SOLVENCY &
FINANCIAL
CONDITION
REPORT
KBC VERZEKERINGEN NV
BELGIUM
2018

KBC

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Disclosure policy

In line with its general communication policy, KBC aims to communicate openly with the market about its exposure to risk (see section 4 of this SFCR).

The most important regulation governing risk and capital management is the Solvency II capital framework applying to insurance entities. Solvency I has been replaced by the fundamentally reformed Solvency II framework, which officially entered into force in January 2016.

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.

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.

In addition, the 2018 Solvency & Financial Condition Report was distributed to the Group Executive Committee, the Board of Directors, as well as to the Risk & Compliance Committee to ensure appropriate approval was obtained from the management body, as requested under Solvency II.

This Solvency & Financial Condition Report is available in English on the KBC website and is updated on a yearly basis. KBC's next update is scheduled for the end of April 2020. Depending on market requirements, KBC may however decide to provide more frequent updates.

Management
summary

1. Management summary

English version

The Solvency & Financial Condition Report (SFCR) has to be published each year by all insurance undertakings and groups. It provides qualitative and quantitative information on the business and performance, the system of governance, the risk profile, the valuation for solvency purposes and capital management of the undertaking.

The SFCR of KBC Insurance NV (Belgium) has a harmonised structure that is defined in Annex XX of the Solvency II Delegated Acts Regulation[1] and includes templates defined by the Implementing Regulation[2] that contain quantitative information in the 'Quantitative Reporting Templates (QRTs)'. The pertaining QRTs are published separately on https://www.kbc.com.

The insurance activities of KBC Insurance NV include their reinsurance branch Maatschappij voor Brandherverzekering CVBA (MVBh for short). A separate section (see section 7) is reserved for the SFCR of fire reinsurance company MVBh.

All amounts quoted in this report and in the tables are in millions of euros, unless otherwise stated.

Highlights in 2018

KBC Insurance NV is an insurance company catering mainly for retail, small and medium-sized enterprises (SME) and mid-cap clients in Belgium.

- ✓ KBC Insurance NV has a medium risk profile, in line with the Risk Appetite Statement (RAS).
- ✓ KBC Insurance NV is strongly capitalised in terms of the level and quality of capital. The Solvency II ratio at 31 December 2018 amounted to 230 % (including volatility adjustment).
- ✓ The result came to 368m EUR compared to 370m EUR in 2017. This 2m EUR decrease was primarily generated due to the storm claims at the beginning of 2018 and a decrease in net interest income.
- ✓ Earned premiums in Non-Life insurance went up by 2,7%; earned premium regular Life remained stable.
- ✓ Costs were under control.
- ✓ The combined ratio (Bgaap) came to a very favourable 86,5%.

1 Commission Delegated Regulation (EU) 2015/35 of 10 October 2014 (CDR EU 2015_35)

2 Commission Implementing Regulation (EU) 2015/2452 of 2 December 2015 (CIR EU 2015-2452)

NEDERLANDSE VERSIE

Jaarlijks publiceert elke verzekeringsonderneming/-groep het Solvency & Financial Condition Report (SFCR). Dit rapport bevat kwalitatieve en kwantitatieve informatie over het verzekeringsbedrijf en zijn performantie, de governance, het risicoprofiel, de waardering volgens de Solvency II reglementering en het kapitaalbeheer van de onderneming.

Het SFCR van KBC Verzekeringen NV (België) heeft een geharmoniseerde structuur zoals gedefinieerd in "Annex XX of the Solvency II Delegated Acts Regulation"[3] en bevat templates zoals bepaald door de "Implementing Regulation".[4]

Kwantitatieve informatie is terug te vinden in de "Quantitative Reporting Templates (QRTs)". Deze QRT's worden apart gepubliceerd op https://www.kbc.com.

De verzekeringsactiviteiten van KBC Verzekeringen NV omvatten ook de branch Maatschappij voor Brandherverzekering CVBA (afgekort MvBH). Het SFCR van deze brandherverzekeringsmaatschappij werd in een apart hoofdstuk opgenomen (zie hoofdstuk 7).

Alle bedragen en tabellen in dit rapport zijn uitgedrukt in veelvouden van miljoen Euro, tenzij anders aangegeven.

Hoogtepunten in 2018

KBC Verzekeringen NV is een verzekeringsgroep die zich voornamelijk richt op retail, KMO's en midcap klanten in België.

- ✓ KBC Verzekeringen NV heeft een medium risicoprofiel in lijn met de RAS (Risk Appetite Statement).
- ✓ KBC Verzekeringen NV is sterk gekapitaliseerd in termen van grootte en ook inzake de kwaliteit van het kapitaal. De Solvency II ratio bedroeg op 31 december 2018 230 % (inclusief de volatiliteitsaanpassing).
- ✓ Het resultaat bedroeg 368m EUR in vergelijking met 370m EUR in 2017. Deze daling van 2m EUR werd veroorzaakt door de stormschadegevallen in het begin van 2018 en een lager netto interest inkomen.
- ✓ Verworven premies stegen in Niet-Leven met 2,7%; verworven premies voor Leven bleven stabiel.
- ✓ Alle kosten bleven onder controle.
- ✓ De combined ratio (in Bgaap) resulteerde in een zeer gunstige 86,5%.

3 Commission Delegated Regulation (EU) 2015/35 of 10 October 2014 (CDR EU 2015_35)

4 Commission Implementing Regulation (EU) 2015/2452 of 2 December 2015 (CIR EU 2015-2452)

Business &
performance

2. Business & performance

2.1. Business

KBC Insurance NV is an insurance company catering mainly for retail, small and medium-sized enterprises (SME) and mid-cap clients on its core market Belgium.

KBC Insurance NV is part of KBC Insurance Group.

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Supervisory authority: **Contact information**:	National Bank of Belgium de Berlaimontlaan 14 1000 Brussels
External auditor: **Contact details**:	PWC Belgium Woluwegarden – Woluwedal 18 1932 Brussels BELGIUM
Management:	CEO Johan Thijs Chairman of the Board of Directors Thomas Leysen

2.2. Strategy

KBC Insurance NV's strategy is embedded in the strategy of the KBC group, given that we are an integrated bank-insurance group. KBC Bank is essentially responsible for the banking business and KBC Insurance for the insurance business. For more detailed information, please see the KBC Group Annual Report for 2018 on www.kbc.com.

2.3. Income Statement KBC Insurance NV

The following annual account of KBC Insurance NV has been prepared according to Belgian Generally Accepted Accounting Principles (BGaap).

KBC Insurance NV (in millions EUR)	31/12/2018	31/12/2017	Difference
Non Life			
Net earned premiums	1062,0	1030,2	31,8
Net claims	-614,9	-628,5	13,6
Net technical result	447,1	401,7	45,3
Investment income & expense	62,8	74,0	-11,2
Net operating expenses	-330,2	-327,8	-2,4
Result of the technical account Non-Life	**179,6**	**147,9**	**31,8**
Net loss ratio non-life	55,6%	56,9%	
Net cost ratio non-life	30,9%	31,7%	
Combined ratio non-life	86,5%	88,5%	
Life			
Class 21 and 26			
Net earned premiums	971,1	919,8	51,3
Net claims	-1140,4	-1104,2	-36,2
Net technical result	-169,3	-184,4	15,2
Investment income & expense	463,2	511,5	-48,3
Net operating expenses	-116,7	-115,2	-1,5
Fund for future appropriations	-30,0	0,0	-30,0
Result class 21 and 26	147,2	211,9	-64,7
Class 23 : net result	47,4	49,6	-2,2
Result of the technical account Life	**194,6**	**261,4**	**-66,9**
Non - technical			
Investment income & expense	110,6	168,9	-58,3
Other income and expenses	-7,4	-4,7	-2,7
Extraordinary result	0,0	0,0	0,0
Result non-technical	**103,2**	**164,1**	**-60,9**
Result before taxes	**477,4**	**573,4**	**-96,0**
Taxes	-107,1	-326,1	219,0
Movement of tax free reserves	0,3	-0,4	0,6
Result for the period available for appropriation	**370,6**	**247,0**	**123,6**

The non-consolidated result of the KBC Insurance NV came to 370,6m EUR in 2018, as opposed to the year-earlier figure of 247m EUR. The main reasons for the increase of 123,6m EUR are a favorable technical result Non-Life, a higher net technical result Life and the reversal of outstanding deferred tax assets in 2017. This was partly compensated by a decrease in net investment income and higher operating expenses. More details are provided in the section 2.4 Underwriting Performance and 2.5 Investment performance.

2.4. Underwriting performance

2.4.1. Underwriting performance Non-Life

2018 had a favorable technical result Non-Life, i.e. an increase of 45m EUR.

In 2018 premium income increased with 31,8m EUR. This increase was mainly situated in Class Motor, Class Fire & Other damage to property and Class Workmen's compensation. Furthermore, the technical charges were 13,6m EUR lower in 2018 compared to 2017).

The decrease in claims can be explained by:

- ✓ Higher claims re storm: -34,4m EUR (heavy jan'18 storm impact:-26,9m EUR).
- ✓ Higher normal claims: -18,7m EUR (mainly in Class Motor, Class Accident & Health and Assistance, partly offset by low normal claims in Class Workmen's compensation).
- ✓ Very low level of major claims: +29,4m EUR (mainly in Class Motor and Class General Third Party liability), partly offset by lower technical charges recovered from reinsurance -5,0m EUR.
- ✓ Lower dotation to the equalization reserve: +18,7m EUR mainly caused by high January storm.
- ✓ Special elements 2017: updated mortality tables (-14,3m EUR) , higher cost for assistance by third party (-18,5m EUR), new indicative tables and adjustment for legal interest (+10,3m EUR). Impact 12M18 vs 12M17: +22,5m EUR.
- ✓ Special elements 2018: adjusted calculation method for bodily injury in General Third Party Liability insurance and Motor Third Party Liability Insurance (-14,2m EUR), higher recourses (+7,2m EUR) and changes in ageing provision (+4,8m EUR).

2.4.2. Underwriting performance Life

The Life insurance business consists of guaranteed-interest (Class 21), Unit-Linked (Class 23) and capitalisation (Class 26) insurance policies. Compared with the guaranteed-interest and Unit-Linked policies, sales of capitalisation insurance is very limited

Net technical result Life Class 21/26 increases with 15,2m in 2018;

- ✓ Mainly attributable to lower up-renting cost in Life Capital (portfolio in decline) and favorable result on riders (supplementary risk) caused by release of provisions.
- ✓ Result negatively impacted by higher profit dotation and adjusted ageing provision. Higher premium income mainly situated in Life Future 8 (+39,3m EUR), 'VAPZ' (+6,0m EUR) and 'IPT' (+9,1m EUR).

More information on the 'underwriting performance of KBC Insurance NV can be found in the Quantitative Reporting Template S.05.01.02 – Premiums, claims and expenses by line of business.

2.5. Investment performance

Net investment income (excluding Unit-Linked products) decreased with 117m EUR in 2018. The main movements are:

- ✓ Lower interest income due to a lower return on bond portfolio by lower reinvestment yields on bonds, decline in Life Capital portfolio and shift to other asset classes partly compensated by higher interest on mortgage loans due to higher volume.
- ✓ Higher dividend income.
- ✓ Lower gains on shares: high impairments on shares (MSCI index declined -14,7 % in 2018 compared to an increase in 2017 of 10,2%), partly compensated by higher realized gains on shares as a consequence of the strategy portfolio management.
- ✓ A decrease in financial fixed assets mainly due to lower dividend income of Group RE.
- ✓ Lower result on derivatives mainly due to lower interest income on swap contracts due to three matured receiver swaps in 4Q17 and the start of one payer swap in Sep'17.

2.6. Performance of other activities

No other activities are material enough to be included in this report.

System of governance

3. System of governance

The activities of KBC Insurance NV are part of the KBC Insurance Group. Therefore the governance of KBC Insurance Group is also applicable to KBC Insurance NV. We present in this section the global system of Governance of the KBC Insurance Group level in which these activities are imbedded. If needed, local accents are added to this chapter.

3.1. Governance

3.1.1. Shareholder structure, corporate bodies and governance

3.1.1.1. Shareholder structure

The shareholder structure of KBC Insurance NV is:

Shareholders	Number of shares	Percentage
KBC Group	1.002.016	95,3%
KBC Bank	1	0,0%
KBC Insurance	48.889	4,7%
Total	**1.050.906**	**100,0%**

3.1.1.2. Corporate bodies of KBC Insurance NV

KBC Insurance NV is managed according to a dual model, which draws a distinction between:

- ✓ The ‘Board of Directors’ (BoD), which has the task of setting strategy and supervising operational management.
- ✓ The ‘Executive Committee’ (ExCo), which is responsible for the operational management of the company.

The tasks and functioning of the Board of Directors and the Executive Committee are described in the *Corporate Governance Charter of KBC Insurance NV* (sections 5 and 7). Reference is made several times to this Charter, the full document can be found at www.kbc.com.

The Board of Directors is assisted by the following advisory committees:

- ✓ The Audit Committee
- ✓ The Risk & Compliance Committee
- ✓ The Remuneration Committee of KBC Group NV
- ✓ The Nomination Committee of KBC Group NV

The tasks and functioning of Audit Committee and the Risk & Compliance Committee of KBC Insurance NV are described in the *Corporate Governance Charter of KBC Insurance NV* (section 6). It also contains the tasks and the rules of procedure for the Remuneration Committee and the Nomination Committee (sections 6.4 and 6.5):

- ✓ While it is legally not recommended for an insurance company to establish a nomination committee, the KBC group decided to establish such a committee at the level of KBC Group NV, which would also operate as a nomination committee for KBC Insurance NV.
- ✓ The Remuneration Committee of KBC Group NV (mixed financial holding company and parent of KBC Insurance NV) operates as the remuneration committee of KBC Insurance NV.

3.1.1.3. *Governance of the Belgian activities of KBC Insurance NV (KBC Insurance Products BE)*

Management Committees at the level of Business Unit Belgium

The insurance activities of KBC Insurance NV are included under Business Unit Belgium. The following management committees have been set up at the level of this Business Unit:

- ✓ The Business Unit Belgium Management Committee, which is accountable for designing and proposing strategy and for managing its execution in Business Unit Belgium (BU BE), implementing the strategy of KBC Group NV and KBC Insurance NV, and, given KBC's bank-insurance strategy, also of KBC Bank NV.
- ✓ The Risk, ALM & Capital Committee, which is dedicated to risk topics (covering all risk types).
- ✓ The PMSC "V2020" is accountable for monitoring of the progress in the implementation of the insurance strategy as approved by the Board of Directors dated 28 October-2015 (concretized into the 5 commitments). The Board of Directors approved the updated strategy at its meeting of 19 April 2018.

The Senior General Manager responsible for the insurance activities of the Business Unit is a member of these committees.

The Business Unit reports on its strategy, activities and results to the Executive Committee and to the Board of Directors of KBC Insurance NV.

Management Committees at the level of Insurance Products Belgium

The activities of KBC Insurance Products are part of the Insurance Products Directorate, headed up by a Senior General Manager. This directorate has its own management committees to steer the activities, including:

- ✓ The Insurance Products Management Committee, which manages the KBC Insurance Products Directorate as a whole. It develops the overall strategy of KBC Insurance Products and monitors the business, operational and insurance risk.
- ✓ The Insurance Products Risk Management Committee, which mission is to anchor the knowledge about SII and the underlying parameters; come to a transparent, documented risk policy; inform about SII; and follow up the SII topics, e.g. parameters, cost allocation, documentation; to support management in ALM matters.
- ✓ The Life & Health insurance activities are managed by following committees: a New & Active Product Process Committee, a Risk Management Committee and an Operational Management Committee.
- ✓ Non-Life insurance activities are managed by the following committees: a New & Active Product Process Committee, a Risk Management Committee and an Operational Management Committee.

Reporting by the control functions

The risk function, the compliance function and the actuarial function (known as the second line of defence) and the audit function (known as the third line of defence) report their findings on the activities of KBC Insurance Products to:

- ✓ The management of KBC Insurance Products
- ✓ The Executive Committee of KBC Insurance NV

- ✓ The Audit Committee, the Risk & Compliance Committee and the Board of Directors of both KBC Group NV and KBC Insurance NV

3.1.2. Remuneration

Introduced in 2010, the KBC Remuneration Policy defines general remuneration guidelines for all staff and specific remuneration guidelines for those employees who could have a material impact on the risk profile of the company, also known as 'Key Identified Staff'. Continuously changing legislation for financial institutions means that the KBC Remuneration Policy is amended each year. For additional details and background information on the remuneration policy, please see the 'Remuneration report for financial year 2018' section of the KBC Group Annual Report for 2018, which is available at www.kbc.com.

The Compensation Report, on the other hand, provides information on the principles governing remuneration at KBC group level and discloses remuneration figures for financial year 2018 based on European and national legislation. This report is also available at www.kbc.com.

3.1.3. Fit & proper policy

Separate policies were approved by the Board of Directors of KBC Group NV, KBC Bank NV and KBC Insurance NV for:

- ✓ The Board of Directors
- ✓ The Executive Committee
- ✓ The persons in charge of independent control functions, i.e. 'Key Function Holders'

The Fit & Proper Policy for the non-executive directors of KBC Group NV, KBC Bank and KBC Insurance include the following requirements:

- ✓ The Board of Directors must have sufficient knowledge and expertise of the financial industry and financial markets, and of the banking and insurance activities which are developed within the KBC group.
- ✓ The Board of Directors must have deep knowledge of KBC's strategy and business model and its shareholder structure.
- ✓ The directors must have the capability to understand and critically assess the strategy and its business model, the strategic planning and its implementation, the financial reporting, the organization, the effectiveness of the steps taken to create effective governance, oversight and controls, the management information systems, the impact of technological changes and the digital innovation in the KBC group, the risk, audit and compliance reports and the reports of the actuarial function holders.
- ✓ The directors who are appointed to an advisory committee (Audit Committee, Risk & Compliance Committee, Nomination Committee and Remuneration Committee) must have expertise that is relevant to the activities of the committee concerned.
- ✓ All directors, whether executive, independent or otherwise, must have sufficient capacity to make independent judgment.

The Fit & Proper Policy for the members of the Executive Committee of KBC Group NV, KBC Bank and KBC Insurance includes the following requirements:

- ✓ The Executive Committee as a whole should have deep knowledge and experience relating to finance, risk management, compliance, audit, actuarial analysis, internal control, information management, innovation and technological transformation, change management, organization, societal issues and the legal and regulatory issues.

- ✓ The Executive Committee (ExCo) must have a deep knowledge and experience of the financial industry and of financial markets.
- ✓ The Executive Committee must have a deep knowledge and experience of KBC's strategy and business model, and of the banking and insurance activities which are developed within KBC-group.
- ✓ ExCo members must have the knowledge and experience to lead the KBC group and must possess strategic insight. They should have, depending on their position in the Executive Committee, the knowledge and experience relating to finance, risk management, compliance, audit, actuarial analysis, internal control, information management, innovation and technological transformation, change management, organization, societal issues and the legal and regulatory issues.
- ✓ ExCo members must have leadership skills in line with the KBC leadership model.
- ✓ ExCo members must have sufficient capacity to make independent judgment.
- ✓ ExCo members practise the values of the KBC group.

The process involves the following steps:

- ✓ The Nomination Committee discusses, assesses and advises the Board of Directors regarding the composition of the Board, its advisory committees and the composition of the Executive Committee.
- ✓ It discusses and proposes to the Board the required profile of new directors.
- ✓ It assesses the candidates.
- ✓ It assesses the fitness and propriety of the directors (in case of re-appointment) or of the candidate directors (in case of appointment) taking into account the regulatory requirements and the requirements referred to in the aforementioned policies. It conducts this assessment based on the files which are prepared for submission to the supervisory body. It presents its advice to the Board of Directors.

The Fit & Proper Policy for the Key Function Holders of KBC Group NV, KBC Bank and KBC Insurance includes the following requirements:

- ✓ The Key Function Holder must have the appropriate knowledge and experience for the corresponding position and with respect to the applicable legal framework and the direction of the institution, through education and training (diploma/on the job) or relevant work experience (in principle, three to five years is advisable).
- ✓ The Key Function Holder must act professionally and have sufficient guarantees to perform the job in a conscientious and independent manner, with specific attention being paid to independence (conflict of interests) and pastimes.
- ✓ The Key Function Holder must have specific competences, such as being client-centric and quality-focused, risk-minded, able to lead, loyal and stress-resistant.
- ✓ The Key Function Holder must be able to perform the job in an honest, dedicated, independent, ethical manner and with integrity.
- ✓ The Key Function Holder may not have been the subject of any of the listed forbidden convictions, or of criminal, civil or administrative convictions / disciplinary actions / penalty procedures / arrangements or settlements inappropriate to the standard of reliability that the person is required to meet.
- ✓ The Actuarial Function Holder should possess the ability to interpret the undertaking's financial and actuarial information, identify key issues, put in place appropriate controls and take necessary measures based on this information.

The process involves the following steps:

- ✓ The Corporate HR department discusses, assesses and gives advice to the Executive Committee regarding the appointment of a Key Function Holder.

- ✓ It discusses and proposes to the Executive Committee the required profile of the Key Function Holder.
- ✓ It assesses the candidates.
- ✓ It assesses the fitness and propriety of the Key Function Holders (in case of re-appointment) or of the candidate Key Function Holders (in case of appointment) taking into account the regulatory requirements and the requirements mentioned in the internal policies. It conducts this assessment based on the files which are prepared for submission to the supervisor.
- ✓ It presents its advice to the Executive Committee for approval.

3.2. Risk Management in the KBC Insurance group

3.2.1. Risk governance

Main elements in our risk governance model:

- ✓ The **Board of Directors**, assisted by the Risk & Compliance Committee (RCC), which decides on and supervises the risk appetite – including the risk strategy – each year. It is also responsible for the development of a sound and consistent group-wide risk culture, based on a full understanding of the risks the group faces and how they are managed, taking into account the group risk appetite.
- ✓ The **Executive Committee** – supported by activity-based risk committees – which is the senior management level committee for integrating risk management with risk appetite, strategy and performance goal setting.
- ✓ The **Risk Management Committee** and activity-based risk committees mandated by the 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 (Group CRO), local CROs, local risk functions and the group risk function. The risk function acts as (part of) the second line of defence, while Internal Audit is the third line.

Relevant risk management bodies and control functions:

1. Executive Committee:
   - ✓ makes proposals to the Board of Directors about risk and capital strategy, risk appetite, and the general concept of the risk management framework;
   - ✓ decides on the integrated and risk-type-specific risk management frameworks and monitors their 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 Assets & Liabilities Committee (Group ALCO);
   - ✓ monitors the group's major risk exposure to ensure conformity with the risk appetite.

2. Group ALCO (Asset & Liability Committee):
   - ✓ is a business committee that assists the Executive Committee in the domain of (integrated) balance sheet management at group level. It handles matters related to ALM and liquidity risk.

3. Risk committees:
   - ✓ The Risk Management Committee supports the 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 activity-based Group Risk Committees (for lending, markets and insurance, respectively) support the Executive Committee in setting and monitoring limits for these activities at group level. Liquidity and ALM issues related to these activities are addressed by the Group ALCO.
- ✓ The Group Internal Control Committee (GICC) supports the Executive Committee in monitoring and strengthening the quality and effectiveness of KBC's internal control system.

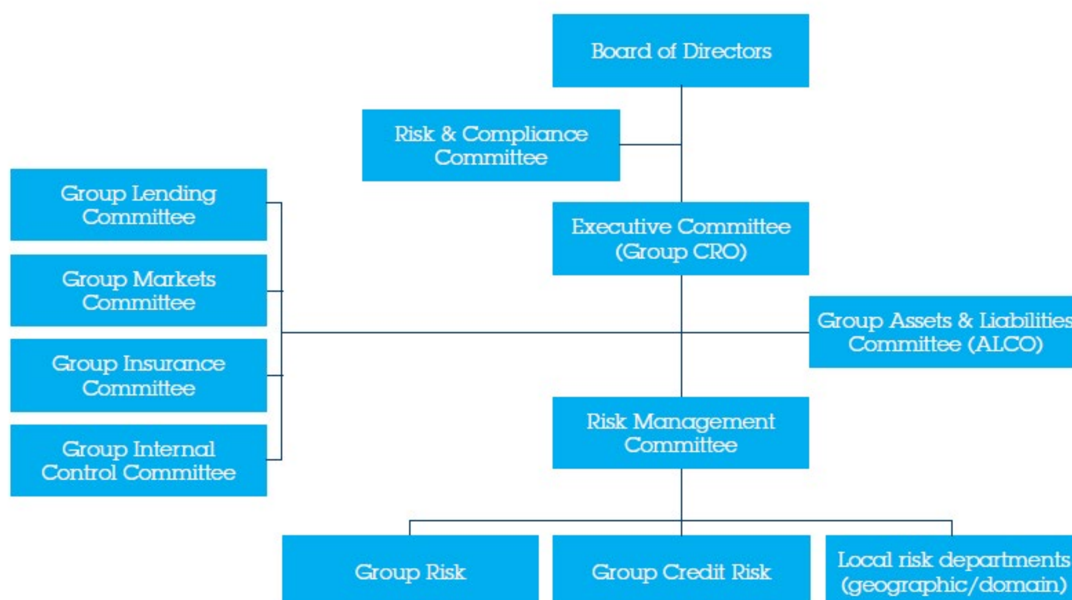
4. In order to strengthen the voice of the risk function and to ensure that the decision-making bodies of the business entities are appropriately challenged on matters of risk management and receive expert advice, KBC has deployed independent Chief Risk Officers (CROs) throughout the group according 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 and, if necessary, can exercise a veto. Independence of the CROs is achieved through a direct reporting line to the Group CRO.

5. Group Risk 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 typically developed by business), performing independent validations of all risk and capital models, developing risk frameworks and advising/reporting on issues handled by the Executive Committee and the risk committees.

6. When appropriate, dedicated working groups comprising risk and business-side representatives are set up to deal with emerging risks or unexpected developments in an integrated way (covering all risk types).

Performance is assessed on a yearly basis as part of the Internal Control Statement.

A simplified schematic of our risk governance model is shown below:



3.2.2. Risk Management Framework & building blocks

Risk management is a key component of the strategic management of KBC group. It aims to improve both KBC's risk resiliency and agility in a changing environment and refers to the coordinated set of activities to manage the many risks that can affect KBC group in its ability to achieve its objectives.

The KBC Risk Management Framework (KBC RMF) defines the standards for risk management, making sure that the risk management process is uniformly and qualitatively implemented throughout the whole of KBC group. As such the RMF also contributes to the establishment of a sound risk culture throughout the organisation. It is also the single point of entry for all documentation on the risk management process within KBC group. The risk management framework consists of following steps:

- ✓ Risk identification
- ✓ Risk measurement
- ✓ Setting and cascading risk appetite
- ✓ Risk analysis, reporting and follow-up

The KBC RMF finds it origin in KBC's overall risk strategy, as defined by the KBC Risk Appetite Statement (the amount and type of risk that KBC is able and willing to accept in pursuit of its strategic objectives). As such the risk appetite, which is formally approved on an annual basis by the Board of Directors (BoD), sets the bar for risk management throughout KBC. It consists of:

- ✓ A number of Risk-Type Specific Risk Management Frameworks that elaborate on the specific measures, methods, processes, tools … that are most suited for the particular risk type.
- ✓ An Integrated Risk Management Framework, which elaborates on the measures, methods, processes, tools used in the integrated cross-risk approach and also points to strategic and business risks.
- ✓ All frameworks refer to a number of generic, group-wide applicable risk concepts and tools/techniques which are an inherent part of the overarching risk management framework such as RMF lifecycle standards, risk map and risk appetite standards.

The KBC RMF is written from a group perspective and defines minimum standards that all entities within the group must adhere to. Group frameworks must therefore be implemented by local entities. Proportionality and materiality are important principles in risk management in general and in the implementation of the different elements of the RMF specifically. Each framework can therefore indicate where implementation might be adjusted on the basis of local conditions and proportionality/materiality (i.e. taking into account size, complexity of each entity).

Risk management within KBC group is organized both on a risk-type basis as well as on an integrated (cross-risk) basis. A comprehensive overview linking all risk (sub-)types to the different frameworks is provided in the KBC RMF Risk Scope. This document also includes the identification of the accountable Competence Centre for each risk (sub-)type. If a specific risk (sub-)type is not included in the scope of a framework, the responsible Competence Centre will elaborate on the motivation for such exclusion.

As the risk management landscape is in constant flux due to changes in internal as well as external contextual elements (industry trends, supervisory expectations and regulatory requirements, expectations of key stakeholders, organizational structure, …) the components of the KBC RMF are reviewed on a regular basis to ensure their ongoing effectiveness.

3.2.3. Own risk & solvency assessment

The KBC Insurance group and its insurance and reinsurance subsidiaries conduct an Own Risk and Solvency Assessment (ORSA) to monitor and ensure that business is managed in a sound and prudent way.

KBC's ORSA policy, which is reviewed on an annual basis, describes the general KBC approach to the ORSA process and its outcome. The ORSA policy describes the objectives and implementation of the ORSA within KBC, highlights its key underlying processes and the roles & responsibilities of the different stakeholders involved.

The ORSA is an integral part of the business strategy and is taken into account on an ongoing basis in the strategic decisions of the KBC Insurance group.

All insurance and reinsurance entities of the KBC Insurance group are covered by ORSA, but a differentiated approach is applied, based on the materiality of the entity. It is decided to conduct the ORSA assessments at the level of the KBC Insurance group and at the level of the individual material subsidiaries.

KBC's ORSA consists of numerous business and risk processes that together contribute to the objectives as set out in the ORSA policy. The reference points for the ORSA are the corporate strategy and the risk appetite objectives. The main processes underlying the regular ORSA are executed on an annual basis and are closely linked to the Strategic Planning Process (Alignment of Planning Cycle or APC) which also follows an annual cycle.

Taking into account the fact that KBC's insurance business is sufficiently mature, this annual periodicity is deemed adequate. The Executive Committee of KBC Insurance NVcan decide to perform an additional ad-hoc ORSA if:

- ✓ major deviations from the business plan (APC) are observed and/or;
- ✓ major changes to the group structure or group composition occur;
- ✓ reclassification of financial assets due to significant changes in the business model.

On a quarterly basis, integrated (insurance) risk reporting reports on: risk signals; the development of the risk profile; results of deep dives, stress & scenario testing. These reports are discussed up to the level of the Executive Committee and the Board of Directors and allow them to manage stress & scenario testing, request (ad-hoc) mid- and long-term risk assessments and review the underpinning ambition and approach.

The annual ORSA process assesses the situation and the data at 31 December and is submitted to the supervisory authority before 30 June of the following year. KBC does not differentiate between the internal and the supervisory ORSA report. Each ORSA report is complemented with an ORSA record which contains all the documents that have been used in the different steps of the ORSA.

Based on the outcome of the above processes and assessments, a conclusion is included in the ORSA report that will indicate to what extent the available capital is sufficient to cover the capital requirements. It will link this conclusion to the:

- ✓ changes in the amount and composition of available regulatory capital over the planning horizon and under different economic circumstances;
- ✓ changes in required regulatory capital over the planning horizon, taking into account expected changes to the risk profile of the entity/group;
- ✓ the impact of scenario analyses and sensitivities on required and available regulatory capital.

KBC relies on the Solvency II standard formula to assess its overall solvency needs. An assessment is performed on an annual basis to check whether the standard formula is appropriate in relation to the risk profile of KBC.

3.3. Other key functions of the KBC Insurance group

3.3.1. Actuarial Function

The Actuarial Function is one of the key control functions that is defined in the Solvency II regulatory framework. Solvency II requires an Actuarial Function to be installed in each insurance entity and at insurance group level. Basically, the task of such a function is to ensure that the company's Board of Directors or Supervisory Board is fully informed in an independent manner. It does this, for example, by:

- ✓ advising on the calculation of the technical provisions (including appropriateness of methodologies, appropriateness and quality of data used, experience analysis);
- ✓ expressing an opinion on the overall underwriting policy;
- ✓ expressing an opinion on the adequacy of reinsurance arrangements;
- ✓ contributing to the effective implementation of the risk management system (risk modelling underlying the SCR calculations, contributing to the ORSA process);
- ✓ reporting and giving recommendations to the supervisory body of the entity.

Implementation of the Actuarial Function:

- ✓ The Actuarial Function is ultimate accountable to the Board of Directors.
- ✓ An 'Actuarial Function Holder' is appointed for every local entity and also at KBC Group level. The Actuarial Function Holder is to be registered on the pay-roll of the entity he/she is representing. Her/his duties cannot be outsourced to a party outside the entity.
- ✓ The Actuarial Function Holder coordinates the activities of the Actuarial Function. In general, 'a function' is the administrative capacity to undertake particular governance tasks and is – as such - not limited to one specific person or one organizational unit, but can be assigned to several persons or departments subject to an adequate segregation of duties.
- ✓ The Actuarial Function's basic task is to provide the independent 'second pair of eyes' required for the Actuarial Function Holder to meet all the assigned obligations. The Actuarial Function provides input to the Actuarial Function Holder, including forming opinions, proposing recommendations and assisting in writing the Actuarial Function Report.

3.3.2. Compliance Function

With a view to centralisation, consistency and synergy, the Compliance Function of KBC Insurance NV is exercised by Group Compliance. Group Compliance plays a double role with regard to the domains within the scope of Compliance:

- ✓ An advisory role to support the business entities in implementing and applying requirements, setting up internal procedures and providing necessary training and awareness communication.
- ✓ A monitoring role by performing second-line controls on compliance with requirements.

An Intragroup Service Agreement has been drawn up defining the way this is organised.

Within the Compliance department, there are several technical units, each dealing with specific Compliance domains:

- ✓ Financial Markets, including the rules of conduct in distribution of insurance products and rules on making and providing information

- ✓ Consumer and Data Protection
- ✓ Corporate governance
- ✓ Embargo Management
- ✓ Anti-Money Laundering (AML) (including OFAC, the Know Your Customer part of FATCA and the Common Reporting Standard, the EU Regulation on information accompanying transfers of funds and tax fraud prevention), financing of terrorism and preventing the funding of the proliferation of weapons of mass destruction
- ✓ Ethics & Fraud

The AML and Ethics & Fraud domain are split between a Policy unit and an Investigations unit.

Both the governance of the Compliance function and its policies within scope, as defined by the Circular on the Compliance Function (Circular NBB_2012_14 d.d. 4 December 2012) , satisfy the relevant requirements. In section 5.4 on the Compliance function, NBB Circular _2016_31 (d.d. 5 July 2016 and the revised version d.d. 13 September 2018) regarding governance of the insurance sector confirms the position reflected in Article 55 of the Act of 13 March 2016 on the status and supervision of insurance and reinsurance undertakings, i.e. the Compliance function has to focus on integrity and codes of conduct.

Based on the same NBB Governance Circular, two specific additional tasks are included in the Compliance domain. An inventory of the Solvency II-related policies is being drawn up, and the structure of these policies is being put in place to ensure that at least its objectives are included in each policy, the tasks to be performed by the relevant person/function, the applicable reporting processes and the requirement to inform all risk-related and actuarial functions, where relevant. Additionally, Compliance has a coordination task and will check the comprehensibility, consistency and accuracy of governance topics *sensu stricto* in the RSR report. These governance topics include ownership, management structure, fit & proper policy, incompatibility of mandates, loans and insurance for managers, independent control functions, remuneration, conflicts of interest and outsourcing.

The legal department of KBC is charged with the task of following up laws and regulations and changes to them in the Solvency II context, as well as communicating to the businesses concerned.

It is key to ensure that crucial pieces of legislation, such as the 4th AML Directive, the GDPR, PRIIPS and IDD, falling under the Compliance domains, are adequately implemented by the businesses within the organisation in 2018-2019.

The Key Function Holder for Compliance at KBC Insurance is the CRO of KBC Insurance, who is also a member of the Executive Committee (ExCo). The Head of the Compliance function of KBC Insurance has a direct reporting line to this member and a functional line with the CEO of KBC Insurance. The Compliance reports are formally submitted every quarter to the ExCo and RCC of KBC Insurance.

Within Compliance, there is also a dedicated Coordinating Compliance Officer who is responsible for coordinating, supporting and following up matters in respect of the Insurance Products Directorate. The Head of Compliance ensures sufficient resources are provided by the department to deal with KBC Insurance. The ExCo of KBC Insurance decides on the annual Compliance plans and submits them to the RCC for confirmation. The Head of Compliance reports to and attends the quarterly meetings of the KBC Insurance RCC. A separate and specific Compliance Charter and Integrity Policy have been drawn up for KBC Insurance, describing the scope, tasks and responsibilities of every party involved at several levels of the organisation. There are two Compliance Risk Managers (CORM) at the level of Insurance Products, one for Life insurance and one for Non-Life insurance. They are not part of the second line of defence (Compliance), but instead are fully incorporated into the business entity. They are facilitators in

implementing and following up Compliance issues and, therefore, support the Senior General Manager and General Managers of Insurance Products in their responsibilities with regard to Compliance. The Insurance Products Coordinating Compliance Officer and the CORMs work closely together, have regular meetings and organise reporting to the business entities' management.

3.3.3. Audit Function

The internal audit function of KBC Insurance NV is exercised by KBC Group Corporate Audit. It is regulated by *NBB Circular NBB_2015_11*. The responsibilities of Internal Audit are:

- ✓ To provide independent assurance to the Board of Directors, the Audit Committee and the Executive Committee on the quality and effectiveness and efficiency of the processes of risk management, internal control and corporate governance that are in place.
- ✓ To support the Board of Directors, the Audit Committee and the Executive Committee in taking up their responsibilities in these processes.
- ✓ To report any serious issues or risks which it becomes aware of and to undertake any required investigations into high-risk situations (e.g. possible fraud, non-compliance with laws, internal guidelines or procedures).
- ✓ To make clear and actionable recommendations which address weaknesses noted during its work and to follow up on the implementation status of these recommendations.
- ✓ To co-ordinate the activities of other audit and review entities, including the Statutory Auditors and the Belgian and local Supervisors, to maximise the efforts of all such entities and to minimise unnecessary overlap and/or disruption. It will hold to this end regular meetings with the Statutory Auditors and with the Supervisors.
- ✓ To carry out any assignment or projects entrusted to it by the Board of Directors, the Audit Committee or the Executive Committee.

To safeguard its independence and objectivity:

- ✓ Internal Audit reports and is accountable to the Audit Committee.
- ✓ The internal audit activity remains free from interference by any part of the organisation, including matters of audit selection, procedures, frequency, timing or report content.
- ✓ The appointment and dismissal of the Head of Internal Audit comes under the authority of the Audit Committee.
- ✓ Internal auditors are, during the exercise of their professional duties, authorised to have direct communication with any member of staff, as well as to access all premises and any records, files or data that are relevant to the performance of an assignment, subject to compliance with local regulations. All members of staff are requested to assist Internal Audit in fulfilling its roles and responsibilities.
- ✓ Internal Audit has the authority to perform assignments on its own initiative in all entities, departments, establishments and functions within its scope, subject to proper reporting to the local Executive and Audit Committees.
- ✓ Internal Audit has the authority to inform directly, and on its own initiative, the Chairman of the Board of Directors or Supervisory Board of the audited entity, the Chairman of its respective Audit Committee, the members of its Executive Committee, its Statutory Auditors or the local Supervisory Authorities.
- ✓ Internal auditors must always be objective and impartial and seek to avoid any conflicts of interest.
- ✓ Internal auditors are not directly involved in the operational organisation of an entity, nor in deciding, developing, introducing or implementing risk management and internal control measures.
- ✓ Internally recruited auditors respect a cooling-off period.

- ✓ Whenever practicable and without jeopardising competence and expertise, internal audit staff will periodically rotate within the internal audit function to boost independence.

The scope of Internal Audit covers all entities, all activities and all divisions, including the various control functions, of KBC Insurance NV. To this end, Internal Audit will periodically – and at least once a year - examine and evaluate the areas within its scope. The audit plan is defined applying a risk-based approach while ensuring adequate coverage of matters of legal or regulatory interest. The audit plan is supplemented with a statement on the necessary resources to execute the plan. The audit plan is approved by the Audit Committee. Deviations from the audit plan must be reported to the Audit Committee at least once a year.

The approach followed in performing the audit assignments should be described in resulting audit reports so that their readers can consider the findings against the approach followed. A risk-based approach is used as the primary auditing method. The level of assurance, which may be gained from Internal Audit's work, is relative to the nature and extent of work carried out. It is therefore essential that the auditor involved, when giving a reasoned opinion, documents the nature and the extent of the work undertaken.

The implementation of the audit recommendations is the responsibility of line management, that will communicate the status of this follow-up regularly to Internal Audit, for monitoring purposes.

To facilitate a consistent approach to internal audit across all entities within the KBC Insurance group, the heads of local internal audit departments are accountable to their supervising Audit Committee and are steered by the Internal Auditor of KBC Group NV. The co-operation between the different internal audit departments is organised in a matrix structure where the competence-based axis intersects with the geographical responsibility axis.

The independence and objectivity of Internal Audit is assured by the KBC Insurance Internal Audit Charter approved by the Board of Directors. The Charter also described the functioning and organisation of the Internal Audit function.

3.3.4. Internal Control System

3.3.4.1. Three lines of defence concept

To continuously monitor and improve the Internal Control System within the KBC group, the three lines of defence concept is in place. The roles and responsibilities of the different parties within this concept are highlighted below.

- ✓ First line of defence: the **business side** assumes responsibility for managing its own risks.
    - o The business operations side is fully responsible for all the risks in its area of activity and has to ensure that effective controls are in place. In so doing, it ensures that the right controls are performed in the right way, that self-assessment of the business side is of a sufficiently high standard, that there is adequate awareness of risk and that sufficient priority/capacity is allocated to risk themes.
- ✓ Second line of defence: as independent control functions, the **Risk function** and **Compliance**, and – for certain matters – Finance, Legal and Tax, constitute the second line of defence.
    - o Independent of the business side, the second-line risk and control functions formulate their own opinion regarding the risks confronting KBC. In this way, they provide an adequate degree of certainty that the first-line control function is keeping these risks under control, without taking over primary responsibility from the first line. In this regard, the second-line functions are tasked to identify, measure and report risks. The risk function has a veto right to ensure that it is respected. The second-line risk and control functions also support the

consistent implementation of the risk policy, the risk framework, etc., throughout the group, and supervise how they are applied.

    - Compliance is an independent function within the KBC group, protected by its modified status (as described in the Compliance Charter), its place in the organisation chart (hierarchically under the CRO with a functional reporting line to the President of the EC) and its reporting lines (reporting to the RCC as the highest body and even to the Board in certain cases). Its prime objective is to prevent KBC from running a compliance risk or from incurring loss/damage – regardless of its nature – due to non-compliance with applicable laws, regulations or internal rules that fall either within the scope of the compliance function or within the areas assigned to it by the EC. Hence, the compliance function devotes particular attention to adherence to the integrity policy.

- ✓ Third line of defence: as independent third line of defence, **Internal Audit** provides support to the EC, AC, RCC and the Board in monitoring the effectiveness and efficiency of the internal control and risk management system.
    - Internal Audit provides reasonable assurance about whether the internal control and risk management system, including corporate governance and risk policy, are effective and efficient. As independent third line of defence reporting to the AC, it performs risk-oriented audits to this end and ensures that policy measures and processes are in place and consistently applied within the group to guarantee the continuity of operations.

3.4. Outsourcing

3.4.1. General outsourcing approach at the level of KBC group

KBC group has set the following strategic goals:

- ✓ KBC strives to offer its clients a unique bank-insurance experience;
- ✓ KBC develops the group with a long-term perspective and therefore achieves sustainable and profitable growth and respects solid risk, capital and liquidity boundaries;
- ✓ KBC puts clients' interests at the heart of everything it does and offers them a high-quality service and relevant solutions;
- ✓ KBC takes its responsibility towards society and local economies very seriously and aims to reflect that in its everyday activities.

The outsourcing approach of the KBC group is embedded in the above-mentioned cornerstones:

- ✓ KBC aims to maximise the retention and development of its internal knowledge of all aspects related to the bank-insurance model, as well as the related processes and activities.
- ✓ In particular, functions, processes, activities that include KBC-specific proprietary information, intellectual property rights, trade secrets, know-how creating a competitive market advantage for KBC over its peers ('Core KBC Know-How'), can never be outsourced to a third party, i.e. an entity outside the KBC group ('External outsourcing').
- ✓ To the extent that technological or economic developments justify the outsourcing of some activities, the KBC group strives for a maximal retention of knowledge and control of these activities. Therefore, the KBC group initially turns to the shared services centres (SSC) within the group ('Internal Outsourcing').
- ✓ In the event of outsourcing, KBC aims for the highest possible quality level in order to ensure and guarantee long-term objectives and clients' interests.

3.4.2. Outsourcing principles

The KBC group has an extensive policy on regulated outsourcing. This policy is similarly applicable to internal and external outsourcing. The policy describes the definition of outsourcing as applied within the group, a high level process description, group coordination and central notification, and the monitoring principles.

For every outsourcing file, an outsourcing coordinator has to be appointed. This coordinator has an internal notification duty to a group-wide coordinator. This notification is not only required for new files, but also for material changes in existing outsourced activities and for renewals.

The outsourcing entity is accountable for the risk assessment of an outsourcing initiative. The outsourcing entity is required to write a mandatory risk assessment, accompanied by mandatory advice from the control functions, covering *inter alia*:

- ✓ Operational risk (as described in the group-wide key controls and zero tolerances)
- ✓ Legal risk (possible legal showstoppers, provided by the (local) legal department)
- ✓ Compliance risk (provided by the (local) compliance function)
- ✓ (if applicable) The risks controlled by the actuarial function

Within the group strategy, KBC Insurance develops its own approach on outsourcing. Core values in this approach are client centricity (putting the clients' interest first), maximum synergy and efficiency and drawing on external expertise if this expertise excels internal knowledge or capacities.

A new outsourcing policy was approved in December 2018 and will as of now be applied on all new outsourcing contracts. The new policy also provides that in the event of a thorough change of an outsourced service the approval procedure will have to be repeated. Therefore it cannot be excluded that some existing contracts may evolve to critical in the future.

3.4.3. Intragroup outsourcing

As already stated in sections 3.3. and 3.4., a number of control and key functions of KBC Insurance are exercised at group level with a view to fostering centralisation, independence, consistency and synergy.

KBC Group provides the following functions on behalf of KBC Insurance:

- ✓ Audit
- ✓ Compliance
- ✓ Risk
- ✓ Finance
- ✓ Asset/Liability Management (ALM)
- ✓ ICT

All these activities are considered to be critical or important operational functions or activities for KBC Insurance.

In addition, KBC Insurance relies on other KBC entities for specific insurance-related tasks:

- ✓ The contact centre of VAB, a Belgian-based subsidiary of KBC Insurance, provides services related to insurance obligations, covering (non-medical) assistance to persons who encounter difficulties while traveling (includes their property or motor vehicles). VAB receives and adjusts claims, and also provides assistance on behalf of KBC Insurance.

- ✓ The Belgian-based contact centre of VAB registers claims notified by phone for other Non-Life insurance products. VAB provides primary advice to clients in the name and on behalf of KBC Insurance, and initiates the claims handling process in urgent cases.
- ✓ As regards Unit-Linked Life insurance policies, KBC Asset Management NV (Belgium) and KBC Asset Management SA (Luxembourg) provide services to KBC Insurance for setting up and managing Luxembourg- and Irish-based investment funds.

KBC Insurance also considers these activities to be critical or important operational functions or activities.

For completeness, KBC Insurance NV is supported by KBC Group for a number of non-core services (communication, procurement, Corporate HR, legal, …). In addition KBC Insurance NV nearshores a number of administrative tasks and activities towards the “Shared Service Centre” in Brno, a Czech branch of KBC Group NV. On the basis of their current nature and size, KBC Insurance NV does not consider these activities as critical.

3.4.4. Critical or important operational functions or activities outsourced

KBC Insurance entrusts its own operational tasks to insurance intermediaries as regards acceptance and claims handling for Non-Life insurance contracts. These activities are only entrusted to Belgian intermediaries, specifically for contracts in which the relationship with the client is maintained.

Outsourcing to tied agents is a standardised process. These agents may perform limited tasks related to the collection of insurance premiums, the settlement of claims (limited in scope) and the provision of green cards. Contracts outsourced to insurance brokers are handled on a case-by-case basis, and may include a wider range of tasks relating to contract management and claims settlement.

KBC Insurance uses the services of a number of Belgian-based, self-employed consulting physicians for specialised medical services (acceptance of certain types of Health and Life insurance, handling claims with complicated medical aspects).

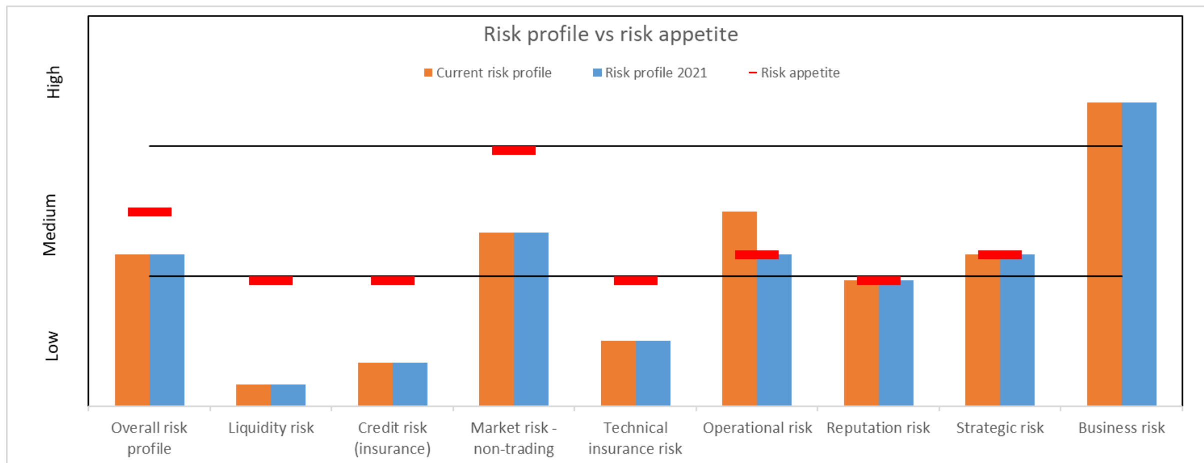
For second-pillar pension products, an external partner processes the annual statement of benefits.

Risk profile

4. Risk profile

KBC Insurance NV is exposed to a number of typical industry-specific risks such as movements in interest rates and exchange rates, insurance underwriting risk, credit risk, operational risks, etc

In this section, we focus on the most material sector-specific risks we face.



The KBC Insurance NV Risk Appetite Statement reflects the view of the Board of Directors and top management on risk-taking in general and in particular on the acceptable level and composition of risks in coherence with the desired return. This statement includes a specification of the risk profile and the risk appetite for each risk type into Low risk, Medium risk and High risk.

The overall risk appetite of KBC Insurance NV remains at the middle of the 'medium' risk appetite range, in line with the risk appetite expressed at KBC Group level. This is based on following elements, which reflect the main objectives of the risk appetite:

- ✓ KBC Insurance NV has a strong capital position: the Solvency II ratio is well above target, and is expected to remain so in the APC base and stress scenarios and under different challenges.
- ✓ Liquidity risk is well under control, as assets are matched with liabilities in terms of maturity, and a large amount of high quality bonds is available that can be used as collateral or in repo transactions.
- ✓ KBC Insurance NV has a stable performance: stability in earnings is pursued by diversification over client segments, products and distribution channels, and over fee and interest income. Volatility of earnings is limited by the reinsurance program.

Also for each risk type separately, the ambition level of the local management is in line with that at group level and the local risk appetite coincides with the risk appetite at group level.

Market risk, operational risk and strategic risk (all medium) remain important drivers in the risk profile of KBC Insurance NV. Since business risk is driven by external factors, no risk appetite is set for business risk. Given the high pace of change in the outside world and the challenging competitive and macro-economic environment, the uncertainty in which the entire industry operates is high. Therefore, the risk profile of business risk has been set to high.

The operational risk profile is assessed to be situated higher in the medium band than the risk appetite as the ongoing digitalization and transformation projects temporarily increase operational risk. As these projects are implemented, as well as other initiatives that were set up to reduce operational risks, the

operational risk profile is expected to be decreased over the coming years, in order to return within the risk appetite by 2021 and eventually into the low operational risk regime.

The risk profile of technical insurance risk is low thanks to the strong diversification within insurance underwriting, i.e. a wide range of insurance product-types that are offered to retail and small enterprises segments.

For more details see: https://www.kbc.com, for the 'Solvency & Financial Condition Report of KBC Insurance Group 2018'.

4.1. Underwriting risk

The 'underwriting risk' or 'technical insurance risk' stems from uncertainty regarding the frequency and severity of insured losses. 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.

Insurance risk is the risk that future claims and benefits cannot be covered by the premium and investment income. Or, the insurance liabilities are not sufficient because the assumptions made and used in determining the best estimate liability differ from the future expenses, claims and benefits.

Insurance risk can be seen in Life, Non-Life and Health portfolios.

To reduce and contain the volatility of results, mitigating measures are used. Risk mitigating also helps to decrease the possible negative impact on value as an alternative for the capital requirement. Proper pricing, underwriting, reinsurance, claims management and diversification are the main mitigating actions for insurance risks. One of the most important elements of the risk profile is KBC Insurance NV's nature as a diversified retail insurer. As such, KBC Insurance NV can rely on a broad client, product and intermediary base to absorb risks at different levels. This is realised by:

- ✓ offering a broad product range, including all important Life and Non-Life products;
- ✓ focusing on retail clients, providing services to a large number of private persons, Small and Medium-Sized Enterprises (SMEs) and the self-employed;
- ✓ operating through digital channels, KBC Live and tied agents, who deal exclusively with KBC Insurance NV, hence, all policies clients serviced by a KBC agent are placed with KBC Insurance NV;
- ✓ being active in the full Belgian territory through a fine-meshed network, that also comprises the KBC bank branches.

These elements result in diversification, geographically as well as over a large number of clients, different branches and products.

KBC Insurance NV holds a solvency buffer to cover the risk that claims may exceed the available insurance provisions and to ensure its solidity. In order to comply with the requirements set by the regulator, solvency ratios are monitored on a monthly basis.

4.1.1. Life risk

The products sold are insurance products, in cash or unit-linked contracts. For cash products, the investment risk is fully borne by the insurer.

The insurance risks involved are:

- ✓ **Mortality risk**:
  Mortality risk pertains to the (re)insurance obligation, such as endowment or term assurance policies, where a payment or payments are made in case of the policyholder's death during the term of the contract. An increase in mortality rates is applied to the obligations pertaining to mortality risk.
  The required capital for this risk is calculated according to article 52 of the European delegated regulations 2015-35. It comes down to calculating the impact on basic own funds following an instantaneous permanent increase of 15% in the mortality rates used for the calculation of the best estimate.
- ✓ **Longevity risk:**
  Longevity risk is associated with the (re)insurance obligation where payments are made until the policyholder's death and where a decrease in mortality rates results in higher provisions.
  The required capital for this risk is calculated as the change in own funds using a permanent decrease of mortality rates by 20%. The decrease in mortality rates is applied to those portfolios where payments are contingent on longevity risk.
- ✓ **Disability – morbidity risk:**
  Disability or morbidity risk is associated with all types of insurance compensating or reimbursing losses (for example loss of income, adverse changes in the best estimate of the liabilities) caused by changes in the disability or morbidity rates.
  The required capital for this risk is calculated using an increase of 35% in disability rates over the next year and 25% in subsequent years, combined with a decrease in recovery rate of 20%.
- ✓ **Expense risk:**
  Expense risk is the risk that the cost of expenses is more than anticipated.
  The required capital for this risk is calculated using a permanent increase in costs of 10% and an increase in the cost inflation of 1% per year. In case of policies with adjustable costs, realistic management actions are taken into account.
- ✓ **Lapse risk:**
  Lapse risk is the risk of losses (or adverse changes in the best estimates of the pertaining liabilities) due to higher or lower policy lapses that were not anticipated, changes to premium payments and surrenders.
  The required capital for this risk is calculated as the maximum of the results in case of a permanent increase in lapse rates of 50%, a permanent decrease of 50% in lapse rates or a mass lapse event. The latter comes down to a lapse of 70% of the insurance policies in collective pension funds or 40% of the remaining insurance policies. The mass lapse is only applied to portfolios where this leads to a higher best estimate.
- ✓ **Revision risk:**
  Revision risk is 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.
- ✓ **Life catastrophe risk:**
  Catastrophe risk arising from extreme events which are not covered by the other Life insurance risks, such as the pandemic threat of bird flu or accidental events.
  The required capital for this risk is calculated using 1.5 per mille increase in mortality rates for the (re)insurance obligations where the increase in mortality rates leads to an increase in technical provisions.

For technical Life insurance risk, the focus is on controlling the volatility of the risk result around its expected average value. The risk insurance covers provide a stable income flow against the more volatile interest

income from the savings part of the portfolio. Life insurance risk is qualified as ‘low’, as it was also the case last year.

4.1.2. Non-Life Insurance risk

The Non-Life insurance risks can be divided into two main types, i.e. catastrophe risks and non-catastrophe risks. Non-Life non-catastrophe risks cover premium risk, reserve risk and lapse risk related to Non-Life insurance contracts.

The overall underwriting policy of KBC Insurance NV is guided by the principle of ‘profitable’ growth. This principle is reflected in the Risk Appetite Statement, in the objectives set on growth and profitability in the annual planning cycle (APC) as well as in the underwriting process and procedures.

To achieve its objectives, KBC Insurance NV mainly aims at the segments of private persons, the self-employed and small enterprises (retail + Small to Medium Enterprises (SME)). Underwriting is selective and based on the combination client, sector and risk profile, with specific attention on the gravity risk.

KBC strives for a balanced proportion between its retail and SME portfolio on the one hand and its midcap and corporate portfolio on the other.

KBC Insurance NV is a multi-line insurer who is not active in the lines of business railway rolling stock, aircraft, ships (sea, lake and river and canal vessels), aircraft liability and liability for ships (sea, lake and river and canal vessels). Neither is KBC active in credit and surety ship insurance and it takes a reserved position in markets dominated by niche players such as a number of specific professional liability insurances.

The most important consideration for technical insurance risk Non-Life is the stability of the technical result and the robustness under stressed circumstances. The underpinning of the risk profile assessment is based on the volatility of the claims according to the Insurance Portfolio Model (IPM), a summary metric related to the stability of earnings under stress. With the IPM, the value of the claims experience (net of reinsurance) that is exceeded once every ten years can be determined. The risk profile is considered ‘low’ if the one in ten years claims experience plus costs is still lower than the net premium income. For KBC Insurance NV, calculations show that this stressed combined ratio is well below 100%.

Taking also into account:

- ✓ the stable and low combined ratio of KBC Insurance NV (in Bgaap: 86,5% at the end of 2018, 88.5% at the end of 2017 and 92.4% at the end of 2016);
- ✓ the limitation of the volatility of the technical result by the reinsurance cover bought;
- ✓ KBC’s nature as a diversified retail insurer as described above.

It is concluded that KBC Insurance NV has a low risk profile for Non-Life insurance risk.

4.1.3. Health Insurance risk

The Health insurance portfolio can be divided into Health SLT (‘similar to life techniques’) and Health NSLT (‘non similar to life techniques’).

The Health SLT Risk

This risk is applicable to the Health SLT portfolio.

The required capital of this risk is scenario-based. The scenarios are similar to the scenarios that are used to calculate the Life insurance risk, i.e.:

- ✓ **Mortality Risk:**
  Mortality risk pertains to the (re)insurance obligation, such as endowment or term assurance policies, where a payment or payments are made in case of the policyholder's death during the term of the contract. An increase in mortality rates is applied to the obligations pertaining to mortality risk.
  The required capital for this risk is calculated based on the impact on basic own funds following an instantaneous permanent increase of 15% in the mortality rates used for the calculation of the best estimate (for all ages and each policy).
- ✓ **Longevity risk:**
  Longevity risk is associated with the (re)insurance obligation where payments are made until the policyholder's death and where a decrease in mortality rates results in higher provisions.
  The required capital for this risk is calculated as the change in own funds using a permanent decrease of mortality rates by 20%. The decrease in mortality rates is applied to those portfolios where payments are contingent on longevity risk.
- ✓ **Disability – morbidity risk:**
  Disability or morbidity risk is the main risk of the Health SLT portfolio. It is associated with all types of insurance compensating or reimbursing losses (for example loss of income, adverse changes in the best estimate of the liabilities) caused by changes in the disability or morbidity rates.
  The required capital for this risk is calculated using an increase of 35% in disability rates over the next year and 25% in subsequent years, combined with a decrease in recovery rate of 20%.
- ✓ **Expense risk:**
  Expense risk is the risk that the cost of expenses is more than anticipated.
  The required capital for this risk is calculated using a permanent increase in costs of 10% and an increase in the cost inflation of 1% per year. In case of policies with adjustable costs, realistic management actions are taken into account.
- ✓ **Lapse risk:**
  Lapse risk is the risk of losses (or adverse changes in the best estimates of the pertaining liabilities) due to higher or lower policy lapses that were not anticipated, changes to premium payments and surrenders.
  The required capital for this risk is calculated as the maximum of the results in case of a permanent increase in lapse rates of 50%, a permanent decrease of 50% in lapse rates or a mass lapse event. The latter comes down to a lapse of 70% of the insurance policies in collective pension funds or 40% of the remaining insurance policies. The mass lapse is only applied to portfolios where this leads to a higher best estimate, which is the case for the Health SLT portfolio.

The Health NSLT Risk

This risk is applicable to the Health NSLT portfolio and includes the following sub-risks:

- ✓ **Premium Risk:**
  The premium risk is the risk that the premium that will be earned next year will not be enough to cover all liabilities resulting from claims in this portfolio, due for instance to the fact that the number of claims will be higher than expected (frequency problem) or the severity of the claims will be higher than expected (severity problem).
  The required capital of the premium risk is calculated over the maximum of the expected written premium of the next year and the written premium of the current year.

- ✓ **Reserve risk:**
  The reserve risk is the risk that the liabilities stemming from claims, which have occurred in the past, but still have to be finally settled, will turn out to be more expensive than expected.
- ✓ **Health catastrophe risk:**
  The required capital is calculated for policies for which an increase in mortality rates or morbidity rates or disability rates leads to an increase in the best estimate.
  There are three scenarios which are calculated for all the Health SLT and Health NSLT portfolios.

  - *Scenario 1 Mass accident:* This scenario comprises the following elements: an accident takes place during a major public event. The risk is that 10% of the attendees are killed, 1.5% are disabled permanently, 5% are disabled for ten years, 13.5% are disabled for one year and 30% of the attendees need medical attention.

  - *Scenario 2 Concentration accident:* This scenario comprises the following elements: most of the insured of KBC are at the same location. The risk is that 10% of the attendees are killed, 1.5% are disabled permanently, 5% are disabled for ten years, 13.5% are disabled for one year and 30% of the attendees need medical attention.

  - *Scenario 3 Pandemic scenario:* This scenario comprises the following elements: 1% of those affected must be hospitalised and 20% need to see a local practitioner.

For Health insurances, the one in ten year claim experience variation is still very low.

Furthermore an important risk for KBC Insurance NV is posed by the Health Insurance products with ageing reserves. For Health insurance products, the risk premium increases significantly with age. To keep the premiums affordable to the client, a fixed premium is charged instead of the actual risk premium. At younger ages, this fixed premium is higher than the risk premium and the excess premium is used to build up ageing reserves. At higher ages, the increasing premium is paid partially from this reserve. The calculation of the ageing reserve takes into account the expected evolution of numerous parameters, such as the costs of hospitalisation and care for the elderly, claims frequency, mortality rate, lapses, yield curve, …. The evolution of these parameters is very uncertain, and the term of the products is very long. Hence, small parameter changes can have a very big effect.

4.1.4. Reinsurance

Besides strict underwriting guidelines that should guarantee sound underwriting, reinsurance is bought to support the strategic objectives as formulated in the Risk Appetite Statement.

The insurance portfolios are protected against the impact of large claims or the accumulation of losses (risk concentration) by means of reinsurance contracts. 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 large claims or loss events.

Major reinsurance programmes on the property and liability of KBC direct insurance companies are centralised via KBC Group Re. These reinsurance programmes are re-evaluated and renegotiated every year.

We are convinced that the reinsurance program of KBC Insurance NV is appropriate. The highest risk is that the risks which are excluded in the reinsurance contract will be insured in the direct policy. The process

to be followed in case of product development or product change, e.g., the New and Active Product Process, mitigate this risk. For an adaptation of the conditions in a specific policy, stringent acceptation rules and competence levels for deciding and executing this exist, but human error can never be excluded.

To protect KBC Insurance NV from important changes in loss ratio due to an exceptionally high number of medium and large claims, a multi-line program was subscribed.

4.1.5. Conclusion

Combining the qualitative and quantitative assessments of the Life, Non-Life and Health technical insurance risks results in a 'low' risk profile, as it was the case last year.

Going forward, sufficient attention has to be paid to the risk profile to monitor whether the implementation of KBC's strategy will cause a deterioration of the current risk profile.

- ✓ KBC has the ambition to grow strongly in a saturated market, which may put pressure on profitability.
- ✓ More focus is being put on the entrepreneur market, which is inherently more risky.
- ✓ Preparing for the online customer and his behavior (changing focus, price comparison online) requires reduction of administration and that a competitive tariff is put forward immediately.

4.2. Market risk

Market risk is the risk of potential losses due to adverse movements in financial market variables. Market risk exposure can be measured by the impact of the (adverse) movements in the financial variables.

The process of managing our 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).

Managing the ALM risk on a daily basis starts with risk awareness at Group Treasury and the local treasury functions. The treasury departments measure and manage interest rate risk within the playing field defined by the Risk Appetite Statement.

4.2.1. Interest rate risk

One of the most important risks for insurance companies in the current economic low yield environment is interest rate risk.

The negative impact of low yields on the available capital is rather straightforward, given the longer duration of the liabilities versus the assets and the increased impact of the convexity effect[5] following from these persistent low yields.

The main technique used to measure interest rate risks is the 10 BPV (Base Point Value) method, which measures the extent to which the value of the portfolio would change if interest rates were to go up by ten basis points across the entire swap curve (negative figures indicate a decrease in the value of the portfolio). We also use other techniques such as gap analysis, the duration approach, scenario analysis and stress testing (both from a regulatory capital perspective and from a net income perspective).

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[5] Relatively speaking, a parallel 10 base point shock to the interest curve is more significant when interest rates are lower. Therefore, the existing increase in interest rate sensitivity, measured by the BPV, is not necessarily a consequence of actively assuming more interest rate risk.

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 cash-flow-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 included here, since this activity does not entail any market risk for KBC.

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

In 2018, the trend towards lower guaranteed interest rates continued. Since older contracts with high guaranteed rates are maturing and being replaced with new contracts or additional savings premiums at a lower guaranteed rate, we expect this trend to continue.

4.2.2. Credit spread risk

We manage the credit spread risk for *inter alia* the sovereign portfolio by monitoring the extent to which the value of the sovereign bonds would change if credit spreads were to go up by 100 basis points across the entire curve.

4.2.3. Currency risk

KBC Insurance NV pursues a prudent policy with regard to currency exposure, essentially seeking to avoid currency risk. Foreign exchange exposures are hedged if material. Equity holdings in non-euro currencies that are part of the investment portfolio are not hedged and the volatility stemming from foreign exchange evolutions are seen as equity risk.

4.2.4. Equity risk

The ALM strategies for the insurance business are based on a risk-return evaluation, account taken of the market risk attached to open equity positions.

In the total equity portfolio, most 'investments in funds' are treated on a 'look-through' basis (according to the underlying asset mix of the fund and therefore also partially classified as 'fixed-income instruments').

4.3. Credit risk

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), 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.

We manage our credit risk at both the transactional and the 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 are set to determine the maximum credit exposure allowed and the level at which acceptance decisions are taken.

Managing the risk at the 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 and taking risk-mitigating measures.

4.4. Liquidity risk

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

The principal objective of our liquidity management is to enable the core business activities of the group to continue to generate revenue, even under adverse circumstances.

The nature of liquidity risk of insurance entities is not comparable to that of banking entities, mainly because of the different structure of the asset/liability profile. Banking activities normally have to cope with assets that have longer durations than the corresponding liabilities. Insurance activities typically have assets that are shorter and much more liquid than the corresponding liabilities. Insurance liabilities are rather stable and illiquid.

KBC has developed a Liquidity Risk Management Framework for Insurance entities (LRMF-I). This should allow for an enhanced risk management practice including identification, measurement, reporting and response and follow-up on liquidity risk for Insurance entities.' For insurance entities, the distinction is made between liquidity risk of Life and Non-Life insurance activities.

4.4.1. Non-Life liquidity risk

Within Non-Life insurance business, liquidity risk could arise if a catastrophe (e.g., a natural disaster) would take place leading to huge claims and, consequently, large cash demands. There are some reasons, however, why this risk exposure differs materially from the liquidity risk to which Life insurance businesses are exposed to. The cash outflows will typically take place over a longer time horizon (i.e., assessment of damage, legal procedures, etc.) and certain claims are covered by re-insurance contracts.

KBC's reinsurance policy states that sufficient claims payment clauses have to be negotiated to ensure that the risk related to a timing mismatch between claims' payments and reinsurance recoverable is restricted as much as possible. More specifically, reinsurance contracts should include provisions allowing to make a request for immediate claim payment for large losses outside the usual accounting periods ('cash loss' clauses). In order to follow up on these (remaining) risks, the (re)insurance exposure point risk will be assessed in the near future. Furthermore, the worst-case exposure to liquidity risk will be analysed including the impact of re-insurance versus the default of re-insurance counterparties under a specific scenario and the quantity and quality of the options to cover outflows in the above scenario (e.g., liquid asset buffer, liquidity lines received, etc.).

4.4.2. Life liquidity risk

Life business consists of long-term pension business and medium-term savings business. Life insurance business might be confronted with liquidity risk as a result of:

- ✓ changing market circumstances (e.g., movement in rates, competition, etc.) leading to a surge in early redemptions;
- ✓ changing regulatory environment (e.g., change in beneficial tax regime) leading clients to switch to other non-insurance products (market-wide scenario);

- ✓ an idiosyncratic scenario where clients question the insurance company's credit worthiness and build down their exposure;
- ✓ a pandemic-like scenario;
- ✓ a combination of the above.

These scenarios could result in a mass lapse of the portfolio. In all of these scenarios, the insurance company should have an adequate liquidity buffer (cash, liquid assets, contingent credit lines, etc.) to cope with these cash outflows. Except for the idiosyncratic scenario, the time horizon in which the cash flows will take place, is expected to be rather long (i.e., longer than one month) hence decreasing the risk of not being able to meet the liabilities at an acceptable cost (e.g., the market value of the assets will be lower than normally expected in the event of idiosyncratic stress situations). The liquidity risk of Life insurance activities will be assessed by an internal stress-test ratio as defined in the LRMF.

Especially in the case of KBC Insurance NV, clients will not benefit from their fiscal advantage in case of early surrender. Surrender risk is therefore partially mitigated through fiscal rules.

4.4.3. Contingent liquidity risk

Liquidity risk can also arise from off-balance sheet exposure at the insurance entities. Collateral agreements for derivative and non-derivative transactions could give rise to liquidity risk when it is required to post additional collateral in adverse market circumstances. These contingent outflows will materialise in the portfolios where the transactions are concluded. However, the off-balance sheet exposure that could give rise to liquidity risk in stressed market circumstances, is rather limited for KBC Insurance NV.

4.5. Operational risk

Operational risk is the risk of loss resulting from inadequate or failed internal processes and systems, human error or sudden external events, whether man-made or natural. Operational risks include non-financial risks such as information and compliance risks, but exclude business, strategic and reputational risks.

The operational risk profile is put at medium based on the forward-looking assessment of a number of key domains of operational risk. The elements that are taken in account when evaluating the different aspects of the operational risk profile are prerequisites to keep the operational losses at a low level on the long term. The key domains are:

- ✓ Process & Product risk
- ✓ People risk
- ✓ Outsourcing risk
- ✓ Cyber & Information risk
- ✓ Business continuity & Disaster recovery risk
- ✓ IT risk

The management assesses that sufficient measures are being taken to mitigate existing risks, but that the risk profile is in the medium range due to new and upcoming risks in the digital era, for which controls and risk management have to be developed. Positive evolutions resulting from various initiatives and projects already resulted in the mitigation of operational risks, and will be further supported by other initiatives in order to reduce the risk profile to within the boundaries of the Risk Appetite Statement.

4.5.1. Internal Control Environment

The strength of the internal control environment, based on a self-assessment by business and challenged by second-line functions, is stated in the Internal Control Statement (ICS).

The Non-Life insurance segment is well controlled and subject to limited improvements only. For Life insurance segment substantial improvements are required in domains with high degree of manual processes (mainly situated in the area of group insurances). Several actions were put in place during 2018 in order to tackle this issue.

This opinion is based on the evaluation of the opinions of the businesses and local Risk Department per process, the evaluation of the review by the Audit Department, as well as the evaluation of the controls in the domains covered by the Compliance Department.

4.5.2. Cyber risk

A lot of improvements have been made to improve the security resilience in 2018. Still the cyber risk environment keeps changing, e.g. the number of phishing attempts is clearly growing and sector is struggling with increased cyber security threats.

Hence cyber remains an important point of attention which requires the continuation of risk mitigating initiatives.

4.6. Other material risks

4.6.1. Concentration risk

Concentration risk has traditionally been analysed in relation to lending activities. However, this constitutes an overly strict interpretation of the concept ‘concentration’, seeing that concentration risk refers to all significant interrelated exposures which, in cases of distress in a particular market, industry, country, etc., may negatively impact the financial stability of an institution. It consequently does not only pertain to, for instance, excessive lending to a multinational or a particular sector, but also to relying too much on a single supplier of services or on a specific source of funding (which makes a company vulnerable to a single event or a single factor). Concentration risk also covers the case where we generate too much of our income from a single market segment or have outsourced all of our IT processing to a third party.

Concentration risk has to be looked at from both a ‘risk type’ point of view (concentrations within a single risk type category or intra-risk concentrations) and across risk types (inter-risk concentrations). The latter refers to risk concentrations that can arise from interactions between different risk exposures across different risk categories. The interactions between the different exposures may stem from a common underlying risk factor or from interrelated risk factors. We monitor the largest risk concentrations in the different risk types via periodic and ad hoc reports and by performing stress tests.

4.6.2. Business risk

Business risk is the risk arising from changes in external factors (the macroeconomic environment, regulations, client behaviour, etc.) that impact the demand for and/or profitability of our products and services.

Business risk is an inherent consequence of being in business. Hence, business risk is driven by external factors and no risk appetite is set for business risk. The main elements considered for business risk are:

- ✓ The rise of new technologies, changing customer behavior, consumer protection regulation and a distribution landscape that is more and more becoming digital pose new opportunities and threats. These elements may lead to disintermediation by putting pressure on the classic distribution model where the distributor builds up a strong relation with his customer. Key for the insurance industry is the ability to adapt to a rapidly changing world with multiple factors that challenge the business model.
- ✓ The continued low interest rate environment weighs on the profitability of the Life insurances, despite that interest rates slightly improved compared to their lowest point. Low bond yields make it very difficult to offer an attractive proposition to new clients, and also put the yields of reinvestment of maturing assets that cover existing contracts under pressure. The resulting search for yield and the abundant liquidity in the market drives up the prices of assets and causes risk premiums to decrease, leading to concerns whether risks are still adequately rewarded and the fear for asset bubbles.
- ✓ Different geopolitical factors, such as trade wars, the uncertain outcome of the Brexit, Italian budget discussions, … will continue to add uncertainty to the financial markets and may weigh on economic growth.

Given the high pace of change in the outside world and the challenging competitive and macro-economic environment, the uncertainty in which the entire industry operates is high. Therefore, the risk profile of business risk has been set to high.

4.6.3. Strategic risk

Strategic risk is the risk due to not taking a strategic decision, taking a strategic decision that does not have the intended effect or not adequately implementing strategic decisions.

KBC’s management is of the opinion that strategic risk remains constant situated low in the medium band, and stays within the boundaries of the Risk Appetite Statement. KBC has sound processes to monitor evolutions in the outside world and identify the potential threats to our business model; and to respond to these by means of the strategy. Processes regarding strategic risk management are strong and awareness about the challenges for the insurance business is high. Business is acting on these challenges to its business model by means of its strategy.

A point of attention for the execution of the strategy is that it requires the implementation of several transformation and digitalization projects, while simultaneously a large amount of regulation that is issued by different parties has to be implemented as well. All these projects draw from the same, limited pool of expert resources; and have to be absorbed by the existing organization, on top of the business as usual. Business has to match these new developments to a complex IT infrastructure that has been developed and built upon over time.

The regulation mentioned earlier impacts the business of insurers in many ways:

- ✓ Regulation regarding consumer protection and privacy implies a large change for distribution channels.
- ✓ Regulation w.r.t. cost transparency in insurance distribution reinforces the rise of online sales and may put additional stress on margins.
- ✓ The preservation of a level playing field between classic insurers and fintech based companies is of utmost importance to the sustainability of the business model. Existing legislation will have to be adapted to take the new possibilities offered by the digital economy into account.

4.6.4. Reputational risk

Reputational risk is the risk arising from the negative perception on the part of clients, 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).

Reputational risk is mostly a secondary or derivative risk since it is usually connected to and will materialise together with another risk. We refined the Reputational Risk Management Framework in 2016, in line with the KBC Risk Management Framework. The pro-active and re-active management of reputational risk is the responsibility of the business, supported by many specialist units (including Group Communication and Group Compliance).

The reputation of KBC is one of the main assets of the company. To manage reputational risks, which are often secondary in nature, KBC sets a strict risk appetite on all its risks, promotes corporate social responsibility, aims for sustainable growth and actively manages incidents if they happen.

Reputation risk remains on the same level as last year and remains within the boundaries of a low risk appetite. It cannot be underpinned through a metric and this assessment is the result of expert judgment.

Under the pillar 2 approach to capital, the impact of reputational risk on the current business is covered in the first place by the capital charge for primary risks (including credit or operational risk).

4.7. Any other information

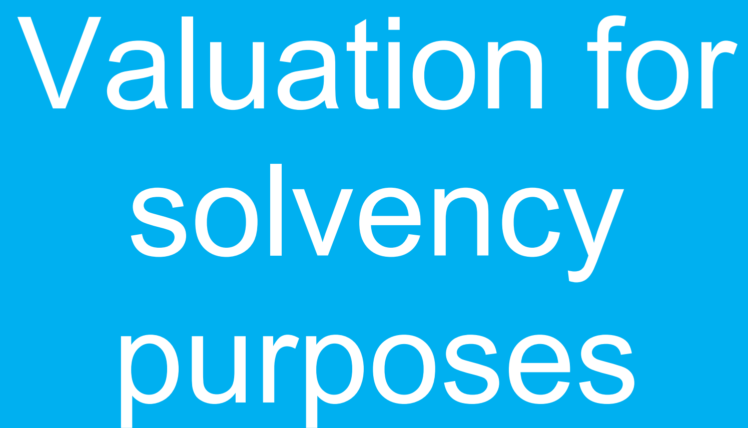
4.7.1. Sensitivity analyses and stress testing

Risk-sensitivity and stress-testing exercises are set up to uncover risks that otherwise stay unidentified and also allow us to observe how risk measurements would evolve under stressed conditions. These sensitivity exercises are performed on a regular basis.

Sensitivity analysis reveals that the sensitivity of the Best Estimate to the interest rate curve is much higher than the sensitivity to the different non-economic parameters (such as mortality, longevity and lapses).

Stress testing is an important risk management tool that adds value both to strategic processes and to day-to-day risk management (risk identification, risk appetite, limit setting, etc.). As such, stress testing is an integral part of our risk management framework, and an important building block of the ORSA (Own Risk and Solvency Assessment).

Stress tests are initiated by the regulator (EIOPA or local regulators) on a regular basis or are performed internally within the insurance group or at the local entity level. KBC also performs ad-hoc integrated stress tests to test its vulnerability for specific risks and potential adverse conditions that may arise.


Valuation for solvency purposes

5. Valuation for solvency purposes

The following table provides both the Solvency II value used in the economic balance sheet and the statutory accounting (Bgaap) value for each material class of assets and liabilities. A description of how this value is determined can be found in the sections below.

A more detailed composition of the Solvency II values can be found in the QRT S.02.01.02 regarding the Balance Sheet.

Economic balance sheet (31/12/2018 - in millions of EUR)	Solvency II value	Statutory accounts value Bgaap	Difference
Property (other than for own use)	228,7	133,4	95,3
Holdings in related undertakings, including participations	1 177,6	844,6	333,0
Equity instruments	1 147,5	998,1	149,5
Bonds	16 000,2	14 648,3	1 351,9
Derivatives	2,5	1,6	0,9
Deposits other than cash equivalents	583,0	454,2	128,8
Assets held for index-linked and unit-linked contracts	12 621,9	12 621,8	0,0
Loans and mortgages	2 467,7	2 286,5	181,2
Reinsurance recoverables	93,8	107,4	-13,6
Own shares	203,2	203,2	0,0
Other	424,6	419,2	5,3
Total assets	**34 950,7**	**32 718,4**	**2 232,3**
Technical provisions – Non-life	1 637,5	2 418,5	-781,0
Technical provisions - Life (excluding index-linked and unit-linked)	14 924,4	13 964,3	960,0
Technical provisions – Index-linked and unit-linked	12 655,7	12 773,9	-118,2
Pension benefit obligations	59,0	0,0	59,0
Deferred tax liabilities	247,0	2,5	244,5
Derivatives	42,8	8,9	33,9
Other	1 922,6	2 181,9	-259,3
Total liabilities	**31 488,9**	**31 349,9**	**139,0**
Excess assets over liabilities	**3 461,8**	**1 368,5**	**2 093,3**

The table below gives a clear overview of how the Bgaap value for ‘excess assets over liabilities’ is reconciled with the Solvency II value for ‘excess assets over liabilities’. The following parts of this section provide a more detailed view on the underlying methodological differences (in m EUR).

Statutory equity	1 368,5
Valuation differences between BGAAP and Solvency II	
of which : valuation difference real estate at fair value (after tax)	71,5
of which: valuation difference participations	333,0
of which : valuation difference fair value equity	149,5
of which : valuation difference fair value bonds (after tax)	1 013,9
of which : valuation difference fair value L&R (after tax)	232,5
of which : valuation difference reinsurance recoverables (after tax)	-10,2
of which : valuation difference technical liabilities (after tax)	-159,7
of which : volatility adjustment	171,1
of which : other	291,8
Assets over liabilities Solvency II	**3 461,8**

5.1. Assets – material classes of assets

5.1.1. Solvency II value

5.1.1.1. Goodwill

Goodwill should be valued at zero (Delegated Regulation (EU) 2015/35, Art. 12).

5.1.1.2. Deferred taxes

Deferred taxes, other than deferred tax assets arising from the carry forward of unused tax credits and the carry forward of unused tax losses, are valued on the basis of the difference between the Solvency II values and the values ascribed to assets and liabilities as recognised and valued for tax purposes (Delegated Regulation (EU) 2015/35, Art. 15). (See also 5.3.1.1 – Deferred taxes – Liability side).

5.1.1.3. Bonds, Equity Instruments, Loans & mortgages and derivatives

- ✓ For Solvency II purposes, 'Bonds', 'Equity instruments' and 'Loans & mortgages' are valued at the amount for which they could be exchanged between knowledgeable willing parties in an arm's length transaction. This definition is in line with the IFRS definition of fair value.
- ✓ KBC defines 'fair value' as 'the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date'. Fair value is not the amount that an entity would receive or pay in a forced transaction, involuntary liquidation or distress sale. A deviation from IFRS is however applicable for the valuation of financial liabilities, as Solvency II explicitly imposes that the fair value may not reflect the own credit risk (Delegated Regulation (EU) 2015/35, Article 14).
- ✓ All internal valuation models used at KBC are validated by an independent Risk Validation Unit. In addition, the Executive Committee has appointed a Group Valuation Committee (GVC) to ensure that KBC and its entities meet all the legal requirements for measuring financial assets and liabilities at fair value. The GVC monitors consistent implementation of the KBC Valuation Framework, which consists of various guidelines, including the Group Market Value Adjustments Policy and the Group Parameter Review Policy. The GVC meets at least twice a quarter to approve significant changes in valuation methods (including, but not limited to, models, market data and inputs) or deviations from group policies for financial assets and liabilities measured at fair value. The committee is made up of members from Finance, Risk Management and the Middle Office. Valuation uncertainty measurements are made and reported to the GVC every semester. Lastly, certain fair values generated by valuation models are challenged by a team set up specifically for this purpose.

- ✓ Market value adjustments are recognised on all positions that are measured at fair value to cover close-out costs, adjustments for less liquid positions or markets, mark-to-model-related valuation adjustments, counterparty risk and funding costs. Credit value adjustments (CVAs) are used when measuring derivatives to ensure that the market value of the derivatives is adjusted to reflect the credit risk of the counterparty. In making this adjustment, both the mark-to-market value of the contract and its expected future fair value are taken into account. These valuations are weighted based on the counterparty credit risk that is determined using a quoted credit default swap (CDS) spread, or, if there is no such spread, on the counterparty credit risk that is derived from bonds whose issuers are similar to the derivative counterparty in terms of rating, sector, geographical location and seniority of exposure. A funding value adjustment (FVA) is a correction made to the fair value of derivatives in order to ensure that the (future) funding costs or income attached to entering into and hedging such instruments are factored in when measuring the value of the instruments.
- ✓ The IFRS9 fair value hierarchy (also used for SII) prioritises the valuation techniques and the respective inputs into three levels.
- ✓ The fair value hierarchy gives the highest priority to 'level 1 inputs'. This means that, when there is an active market, quoted prices have to be used to measure the financial assets or liabilities at fair value. Level 1 inputs are prices that are readily and regularly available from an exchange, dealer, broker, industry group, pricing service or regulatory agency (and that are quoted in active markets accessible to KBC). They represent actual and regularly occurring market transactions on an arm's length basis. The fair value measurement of financial instruments with quoted prices is based on a mark-to-market valuation derived from currently available transaction prices. No valuation technique (model) is involved.
- ✓ If there are no price quotations available, the reporting entity establishes fair value using a model based on observable or unobservable inputs. The use of observable inputs needs to be maximised, whereas the use of unobservable inputs has to be minimised.
- ✓ Observable inputs are also referred to as 'level 2 inputs' and reflect the assumptions market participants would use in pricing the asset or liability based on market data obtained from sources independent of the reporting entity. Observable inputs reflect an active market. Examples of observable inputs are the risk-free rate, exchange rates, stock prices and implied volatility. Valuation techniques based on observable inputs 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 are also referred to as 'level 3 inputs' and reflect the reporting entity'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 valuation methodology and the corresponding classification in the fair value hierarchy of the most commonly used financial instruments are summarised in the table below. This table provides an overview of the level in which the instruments are generally classified, but exceptions are possible. In other words, whereas the majority of instruments of a certain type are within the level indicated in the table, a small portion may actually be classified in another level.

	Instrument type	Products	Valuation technique
Level 1	Liquid financial instruments for which quoted prices are regularly available	FX spots, exchange traded financial futures, exchange traded options, exchange traded stocks, exchange traded funds, liquid government bonds, other liquid bonds, liquid asset backed securities (ABS) in active markets	Mark-to-market (quoted prices in active markets)
Level 2	Plain vanilla/liquid derivatives	(Cross-currency) interest rate swaps (IRS), FX swaps, FX forwards, forward rate agreements (FRA), inflation swaps, dividend swaps, commodity swaps, reverse floaters, bond future options, interest rate future options, overnight index swaps (OIS), FX resets	Discounted cashflow analysis based on discount and estimation curves (derived from quoted deposit rates, FX swaps and (CC)IRS)
		Caps & floors, interest rate options, European & American stock options, European & American FX options, forward starting options, digital FX options, FX strips of simple options, European swaptions, constant maturity swaps (CMS), European cancellable IRS, compound FX options	Option pricing model based on observable inputs (e.g., volatilities)
		Credit default swaps (CDS)	CDS model based on credit spreads
	Linear financial assets (without optional features) – cash instruments	Deposits, simple cashflows, repo transactions	Discounted cashflow analysis based on discount and estimation curves (derived from quoted deposit rates, FX swaps and (CC)IRS)
	Asset backed securities	Medium liquid asset backed securities	Third-party pricing (e.g., lead manager); prices corroborated by alternative observable market data, or using comparable spread method
	Debt instruments	KBC IFIMA own issues (liabilities)	Discounted cashflow analysis and valuation of related derivatives based on observable inputs
	Linear financial liabilities (cash instruments)	Loans, commercial paper	Discounted cashflow analysis based on discount and estimation curves (derived from quoted deposit rates, FX swaps and (CC)IRS)
Level 3	Exotic derivatives	Target profit forwards, target strike forwards, Bermudan swaptions, digital interest rate options, quanto interest rate options, digital stock options, Asian stock options, barrier stock options, quanto digital FX options, FX Asian options, FX European barrier options, FX simple digital barrier options, FX touch rebates, double average rate options, inflation options, cancellable reverse floaters, American and Bermudan cancellable IRS, CMS spread options, CMS interest rate caps/floors, (callable) range accruals, outperformance options, auto-callable options	Option pricing model based on unobservable inputs (e.g., correlation)
	Illiquid credit-linked instruments	Collateralised debt obligations (notes)	Valuation model based on correlation of probability of default of underlying assets
	Private equity investments	Private equity and non-quoted participations	Based on the valuation guidelines of the European Private Equity

		& Venture Capital Association (EVCA)
Illiquid bonds/asset backed securities	Illiquid bonds/asset backed securities that are indicatively priced by a single pricing provider in an inactive market	Third-party pricing (e.g., lead manager), where prices cannot be corroborated due to a lack of available/reliable alternative market data
Debt instruments	KBC own issues (KBC IFIMA)	Discounted cashflow analysis and valuation of related derivatives based on unobservable inputs (indicative pricing by third parties for derivatives)

5.1.1.4. Property (other than for own use)

Property other than for own use is valued at the amount for which they could be exchanged between knowledgeable willing parties in an arm's length transaction under Solvency II.

5.1.1.5. Assets held for Index-Linked and Unit-Linked funds

Assets held for Index-Linked and Unit-Linked contracts (classified in line of business 31 (Class 23) as defined in Annex I of Delegated Regulation (EU) 2015/35), are measured at fair value.

5.1.1.6. Deposits other than cash equivalents

Deposits other than cash equivalents are measured at fair value. The same principles are applied as discussed for 'Bonds', 'Equity instruments' and 'Loans & mortgages'.

5.1.1.7. Own shares

This is the total amount of own shares held directly by the group (also referred to as 'Treasury shares' under IFRS). The amount of own shares is deducted from the excess of assets over liabilities when determining the available capital as illustrated in section '6.3. Basic own funds'.

5.1.2. Bgaap

To determine the Bgaap value reference can be made to the Bgaap valuation rules applicable within KBC Insurance NV as included in the Annual Accounts of KBC Insurance NV in note 20 of the Bgaap valuation rules.

Under Bgaap assets and liabilities are measured at costs and no fair valuing is applied within the statutory accounts of KBC Insurance NV.

5.1.2.1. Formation expenses, intangible and tangible assets

Formation expenses are charged directly to the profit and loss account unless the Board of Directors decides otherwise.

Intangible fixed assets whose useful lifetime is limited are depreciated over five years unless the Board of Directors decides otherwise. Systems software is depreciated at the same rate as hardware and is therefore depreciated over a period of three years. Software other than systems software is depreciated over five years. Core systems with a longer useful life are depreciated straight line over an eight-year period. Core

systems are types of standard software, including back-end data applications, for processing operations during the day and updates of the general ledger balances on the mainframe.

All tangible fixed assets are recognised at acquisition cost, less accumulated depreciation. They are recorded at acquisition cost, including ancillary, directly allocable costs (acquisition costs, non-deductible VAT etc.).

The rates of depreciation are determined on the basis of the anticipated useful economic life of the item and are applied according to the straight-line method. All tangible fixed assets are depreciated on an accruals basis from the time they are available for use. The ancillary costs are written off over the life of the asset. A write-down is charged for ancillary costs on the acquisition of land.

5.1.2.2. Equity shares

Participating interests and shares that are considered financial fixed assets are recognised at acquisition costs. Write downs are applied only in the event of a lasting impairment in or loss of value, established on the basis of the financial position, the profitability and the prospectus of the company concerned.

Impairment charges are written back immediately the stock market price rises, albeit to no more than the acquisition value.

Listed shares are recognised at acquisition cost and impaired if the stock market price is sustainably (> 1 year) or significantly (> 30%) lower than the book value, showing that the impairment is sufficiently lasting in nature. The impairment charge is then equal to the difference between the carrying value and the stock market price. Impairment charges are reversed immediately when the stock market price rises, albeit to no more than the acquisition value.

Unlisted shares are written down in the event of a lasting diminution in value or impairment justified by the state, profitability or prospects of the company in which the holdings, shares or profit-share certificates are held.

5.1.2.3. Bonds

Fixed-income securities are recognised at amortised costs and interest is recognised according to the effective interest method.

The fixed-income securities are impaired according to the principles that apply for the valuation of granted loans. When market value are declining below acquisition value, an impairment is recognised when there is uncertainty as to whether all or part of the receivable or security will be paid when due.

Fixed-income treasury securities (under ‘other financial investments’) serving to support liquidity are impaired if their market value is lower than the book value.

Impairment is booked on real estate certificates if their market value is less than their acquisition cost (LOCOM). These impairment charges are written back where the market value rises, up to a maximum of the acquisition cost of the underlying security.

5.1.2.4. Loans and advances

Loans and advances are recorded in the balance sheet for the outstanding principal amount, plus the interest past due and sundry costs to be paid by the customers. Loans classified as irrecoverable and

doubtful, specific write-downs are posted on a case-by-case basis in order to cover the losses which are considered certain or likely to ensue on the outstanding loans.

5.1.2.5. Assets held for Index-Linked and Unit-Linked funds

Assets held for Index-Linked and Unit-Linked funds are recognised as investment contracts in financial assets mandatorily at fair value through P&L other than Held For Trading (MFVPL).

5.1.2.6. Deposits other than cash equivalents

Deposits other than cash equivalents are measured at amortised cost.

5.1.2.7. Own shares

If an entity reacquires its own equity instruments, those instruments ('treasury shares') are recognised as an asset on the balance sheet and an undistributable reserve is recognised for the same amount as part of equity.

5.2. Technical provisions

5.2.1. Solvency II value

5.2.1.1. Technical provisions in general

In general, the technical provisions on the Solvency II economic balance sheet have to be calculated as the sum of a best estimate and a risk margin:

- ✓ The **best estimate** corresponds to the probability-weighted average of future cashflows, taking into account the time value of money, using the relevant risk-free interest rate term structure.
- ✓ The **risk margin** is calculated by determining the cost of providing an amount of eligible own funds equal to the Solvency Capital Requirement necessary to support the insurance and reinsurance obligations over their lifetime. The cost of capital rate is defined by the regulator, and is set at 6%.

An exception to the requirement to calculate a best estimate and a risk margin is made for insurance obligations for which the value can be replicated reliably using financial instruments for which a reliable market value is observable. The value of the technical provisions associated with these future cash flows shall be determined 'as a whole' (i.e. no separate calculation of best estimate and risk margin), based on the market value of the financial instruments.

Previous years, the technical provisions calculated as a whole related to our portfolio of Unit-Linked contracts. However, this division was not completely correct and therefore we now include our portfolio of Unit-Linked contracts in the best estimates. The calculation of this specific part of the Unit-Linked technical provisions did not change, it still corresponds to the market value of the assets held for Index-Linked and Unit-Linked.

Technical provisions Life in general relate to those insurance liabilities that are 'pursued on similar technical basis to that of Life insurance', even if they are not Life insurances from a pure legal perspective. In practice the classification into Life resp. Non-Life liabilities is based on the actuarial techniques used for calculating the technical provisions. This split up, specific for the solvency II regulation framework, entails some classification differences with the IFRS balance sheet.

For calculation of the best estimate, within the Life respectively Non-Life obligations, the contracts have to be split up in so called 'homogeneous risk groups'. These are group of contracts with similar characteristics

and dynamics, for which the same assumptions can be used when projecting the insurance cash flows in the future.

In order to obtain the best estimate which corresponds to the probability-weighted average of future cashflows, the best estimate calculation must take into account all uncertainties in the cash flows. Note however that an allowance for uncertainty does not mean that additional margins should be included in the best estimate.

Including these uncertainties requires particular cashflow characteristics to be accounted for in the valuation methodology. This gives rise to specific assumptions on the uncertainty surrounding a number of factors, including the following:

- ✓ the timing, frequency and severity of insured events;
- ✓ claim amounts and the period needed to settle the claims;
- ✓ the amount of expenses;
- ✓ policyholder behaviour;
- ✓ expected future developments such as future demographic, legal, medical, technological, social, environmental developments including inflation, both entity- and portfolio-specific. For example, in a particular country, this may include changes as a result of legislation, tax measures or the cost of care;
- ✓ interdependency between two sources of uncertainty.

Note that this list is also applicable to Non-Life and Health obligations.

When calculating the best estimate, a projection of the estimated future cashflows is made.

The cashflows are subsequently discounted using the risk free interest rate term structure, as set-up and provided by the regulator. The volatility adjustment (VA) can be added to this curve in order to compensate the spread movements of the assets.

The VA is designed to protect insurers with long-term liabilities from the impact of volatility on the insurers' solvency position. The VA is based on a risk-corrected spread on the assets in a reference portfolio. It is defined as the spread between the interest rate applying to the assets in the reference portfolio and the corresponding risk-free rate, minus the fundamental spread (which represents default or downgrade risk). The VA is provided and updated by EIOPA and can differ for each major currency and country.

5.2.1.2. Technical provisions (Life business)

When projecting future cashflows for Life obligations, so-called 'Similar to Life Techniques' are used.

In principle, these Life obligation cashflow projections are made on a policy-by-policy basis. Only in situations when such a calculation is unpractical policies can be grouped together and the methodology is then applied to the group of policies. This grouping is subject to strict conditions (for instance, it must give approximately the same results as a calculation made on a policy-by-policy basis).

The following cashflows should be taken into account when generating the best estimate of Life insurance obligations:

The **cash inflows** should at least include the gross premiums (after tax) included in the contract boundaries at the valuation date. It should be noted that contract boundaries may in some cases not be the same for IFRS and Solvency II.

In addition, all cashflows resulting from these premiums are taken into account, e.g., expenses, commissions and guarantees.

Investment returns (interests earned, dividends, etc.) are not taken into account. In the case of Unit-Linked contracts, only the risk premiums related to the non-hedgeable portion of the liabilities are taken into account.

The **cash outflows** must include at least:

- ✓ Benefit payments to policyholders and beneficiaries. The benefit cash outflows should include (non-exhaustive list):
  - Maturity benefits
  - Death benefits
  - Disability benefits
  - Surrender benefits
  - Annuity payments
  - Profit sharing bonuses (e.g., financial or mortality profit sharing)
  - Payments with respect to additional riders
- ✓ Claims payments incurred by the insurer in providing contractual benefits that are paid in kind (if they exist).
- ✓ Expenses that are incurred in servicing insurance obligations, such as: administrative expenses, investment management expenses, claims management expenses, acquisition expenses, overhead expenses. The projection of expenses has to include future expected inflation.

The cashflow projection method also includes options and guarantees that are related to the contract.

A **contractual option** is defined as a right to change the benefits, to be exercised at the discretion of its holder (generally the policyholder), on terms that are established in advance. Thus, in order to trigger an option, a deliberate decision of its holder is necessary. Examples of such options are:

- ✓ Surrender value option: the policyholder has the right to fully or partially surrender the policy and receive a pre-defined lump sum amount.
- ✓ Paid-up policy: the policyholder has the right to stop paying premiums and change the policy status to paid-up. Payments may not be reactivated in the future.
- ✓ Dormancy option: the policyholder has the right to partially or completely stop paying premiums, but with the option to reactivate the payments in the future.
- ✓ Annuity conversion option: the policyholder has the right to convert a lump-sum survival benefit into an annuity at a pre-defined minimum rate of conversion.
- ✓ Policy conversion option: the policyholder has the right to convert from one policy to another at pre-determined terms and conditions.
- ✓ Extended coverage option: the policyholder has the right to extend the coverage period when the original contract expires, without having to produce further evidence of health.

A **financial guarantee** is present when there is the possibility to pass losses to the undertaking or to receive additional benefits as a result of changed financial variables (e.g. investment return of the underlying asset

portfolio, performance of indices, etc.). In the case of guarantees, the trigger is generally automatic (the mechanism would be set in the policy's terms and conditions) and thus not dependent on a deliberate decision of the policyholder.

The following is a non-exhaustive list of examples of common financial guarantees embedded in Life insurance contracts:

- ✓ Guaranteed invested capital: include a capital guarantee of the initial investment amount, usually up to a set percentage. This can be considered as a 0% interest rate guarantee.
  e.g., a guaranteed return of investment in Unit-Linked funds.
- ✓ Guaranteed minimum investment return: minimum interest rate is guaranteed.
  e.g., investment insurance with a guaranteed minimum return plus a variable – but not guaranteed – profit sharing amount.
- ✓ Minimum guaranteed benefits: e.g., return of initial investment.

If contracts are expected to benefit from profit sharing, this profit sharing must also be included in the projection of the cashflows.

According to the Solvency II regulatory framework, obligations arising from Health insurance must be assigned to 'Health SLT' (Similar to Life Techniques) if the actuarial methods used to calculate these cashflow projections are similar as the ones mentioned in this subchapter.

The table below gives an overview of the best estimate provisions of the Life and Health Similar to Life lines of business, gross of ceded reinsurance, measured according to the Solvency II valuation principles above.

Line of business (in millions of EUR)	Best Estimate *(gross of reinsurance recoverables)*	%
Total Best Estimate Life excluding Health and Unit Linked	**14.131,1**	**52,0%**
30 Insurance with profit participation	14.131,1	52,0%
32 Other Life insurance	0,0	0,0%
34 Annuities stemming from NL not related to health	0,0	0,0%
Total Best Estimate Health similar to Life	**478,8**	**1,8%**
29 Health reinsurance	142,4	0,5%
33 Annuities stemming from NL related to health	336,5	1,2%
Total Unit linked Best Estimate	**12.568,5**	**46,2%**
31 Index-linked and unit linked insurance	12.568,5	46,2%
Total Best Estimate provision Life (incl. Health similar to Life and Unit Linked)	**27.178,4**	**100,0%**

Split up in solvency II lines of business of the best estimate provisions Life gross of ceded reinsurance, situation 31.12.2018

5.2.1.3. Technical provisions (Non-Life business)

The same general principles as outlined in 'Technical provisions (Life business)' apply to Non-Life obligations. When projecting future cashflows for Non-Life obligations, so called 'Similar to Non-Life Techniques' are used. Specifically for Non-Life obligations, Solvency II requires calculations to be performed separately for 'premium provisions' and 'provisions for claims outstanding':

- ✓ The **premium provisions** relate to claim events occurring after the valuation date and during the remaining in-force period (coverage period) of existing policies held by the undertaking.

The calculation of the gross BE of the premium provision relates to:

- all expected future premiums for existing policies;
- all future claim payments for existing policies;
    - arising from future events;
    - past the valuation date;
    - that will be insured under the insurer's existing policies that have not yet expired;
- expenses (allocated and unallocated claims expenses, as well as ongoing administration of in-force policies, acquisition costs, overhead expenses, investment management expenses) related to the above.

✓ The **provisions for claims outstanding** relate to claim events that have already occurred but that are not settled yet, regardless of whether the claims arising from these events have been reported or not.

Both types of provisions are calculated according to different (standard) actuarial techniques.

The premium provision is calculated on the assumption that the portfolio of policies in a certain line of business is stable enough, so that claims experience from the past can be used to make predictions of claims that will occur in the future. In addition, the assumptions regarding the timing of future cashflows are based on past claims experience.

For the claims provisions, different techniques are used depending on the claim sizes (attritional, large and extra-large claims). An estimate is also made for those claims that have already occurred but which have not yet been reported at valuation date. The best estimate for claims outstanding also includes provisions for claim handling costs, both internal and external costs.

According to the Solvency II regulatory framework, obligations arising from Health insurance must be assigned to 'Health NSLT' (Non-Similar to Life Techniques) if the actuarial methods used to calculate these cashflow projections are similar as the ones mentioned in this subchapter. It should be noted that provisions for annuities stemming from Non-Life contracts form part of the Life technical provisions.

The table below provides an overview of the best estimate provisions of the Non-Life and the Health Non-Similar to Life lines of business, gross of ceded reinsurance, measured according to the Solvency II valuation principles above.

Lines of business (in millions of EUR)	Best Estimate *(gross of reinsurance recoverables)*	%
Total Best estimate excluding Health non similar to Life	**1.156,4**	**84,1%**
4 Motor vehicle liability insurance	553,2	40,2%
5 Other Motor Insurance	23,5	1,7%
6 Marine, aviation and transport insurance	0,2	0,0%
7 Fire and other damage to property insurance	114,9	8,4%
8 General liability insurance	361,2	26,3%
9 Credit and suretyship insurance	0,0	0,0%
10 Legal Expenses insurance	88,8	6,5%
11 Assistance	4,9	0,4%
12 Miscellaneous financial loss	5,5	0,4%
16 Proportional Motor Vehicle Liability reinsurance	0,1	0,0%
18 Proportional Marine, aviation and transport reinsurance	0,3	0,0%
19 Proportional Fire and other damage to property reinsurance	0,7	0,0%
20 Proportional General liability reinsurance	0,8	0,1%
21 Proportional Credit and suretyship reinsurance	0,0	0,0%
22 Proportional Legal Expenses reinsurance	0,0	0,0%
24 Proportional Miscellaneous financial loss reinsurance	0,0	0,0%
26 Non-Proportional Casualty reinsurance	2,3	0,2%
28 Non-Proportional Property reinsurance	0,0	0,0%
27 Non-Proportional Marine, aviation and transport reinsurance	0,1	0,0%
Total Best estimate Health non similar to Life	**219,2**	**15,9%**
1 Medical Expense insurance	11,8	0,9%
2 Income Protection insurance	9,7	0,7%
3 Workers' Compensation insurance	195,9	14,2%
13 Proportional Medical expense reinsurance	0,0	0,0%
14 Proportional Income Protection reinsurance	0,6	0,0%
15 Proportional Workers' compensation reinsurance	1,2	0,1%
25 Non-Proportional Health Reinsurance	0,1	0,0%
Total Best Estimate provision Non-Life (incl. Health non similar to Life)	**1.375,6**	**100,0%**

Breakdown by Solvency II lines of business of the best estimate Non-Life provisions gross of ceded reinsurance, situation at 31.12.2018.

5.2.1.4. Technical provisions (total)

The following table presents the gross best estimate, the risk margin and the reinsurance recoverables of KBC Insurance NV, consistent with the figures on the Economic Balance Sheet at year-end 2018.

The best estimates and reinsurance recoverables are discounted at the EIOPA risk free rate, including the volatility adjustment as described in the previous paragraphs.

in millions of EUR	Best Estimate *(gross of reinsurance)*	Risk margin	Reinsurance recoverables
Technical provisions - Non-life	**1.375,6**	**261,9**	**112,2**
Non-life (excl. Health)	1.156,4	211,8	107,6
Health (similar to Non-life)	219,2	50,1	4,6
Technical provisions - Life (incl. Index-Linked & Unit-Linked)	**27.178,4**	**401,6**	**-18,4**
Life (excl. Health and Index-Linked & Unit-Linked)	14.131,1	271,6	-14,1
Health (similar to Life)	478,8	42,9	-4,3
Index-Linked & Unit-Linked	12.568,5	87,1	0,1
Total technical provisions	**28.554,0**	**663,5**	**93,8**

Technical provisions gross of ceded reinsurance & reinsurance recoverables, situation at 31/12/2018

5.2.2. Bgaap

5.2.2.1. Provisions for unearned premiums and unexpired risk

For the primary business, the provision for unearned premiums is in principle calculated on a daily basis, based on the gross premiums. For inward treaties, i.e. reinsurance business received, the provision for unearned premiums is calculated for each contract separately on the basis of the information communicated by the ceding undertaking and, where necessary, supplemented on the basis of the company's own experience regarding the evolution of the risk over time. The provision for unearned premiums for the Life insurance business is recorded under the provision for the Life insurance group of activities.

5.2.2.2. Life insurance provision

Except for Unit-Linked Life insurance products, this provision is calculated according to current actuarial principles, with account being taken of the provision for unearned premiums, the ageing reserve, the provision for annuities payable but not yet due, etc. In principle, this provision is calculated separately for every insurance contract. For accepted business, a provision is constituted for each individual contract, based on the information supplied by the ceding undertaking and supplemented, where necessary, by the company's own past experience.

Besides the rules set out below, an additional provision is set aside as required by law, called the flashing light reserve. As of 1 January 2016, KBC Insurance NV uses the exemption to further increase the 'flashing light', after the formal approval of the National Bank of Belgium, under the condition that KBC Insurance NV respects the Solvency II rules without application of the so called transitional measures.

The following rules apply:

- ✓ **Valuation according to the prospective method.** This method is applied for the provisions for conventional non-Unit-Linked Life insurance policies, modern non-Unit-Linked Universal Life insurance policies offering a guaranteed rate of interest on future premium payments and for the provision for extra-legal benefits for employees in respect of current annuities. Calculations according to prospective actuarial formulas are based on the technical assumptions made in the contracts.
- ✓ **Valuation according to the retrospective method.** This method is applied for the provision for modern non-Unit-Linked Universal Life insurance policies and for the provision for extra-legal benefits for employees in respect of new supplementary premium payments. Calculations

according to retrospective actuarial formulas are based on the technical assumptions made in the contracts, though no account is taken of future payments.

5.2.2.3. Provision for claims outstanding

For claims reported, the provision is in principle measured separately in each case, taking into account the known facts in the claims file, on the basis of the amounts still due to the injured parties or beneficiaries, plus external costs of settling claims. Where benefits have to be paid in the form of an annuity, the amounts to be set aside for that purpose are calculated using recognised actuarial methods.

For 'claims incurred but not reported' at balance sheet date, an IBNR (Incurred But Not Reported) provision is set aside. In the primary business, this IBNR provision is based on a lump sum per class of insurance depending upon past experience and the trend in the insured portfolio. For extraordinary events, additional amounts are added to the IBNR provision.

For 'claims incurred but not enough reserved' at balance sheet date, an IBNER (Incurred But Not Enough Reserved) provision is set aside if the adequacy procedures demonstrate that the other claims provisions are insufficient to meet future liabilities. This provision contains amounts for claims which have already been reported but which, for technical reasons, could not yet be recorded in the claims file. Where appropriate, a provision is set aside on a prudent basis for possible liabilities arising for claims files already closed.

A provision for the internal cost of settling claims is calculated at a percentage that is based on past experience.

Additional provisions are also constituted as required by law, such as supplementary workmen's compensation provisions.

5.2.2.4. Provision for profit sharing and rebates

This heading includes the provision for the profit share that has been allocated but not yet awarded at the end of the financial year for both the group of Life insurance activities and the group of Non-Life insurance activities.

5.2.2.5. Equalisation and catastrophe provision

All amounts in the equalisation and catastrophe provision are allocated to offsetting non-recurring underwriting losses in the years ahead, equalising in the loss ratio and covering special risks.

5.2.2.6. Ceded reinsurance and retrocession

The effect of reinsurance business ceded and retrocession is entered as an asset and calculated for each contract separately, supplemented where necessary by the company's own past experience regarding the evolution of the risk over time.

5.3. Other liabilities

5.3.1. Solvency II value

5.3.1.1. Deferred taxes

Deferred taxes, other than deferred tax assets arising from the carry forward of unused tax credits and the carry forward of unused tax losses, are valued on the basis of the difference between the Solvency II values

and the values ascribed to assets and liabilities as recognised and valued for tax purposes (Delegated Regulation (EU) 2015/35, Art. 15).(see also 5.1.1.2 – Deferred taxes – Asset side).

5.3.2. Bgaap

To determine the Bgaap value reference can be made to the Bgaap valuation rules applicable within KBC, as included in the Annual Accounts of KBC Insurance NV – Note 20 on the accounting policies

5.3.2.1. Deferred taxes

Under Bgaap deferred taxes are not recognised.

5.3.2.2. Financial Liabilities

Financial liabilities are measured at amortised cost.

5.4. Alternative methods for valuation

Not applicable to KBC Insurance NV.

Capital
management

6. Capital Management

The solvency of KBC Insurance NV is calculated on the basis of Solvency II. .A solvency ratio of 100% is required as a minimum by the regulator. Within KBC Insurance NV, the capital management process aims at reaching an optimal balance between regulatory requirements, rating agencies views, market expectations and management ambitions. It is a key management process relating to all decisions on the level and composition of the capital.

An important process in this context is the Alignment of Planning Cycles (APC). This yearly process aims to create an integrated three-year plan in which the strategy, finance, treasury and risk perspectives are collectively taken into account. In this process, the risk appetite of the group is set and cascaded by setting risk limits at entity level. The APC is not only about planning, it is also about closely monitoring the execution of the plan in all its aspects. Such monitoring is reflected in dedicated reports drawn up by the various Group functions.

In addition to APC, KBC Insurance NV has conducted an Own Risk and Solvency Assessment (ORSA) on a regular basis, in accordance with Solvency II requirements. The aim of the ORSA is to monitor and ensure that business is managed in a sound and prudent way and that KBC Insurance NV is adequately capitalised in view of its risk profile and the quality of its risk management and control environment. The ORSA process draws to a large extent on the same 'core processes' as the ICAAP and includes APC, risk appetite setting and ongoing business, risk and capital management processes. Where necessary, these processes are enhanced to take account of the specific nature of the (re)insurance activities and to comply with Solvency II requirements.

6.1. Solvency II ratio

As also stated in the 'Capital adequacy' section of the Annual Report, the Solvency II ratio of KBC Insurance NV amounted to 230%, which is an increase of 13% compared to year-end 2017. KBC Insurance NV does not use any of the transitional measures.

The main drivers of the year-on-year evolution of the Solvency II ratio (including volatility adjustment) are:

- ✓ higher dividend pay-out, leading to a lower available capital;
- ✓ lower equity markets leading to a decrease in the value of equity and by consequence a decrease in required capital;
- ✓ higher European spreads leading to a higher volatility adjustment: this has a positive impact on the ratio;
- ✓ shifting interest rate curves (increase on the short term, decrease on the long term) leading to a negative impact on the ratio (decrease in the bonds).

Solvency, KBC Insurance (including volatility adjustment)	31/12/2018	31/12/2017
Own funds	**3 626,5**	**3 899,3**
Tier-1	3 126,1	3 399,0
BGAAP parent shareholders' equity	1 368,5	1 368,8
Dividend payout	-132,4	-244,4
Valuation differences (after tax)	1 427,3	1 835,1
Volatility adjustment	171,1	23,0
Other	291,8	416,6
Tier-2	500,3	500,3
Subordinated liabilities	500,3	500,3
Solvency capital requirement (SCR)	1 575,7	1 796,9
Solvency II ratio	230%	217%
Solvency II ratio above 100%	2 050,7	2 102,4

6.2. Material differences between equity

In the table below, a reconciliation is made between Bgaap equity as shown in the financial statements of KBC Insurance NV and the excess of assets over liabilities according to Solvency II.

Reconciliation BGAAP equity & assets over liabilities Solvency II	31/12/2018
Share capital	65,2
Share premium	1 085,6
Treasury shares	203,2
Reserves	14,5
Profit from previous years	0,1
BGAAP equity	**1 368,5**
Valuation differences between BGAAP and Solvency II	
of which : valuation difference real estate at fair value (after tax)	71,5
of which: valuation difference participations	333,0
of which : valuation difference fair value equity	149,5
of which : valuation difference fair value bonds (after tax)	1 013,9
of which : valuation difference fair value L&R (after tax)	232,5
of which : valuation difference reinsurance recoverables (after tax)	-10,2
of which : valuation difference technical liabilities (after tax)	-159,7
of which : volatility adjustment	171,1
of which : other	291,8
Assets over liabilities Solvency II	**3 461,8**

The reasons for the valuation differences between Bgaap equity according to the financial statements and the excess of assets over liabilities according to Solvency II, as shown in the table, are explained in the section ‘5. Valuation for solvency purposes’.

6.3. Basic own funds

The total available capital of KBC Insurance NV amounted to 3 626m EUR at 31 December 2018. This amount comprises solely basic own fund items, which are eligible to cover the Solvency Capital Requirement and the Minimum Capital Requirement.

More information about 'Own funds' can be found in QRT S.23.01.01.

Solvency II, in millions of EUR	31/12/2018	31/12/2017
Share capital	65,2	65,2
Share premium	1 085,6	1 085,6
Surplus funds	127,6	97,6
Reconciliation reserve	1 847,8	2 150,7
Excess of assets over liabilities	3 461,8	3 846,6
Own shares (held directly and indirectly)	-203,2	-203,2
Foreseeable dividends, distributions and charges	-132,4	-244,4
Other basic own fund items	-1 278,3	-1 248,3
Tier 1 capital	**3 126,1**	**3 399,1**
Tier 2	500,3	500,3
Tier 2 capital	**500,3**	**500,3**
Total available basic own funds	**3 626,5**	**3 899,3**

Tier-1 capital amounted to 3 126m EUR at year-end 2018, down 273m EUR on its year-earlier level, due to movements in excess of assets over liabilities, caused mainly by a decrease in excess of assets over liabilities (-385m EUR) and due to the difference in dividend pay-out (+112m EUR).

Tier-2 capital consists of a 10-year, subordinated, Solvency II-compliant tier-2 loan granted by KBC Insurance Group to KBC Insurance NV for a nominal amount of 500m EUR on 18 March 2015. The year-on-year changes in tier-2 capital were due to the changes in fair value of this loan.

6.4. Ancillary own funds

No ancillary own funds are taken into account, as these funds are not available.

6.5. Solvency Capital Requirements and Minimum Capital Requirements

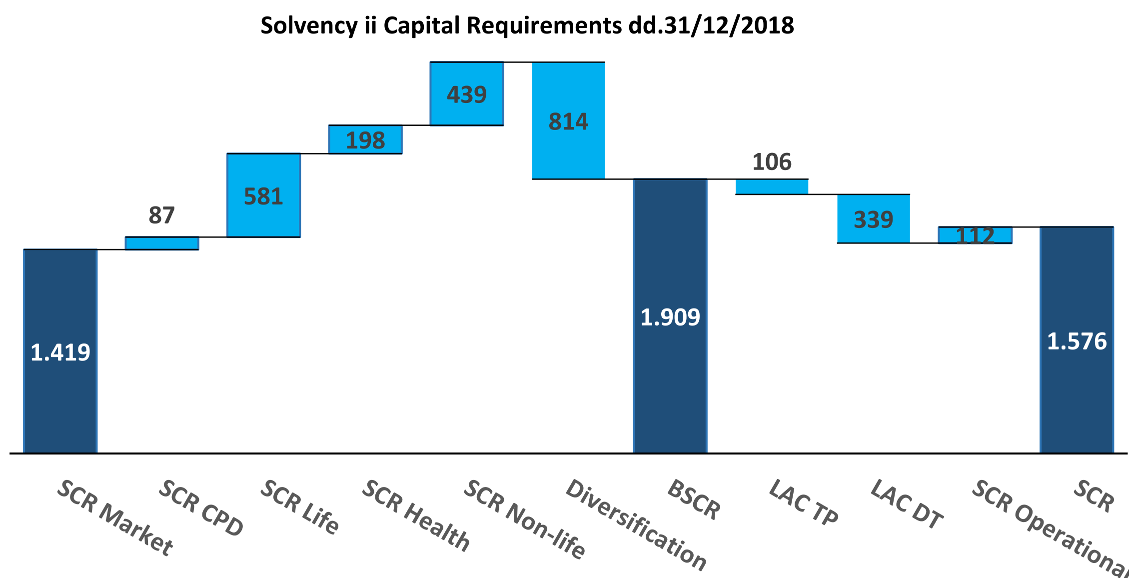
In the standard formula, the SCR is calculated as the sum of different components. KBC Insurance NV uses the distinguishable components (SCR Market Risk, SCR Counterparty Risk, SCR Life Risk, SCR Health Risk, and SCR Non-Life Risk) to calculate the Basic SCR (BSCR). Because there is some risk of overlap between the different components, diversification reduces the risk involved and the related SCR. After calculating the Basic SCR, three components are added in order to calculate the total SCR. These three elements are the Loss Absorbing Capacity of the Technical Provisions, the Loss Absorbing Capacity of the Deferred Taxes and the SCR Operational Risk.

- ✓ The Loss Absorbing Capacity of the Technical Provisions (LAC TP) is calculated according to Art. 206 of the Delegated Regulations 2015-35 and takes into account any legal, regulatory or contractual restrictions in the distribution of future discretionary benefits.

- ✓ The adjustment for the Loss Absorbing Capacity of the Deferred Taxes (LAC DT) is calculated according to Art. 207 of the Delegated Regulations 2015-35, whereby a decrease in deferred tax liabilities or an increase in deferred tax assets results in a negative adjustment for the loss-absorbing capacity of deferred taxes. If this adjustment is positive, the adjustment is nil.

The waterfall chart below (in m EUR) shows the major components of the SCR, which stands at 1 576m EUR. The SCR Market Risk (1.419m EUR) is clearly the biggest contributor to the SCR. SCR Life Underwriting Risk (581m EUR) and SCR Non-Life underwriting Risk (439m EUR) are second and third, respectively. It should be noted that the total SCR market risk accounts for 53% of undiversified basic Solvency II Pillar 1 capital.

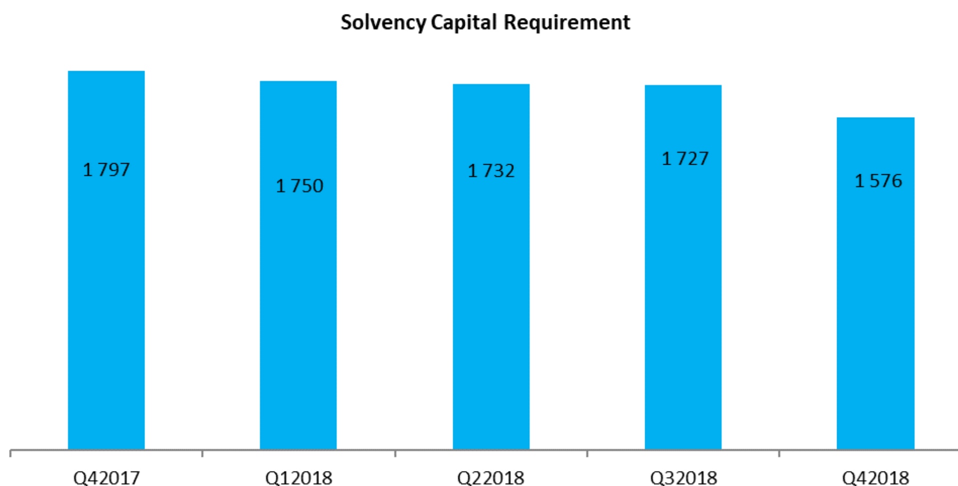
More information on this matter can be found in Quantitative Reporting Template (QRT) S.25.01.21.



Total eligible own funds to meet the SCR amounted to about 3 626m EUR, which gives a Solvency II ratio of about 230%. This ratio is well above the minimum 100% required by the Delegated Regulations 2015-35.

KBC Insurance NV reaches the cap of the MCR, being 45% of the SCR. Therefore, the evolution of the MCR will follow the evolution of the SCR.

In the figure below the evolution of the SCR over the year 2018 is shown. The decrease in SCR is mainly due to a decrease in the required capital for market risk.



6.6. Use of the duration-based equity risk sub-module in the calculation of SCR

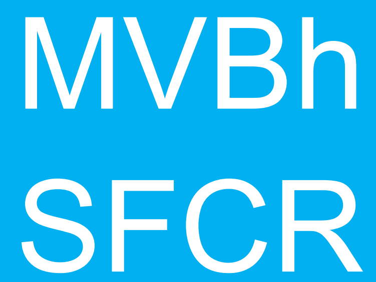
Due to the demands of the National Bank of Belgium, and noting that the requisite ring-fenced funds do not exist in Belgium, the Solvency Capital Required calculation method using a duration based equity is not applicable.

6.7. Differences between the standard formula and any internal model used

KBC Insurance NV has opted to calculate the Solvency Capital Requirements based on the standard formula (without any simplifications), rather than calculating them with a self-developed (partial) internal model. Also no undertaking specific parameters (USP's) have been used in the calculation.

6.8. Non-compliance with the MCR and non-compliance with the SCR

As the KBC Insurance NV has not faced any form of non-compliance with either the Minimum Capital Requirement or the Solvency Capital Requirement during the reporting period, further information has not been included.


MVBh
SFCR

Maatschappij voor Brandherverzekering CVBA (MVBh) 2018

Based on situation as at 31 December 2018

7.1. Introduction

Insurance activities of KBC Insurance NV in Belgium include their reinsurance subsidiary Maatschappij voor Brandherverzekering CVBA (MVBh), a fire reinsurance company, which is discussed in this section.

In general the policies which are applicable to KBC Insurance NV are applicable as well to MVBh, taking into account the limited nature, small scale and simplicity of the risks inherent in its business.

7.2. Business and performance

7.2.1. Business

Business model

Local insurers, characterised by the very local nature of their activities, still have a role to play in society and therefore remain socially relevant since they belong to a local community's social network that mutualises its risks. Their risk profile is generally defensive and well under control. They are very often legally incorporated as 'mutual insurance association' or in some cases as 'insurance cooperative'.

MVBh's mission is to provide adequate protection to these local insurers against volatility of their underwriting results.

Since underwriting results of all affiliated insurers are mutualised within MVBh, a stable revenue stream for local insurers can be generated through yearly profit participation.

Except for KBC Insurance NV, MVBh doesn't accept shareholders other than local insurers, and all these shareholders – local insurers are MVBh's (only) clients as well. KBC Insurance NV is the largest shareholder, holding 24 799 shares, out of a total of 27 500. The remaining shares are owned by 33 local insurers, all geographically located in the provinces of West and East Flanders.

MVBh was incorporated on 10 April 1917, as published in the enclosures to the Belgian Official Gazette dated 21 May 1917, charter n°. 1763. Its mission is to conclude reinsurance contracts against fire damage and ancillary perils with the above-mentioned local insurers, MVBh's shareholders, in order to allow them to maintain their cooperative structure.

MVBh's size is small since reinsurance activities are limited to local insurers which do not grow in number and have limited growth opportunities due to their local character.

Name, legal form and address

Maatschappij voor Brandherverzekering CVBA

Professor Roger Van Overstraetenplein 2

3000 Leuven

BELGIUM

Supervisory authority

National Bank of Belgium

de Berlaimontlaan 14

1000 Brussels

BELGIUM

External auditor

CVBA PwC Bedrijfsrevisoren (Auditors)

Woluwedal 18

1932 Sint-Stevens-Woluwe

BELGIUM

Representative: Tom Meuleman

7.2.2. Underwriting performance

The following table has been derived from statutory financial statements and demonstrates the historical underwriting profitability of the company:

	2014	2015	2016	2017	2018
Gross earned premium (amount x 1.000 EUR)	6.604,408	6.735,868	7.245,893	7.277,620	7.364,887
Gross earned premium (100%)	100,00%	100,00%	100,00%	100,00%	100,00%
Gross incurred losses	-47,90%	-29,46%	-34,06%	-20,41%	-26,00%
Change in equalization reserves	0,60%	-0,59%	3,73%	-7,50%	0,00%
Profit participation to clients	-13,00%	-20,00%	-24,85%	-20,10%	-20,04%
Expenses and commissions	-25,62%	-25,52%	-25,21%	-25,49%	-25,07%
Other items	0,02%	-0,02%	-0,26%	-0,13%	-0,07%
Gross technical balance	14,10%	24,41%	19,34%	26,37%	28,82%
Investment income and expenses	3,29%	5,43%	6,79%	11,21%	0,80%
Gross technical - financial balance	17,39%	29,84%	26,13%	37,58%	29,62%
Retrocession balance	-14,91%	-23,95%	-21,32%	-26,57%	-26,63%
Net balance	2,48%	5,89%	4,82%	11,01%	2,98%

7.2.3. Investment performance

The following information has been copied from statutory financial statements:

x 1.000 EUR	2014	2015	2016	2017	2018
Investment income					
Dividends	75,977	64,299	67,285	63,373	4,007
Fixed income	152,420	149,271	138,976	120,946	99,352
Term deposits	2,166	2,166	0,688		
	230,562	215,736	206,949	184,320	103,359
Impairment reversals	62,222	52,075	129,962	161,041	40,131
Realized capital gains	12,402	184,781	368,689	696,968	57,803
Other	0,006	0,000	0,142	0,000	10,593
	305,193	452,591	705,743	1.042,328	211,886
Investment expenses					
Asset management expenses	5,674	7,241	12,734	14,438	5,762
Investment management expenses	20,219	25,552	26,675	28,054	31,288
Impairments	16,766	53,784	45,029	1,620	69,554
Realized capital losses	45,264	0,078	129,075	182,039	46,366
	87,923	86,655	213,512	226,151	152,970
Investment income, net of expenses	217,269	365,936	492,231	816,177	58,916
Average statutory balance sheet total	11.042,577	11.423,126	12.258,561	13.133,170	13.544,331
Return on average balance sheet total	1,97%	3,20%	4,02%	6,21%	0,43%

7.3. System of Governance

7.3.1. Legal management structure

7.3.1.1. Dual structure

MVBh is managed according to a dual model, which draws a distinction between:

- ✓ The ‘board of directors’, which has the task of setting strategy, determining general policy, supervising operational management and performing acts which are reserved to the board of directors in accordance with applicable legislation and MVBh’s bylaws.
- ✓ The ‘executive committee’, which is responsible for the operational management of the company.

The board of directors is composed of at least seven directors (currently 9), who are nominated by the general assembly. The board of directors is composed of executive directors, who constitute the executive committee and are in charge of MVBh’s operational management, and non-executive directors. They are exclusively natural persons.

The non-executive directors, who are therefore no members of the executive committee, always constitute a majority within the board of directors. The chairman of the board of directors is a non-executive director.

The board of directors assumes final accountability for MVBh. Therefore the board of directors determines and controls more specifically:

- ✓ MVBh’s strategy and objectives;
- ✓ the risk policy, including general risk tolerance limits.

Moreover, the board of directors oversees the executive committee and its functioning.

- ✓ The executive committee is composed of three executive members of the board of directors (natural persons) together constituting a board. They are nominated and dismissed by the board of directors.
- ✓ The executive committee is accountable for elaborating, executing and pursuing the strategy decided upon by the board of directors, taking into account MVBh's values, risk appetite and policies.

7.3.1.2. Committees

Based upon article 52 of the Insurance and Reinsurance Supervision Act dated 13 March 2016, the tasks assigned to the audit committee, the remuneration committee and the risk committee are executed by the board of directors of MVBh as a whole.

7.3.2. Operational management structure

MVBh has no employees on its payroll.

Activities which are not performed by members of the executive committee, are performed by KBC Group NV, KBC Bank NV and KBC Insurance NV staff.

7.3.3. (Regulated) outsourcing

The outsourcing approach of MVBh is embedded in the approach of KBC Group and KBC Insurance NV. With the aim of providing its clients the best possible service, MVBh appeals to the knowledge and efficiency present in the Belgian-based entities of KBC Group. No activities or functions are outsourced to external parties.

KBC Group NV provides audit, finance and tax services. The compliance function is not formally outsourced; necessary guidance and support from KBC Group NV, Group Compliance division is, however, provided.

KBC Insurance NV supports MVBh with the following services:

- ✓ underwriting, acceptance of insurance policies;
- ✓ administration of insurance policies;
- ✓ settlement of claims reported by the mutual insurers and insurance cooperatives;
- ✓ network expertise and support provided to business managers of the mutual insurers and insurance cooperatives;
- ✓ administration of incoming and outgoing reinsurance contracts;
- ✓ end user computing services;
- ✓ actuarial tasks in execution of the calculation of the solvency position;
- ✓ Risk management.

The first three services are performed by KBC Insurance NV as part of a retrocession agreement between MVBh and KBC Insurance NV, and are therefore not to be considered as regulated outsourcing.

MVBh's CRO is accountable for the risk function and takes up some of the concerned tasks and activities. However, others are formally outsourced to KBC Insurance NV's risk management department.

MVBh considers all these activities to be critical or important functions or activities.

The executive committee's chairman oversees and coordinates the activities which are related to outsourcing, except those relative to outsourced 2nd line of defence management activities which are coordinated by MVBh's CRO.

7.3.4. Independent control functions

7.3.4.1. General

The persons executing the independent control functions are independent of the business units and operational functions of MVBh. They report at least once a year directly to the board of directors about the execution of their task and inform the executive committee.

7.3.4.2. Risk management function, compliance function and actuarial function

In accordance with article 56, §3, 2nd subsection, 2° of the Insurance and Reinsurance Supervision Act, the head of the risk management function is a member of the executive committee of MVBh. This executive committee member is the acting Chief Risk Officer (CRO) and also takes accountability for the compliance and actuarial functions. These three independent control functions are executed independently from one another.

The risk management function within MVBh is partially outsourced towards KBC Insurance NV, under the general supervision of the CRO of MVBh (key function holder). The person accountable for the risk management function is actively involved in determining MVBh's risk strategy and in all policy decisions having a significant impact on the risks and can provide a full picture of the whole range of risks MVBh is exposed to.

The compliance function ascertains that MVBh, the directors, employees and authorised representatives comply with legal and regulatory provisions regulating the reinsurance activity (in particular the rules with respect to integrity and behaviour applying to this activity). The compliance function also assesses potential consequences of changes in the legal framework for MVBh's activities and identifies and assesses compliance risks.

The actuarial function ascertains that MVBh uses an adequate underwriting methodology, coordinates and controls the calculation of the technical provisions and provides an opinion on MVBh's retrocession programme, in accordance with article 59 of the Insurance and Reinsurance Supervision Act.

7.3.4.3. Internal audit function

The internal audit of MVBh is outsourced towards KBC Group NV, under the general supervision of the CEO of MVBh (key function holder). The internal audit function provides the board of directors and executive committee with an independent assessment of the quality and effectiveness of the internal controls, risk management and governance system of MVBh.

The person who is accountable for the internal audit function or the person designated for these purposes communicates their findings and recommendations with the board of directors and executive committee.

7.3.5. Remuneration policy

Members of the executive committee receive a fixed remuneration. There is no variable component.

Apart from a pension plan for MVBh's chairman of the executive committee there are no supplementary pension or early retirement schemes for the members of the administrative, management or supervisory body and other key function holders.

7.3.6. Fit & proper requirements

MVBh's requirements concerning skills, knowledge and expertise applicable to the persons who effectively run MVBh or have other key functions as well as its process for assessing their fitness and propriety are virtually identical to the ones applicable for KBC Group.

No loans, credits or suretyships have been granted to members of the board of directors (whether smaller or larger than 100 000 euros).

7.4. Risk Profile

7.4.1. Underwriting risk

MVBh only writes reinsurance business with local Belgian mutual insurers and limits underwriting to fire business and allied perils. Reinsurance is on a 100% quota–share basis.

Mutual insurers only write policies against fire damage and ancillary perils for 'simple risks' (together with the minor liability and legal expenses insurance cover that can typically be included in these fire policies), mainly located in their local municipality or neighbouring municipalities in West and East Flanders. Underlying policies relative to product offering, underwriting, pricing, reserving and claims settlement are copied from the ones applied by KBC Insurance NV.

Underwriting limits, in terms of sums insured, as defined by the inward reinsurance contracts, must be strictly applied.

Technical insurance risk represents the 2nd largest risk within MVBh (cf. QRT S.25.01.21). Moreover, technical insurance performance is the decisive factor in determining how much profit is returned by MVBh to clients/mutual insurers. Therefore, limiting volatility of technical insurance performance is key.

The reinsurance portfolio, gross of proportional retrocession, is adequately protected by non-proportional retrocession cover, in terms of deductible, limit and amount of cover on an annual basis, against the consequences of claims in risk concentrations.

Due to the local character of MVBh's ceding companies/local insurers, risk locations may be geographically highly concentrated. These concentrations are mapped on a regular basis. As explained in the previous paragraph, ensuing risks are adequately retroceded.

MVBh monitors the underwriting performance of individual mutual insurers, and encourages individual mutual insurers to eliminate systematic underperformance, compared to their peers.

MVBh conducts portfolio checks on (at least) a yearly basis, aiming at controlling compliance with the above-mentioned policies, monitoring evolution of claims ratios of individual local insurers, and detecting and rectifying potential errors and mistakes.

MVBh pays appropriate attention to opinions of the actuarial function holder, and takes appropriate measures, if necessary.

MVBh's exposure to natural catastrophes (i.e., windstorm, flood and earthquake), man-made catastrophes, as well as large individual fire claims, are analysed on a regular basis and reported to the board of directors.

7.4.2. Market risk

Market risks represent the largest risk which MVBh is exposed to (cf. QRT S.25.01.21), triggered by (i) the investment of shareholders' funds and (ii) differences between risk profiles of cash flows, originating from reinsurance liabilities on the one hand and assets, covering reinsurance liabilities on the other hand. Being exposed to market risks is an inevitable consequence of operating in the (re)insurance business.

MVBh relies on KBC Group's expertise with respect to market risk and investment portfolio management. So-called 'ALM limits' have been set specifically for MVBh. Compliance with these limits is reported on every meeting of the board of directors.

7.4.3. Credit risk

Counterparty default risk on issuers of financial instruments is managed within the 'ALM limits' framework mentioned above, relying on KBC Group's expertise with respect to credit risk management.

MVBh's credit risk largely stems from counterparty default risk exposure to KBC Insurance NV, originating from retrocession contracts. KBC Insurance NV is indeed MVBh's preferred retrocessionaire.

Although credit risk is quite significant within MVBh's overall risk profile because of counterparty default risk exposure to KBC Insurance NV – it is the 3rd largest risk MVBh is exposed to (cf. QRT S.25.01.21) – MVBh accepts this risk.

7.4.4. Liquidity risk

This risk may emerge when a catastrophic event occurs which generates high incurred claims in the reinsurance portfolio, more specifically when a time gap occurs between the moment MVBh is expected to pay these claims to its ceding companies on the one hand, and the moment the retroceded part can be recovered from the retrocessionaire on the other hand.

This risk has been neutralised by the retrocession contract through a clause which foresees the possibility for MVBh to request cash claims from its retrocessionaire once a contractually determined threshold has been exceeded.

7.4.5. Operational risk

Operational risk represents the fourth largest risk MVBh is exposed to (cf. QRT S.25.01.21).

MVBh endorses the group-wide framework for non-financial risk management and business continuity management.

In as far as relevant for MVBh, non-financial risk management tools such as group key controls, internal control statement, competition compliance program, etc. are applied.

For its business continuity plan, MVBh is obviously highly dependent on KBC Insurance NV and KBC Group.

MVBh analyses the adequacy of business processes both systematically and on an ad-hoc basis.

Compliance with the group-wide framework for non-financial risk management and business continuity management is ascertained by an adequate execution of the local operational risk manager's and business continuity manager's roles. Guidance and steering for the execution of these roles is provided by the KBC Belgium Business Unit's risk management and crisis management departments.

Audit recommendations are executed in a timely and correct manner. There are no outstanding audit recommendations at present.

7.4.6. Other material risks

7.4.6.1. Business risk

Portfolio growth depends to a large extent on local insurers' business managers' willingness to place business with the local insurer. Professional relationship management with these local business managers is key.

MVBh's development is very closely linked to local Belgian mutual insurers' development. Should, for example, their survival be compromised due to unrealistically high regulatory obligations, MVBh's future would inevitably be jeopardised.

The Insurance and Reinsurance Supervision Act imposes strict requirements on (re)insurance undertakings to ensure their solvency. Should mutual insurers have to comply with these requirements, they would inevitably have to cease business. Fortunately, the bill allows for a 'soft' regime in a number of cases, including for 'small' insurers.

Mutual insurers (i.e., MVBh's clients) have assumed the regime of 'small' insurers, which reinsure 100% of their insurance obligations, entailing a huge simplification of their solvency regime i.e.:

- ✓ the Insurance and Reinsurance Supervision Act is (quasi) not applicable;
- ✓ the insurance undertaking must submit an application file for registration with the National Bank of Belgium (NBB) and demonstrate it complies with all required conditions;
- ✓ NBB must approve the application for registration;
- ✓ once approved, the insurance undertaking will be listed on a specific register to be published on NBB's website;
- ✓ NBB may decide at its discretion to further regulate all additional information requirements, either on an individual or a general basis.

Application files for registration have been submitted by the mutual insurers to the NBB, and approved by the NBB. They are now listed on the NBB's website.

7.4.6.2. Reputation risk

The reputation of MVBh is a strategic asset of the firm. We aim to protect and grow our reputation in the eyes of our clients by managing our business in a responsible manner.

MVBh champions a strong compliance culture and has zero tolerance for any intentional violation of mandatory legal norms that are sanctioned with criminal penalties against our company, its directors or employees or administrative measures which could result in the revocation, suspension, modification or nonrenewal of the licenses issued to MVBh.

Regular reporting to the KBC Group Compliance division is done in compliance with Group Compliance Rules.

7.4.6.3. Concentration risk

KBC Insurance NV is MVBh's preferred reinsurer. MVBh is also exposed to KBC Bank, through current, savings and investment accounts, as well as, potentially, term deposits and other securities. KBC Insurance NV and KBC Bank maintain close (commercial) relationships. Potential impact on MVBh of ensuing contagion risk is adequately monitored and kept under control.

The global limit relative to counterparty default risk, withheld in the ALM limit framework, applies to KBC group as a whole. On top of that comes exposure to KBC Insurance NVgenerated by MVBh's retrocession programme, as well as exposure to KBC Bank due to current and savings accounts which are held by MVBh with KBC Bank in view of its daily operations. Outstanding balances of these accounts are kept at a minimum level to ensure smooth daily operations. Surpluses are transferred to KBC Asset Management, and from then onwards fall within the global limit relative to counterparty default risk.

7.5. Valuation for Solvency Purposes

7.5.1. Assets

7.5.1.1. Valuation bases for solvency purposes

These are identical to the ones used by KBC Insurance NV. Actual values can be found in QRT S.02.01.02.

7.5.1.2. Valuation bases in statutory financial statements

Impairments

For both financial fixed assets and unlisted shares, recorded under 'other financial assets', impairments are entered in the books in case of durable depreciations in value.

Listed shares are impaired in case their market value is sustainably (longer than one year) or significantly (more than 30%) lower than their book value, demonstrating that the depreciation in value is sufficiently durable.

The resulting impairments equal the difference between book value and market value.

The recorded impairments are reversed as soon as the market value is higher again, up to the purchase value at maximum.

For treasury investments, impairments are recorded when the realisation value of the investment at balance sheet date is lower than the purchase value.

For the other receivables and fixed income securities, impairments are recorded when reimbursement at maturity date is fully or partially uncertain or at risk.

Impairments are not maintained if, at fiscal year–end, they are higher than when based upon a current assessment, in accordance with the standards used at the time the impairments were recorded.

Provisions for risks and costs

At fiscal year–end, all foreseeable risks and charges which originated during the fiscal year are provisioned for, in accordance with the provisions of the Royal Decree of 17 November 1994.

Technical provisions

The technical provisions for claim payments to be made in the future are calculated per claim or per contract, taking known elements of the file into account.

Revaluations

Financial fixed assets as well as investment securities can be revalued when they show a certain and permanent capital gain compared to their purchase value.

Actual values can be found in template SE.02.01.16.

7.5.2. Technical provisions

7.5.2.1. Valuation bases and methods

In general, expected future cash flows related to reinsurance liabilities have been calculated and documented by KBC Insurance NV's Non-Life actuarial department in accordance with technical provisions guidelines as provided by KBC Group and taking into account the Risk Measurement Framework of KBC. We will briefly describe the main principles.

Pre-claim versus post-claim Non-Life obligations

For Non-Life obligations, separate cash-flow projections are made relative to:

- ✓ claim events that are expected to occur after the valuation date and during the remaining in-force period of existing contracts (pre-claim liabilities);
- ✓ claim events that have already occurred but that are not settled yet, regardless of whether the claims arising from these events have been reported or not (post-claim liabilities).

Gross liabilities versus retrocession recoverables

Cash-flow projections are initially made on a gross basis, without deduction of retrocession recoverables;

Retrocession recoverables are valued separately. They are included on the asset side of the economic balance sheet, and are calculated separately for Non-Life pre-claim and post-claim expected cash flows. Their valuation allows for expected losses due to counterparty default (i.e., the reinsurer); the impact thereof is however negligible.

Segmentation into homogeneous risk groups

Reinsurance liabilities have been grouped according to the nature of their risks, and calculations have been done separately for fire and allied perils (including natural catastrophes), general third-party liability ensuing from insured buildings, and legal expenses linked to the latter. These homogeneous risk groups have a one-to-one link with Solvency II lines of business (LOB) 19, 20 and 22:

- ✓ LOB 19 – proportional Non-Life reinsurance – fire and other damage to property insurance;
- ✓ LOB 20 – proportional Non-Life reinsurance – general liability insurance;
- ✓ LOB 22 – proportional Non-Life reinsurance – legal expenses insurance.

Where required by Solvency II regulations (i.e., if both parties are committed), future premiums on existing contracts are taken into account in valuing current liabilities. All contracts incept at 1 January, with a minimum 3-month cancellation period, ending on 30 September. Tacit renewal of these reinsurance

contracts implies both parties are committed; therefore, in this case, at 31 December, the next generation of reinsurance contracts is within scope of the valuation of reinsurance liabilities.

Technical provisions are calculated according to the 'Mark to Model' method; i.e., a theoretical 'transfer value' is calculated at which the liabilities would be valued when transferred to another company. This includes the calculation of the:

- ✓ discounted best estimate of liabilities: models are used to generate cash-flow projections. The present value is then calculated at the risk-free discounting yield curve;
- ✓ risk margin: in such a manner as to ensure that the value of the technical provisions is equivalent to the amount that (re)insurance undertakings would be expected to require in order to take over and meet the (re)insurance obligations. It is calculated according to the cost of capital approach; i.e., the present value of the cost of holding expected required capital during the remaining lifetime of the liabilities.

At present only deterministic calculations are made.

The matching adjustment referred to in Article 77b of Directive 2009/138/EC, the volatility adjustment referred to in Article 77d, the transitional risk-free interest rate term structure referred to in Article 308c and the transitional deduction referred to in Article 308d are either not relevant or not applied.

7.5.2.2. Overview of Solvency II technical provisions

The enclosed table provides an overview, as at 31 December 2018 of Solvency II technical provisions (cf. also QRT S.17.01.02):

- ✓ broken down into pre-claim and post-claim obligations;
- ✓ broken down into gross and retroceded obligations;
- ✓ per Solvency II line of business.

All amounts in the SOLVENCY II columns are expressed in terms of 'liabilities'; i.e., a negative liability represents an asset. Gross pre-claim liabilities are negative since they represent the economic profit expected to be generated by the 2019 generation of inward reinsurance contracts.

The risk margin is very high compared to the discounted best estimate of gross liabilities. However, the latter is composed of a positive value for the discounted best estimate of gross post-claim liabilities, and a negative one, more than compensating the positive one, for the best estimate of gross pre-claim liabilities. This negative value reflects the economic profits expected to be generated by the 2019 generation of inward reinsurance contracts; these expected economic profits are of course uncertain, and the risk margin represents the amount that (re)insurance undertakings would be expected to require in order to take over and meet the (re)insurance obligations.

Note that the risk margin is relevant only with respect to gross liabilities. A breakdown is available along the line of business criterion only.

7.5.2.3. Comparison between Solvency II and statutory valuation

The enclosed table also compares Solvency II with statutory technical provisions.

Provisions for unexpired risks as at 31 December 2018 don't figure in the statutory balance sheet since (almost) all underlying policies have a principal premium due date at 1 January. As reinsurance contracts are renewed as at 1 January 2019, the Solvency II economic balance sheet contains pre-claim liabilities related to these renewed contracts.

The equalisation reserves do not figure in the Solvency II economic balance sheet.

All amounts in the SOLVENCY II and STATUTORY columns are expressed in terms of ‘liabilities’; i.e., a negative liability represents an asset.

A negative (STATUTORY MINUS SOLVENCY II) figure represents a statutory deficiency whereas a positive figure represents a statutory redundancy, compared to the Solvency II economic balance sheet.

Since statutory valuation bases are very prudent, not surprisingly, gross liabilities represent a statutory redundancy.

However, retroceded liabilities represent a statutory deficiency since:

- ✓ the statutory balance sheet doesn’t contain pre-claim liabilities towards MVBh’s retrocessionaire, whereas the Solvency II economic balance sheet does, since in Solvency II, gross pre-claim obligations are expected to generate a profit, part of which will be due to the retrocessionaire;
- ✓ post-claim retrocession recoveries are overestimated in the statutory balance sheet, compared to the Solvency II economic balance sheet.

Liabilities, net of retroceded obligations, represent a statutory redundancy, compared to the Solvency II economic balance sheet.

31/12/2018 (x 1.000 EUR)	SOLVENCY II				STATUTORY (BGAAP)			STATUTORY (BGAAP) MINUS SOLVENCY II			
Reinsurance liabilities	Pre-claim	Post-claim	Risk margin	Total	Pre-claim	Post-claim	Total	Pre-claim	Post-claim	Risk margin	Total
Gross liabilities											
- LOB 19 (Fire)	-1.792,911	1.177,059	124,571	-491,282	0,000	1.482,383	1.482,383	1.792,911	305,324	-124,571	1.973,664
- LOB 20 (GTPL)	-5,966	10,283	0,004	4,321	0,000	18,987	18,987	5,966	8,704	-0,004	14,666
- LOB 22 (LA)	-2,247	30,769	0,012	28,534	0,000	25,877	25,877	2,247	-4,893	-0,012	-2,658
- Equalization reserves					1.623,918		1.623,918	1.623,918			1.623,918
- Total	-1.801,124	1.218,111	124,586	-458,427	1.623,918	1.527,246	3.151,164	3.425,041	309,136	-124,586	3.609,591
Retroceded liabilities											
- LOB 19 (Fire)	1.470,806	-1.058,222		412,583	0,000	-1.187,394	-1.187,394	-1.470,806	-129,171		-1.599,977
- LOB 20 (GTPL)	14,470	-10,172		4,297	0,000	-18,987	-18,987	-14,470	-8,814		-23,284
- LOB 22 (LA)	6,574	-30,438		-23,864	0,000	-25,877	-25,877	-6,574	4,562		-2,012
- Total	1.491,849	-1.098,833		393,016	0,000	-1.232,257	-1.232,257	-1.491,849	-133,424		-1.625,273
Net liabilities											
- LOB 19 (Fire)	-322,105	118,836	124,571	-78,698	0,000	294,989	294,989	322,105	176,153	-124,571	373,687
- LOB 20 (GTPL)	8,504	0,110	0,004	8,618	0,000	0,000	0,000	-8,504	-0,110	-0,004	-8,618
- LOB 22 (LA)	4,327	0,331	0,012	4,670	0,000	0,000	0,000	-4,327	-0,331	-0,012	-4,670
- Equalization reserves					1.623,918		1.623,918	1.623,918			1.623,918
- Total	-309,274	119,278	124,586	-65,410	1.623,918	294,989	1.918,907	1.933,192	175,711	-124,586	1.984,317

7.5.3. Other liabilities

Valuation bases are identical to the ones used by KBC Insurance NV.

7.6. Capital Management

7.6.1. Own funds

We refer to QRT S.23.01.01 to show that total unrestricted tier 1 basic own funds of 9 731 708 EUR are eligible and available to meet SCR and MCR. There are no ancillary own funds.

The origins of differences with statutory own funds are listed in the following table:

SE.02.01.16 x 1.000 EUR	Solvency II value	Statutory accounts value	Difference
Own funds	9.733,889	8.048,492	1.685,397
Foreseeable dividends	2,181	2,181	0,000
	9.731,708	8.046,311	1.685,397
ASSETS			
Listed equities	120,016	120,531	-0,515
Collective investments undertakings	2.012,306	2.324,416	-312,110
Government bonds	2.969,273	2.870,062	99,211
Corporate bonds	3.829,852	3.790,603	39,249
Reinsurance recoverables	-393,016	1.232,257	-1.625,273
LIABILITIES			
Technical provisions	-458,427	3.151,164	-3.609,591
Deferred tax liabilities	124,756	0,000	124,756
Payables (trade, not insurance)	6,069	6,133	-0,064
Any other liabilities, not elsewhere shown	141,555	143,672	-2,117
TOTAL [ASSETS - LIABILITIES]			1.685,397

7.6.2. Solvency Capital Requirement and Minimum Capital Requirement

MVBh's SCR calculations are based upon the standard formula. No (partial or full) internal model is used. As shown in QRT S.25.01.21, the SCR as at 31 December 2018 amounts to 2 849 024 EUR, giving rise to a solvency ratio of 342% of SCR.

Market risk (1 645 772 EUR), Non-Life underwriting risk (1 282 553 EUR), counterparty default risk (758 897 EUR), and operational risk (220 947 EUR) are the largest risks MVBh is exposed to.

No simplified calculations, nor undertaking-specific parameters are used.

The MCR is considerably higher than the SCR i.e. 3 600 000 EUR (as shown in QRT S.28.01.01), giving rise to a solvency ratio of 270% of MCR.

The Solvency II ratio with respect to the SCR is of course higher than the Solvency II ratio with respect to the MCR. When considering the solvency ratios, the SCR is less relevant in our case.

List of abbreviations

8. List of abbreviations

(3)LOD	(Three) Line(s) of defence
(A)RCC	(Audit,) risk & compliance committee
(G)ExCo	(Group) Executive committee
(N)SLT	(Non-) Similar to Life Techniques
ABS	Asset-backed security
AFH	Actuarial function holder
AFS	Available for sale
ALCO	Asset liability committee
ALM	Asset-liability management
AML	Anti-money laundering
APC	Alignment of planning cycles
BE	Best estimates
BoD	Board of directors
BPV	Basis point value
CDS	Credit default swap
CEO	Chief executive officer
CFO	Chief financial officer
CMS	Constant maturity swaps
CORM	Compliance risk manager
CRO	Chief risk officer
CVA	Credit value adjustment
DPF	Discretionary participation feature
DTL	Deferred tax liabilities
EBS	Economic balance sheet

EIOPA	European Insurance and Occupational Pensions Authority
EOY	End of year
EPIFP	Expected profits included in future premiums
EU	European Union
FATCA	Foreign account tax compliance act
FIFV	Financial liabilities designated at fair value through profit or loss
FRA	Forward rate agreements
FX	Foreign exchange
GDPR	General data protection regulation
GIC	Group insurance committee
GICC	Group internal control committee
GLC	Group lending committee
GMC	Group markets committee
G-RISK	Group risk
GVC	Group valuation committee
GWP	Gross written premium
HFT	Held for trading
HR	Human resources
HTM	Held to maturity
IAS	International accounting standard
IBNER	Incurred but not enough reserved
IBNR	Incurred but not reported
ICO	Intercompany
ICT	Information & communication technology
IDD	Insurance distribution directive
IFRS	International financial reporting standards

IM MC	International markets management committee
IR(R)	Interest rate (risk)
IT	Information technology
L&R	Loans & receivables
LAC DT	Loss absorbing capacity deferred taxes
LAT	Liability adequacy test
LGD(irr)	Loss given default (irrecoverable)
LoB	Line of business
LRMF(i)	Liquidity risk management framework (insurance)
LTG	Long term guarantee
MCR	Minimum capital requirement
MiFID	Markets in financial instruments directive
MRBB	Maatschappij voor roerend bezit van de boerenbond cvba
NAPP	New and active product process
NBB	National bank of Belgium
NII	Net interest income
NL	Non-Life
NPS	Net promoter scores
NSLT	Non Similar to Life Techniques
OFAC	Office of Foreign Assets Control
OIS	Overnight index swaps
ORSA	Own risk & solvency assessment
P&L	Profit & loss
PD	Probability of default
PLS	Portfolio limit system
PRIIPS	Packaged retail and insurance-based investment products

PWC	PricewaterhouseCoopers
QRT	Quantitative reporting template
Risk ManCo	Risk Management Committee
RM	Risk margin
RMF	Risk management framework
ROE	Return on equity
S&P	Standard & Poor’s
SA	Symmetric adjustment
SCR	Solvency capital requirements
SFCR	Solvency and financial condition report
SII	Solvency II
SII SF	Solvency II standard formula
SME	Small and medium-sized enterprises
SRI	Socially responsible investing
SSC	Shared service centres
T1/T2	Tier 1 / Tier 2
TP	Technical provisions
TRIP	Terrorism reinsurance and insurance pool
VA	Volatility adjustment
VaR	Value at risk

Glossary

9. Glossary

3 LOD (Three Lines of Defence)

The 3 LOD model ensures the resilience of KBC's risk and control environment and safeguards the sustainability of our business model going forward. In this model, Business acts as the first line of defence, Risk as one of the second lines and Internal Audit as the third line. They all work together in order to prevent big impact losses for the KBC group.

Annuity

A contract that provides a series of regular payments (both amount and timing) by the insurer (amount payable / benefit) under specified conditions for a specified period of time.

An annuity may begin at a specified time after the issuing of the contract (deferred annuity), or following a specified trigger such as death or disability, e.g. orphans' benefits or disability annuities. Annuity benefits under an insurance contract typically end upon the death of the insured person, or cease upon recovery of the insured from disability or after a predefined period. Coverage may relate to one or two persons, respectively single-life or joint-life.

The contract can be funded by the policyholder by means of a single premium or through a series of instalments. The amount of regular payments to the beneficiary may be fixed or not, i.e. variable or fixed annuity, certain or temporary. Annuity contracts are sold on an individual and group basis.

Asset-liability management (ALM)

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

Best Estimate

The best estimate shall correspond to the probability-weighted average of future cash-flows, taking account of the time value of money (expected present value of future cash-flows), using the relevant risk-free interest rate term structure.

The calculation of the best estimate shall be based upon up-to-date and credible information and realistic assumptions and be performed using adequate, applicable and relevant actuarial and statistical methods.

The cash-flow projection used in the calculation of the best estimate shall take account of all the cash in- and out-flows required to settle the insurance and reinsurance obligations over the lifetime thereof.

BPV (Basis Point Value)

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

Business risk

Business risk is the risk arising from changes in external factors that impact the demand for and/or profitability of our products and services. Risk factors that are taken into consideration include the macroeconomic environment, the regulatory framework, client behaviour, the competitive landscape and the socio-demographic environment. Business risk is assessed on the basis of structured risk scans.

Strategic risk is the risk caused by not taking a strategic decision, by taking a strategic decision that does not have the intended effect or by not adequately implementing strategic decisions.

Carrying amount

The amount at which an asset or liability is recognised in the balance sheet.

Linked to IAS 36.6 (impairment of assets), IAS 16.6 (property, plant and equipment) and IAS 38.8 (intangible assets).

This value is not necessarily the same as historic cost, e.g. because the carrying amount takes into account depreciation or could be a fair value.

Catastrophe risk

The risk that a single event, or series of events, of major magnitude, usually over a short period (often 72 hours), leads to a significant deviation in actual claims from the total expected claims.

The notion of catastrophe risk is per definition relative to the financial position of the individual insurer and any significance will need to be defined in mathematical terms. The exact definition of what constitutes a catastrophe hence varies per insurer.

Credit risk

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.

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

EBS (Economic Balance Sheet)

Balance sheet statement based on one of those accounting approaches using market-consistent values for all current assets and current obligations relating to in-force business, including off-balance sheet items.

Depending on the reporting approach different items can be recognised or not recognised in the balance sheet, as well the definition of a current resource or obligation can vary from approach to approach. The economic balance sheet provides the market-consistent value of the shareholder equity.

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.

Eligible capital

Capital (either on or off-balance sheet) which, under regulatory rules, may be taken into account (fully or partially) in determining the insurer's available capital for solvency purposes.

Equity risk

The risk of a change in value caused by deviations of the actual market values of equities and/or income from equities from their expected values

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.

Foreign exchange risk

The risk of a change in value caused by the fact that actual foreign currency exchange rates differ from those expected.

Foreign exchange risk can arise if the assets and liabilities of an insurer are not in the same currency, or if contracts for administrative and other services are contracted in a currency different to the currency implied in the premium determination.

Guaranteed benefit

Payments or other benefits to which a particular policyholder or investor has an unconditional right that is not subject to the contractual discretion of the issuer.

The unconditional right of the policyholder implies that no condition is subject to the insurer's discretion, nor to insurer's performance. Hence, a guaranteed benefit, or its determination, is contractually stipulated without any ability of the insurer to influence that benefit, neither by discretion nor by its performance. Accordingly, a guarantee is a risk bearing feature, since the amount to be paid might deviate from the earnings of the insurer, without the ability of the insurer to avoid that.

Health insurance

Generic term applying to all types of insurance indemnifying or reimbursing for losses (e.g. loss of income) caused by illness or disability, or for expenses of medical treatment necessitated by illness or disability.

IBNR (Incurred but not Reported) reserves

IBNR is the abbreviation of incurred but not reported reserves (IBNR), these are the reserves for claims that become due with the occurrence of the events covered under the insurance policy, but have not been reported yet.

Inflation risk

The risk of a change in value caused by a deviation of the actual market-consistent value of assets and/or liabilities from their expected value, due to inflation, e.g. price inflation, wage inflation, etc., leading to an unanticipated change in insurance cost and/or impact of an insurance contract, e.g. with respect to contract limits.

Insurance contract

A contract under which one party (the insurer) accepts significant insurance risk from another party (the policyholder) by agreeing to compensate the policyholder or its beneficiary if a specified uncertain future event (the insured event) affects the policyholder.

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.

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.

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.

Life insurance

Category of insurance contracts for which the benefit payment is based on the occurrence of death, disability, or critical illness of the insured within the specified coverage term, or on the life status of the insured at maturity.

Life insurance offers life and/or death coverage of the insured in the form of a single or multiple (as well regular in case of an annuity) lump sum payments to a beneficiary.

Health insurance products are often sold as a rider to a (group) Life contract. In *sensu stricto* these are not Life insurance, because they do not relate to the occurrence of death.

Liquidity risk

Liquidity risk is the risk that an organisation will be unable to meet its payment obligations as they come 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).

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.

Mark-to-Market

The act of assigning a market value to an asset

MCR (Minimum Capital Requirement)

The capital level representing the final threshold that triggers ultimate supervisory measures in the event that it is breached.

Non-Life insurance

Generic term used to refer to all types of insurance business other than Life insurance, including for example Property insurance, Liability insurance, Motor insurance, Accident insurance, and Health insurance.

Operational risk

The potential negative deviation from the expected value of the organisation resulting from inadequate or failed internal processes and systems, human error or sudden external events, whether man-made or natural. 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.

PD (Probability of Default)

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

Risk appetite

Risk appetite, as defined by the Board of Directors, is the amount and type of risk that KBC is able and willing to accept in pursuit of its strategic objectives. While the ability to accept risk is limited by financial (e.g., available capital) and non-financial regulatory and legal constraints, the willingness to accept risk depends on the interests of various stakeholders (shareholders, creditors, employees, management, regulators, clients, etc.). Risk appetite aims to find the right balance of satisfaction for all stakeholders.

Risk margin

A generic term, representing the value of the deviation risk of the actual outcome compared with the best estimate, expressed in terms of a defined risk measure

The term ‘risk margin’ in the context of Solvency II refers to the amount above the best estimate liability.

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.

Solvency II

Solvency II is a project, initiated by the European Commission in 2001, and resulted in the European directive 2009/138/ EC of 25/11/2009 (Solvency II) which establishes capital requirements and risk management standards that apply across the EU and 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.

SCR (Solvency Capital Requirement)

The amount of capital to be held by an insurer to meet the Pillar I requirements under the Solvency II regime.

Spread risk

The risk of a change in value due to a deviation of the actual market price of credit risk from the expected price of credit risk.

Underwriting risk

The risk of a change in value due to a deviation of the actual claims payments from the expected amount of claims payments (including expenses).

Total underwriting risk for Non-Life insurance includes the total of claims risk and expense risk for claims. For Life insurance it includes the total of lapse, surrender, and biometric risks, as well as expense risk for claims.

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.