, the notes are subordinated and will qualify as tier-2 capital under Basel III standards (based on the draft CRD IV of 20 July 2011). A Write-Down trigger event has been added to the terms and conditions of the instruments, which means that if the Common Equity tier-1 capital ratio is less than 7%, the principal amount of each security will be written down to zero and the notes cancelled. The Holders will no longer have any rights against the KBC group with respect to interest and the repayment of the aggregate principal amount written down.

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 31-12-2012	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	169 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 2012, material banking subsidiaries

Solvency information is also disclosed for material banking subsidiaries. Materiality in this respect is defined by KBC in the way 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 market share, for instance.

CBC Banque, ČSOB (Czech Republic), ČSOB (Slovak Republic), KBC Bank (Ireland) and K&H Bank have been identified as material banking subsidiaries.

A summary of the solvency information for these entities is provided in the table below. For details on the capital profile of material banking subsidiaries, please refer to the capital disclosures in the annual reports of the relevant entities.

Solvency, significant banking subsidiaries (in millions of EUR)		31-12-2011			31-12-2012		
		Total regulatory capital	Total weighted risk	CAD ratio	Total regulatory capital	Total weighted risk	CAD ratio
CBC Banque	Belgian GAAP	518	2 784	18.6%	485	2 303	21.0%
ČSOB (Czech Republic)	IFRS	2 117	13 577	15.6%	2 074	13 612	15.2%
ČSOB (Slovak Republic)	IFRS	586	4 107	14.3%	576	3 973	14.5%
KBC Bank Ireland	IFRS	783	7 115	11.0%	912	8 181	11.1%
K&H Bank	IFRS	634	5 696	11.1%	650	4 985	13.0%

Solvency, KBC Insurance (consolidated)

At present, KBC Insurance applies Solvency I rules to calculate the solvency ratio, in accordance with the regulator's guidelines.

Some specific elements in the available capital calculation are:

- The equalisation reserve – calculated under Belgian GAAP – which is deducted from available capital
- The available capital, which includes:
  - 90% of the *net positive* revaluation reserve for available-for-sale shares and 100% of the *net positive* revaluation reserve for available-for-sale 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).

The Solvency I capital ratio amounted to 322% at the end of 2012, comfortably above the minimum regulatory solvency requirement of 100%.

Under Solvency I, the solvency capital requirements 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 (Solvency II) is being drafted (see separate section on Solvency II).

Solvency, KBC Insurance (consolidated) (in millions of EUR)	31-12-2011	31-12-2012
Available capital	2 533	3 190
Parent shareholders' equity	2 850	3 292
Dividend payout (-)	-96	-286
Minority interests	44	0
Subordinated liabilities	10	10
Intangible fixed assets (-)	-11	-9
Goodwill on consolidation (-)	-347	-162
Revaluation reserve available-for-sale investments (-)	-337	-920
Equalisation reserve (-)	-139	-111
Equity guarantee (Belgian State)	121	36
Cashflow hedge reserve	-17	-28
90% of positive revaluation reserve, available-for-sale shares	193	142
Latent gains on bonds	221	1 173
Latent gains on real estate	41	52
Limitation of latent gains on shares and real estate	0	0
Required solvency margin	1 263	991
Subtotal, non-life insurance	316	208
Non-life and industrial accident (legal lines)	308	201
Annuities	9	7
Subtotal, life insurance	932	767
Class-21 life insurance	915	752
Class-23 life insurance	16	15
Other	15	15
Solvency ratio and surplus		
Solvency ratio (%)	201%	322%
Solvency surplus (in millions of EUR)	1 270	2 199

Economic capital

We use an economic capital model to measure the overall risk KBC is exposed to through its various activities, taking the different risk factors into consideration. We report the estimates generated by this model on a quarterly basis to the Group Executive Committee, the ARC Committee and the Board of Directors.

We define economic capital as the amount of capital required to absorb very severe losses, expressed in terms of the potential reduction in the economic value of the group (i.e. the difference between the current economic value and the worst-case economic value over a one-year time horizon and at a certain confidence level), in line with the risk appetite set by the Board of Directors. We calculate economic capital per risk category using a common denominator (the same time horizon of one year and the same confidence interval) and then aggregate them. 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.

As mentioned previously, economic capital is used as a major building block for ICAAP (Basel II, pillar 2). In addition, it provides essential input for risk-adjusted performance measurement and internal valuation models, such as the Market Consistent Embedded Value model.

The breakdown of KBC's economic capital per risk type is provided in the table. The noticeable movement in the distribution of economic capital across the different risk types is only partly related to changes in risk exposures. Differences also arise 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*	2011	2012
Credit risk	68%	67%
Non-trading market risk	12%	10%
Trading market risk	2%	4%
Business risk	8%	9%
Operational risk	6%	6%
Technical insurance risk	3%	3%
Funding cost and bid/offer spread risk	1%	1%
Total	100%	100%

* All percentages relate to figures at the end of September. Excluding entities classified as 'disposal groups' under IFRS 5 (see 'Remark' at the start of this report) and whose contribution to KBC's economic capital was around 5% in 2011 and 6% in 2012.

Risk-Adjusted Performance Measurement

In 2011, KBC developed a Risk-Adjusted Performance Measurement (RAPM) policy, whereby risk-adjusted performance metrics are used for allocating capital and setting variable remuneration. The capital allocation track of this policy is fully embedded in the strategic planning process. Based on *inter alia* the relative risk-adjusted profitability of different activities, it can be decided whether more or less capital should be allocated to the respective entities. The new remuneration policy, which includes risk-adjusted features based on RAPM metrics, was implemented for the first time in 2012.

RAPM introduces two risk-adjusted measures, namely Risk Adjusted Profit, which is an absolute measure of profitability and is expressed in euros, and Risk Adjusted Return on Capital, a relative measure of profitability and expressed as a percentage.

Risk adjustment relates to both the generated income and the capital base. As regards generated income, instead of using the actual accounting losses incurred in the reporting period, risk-adjusted measures calculate profitability using expected losses, i.e. losses that would be expected given the risk profile of the portfolio. Using expected losses and hence a longer term view of the profitability of the portfolio not only guarantees that management is aware of risks when times are good, but also avoids disproportionate decisions and actions being taken during adverse economic periods.

The basic idea behind the risk adjustment of the capital base is that neither economic capital nor regulatory capital is fully appropriate in itself to determine how capital should be allocated. Regulatory capital has limited coverage in terms of risk types and only partly reflects the specific characteristics of KBC. Although economic capital (ECap) covers a broader scope of risk and reflects KBC's own estimates of the risk profile, it is less granular at present. Given these constraints, it was decided to allocate capital to businesses based on RWA multiples that reflect ECap insights, with the capital requirements of a business being derived from its use of ECap. If a business uses a high proportion of ECap, it will also be allocated a high proportion of regulatory capital and *vice versa*.

Regulatory environment

Basel III

The Basel III agreement and corresponding draft European CRD IV Directive and Regulation will introduce new, more stringent capital requirements for financial institutions. According to these proposals, the legal minimum tier-1 ratio, which stood at 4% under Basel II, will be increased to 4.5% in 2013, and gradually increase to 6% in 2015 (with a 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' (of between 0% and 2.5%, to be determined by the national regulatory authority) and an extra charge for global systemic banks will be applied. Certain elements used in the calculation of regulatory capital will be gradually phased out or changed.

Under the current CRD IV draft, the capital injections received from the government (for KBC, the 7 billion euros' worth of core-capital securities sold to the Belgian State and Flemish Region in 2008 and 2009, but which now stands at 3.5 billion euros after 3.5 billion euros of Belgian State aid was reimbursed in 2012) will be classified as common equity tier-1 capital and will be grandfathered until 2018.

Basel III was meant to come into force on 1 January 2013, but a postponement of 12 months now seems like the most realistic scenario.

Solvency II

The current solvency requirements for insurance undertakings (Solvency I) are purely volume-based and do not take into account the asset mix and asset quality. In order to improve the capital regulations, a new EU solvency regime (Solvency II) is being drafted. Solvency II will apply to all EU insurance and reinsurance companies and incorporates a risk-based approach. It aims to implement solvency requirements that better reflect the risks that companies face and to deliver a supervisory system that is consistent across all EU Member States. In line with the ICAAP in Basel II, Solvency II introduces a Pillar 2 internal view of 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.

The official entry into force of Solvency II – previously scheduled for January 2013 – is now January 2014. However, because of delays in the development and adoption of the new regulatory framework, it is not inconceivable that this date could be further postponed until 2015 or even 2016.

Based on the most recent draft version of the Solvency II regulation, the Solvency II ratio for the KBC Insurance Group in 2012 amply exceeded the minimum requirements.

In 2011, KBC invested in a Solvency II solution. In the course of 2013 it will be able to monitor its key metrics on a regular basis, with a central Solvency II solution performing the calculations for all insurance entities within the KBC group.

Liquidity risk management

Liquidity risk is the risk that an organisation will be unable to meet its liabilities/obligations as they come due, without incurring unacceptable losses.

Strategy and processes

The principal objective of our 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.

We are preparing for the Basel III era by incorporating Basel III concepts into our liquidity and funding framework, as well as into our financial planning.

The liquidity management framework and group liquidity limits are set by the Board of Directors. Liquidity management is organised within the Group Treasury function, which is responsible for the overall liquidity and funding management of the KBC group. The Group Treasury function monitors and steers the liquidity profile on a daily basis and sets the policies and steering mechanisms for funding management (intra-group funding, funds transfer pricing). These policies ensure that local management has an incentive to work towards a sound funding profile. The local treasuries in the subsidiaries implement these policies and report to the Group Treasury function, which in turn further centralises collateral management and the acquisition of long-term funding. The local treasuries are directly responsible for liquidity management in their respective entities. However, the liquidity contingency plan requires all significant local liquidity issues to be escalated to group level.

Our liquidity risk management 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*. We manage our funding structure so as to maintain substantial diversification, to minimise funding concentrations in time buckets, and to limit the level of reliance on short-term wholesale funding. We manage the structural funding position as part of the integrated strategic planning process, where funding – in addition to capital, profits and risks – is one of the key elements. At present, our strategic aim for the next few years is to build up a sufficient buffer in terms of the Basel III LCR and NSFR requirements via a new funding management framework, which sets clear funding targets for the subsidiaries (own funding, reliance on intra-group funding) and provides further incentives via a system of intra-group pricing to the extent subsidiaries run a funding mismatch.

  In the table below, we have illustrated the 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 2012, KBC had attracted 29 billion euros' worth of funding from the professional interbank and repo markets. Please note that US dollar funding obtained from these markets amounted to approximately 3 billion euros on the position at year-end (total US dollar funding of 8 billion euros).
- *Operational liquidity risk*. Operational liquidity management is conducted in the treasury departments, based on estimated funding requirements. Group-wide trends in funding liquidity and funding needs are monitored on a daily basis by the Group Treasury function, 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 the KBC group that carry out banking activities, i.e. KBC Bank NV, CBC Banque SA,, KBC Lease, KBC Financial Products, ČSOB Czech Republic, ČSOB Slovakia, KBC Bank Ireland, CIBank, KBC Credit Investments, KBC Finance Ireland and Absolut Bank. KBC Insurance entities are not included, since they 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'.

Liquidity risk at year-end (excluding intercompany deals)* (in billions of EUR)	<= 1 month	1-3 months	3-12 months	1-5 years	5-10 years	> 10 years	not defined	Total
31-12-2011								
Total inflows	32	11	17	55	40	36	50	241
Total outflows	51	17	12	36	5	2	118	241
Professional funding	28	10	1	4	0	0	0	43
Customer funding	17	6	8	11	3	1	77	123
Debt certificates	3	2	3	20	2	1	1	31
Other	3	0	0	0	0	0	40	43
Liquidity gap (excl. undrawn commitments)	-20	-6	5	19	36	34	-68	0
Undrawn commitments	–	–	–	–	–	–	-34	–
Financial guarantees	–	–	–	–	–	–	-12	–
Net liquidity gap (incl. undrawn commitments)	-20	-6	5	19	36	34	-114	-46
31-12-2012								
Total inflows	29	12	17	50	44	34	39	225
Total outflows	31	20	14	36	5	1	118	225
Professional funding	13	12	2	1	0	0	0	29
Customer funding	13	5	7	15	4	1	79	124
Debt certificates	1	4	4	20	1	1	1	32
Other	3	0	0	0	0	0	38	40
Liquidity gap (excl. undrawn commitments)	-2	-8	2	15	39	33	-79	0
Undrawn commitments	–	–	–	–	–	–	-28	–
Financial guarantees	–	–	–	–	–	–	-11	–
Net liquidity gap (incl. undrawn commitments)	-2	-8	2	15	39	33	-118	-39

* Cashflows exclude interest rate flows consistent with internal and regulatory liquidity reporting. Inflows/outflows that arise from margin calls posted/received for MtM positions in derivatives are reported in the 'not defined' bucket. Entities classified as 'disposal groups' under IFRS 5 (see 'Remark at the start of this report) have also been excluded (balance sheet total of 7.1 billion euros in 2012). 'Professional funding' includes all deposits from credit institutions and investment firms, as well as all repos.

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 if KBC would be unable to renew maturing short-term funding. Our liquidity framework imposes a funding strategy to ensure that the liquidity risk remains within the group's risk appetite.

KBC has a solid liquidity position. Historically, we have always had a substantial amount of liquid assets. At year-end 2012, KBC Bank (at the consolidated level) had 54 billion euros' worth of central bank eligible assets, 37 billion euros of which in the form of liquid government bonds.

During 2012, KBC Bank used its EMTN programme to raise 3.95 billion euros in long-term funding, 2.75 billion euros of which through wholesale benchmark issues. We also recorded continuous solid growth in customer deposits at different entities, especially in Ireland, where concerted efforts to build a retail deposit base have helped increase KBC Bank Ireland's funding independence.

In November 2012, we announced our Belgian residential mortgage covered bonds programme. This 10-billion-euro programme was set up following the entry into force of the Act of 3 August 2012 that established a legal framework for Belgian covered bonds. This new bond programme gives KBC access to the covered bond market, allowing it to diversify its funding structure and reduce the cost of long-term funding. We plan to issue 2 to 3 billion euros' worth of these bonds annually in the coming years. At the start of December 2012, we launched a first covered bond issue in the amount of 1.25 billion euros, which was extremely well received by the market. A second issue for 0.750 billion euros followed in January 2013.

We also announced our intention to repay 8.3 billion euros of the 8.67 billion euros borrowed from the ECB under the long-term refinancing operations (LTROs) of December 2011 and February 2012. The remaining LTRO is being used at companies earmarked for divestment.

Credit risk management

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

Credit risk can occur both in the banking entities and in the insurance entities of the group. As regards banking activities, credit risk occurs mainly in lending activities (including leasing and factoring). However, it can also arise through trading activities and in treasury activities.

Credit risk arising from insurance activities stems mostly from the investment portfolios, which, for instance, include investments in debt securities.

Strategy and processes

We manage credit risk at both transactional and portfolio level. Managing credit risk at the transactional level means that we have sound practices, processes and tools in place to identify and measure the risks before and after accepting individual credit exposures. Limits and delegations (based on parameters such as internal risk class, type of counterparty) are set to determine the maximum credit exposure allowed and the level at which acceptance decisions are taken. Managing the risk at portfolio level encompasses *inter alia* periodic measuring and analysing of risk embedded in the consolidated loan and investment portfolios and reporting on it, 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

We have sound acceptance policies and procedures in place for all kinds of credit risk exposure. However, we are limiting our description here 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.

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. Lending to businesses is subject to a more integrated acceptance process in which relationship management, credit acceptance committees and model-generated output are taken into account.

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.

In order to determine the risk class, we have developed various rating models for measuring how creditworthy borrowers are and for estimating the expected loss of various types of transactions. We use a number of uniform models throughout the group (models for governments, banks, large companies, etc.), while others have been designed for specific geographic markets (SMEs, private individuals, etc.) or types of transaction. We use the same internal rating scale throughout the group.

We use the output generated by these models to split the normal loan portfolio into internal rating classes ranging from 1 (lowest risk) to 9 (highest risk) for the PD. We assign an internal rating ranging from PD 10 to PD 12 to a defaulted obligor. 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. PD 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.

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

For credit linked to defaulted borrowers in PD classes 10, 11 and 12 (impaired loans), we record 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 non-defaulted credit in PD classes 1 to 9, we record impairment losses on a 'portfolio basis', using a formula based on the IRB Advanced models used internally, or an alternative method if a suitable IRB Advanced model is not yet available.

In order to avoid a situation where an obligor facing financial difficulties ends up defaulting, we can decide to renegotiate its loans in accordance with internal policy guidelines. Renegotiated loans are loans whose original payment terms have been altered, due to a deterioration in the borrower's financial condition. Renegotiation may involve changing the contractual repayment schedule, lowering or postponing interest or fee payments, or partially charging-off the loan as uncollectible. The negotiated changes must be reflected in a new, or an amended, and duly signed loan agreement.
A client with a renegotiated loan will in principle be assigned PD class 9 or higher.
If – based on the bank's assessment of the borrower's revised financial projections/restructuring plans – there is a reasonable chance that the borrower will be able to meet the renegotiated terms of the loan, and the expected loss (in the broad sense) for the bank after renegotiation will be lower than it would have been without renegotiation, the credit committee will assign/confirm PD 9. However, if a renegotiated loan is approved and the credit committee is of the opinion that it is unlikely that the borrower will be able to meet the renegotiated terms – or if a loan to a counterparty was (partially) charged off – then a PD class 10 (or higher) will be assigned. In this case, it is highly likely that an impairment charge will be recorded. An obligor in this situation needs to be classified as 'defaulted' according to KBC's rules. A renegotiation tag is attached to the file in the credit systems for identification and reporting purposes.
If, after one year, the credit committee is of the opinion that the borrower is showing signs of improvement and that the loan's renegotiated terms are likely to be met, then – in the case of PD 9 – a better classification may be assigned to the borrower and the renegotiation tag can be removed. If a borrower is classified as PD 10 (or higher), PD 9 (only) may in principle be assigned for one year and the renegotiation tag kept in place. If the credit committee decides that the existing PD class 9 (or higher) should remain unchanged or a worse rating be assigned, then the renegotiation tag may not be removed for the time being (i.e. at least until the next review takes place).
Some exceptions to the PD 9 principle exist for certain retail portfolios. In these cases, the PD class assigned is determined on the basis of the behavioural score, and may result in a PD class that is lower than 9.
At the end of 2012, loans that were renegotiated to avoid impairment accounted for some 2.7% of the total loan portfolio (amount outstanding, including planned divestments), compared with 2.6% at the end of 2011. A breakdown by business unit is provided below. The renegotiated loans at the Merchant Banking Business Unit relate primarily to KBC Bank Ireland, where 14% of the portfolio has been renegotiated (as opposed to 11% by year-end 2011).

Renegotiated loans avoiding impairment (as a % of the total portfolio of renegotiated loans)	31-12-2011	31-12-2012
Belgium Business Unit	20%	12%
CEE Business Unit	19%	18%
Czech Republic	5%	5%
Slovakia	1%	1%
Hungary	11%	11%
Bulgaria	2%	2%
Merchant Banking Business Unit	57%	66%
Group Centre (including planned divestments)	4%	4%
Total	100%	100%
In billions of EUR	4.0	4.0

Credit risk management at portfolio level

We also monitor credit risk on a portfolio basis, *inter alia* by means of monthly and/or quarterly reports on the consolidated credit portfolio in order to ensure that lending policy and limits are being respected. In addition, we monitor the largest risk concentrations 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, we perform stress tests on certain types of credit (for instance, mortgages), as well as on the full scope of credit risk.

Whereas some limits are still in notional terms, we also use concepts such as 'expected loss' and 'loss given default'. Together with 'probability of default' and 'exposure at 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. After receiving the approval of the regulators in 2012, the main group entities have adopted the IRB Advanced approach. Others are scheduled to shift to the IRB Advanced or Foundation approaches in 2013. 'Non-material' entities will continue to adopt the Basel II Standardised approach. However, entities on the divestment list will stick with their current Basel II approach.

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 yearly. The first set of material entities started adopting the IRB Foundation approach at the beginning of 2007. As already mentioned above, the main group entities received regulatory approval to switch to the IRB Advanced approach during 2012. The internal target dates for the other material entities to adopt the IRB Foundation or IRB Advanced 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 or Advanced approach in 2012 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 the KBC group.

The scope of this report is limited to the material entities appearing in the roll-out table below. These entities accounted for 95% of the total credit risk weighted assets of the KBC group in 2012.

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 2012 annual report.

Roll-out of Basel II pillar 1 approach at end of	2011	2012	2013	2014
IRB Advanced approach		KBC Bank CBC Banque ČSOB Czech Republic KBC Credit Investments KBC Finance Ireland KBC Lease Belgium KBC Real Estate[1]	KBC Bank CBC Banque ČSOB Czech Republic KBC Credit Investments KBC Finance Ireland KBC Lease Belgium K&H Bank	KBC Bank CBC Banque ČSOB Czech Republic KBC Credit Investments KBC Finance Ireland KBC Lease Belgium K&H Bank
IRB Foundation approach	KBC Bank CBC Banque ČSOB Czech Republic KBC Bank Ireland KBC Credit Investments KBC Financial Products KBC Finance Ireland KBC Bank Deutschland[4] KBC Real Estate[1] KBC Lease Belgium Antwerp Diamond Bank[4] K&H Bank	KBC Bank Ireland KBC Financial Products KBC Bank Deutschland[4] Antwerp Diamond Bank[4] K&H Bank	KBC Bank Ireland KBC Financial Products KBC Bank Deutschland[4] Antwerp Diamond Bank[4] ČSOB Slovak Republic	KBC Bank Ireland KBC Financial Products KBC Bank Deutschland[4] Antwerp Diamond Bank[4] ČSOB Slovak Republic
Standardised approach	Kredyt Bank[2] KBL EPB[2] ČSOB Slovak Republic Absolut Bank[3] Non-material entities	ČSOB Slovak Republic Absolut Bank[3] Non-material entities	Absolut Bank[3] Non-material entities	Non-material entities

1 Although KBC Real Estate is not a material entity according to KBC's definition above, it also uses the IRB approach as it operates on a shared IT platform. During 2012, the activities of KBC Real Estate were integrated into KBC Bank and the company dissolved.
2 KBL EPB and Kredyt Bank were sold during 2012 and, therefore, are no longer included in the 2012 figures of this report.
3 Absolut Bank will be divested in the course of 2013.
4 Antwerp Diamond Bank and KBC Bank Deutschland have been targeted for divestment under the KBC strategic plan approved by the EU.

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 2012. 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.

[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.

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 Advanced, 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 can be determined either on a regulatory basis according to the IRB Foundation approach or via internal models according to the IRB Advanced approach. For retail exposures, the weight is always determined via internal models, in line with the IRB Advanced approach for this asset class. For lending exposures treated under the Standardised approach, EAD 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 sold.

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 loss given default (LGD which in turn is driven by such factors as the amount of collateral or guarantees), the maturity of the exposure and the probability of default (PD) of the obligor.

As regards the group-wide framework for dealing with model uncertainty – as referred to in the section on 'Internal modelling' later on in this report – KBC has taken (and reported under pillar 1) additional RWA for known deficiencies and avoidable uncertainties into account for its PD models since mid-2010 and for its LGD models since mid-2012. At year-end 2012, this additional RWA amounted to 0.6 billion euros for PD models and to 2.0 billion euros for LGD models. Ultimately, KBC started to capitalise unavoidable uncertainties in PD models as of 2012, with an additional RWA impact of 1.1 billion euros.

The table below provides an overview of how Basel II credit risk EADs and RWA for the KBC group changed over 2012. This table shows the overall EAD and RWA figures, including non-material entities and KBL EPB, the structured credit portfolio and the additional RWA for model deficiencies and uncertainties. Please note, that in all other tables in this report, the scope will be limited to the material entities (see table above) and exclude the structured credit portfolio.

Entity	BII approach (at 31/12/2012)[2]	Credit RWA (in millions of EUR)			Exposure [EAD] (in millions of EUR)		
		31 Dec 2011	31 Dec 2012	Δ 2012 vs 2011	31 Dec 2011	31 Dec 2012	Δ 2012 vs 2011
KBC Bank	IRB Advanced	36 537	28 726	-7 812	125 368	122 535	-2 883
CBC Banque	IRB Advanced	2 088	1 642	-446	10 977	10 954	-23
ČSOB Czech Republic	IRB Advanced	11 258	10 526	-731	41 214	41 980	766
KBC Credit Investments	IRB Advanced	1 036	1 260	224	5 250	5 747	496
KBC Lease Belgium	IRB Advanced	1 569	1 329	-239	2 216	2 151	-65
KBC Finance Ireland	IRB Advanced	2 077	936	-1 141	2 032	1 637	-395
KBC Bank Ireland	IRB	6 285	7 402	1 117	18 043	17 250	-792
K&H Bank	IRB	4 815	4 131	-684	9 716	8 720	-997
KBC Deutschland[5]	IRB	2 008	2 105	97	3 297	3 463	166
ADB[5]	IRB-	1 420	1 385	-35	1 875	1 893	19
KBC Financial Products	IRB-	1 352	1 105	-247	1 821	1 473	-348
Kredyt Bank[4]	Standardised	5 982	-	-5 982	9 657	-	-9 567
ČSOB Slovakia	Standardised	3 583	3 353	-231	5 891	5 999	108
KBL EPB[4]	Standardised	2 986	-	-2 986	12 803	-	-12 803
Absolut Bank[5]	Standardised	1 628	1 669	41	2 514	2 610	96
Cibank	Standardised	514	516	2	741	811	70
KBC Commercial	Standardised	993	1 149	156	1 054	1 271	217
Other entities	Mixed	2 823	2 133	- 690	3 599	2 910	-690
Total[1 3]		88 955	69 369	-19 586	258 068	231 404	-26 664

1 KBC Banka, as a subsidiary of KBC Insurance NV, is not included in the total EAD and RWA figures.
2 Basel II is the main approach pursued by a legal entity. Some entities report under IRB, but still have sub-portfolios or subsidiaries that are reported under the Standardised approach.
3 The figures shown are for the overall scope of credit risk RWA, including structured credit products, counterparty risk and other non-credit obligation, assets but excluding bonds in trading books and KBC intra-group exposures.
4 Kredyt Bank and KBL EPB were divested in 2012.
5 To be divested.

Overall, there was a substantial decrease in RWA and to a lesser extent in EAD. At KBC group level, credit risk RWA fell by 19.6 billion euros down 22% on a year-on-year basis. This can be broken down as follows:

- Divestments account for a large part of the reduction in EAD and RWA, due to the deconsolidation in 2012 of Kredyt Bank (-6.0 billion euros in RWA), KBL EPB (-3.0 billion euros in RWA) and some smaller subsidiaries (-0.4 billion euros in RWA, with KBC Lease Deutschland as the most material entity).

- The further de-risking of the KBC portfolio, as well as the renewed focus on retail and SME lending in core countries, continued in 2012, with an estimated impact on RWA of -5.9 billion euros. This figure includes a sharp reduction in capital requirements for the legacy structured credit portfolio, owing to the sale or maturity of various positions. The remaining fall in EADs and RWA is related to the decrease in lending in non-core portfolios (such as KBC Bank's corporate branch network abroad), a reduction in exposure to distressed sovereign bonds, etc.

- In 2012, KBC received regulatory approval to move from the IRB Foundation to the IRB Advanced approach for seven legal entities (KBC Bank, ČSOB Czech Republic, CBC Banque, KBC Lease Belgium, KBC Finance Ireland, KBC Credit Investments, KBC Real Estate). This improved risk measurement, allowing for the internal modelling of EADs and LGDs, resulted in a reduction in RWA of 5.4 billion euros. Please note, however, that EADs increased overall due to the switch to the IRB Advanced approach.

- The remaining unexplained change in RWA (1.1-billion euro increase) can be attributed to changes (such as volumes, PD migration, etc.) in the lending portfolio, as well as to the recalibration of the PD, LGD or EAD models. Smaller changes were attributable to the effects of exchange rates on FX lending (+0.6 billion euros in RWA, in particular due to the appreciation of the Czech koruna, Hungarian forint and Sterling) and to lower capital requirements on other non-credit obligation assets (-0.4 billion euros in RWA).

Total 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 assets 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 the 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'.

EAD is the Exposure At Default after application of the credit conversion factor and substitution due to guarantees. For IRB exposures, the EAD is before the application of eligible collateral (as this is included in the LGD), for Standardised exposures the EAD is after the application of eligible collateral.

Exposure 31-12-2011* (in billions of EUR)	Lending (on-balance-sheet)	Lending (off-balance-sheet)	Derivatives	Repo-like transactions	Total
Total EAD	192	18	10	16	237
Total RWA	65	9	4	0	77
Exposure 31-12-2012* (in billions of EUR)	**Lending (on-balance-sheet)**	**Lending (off-balance-sheet)**	**Derivatives**	**Repo-like transactions**	**Total**
Total EAD	188	18	9	11	225
Total RWA	52	5	4	0	62

* KBL EPB was divested during 2012 and has been excluded from the 2011 and 2012 figures. At year-end 2011, its exposure totalled 13 billion euros (6.5 billion euros of which for on-balance-sheet assets and 5.0 billion euros for repo-like transactions) and RWA amounted to 3 billion euros.

Credit risk in the lending portfolio

The lending portfolio excludes all derivatives (except for CDS in the 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. In light of the capital calculations, the corresponding issuer risk is included in trading market risk.

Lending portfolio [EAD] 31-12-2011 (in millions of EUR)	EAD of main categories	'Other'[1]	Total EAD
Subject to IRB approach	157 781	4 252	162 032
Subject to Standardised approach[2]	46 541	1 099	47 640
Total	204 322	5 351	209 673
Lending portfolio [EAD] 31-12-2012 (in millions of EUR)	**EAD of main categories**	**'Other'[1]**	**Total EAD**
Subject to IRB approach	160 092	3 749	163 842
Subject to Standardised approach	40 684	920	41 603
Total	200 776	4 669	205 445

1 Exposure to 'Other' is given separately and is 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, cash balances at central banks).
2 As already mentioned, KBL EPB has been excluded from the 2011 figures (for the Standardised approach). At year-end 2011, its 'EAD of main categories' amounted to 7 146 million euros, while 'Other' assets amounted to 399 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. This is because 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 categorised 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 (the figures exclude residential mortgages as of 2012), such as 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. It should be noted that the IRB Foundation approach for retail exposure does not exist and that IRB Advanced is the only approach for this asset class.
- *Residential mortgages:* this category includes home loans to individuals, secured or partly secured by residential mortgages.
- *Other*: besides 'other assets', this category includes the residual value of leasing transactions.

IRB exposure [EAD] 31-12-2011 (in millions of EUR)	Sovereign	Institutions	Corporates	SME Corporates	Retail[1]	Residential Mortgages[1]	(sub)Total[2]	Other	Total
Exposure	21 876	5 985	42 152	17 897	69 870	-	157 781	4 252	162 032
RWA	3 027	1 896	28 475	11 650	11 228	-	56 276	4 218	60 494
IRB exposure [EAD] 31-12-2012 (in millions of EUR)	Sovereign	Institutions	Corporates	SME Corporates	Retail	Residential Mortgages	(sub)Total[2]	Other	Total
Exposure	16 881	7 766	44 098	18 719	18 893	53 734	160 092	3 749	163 842
RWA	1 726	1 592	23 669	8 091	3 602	8 417	47 097	3 741	50 838

1 In 2011, the figures for residential mortgages were included in the retail asset class, whereas they were reported separately in 2012. In 2011, the EAD of the retail class consisted of 53 093 million euros in mortgages and 16 777 million euros in other retail. The related RWA amounted to 8 225 million euros and 3 004 million euros, respectively.
2 The (sub)Total is accounted for in the section on concentrations in the lending portfolio.

It should be noted that the EAD in 2011 is based on an IRB Foundation approach. In 2012, however, KBC received regulatory approval to use IRB Advanced EAD (under Basel II Pillar 1 rules) for several subsidiaries (see above). The switch to the IRB Advanced approach had an impact of +4.1 billion euros on EAD. It also affected the allocation of EAD to the various exposure classes, as the substitution effect of the IRB Foundation approach was no longer in place (hence, lending to 'Institutions' or 'Corporates' covered by government guarantees are no longer re-allocated to the 'Sovereign' exposure class).

The material reduction in 'Sovereign' exposure is explained by scaling back exposure due to the debt crisis and the transition to the IRB Advanced approach. The de-risking of the KBC portfolio is less visible in this table, as the entities that were divested in 2012 (Kredyt Bank, KBL EPB, KBC Lease Deutschland) reported under the Standardised approach. In addition, the reduction in lending in non-strategic markets and segments has been more than offset by volume growth in our core markets. Overall, there was an upwards effect on exposures and RWA, owing to the effect of FX rates on lending in other currencies than the euro, in particular due to the appreciation of Czech koruna, Hungarian forint and Sterling.

There was an increase in lending to institutions. Firstly, this related to transactions with Kredyt Bank, which were no longer being treated as intra-company. Secondly, there was an increase in the EAD for documentary credits – as under the IRB Advanced approach – modelled Credit Conversion Factors are higher than the regulatory CCFs used under the IRB Foundation approach.

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 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 of 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).

Exposures are reported net, i.e. after the application of guarantees and eligible collateral.

Standardised exposure [EAD] 31-12-2011[2] (in millions of EUR)	Exposure	RWA
Sovereign	31 032	143
RGLA	169	74
PSE	84	21
MDB	13	1
International Organisations	0	0
Institutions	781	404
Corporates	4 632	4 633
Retail	5 174	3 881
Secured by real estate	4 423	2 790
Past due	227	245
CIU	0	0
(sub)Total[1]	46 537	12 195
High risk	5	7
Covered bonds	0	0
Short term	17	3
Other	1 077	442
Total	47 636	12 647

Standardised exposure [EAD] 31-12-2012 (in millions of EUR)	Exposure	RWA
Sovereign	31 817	133
RGLA	146	40
PSE	0	0
MDB	9	1
International Organisations	0	0
Institutions	566	272
Corporates	3 448	3 449
Retail	2 149	1 607
Secured by real estate	2 315	870
Past due	233	265
CIU	0	0
(sub)Total[1]	40 684	6 638
High risk	0	0
Covered bonds	0	0
Short term	31	15
Other	889	437
Total	41 603	7 090

1 Accounted for in the section on concentrations in the lending portfolio.
2 The 2011 portfolio of KBL EPB was mostly concentrated in sovereign (3 167 million euros), institutions (1 000 million euros) and corporate exposure (1 365 million euros).

The high exposure in the 'Sovereign' category is the result of the application of a specific carve-out from the IRB to the Standardised approach. This means that home country sovereign exposure in the books of KBC's IRB entities in Belgium, the Czech Republic and Hungary has been carved out from the IRB approach and been treated under the Standardised approach.

The substantial reduction in the 'Corporates', 'Retail' and 'Secured by real estate' exposure types was driven by the sale of Kredyt Bank in 2012. In 2011, Kredyt Bank accounted for 1 169 million euros of EAD and 1 169 million euros of RWA for 'Corporates'. For the 'Retail' exposure class, Kredyt Bank accounted for 2 995 million euros of EAD and 2 246 million euros of RWA. For the 'Secured by real estate' exposure class, Kredyt Bank accounted for 2 699 million euros of EAD and 2 157 million euros of RWA.

Concentrations to credit risk in the lending portfolio

In order to portray an overall picture of the lending portfolio, the exposure (EAD) 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 'Residential mortgages', '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 'Sovereigns' asset class.
- *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 mapping exercises are rather straightforward.

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

Unless otherwise stated, all 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. This logic only applies to exposures treated under the Standardised or IRB Foundation approach (under the IRB Advanced approach, the effect of the guarantee is included in the LGD measurement).

Total credit exposure in the lending portfolio per geographic region

Exposure [EAD] 31-12-2011[1] (in millions of EUR)	Sovereign	Institutions	Corporates	SME Corporates	Retail[2]	Residential Mortgages[2]	Total
Africa	10	168	144	2	1	-	325
Asia	299	1 139	1 161	102	0	-	2 702
Central and Eastern Europe & Russia	15 243	1 713	9 408	6 759	21 896	-	55 019
Latin America	0	59	114	0	0	-	173
Middle East	0	622	474	4	0	-	1 101
North America	2 597	395	3 087	118	1	-	6 197
Oceania	0	47	634	1	0	-	682
Western Europe	34 831	2 684	30 937	12 926	56 745	-	138 124
Total	52 980	6 828	45 958	19 912	78 644	-	204 322

Exposure [EAD] 31-12-2012[1] (in millions of EUR)		Sovereign	Institutions	Corporates	SME Corporates	Retail	Residential mortgages	Total
Africa		199	361	105	122	2	0	788
Asia		163	1 416	1 262	121	0	0	2 962
Central and Eastern Europe & Russia		13 219	2 693	10 153	5 440	4 078	14 157	49 740
Of which	Bulgaria	149	8	234	141	127	105	765
	Czech Republic	7 834	1 004	5 660	3 193	2 685	9 627	30 002
	Hungary	3 411	38	1 531	1 042	309	1 980	8 312
	Poland	114	694	389	140	2	1	1 342
	Russia	290	513	1 205	54	169	822	3 054
	Slovak Republic	1 302	116	1 044	865	777	1 609	5 718
Latin America		0	61	84	0	1	0	146
Middle East		0	707	628	9	0	0	1 345
North America		1 020	413	2 417	25	2	0	3 876
Oceania		0	21	617	2	0	1	640
Western Europe		33 734	2 826	31 856	14 053	16 680	42 128	141 278
Of which	Belgium	24 290	761	19 033	12 347	16 609	29 676	102 716
	Ireland	403	19	2 347	1 042	0	12 446	16 256
Total		48 335	8 498	47 122	19 773	20 762	56 287	200 776

1 KBL EPB, which is not included in the 2011 figures in the table, focuses most of its activities on Western Europe.
2 Figures for residential mortgages were reported in the 'Retail' exposure class in 2011.

The geographic regions in the above table are those where each borrower (or guarantor) is situated. As of 2012, we have also split the Central and Eastern Europe and Western Europe regions into the most significant individual countries. The table shows that the KBC home markets comprise mainly Belgium, Ireland and the six CEE countries, which combined represented 84% of exposures in 2012. They even represented more than 99% of EAD for the residential mortgage and retail exposure classes and more than 95% of EAD for 'SME Corporates'. For corporates and institutions, exposures outside the home markets were predominantly in Western Europe (mainly Germany, France, the Netherlands and to a lesser extent the UK, Spain and Luxembourg), in North America and in Asia (mainly China, Hong Kong and Singapore). The decline in the North American sovereign exposure class was due to the reduction in the US public finance portfolio of KBC Bank.

Total credit exposure in the lending portfolio per sector

Exposure [EAD] 31-12-2011[2] (in millions of EUR)	Sovereign	Institutions	Corporates	SME Corporates	Retail[3]	Residential Mortgages[3]	Total
Agriculture, Farming & Fishing	0	0	534	1 031	2 107	-	3 672
Authorities	52 917	30	502	0	0	-	53 449
Automotive	0	0	1 389	725	510	-	2 624
Building & Construction	0	0	3 525	1 316	1 310	-	6 150
Chemicals	0	0	1 740	443	56	-	2 240
Commercial Real Estate	0	0	8 056	2 502	856	-	11 414
Distribution	0	0	5 212	4 006	2 674	-	11 892
Electricity	0	0	2 917	271	5	-	3 193
Finance & Insurance	64	6 787	3 379	152	373	-	10 755
Food Producers	0	0	1 565	464	202	-	2 231
Metals	0	0	1 425	515	232	-	2 171
Oil, Gas & Other Fuels	0	0	1.205	133	4	-	1 342
Private Persons	0	0	81	94	62.528	-	62.703
Services	0	10	6.040	4 759	3 408	-	14 217
Other[1]	0	0	8.388	3 501	4 379	-	16 269
Total	52 980	6 828	45 958	19 912	78 644	-	204 322

Exposure [EAD] 31-12-2012 (in millions of EUR)	Sovereign	Institutions	Corporates	SME Corporates	Retail	Residential mortgages	Total
Agriculture, Farming & Fishing	0	0	399	1 129	2 252	0	3 781
Authorities	48 313	133	421	9	0	0	48 877
Automotive	0	0	1 478	1 048	505	0	3 031
Building & Construction	0	0	3 784	1 422	1 426	0	6 631
Chemicals	0	0	1 398	412	55	0	1 865
Commercial Real Estate	0	0	8 453	2 904	1 146	0	12 504
Distribution	0	0	5 512	3 684	2 517	0	11 713
Electricity	0	0	2 984	410	18	0	3 412
Finance & Insurance	22	8 365	3 650	290	374	0	12 701
Food Producers	0	0	1 423	436	195	0	2 054
Metals	0	0	1 451	569	223	0	2 243
Oil, Gas & Other Fuels	0	0	1 290	61	5	0	1 356
Private Persons	0	0	2	79	6 100	56 287	62 467
Services	0	0	6 281	4 288	3 868	0	14 438
Other[1]	0	0	8 595	3 031	2 077	0	13 703
Total	48 335	8 498	47 122	19 773	20 762	56 287	200 776

1 All sectors with a concentration of less than 0.75% of the total EAD are aggregated into this category.
2 The largest part of the exposure attributed to KBL EPB (for 2011) was situated in the 'Authorities' and 'Finance & Insurance' sectors.
3 Figures for residential mortgages were reported in the 'Retail' exposure class in 2011.

In view of KBC's substantial retail activities in most markets, 'Private Persons' represent a large share of this sector distribution. The exposure to 'Private Persons' remained stable, despite the divestment of Kredyt Bank, which had accounted for 4 744 million euros of EAD in 2011. The decline in 'Authorities' illustrates the above-mentioned effect of switching to the IRB Advanced approach (ending the IRB Foundation substitution effect for exposures secured by sovereign guarantees).

Maturity analysis of the total credit exposure in the lending portfolio

Residual maturity 31-12-2011 (in millions of EUR)	Sovereign	Institutions	Corporates	SME Corporates	Retail[2]	Residential Mortgages[2]	Total
<1 year	11 972	3 537	20 173	7 281	3 869	-	46 833
=>1 to <5 years	23 774	2 315	12 197	4 101	7 184	-	49 572
=>5 to <10 years	8 397	530	4 729	2 956	31 186	-	47 798
=>10 years	8 590	303	4 864	4 205	33 827	-	51 789
Until Further Notice[1]	247	142	3 996	1 368	2 577	-	8 330
Total	52 980	6 828	45 958	19 912	78 644	-	204 322
Residual maturity 31-12-2012 (in millions of EUR)	**Sovereign**	**Institutions**	**Corporates**	**SME Corporates**	**Retail**	**Residential mortgages**	**Total**
<1 year	10 584	5 265	20 778	7 345	3 122	608	47 701
=>1 to <5 years	15 193	2 132	10 799	3 444	5 563	1 561	38 692
=>5 to <10 years	16 613	736	4 476	3 176	5 388	27 142	57 531
=>10 years	5 733	147	4 672	3 942	4 370	26 848	45 712
Until Further Notice[1]	211	218	6 397	1 866	2 321	127	11 140
Total	48 335	8 498	47 122	19 773	20 762	56 287	200 776

1 Exposure without a concrete end-date is assigned to the 'Until Further Notice' category.
2 Figures for residential mortgages were reported in the 'Retail' exposure class in 2011.

About 43% of the lending portfolio will mature within five years. Within the 'Institutions' and 'Corporates' exposure classes, this percentage even reached 87% and 67%, respectively. The longest maturities are mainly found in the 'Retail' and 'Residential mortgages' classes.

There was an increase in the 'Until Further Notice' bucket for the 'Corporates' and 'SME Corporate' exposure classes. This was not driven by higher amounts granted in this category, but rather by higher Credit Conversion Factors (CCF) on the undrawn part of credit facilities as a result of switching to the IRB Advanced approach.

Total credit exposure in the lending portfolio per product type

Exposure [EAD] 31-12-2011 (in millions of EUR)	Sovereign	Institutions	Corporates	SME Corporates	Retail[1]	Residential Mortgages[1]	Total
Guarantee	1 015	453	3 399	937	273	-	6 077
Debt instrument	36 185	2 244	1 136	3	0	-	39 569
Equity	0	7	68	1	0	-	76
Leasing	40	7	1 507	887	1 647	-	4 088
Home loans	0	0	1	27	58 798	-	58 825
Other lending	15 739	4 116	39 848	18 057	17 926	-	95 696
Total	52 980	6 828	45 958	19 912	78 644	-	204 322
Exposure [EAD] 31-12-2012 (in millions of EUR)	**Sovereign**	**Institutions**	**Corporates**	**SME Corporates**	**Retail**	**Residential mortgages**	**Total**
Guarantee	669	499	4 939	1 210	498	0	7 816
Debt instrument	37 390	1 797	954	3	0	0	40 145
Equity	0	7	121	17	0	0	146
Leasing	33	1	1 460	794	1 714	0	4 002
Home loans	0	0	0	0	1 171[2]	56 287	57 457
Other lending	10 242	6 193	39 648	17 749	17 379	0	91 210
Total	48 335	8 498	47 122	19 773	20 762	56 287	200 776

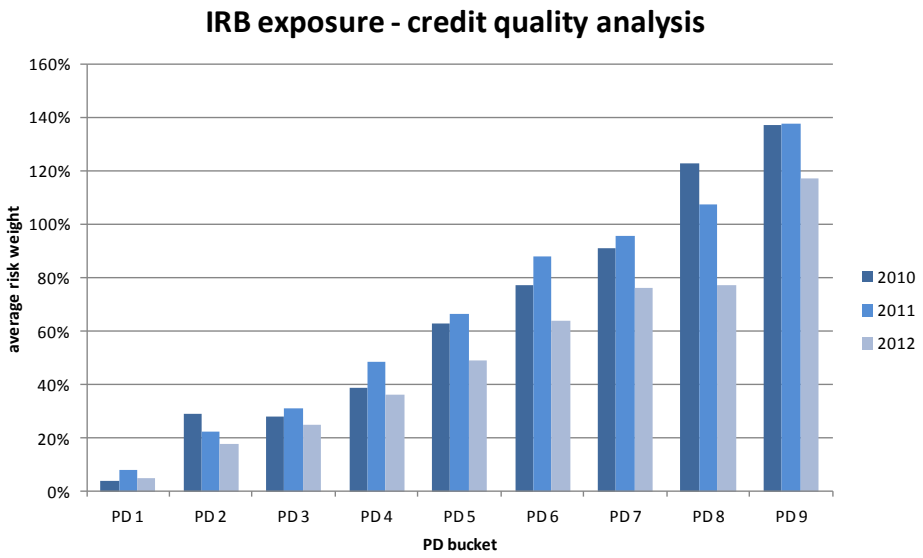
1 Figures for residential mortgages were reported in the 'Retail' exposure class in 2011.
2 Home loans to individuals which are not (partly) secured by residential mortgages.

The decrease in 'Other lending' to sovereigns was partly related to the reduced substitution effect due to sovereign guarantees on other lending exposures (arising from the transition to the IRB Advanced approach (see above)) and partly related to lower cash balances with central banks.

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

The graph and table below show credit risk exposure per Probability of Default (PD) class in terms of average risk weight or 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 table below shows 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 RWA for a certain original exposure. The latter is also reflected in the 'weighted average' percentage.



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 Master Scale for Probability of Default. For more information in this regard, please refer to the 'Internal modelling' section.

The average risk weight decreased substantially in 2012, from 38% to 31%, due to the non-retail exposures classes ('Sovereigns', 'Institutions', 'Corporates', 'SME Corporates') which benefitted from the transition from the IRB Foundation to the IRB Advanced approach. As internally modelled LGDs are on average lower than regulatory IRB Foundation LGDs, this reduced the average risk weight. It should be noted that the transition did not impact the retail portfolios, where risk weights remained stable over 2012.

For 'Institutions', the substantial drop in the average risk weight can be explained by lower RWAs for documentary credits under the IRB Advanced approach. Modelled Credit Conversion Factors are higher than the regulatory Credit Conversion Factors used under the IRB Foundation approach, but LGDs are substantially lower, leading to a downwards effect on RWA. For 'Retail' and 'Residential mortgages', there was an increase in exposure in PD class 9, owing to renegotiated mortgages in the portfolio at KBC Bank Ireland.

In millions of EUR – 31-12-2011

PD Master scale	Exposure [EAD] RWA Average in %	Sovereign	Institutions	Corporates	SME Corporates	Retail[2]	Residential Mortgages[2]	Total
1 [0.00% - 0.10%]	Sum of EAD	18 679	3 483	6 656	591	24 369	-	53 777
	Sum of RWA	1 772	597	1 536	130	415	-	4 450
	weighted average	9%	17%	23%	22%	2%	-	8%
2 [0.10% - 0.20%]	Sum of EAD	393	690	5 861	1 520	8 344	-	16 808
	Sum of RWA	260	178	2 332	543	471	-	3 783
	weighted average	66%	26%	40%	36%	6%	-	23%
3 [0.20% - 0.40%]	Sum of EAD	592	602	6 308	3 013	11 110	-	21 623
	Sum of RWA	433	277	3 441	1 496	1 084	-	6 731
	weighted average	73%	46%	55%	50%	10%	-	31%
4 [0.40% - 0.80%]	Sum of EAD	94	66	7 600	3 360	7 731	-	18 851
	Sum of RWA	86	32	5 733	2 107	1 185	-	9 143
	weighted average	91%	49%	75%	63%	15%	-	49%
5 [0.80% - 1.60%]	Sum of EAD	90	694	5 859	3 161	5 647	-	15 451
	Sum of RWA	109	494	5 664	2 459	1 531	-	10 256
	weighted average	121%	71%	97%	78%	27%	-	66%
6 [1.60% - 3.20%]	Sum of EAD	65	59	3 776	2 162	2 357	-	8 418
	Sum of RWA	93	63	4 277	2 017	945	-	7 395
	weighted average	143%	107%	113%	93%	40%	-	88%
7[1] [3.20% - 6.40%]	Sum of EAD	35	82	1 902	1 148	2 329	-	5 497
	Sum of RWA	54	103	2 720	1 210	1 174	-	5 260
	weighted average	155%	125%	143%	105%	50%	-	96%
8 [6.40% - 12.80%]	Sum of EAD	18	10	782	451	1 573	-	2 835
	Sum of RWA	33	13	1 386	625	990	-	3 047
	weighted average	183%	126%	177%	139%	63%	-	107%
9 [12.80% - 100.00%]	Sum of EAD	6	1	735	647	2 934	-	4 323
	Sum of RWA	17	2	1 645	1 098	3 176	-	5 937
	weighted average	0%	256%	224%	170%	108%	-	137%
Total exposure		19 972	5 687	39 479	16 052	66 394	-	147 583
Total risk-weighted assets		2 856	1 758	28 733	11 686	10 970	-	56 004
Total weighted average		14%	31%	73%	73%	17%	-	38%

1 Unrated exposure has been assigned a PD of 4.53% and been allocated to PD bucket 7.
2 Figures for residential mortgages were reported in the 'Retail' exposure class in 2011.

In millions of EUR – 31-12-2012

PD Master scale	Exposure [EAD] RWA Average in %	Sovereign	Institutions	Corporates	SME Corporates	Retail	Residential Mortgages	Total
1 [0.00% - 0.10%]	Sum of EAD	15 145	4 109	5 490	576	3 232	21 786	50 339
	Sum of RWA	804	349	782	68	127	291	2 421
	weighted average	5%	8%	14%	12%	4%	1%	5%
2 [0.10% - 0.20%]	Sum of EAD	641	1 380	4 937	1 663	2 730	4 509	15 859
	Sum of RWA	330	240	1 449	391	189	208	2 807
	weighted average	52%	17%	29%	24%	7%	5%	18%
3 [0.20% - 0.40%]	Sum of EAD	150	549	6 965	3 301	3 244	4 552	18 761
	Sum of RWA	88	102	2 604	1 107	392	387	4 680
	weighted average	59%	19%	37%	34%	12%	9%	25%
4 [0.40% - 0.80%]	Sum of EAD	285	530	8 181	3 005	2 760	8 338	23 098
	Sum of RWA	227	110	4 985	1 215	512	1 152	8 202
	weighted average	80%	21%	61%	40%	19%	14%	36%
5 [0.80% - 1.60%]	Sum of EAD	222	849	6 590	3 267	2 334	4 597	17 860
	Sum of RWA	114	407	4 799	1 605	711	1 089	8 725
	weighted average	51%	48%	73%	49%	30%	24%	49%
6 [1.60% - 3.20%]	Sum of EAD	347	52	3 320	2 278	1 712	909	8 617
	Sum of RWA	64	17	3 102	1 336	621	355	5 496
	weighted average	18%	32%	93%	59%	36%	39%	64%
7* [3.20% - 6.40%]	Sum of EAD	13	144	2 215	1 491	851	999	5 713
	Sum of RWA	7	87	2 415	979	318	533	4 338
	weighted average	54%	61%	109%	66%	37%	53%	76%
8 [6.40% - 12.80%]	Sum of EAD	7	86	839	586	621	1 029	3 167
	Sum of RWA	7	41	1 046	459	235	658	2 446
	weighted average	101%	47%	125%	78%	38%	64%	77%
9 [12.80% - 100.00%]	Sum of EAD	44	20	1 117	629	627	3 510	5 946
	Sum of RWA	84	11	2 076	717	308	3 743	6 940
	weighted average	0%	57%	186%	114%	49%	107%	117%
Total exposure		16 853	7 718	39 655	16 794	18 110	50 229	149 361
Total risk-weighted assets		1 726	1 364	23 258	7 877	3 413	8 417	46 055
Total weighted average		10%	18%	59%	47%	19%	17%	31%

* Unrated exposure has been assigned a PD of 4.53% and been allocated to PD bucket 7.

With reference to EAD and LGD, 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). Only exposures where KBC uses own CCF and LGD estimates are shown (IRB Advanced approach). Up to 2011, this had only been the case for retail exposures. As of 2012, the non-retail exposures of KBC Bank, ČSOB Czech Republic, CBC Banque, KBC Lease Belgium, KBC Finance Ireland and KBC Credit Investments has also been treated under the IRB Advanced approach.

Further detailed quality information on IRB-Advanced exposure, 31-12-2011
(in millions of EUR)

Asset class	PD	1	2	3	4	5	6	7	8	9	Total
Retail	EAD	24 369	8 344	11 110	7 731	5 647	2 357	2 329	1 573	2 934	66 394
	Outstanding amount	23 757	7 979	10 845	7 436	5 164	2 197	2 264	1 551	2 902	64 094
	Undrawn amount	862	891	699	641	698	282	139	49	48	4 310
	Average CCF %	71.0%	40.9%	38.0%	46.0%	69.2%	56.7%	47.5%	43.9%	67.4%	53.4%
	LGD %	13.5%	16.6%	16.9%	17.6%	20.8%	23.0%	19.2%	18.7%	20.8%	16.5%

Further detailed quality information on IRB Advanced exposure, 31-12-2012
(in millions of EUR)

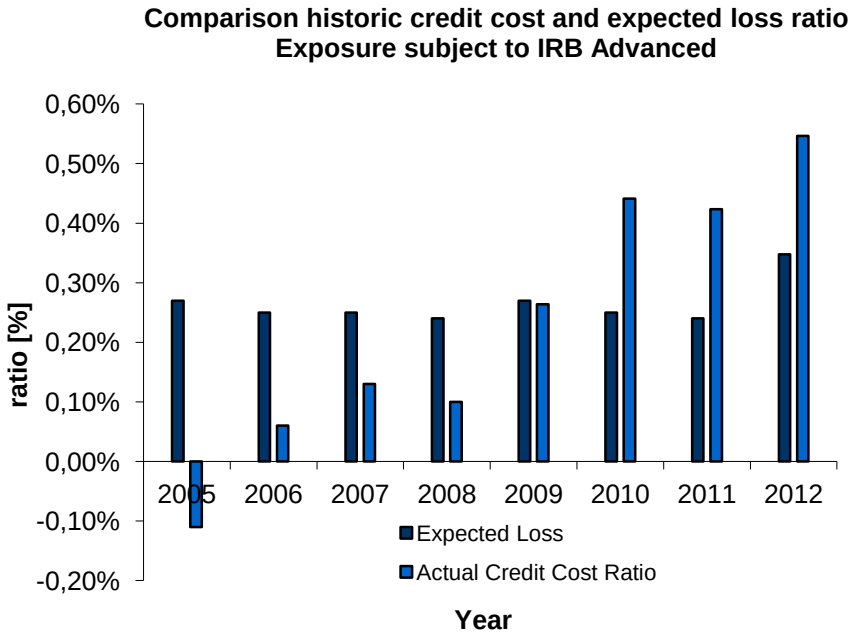
Asset class	PD	1	2	3	4	5	6	7	8	9	Total
Sovereign	EAD	22 190	292	33	50	90	258	6	0	16	22 935
	Outstanding amount	21 497	290	33	50	87	232	5	0	1	22 196
	Undrawn amount	838	15	4	0	4	26	0	0	16	902
	Average CCF %	82.7%	14.0%	9.6%	84.3%	90.3%	100.0%	32.1%	0.0%	90.8%	81,9%
	LGD %	18.1%	21.2%	34.5%	26.5%	16.4%	5.8%	37.7%	0.0%	15.9%	18.1%
Institutions	EAD	7 859	2 276	604	591	857	57	166	98	20	12 527
	Outstanding amount	7 085	2 187	463	272	645	31	91	82	13	10 870
	Undrawn amount	1 610	141	152	322	220	29	77	24	7	2 581
	Average CCF %	48.1%	63.4%	92.2%	98.9%	96.2%	91.8%	96.2%	69.3%	87.4%	64.2%
	LGD %	23.5%	29.4%	20.0%	17.2%	18.5%	13.8%	20.4%	11.6%	11.1%	23.0%
Corporates	EAD	6 209	4 865	6 241	7 323	5 785	2 511	1 715	682	834	36 164
	Outstanding amount	4 992	3 041	4 170	5 618	4 602	2 002	1 392	592	715	27 123
	Undrawn amount	1 566	2 349	2 719	2 334	1 563	678	370	104	136	11 819
	Average CCF %	77.7%	77.7%	76.2%	73.0%	75.7%	75.1%	87.4%	87.0%	87.7%	76.5%
	LGD %	29.8%	31.0%	21.7%	39.2%	39.3%	27.8%	24.2%	26.8%	26.1%	31.5%
SME	EAD	579	1 669	3 269	2 805	2 892	1 832	1 168	487	442	15 142
	Outstanding amount	529	1 496	2 832	2 351	2 411	1 625	1 009	431	406	13 091
	Undrawn amount	113	411	766	777	823	370	239	74	66	3 639
	Average CCF %	44.2%	42.0%	57.0%	58.4%	58.4%	55.9%	66.4%	75.8%	53.6%	56.3%
	LGD %	23.1%	27.5%	27.6%	26.1%	24.6%	22.8%	19.7%	19.4%	19.4%	24.9%
Retail	EAD	3 233	2 731	3 246	2 761	2 335	1 712	851	621	627	18 116
	Outstanding amount	2 688	2 512	3 006	2 559	2 001	1 567	784	583	602	16 303
	Undrawn amount	702	564	594	433	507	258	134	66	46	3 304
	Average CCF %	77.6%	38.8%	40.3%	46.6%	65.9%	56.0%	50.4%	56.5%	53.2%	54.9%
	LGD %	24.7%	21.1%	22.3%	22.4%	27.1%	26.3%	24.2%	22.2%	21.3%	23.6%
Residential mortgages	EAD	21 786	4 509	4 552	8 338	4 597	909	999	1 029	3 510	50 229
	Outstanding amount	21 786	4 509	4 552	8 227	4 387	897	982	1 028	3 503	49 871
	Undrawn amount	0	0	0	111	210	11	17	1	6	358
	Average CCF - %	0.0%	0.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%
	Average LGD - %	11.8%	12.9%	14.2%	16.3%	17.3%	17.5%	16.2%	14.4%	18.1%	14.1%

The table shows that LGDs are the lowest for residential mortgages, which by definition have a partly or fully secured nature. Furthermore, LGDs are on average higher for 'Corporates' than for the 'SME' or 'Retail' classes. The relationship between PDs and LGDs is not a strong one. Even though PD information can be included in LGD modelling through the probability of cure, LGDs will instead be driven by risk mitigants, such as collateral or guarantees, and through a product- or country-specific calibration.

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. Unfortunately, historical loan loss information is generally not available at Basel II asset class level. KBC believes that this disclosure is also less relevant to the extent that, up to 2012, the portfolio was largely made up of exposure subject to the IRB Foundation approach, for which 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 total portfolio which is subject to the IRB Advanced approach. The graph compares KBC's EL ratio (EL related to the EAD) 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. This implies that the 2012 credit cost ratio shown is the actual ratio over 2012, whereas the EL for 2012 is calculated on the basis of the portfolio at year-end 2012 and is thus a modelled expectation for 2013. Only the normal (i.e. non-default) portfolio is taken into account. Exposures to the low-default 'Sovereigns' and 'Institutions' classes have been excluded from this comparison, which means that the focus lies with the corporate, SME and retail credit portfolio.

Given the focus on the IRB Advanced portfolio, the scope of the graph changes over time. Up to 2008, it had been limited to the Belgian retail portfolio. KBC Homeloans (the retail portfolio of KBC Bank Ireland) only switched from the Standardised to the IRB approach halfway through 2008 and was thus only incorporated into the graph below from 2009 on. As of 2012, the graph includes both the retail and corporate/SME portfolio of those entities that have adopted the IRB Advanced approach, as well as the retail portfolio of KBC Bank Ireland and K&H Bank.



The economic downturn of recent years, especially in Ireland, is responsible for an increased number of defaults and higher losses, and is thus reflected in the fact that the credit cost ratio shown in the graph was higher than the EL ratio in 2010, 2011 and 2012.

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's, Fitch and Moody's to define the risk bucket of exposures. If there are three external ratings with different risk weights attached to them, the risk weight corresponding with the second best external rating is applied.

The table below shows credit risk exposure calculated according to the Standardised approach and broken down by type of exposure and risk bucket.

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. Even for the 'Corporates' exposure, unrated debtors account for 99% of the portfolio, as can be expected for a portfolio with a focus on Central and Eastern European midcaps (over half of the unrated corporate exposure originates from ČSOB Slovakia). Due to the absence of external ratings, the RWA of the KBC standardised portfolio is primarily volume-driven over time.

Standardised exposure [EAD] 31-12-2011 (in millions of EUR)	Quality steps							
	1	2	3	4	5	6	Unrated	Total
Sovereign	23 270	2 103	3 125	0	0	0	1 429	29 927
RGLA	0	35	0	0	0	0	135	169
PSE	41	26	0	0	0	0	59	125
MDB	12	0	1	0	0	0	0	13
International organisations	0	0	0	0	0	0	0	0
Institutions	282	231	276	23	22	0	119	954
Corporates	890	25	1	26	0	0	4 582	5 524
Retail	0	0	0	0	0	0	5 174	5 174
Secured by real estate	0	1	0	0	0	0	4 422	4 423
Past due	0	0	0	0	0	0	227	227
High risk	0	0	0	0	0	0	5	5
Covered bonds	0	0	0	0	0	0	0	0
CIU	0	0	0	0	0	0	0	0
Short term	17	0	0	0	0	0	0	17
Other	1	0	0	0	0	0	1 076	1 077
Total	24 513	2 421	3 403	49	22	0	17 228	47 636

Standardised exposure [EAD] 31-12-2012 (in millions of EUR)	Quality steps							
	1	2	3	4	5	6	Unrated	Total
Sovereign	27 147	3	416	0	3 103	0	1 148	31 817
RGLA	0	0	6	0	0	0	140	146
PSE	0	0	0	0	0	0	0	0
MDB	2	0	1	0	0	0	7	9
International organisations	0	0	0	0	0	0	0	0
Institutions	84	197	266	0	0	0	18	566
Corporates	0	0	34	10	0	0	3 404	3 448
Retail	0	0	0	0	0	0	2 149	2 149
Secured by real estate	0	0	0	0	0	0	2 315	2 315
Past due	0	0	0	0	0	0	233	233
High risk	0	0	0	0	0	0	0	0
Covered bonds	0	0	0	0	0	0	0	0
CIU	0	0	0	0	0	0	0	0
Short term	0	0	0	0	31	0	0	31
Other	0	0	0	0	0	0	889	890
Total	27 233	200	724	10	3 134	0	10 303	41 603

The overall decrease in exposures, especially in the unrated quality step, is due to the divestment of Kredyt Bank in 2012. For 'Sovereigns', there was an increase in exposure in quality step 1 (Kingdom of Belgium) and a sharp reduction in quality step 2 (in 2011, credit risk exposure related mainly to the Republic of Poland (in the portfolio of Kredyt Bank)) and a shift in exposure from quality step 3 to 5 (due to a rating downgrade of the Republic of Hungary).

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.

Impaired exposure per geographic region [EAD] (in millions of EUR)	31-12-2011*	31-12-2012
Africa	10	0
Asia	116	71
Central and Eastern Europe & Russia	2 196	2 401
Latin America	4	4
Middle East	17	30
North America	240	301
Oceania	44	328
Western Europe	8 171	8 341
Total	10 800	11 477

* In 2011, KBL EPB's impaired exposure amounted to 50 million euros, mainly situated in Western Europe.

Impaired exposure per sector [EAD] (in millions of EUR)	31-12-2011	31-12-2012
Agriculture, Farming & Fishing	133	98
Automotive	215	152
Building & Construction	559	717
Chemicals	148	122
Commercial Real Estate	2 412	2 638
Distribution	1 004	948
Electrotechnics	72	48
Finance & Insurance	154	181
Horeca	350	376
IT	131	101
Machinery & Heavy Equipment	90	57
Metals	228	174
Private Persons	2 414	3 424
Services	783	813
Shipping	192	252
Textile & Apparel	201	132
Other*	1 714	1 245
Total	10 800	11 477

* All sectors with a concentration of less than 1% of the total EAD 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 2012.

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'.

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 bottom part of the table below.

Transaction type 31-12-2011 (in millions of EUR)	Marked-to-market	Add-on	Counterparty risk [EaD]	Notional value of contracts	Regulatory capital[1]
CDS bought -Trading	1 112	1 708	2 820	21 322	102
CDS sold - Trading	21	357	378	25 289	4
Other	0	2	2	15	0
Total credit derivatives	1 133	2 067	3 199	46 627	106
Interest Rate Swaps (IRS)	6 900	1 315	8 215	262 496	142
Caps/Floors	722	278	999	31 203	9
Other	412	350	762	45 056	8
Total interest-related transactions	8 034	1 943	9 976	338 755	159
FX forward	352	229	581	17 066	11
FX swap	998	665	1 663	60 958	8
Cross Currency IRS	1 079	798	1 878	51 406	18
Other	168	131	299	9 951	2
Total currency-related transactions	2 598	1 823	4 421	139 382	40
Equity swaps	2 367	1 776	4 142	53 825	16
Equity options	459	219	678	4 411	3
Total equity-related transactions	2 826	1 994	4 820	58 236	19
Total commodity transactions	27	40	67	379	1
Gross counterparty risk	14 617	7 866	22 483	583 378	
Netting benefit (-)			-12 056		
Total counterparty risk after netting			10 427		
Collateral benefit (-)			-1 525		
Total net Counterparty risk[2]			8 902		324

1 Based on the net counterparty risk of the transaction type.
2 KBL EPB's net counterparty credit risk (EAD) amounted to 298 million euros at the end of 2011.

Transaction type 31-12-2012 (in millions of EUR)	Marked-to-market	Add-on	Counterparty risk [EaD]	Notional value of contracts	Regulatory capital*
CDS bought -Trading	354	1 482	1 836	18 762	71
CDS sold - Trading	51	193	244	18 970	2
Other	0	1	1	15	0
Total credit derivatives	405	1 676	2 080	37 747	73
Interest Rate Swaps (IRS)	7 024	1 038	8 063	206 635	158
Caps/Floors	692	234	926	28 794	14
Other	519	319	838	30 389	8
Total interest-related transactions	8 235	1 591	9 827	265 819	179
FX forward	148	165	313	12 720	8
FX swap	497	718	1 215	66 287	6
Cross Currency IRS	761	760	1 521	40 341	14
Other	64	109	173	7 973	2
Total currency-related transactions	1 470	1 752	3 222	127 320	30
Equity swaps	1 938	1 503	3 441	43 389	18
Equity options	319	157	476	2 939	1
Total equity-related transactions	2 257	1 659	3 916	46 327	19
Total commodity transactions	19	34	52	313	0
Gross counterparty risk	12 386	6 711	19 097	477 527	
Netting benefit (-)			-10 068		
Total counterparty risk after netting			9 031		
Collateral benefit (-)			-1 912		
Total net Counterparty risk			7 118		301

* Based on the net counterparty risk of the transaction type.

In 2012, KBC significantly reduced its exposure to counterparty credit risk. Gross counterparty risk decreased by 15% and net counterparty risk (after netting and collateral benefit) by 20% on an annual basis. This decrease is volume rather than marked-to-market driven, as illustrated by the fact that also the notional value of contracts decreased by 18%.

A breakdown of the net counterparty risk is provided below, 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.

Net derivative exposure per geographic region [EAD][1] (in millions of EUR)	31-12-2011	31-12-2012
Africa	1	1
Asia	195	100
Central and Eastern Europe & Russia	654	953
Latin America	0	0
Middle East	62	65
North America	833	412
Oceania	70	61
Western Europe	7 086	5 526
Total	8 902	7 118

Net derivative exposure per rating band[2] [EAD][1] (in millions of EUR)	31-12-2011	31-12-2012
AAA	636	9
AA	2 093	1 841
A	3 540	2 618
BBB	1 044	1 138
BB	1 155	615
B and below	316	630
No rating	117	267
Total	8 902	7 118

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. If no external rating is available, the internal rating is mapped to the corresponding external rating.

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 Financial Products. 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 Financial Products 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

To date, KBC has not engaged 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, 'suitable for netting' 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 2012, the netting impact on derivative exposure amounted to 10.1 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 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, 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) 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.

31-12-2011[4] (in millions of EUR)	Exposure [EAD]	Covered exposure [EaD]	Covered exposure [%]
Reverse repos/'buy and sell-back'[1]	8 600	2 469	29%[3]
Repos/'sell and buy-back'[2]	7 862	7 743	98%
Total	16 461	10 212	62%
31-12-2012[5] (in millions of EUR)	Exposure [EAD]	Covered exposure [EaD]	Covered exposure [%]
Reverse repos/'buy and sell-back'[1]	5 308	1 486	28%[3]
Repos/'sell and buy-back'[2]	5 294	5 251	99%
Total	10 602	6 737	64%

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 mainly due to transactions at ČSOB Czech Republic, where the reverse repo counterparty and the counterparty of the securities is the same entity, namely the Czech National Bank. Therefore, the collateral is not eligible for capital purposes and thus not included in the coverage percentage. ČSOB Czech Republic accounted for 65% of the reverse repo exposure [EAD] at year-end 2011 and for 77% at year-end 2012.
4 In 2011, KBL EPB's exposure to repo-like transactions amounted to 5.0 billion euros, 3.7 billion euros of which for reverse repos and 1.3 billion euros for repos. The covered exposure amounted to 4.8 billion euros.
5 Figures exclude the LTRO repo with the ECB at KBC Bank Ireland (exposure of 3.8 billion euros, 3.6 billion euros of which covered), which was repaid at the beginning of 2013.

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, 21.2% (1 912 million euros of 9 031 million euros) was classified as collateralised at the end of 2012. A breakdown of covered exposure values by exposure classes and type of collateral is provided in the table below. Both debt securities and cash collateral were taken into account for credit risk mitigation of counterparty risk exposure. In this respect, it should be noted that, according to the applicable policy, equity collateral is not eligible.

Covered exposure [1,2] [EaD] 31-12-2011 (in millions of EUR)	LGD % applied under IRB Foundation	Sovereigns	Institutions	Corporates	SME Corporates	Total
Cash	0%	0	944	491	0	1 435
Debt securities	0%	0	90	0	0	90
Total		0	1034	491	0	1 525
Covered exposure [1,2] [EaD] 31-12-2012 (in millions of EUR)	LGD % applied under IRB Foundation	Sovereigns	Institutions	Corporates	SME Corporates	Total
Cash	0%	0	1 383	120	0	1 503
Debt securities	0%	0	116	293	0	409
Total		0	1 499	413	0	1 912

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.

Lending portfolio

Exposures and collateral subject to the Standardised and IRB Advanced approaches are excluded from the table below. 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. Collateral applying to lending exposure subject to the IRB Advanced approach affects RWA only indirectly as collateral is included in LGD modelling (see 'IRB Quality analysis' and 'Internal modelling').

Of the lending EAD subject to the IRB-Foundation approach, 1.1 billion euros was classified as collateralised at the end of 2012, 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. At year-end 2012 collateralised lending exposure under the IRB Foundation approach accounted for 1.0 billion euros. The year-on-year decrease was due to the switch to the IRB Advanced approach for the bulk of the portfolio. Additional information on the extent to which collateral was taken into account in the internal LGD estimation under this approach is provided in the 'Internal modelling' section.

It is clear that credit risk mitigation is only applied when the necessary policies and procedures are in place. Under the IRB Foundation approach, 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.

The table below gives the total EAD covered by eligible financial and physical collateral for each exposure class (limited to exposures treated under the IRB Foundation approach).

In millions of EUR – 31-12-2011

Covered IRB Foundation lending exposure [EAD][1] 31-12-2011 (in millions of EUR)	LGD applied under IRB Foundation[2]	Sovereign	Institutions	Corporates	SME Corporates	Total
Cash	0%	2	3	328	235	568
Debt securities	0%	0	0	56	21	77
Equity collateral	0%	0	0	132	76	208
Total financial collateral		3	3	515	332	853
Real estate[3]	30%	40	9	1 961	3 191	5 202
Receivables	35%	0	0	539	283	822
Lease collateral	35%	0	0	104	154	259
Other physical collateral	40%	0	1	298	330	629
Total physical collateral		40	10	2 902	3 959	6 911
General total		43	14	3 417	4 291	7 765
Covered IRB Foundation lending exposure [EAD][1] 31-12-2012 (in millions of EUR)	LGD applied under IRB Foundation[2]	Sovereign	Institutions	Corporates	SME Corporates	Total
Cash	0%	3	0	93	71	166
Debt securities	0%	0	33	0	0	33
Equity collateral	0%	0	0	0	0	0
Total financial collateral		3	33	93	71	200
Real estate[3]	30%	10	0	184	601	795
Receivables	35%	0	0	18	2	20
Lease collateral	35%	0	0	0	0	0
Other physical collateral	40%	0	0	2	8	10
Total physical collateral		10	0	204	610	825
General total		13	33	297	681	1 025

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.

The table shows that the bulk of the collateralised amounts relates to physical collateral (0.8 billion euros), while financial collateral, which has a bigger impact on capital as it attracts a LGD of 0%, is limited to 0.2 billion. 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.

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

Unfunded credit protection

Unfunded credit protection is provided mainly through guarantees and – to a much 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 2.1 billion euros at the end of 2012. This relates solely to exposures treated under the Standardised and IRB Foundation approaches. Unfunded credit protection applying to lending exposure under the IRB Advanced approach affects RWA only indirectly as guarantees are included in LGD modelling. Additional information on how unfunded credit protection was taken into account in the internal LGD estimation under this approach can be found in the 'Internal modelling' section.

Covered exposure [EAD][1,2,3] 31-12-2011 (in millions of EUR)	Sovereign	Institutions	Corporates	SME Corporates	Total
Credit derivatives	0	0	2	0	2
Guarantees	2 315	501	3 386	494	6 697
Total	2 315	501	3 389	494	6 699
Covered exposure [EAD][1,2,3] 31-12-2012 (in millions of EUR)	**Sovereign**	**Institutions**	**Corporates**	**SME Corporates**	**Total**
Credit derivatives	0	0	0	0	0
Guarantees	95	436	1 373	227	2 131
Total	95	436	1 373	227	2 131

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 IRB Foundation approaches.

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 Master Scale.

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.

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

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

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 historical data can be found. To raise awareness, estimates of potential errors are made for unavoidable uncertainties. For PD models, a portion of these uncertainties is also covered by means of capital penalties.

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

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

Overview of credit risk models

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

PD models used under the IRB approach[1] In billions of EUR	Exposure granted [EAD]	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	41.1	0.70%	0.06%	0.45%
Czech municipalities	0.4	0.30%	0.17%	0.30%
Hungarian municipalities	0.0	1.04%	1.04%	0.95%
PD models for corporate and institutional segments[6]				
Asia-Pacific corporates	0.9	1.55%	1.85%	1.65%
US corporates	0.8	1.36%	1.06%	1.68%
Western-European corporates				
of which non-Irish	*19.0*	*1.64%*	*1.64%*	*1.28%*
of which Irish	*0.3*	*4.50%*	*5.67%*	
Czech corporates and large SMEs	5.8	1.80%	1.86%	1.80%
Hungarian corporates	1.5	3.54%	3.65%	2.41%
(Worldwide) model for banks				
of which Developed	*22.2*	*0.30%*	*0.10%*	*0.41%*
of which Others		*1.13%*	*0.46%*	*1.00%*
(Worldwide) model for project finance	3.0	1.54%	1.47%	0.99%
(Worldwide) model for management buy outs	1.3	3.66%	3.84%	2.90%
PD models for SME segments				
models for Belgian professionals				
of which liberal professions[5]	*0.2*	*0.44%*	*0.44%*	*0.46%*
of which self-employed professionals[5]	*1.1*	*1.93%*	*1.93%*	*1.34%*
of which private persons[5]	*0.4*	*1.70%*	*1.70%*	*1.30%*
Belgian farmers[5]	1.2	1.58%	1.58%	1.42%
Belgian SMEs – small businesses[5]	16.5	1.95%	2.00%	1.40%
Czech SMEs	0.5	2.90%	3.29%	2.90%
Hungarian upper SMEs	1.1	4.46%	3.83%	4.00%

1 Non-exhaustive list of models used under the IRB approach, and excluding all retail pooling models.
2 The central tendency is the average through-the-cycle default probability of a portfolio.
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 according to the model. The value at the time of the latest review is shown.
5 Central tendency, default rate and average model PD values can differ from entity to entity. The values shown here are those for KBC Bank NV.
6 The worldwide model for commercial real estate project finance is material (5.9 billion euros of exposure) but is excluded from this list as it consists of various sub-models, each with distinct central tendencies, default rates and average model PDs.

The table below shows information on some of the most relevant LGD models used for capital calculations under the IRB Advanced approach. The scope of the tables is limited to the lending portfolio and does not include derivatives or repo-like transactions.

LGD models used under the IRB-Advanced approach In billions of EUR	Exposure granted [EAD]	average LGD non-defaulted exposures (PD 1-9)	average LGD defaulted exposures (uncertain, PD 10-11)	average LGD defaulted exposures (irrecoverable, PD	Exposure covered by financial collateral	Exposure covered by physical collateral	Exposure covered by guarantees	Exposure covered by credit derivatives
LGD models for government and public sector segments								
(Worldwide) model for central governments	22.6	20.54%	-[1]	-[1]	-	-	-	-
LGD models for corporate and financial segments[2]								
(Worldwide) financial institutions[3]	10.1	31.06%	38.72%	N/A	0.04	0.09	0.55	0.00
(Worldwide) corporates	20.5	31.80%	36.28%	64.44%	0.42	4.11	1.42	0.00
(Worldwide) commercial real estate project finance	3.8	32.93%	45.00%	n/a	0.04	1.83	0.23	0.00
(Worldwide) project finance[4]	3.0	20.60%	12.12%	n/a	-	-	-	-
LGD models for SME segments								
Belgian SME	26.3	21.00%	9.13%	26.03%	0.55	16.67	2.40	0.00
Czech corporates and SME	7.9	28.46%	20.39%	61.58%	0.13	1.40	1.16	0.00
LGD pooling models for retail[5]								
LGD pooling model for Belgian regulated retail	32.4	13.20%	14.17%	43.64%	-	-	-	-
LGD pooling model for Irish mortgage loans	12.4	19.70%	31.30%	40.00%	-	-	-	-
LGD pooling models for Czech retail	11.2	19.43%	38.10%	38.10%	-	-	-	-
LGD pooling model for Hungarian retail	2.1	30.06%	41.79%	69.56%	-	-	-	-

1 At year-end 2012, KBC had no defaulted exposures using the LGD model for central governments.
2 No specific LGD model exists for irrecoverable (PD 12) exposure to financials, commercial real estate or project finance. Instead, the generic irrecoverable LGD model for worldwide corporates is used.
3 The LGD model for financial institutions is also used for non-bank financials that are treated as corporates under Basel II. Hence, the scope should not be confused with 'Institutions' in this report.
4 No collateral or guarantee information available for the worldwide project finance model.
5 No collateral or guarantee information provided for retail pooling models, as LGDs are determined based on the allocation of transactions to predefined pools and not on the level of risk mitigation at a transactional level.

In terms of credit risk mitigation there is an important presence of physical collateral, a material presence of guarantees and a more modest presence of financial collateral. For the worldwide corporate model, physical collateral mostly comprises mortgage registrations (1.0 billion euros), powers of attorney to create a mortgage (0.7 billion euros), pledges (1.3 billion euros), powers of attorney to establish a pledge (0.5 billion euros) and leased objects (0.5 billion euros), while guarantees are mostly issued by governments (0.7 billion euros). For the worldwide commercial real estate project finance model, physical collateral is almost exclusively mortgage registrations and powers of attorney to create a mortgage. For the Belgian SME model, the bulk of credit risk mitigation comes from physical collateral. The most material collateral types are mortgage registrations (5.6 billion euros), powers of attorney to create a mortgage (8.5 billion euros), pledges (1.1 billion euros), powers of attorney to establish a pledge (0.5 billion euros) and leased objects (0.7 billion euros). The guarantees are mostly issued by governments (1.0 billion euros) and banks (0.1 billioneuros) or sureties provided by private persons (0.8 billion euros).

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

Where the insurance activities are concerned, credit exposure exists primarily in the investment portfolio (towards issuers of debt instruments) and towards reinsurance companies. We have guidelines in place for the purpose of controlling credit risk within the investment portfolio with regard to, for instance, portfolio composition and ratings. The table below provides an overview of the total investment portfolio of the group's insurance entities.

Investment portfolio of KBC group insurance entities (in millions of EUR, market value)[1]	31-12-2011[5]	31-12-2012[5]
Per balance sheet item		
Securities	18 447	19 634
Bonds and other fixed-income securities	17 490	18 983
Held to maturity	3 518	5 788
Available for sale	13 912	13 190
At fair value through profit or loss and held for trading	49	0
As loans and receivables	9	5
Shares and other variable-yield securities	948	633
Available for sale	946	630
At fair value through profit or loss and held for trading	2	3
Other	8	18
Property and equipment and investment property	381	408
Investment contracts, unit-linked[2]	7 652	11 847
Other	326	89
Total	26 824	31 978
Details for bonds and other fixed-income securities		
By rating[3, 4]		
Investment grade	98%	95%
Non-investment grade	1%	1%
Unrated	1%	4%
By sector[3]		
Governments	66%	63%
Financial[6]	23%	26%
Other	11%	11%
By currency[3]		
Euro	94%	94%
Other European currencies	5%	6%
US dollar	0%	0%
By remaining tenor[3]		
Not more than 1 year	8%	13%
Between 1 and 3 years	22%	19%
Between 3 and 5 years	14%	15%
Between 5 and 10 years	34%	33%
More than 10 years	21%	20%

1 The total carrying value amounted to 26 613 million euros at year-end 2011 and to 31 277 million euros at year-end 2012
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 entities classified as 'disposal groups' under IFRS 5. In 2011, these entities (KBL EPB (VITIS Life), Fidea and WARTA) had an investment portfolio of 6.5 billion euros. In 2012, the relevant entities had an investment portfolio of 0.2 billion euros.
6 Including covered bonds and non-bank financial companies.

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 us. We measure this particular type of credit risk 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. We determine the exposure at default 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[1]: Exposure at Default (EAD) and Expected Loss (EL)[2] (in millions of EUR)	EAD 2011	EL 2011	EAD 2012	EL 2012
AAA up to and including A-	309	0.06	179	0.03
BBB+ up to and including BB-	150	0.17	111	0.10
Below BB-	0	0	0	0
Unrated	5	0.10	10	0.22
Total	463	0.33	299	0.35

1 Based on internal ratings when available. Otherwise external ratings.
2 EAD figures: are audited, whereas EL figures are unaudited.

Credit risk related to sovereign bond exposures

KBC holds a significant portfolio of government bonds, primarily as a result of our considerable excess liquidity position and for the reinvestment of insurance reserves into fixed instruments. Given the fact that KBC's banking and insurance subsidiaries hold positions in government bonds, we have provided a break down per country at KBC group level, covering banking, trading and insurance portfolios. While most credit risk tables are expressed in terms of gross exposure [EAD], this is not possible for the table below, as the Basel II EAD concept cannot be applied to insurance entities. Therefore, exposures are reported in terms of carrying value.

Overview of exposure to sovereign bonds at year-end 2012, carrying value[1]
(in millions of EUR)

	Total (by portfolio)							Total (by remaining term to maturity)		
	Available for sale	Held to maturity	Designated at fair value through profit or loss	Loans and receivables	Held for trading	Total	*For comparison purposes: total at year-end 2011*	Maturing in 2013	Maturing in 2014	Maturing in 2015 and later
Southern Europe and Ireland										
Greece	0	0	0	0	0	0	*197*	0	0	0
Portugal	38	56	0	0	0	94	*133*	0	0	94
Spain	229	0	0	0	1	230	*1 939*	12	0	218
Italy	732	152	0	0	27	911	*2 076*	62	13	837
Ireland	137	314	0	0	0	452	*413*	0	0	452
KBC core countries										
Belgium	11 607	14 674	602	0	1 043	27 925	*22 889*	3 871	3 002	21 053
Czech Rep.	2 551	5 735	68	0	1 149	9 503	*8 596*	987	748	7 769
Hungary	295	1 830	63	190	225	2 603	*2 243*	835	252	1 516
Slovakia	483	1 034	20	0	214	1 751	*1 317*	83	175	1 493
Bulgaria	161	0	0	0	0	161	*100*	15	8	138
Other countries										
France	1 253	1 836	0	0	3	3 091	*3 428*	115	322	2 655
Poland	172	75	0	0	3	250	*2 847*	31	20	199
Germany	344	510	16	0	336	1 206	*2 107*	136	125	946
Austria	111	442	0	0	0	553	*818*	51	39	464
Netherlands	311	208	0	0	12	530	*724*	22	55	453
Finland	162	132	0	0	1	296	*319*	22	26	248
Rest[2]	1 751	464	42	0	377	2 634	*3 340*	1 283	374	978
Total	20 336	27 463	811	190	3 390	52 191	*53 487*	7 522	5 158	39 510

1 Including entities classified as 'disposal groups' under IFRS 5 (accounted for an aggregate 4 billion euros at year-end 2011 and 0.5 billion euros at year-end 2012). Excluding exposure to supranational entities of selected countries.
2 Sum of countries whose individual exposure is less than 0.5 billion euros at year-end 2012 and also including 0.9 billion euros of deposits at the National Bank of Hungary.

In 2012, KBC sold its last Greek government bonds and sharply reduced its exposure to Italy and Spain. The decrease in Polish bonds came about as a result of the divestment of both Kredyt Bank and WARTA.

Structured credit products

This section deals with KBC's structured credit activities at year-end 2012. 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 has tightened its strategy in this regard (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 at year-end 2012, 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

KBC has tightened its strategy over the past five years and has implemented a moratorium on investments in ABS/CDOs and on new originations thereof by KBC Financial Products (a fully owned subsidiary of KBC Bank). During 2012, the risk management of structured credits was further enhanced by processes centred around KBC's continued de-risking strategy for structured credit exposures. These de-risking activities have significantly lowered the sensitivity of P&L to movements in credit spreads.

A dedicated risk department focuses exclusively on structured credit positions for the entire KBC group. This department serves as a direct counterpart to the de-risking focused managers of structured credit positions. It analyses, identifies and advises – from a risk and capital perspective – on proposals made by these portfolio managers to reduce the exposure to structured credit positions in the KBC group. It is also responsible for producing consolidated reports on both securitised and re-securitised positions and for submitting them to senior management of KBC and the regulators. In producing these reports, there is no specific or different approach between securitisation and re-securitisation positions, though members of the dedicated risk department have in-depth knowledge about the specific risk drivers. This dedicated team not only reports on positions, but also monitors overall governance to ensure that appropriate decision authorities and business processes are in place at all levels of the organisation.

Scope of structured credit activities

All KBC group banking (incl. KBL EPB up until its sale was completed in 3Q 2012) and insurance entities that engage in structured credit activities are covered in this disclosure.

During 2012, the number of CDOs and ABS in scope decreased, as some matured, some were de-risked and others were sold. More details in this regard are given in the relevant sections below.

Structured credit programmes for which KBC acts as originator

The structured credit transactions in which KBC entities have an originating role are summarised under this heading. 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 transactions fall under this heading:

Structured credit transactions whose underlying assets arise directly from KBC's credit-granting activities, 31-12-2012
(in millions of EUR)

Programme	Role	Type of underlying exposure	Nominal amount of the underlying
Home Loan Invest 2007	Originator	Mortgage loans	3 500
Home Loan Invest 2008	Originator	Mortgage loans	2 942
Home Loan Invest 2009	Originator	Mortgage loans	3 804
Home Loan Invest 2011	Originator	Mortgage loans	3 482
Phoenix 2 Funding 2008	Originator	Mortgage loans	6 403
Phoenix 3 Funding 2008	Originator	Mortgage loans	2 683
Phoenix 4 Funding 2009	Originator	Mortgage loans	718
Phoenix 5 Funding 2012	Originator	Mortgage loans	886

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 is a revolving facility where the number of loans and total amount can vary. In July 2012, the portfolio started to amortise and as such comprised 83 757 loans totalling 3 500 million euros at year-end 2012. 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 as a revolving transaction in November 2008. In January 2011, the vehicle underwent some changes to allow the addition of a Fitch rating for the transaction. A portfolio of 2 942 million euros' worth of Belgian mortgage loans has been securitised and 2 500 million euros in Notes issued. KBC Bank holds the subordinated loan of 442 million euros and notes worth 1 871million 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 euros' worth of Belgian mortgage loans and set aside a reserve of 60 million euros on account. In January 2011, this deal was restructured to allow the addition of a Fitch rating. KBC Bank holds the subordinated loan of 727 million euros. The SPV issued notes in the amount of 6 000 million euros. At issuance, approximately 350 million euros' worth of notes was placed with external investors, while the rest was 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. This issue amortises over the tenor of the transaction. At 31 December 2012, the outstanding notes amounted to 3 137 million euros (the notional amounts of the underlying loans are shown in the table above). The subordinated loan amount remained unchanged.

Home Loan Invest 2011

In October 2011, KBC Bank set up its fourth securitisation transaction. Home Loan Invest 2011 securitised a portfolio of 4 351 million euros' worth of Belgian mortgage loans and set aside a reserve of 50 million euros on account. The SPV issued notes in the amount of 3 500 million euros. At issuance, approximately 175 million euros' worth of notes was placed with external investors, while the rest was 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. This issue amortises over the tenor of the transaction. At 31 December 2012, the outstanding notes amounted to 2 931 million euros (the notional amounts are shown in the table above). The subordinated loan amount remained unchanged.

Phoenix Funding 2

On 16 June 2008, a residential mortgage backed securitisation (RMBS) transaction called Phoenix Funding 2 was set up as a source of contingent funding. The SPV has a remaining underlying pool of residential mortgages originated by KBC Bank Ireland[4] (a fully owned subsidiary of KBC Bank), with corresponding note balances amounting to 6 403 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 divided into two classes, i.e. 77.1% in class A (Moody's 'A3' / Fitch 'A+' ratings) and 22.9% in class B (these notes are not rated), maturing in 2050. 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, with corresponding note balances amounting to 2 683 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. 84.6% in class A (Moody's 'A3' / Fitch 'A+' ratings) and 15.4% in class B (the class B notes are not rated), maturing in 2050. 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 with corresponding note balances amounting to 718 million euros. KBC Bank Ireland plc has retained all of the notes. The notes are split into two classes, i.e. 88% in class A (Moody's 'A3' / Fitch 'A+' ratings) and 12% in class B (these notes are not rated), maturing in 2046. The class A notes of Phoenix Funding 4 are eligible for placement with the ECB.

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

Phoenix Funding 5

Phoenix Funding 5 was set up on 6 June 2012. The SPV has a remaining underlying pool of residential mortgages originated by KBC Bank Ireland plc with corresponding note balances amounting to 886 million euros. KBC Bank Ireland plc has retained all of the notes. The assets are split into class A notes totalling 72% (Fitch 'A+' and DBRS A (h) ratings) and an unrated class Z loan of 28%. The class A notes of Phoenix Funding 5 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. All but about 2% relates to CDOs issued by KBC Financial Products, with the original notional underlying pools generally consisting of corporate reference names (on average 85%) and ABS (on average 15%).

The CDOs structured by KBC Financial Products 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 2012.

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 protected with MBIA and partly covered by the Guarantee Agreement (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 CDOs protected with MBIA, other CDOs, and other ABS exposure. Firstly, an overview is given of the overall exposure, 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, the valuation principles, accounting principles and stress tests are examined.

Overall exposure

KBC investments in structured credit products (CDOs and other ABS) (in billions of EUR)	31-12-2011	31-12-2012
Total nominal amount	20 447	17 143
of which CDO exposure protected with MBIA	*10 855*	*10 075*
of which other CDO exposure	*6 448*	*5 449*
of which other ABS exposure	*3 144*	*1 620*
Cumulative value markdowns (mid-2007 to date)[1]	-5 494	-4 070
of which value markdowns	*-4 540*	*-3 578*
for other CDO exposure	*- 4 101*	*-3 430*
for other ABS exposure	*- 440*	*-149*
of which Credit Value Adjustment (CVA) on MBIA cover[2]	*-954*	*-492*

1 Value adjustments to KBC's CDOs are accounted for via profit or loss instead of directly via shareholders' equity, since the group's CDOs are mostly of a synthetic nature (meaning that the underlying assets are derivative products such as credit default swaps on corporate names). Their synthetic nature is also the reason why KBC's CDOs are not eligible for accounting reclassification under IFRS in order to neutralise their impact.
2 Provisioning rate increased from 70% to 80% in December 2012. For background information, please refer to the 'Stress testing' section.

In 2012, the total nominal amount decreased by 3.3 billion euros This was due mainly to:

- the collapse of two CDOs, which reduced the outstanding notional by 1.7 billion euros;
- a 0.4-billion euro reduction in 'other ABS exposure' due to the sale of KBL EPB being completed in the third quarter of 2012;
- a 1.2-bln euro decrease due to the sale and amortisation of ABS assets held by the KBC group.

As mentioned in the 'Additional Information' section of the 2012 Annual Report of KBC Group NV (see *www.kbc.com*), the notional amount at risk has been lowered due to the Guarantee Agreement that was signed with the Belgian State on 14 May 2009 (PPA – Portfolio Protection Agreement). Of the 15.5 billion euros in nominal exposure to CDOs shown in the table above, 12.2 billion euros is covered by the PPA. This level of exposure reduces to 4.1 billion euros when the PPA is taken into account.

CDO exposure protected with MBIA

Details of the CDO exposure protected with MBIA (in millions of EUR)	31-12-2011	31-12-2012
Total insured amount (notional amount of super senior swaps)[1]	10 855	10 075
Details for MBIA insurance coverage		
- Fair value of insurance coverage received (modelled replacement value, after taking the Guarantee Agreement into account)	1 362	615
- CVA for counterparty risk, MBIA	-954	-492
(as a % of fair value of insurance coverage received)	70%	80%[2]

1 The amount insured by MBIA is included in the Guarantee Agreement with the Belgian State (14 May 2009).
2 For background information on this increase in the provisioning rate, please refer to the 'Stress testing' section.

The super senior portions of CDOs originated by KBC Financial Products are mostly hedged via swap contracts with MBIA, a US monoline insurer. The value of this insurance coverage is adjusted by a Credit Value Adjustment intended to reflect the creditworthiness of MBIA, as shown in the table above.

Moreover, the remaining risk related to MBIA's insurance coverage is largely mitigated, as it is included in the scope of the Guarantee Agreement (PPA) signed with the Belgian State.

KBC has not granted any straightforward credit facilities to MBIA, but is exposed to reinsurance cover received for CDOs.

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).

Other KBC group investment in structured credit (year-end 2012)

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), as well as other ABS held by the KBC group.

The total nominal amount outstanding in the portfolio fell by 2.5 billion euros, 0.9 billion euros of which was accounted for by the portions of de-risked CDOs not insured with MBIA. The remaining amount is dealt with in the 'KBC's structured credit position' section above.

KBC-owned positions arising from CDOs issued by KBC Financial Products have incurred net effective losses totalling 2.2 billion euros, caused by claimed credit events in the lower tranches of the CDO structure (situation at 7 January 2013). Of this figure, 2.1 billion euros' worth of events have been settled. These have had no further impact on the income statement, because complete markdowns for these tranches had already been absorbed in the past.

Please note that a portion of the risk attached to KBC group investments in CDOs is mitigated, due to the fact that the super senior CDO tranches that are not insured with MBIA are fully covered by the Guarantee Agreement (PPA) signed with the Belgian State.

Credit quality of securities held (year-end 2012)

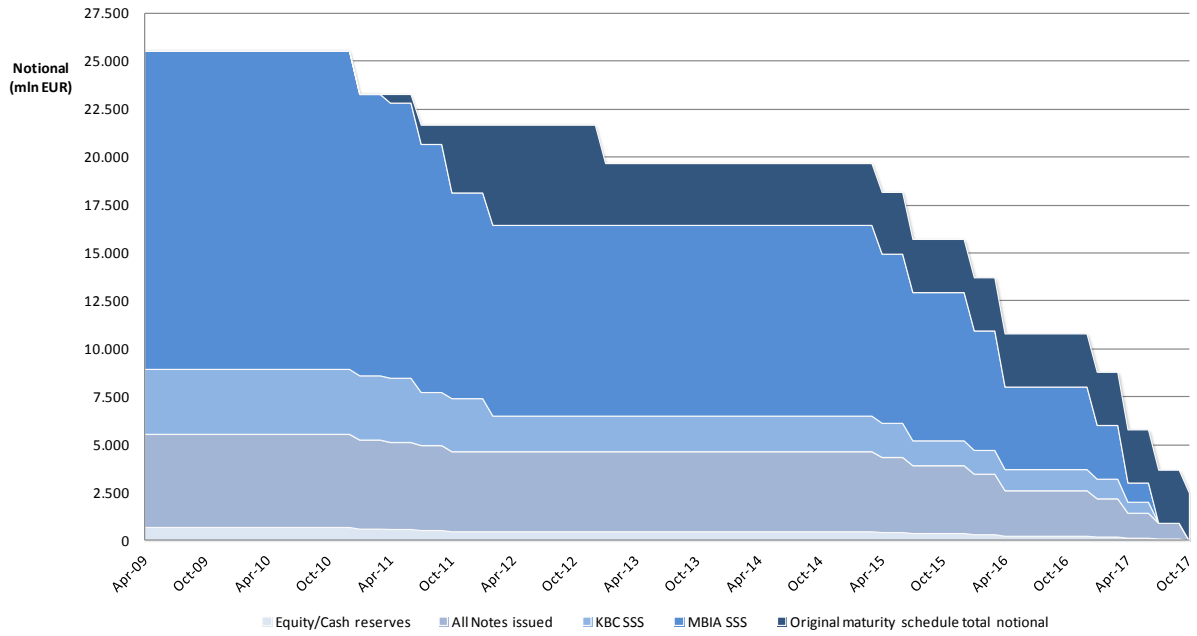
An overview of the quality of the notes and super senior swaps held at year-end 2012 is shown in the table below.

Credit quality of securities held – based on Moody's ratings, 31-12-2012
Amounts at nominal value (in millions of EUR)

	Super Senior (SS)	Aaa	Aa	A	Baa	<Baa3	Unrated	Total
CDO exposure protected by MBIA	10 075	-	-	-	-	-	-	10 075
Other CDOs [1,2]	2 089	-	-	20	-	1 232	-	3 341
Other ABS	-	498	43	420	395	193	71	1 620
Total for 2012	12 164	498	43	440	395	1 424	71	15 035
Total for 2011	13 853	1 291	989	412	191	399	1 423	18 558

1 All Super Senior positions fall within the scope of the Guarantee Agreement signed with the Belgian State (see the 'Additional information' section in the 2012 Annual Report of KBC Group NV (see *www.kbc.com*).
2 Figures are net of settled credit events (i.e. minus 2.1 billion euros in 2012, which is a year-on-year increase of 0.3 billion euros).

Maturity schedule for CDOs issued by KBC Financial Products



The above graph shows how the CDOs originated by KBC Financial Products amortise over the next number of years . It should be noted that KBC is continuing to look at reducing ABS and CDO exposure and thus further de-risking would affect the maturity schedule. The first drop in the maturity schedule is in April 2015. By October 2017, all CDOs issued by KBC Financial Products are expected to have matured.

Overview of the underlying collateral of the securities held (31-12-2012)

The next few tables provide a breakdown of the underlying assets of the CDO reference portfolios (both those insured and those not insured by MBIA) and the other ABS portfolio. They contain more detailed information on KBC's 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 and prepayments.

CDO exposure protected by MBIA

Credit quality of securities held – based on Moody's ratings 31-12-2012
Amounts at nominal value (in millions of EUR)

		Aaa	Aa	A	Baa	Ba	B	Caa	<Caa3	Unrated	Total
Corporates		**4**	**164**	**1 439**	**4 127**	**1 449**	**650**	**362**	**41**	**1 502**	**9 738**
Sector	Buildings & Real Estate	-	-	64	852	188	142	40	-	230	1 517
	Banking	-	90	360	307	136	1	-	-	301	1 195
	Insurance	-	20	267	294	59	-	157	-	150	948
	Finance	-	40	62	204	170	39	48	-	233	795
	Mining, Steel, Iron & Nonprecious Metals	-	-	82	211	123	34	-	-	28	478
	Printing & Publishing	-	-	-	90	211	70	43	-	31	444
	Telecommunications	-	2	152	161	20	37	13	-	36	421
	Utilities	-	3	74	305	5	1	-	-	27	416
	Retail Stores	-	-	50	182	41	72	49	-	15	409
	Oil & Gas	4	-	35	276	47	-	-	-	12	375
	Automobile	-	-	41	145	106	53	-	-	8	353
	Electronics	-	-	31	61	70	-	2	-	134	297
	Other	-	9	221	1 039	273	201	10	41	295	2 090
Region	US	4	29	632	2 825	1 112	505	395	50	661	6 212
	EU	-	30	388	1 085	476	213	29	-	473	2 693
	Asia	-	123	334	461	101	3	9	-	461	1 492
	Latin America	-	-	19	4	-	-	-	-	-	22
	Other	-	10	258	403	31	60	-	-	155	917
CMBS		**-**	**-**	**1**	**-**	**-**	**-**	**3**	**-**	**-**	**4**
RMBS		**-**	**-**	**-**	**-**	**6**	**7**	**13**	**118**	**-**	**143**
Origin	Prime	-	-	-	-	-	-	-	-	-	-
	ALT-A	-	-	-	-	-	-	1	19	-	20
	ALT-A (<2005 vintage)	-	-	-	-	-	-	*1*	*1*	-	*2*
	ALT-A (2005-2008 vintage)	-	-	-	-	-	-	-	*18*	-	*18*
	Subprime	-	-	-	-	6	7	12	99	-	123
	Subprime (<2005 vintage)	-	-	-	-	-	-	*9*	*42*	-	*51*
	Subprime (2005-2008 vintage)	-	-	-	-	*6*	*7*	*3*	*56*	-	*72*
Region	US	-	-	-	-	6	7	13	118	-	143
Other ABS		**11**	**22**	**8**	**12**	**5**	**-**	**-**	**-**	**22**	**80**
CDO		**10**	**3**	**3**	**-**	**13**	**15**	**7**	**22**	**37**	**109**
Total		**24**	**189**	**1 451**	**4 140**	**1 472**	**672**	**385**	**181**	**1 560**	**10 075**

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

Other CDO exposure

Credit quality of underlying collateral of CDO held – based on Moody's ratings 31-12-2012
(in millions of EUR)

		Aaa	Aa	A	Baa	Ba	B	Caa	<Caa3	Unrated	Total
Corporates		**1**	**53**	**466**	**1 337**	**469**	**211**	**117**	**13**	**487**	**3 155**
Sector	Buildings & Real Estate	-	-	21	276	61	46	13	-	75	491
	Banking	-	29	116	99	44	-	-	-	98	387
	Insurance	-	6	87	95	19	-	51	-	49	307
	Finance	-	13	20	66	55	13	15	-	75	257
	Mining, Steel, Iron & Nonprecious Metals	-	-	27	68	40	11	-	-	9	155
	Printing & Publishing	-	-	-	29	68	23	14	-	10	144
	Telecommunications	-	1	49	52	6	12	4	-	12	136
	Utilities	-	1	24	99	2	-	-	-	9	135
	Retail Stores	-	-	16	59	13	23	16	-	5	133
	Oil & Gas	1	-	11	90	15	-	-	-	4	121
	Automobile	-	-	13	47	34	17	-	-	3	114
	Electronics	-	-	10	20	23	-	1	-	43	96
	Other	-	3	72	337	89	65	3	13	96	677
Region	US	1	10	205	915	360	164	128	16	214	2 012
	EU	-	10	126	351	154	69	9	-	153	872
	Asia	-	40	108	149	33	1	3	-	149	483
	Latin America	-	-	6	1	-	-	-	-	-	7
	Other	-	3	84	131	10	19	-	-	50	297
CMBS		**-**	**-**	**-**	**-**	**-**	**-**	**1**	**-**	**-**	**1**
RMBS		**-**	**-**	**-**	**-**	**2**	**2**	**4**	**38**	**-**	**48**
Origin	Prime	-	-	-	-	-	-	-	-	-	-
	ALT-A	-	-	-	-	-	-	-	5	-	7
	ALT-A (<2005 vintage)	-	-	-	-	-	-	-	-	-	*1*
	ALT-A (2005-2008 vintage)	-	-	-	-	-	-	-	*6*	-	*6*
	Subprime	-	-	-	-	2	2	4	32	-	40
	Subprime (<2005 vintage)	-	-	-	-	-	-	*3*	*14*	-	*17*
	Subprime (2005-2008 vintage)	-	-	-	-	*2*	*2*	*1*	*18*	-	*23*
Region	US	-	-	-	-	2	2	4	38	-	46
Other ABS		**4**	**7**	**3**	**4**	**2**	**-**	**-**	**-**	**10**	**29**
CDO		**3**	**1**	**21**	**30**	**24**	**5**	**2**	**7**	**17**	**109**
Total		**8**	**61**	**490**	**1 371**	**496**	**218**	**125**	**59**	**513**	**3 341**

'Full look through approach', which means that the subordination of the notes held is not taken into account.
'Settled defaulted names and paydowns (2.1 billion euros) not taken into account'.

Other ABS exposure

Other ABS exposure breakdown by type and quality – based on Moody's ratings 31-12-2012
Amounts at nominal value (in millions of EUR)

		Aaa	Aa	A	Baa	Ba	B	Caa	<Caa3	Unrated	Total
CMBS		**34**	**8**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**42**
RMBS		**180**	**19**	**374**	**390**	**193**	**-**	**-**	**-**	**71**	**1 226**
Origin	Prime	171	3	370	390	192	-	-	-	71	1 197
	Prime (<2005 vintage)	*60*	*3*	*218*	*220*	*156*	-	-	-	*41*	*698*
	Prime (2005-2008 vintage)	*111*	-	*152*	*170*	*35*	-	-	-	*30*	*499*
	ALT-A	-	-	4	-	1	-	-	-	-	5
	ALT-A (<2005 vintage)	-	-	*4*	-	*1*	-	-	-	-	*5*
	ALT-A (2005-2008 vintage)	-	-	-	-	-	-	-	-	-	-
	Subprime	8	16	-	-	-	-	-	-	-	24
	Subprime (<2005 vintage)	*8*	*10*	-	-	-	-	-	-	-	*18*
	Subprime (2005-2008 vintage)	-	*6*	-	-	-	-	-	-	-	*6*
Region	United States	8	16	4	-	1	-	-	-	5	34
	Spain	-	-	162	330	35	-	-	-	53	580
	Portugal	-	-	-	60	156	-	-	-	-	216
	Italy	-	-	205	-	-	-	-	-	11	215
	Netherlands	158	-	-	-	-	-	-	-	-	158
	United Kingdom	13	-	-	-	-	-	-	-	-	13
	Other	-	3	3	-	-	-	-	-	3	9
	Greece	-	-	-	-	-	-	-	-	-	-
	Belgium	-	*3*	-	-	-	-	-	-	-	*3*
	Austria	-	-	-	-	-	-	-	-	-	-
	Germany	-	-	-	-	-	-	-	-	-	-
	Ireland	-	-	-	-	-	-	-	-	-	-
	South Korea	-	-	-	-	-	-	-	-	*3*	*3*
	France	-	-	-	-	-	-	-	-	-	-
	Western Europe	-	-	*3*	-	-	-	-	-	-	*3*
Other ABS		**285**	**17**	**47**	**4**	**-**	**-**	**-**	**-**	**-**	**352**
Type	CLO	270	17	-	-	-	-	-	-	-	287
	Leases	-	-	22	4	-	-	-	-	-	27
	SME loans	1	-	24	-	-	-	-	-	-	25
	Consumer loans	9	-	-	-	-	-	-	-	-	9
	Auto loans/leases	4	-	-	-	-	-	-	-	-	4
	Other	-	-	-	-	-	-	-	-	-	-
Total		**498**	**43**	**420**	**395**	**193**	**-**	**-**	**-**	**71**	**1 620**

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 cashflows 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. Please refer to note 26 in the 2012 annual report of KBC Group NV for more information on the methodology we use to value CDOs.

It should be noted that value adjustments to KBC's CDOs are accounted for via profit and loss (instead of directly via shareholders' equity), since the group's CDOs are mostly of a synthetic nature (meaning that the underlying assets are derivative products such as credit default swaps on corporate names). Their synthetic nature is also the reason why KBC's CDOs are not eligible for accounting reclassification under IFRS in order to neutralise their impact.

Securitisation activities are accounted for under IFRS according to the guidelines provided by 'IAS 39 Financial Instruments: Recognition and Measurement' and 'SIC 12 Consolidation – Special Purpose Entities'.

The derecognition rules of IAS 39 determine when the securitised assets may be derecognised from the balance sheet. This is the case when the contractual rights to receive the cashflows of the financial asset are transferred or retained but 'passed through' and substantially all the risk and rewards of ownership of the asset are transferred.

In many cases Special Purpose Entities are set-up for securitisation activities. SIC 12 determines that a company should consolidate this entity if:
(i) it is undertaking activities on its behalf and its benefits;
(ii) it effectively controls the SPE;
(iii) it has the majority of the residual or ownership risks of the SPE, or;
(iv) it receives the majority of the benefits of the SPE.

Stress-test results for KBC group investments in structured credits (31-12-2012)

Two sorts of stress tests have been conducted on the portfolio of investments in CDOs originated by KBC Financial Products, 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 Financial Products 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 Financial Products. 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 Financial Products 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 an 8.9% 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 9.5% 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 an 11.7% 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]

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

Stress test results for credit default[1]

In millions of EUR – 31-12-2012

		Notional	Estimated loss	Estimated loss as % of notional
Fundamental value scenario	CDO protected with MBIA	10 075	-	0%
	Other retained positions[2]	4 749	2 392	50%
Stress scenario 1	CDO protected with MBIA	10 075	15	0%
	Other retained positions[2]	4 749	2 514	53%
Stress scenario 2	CDO protected with MBIA	10 075	81	1%
	Other retained positions[2]	4 749	2 773	58%

1 Account taken of the Guarantee Agreement with the Belgian State.
2 Nominal value of 'other retained positions' excluding equity and junior pieces (already fully provisioned).

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 portfolio of CDOs originated by KBC Financial Products (nominal value in scope of 14.8 billion euros). As can be seen from the table below, the de-risking activities undertaken during 2012 have significantly reduced the sensitivity of P&L to movements in credit spreads.

The calculations take into account the impact of the Guarantee Agreement (PPA) signed with the Belgian State, which reduces the volatility of the super senior positions in scope on P&L. The provisioning rate of 80% for MBIA has also been taken into account. It should be noted that KBC decided to increase the provisioning rate from 70% to 80% in December 2012 based on a fundamental internal analysis.

Stress test results for the market sensitivity of CDOs

In millions of EUR – 31-12-2012 (pre-tax)

	Market valuation sensitivity	Stress test result
Test assumptions	Credit spreads in December x 1.10	-61
	Credit spreads in December x 1.20	-120
	Credit spreads in December x 1.50	-280
Test assumptions	Credit spreads in December x 0.90	67
	Credit spreads in December x 0.80	135
	Credit spreads in December x 0.50	342

Structured credit exposure – capital charges under the CRD III (re)securitisation framework

Regulatory capital requirements for structured credit positions are held against credit and market risks related to such products and positions. Market risk (trading) regulatory capital requirements are determined through the new CRD III requirements. Under Basel II, there are different approaches 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 KBC Asset Management and ČSOB Slovakia, which report under the Basel II Standardised Approach.

As regards the investments in structured credit products (i.e. this section of the report), the risk weightings applied for regulatory capital calculations are linked directly to the rating of the structured credit products invested in. A further distinction is made depending on their classification as securitisation or re-securitisation (see CRD III, implemented at year-end 2011) and whether they are senior or non-senior positions. 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 this capital, but this situation will change when the Solvency II regulations are implemented. The following table refers to the Regulatory Capital charges for the ABS and retained CDO exposure held by the KBC group under the CRD III (re)securitisation framework. The capital charges for the single names credit derivatives portfolio and the remaining correlation portfolio within the approved HVaR model are not shown in the table as they are covered in the 'Market risk' section (total capital of 48 million euros for HVaR, SVaR, CRM and the IRC charge). Please note that the 340 million euros relating to the resecuritisation capital requirement referred to in the 'Market risk' section is also included in the following table.

Structured credit products – details of capital charges under the CRD III (re)securitisation framework, 31-12-2012 (in millions of EUR)											
		Securitisation	Re-securitisation	Total nominal amount	Total EAD for CRD III	Of which 6 – 18%	Of which 20 – 35%	Of which 50 – 100%	Of which 250 – 850%	Of which 1250%	RWA 31-12-2012
Banking entities											
Trading book		-	12 493	12 493	2 320	-	1 721	141	97	361	1 722
	CDO exposure	-	12 493	12 493	2 320	-	1 721	141	97	361	1 722
	of which senior positions	-	*11 237*	*11 237*	*2 293*	-	*1 721*	*141*	*97*	*334*	*1 389*
	of which non-senior positions	-	*1 256*	*1 256*	*27*	-	-		-	*27*	*334*
Banking book		1 672	2 071	3 742	1 849	992	428	152	100	177	2 944
	CDO exposure	69	2 071	2 140	246	-	-	40	29	177	2 356
	of which senior positions	*69*	-	*69*	*69*	-	-	*40*	*29*	-	*139*
	of which non-senior positions	-	*2 071*	*2 071*	*177*	-	-	-	-	*177*	*2 217*
	Other ABS exposure	1 603	-	1 603	1 603	992	428	112	71	-	588
	of which senior positions	*1 573*	-	*1 573*	*1 573*	*992*	*398*	*112*	*71*	-	*578*
	of which non-senior positions	*30*	-	*30*	*30*	-	*30*	-	-	-	*10*
Total for banking entities		**1 672**	**14 564**	**16 235**	**4 169**	**992**	**2 149**	**292**	**198**	**538**	**4 666**
Insurance entities											
	CDO exposure	-	891	891	-	-	-	-	-	-	-
	Other ABS exposure	17	-	17	-	-	-	-	-	-	-
Total for insurance entities		**17**	**891**	**908**	**-**	**-**	**-**	**-**	**-**	**-**	**-**
Total nominal amount for KBC Group		**1 689**	**15 454**	**17 143**	**-**	**-**	**-**	**-**	**-**	**-**	**-**
Client credit facility [1]		N/A	N/A	337	N/A	N/A	N/A	N/A	N/A	N/A	32
ABS protection at KBC Financial Products[2]		126	50	176	97	25	8	8	13	32	306
Total capital charge											**5 004**

1 For historical reasons, this credit facility, (with receivables as collateral), is provided to a single client in the form of commercial paper, all of which is held by KBC Group. It is therefore subject to the Supervisory Formula Approach for the purpose of capital adequacy calculations and is tincluded in this table for the sake of completeness.
2 This protection is retained at KBC Financial Products to facilitate the de-risking process, but does attract Regulatory Capital.

Market risk management (non-trading)

The process of managing 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 our commercial activity or in our long-term positions (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

The main building blocks of KBC's ALM Risk Management 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 across the group 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. VaR losses are estimated based on a sample period of 20 years for the most important risk drivers.
- 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.
- the use of other risk measurement methods, such as Basis-Point-Value (BPV), notional amounts, etc., to supplement VaR.

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]	31-12-2011	31-12-2012
Interest rate risk[2]	0.67	0.08
Equity risk[3]	0.19	0.88
Real estate risk	0.06	0.14
Other risks[4]	0.05	-0.04
Total diversified VaR (group)	0.96	1.06

1 Excluding a number of small group companies. Cyclical prepayment options embedded in mortgage loans and spread risk have not been captured. Excluding entities classified as 'disposal groups' under IFRS 5. In 2011, the impact of these entities (see 'Remark' at the start of this report) on the group's ALM VaR was 89 million euros. In 2012, the impact of the relevant entities (see 'Remark' at the start of this report) on the group's ALM VaR was 85 million euros.
2 The substantial decrease in the VaR for interest rate risk was due to an adjustment in liabilities modelling of savings and current accounts.
3 The equity investment in Bank Zachodni (acquired as part of the divestment deal involving Kredyt Bank) has been included in the equity VaR figure, therefore causing it to increase.
4 Foreign exchange risk and inflation risk.

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

We use two main techniques to measure interest rate risks: 10 BPV and VaR (see above). The 10 BPV measures the extent to which the value of the portfolio would change if interest rates were go up by ten basis points across the entire curve (negative figures indicate a decrease in the value of the portfolio). We set 10 BPV limits in such a way that interest rate positions combined with the other structural exposures (equity, real estate, etc.) remain within the overall VaR limits. We also use other techniques such as gap analysis, the duration approach, scenario analysis and stress testing (both from an economic value perspective and from an income perspective).
We manage the ALM interest rate positions of the banking entities via a market-oriented internal pricing system for products with a fixed maturity date, and via a replicating portfolio technique – reviewed on a dynamic basis – for products without a fixed maturity date (e.g. current and savings accounts).

With a view to acquiring interest income, the bank takes interest rate positions mainly through government bonds, both in a bond portfolio used for reinvesting equity and in a bond portfolio financed by short-term funds.

The table shows the bank's exposure to interest rate risk in terms of 10 BPV.

BPV of the ALM book, banking activities* (in millions of EUR)	2011	2012
Average for 1Q	-61	-52
Average for 2Q	-62	-49
Average for 3Q	-58	-49
Average for 4Q	-45	-47
As at 31 December	-40	-39
Maximum in year	-65	-57
Minimum in year	-40	-39

* Excluding entities classified 'as disposal groups' under IFRS 5. Including these entities would lead to an overall BPV for the banking activities of -42 million euros at year-end 2011 and -44 million euros at year-end 2012.

In line with the Basel II guidelines, we conduct a 200-basis-point stress test 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, this risk came to 11.19% of total capital and reserves at year-end 2012. This is 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, we break down the carrying value of assets (positive amount) and liabilities (negative amount) according to either the contractual repricing date or the maturity date, whichever is earlier, in order 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.

Interest sensitivity gap of the ALM book (including derivatives), banking activities* (in millions of EUR)								
	≤ 1 month	1–3 months	3–12 months	1–5 years	5–10 years	> 10 years	Non-interest-bearing instruments	Total
31-12-2011	-8 138	3 220	2 563	7 107	2 822	2 900	-10 474	0
31-12-2012	3 731	3 904	-1 251	-7 095	4 450	2 039	-5 778	0
*Entities classified as 'disposal groups' under IFRS 5 have also been excluded (figures for these entities are given below). Excluding a number of small group companies.								
31-12-2011	-114	43	125	580	129	15	-777	0
31-12-2012	633	-74	-220	128	258	258	-981	0

The interest sensitivity gap shows our overall long position in interest rate risk. Generally speaking, assets reprice over 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.

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

In the table below, we have summarised the exposure to interest rate risk in our 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* (in millions of EUR)	0–5 years	5–10 years	10–15 years	15–20 years	> 20 years	Total
31-12-2011						
Fixed-income assets backing liabilities, guaranteed component	12 408	6 197	1 842	1 333	753	22 534
Liabilities, guaranteed component	10 020	4 330	1 751	1 341	1 945	19 387
Difference in expected cashflows	2 388	1 867	91	-7	-1 192	3 147
Mean duration of assets						5.44 years
Mean duration of liabilities						6.03 years
31-12-2012						
Fixed-income assets backing liabilities, guaranteed component	10 747	5 236	1 745	1 240	810	19 778
Liabilities, guaranteed component	10 131	3 409	1 742	1 209	1 584	18 075
Difference in expected cashflows	616	1 828	3	31	-774	1 703
Mean duration of assets						5.29 years
Mean duration of liabilities						6.11 years

* Excluding a number of small group companies and entities classified as 'disposal groups' under IFRS 5. In 2011, the entities classified as 'disposal groups' (see 'Remark' at the start of this report) accounted for 3.6 billion euros in fixed-income assets backing 3.6 billion euros' worth of guaranteed liabilities. In 2012, entities classified as 'disposal groups' under IFRS 5 (see 'Remark' at the start of this report) did not have any insurance liabilities.

The main interest rate risk for the insurer is a downside one. KBC adopts a liability driven ALM approach focused on mitigating the interest rate risk in accordance with KBC's risk appetite. For the remaining interest rate risk, KBC adheres to a policy that takes into account the possible negative consequences of a sustained decline in interest rates, and has built up adequate supplementary reserves.

Breakdown of the reserves for non-unit-linked life insurance by guaranteed interest rate, insurance activities[1]	31-12-2011	31-12-2012
5.00% and higher[2]	3%	3%
More than 4.25% up to and including 4.99%	6%	6%
More than 3.50% up to and including 4.25%	11%	10%
More than 3.00% up to and including 3.50%	33%	30%
More than 2.50% up to and including 3.00%	24%	24%
2.50% and lower	22%	27%
0.00%	2%	2%
Total	100%	100%

1 Excluding a number of small group companies and entities classified as 'disposal groups' under IFRS 5. In 2011, the entities classified as 'disposal groups' (see 'Remark' at the start of this report) accounted for 15.2% of total nominal exposure (with 19% of their exposure in the 'More than 2.50% up to and including 3.00%' category). In 2012, entities classified as 'disposal groups' under IFRS 5 (see 'Remark' at the start of this report) did not have any nominal exposure.
2 Contracts in Central and Eastern Europe.

Aggregate interest rate risk for the KBC group

The figures below show the impact on the KBC group of a 10-basis-point parallel upward shift of yield curves by the end of 2012, broken down by currency.

Interest Rate Risk - BPV in thousands of EUR – 31-12-2011[1]	Overall	EUR	CHF	USD	GBP	CZK	HUF	PLN	Other
Bank	-40 154	-27 138	-213	1 957	307	-8 651	-656	-1 990	-3 770
Insurance	5 468	5 634	0	-433	-69	610	32	-16	-290
KBC Group[2]	-26 288	-13 107	-213	1 524	238	-8 041	-623	-2 006	-4 060
Interest Rate Risk - BPV in thousands of EUR – 31-12-2012[1]	**Overall**	**EUR**	**CHF**	**USD**	**GBP**	**CZK**	**HUF**	**PLN**	**Other**
Bank	-39 272	-28 396	-171	181	63	-9 520	-1 676	142	103
Insurance	8 174	8 243	21	-26	0	411	-201	4	-279
KBC Group[2]	-22 145	-11 157	-150	151	63	-9 109	-1 876	135	-203

1 KBL EPB, Vitis Life, Fidea & WARTA were recognised as 'disposal groups' under IFRS 5 at year-end 2011. Their total +10BPVwas 3.2 million euros. At year-end 2012, the entities classified as 'disposal group' under IFRS 5 had a total BPV of -5 million euros.
2 KBC Pension Fund has been 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%[2]		Decrease by 1%[2]	
	2011	2012	2011	2012
Insurance	-8	10	2	-12
Banking	-27	-44	44	55
Total for the KBC Group	-35	-34	46	43

1 Excluding a number of small group companies.
2 Entities classified 'as disposal groups' under IFRS 5 in 2012 have been excluded. A 1% increase/decrease in the yield curve would have a very limited impact on the net profit of these divested entities (absolute value of < 1 million euros).

Equity risk

The main exposure to equity is within our insurance business, where the ALM strategies are based on a risk-return evaluation, account taken of the market risk attached to open equity positions. Please note that a large part of the equity portfolio is held for the 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 and KBC Asset Management.

We have provided more information on total non-trading equity exposures at KBC in the tables below.

Equity portfolio of the KBC group[1] (breakdown by sector, in %)	Banking activities [2]		Insurance activities		Group	
	31-12-2011	31-12-2012	31-12-2011	31-12-2012	31-12-2011	31-12-2012
Financial	32%	23%	19%	26%	21%	29%
Consumer non-cyclical	9%	11%	14%	12%	11%	10%
Communication	2%	0%	3%	1%	3%	1%
Energy	0%	3%	10%	7%	8%	6%
Industrial	28%	21%	18%	9%	18%	11%
Utilities	3%	2%	3%	3%	4%	4%
Consumer cyclical	3%	4%	8%	4%	7%	4%
Basic materials	13%	3%	8%	11%	8%	9%
Other and not specified	10%	33%	15%	27%	21%	26%
Total	100%	100%	100%	100%	100%	100%
In billions of EUR	0.2	0.2	0.9	0.5	1.6	1.4
of which unlisted	0.1	0.1	0.03	0.06	0.2	0.2

1 Excluding a number of small group companies and entities classified as 'disposal groups' under IFRS 5. In 2011, the entities classified as 'disposal groups' (see 'Remark' at the start of this report) had an equity portfolio of 0.39 billion euros, 28% of which was invested in unlisted equities. In 2012, the entities with this classification (see 'Remark' at the start of this report) did not have an equity portfolio. The equity portfolio of KBC Pension Fund (0.7 billion euros) has only been included in the 'Group' columns and not in the 'Banking activities' or 'Insurance activities' columns.
2 The merger of Kredyt Bank and Bank Zachodni has not been captured in the table; it resulted in an equity position in the new entity (estimated market value of 0.9 billion euros at year-end 2012).

The table below provides an overview of the sensitivity of income and economic value to fluctuations in the equity markets.

Impact of a 12.5% drop in equity prices[1] (in millions of EUR)	Impact on net profit (IFRS)		Impact on value	
	2011	2012	2011	2012
Insurance activities	-36	-4	-57	-54
Banking activities	-28	-12	-26	-22
Total[2]	-67	-18	-145	-159

1 Excluding entities classified as 'disposal groups' under IFRS 5 (see 'Remark' at the start of this report). A 12.5% drop in equity prices at year-end 2011 would have an impact of -6 million euros on the net profit of these entities and -37 million euros on economic value. At year-end 2012, the entities classified as 'disposal groups' under IFRS 5 (see 'Remark' at the start of this report) did not have any equity exposure.
2 KBC Pension Fund has only been included in this figure and not in the figures for 'Banking activities' or 'Insurance activities'.

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

Non-trading equity exposure[1] (in millions of EUR)	31-12-2011		31-12-2012	
	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]	106	202	156	215
Banking entities	31	29	11	47
Insurance entities	74	171	143	160

1 Excluding a number of small group companies and entities classified as 'disposal groups' under IFRS 5. In 2011, the net unrealised gains for the entities classified as 'disposal groups' (see 'Remark' at the start of this report) came to 71 million euros (recognised in equity) and the losses on year-end exposure to 4 million euros (recognised in the income statement). In 2012, the entities with this classification (see 'Remark' at the start of this report) did not have any equity exposure.
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 at group level. Realised and unrealised gains on the KredietCorp position amounted to 1.9 million euros and 5.1 million euros, respectively.

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	
	2011	2012
Bank portfolios	-68	-66
Insurance portfolios	-43	-37
KBC group[2]	-124	-120

1 Excluding a number of small group companies. Entities classified as 'disposal groups' under IFRS 5 have also been excluded (see 'Remark' at the start of this report). Whereas these entities would have had an additional impact of -8 million euros in 2011, they had no impact at all in 2012.
2 KBC Pension Fund has only been included in this figure and not in the figures for 'Bank portfolios' or 'Insurance portfolios'.

Inflation risk

KBC's exposure to inflation is primarily secondary in nature, i.e. via changes in interest rates. We monitor and hedge this risk 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 the KBC group.

Foreign exchange risk

We pursue a prudent policy as regards our 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 value of a financial instrument (or portfolio of such instruments) due to changes in the level or in the volatility of market prices, e.g., 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. The interest rate, foreign exchange and equity risks of the non-trading positions in the banking book and of the insurer's positions are all included in ALM exposure.

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 'Market risk management (non-trading)' section.

Strategy and processes

The objective of market risk management (trading) is to measure, report and advise on the market risk of the aggregate trading position at group level, taking into account the main risk factors and specific risk in order to ensure that activities are consistent with the Group Risk Appetite. The Group Risk Appetite, including the strategic objectives with regard to (trading) market risk tolerance, is determined by the Board of Directors by means of an annual review. For the 2012 reporting period, the Group Capital and Risk Oversight Committee and the Group Trading Subcommittee decide upon and periodically review a framework of limits and policies on trading activities that is consistent with this Group Risk Appetite. This framework is submitted to the Board of Directors for approval (please refer to the 'Risk management governance' section for more information on the governance system applying as of 1 January 2013).

This risk framework consists of a hierarchy of limits. Whereas HVaR calculations serve as a primary risk measurement tool, risk concentrations are monitored via a series of secondary limits including equity concentration limits, FX concentration limits and basis-point-value limits for interest rate risk and basis risk. The specific risk associated with a particular issuer or country is also subject to concentration limits. Scenario analysis limits have also been set up, involving multiple shifts of underlying risk factors. In addition, secondary limits are in place to monitor the risks inherent in options (the so-called 'greeks'). Complex and/or illiquid instruments, which cannot be modelled in an HVaR context, are subject to nominal and/or scenario limits.

The centralisation of trading risk management implies close co-operation between all value and risk management units at both group and local level. This close co-operation allows consistent reporting to group senior management through the Group Trading Subcommittee, which is chaired by the Group CRO and includes senior representatives from line management, risk management and other top management. It manages market risk and addresses the operational and counterparty risks of the dealing rooms. It keeps track of structural trends, monitors group-wide risk limits and may decide to impose corrective actions. The subcommittee meets every two weeks in order to enable the KBC group to take decisions regarding trading risk on the basis of accurate and up-to-date information. Please refer to the 'Risk management governance' section for more information on the governance system applying as of 1 January 2013.

Scope of Market Risk Management

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 limit exposures and risks, focus on trading in interest rate instruments, while activity on the FX markets has traditionally been limited. This trading has to do with client-related business. 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.

At KBC Financial Products, the only ongoing activity – European Equity Derivatives – has been managed directly from Brussels since March 2012. The market risk of the legacy CDO portfolio is managed stringently, with a number of de-risking trades taking place during the year. These trades have significantly
lowered the sensitivity of P&L to credit spread movements.

The remaining legacy business lines at KBC Financial Products, which represent less than 2% of market risk regulatory capital charges for trading activities, continue to be wound down by dedicated teams.

The VaR model

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.

The risk factors used in the VaR calculations cover all the main market risk drivers for the trading books, namely interest rates, interest rate volatility, basis risk, credit spreads, exchange rates, exchange rate volatility, equity, equity volatility and inflation rates. To compute shifts in the risk factors, the historical method is used (HVaR). This means that the actual market performance is used in order to simulate possible future market evolutions, i.e. this method does not rely on assumptions regarding the distribution of price fluctuations or correlations, but is based on patterns of experience in the past. Past movements in market parameters are transformed into scenarios that are applied to the current market situation and the corresponding P&Ls are computed. KBC's current HVaR methodology is based on a 10-day holding period and a 99% confidence level, with historical data going back 500 working days i.e. it equals the fifth worst outcome (1% of 500 scenarios). This is in compliance with regulatory requirements.

We calculate an overall HVaR for each specialised subsidiary and for all trading entities worldwide. The HVaR for the latter (see 'KBC Bank' in the table) includes both the linear and non-linear exposure of the traditional dealing rooms.

The HVaR model for KBC Financial Products comprises the single names credit derivatives portfolio and the remaining correlation portfolio (and the European equity derivatives business until March 2012). Business lines and exposures that are more illiquid and have more of a credit character, such as the fund derivatives business, do not lend themselves to VaR modelling and therefore fall outside the scope of HVaR. The fund derivatives business is considered to be a legacy activity (i.e. no new activity is carried out) and is monitored on the basis of Key Performance Indicators relating to, for example, strike and redemption trends.

KBC's Financial Markets activities (referred to as "KBC Bank" in the table below) and KBC Financial Products easily account for the largest part of (trading risk) HVaR exposure within the KBC group. Their respective quarterly average HVaR outcomes in 2011 and 2012 are displayed in the table below. At the end of 2012, the HVaR for the KBC Securities Group amounted to 0.46 million euros (not shown in the table as only a minor amount of trading is conducted at this group).

	HVaR			
Market risk (VaR)[1] (in millions of EUR)	2011 KBC Bank	2011 KBC Financial Products	2012 KBC Bank	2012 KBC Financial Products
Holding period: 10 days				
Average for 1Q	13	16	30	12
Average for 2Q[2,3]	13	16	34	2[4]
Average for 3Q	14	22	30	2
Average for 4Q	26	8	30	1
As at 31 December	28	18	37	2
Maximum in year	33	29	39	18
Minimum in year	10	4	23	1

1 KBC Bank: excluding 'specific interest rate risk' (measured using other techniques); Swap basis risk has been included since the end of October 2011 for the dealing rooms in Brussels and at certain branches (significant upward effect on HVaR), and extended to the remaining subsidiaries since March 2012 (minor effect). KBC Financial Products: excluding Avebury and the fund derivatives business line.
2 KBL EPB included until the second quarter of 2012.
3 Change in scope as of 1 March 2012 when European Equity Derivatives moved from KBC Financial Products to KBC Bank.
4 Large decrease in average HVaR usage for at KBC Financial Products due to simplification of the credit event settlement process.

As can be seen in the table above, the relative importance of HVaR figures for KBC Bank and KBC Financial Products changed during 2012, with KBC Bank's figures becoming by far the most important. A breakdown of the risk factors (averaged) in KBC Bank's HVaR model from 1 March 2012 (when the scope changed) to 31 December 2012 is shown in the table below. Please note that the equity risk stems from the European Equity Business (the other equity positions are held at KBC Securities).

Breakdown by risk factor of the trading HVaR for KBC Bank (in millions of EUR)	31-12-2012
Interest rate risk	31.0
FX risk	2.2
FX Option Risk	2.0
Equity risk	1.6
Diversification effect	-5.7
Total HVaR	31.1

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

Both KBC Bank and KBC Financial Products have been authorised by the Belgian regulator to use their respective HVaR models to calculate regulatory capital requirements for part of their trading activities (Approved Internal Models or AIM). ČSOB (Czech Republic) has also received approval from the local regulator to use its HVaR model for capital requirement purposes. These models are also used for the calculation of Stressed VaR (SVaR), which is one of the new CRD III Regulatory Capital charges that entered into effect at year-end 2011. The SVaR, like the HVaR, measures the maximum loss from an adverse market movement within a given confidence level (99%) and for a given holding period (10 days). However, the 500 scenarios which are used for calculating the SVaR are not based on the most recent past, but consist of 250 'regular' historical scenarios from the period which resulted in the most negative VaR figure for that entity (the 'stressed' period), and 250 anti-thetic ('mirror') scenarios, obtained by reversing these 250 regular scenarios. The stressed period which is used for calculating the SVaR has to be calibrated at least on a yearly basis and needs to be approved by the regulator. As at the date of preparation of this report, the period relevant to the measurement of SVaR for 2012 and the period that will be used from 2013 on are shown in the table below:

Approved Internal Model	2012	2013
KBC NV AIM	Jan 2008 – Dec 2008	Jan 2008 – Dec 2008
KBC FP AIM	Jan 2008 – Dec 2008	Sep 2006 – Aug 2007
ČSOB (Czech Republic) AIM	Jul 2008 – June 2009	Mar 2008 – Mar 2009

In addition, KBC Financial Products has implemented models (as required by CRD III) to calculate and report an Incremental Risk Charge (IRC) for the credit risk positions that carry default and migration risks (i.e. the single name corporate CDS). The risk is measured using a 99.9% confidence level over a one-year holding period for a constant level of risk (constant position). The liquidity horizon for the portfolio in scope is set to one year. Furthermore, a Comprehensive Risk Measure (CRM) is calculated to cover all price risks in the bespoke CDO tranches. The risk attached to ABS and retained CDO positions follows the (re)securitisation framework (for further information, please refer to the 'Structured credit products' section of this risk report).

The resulting capital requirements for trading risk at year-end 2011 and year-end 2012 are shown in the table below. The trading regulatory capital requirements of local KBC entities not receiving approval from their respective regulator to use an internal model for capital calculations, as well as the business lines not included in the HVaR calculations, are measured according to the Standardised approach. This approach sets out general and specific risk weightings per type of market risk (interest risk, equity risk, foreign exchange risk and commodity risk).

Trading regulatory capital requirements, by risk type (in millions of EUR)									
		Interest rate risk	Equity risk	FX risk	Commodity risk	Incremental Risk Charge	Com-prehen-sive Risk Measure	Re-Securitisation*	Total
31-12-2011									
Market risks assessed by internal model	HVaR SVaR	109 159	4 6	18 43	- -	5	101	-	445
Market risks assessed by the Standardised Approach		76	18	18	1	-	-	216	329
Total		344	28	78	1	5	101	216	773
31-12-2012									
Market risks assessed by internal model	HVaR SVaR	88 114	3 4	10 20	- -	1	34	-	274
Market risks assessed by the Standardised Approach		60	12	11	2	-	-	340	425
Total		263	18	42	2	1	34	340	698

* This is the (re)securitisation charge for all ABS and retained CDO positions held at KBC Financial Products and is also included in the 'Details of capital charges under the CRD III (re)securitisation' table in the 'Structured credit products' section of this report.

Stress testing

As the VaR model cannot encompass all potential extreme events, the VaR calculations are supplemented by stress tests which reflect the impact of exceptional circumstances and events with a low degree of probability. Stress tests help to verify the adequacy of established limits and assigned capital and is sometimes used as a basis for informed decisions about how much risk senior management is willing to take (acting as a tool that helps to evaluate risk tolerance).

For the Financial Markets activities, including European Equity derivatives, both hypothetical and historical stress tests are performed on a weekly basis, whereby interest rates (IR), exchange rates (FX) and equity prices (EQ) are shifted.

On the one hand, hypothetical stress tests encompass portfolio-dependent scenarios, i.e. simulating predefined events that are independent of the portfolio composition. These scenarios model *inter alia* parallel interest rate shifts, steepening/flattening of interest rate curves, changes in basis swap spreads, FX rate (volatility) movements and equity price shifts. On the other, portfolio-independent stress tests apply shifts to the risk factors driving the major positions.

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

Events	Period (start to end)
Financial crisis after collapse of Lehman Brothers	01-07-2007 to 01-07-2009
2nd Gulf War	01-09-2002 to 30-04-2003
11 September 2001	10-09-2001 to 12-12-2001
Increase in long-term interest rates	18-01-1999 to 14-10-1999
Brazilian crisis	18-01-1999 to 14-10-1999
LTCM-fund collapse	25-09-1998 to 17-11-1998
Large swing in exchange rates	17-08-1998 to 17-11-1998
Russia crisis	15-06-1998 to 17-11-1998
Southeast-Asian crisis	01-01-1997 to 01-08-1998
Kobe earthquake (Japan)	16-01-1995 to 16-04-1995
Mexico crisis	15-12-1994 to 30-04-1995
Increase in long-term interest rates	31-12-1993 to 05-10-1994
1st Gulf War	02-08-1990 to 31-03-1991
Stock market decline	25-08-1987 to 31-03-1988
ERM crisis	28-12-1992 to 31-08-1993

For KBC Financial Products, 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 level of credit spreads. Further stress tests are conducted by simulating losses in the underlying collateral pool, based on the current level of the credit spreads

The stress test results are presented to the Group Trading Subcommittee on a bi-weekly basis. In addition, a more in-depth report on stress test results, as well as historical stress tests, is submitted to it on a quarterly basis. In all the stress tests conducted during the year, both Regulatory and Economic Capital provide a sufficient buffer were such scenarios to materialise.

Back-testing

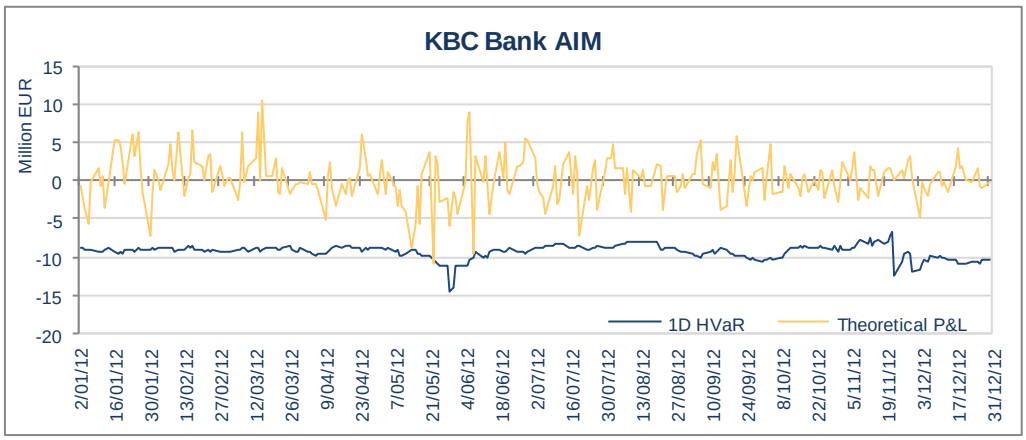
Back-testing plays a crucial role in assessing the quality and accuracy of the HVaR model, as it compares model-generated risk measures to daily P&L figures.

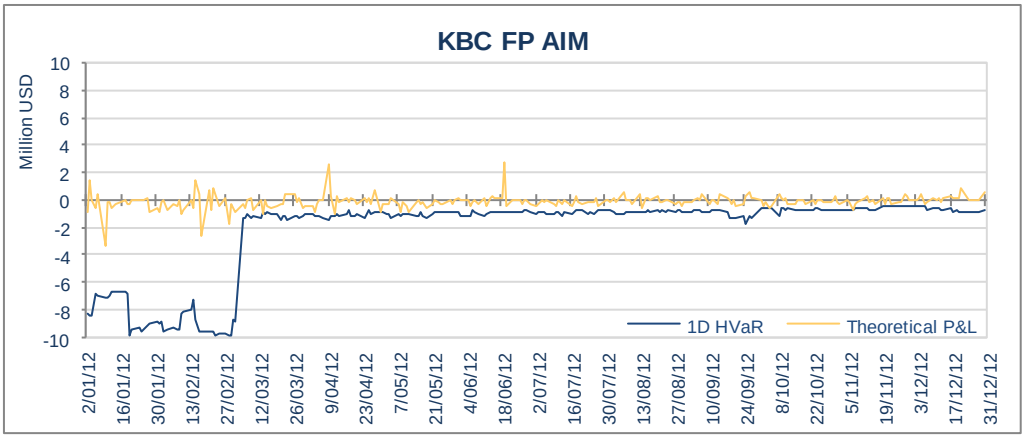
In line with regulatory requirements, a daily theoretical back-test procedure is in place, consisting of three steps. Firstly, a 'no action P&L' is generated. This is the P&L that the portfolio produces if all positions remain unchanged, but the market data changes to the next day's data. This P&L excludes non-trading components such as commissions and fees, and P&L 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 relevant risk committees (on both an *ad-hoc* and a quarterly basis), i.e. when the negative P&L result exceeds the one-day VaR. These negative exceptions are also referred to as outliers.

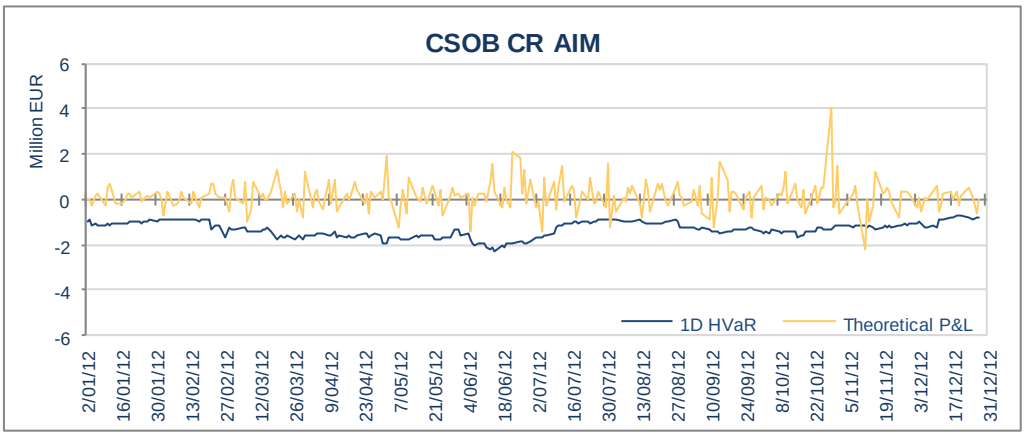
The 2012 theoretical back-tests at Approved Internal Model (AIM) level resulted in one outlier for KBC Bank AIM and two outliers for both KBC Financial Products AIM and ČSOB Czech Republic AIM (see graphs below). This signifies a significant drop in outliers compared to 2011, due to the inclusion of the volatile 2011 scenarios in the 500-day HVaR scenario window (these table below). For KBC Bank AIM and ČSOB Czech Republic AIM, interest rates were the main driver of these outliers. For the KBC Financial Products AIM, the driver was movements in credit correlation.

	KBC Bank AIM	KBC FP AIM	CSOB CR AIM
Number of outliers for theoretical back testing of the Approved Internal Models of the KBC group			
2012	1	2	2
2011	9	2	8

Graphs comparing the 1-day HVaR with the daily theoretical P&L results during 2012 at AIM level:







Please note that theoretical and real back-testing is performed on a wide variety of portfolios for which an HVaR limit is defined. This provides a good indication of the HVaR model performance for a specific (product) portfolio. In general, the number of outliers on a more granular (product) portfolio level increases as there is less diversification. However, allowing for this, the number of outliers for all entity levels underpinned the quality of the HVaR model.

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.

Valuation

One of the building blocks of sound risk management is prudent valuation. A daily independent middle-office valuation of front-office positions is performed. Whenever the independent nature or the reliability of the valuation process is not guaranteed, a parameter review is performed. Where applicable, adjustments to the fair value are made to reflect close-out costs, adjustments for less liquid positions or markets, mark-to-model-related valuation adjustments, counterparty risk, liquidity risk and operations-related costs.

KBC applies the IFRS fair value hierarchy which gives priority to the use of quoted prices in an active market whenever they are available. If there are no price quotes available, KBC determines the fair value by using a model based on observable or unobservable inputs. In line with the IFRS principles, the use of observable inputs is maximised, whereas the use of unobservable inputs is minimised.

Examples of observable inputs are the risk-free rate, exchange rates, stock prices and implied volatility. Valuation techniques based on observable inputs can include discounted cash flow analysis, reference to the current or recent fair value of a similar instrument, or third-party pricing, provided that the third-party price is in line with

alternative observable market data. Unobservable inputs reflect KBC's own assumptions about the assumptions that market participants would use in pricing the asset or liability (including assumptions regarding the risks involved). Unobservable inputs reflect a market that is not active. For example, proxies and correlation factors can be considered to be unobservable in the market.

The KBC valuation methodology of the most commonly used financial instruments are summarised in Note 24 of the annual report.

Within KBC, valuation models are validated by an independent Risk Validation Unit. In addition, the Group Executive Committee of KBC established a Group Valuation Committee (GVC) to ensure that KBC Group NV and its entities are compliant with all the relevant regulatory requirements concerning the valuation of financial instruments that are measured at fair value. For this purpose, the GVC monitors the consistent implementation of the KBC Valuation Framework, which consists of several policies including the CDO Revaluation Policy, the Group Market Value Adjustments Policy and the Group Parameter Review policy. Furthermore, the GVC meets twice per quarter to approve significant changes in valuation methodologies (including but not limited to models, market data, input parameters) or deviations from group policies for financial instruments measured at fair value. The GVC consists of members of the Group Finance, Group Risk and Middle Office units.

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 the 'Other non-financial risks' heading at the end of this section.

Information on legal disputes can be found in Note 36 of the 'Consolidated financial statements' section in the 2012 annual report of KBC Group NV (see *www.kbc.com*).

Strategy and processes

We have 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.

Scope of operational risk management

KBC's operational risk management framework covers all entities in which it, 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.

We have 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 Group risk function is primarily responsible for defining the operational risk management framework for the entire group. The development and implementation of this framework is supported by an extensive operational risk governance model covering all entities of the group. This framework was redesigned in 2012 in line with the KBC Risk Management Framework and will gradually be implemented (with full implementation during 2014).

The Group risk function creates an environment where risk specialists (in various areas, including information risk management, business continuity and disaster recovery, compliance, anti-fraud, legal, tax and accounting 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.

Between 2011 and 2015, specific attention will be given to the structured set-up of process-based Group Key Controls, which will gradually replace the former Group Standards. These Controls are policies containing top-down basic control objectives and are used to mitigate key and killer risks inherent in the processes of KBC entities. As such, they are an essential building block of the Operational Risk Management Framework.

- A first set was approved in 2011 for the Credit, Life, Non-life, Personal Financial Advice, Legal, Tax, Business Continuity Management and Risk & Capital Management processes.
- A second set was approved in 2012 for the Cash, Current Accounts, Saving Accounts, Lease, Trading and Sales (part 1), Portfolio Management, Customer Administration, Human Resources, Corporate Communication and Accounting and External Financial Reporting Processes.

These Group Key Controls are assessed by the business and (local) control functions. The risk self-assessments are consolidated at the Group risk function and ensure that there is a consistent relationship between (i) processes, (ii) risks, (iii) control activities and (iv) assessment scores. KBC created an objective management tool to evaluate its internal control environment and to benchmark the approach across its entities.

Besides these Group Key Controls, there are a number of other building blocks:

- *The Loss Event Database*. All operational losses of 1 000 euros or more have been recorded in a central database since 2004. This database also includes all legal claims filed against group companies. Consolidated loss reports are regularly submitted to the GICC, the Group Executive Committee and the ARC Committee.
- *Risk Scans (bottom-up and top-down)*. These *self-assessments* focus on the identification of 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.
- *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*. A limited set of KRIs are used to monitor the exposure to certain operational risks and track the existence and effectiveness of the internal controls.

The quality of the internal control environment and related risk exposure as identified, assessed and managed by means of these building blocks is reported to KBC's senior management via a management dashboard and to the National Bank of Belgium and the FSMA via the annual Internal Control Statement. Information on the internal control and risk management systems can be found in the 'Corporate governance statement' section in the 2012 annual report of KBC Group NV (see *www.kbc.com*).

Operational risk capital charge

KBC uses the Standard approach to calculate operational risk capital under Basel II (pillar 1 regulatory capital). Operational risk capital for KBC Bank at the consolidated level totalled 873 million euros at the end of 2012, compared with 862 million euros at the end of 2011.

For divested entities, KBC keeps operational risk capital (under pillar 2) in line with the outstanding contractual liabilities.

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 to have 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 Reputation Risk Management Framework was redesigned in 2012 in line with the KBC Risk Management Framework. The pro-active and re-active management of reputation risk is the responsibility of the business, supported by many specialist units (e.g., the Press Office, Investor Relations).

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 Group risk function is responsible for developing a group-wide framework to ensure the continuity of operations, following the operational risk governance. Via the local value and risk management units, the Group risk function is also responsible for overseeing the practical implementation of this framework by line management.

The annual business continuity report has also been included in KBC's Internal Control Statement as of 2011.

Insurance risk management

Technical insurance risks stem from uncertainty regarding how often insured losses will occur and how extensive they will be. All these risks are kept under control through appropriate underwriting, pricing, claims reserving, reinsurance and claims handling policies of line management and through independent insurance risk management.

Strategy and processes

The Insurance Risk Competence Centre in the Group Risk Integration & Solutions Directorate develops and rolls out a group-wide framework for managing insurance risks. It is responsible for providing support for local implementation and for the functional direction of the insurance risk management process of the insurance subsidiaries.

The insurance risk management framework is designed primarily around the following building blocks:

- Adequate identification and analysis of material insurance risks by, *inter alia*, analysing new emerging risks, concentration or accumulation risks, and developing early warning signals.
- Appropriate risk measurements and use of these measurements to develop applications aimed at guiding the company towards creating maximum shareholder value. Examples include best estimate valuations of insurance liabilities, *ex post* economic profitability analyses, natural catastrophe and other life, non-life and health exposure modelling, stress testing and required economic capital calculations.
- Determination of insurance risk limits and conducting compliance checks, as well as providing advice on reinsurance programmes.

Scope of insurance risk management

The following entities are in scope, viz. KBC Insurance (Belgium), Maatschappij voor Brandherverzekering, Sepia, KBC Group Re, K&H Insurance, ČSOB Pojišťovna (Czech Republic), ČSOB Poisťovňa (Slovak Republic) and DZI Insurance.

Insurance risk classification

Part of the risk identification process consists of reliably classifying all insurance risks that may be triggered by (re)insurance contracts.

Under the Solvency II directive, insurance activities are split up into three main categories, namely Life, Non-life and Health.

- **Life insurance** risks are further split up into catastrophe and non-catastrophe risks. Life non-catastrophe risks cover the biometric risks (longevity, mortality and disability-morbidity risk), revision risk, expense risk and lapse risk related to life insurance contracts.
- **Non-life insurance** risks are further split up into catastrophe and non-catastrophe risks. Non-life, non-catastrophe risks cover the premium risk, reserve risk and lapse risk related to non-life insurance contracts.
- **Health risks** are also split up into catastrophe risks and non-catastrophe risk. The latter are then further subdivided into Health Similar to Life Techniques (includes longevity, mortality, disability-morbidity, expense risk and lapse risk) and Health Non Similar to Life Techniques (premium and reserve risk, lapse risk). In other words, all subtypes included under life and non-life also appear in the health category.

The various subtypes of insurance risk, linked to the different insurance categories (life, non-life and also health) are defined as follows:

- *Catastrophe risk*: the risk that a single damaging event, or series of correlated events, of major magnitude, usually over a well-defined short-time period leads to a significant deviation in actual claims from the total expected claims. 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.
- *Lapse risk*: the risk that the actual rate of policy lapses (i.e. premature full or partial termination of the contract by the policyholder) differs from those used in pricing.
- *Expense risk*: the risk that the cost assumptions used in pricing or valuing insurance liabilities in terms of acquisition costs, administration costs or internal settlement costs, turn out to be too optimistic.

- *Revision risk*: the potential negative deviation from the expected value of an insurance contract or a portfolio thereof due to unexpected revisions of claims. Only to be applied to annuities where the amount of the annuity may be revised during the next year.
- *Biometric risk*: the potential negative deviation from the expected value of an insurance contract or a portfolio thereof due to unexpected changes related to human life conditions.
    - *Longevity risk*: the risk that the mortality rates used in pricing annuity products (or other products with negative capital at risk) turn out to be too high, i.e. people live longer than expected.
    - *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.
    - *Disability-morbidity 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.
- *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)
- *Reserve risk*: the risk that the liabilities stemming from claims, which have occurred in the past, but have still to be finally settled, will turn out to be more expensive than expected.

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 other internal models for measuring 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 mission to independently monitor insurance risks, the Group Value and Risk Management Directorate regularly carries out in-depth studies. These confirm that there is a high degree of probability that the non-life technical provisions at subsidiary level are adequate. Adequacy is checked per business line at subsidiary level and the overall adequacy is assessed at subsidiary level for all business lines combined.

In addition, 'Liability Adequacy Tests' (LAT) that meet local and IFRS requirements are conducted by the various group companies for the life technical provisions. 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 2012, there was no need for a deficiency reserve to be set aside within the KBC group.

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 Solvency II and IFRS 4/2.

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 (up to and including financial year 2010), ČSOB Pojišťovna (Czech Republic), ČSOB Poist'ovňa (Slovakia, from financial year 2008), DZI Insurance (from financial year 2008), K&H Insurance, Secura (up to and including financial year 2009), KBC Group Re (from financial year 2005) and WARTA (from financial year 2004 up to and including financial year 2010). All provisions for claims to be paid at the close of 2012 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. We restated the amounts to reflect exchange rates at year-end 2012.

Loss triangles, KBC Insurance (in millions of EUR)	Year of occurrence 2003	Year of occurrence 2004[1]	Year of occurrence 2005[2]	Year of occurrence 2006	Year of occurrence 2007	Year of occurrence 2008[3]	Year of occurrence 2009	Year of occurrence 2010	Year of occurrence 2011[4]	Year of occurrence 2012
Estimate at the end of the year of occurrence	778	1 079	1 119	1 200	1 270	1 391	1 470	1 464	814	859
1 year later	798	983	1 026	1 090	1 171	1 335	1 176	1 058	722	-
2 years later	766	939	992	1 056	1 129	1 171	1 013	1 009	–	-
3 years later	747	926	983	1 042	997	1 075	992	–	–	-
4 years later	731	916	963	908	919	1 066	–	–	–	-
5 years later	702	912	876	852	915	–	–	–	–	-
6 years later	694	853	838	837	–	–	–	–	–	-
7 years later	655	808	834	–	–	–	–	–	–	-
8 years later	626	806	–	–	–	–	–	–	–	-
9 years later	623	–	–	–	–	–	–	–	–	-
Current estimate	623	806	834	837	915	1 066	992	1 009	722	859
Cumulative payments	-575	-748	-748	-766	-813	-932	-843	-852	-469	-342
Current provisions	48	58	85	71	101	134	149	158	253	517

1 From financial year 2004, WARTA's figures have been included. If this company had not been taken into account, the following amount would have been arrived at for financial year 2004 (amount and year of occurrence): 696 for 2003.
2 From financial year 2005, KBC Group Re'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): 765 for 2003; and 955 for 2004.
3 From financial year 2008, 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): 692 for 2003; 905 for 2004; 953 for 2005; 1 031 for 2006; and 1 124 for 2007.
4 For financial year 2011, the figures for WARTA and Fidea have been excluded.

Stress testing and scenario analysis

In 2012, the sensitivity of technical insurance risks to extreme events was analysed in a number of ways, including the IMF stress test. The goal of these tests was to identify and quantify the impact of different stress scenarios on the financial position of the insurance group and included catastrophic and severe insurance events for both the life (e.g., mass lapse shock) and non-life insurance businesses (e.g., Maximum Probable Loss for either a natural or man-made catastrophe event, whichever is largest).

In addition to the regulatory required stress tests, we perform internal stress tests. For the non-life business, 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).

For the life insurance business, a sensitivity analysis is typically performed within the framework of the annual calculation of the market consistent 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 by reinsurance

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. We divide these reinsurance programmes into three main groups i.e. property insurance, liability insurance and personal insurance, and we re-evaluate and renegotiate them every year.

Most of our 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.

More information on the insurance activities of the group can be found under Notes 9, 10, 11 and 35 of the 'Consolidated financial statements' section of the 2012 annual report of KBC Group NV. 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.

Basel III

Basel III is a global regulatory standard on bank capital adequacy, stress testing and market liquidity risk agreed upon by the members of the Basel Committee on Banking Supervision in 2010. Basel III was developed in response to the deficiencies in financial regulation revealed by the late-2000s financial crisis.

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. (BIS website: 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

The potential negative deviation from the expected value of the organisation arising from changes in the macroeconomic environment, the financial services industry or market for products and services, as well as from other changes in the regulatory, socio-demographic, political, cultural or ecological environment.

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').

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 turn transposed into the national legislation and regulations of the EU Member States.

Credit risk

The potential negative deviation from the expected value of a financial instrument arising from non-payment or non-performance by a contractual party (for instance, a borrower, a guarantor, an insurer or re-insurer, a counterparty in a professional transaction or an issuer of a debt instrument), 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)

The successor to the CEBS (Committee of European Banking Supervisors).
A 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 co-operation 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)

Economic capital is the amount of capital needed to absorb very severe losses, expressed in terms of the potential reduction in the economic value of the group (= difference between the current economic value and the worst case economic value over a one-year time horizon and measured at a certain confidence level). It represents the minimum amount of capital which is required in order to protect KBC group debt holders against economic insolvency under extreme circumstances.

EIOPA (European Insurance and Occupational Pensions Authority)

The successor to the Committee of European Insurance and Occupational Pensions Supervisors (CEIOPS), EIOPA is part of the European System of Financial Supervision consisting of three European Supervisory Authorities and the European Systemic Risk Board. It is an independent advisory body to the European Parliament and the Council of the European Union. EIOPA’s core responsibilities are to support the stability of the financial system, transparency of markets and financial products, as well as the protection of insurance policyholders, pension scheme members and beneficiaries.

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.

FSMA (Financial Services and Markets Authority)

The FSMA is the successor to the former Banking, Financial and Insurance Commission (CBFA). It is responsible for supervising the financial markets and listed companies, authorising and supervising certain categories of financial institutions, overseeing compliance by financial intermediaries with codes of conduct and supervising the marketing of investment products to the general public, as well as for the 'social supervision' of supplementary pensions. The Belgian government has also tasked the FSMA with contributing to the financial education of savers and investors.

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 among other tasks, monitors the integrated risk profile, proposes mitigating measures to the Group Executive Committee, 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 among other tasks, 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 whose mission is to create – independently of the line and in keeping with advanced industry standards – a group-wide framework for value, risk and capital management, monitor the implementation of this framework, and provide assistance to the business 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

The potential negative deviation from the expected value of an insurance contract or pension claim (or a portfolio thereof).

Interest rate risk

The potential negative deviation from the expected value of a financial instrument or portfolio thereof 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 International Swaps and Derivatives Association and 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

The potential negative deviation from the expected value of an insurance contract or a portfolio thereof due to unexpected changes in policy lapses. Note that the term surrender risk refers specifically to contracts with surrender value.

LCR (Liquidity Coverage Ratio)

'Stock of high-quality liquid assets minus Total net cash outflows over the next 30 calendar days'. A result of 100% (or more) indicates that a bank is maintaining a sufficient stock of 'high-quality liquid assets' to cover net cash outflows for a 30-day period under a stress scenario. The parameters of the stress scenario are defined under Basel III.

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

The potential negative deviation from the expected value of a financial instrument (or portfolio thereof) due to changes in the level or volatility of market 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.

NBB (National Bank of Belgium)

One of the tasks of the NBB is financial supervision, which is the instrument for ensuring financial stability, and the second key function of a central bank, alongside monetary stability. Financial supervision covers the:

1. prudential supervision of financial institutions from both the micro-prudential and macro-prudential angle, and the prompt detection of systemic risk;
2. supervision of information, the functioning of the financial markets and respect for the appropriate code of conduct, together with consumer protection.

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.

NSFR (Net Stable Funding Ratio)

'Available Stable Funding/Required Stable Funding', where available stable funding is derived from different components on the liabilities side of the balance sheet (required funding = assets side). Basel III defined weightings for determining stability are assigned to the different components (both assets and liabilities). An NSRF of 100% means that the funding situation is stable.

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 value of the organisation resulting from inadequate or failed internal processes, people and systems or from sudden man-made or natural external events. Operational risk excludes business, strategic and reputational risk.

ORSA (Own Risk and Solvency Assessment)

The Own Risk and Solvency Assessment covers the entirety of the processes and procedures employed for identifying, assessing, monitoring, managing, and reporting on the short- and long-term risks a (re)insurance undertaking faces or may face, and for determining the own funds necessary to ensure that the undertaking's overall solvency needs are met at all times.

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 (contrast with Through-the-cycle PD).

RAPM (Risk-Adjusted Performance Measurement)

The risk-adjusted performance measurement policy defines a set of risk-adjusted performance metrics to be used for (1) allocating capital and (2) setting variable remuneration.

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. Generally 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.

Solvency II

Solvency II is a project, initiated by the European Commission in 2001, which establishes capital requirements and risk management standards that will apply across the EU and will affect all areas of an insurer’s operations. Solvency II aims to move away from the idea that ‘one approach fits all’ and thus encourages companies to manage risk in a way which is appropriate to the size and nature of their business in order to provide protection to policyholders by reducing the risk of insolvency to insurers.

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.

SVaR (Stressed Value At Risk)

Stressed Value-At-Risk is analogous to the Historical VaR, but it is calculated for the time series of a maximum stressed period in recent history.

(Core) Tier 1-ratio

[tier-1 capital] / [total weighted risks]. The calculation of the core tier-1 ratio does not include hybrid instruments (but does include the core-capital securities sold to the Belgian and Flemish governments).

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 (contrast with Point-in-time PD).

VaR (Value At Risk)

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