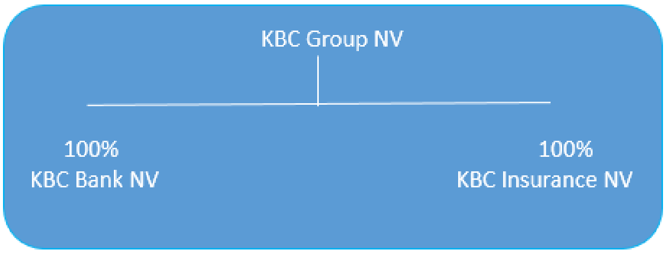

SOLVENCY &
FINANCIAL
CONDITION
REPORT
2018

Difference between KBC Insurance and KBC Group

KBC Insurance NV is a subsidiary of KBC Group NV. The KBC group's legal structure is given in the diagram and is made up of one single entity – KBC Group NV – in control of two underlying companies, viz. KBC Bank NV and KBC Insurance NV. All KBC Insurance NV shares are owned (directly and indirectly) by KBC Group NV.



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Solvency & Financial Condition Report

KBC Insurance Group

Activity Year 2018

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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). Risk management information is therefore provided in a separate section of the 2018 Annual Report of KBC Group NV and – more extensively – in this publication.

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 Solvency I has been replaced by the fundamentally reformed Solvency II framework, which officially entered into force in January 2016.

Information is disclosed at the highest consolidated level. For more detailed information, please refer to the local disclosures of the entity concerned (for instance, those provided on their websites).

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.

One-on-one comparison of figures presented in the annual report and figures presented in this report cannot always be made due to the different risk concepts used under IFRS and Solvency II. In order not to compromise on the readability of this document, relevant parts of the annual report have been reproduced here or, where relevant, clarification is given to explain the differences between the accounting values and the Solvency II values (section 5 of this SFCR).

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 report 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)'.

All amounts quoted in this report and in the tables are in millions of euros, unless otherwise stated. This report has been published for the third time and therefore comparisons are made with available Solvency II-related data of the previous year.

Highlights in 2018

The KBC Insurance Group caters mainly for retail, SME and mid-cap clients. It concentrates on its home markets of Belgium and four countries in Central and Eastern Europe, namely the Czech Republic, Slovakia, Hungary and Bulgaria.

- ✓ The KBC Insurance Group has a well-diversified – Medium – risk profile, in line with the Risk Appetite Statement (RAS). It benefits from diversified activities that target retail, SME and mid-cap clients across multiple distribution channels.
- ✓ All of the material insurance entities are present in KBC's core markets (except for Ireland) and operate according to an integrated bank-insurance model. KBC Group Re is a captive reinsurer providing services out of Luxembourg. KBC Insurance NV accounts for almost 90%[3] of the KBC Insurance Group's overall risk profile .
- ✓ The KBC Insurance Group is strongly capitalised in terms of the level and quality of capital. The Solvency II ratio at 31 December 2018 amounted to 217 %.
- ✓ The consolidated result came to 469 million euros compared to 465 million euros in 2017, which is an increase of 4 million euros. This is the result of a higher technical result in Life and Non-Life and lower taxes, but compensated by lower net interest income, decline in net fee and commission income, higher impairments on shares and lower result in reinsurance.
- ✓ Earned premiums in Non-Life insurance went up by 6% to 1 601 million euros, with all entities recording an increase .
- ✓ Earned premiums in Life insurance increased with almost 7% to 1 361 million euros.
- ✓ The combined ratio for Non-Life business of KBC Insurance Group came to a very favourable 88,2%.
- ✓ Operating expenses went up with 3%.

[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)
[3] In terms of SCR: **S**olvency **C**apital **R**equirement

NEDERLANDSTALIGE VERSIE

Dit Solvency & Financial Condition Rapport is beschikbaar in het Engels op de KBC website en hiervan wordt jaarlijks een update gemaakt. De volgende update wordt gepubliceerd eind April 2020. Afhankelijk van de marktomstandigheden kan KBC beslissen om meer frequente updates te doen.

Het Solvency & Financial Condition Report (SFCR) wordt elk jaar door elke verzekeringsonderneming/groep gepubliceerd. Het rapport voorziet in kwalitatieve en kwantitatieve informatie over het verzekeringsbedrijf en de performantie, het governance systeem, het risico profiel, de waardering volgens de solvency II reglementering en het kapitaalmanagement van de onderneming/groep.

Het rapport heeft een geharmoniseerde structuur, die gedefinieerd is in Annex XX of the Solvency II Delegated Acts Regulation[1] en bevat de templates zoals gedefinieerd door "the Implementing Regulation[2] ". De kwantitatieve informatie is vervat in de 'Quantitative Reporting Templates (QRTs)'.

Alle bedragen die in het rapport alsook in de tabellen voorkomen, zijn uitgedrukt in veelvouden van miljoen euro, tenzij anders aangegeven. Het rapport bevat vergelijkingen met de Solvency II gerelateerde data van vorig jaar.

Highlights in 2018

De grootste groep klanten binnen de KBC Insurance Group bevindt zich bij retail, KMO's en mid-cap ondernemingen. De focus ligt op de Belgische thuismarkt en 4 landen in Centraal en Oost Europa, namelijk Tsjechië, Slowakije, Hongarije en Bulgarije.

- ✓ KBC Insurance Group heeft een goed gediversifieerde portefeuille met een laag risicoprofiel dat in lijn is met de RAS (Risk Appetite Statement). De diversificatie tussen activiteiten zowel in retail, in SME alsook bij mid-cap klanten via verschillende distributiekanalen resulteert in positieve resultaten.
- ✓ Alle verzekeringsentiteiten zijn aanwezig in de core markten van KBC (behalve voor Ierland) en opereren volgen een geïntegreerd bank-verzekeringsmodel. KBC Group Re is een captive herverzekeraar die diensten aanbiedt vanuit Luxemburg. KBC Insurances NV is verantwoordelijk voor ongeveer 90%[4] van het globale risicoprofiel van KBC verzekeringen op groepsniveau.
- ✓ KBC Insurance Group is sterk gekapitaliseerd in termen van grootte en ook qua kwaliteit van kapitaal. De Solvency II ratio op 31 December 2018 bedroeg 217%.
- ✓ Het geconsolideerde resultaat bedraagt 469 miljoen euro in vergelijking met 465 miljoen euro in 2017, wat een verhoging is met 4 miljoen euro. Dit is het resultaat van een beter technisch resultaat in Leven en Niet-Leven en lagere taxen maar aan de andere kant zijn er een lager netto interest inkomen, lagere netto fees, lagere commissies en hogere waardeverminderingen op aandelen en een lager resultaat in herverzekering.
- ✓ De verworven premies in Niet-Leven stegen met 6% tot 1 601 miljoen Euro en dit voor alle entiteiten.
- ✓ In Leven stegen de verworven premies met bijna 7 % tot 1 361 miljoen euro.
- ✓ De combined ratio voor niet-leven is zeer gunstig en bedraagt 88,2%.
- ✓ De operationele kosten stijgen met 3% in vergelijking met 2017

[4] In termen van SCR: **S**olvency **C**apital **R**equirement

Business & performance

2 Business & performance

2.1 Business

2.1.1 Brief presentation of the KBC Insurance Group at year-end 2018

Our area of operation

The KBC Insurance Group is an insurance group catering mainly for retail, SME and mid-cap clients. It concentrates on its home markets of Belgium and four countries in Central and Eastern Europe, namely the Czech Republic, Slovakia, Hungary and Bulgaria.

Main group companies

Belgium	KBC Insurance NV
Czech Republic	ČSOB Pojišt'ovna a.s.
Slovakia	ČSOB Poist'ovňa a.s.
Hungary	K&H Insurance Zrt.
Bulgaria	DZI Insurance
Luxembourg	KBC Group Re

Our shareholders

All KBC Insurance NV shares are owned (directly and indirectly) by KBC Group NV. KBC Group NV is a listed company.

Our clients, staff and network

Clients (estimate)	4 million
Number of staff (2018 average in FTEs)	4 202
Insurance network	372 agencies in Belgium, various distribution channels in Central and Eastern Europe

Our long-term credit ratings (14 March 2019)

	Standard & Poor's
KBC Insurance NV	A

Management

CEO	Johan Thijs
Chairman of the Board of Directors	Thomas Leysen

More information

Website	www.kbc.com

Data relates to year-end 2018, unless otherwise indicated. For definitions and comments, please see the detailed tables and analyses in this report.

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Our supervisory authority

National Bank of Belgium

De Berlaimontlaan 14

1000 Brussels

Our external auditor

PWC Bedrijfsrevisoren

Woluwedal 18

1932 Sint-Stevens-Woluwe

2.1.2 Strategy & business model

KBC Insurance NV's strategy is embedded in the strategy of the KBC group, given that we are an integrated bank-insurance group. A summary is provided below of the strategy of the KBC group, where 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.

How do we create value? (KBC Group)

We want to be able to meet the expectations of all our stakeholders in our core countries and to live up to our commitments. Integrating sustainability in our day-to-day activities is, in our view, the best guarantee for the creation of long-term value for all these stakeholders.

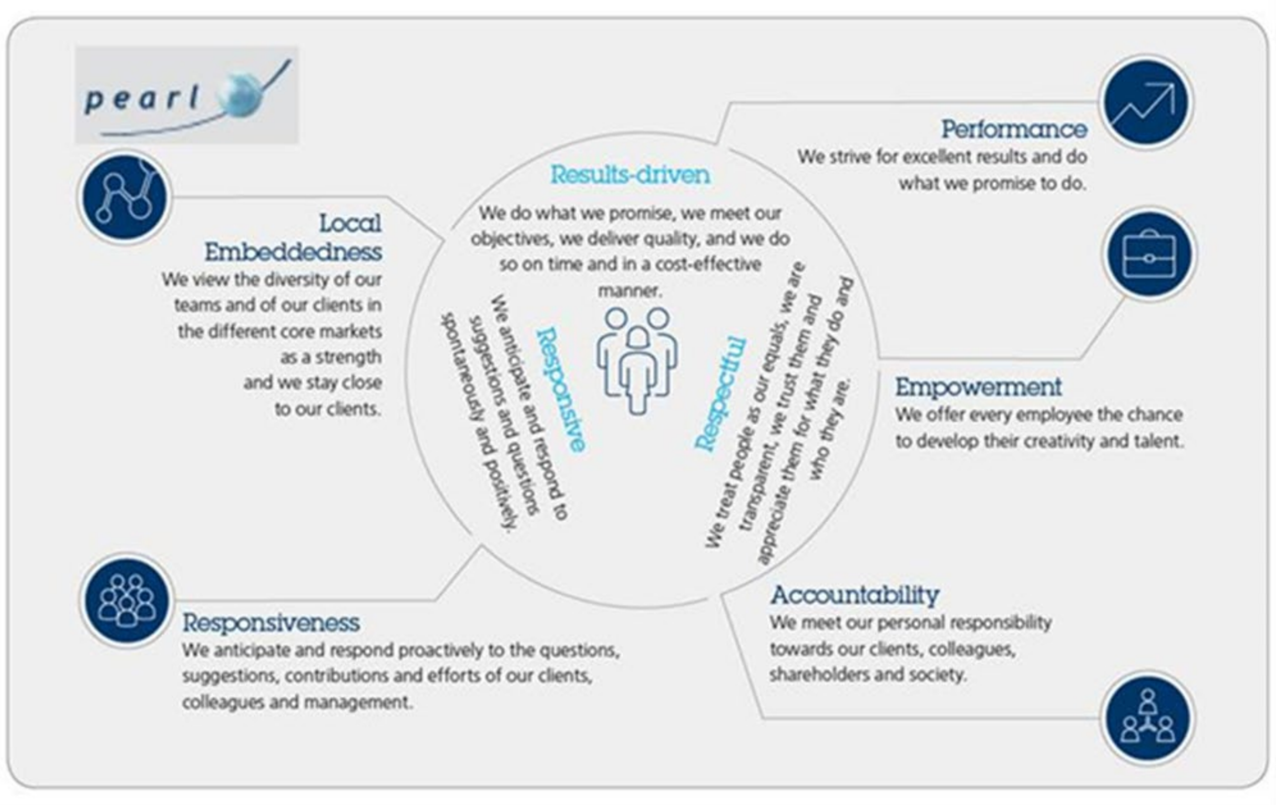
As a banker, for instance, we see to it that our clients are able to save and invest in a well-informed manner and that we actively offer them sustainable investment products. In this way, every client can grow their assets in keeping with their personal wishes and risk profile, and call on the expertise of our staff to assist them. We use the money from the deposits our clients entrust to us to provide loans to individuals, businesses and public authorities, thereby putting that money to productive use in the local society and economy. As a lender, we enable people to build a house or buy a car, for instance, and businesses to be created or to grow. We also hold a portfolio of investments, which means we invest in the economy indirectly too. In all these activities, we seek to take account of the impact on society and the environment, which we translate into targets for SRI funds, lending to renewable energy projects and similar initiatives. Besides providing finance to individuals and businesses, we fund specific sectors and projects, such as the social profit sector and infrastructure projects that have a major impact on the domestic economy. The role we play as a deposit-taker and a lender ultimately means that we assume our clients' risks for them. Our highly developed risk and capital management know-how allows us to manage those risks.

As an insurer, we enable our clients to operate free of worry and to limit their risks. We work hard every day to provide the best insurance cover at a fair price and we invest in a high-quality claims-handling service, because that will always be the true litmus test of any Non-Life policy. What's more, we use our knowledge of the causes of accidents to develop accident prevention campaigns and we have a long-standing tradition of working with organisations involved in road safety, welfare and victim assistance.

We also offer our clients a variety of other services that are important to them in their everyday lives, including payments, cash management, trade finance, leasing, corporate finance, and money and capital market products. In this way too, we contribute to the economic system.

At the same time, we have made a conscious choice to enhance our positive impact on society – where possible – by focusing on areas where we can make a difference as a bank-insurer. The areas in question include financial education, environmental awareness, entrepreneurship and the issue of demographic ageing and health. We likewise support social projects that are closely aligned with our business operations and through which we can play our role in society.

What makes us who we are? (KBC Group)



We sum up our business culture in the acronym '**PEARL**', which stands for **Performance**, **Empowerment**, **Accountability**, **Responsiveness** and **Local Embeddedness**. We also encourage all our employees to behave in a way that is **responsive**, **respectful** and **results-driven**. An explanation of what we mean is given in the diagram.

PEARL is a mindset, a working culture, shared by all our staff. We have appointed a dedicated PEARL manager to make sure that all our employees are thoroughly imbued with these values. The PEARL manager reports to our CEO. To embed this culture across the entire group and to ensure its success, we adopt not only a top-down approach, but also a bottom-up approach to its implementation. This includes appointing hundreds of PEARL ambassadors in the workplace, who give concrete shape to PEARL and help other colleagues to apply it.

We also distinguish ourselves from our competitors through several specific features, including our integrated bank-insurance model and our focus on a number of specific countries. The table below goes into this in greater depth:

What differentiates us from our peers? (KBC Group)

Our integrated bank-insurance model

We offer an integrated response to our clients' banking and insurance needs. Our organisation is similarly integrated, with most services operating at group level and the group also managed in an integrated style. Our integrated model offers our clients the benefit of a comprehensive, one-stop financial service that allows them to choose from a wider, complementary and optimised range of products and services. For ourselves, it offers benefits in terms of income and risk diversification, additional sales potential through intensive co-operation between the bank and insurance distribution channels, and significant cost-savings and synergies.

Our strong geographical focus

We focus on our core markets of Belgium, Bulgaria, the Czech Republic, Hungary, Ireland and Slovakia. As a result, we now operate in a mix of mature and growth markets, taking advantage in the latter of the catch-up potential for financial services. We have a limited presence elsewhere in the world, primarily to support activities in our core markets.

Our focus on local responsiveness

We want to build sustainable local relationships with private individuals, SMEs and mid-caps in our core countries. Local responsiveness is very important to us in that regard. It means that we know and understand our local clients better, that we pick up signals effectively and respond to them proactively, that we offer products and services tailored to these local needs, and that we focus on the sustainable development of the different communities in which we operate. Where relevant, we facilitate collaboration among core countries to avoid duplicating our efforts and to offer our clients the best solutions.

Our approach to sustainability

Sustainability is not a separate policy at KBC, but an integral part of our overall business strategy, which is anchored in our day-to-day activities. Our sustainability strategy, which is geared towards the local economy and society, consists of three cornerstones: encouraging responsible behaviour on the part of all our employees, increasing our positive impact on society and limiting any adverse social impact we might have.

Our shareholder structure

A special feature of the KBC Group shareholder structure is the core shareholder syndicate consisting of Cera, KBC Ancora, MRBB and the other core shareholders, which together held roughly 40% of the shares at the end of 2018. These shareholders act in concert, thereby ensuring shareholder stability in our group.

Our strengths

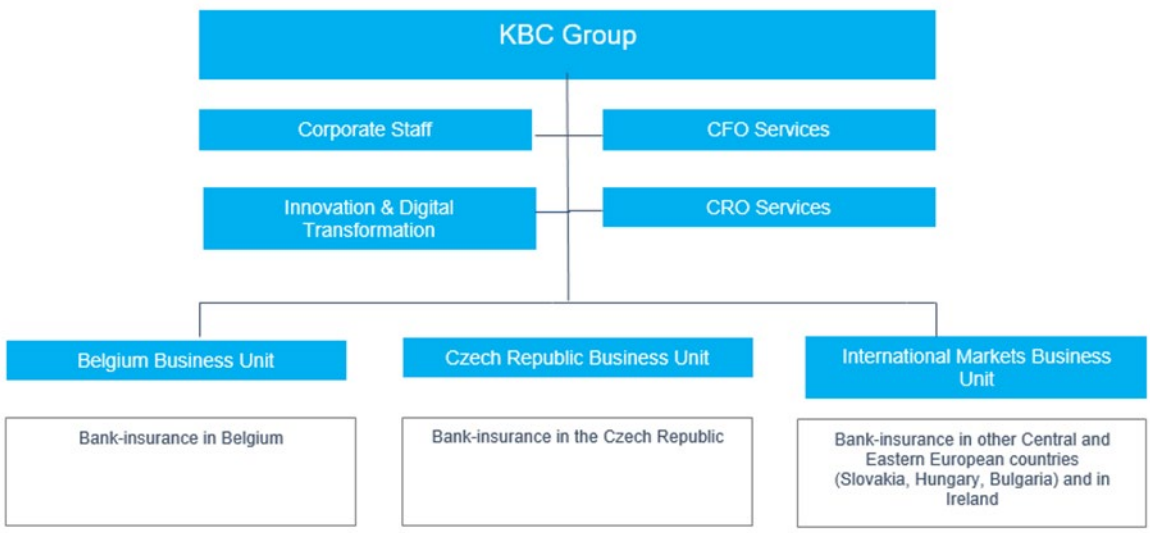
A well-developed multichannel bank-insurance and digital strategy, which enables us to respond immediately to our clients' needs	Strong commercial banking and insurance franchises	Turnaround achieved in the International Markets Business Unit and position in Bulgaria considerably strengthened	Successful track record of underlying business results

Our challenges

Macroeconomic environment characterised by low interest rates, demographic ageing, increased nervousness on the financial markets, and geopolitical and climate-related challenges	Stricter regulation in areas like client protection and solvency	Changing client behaviour, competition and new players in the market	New technologies and cyber crime

We have structured our group around three business units, which focus on local activities and contribute to sustainable earnings and growth. The units are **Belgium**, the **Czech Republic** and **International Markets**. We have illustrated the importance of each business unit in the diagram below.

The Board of Directors is responsible for defining our group's strategy, general policy and risk appetite. It is supported by several specialised committees, namely the Audit Committee, the Risk & Compliance Committee, the Nomination Committee and the Remuneration Committee. Our Executive Committee provides the operational management of the group within the confines of the general strategy approved by the board. Besides the **CEO**, the Executive Committee includes the Chief Financial Officer (**CFO**), the Chief Risk Officer (**CRO**) and the Chief Innovation Officer (**CIO**) of the group, as well as the CEOs of the three business units.



In what environment do we operate? (KBC Group)

The main challenges facing us are, of course, the economic situation, intensifying competition and technological change, regulation, and cyber and ICT risks. The way in which we are dealing with them is set out below:

The world economy, geopolitical challenges and the environment

The world economy, the financial markets and demographic developments can strongly influence our results. This relates to matters like growth, interest rates, inflation, employment, population structure, bankruptcies, household income, financial market liquidity, exchange rate movements, availability of funding, investor and consumer confidence, credit spreads and asset bubbles.

Persistently low interest rates have become an important factor in recent years, exerting significant pressure on the income of banks and insurers and prompting a search for yield. Demographic ageing is also a challenge for our life insurance business, for instance, where it can lead to a changing product offering due to the shift in the structure of the insurance population, and because it drives up demand for rate products with longer maturities. There is a risk, moreover, of corrections in markets where disequilibrium may have built up (asset bubbles).

Recent geopolitical developments (such as Brexit, political tensions and military threats) could also have significant implications for the economy and hence our results. The same goes for climate change and the transition to a low-carbon society.

How are we addressing them?

- ✓ We ensure in our long-term planning/scenario that our capital and liquidity position is capable of withstanding a negative scenario.
- ✓ We take proactive measures. Examples include adjusting our offering to take account of demographic ageing (more insurance policies relating to health care, investment products linked to financial planning, etc.) and of demand for sustainable products like green bonds and sustainable pension saving.
- ✓ We calculate the potential impact of changes in key parameters and estimate the impact of material events as effectively as possible.
- ✓ We intend to diversify our income sources further to include more fee business, for example, alongside interest income.
- ✓ Limiting our negative impact on the environment (both direct and indirect) is an important strand of our sustainability strategy.

Shifting client behaviour and competition

We carry out our activities in a highly competitive environment. Our competitors too are being affected by technological change (e.g., online services, artificial intelligence) and shifting client behaviour. Besides the traditional players, there is also intensifying competition from online banks, fintechs and e-commerce in general. Intensifying competition and technological change are exerting potential pressure on cross-selling opportunities and influencing client expectations. Clients are placing ever more importance on things like speed, the possibility of digital interaction and simple solutions. All this is increasing the significance of digitalisation and an effective framework for it and creating the need for a resilient, responsive organisation capable of continuously adapting its processes and systems.

How are we addressing them?

- ✓ The creative input and training of our employees is highly important when it comes to equipping ourselves to deal with competition and technological change.
- ✓ As an integrated financial institution, we can draw on an immense volume of data, which enables us to understand more clearly what clients really want. What's more, our integrated model allows us to offer our clients more comprehensive solutions than pure banks or insurers can.
- ✓ We have a specific process in place to ensure that the business side receives approval efficiently for new product launches. The process also includes a thorough examination of the potential risks. We regularly review all our existing products, so that they can be adapted to take account of evolving client needs or changing circumstances.
- ✓ Research and development have been performed at a variety of group companies as part of a programme to develop new and innovative financial products and services. Over the past few years, we have launched numerous successful mobile and other innovative apps (examples are provided in the section dealing with the business units).
- ✓ We are open to partnerships with fintech firms or even sector peers.
- ✓ We have committed ourselves in Ireland to implementing a 'Digital First' strategy. Cooperation with other group entities is being increased to speed up digitalisation and innovation.
- ✓ In addition to digitalisation, we are working hard to simplify products and processes.
- ✓ We are investing 1,5 billion euros throughout the group in digital transformation between 2017 and the end of 2020.

Regulation

Increasing regulation is an issue for the financial sector as a whole. In addition to legislation already in force, such as the General Data Protection Regulation (GDPR), Markets in Financial Instruments Directive II (MiFID II and MiFIR) and Payment Services Directive II (PSD2), it includes the following in the years ahead:

- ✓ EU measures to mobilise financial resources for sustainable growth (including disclosure requirements for environmental, social and governance (ESG) matters).
- ✓ The Shareholder Rights Directive (SRD II), which will, amongst other things, affect the way banks, as security custodians, communicate certain information to their investor clients.
- ✓ Planned reforms to the European Market Infrastructure Regulation (EMIR) to enhance the functioning of the derivatives market in the EU, the new Prospectus Regulation (PR3) and the new Securitisation Regulation for simple, transparent and standardised (STS) securitisation. We also expect a European Regulation on crowdfunding.
- ✓ The ePrivacy Regulation (ePR), which will supplement the GDPR to improve privacy in electronic communication.
- ✓ The ECB is working on a regulatory framework to cover the outsourcing of activities and services by banks, with the emphasis on internal governance, risk management and reporting.
- ✓ Initiatives with regard to solvency, including the calculation of risk-weighted assets (Basel IV) and the further streamlining of legislation to ensure that shareholders and creditors absorb losses at banks rather than the government (bail-in and MREL).
- ✓ New IFRS, including IFRS 17, which applies to insurance activities and will probably become effective as from 2022.

How are we addressing them?

- ✓ We are making thorough preparations for the new regulations. Specialised teams (group legal, capital management, group risk and compliance) keep close track of the rules and propose the necessary responses in terms, for instance, of the group's capital planning.
- ✓ We study the impact of regulations like PSD2 and MiFID on client behaviour and, where appropriate, adjust our products and processes to take account of shifts in that behaviour.
- ✓ We participate in working groups at sector organisations, where we analyse draft texts.
- ✓ A special team focuses on contacts with government and regulators.
- ✓ We produce memorandums and provide training courses for the business side.

Cyber risk and information security

Robust ICT systems are extremely important in an increasingly digital world where hacking and cyber attacks are a constant threat, with the potential to cause significant financial and reputational harm.

Our focus here is on the optimum protection of both our clients and our group itself.

How are we addressing them?

- ✓ We raise our employees' awareness of cyber risks by providing training in areas like phishing and vishing, and fraud in general.
- ✓ We work to achieve highly secure and reliable ICT systems and robust data protection procedures, and we constantly monitor our systems and the environment.
- ✓ We analyse cyber risks from an IT and business perspective, so that we can offer maximum resistance and are able to remedy attacks swiftly and efficiently. We regularly evaluate our action plans and adapt them on the basis of new internal and external information.
- ✓ A certified Cyber Expertise & Response Team focuses on cyber crime, informs and assists local entities, tests KBC's defence mechanisms and provides training and cyber-awareness in the group. A group-wide Competence Centre for Information Risk Management concentrates on the risks associated with information security and cyber crime, and on operational IT risks.
- ✓ We are members of the Belgian Cyber Security Coalition – a knowledge and consultative platform consisting of around 50 public and private-sector enterprises and academics.
- ✓ We also have our entities' cyber risks and defence mechanisms evaluated on an annual basis by an international team of internal information security experts.

Our employees, capital, network and relationships (KBC Group)

As a financial group, we draw on many different types of capital, including our employees and our capital base, but also our brands, reputation and capacity to innovate, our relationships with all our stakeholders, our networks – both electronic and bricks-and-mortar – and our ICT infrastructure.
We create a motivating working environment where our employees are given the opportunity to develop their talents and skills – and to put them to work in implementing our business strategy – not only by learning, but also by communicating their ideas and taking responsibility. We view self-development as key to professional growth, along with KBC. Our staff can choose among a wide range of training methods, including e-learning, workplace coaching and traditional courses. In Hungary, for example, K&H Insurance Zrt. gave tangible shape in 2018 to the new learning culture using digital possibilities through the Retail Network Starter Course. Commercial trainees complete an online learning journey through videos, Skype training sessions and gamification to build up knowledge of their future job and to put that knowledge into practice.

Our staff increasingly collaborate in multidisciplinary teams on both long-term projects and short-term assignments, encouraging them to think creatively and to take on new roles. This opens up the prospect of a richer career path, which is fully aligned with the employee's individual talents and KBC's goals. We understand that it is the flexibility of our staff themselves that enables us as an organisation to respond proactively to our clients' wishes. The increasingly digital character of our work is having a substantial impact on jobs at KBC. We are approaching this transformation in such a way that our employees can evolve with it. To achieve this, we have opted to continue investing in lifelong learning, internal redeployment and retraining.

We realise that good managers are key when it comes to enabling employees to bring out the best in themselves. That's why we are committed to intensive leadership tracks. In the Czech Republic, for instance, we have combined these activities in the 'Leaders World' programme, which aims to help managers grow on all levels.

HR policy features individual focuses in each country, so that we can respond in an optimum way to the local labour market. For instance, to address the challenge of the rising retirement age in Belgium, we have introduced an updated age-independent pay policy and operate an innovative late-career policy (Minerva), in which employees can spend the final years of their career working at an external, socially relevant organisation. At UBB in Bulgaria, the focus in 2018 following the merger of CIBANK and UBB has been on harmonious team work to ensure that the needs of clients are met as much as possible. We also introduced a unified remuneration and benefits package there.

We take the well-being of our employees very seriously a vision that has long been embedded in our organisation. 'Healthy' employees feel at ease with themselves and are strong enough to use their own creativity in pursuit of client-focused solutions. To that end, we aim to keep our staff as fit and deployable as possible in the long term, both mentally and physically. An intensive project on well-being is underway in Slovakia, for example, with specific prevention initiatives in which employees can – in addition to a medical examination every three years – receive a quick check-up on regular 'Health Days'. Particular attention is paid in Belgium to mental health, including presentations and interactive sessions with managers, so that stress and burn-out can be discussed openly within their teams.

We do not make any distinction on the grounds of gender, religion, ethnic background or sexual orientation in our HR, recruitment and promotion policies or remuneration systems. Equal treatment of employees is also enshrined in the KBC Code of Conduct and in the various manifestos and charters we have endorsed. As an employer, we want to give a clear signal to society: we treat our employees in a socially responsible manner and that relationship is grounded in mutual trust and respect. We also raise diversity awareness among our employees.

We encourage our employees to develop ideas as a team. 'Team Blue' is KBC's way of uniting employees from different countries and departments, to make them proud of their team and their company, so that they can draw on each other's experience and engage in 'smart copying'. This collective awareness is also promoted in a light-hearted way, including our 'Team Blue Challenges', in which the group CEO sets the company a task to complete. One such challenge last year led to us breaking the world record for the biggest online quiz. Another challenge that Team Blue took on was to 'accumulate kilometres' through sporting activities with colleagues, friends and family. The final score was over 770 000 kilometres and 500 000 euros raised for charity.

Senior managers from across the group take part in the 'KBC University' to enable them to pursue a common vision. This ambitious development programme offers different speakers and modules focusing on bank-insurance, leadership and client-centricity. At the same time, KBC is actively working on a separate policy for top talent management, in which we identify future senior managers and fast-track them to face tomorrow's challenges.

We use an operational risk framework to perform an annual review of key risks in the HR process. The implementation and monitoring of legislation forms an important part of this process and we ensure that it is applied strictly in the area of HR. Examples in this regard include EBA guidelines on remuneration policy (including the variable wage component) and the General Data Protection Regulation (privacy legislation). We also raise risk-awareness among our staff through targeted information campaigns and training. Individual local focuses and initiatives are pursued in each country too. At KBC Ireland, for instance, 800 employees were required to participate in the 'Regulatory Fitness and Probity' programme, which concentrates on the local rules of the Irish regulator.

Without the right staff, KBC would not be able to remain a reference in the European financial sector and so this, too, is an operational risk. We face it through carefully targeted recruitment and by encouraging our employees to update their skills continuously.

The application of our HR policy is closely monitored, not only by means of high-quality surveys, but also on the basis of accumulated HR data. Information on reward components, hours of training and lost working days, for instance, is taken into account. And we continuously test our policy against market indicators. We also monitor staff numbers group-wide and country by country, and present these figures every quarter to the Executive Committee.

KBC invests in good social dialogue with employee representatives. This consultation covers a very wide range of themes, such as pay and employment conditions, reorganisation and well-being. It is organised primarily on an individual country and company basis to take account of the local legal and business-specific situations. The process also resulted in collective agreements being concluded in the different countries in 2018. Meanwhile, an annual meeting of the European Works Council has been held at group level for over 20 years now. It brings together employee representatives from the various countries, senior KBC management and a broad, international HR delegation to deal with topics of cross-border importance, so ensuring that there is a forum for discussing the impact of decision-making at group level too.

We closely monitor employee satisfaction and engagement and consult our staff every two years by means of the Group Employee Survey. The most recent survey was held in 2017, with a response rate of over 87%. The survey revealed an engagement level for the group as a whole that was up on the previous year, putting it a percentage point ahead of the European financial sector average. The engagement index rose in the Czech Republic, Hungary and Ireland, but was down slightly on its year-earlier level in Slovakia and Bulgaria. The index was stable in Belgium, but still four percentage points ahead of the national benchmark.

The KBC Group annual report contains a table with an overview of the total workforce and a breakdown into various categories.

Our capital

Our activities are only possible if we have a solid capital base. At year-end 2018, KBC Group's total equity came to 19,6 billion euros and chiefly comprised own share capital, share premiums, reserves and additional tier-1 instruments. KBC Group's capital was represented by 416 155 676 shares at year-end 2018, a decline of 2 441 891 shares on the previous year, due to the share buyback programme (-

2,7 million shares), partially offset by the capital increase reserved for staff in December each year (+258 109 shares).
At year-end 2018, KBC Insurance's Group total equity was 2,7 billion euros.

KBC Group is the sole shareholder of KBC Insurance Grouop. KBC Group shares are held by a large number of shareholders in a number of countries. A group of shareholders consisting of MRBB, Cera, KBC Ancora and the Other core shareholders, constitute KBC Group's core shareholders. A shareholder agreement was concluded between these core shareholders in order to ensure shareholder stability and guarantee continuity within the group, as well as to support and co-ordinate its general policy. To this end, the core shareholders act in concert at the General Meeting of KBC Group NV and are represented on its Board of Directors. The current agreement applies for a ten-year period with effect from 1 December 2014. According to the most recent notifications, the core shareholders own 40% of our shares between them. More information on the KBC Group's shareholder structure can be found in the KBC Group annual report. The KBC Insurance Group share is not traded on the stock market.

Our network and our relationships

Alongside staff and capital, our network and relationships are especially important to our activities. An overview of our network can be found under 'Market conditions in our most important countries in 2018'.

Our social and relationship capital comprises all relationships with our clients, shareholders, government, regulators and other stakeholders who enable us to remain socially relevant and to operate as a socially responsible business. This theme is dealt with in depth under 'Our role in society' in the 'Our strategy' section.

The core of our strategy for the future (KBC Group)

Our strategy rests on **four principles**:

- ✓ Principle 1: **We place our clients at the centre of everything we do**.
- ✓ Principle 2: **We look to offer our clients a unique bank-insurance experience.**
- ✓ Principle 3: **We focus on our group's long-term development and aim to achieve sustainable and profitable growth.**
- ✓ Principle 4: **We meet our responsibility to society and local economies.**

We implement our strategy within a strict risk, capital and liquidity management framework.

Sustainability is embedded in our strategy. To us, this primarily means the ability to live up to the expectations of all our stakeholders and to meet our obligations, not just today but also in the future. Our sustainability strategy has **three cornerstones**:

- ✓ Cornerstone 1: **Enhancing our positive impact on society.**
- ✓ Cornerstone 2: **Limiting any negative impact we might have.**
- ✓ Cornerstone 3: **Encouraging responsible behaviour on the part of all our employees.**

Principle 1: The client is at the centre of our business culture (KBC Group)

We have to earn our clients' trust every day. We work hard to offer them complete, accessible and relevant solutions at a fair price and do our utmost to achieve an optimum client experience. That means taking their needs rather than our banking or insurance products as our starting point.

We have to adapt constantly to a highly dynamic environment, the changing behaviour and expectations of our clients and new technologies. For that reason, we listen to our clients all the time and keep our finger on the pulse when launching new products. But we also like to have our clients on board as we develop those products. At the same time, we're aware of current issues and developments in society. The insights we gain in this way are vital if we are to grow in line with our clients and community.

Everyone knows that the digital dimension has assumed overwhelming importance in the financial world in recent years. This has had a powerful effect on client behaviour too. Today's clients expect even faster, not to say immediate service. They dislike complexity, want as much convenience as possible and are much better informed than they used to be in all sorts of areas, thanks to the Internet, which allows them to readily compare different service providers. This makes it essential to keep earning our clients' confidence.

We continue to provide an integrated response to our clients' banking and insurance needs in this more digital world too, in the shape of a comprehensive, one-stop financial service, in which they can choose from a wider, complementary and optimised offering. We are investing around 1.5 billion euros throughout the group in digital transformation between 2017 and year-end 2020.

Digitalisation is a means for us, however, not an end. Our ambition is to further strengthen our human approach through appropriate deployment of digitalisation and artificial intelligence. Each client gets to decide their own degree of digitalisation and where the boundaries of their privacy lie. Human contact will continue to play a crucial role, but backed up with digital possibilities: face-to-face contact, for instance, supported by robot advice or chatbots, as in the K'Ching app in Belgium.

This approach also entails further internal simplification of processes, systems and products. To this end, we will continue to enhance the efficiency and effectiveness of our processes and our data management, so that we act swiftly and decisively to offer our clients a convenient and pleasant experience.
We are ensuring, moreover, that ideas are exchanged within our group and that apps are copied and reused as much as possible in other core countries. In this way, we create additional synergies and leverage the talent, entrepreneurship and resources available within our organisation.

Privacy and data protection are an integral part of our profession as a bank-insurer, making them extremely important to both our internal and external stakeholders. Digitalisation provides us with a multiplicity of data, which means we know our clients better and can advise them more effectively. But it goes without saying that clients only accept us analysing their data once they already trust us, which is why we have drawn up a carefully thought-out privacy policy. Privacy and data protection are not only objective concepts, defined by law, they are highly subjective ones too. For that reason, we want to let clients themselves choose what we can do with their data. In the process, we aim to communicate in a transparent way and offer our clients a clear privacy overview, in which they can adjust their choices at any moment. We view smart data analysis allied with effective privacy protection as the ideal opportunity to enhance our clients' trust.

We expect our employees to communicate in an accessible, clear, understandable and transparent way with our clients. This is not easy given the duties imposed on us by the legislator, such as sending out letters on risks, costs and fees. A few years ago, therefore, we launched a project in Belgium to simplify and improve our client communication.
We also provide our commercial staff with constant training to ensure that they pay sufficient attention to evaluating the risks associated with the different products and services.

Access to financial services and solid financial advice for all sections of society contributes to economic development and forms the basis for financial and social integration. We fulfil our responsibility as a bank-insurer in this regard too, we promote financial literacy and seek by means of solid and transparent advice to help our clients make the right decisions. Various examples of our financial literacy initiatives are set out under 'Our role in society' in the 'Our strategy' section of this report.

Since putting the interests of our clients at the heart of everything we do is the cornerstone of our strategy, we keep a close eye on their situation. We continuously survey our clients and organise regular debates with client panels. A specific dialogue is likewise maintained with NGOs, and a stakeholder debate also organised each year. We closely monitor our reputation and communicate this analysis to all the departments and individuals concerned, so they can take appropriate action.

The most important Key Performance Indicators (KPIs) relating to the client being put at the heart of everything we do, are set out in the KBC Group annual report.

Principle 2: We offer our clients a unique bank-insurance experience (KBC Group)

As a bank-insurer, we put our clients at the heart of what we do by offering them an integrated product range. We advise them based on needs that transcend pure banking or insurance, including family, the home and mobility. After all, our clients don't dream about loans or insurance policies, but about a car, a house, a holiday or a business of their own – things for which they need money. And when they have them, they want to protect them, so they look for insurance too. Thanks to our integrated bank-insurance model, we can proactively offer them a comprehensive range of banking and insurance products.

Our integrated model offers the client the benefit of a comprehensive, one-stop service that allows them to choose from a wider, complementary and optimised range of products and services. It offers the group benefits in terms of income and risk diversification, additional sales potential through intensive co-operation between the bank and insurance distribution channels, and significant cost-savings and synergies.

As stated earlier, we do everything we can to integrate our channels (bank branches and insurance agencies, contact centres, self-service terminals, the website, our home banking application and mobile apps). Because we are both a bank and an insurer, we can commit ourselves completely to this integrated approach and seamless service. The best mix of channels is determined locally based on the client's needs and also depends on the degree of maturity of our bank and insurer in each country.

We have developed a unique bank-insurance co-operation concept within our group, the roll-out of which varies from one country to another. We are furthest advanced in this area in Belgium, where our bank-insurance business operates as a single unit that is achieving both commercial and non-commercial synergies. An important feature of our model in Belgium is the unique co-operation between our bank branches and insurance agencies in micro markets. The branches sell bank and standard insurance products, and refer clients to the insurance agency in the same micro market for other insurance products. The insurance agencies sell the full range of insurance products and handle all claims, including those relating to policies taken out at a bank branch. We have not yet gone so far as in Belgium in our other core countries, but we want to create an integrated distribution model as swiftly as possible, which will allow commercial synergies. In Ireland, our focus is on working together with third parties.

Our bank-insurance model also enables us to achieve various commercial synergies. In Belgium, for instance, roughly eight out of ten clients who agreed home loans with KBC Bank in 2018 also took out mortgage protection cover with KBC Insurance, while eight to nine out of ten purchased home insurance. At ČSOB in the Czech Republic, six out of ten clients who took out home loans in 2018 also purchased home insurance from the group.
To give another example, roughly half of households in Belgium that bank with KBC Bank hold at least one KBC Insurance product. About one in five of these households actually held three banking and three insurance products from KBC. The number of clients holding both banking and insurance products from our group rose again in 2018.

The most important Key Performance Indicators (KPIs) relating to bank-insurance are set out in the KBC Group annual report.

Principle 3: We focus on sustainable and profitable growth (KBC Group)

Developing long-term relationships with our clients is crucial if we are to secure our long-term future. Therefore, we do not pursue high short-term returns that come with excessive risks but rather focus on sustainable and profitable growth in the long run.

Sustainable and long-term thinking also means concentrating on the local economies of the core markets in which we operate and that we invest only to a very limited extent in projects outside these markets. Our geographical footprint remains firmly focused on our core countries. We view our presence in these countries as a long-term commitment and want to consolidate our presence there by means of organic growth or attractive acquisitions, in line with clear and strict strategic and financial criteria.

Our takeover activity was limited in 2018. In Bulgaria, we acquired the remaining 40% stake in UBB Life, the life-insurance joint venture of our subsidiary United Bulgarian Bank, and integrated UBB Life into DZI Insurance. The deal means that we can distribute DZI's Life and Non-Life products through UBB's branches and fully roll out our bank-insurance model in Bulgaria, which is one of our core markets. As a result, DZI Life Insurance Jsc and UBB Life's aggregate share of the Bulgarian life insurance market is now over 20%.

The pursuit of sustainable and profitable growth also guarantees us a diversified income base. In that respect, we want to generate more revenue from the fee business (including fees from asset management activities) and insurance activities (earned premiums), alongside our interest income. We also want to build on the one-stop-shop offering to our clients through partnerships with fintech firms or even sector peers, and to offer services related to bank-insurance, such as advice.

Lastly, stringent risk management in everything we do is an absolute precondition in terms of guaranteeing sustainability.

The most important Key Performance Indicators (KPIs) relating to sustainable and profitable growth are set out in the KBC Group annual report.

Principle 4: Our role in society: to be responsive to society's expectations (KBC Group)

As a sustainable bank-insurer, we aim primarily to live up to the expectations of all our stakeholders. We also want to meet our obligations, so that we can deliver sustainable services not just today but also in the future. When engaging in this core business, we take full account of its ethical, social and environmental aspects, as we are convinced that this is the best guarantee of long-term value creation for all our stakeholders.

We believe that by steadily increasing the sustainability of our core activities, we can make a real difference to the local economy and society. In our view, it is also very important that sustainability is integrated throughout our business operations and is supported by all our employees. And we can only achieve this if we have the necessary financial resilience. For that reason, we constantly pursue a balance between healthy profitability and fulfilling our role as a socially responsible business by encouraging responsible behaviour on the part of our employees, enhancing our positive impact on society and limiting any adverse impact we might have on society.

Sustainable Development Goals

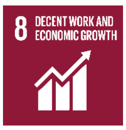
In 2015, UN member states signed a development plan to improve the world by 2030. The ambitious action plan comprised 17 Sustainable Development Goals (SDGs). Meeting these SDGs requires an effort on the part of every element of society, including the business world.
As a financial institution, KBC wants to contribute to the economic well-being of companies, private individuals and governments and to support them in achieving better social outcomes. We develop sustainable banking and insurance products and services that meet social and environmental challenges, and so have geared our sustainability strategy towards the SDGs. Although the 17 SDGs are all interconnected and relevant, we have selected the particular goals on which we can have the greatest impact through our core business. The diagram illustrates the connections between our sustainability strategy and the SDGs.

Good health and well-being

We aim to develop banking and insurance products that focus on health, health care and improving quality of life. Our social projects focus on themes like health and road safety. We promote a good work-life balance among our employees.

Affordable and clean energy

We actively contribute to raising the share of renewables in the energy mix. We invest in initiatives in the field of renewable energy and energy efficiency through our banking and insurance activities and have drawn up an exit programme for the financing of non-sustainable energy solutions.



Decent work and economic growth

Our banking and insurance business supports entrepreneurship and job creation and contributes to sustainable economic growth. We support new businesses and invest in innovation and technology through alliances with start-ups and fintechs. We play an important role in protecting basic labour rights, fair pay, equal opportunities and training and development opportunities for all our employees.

Responsible consumption and production

We support the transition to a low-carbon and circular economy. We develop sustainable banking and insurance products and services that meet a range of social and environmental challenges. Sustainable investments are offered as a fully fledged alternative to conventional funds. We endeavour to mitigate our own negative impact on the environment by dealing sustainably with energy, paper, water, mobility and waste and by reducing our greenhouse gas emissions.

Climate action

We apply a strict environmental policy to our loan, investment and insurance portfolios. We develop business solutions that help clients reduce their greenhouse gas emissions and make the transition to a low-carbon economy. We limit our own environmental impact and communicate on that. We seek to address climate-related risks and focus on related opportunities in that area.

Cornerstone 1: Aiming to enhance our positive impact on society

Besides contributing to the real economy, we want to increase our positive impact on society. We look to address global challenges by developing innovative financial and insurance solutions in response to local social themes.
Bearing in mind the local context in our different core markets, we have prioritised the following focus areas: ‘financial literacy’, ‘entrepreneurship’, ‘environmental awareness’ and ‘demographic ageing and/or health’. These areas are used to incorporate the SDGs into our sustainability strategy and everyday activities.

We believe that by actively helping to increase the sustainability of the financial markets, we can create leverage in the transition to a low-carbon economy. In June, we duly became the first Belgian financial institution to issue a green bond (worth 500 million euros and with a term of five years, the issue was reserved for institutional and professional investors). A bond of this kind is one that complies with the Green Bond Principles, a set of guidelines produced by the International Capital Markets Association, under which the proceeds of the bond issue can only be used to finance or refinance sustainable projects.

We also continue to back sustainable investment funds by offering our clients a wide range of SRI funds, varying from traditional best-in-class funds and funds with sustainable themes to the more recent impact investing funds. Thorough screening is applied to determine which companies and countries belong to the investment universe for sustainable and socially responsible investment solutions. The target we have set ourselves for SRI funds is 10 billion euros of sustainable investments (under management) by 2020. At year-end 2018, that figure had already reached 9 billion euros.

In May 2018, KBC – as promoter – became the first in the Belgian market to launch an SRI pension savings fund that is fully compliant with BEAMA sustainability criteria. Managed by KBC Asset Management, Pricos SRI – which is open-ended and does not offer capital protection – is an actively managed pension savings fund that invests exclusively in companies and issuers that come through KBC Asset Management’s sustainability screening. This requires the firms in question to achieve a high score in terms of environment, social policy and corporate governance.

We communicate transparently on our policy guidelines and codes of conduct, which are published on our corporate website (https://www.kbc.com/en/policies). More information on our Integrity Policy and its application is provided in the ‘Corporate governance statement’ section of the annual report of KBC Insurance Group.

Focus areas	Description	How? A few recent examples:
Financial literacy	• Helping clients make the right choices through good and transparent advice, and clear communication. • Improving general public knowledge of financial concepts and products.	• Launching financial education initiatives in all countries, including seminars, various master's programmes, a range of digital learning packs and internships. • ČSOB staff have been providing lessons on financial themes at various schools in the Czech Republic since 2016. • Organising projects to simplify and improve our client communication. • Running the 'Get-a-teacher' initiative at KBC Belgium to give schools the opportunity to extend financial knowledge by 'ordering' a teacher from KBC.
Environmental awareness	• Reducing our environmental footprint through a diverse range of initiatives and objectives. • Developing products and services that can make a positive contribution to the environment.	• Issuing the first green bond and SRI pension savings fund in Belgium. • Expanding multi-mobility at KBC Autolease, including the development of bicycle leasing for companies. • Providing the Home Energy Checker in Belgium, an online tool that generates an overview of appropriate energy-saving measures for homes. • Collaboration between the insurer DZI in Bulgaria and SPARK, the first car-share firm with electric vehicles in Sofia.
Entrepreneurship	• Contributing to economic growth by supporting innovative ideas and projects.	• Setting up the KBC Trade Club, a matchmaking community and library with market information for entrepreneurs, providing access to thousands of companies in different countries via the Trade Club Alliance. • Expanding Start it @KBC to include a focus on diversity (women business founders), corporate ventures and internationalisation. • Setting up Start it @K&H in Hungary. • Supporting local initiatives through the Bolero crowdfunding platform. • Encouraging clients to take the step to e-commerce via Storesquare, FarmCafe and similar initiatives.
Demographic ageing and health	• We have opted for 'demographic ageing' as our fourth pillar in Belgium and the Czech Republic. This requires us to adapt our policy and our range of products and services to the fact that people are living longer and to make a positive contribution to the issues surrounding an ageing population by offering specific solutions through our core activities. • We chose 'health' as the fourth pillar in Bulgaria, Slovakia, Hungary and Ireland. These core countries will develop products, services and projects geared towards improving general health, healthcare and quality of life.	• Organising Digi Tuesday, a range of free courses that familiarise clients with digital trends and make them aware of their convenience and possibilities. • Launch by ČSOB in the Czech Republic of the online portal 'Don't get lost in old age' in collaboration with the Sue Ryder Home advisory centre. • Launch of FitBit Pay in Ireland, a payment solution for health-conscious clients that can connect with fitness and other devices. • Providing financial and material assistance to sick children through the 'K&H MediMagic Programme' in Hungary.

Cornerstone 2: Limiting any negative impact we might have on society

Climate change is one of the 21st century's biggest challenges worldwide. KBC has committed itself to contributing to the transition to a low(er)-carbon economy and society. We are pursuing this in three ways, namely by investing more in renewable energy and less in fossil fuels, by encouraging energy-saving and by limiting our own environmental footprint.

Our direct impact:

We limit our own environmental footprint by:

- Setting targets for our carbon emissions. We aim to cut our greenhouse gas emissions by 50% between 2015 and 2030 (currently already -38%).
- Increasing the proportion of green energy in KBC buildings and pursuing energy efficiency.
- Obtaining ISO 14001 certification in all our core countries.
- Also working towards a low(er)-carbon society through our HR policy. We seek to reduce commuting and business travel through teleworking and Skype meetings, promoting the use of public transport, providing bike leasing opportunities and giving car-leasers a 'green nudge'.

2018 (KBC Group)

595 thousand GJ of electricity used

314 thousand GJ of gas and heating oil used

377 million km in commuter and business travel

3 391 tonnes of paper used

86 thousand tonnes of CO_2e emissions

Carbon emission data and calculations are verified by Vinçotte in accordance with ISO 14064-3. More detailed information on our environmental footprint can be found in KBC Group's sustainability report.

Our indirect impact:

As a bank-insurer, our indirect impact on the environment and society – partly through our loans, investments and fund offering – is considerably larger than our direct impact.

We limit this indirect impact through measures such as encouraging energy-saving. KBC offers its clients plenty of opportunities to contribute to a low-carbon society themselves. These include numerous finance and insurance products and services, and we also work closely with various partners. In 2018, KBC Group also became the first Belgian financial institution to issue a green bond for institutional investors.
We invest in renewable energy and less so in fossil fuels. For some years now, KBC has been scaling back its funding of polluting energy sources and we refuse to finance large-scale biomass operations, oil and gas extraction, and oil and coal-fired power generation. The Czech Republic is the sole exception to this. We amended our policy in this regard in 2018, deciding that ČSOB will withdraw from the coal sector in that country and that the current exposure to coal-fired power generation would be phased out by 2023 at the latest. This means no funding will be provided to any new or existing coal-fired power stations or coal mines from mid-2018 on (with one exception: existing coal-fired plants for centrally controlled heating systems can continue to be funded until 2035 to allow further ecological improvements to be made to them). At year-end 2018, coal funding by KBC/ČSOB totalled less than 40 million euros, compared to 252 million euros two years previously. We are not only ceasing to fund polluting energy companies, we will no longer insure them either. KBC has set itself the target of providing 50% of its energy loans to renewable energy by 2030 (44% at year-end 2018). KBC already accounts for a significant proportion of the financing of wind energy in Flanders, both on land and offshore. We have also signed the 'Green Deal for Circular Procurement' to help achieve a more circular economy in Flanders.

We apply strict sustainability rules to our business activities in respect of human rights, the environment, business ethics and sensitive or controversial social themes. The table sets out the most important, recently updated sustainability policies.

Important KBC sustainability policies		Applies to
Blacklist of companies and activities	We place businesses on this list that are involved with controversial weapons systems (including nuclear weapons with effect from 2018) or which commit serious breaches of UN Global Compact Principles. No entity belonging to our group is permitted to do business with such enterprises. For KBC Group NV, speculative, soft commodity transactions are also blacklisted.	Lending, insurance, own investments, SRI and traditional funds, suppliers
Human rights	We have updated our human rights policy to bring us in line with the UN Guiding Principles on Business and Human Rights and UN Global Compact Principles. See also the separate section below.	Lending, insurance, own investments, SRI and traditional funds, suppliers, personnel
Controversial regimes	We do not wish to be involved in financial activities with controversial regimes that fundamentally violate human rights and lack any form of good governance, rule of law or economic freedom. We do, however, make an exception for humanitarian goods. Based on reputable external sources, we decide each year what countries are to be included on our list of controversial regimes.	Lending, insurance, own investments, SRI and traditional funds, suppliers
Sustainable and responsible banking and insurance policy	We have imposed restrictions on providing loans and insurance to controversial socially sensitive sectors and activities such as: the energy sector, project finance, arms-related activities, narcotic crops, gambling, fur, palm oil production, mining, deforestation, land acquisition and involuntary resettlement of indigenous populations, and prostitution. We recently updated our Energy Credit & Insurance Policy for coal funding in the Czech Republic, the Policy on Arms-Related Activities and the Policy on the Tobacco Industry, and also introduced a new Mining Policy and an Animal Welfare Statement.	Lending, insurance
KBC Asset Management SRI exclusions	In the case of traditional funds, we apply the minimum exclusions based on the blacklist of businesses that are involved with controversial weapons systems or which commit serious breaches of UN Global Compact Principles, and the policies on human rights and controversial regimes. What's more, investment products involving food-price speculation are entirely excluded. For SRI funds, we go even further in the exclusion and restriction of controversial activities like gambling, tobacco, aerospace and defence, fur, etc.	SRI funds

Human rights

We are fully committed to meeting our responsibility to respect human rights throughout the group. It goes without saying that we comply with the laws, rules and regulations of every country in which our group operates. With specific reference to human rights, we implement the UN Protect, Respect and Remedy Framework for businesses and human rights. These form the global standard for avoiding and addressing the risk of business operations negatively impacting human rights. We are committed in particular to respecting the letter and the spirit of the United Nations Universal Declaration of Human Rights; the principles concerning fundamental rights in the eight International Labour Organisation core conventions as set out in the Declaration on Fundamental Principles and Rights at Work; the UN Declaration on the Rights of Indigenous Peoples; the UK Modern Slavery Act and other international and regional human rights treaties containing internationally recognised standards by which the business sector must abide. We have also signed the UN Global Compact principles, which we have incorporated into our policies to ensure that they are applied throughout our operations.

KBC acknowledges that financial institutions, like all businesses, can encounter practices that harm human rights. We also acknowledge that businesses, including financial services providers, can encounter human rights violations in three ways. As set out in the UN Guiding Principles Reporting Framework, businesses can: (i) have a negative impact; (ii) contribute to a negative impact; or (iii) pursue operations that can be directly linked to a negative impact caused by a company with which they have a business relationship.

We have therefore implemented the KBC Human Rights Policy in our relationships with stakeholders, including our clients, suppliers and employees.

We expect our clients to at least comply with local and international laws and regulations, and our Compliance department ensures that this is the case. Our day-to-day operations are all performed subject to the KBC Group Policy on Blacklisted Companies and the KBC Group Policy on Controversial Regimes. These exclude companies or countries that are involved in a serious infringement of human rights. The Equator Principles apply in the case of international project finance. Where relevant, we ask our clients to demonstrate their compliance with particular industry standards. We have developed a specific due diligence process for lending and insurance activities (Credit Risk Standards on Sustainable and Responsible Lending and the KBC Sustainable and Responsible Insurance Policy). This likewise incorporates procedures to deal with any infringements that are detected. For instance, businesses can be excluded from all our activities, an exit strategy can be launched or special conditions imposed on existing loans and insurance cover. Our investment activities (asset management and own investments) are also subject to internal screening. SRI funds, moreover, have to undergo additional controls (KBC Asset Management Exclusions List for Sustainable Investments).

We are fully committed to respecting and upholding our employees' human rights. More information in this regard (including various KPIs relating to gender, engagement, sick leave and staff turnover, training, etc.) can be found in the 'Our employees, capital, network and relationships' section. We likewise expect our employees to apply and respect human rights in the course of their work. These principles are dealt with in more detail in the Code of Conduct for KBC Group Employees (available at www.kbc.com). Strict national and international laws and regulations are in place in all our core countries to protect human rights. We expect our employees to act in accordance with the regulations and to behave responsibly in everything they do. Specific procedures are in place, moreover, to guarantee compliance and to deal with complaints, including the 'Policy for the Protection of Whistleblowers in the KBC group'.

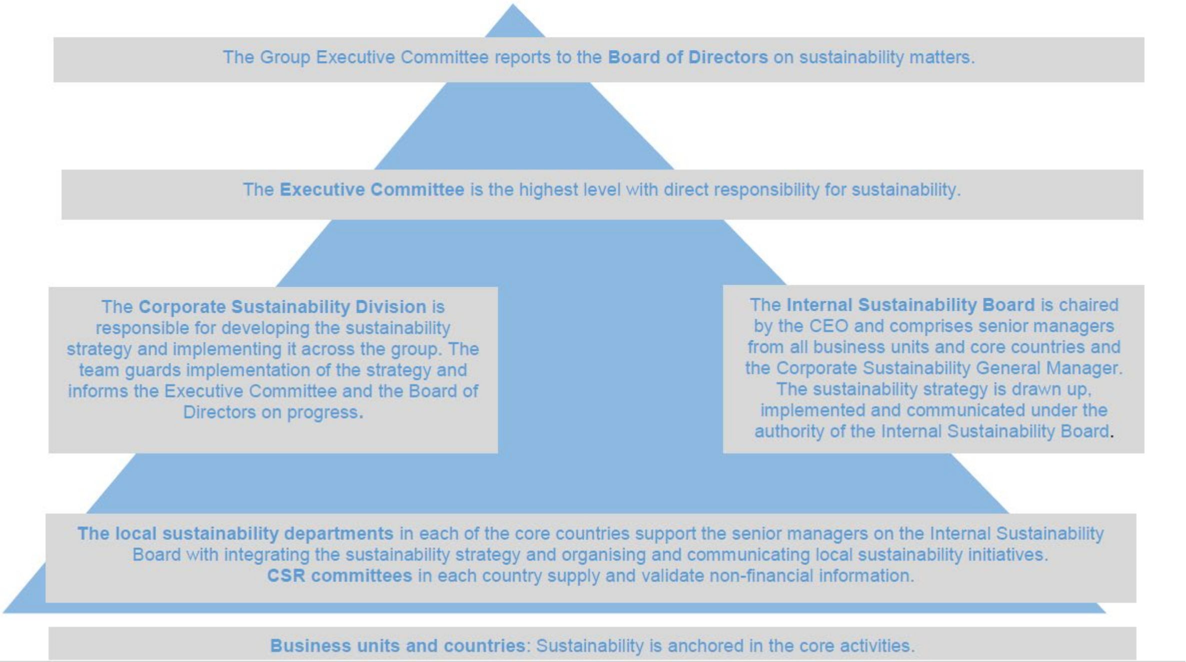
As a bank-insurer, we also work closely with external partners such as suppliers. Strict rules and frameworks therefore apply to purchase, sale and outsourcing activities, and we evaluate the associated environmental, social and ethical matters, including respect for human rights. All the suppliers we work with are screened against the KBC Blacklist and any firms on it are excluded from doing business with us. Our Compliance and Corporate Sustainability departments thoroughly investigate any hits on WorldCheck. We also apply a standard questionnaire when screening key suppliers. Suppliers that come through the screening with a positive evaluation are required to sign the 'KBC Sustainability Code of Conduct for Suppliers'. Any infringements that are detected and which cannot be put right fundamentally within an appropriate period result in the termination of our business relationship.

Strict application of these sustainability rules enables us to oversee the reputational and financial risks arising from potential breaches of human rights and other controversial developments in our core activities.

Our human rights guidelines, blacklists and other relevant documentation are available at www.kbc.com. We report on the application of the Equator Principles in our Sustainability Report.

Our sustainability governance

We have anchored sustainability at the different levels within our group, guaranteeing that it receives attention from the highest decision-making bodies while also being broadly integrated into our operations.



In addition to our internal organisation, we have set up external advisory boards to advise KBC on various aspects of sustainability. They consist of experts from the academic world:

- An **External Sustainability Board** advises the Corporate Sustainability Division on KBC sustainability policies.
- An **SRI Advisory Board** acts as an independent body for the SRI funds and oversees screening of the socially responsible character of the SRI funds offered by KBC Asset Management.

Cornerstone3 : Aiming to encourage responsible behaviour on the part of all our employees

If we want to retain and grow our stakeholders' trust, it is extremely important that we behave responsibly in everything we do. For that reason, this theme comes high on our agenda. A considerable amount of work went into responsible behaviour once again in 2018, more specifically on promoting the right mindset. Behaving responsibly is not just about regulations and compliance, it's an attitude. It's the duty of everyone at every level of the organisation to act in an appropriate way, day in, day out.

Responsible behaviour is tricky to define and so we have specifically decided not to draw up detailed guidelines for it, but to set out the underlying principles. These are presented in 'Compass for Responsible Behaviour'. It is not an all-embracing document listing every situation with which employees might be confronted in their everyday work, as there needs to be room for common sense and a professional, multidimensional awareness that goes beyond statistics. The basis of responsible behaviour is integrity, which requires honesty, fairness, transparency and confidentiality, as well as a healthy awareness of risk. Integrity and ethical values are also reflected in our Code of Conduct for KBC Group Employees.

Responsible behaviour is especially relevant for a bank-insurer when it comes to appropriate advice and sales. We pay particular attention, therefore, to training and awareness. For that reason, responsible behaviour is also a theme at KBC University, our senior management training programme, in which the theory is taught and practised using concrete situations. Senior managers are then tasked with disseminating it throughout the organisation. In Belgium, for instance, we also publish a monthly dilemma on our Intranet. Employees are invited to discuss the dilemma collectively and to consider it from various different angles.

We communicate transparently on our rules and policy guidelines, which are published at www.kbc.com/en/policies. More information on our Integrity Policy and its application is provided in the 'Corporate governance statement' section.

We aim to achieve our ambitions within a stringent risk management framework (KBC Group)

Risk management is an integral part of our strategy and our decision-making process.

- ✓ We perform risk scans to identify all key risks.
- ✓ We define our risk appetite in a clear manner.
- ✓ We translate that into strict limit tracking per activity and business unit.
- ✓ We monitor the risk profile of existing and new products via a New and Active Product Process.
- ✓ We challenge the results of the periodic planning process via stress tests.
- ✓ We have installed independent chief risk officers in all relevant parts of our organisation.

Although the activities of a large financial group are exposed to risks that only become apparent in retrospect, we can currently identify a number of major challenges for our group. These are set out under 'In what environment do we operate? As a bank-insurer, we are also exposed to the typical risks for the sector, such as credit risk, market risk, technical insurance risk, liquidity risk, solvency risk and non-financial risk, including operational risk. A list of these risks can be found in the table.

Our 'Three Lines of Defence' model	
1	The business operations side is responsible for managing its risks
2	The second line of defence comprises the control functions, i.e. the Group risk function and Compliance, which ensure that risks are identified and managed by the business side
3	As independent third line of defence, Internal Audit provides support to the Executive Committee, the Audit Committee and the Risk & Compliance Committee in monitoring the effectiveness and efficiency of the internal control and risk management system

Sector-specific risks	How are we addressing them?
Credit risk The potential negative deviation from the expected value of a financial instrument caused by default on the part of a party to a contract, due to the inability or unwillingness of that party to pay or perform, or due to particular measures on the part of political or monetary authorities in a particular country.	• Existence of a robust management framework • Recording impairment charges, taking risk-mitigating measures, optimising the overall credit risk profile, reporting, stress testing, etc. • Limit systems to manage concentration risk in the loan portfolio.
Market risk in trading activities The potential negative deviation from the expected value of a financial instrument caused by fluctuations in the level or volatility of market prices, such as interest rates, exchange rates, and share and commodity prices.	• Existence of a robust management framework • Historical VaR method, BPV and basis risk limits, 'greeks' and scenario limits for products with options, stress tests, etc.
Operational and other non-financial risks 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. Other non-financial risks include reputational risk, business risk and strategic risks, including climate-change-related risks.	• Existence of a robust management framework • Group key controls, risk scans, Key Risk Indicators (KRIs), etc.
Market risk in non-trading activities Structural market risks, such as interest risk, equity risk, real estate risk, spread risk, currency risk and inflation risk. Structural risks are risks inherent to the commercial activity or long-term positions.	• Existence of a robust management framework • Basis Point Value (BPV), sensitivity of net interest income, sensitivity per risk type, stress tests, limit tracking for crucial indicators, etc.
Liquidity risk The risk that an organisation will be unable to meet its obligations on time, without incurring higher-than-anticipated costs.	• Existence of a robust management framework • Drawing up and testing emergency plans for managing a liquidity crisis • Liquidity stress tests, management of funding structure, etc.
Technical insurance risks Risks stemming from uncertainty as to how often insured events will occur and how extensive they will be.	• Existence of a robust management framework • Underwriting, pricing, claims reserving, reinsurance and claims handling policies, etc.

The most important Key Performance Indicators (KPIs) relating to solvency and liquidity are set out in the KBC Group annual report.

2.1.3 Market conditions in our most important countries in 2018

A summary of our market position and the economic context of our most important countries are given below. KBC Bank also includes Ireland as a most important country. In Ireland we provide insurance through co-operation agreements with other parties. More information on the 'undertakings in scope of the Group' can be found in Quantitative Reporting Template (QRT) S.32.01.22.

Belgium

Market environment

- The Belgian economy remained on the path of steady but very modest growth, with GDP expanding by 1,4%
- The economic situation in Belgium remained favourable all in all, supported by both domestic demand and net exports
- Mortgage lending continued to grow vigorously, while business lending increased sharply until May, after which it slowed but was still robust. Deposits continued to rise at a healthy pace
- At 2,3%, inflation was slightly higher than in 2017
- Forecast real GDP growth in 2019 of 1,2%

KBC Group in Belgium

- Main brands: KBC, KBC Brussels and CBC
- 374 insurance agencies, electronic channels
- Estimated 13% share of the market for life insurance and 9% for Non-Life insurance
- 3,5 million clients (insurance alone: 0,8 million)
- 28,7 billion euros in technical provisions and liabilities under investment contracts

Czech Republic

Market environment

- Real GDP growth eased to 2,9%
- Consumer spending was supported by wage increases and job creation.
- The central bank tightened monetary policy, raising its key rate from 0,50% at year-end 2017 to 1,75 % at year-end 2018
- Average inflation was 2,0%
- Growth in lending to businesses was extremely volatile, suffering a dip in April-May and peaking in October, whereas growth in lending to other segments remained robust. Client deposits increased at a slower rate than in 2017, but still remained at a healthy level
- Forecast real GDP growth in 2019 of 2,6%

KBC Group in the Czech Republic

- Main brand: ČSOB
- Various distribution channels for insurance, electronic channels
- Estimated 8% share of the market for life insurance and 8% for Non-Life insurance
- 3,6 million clients (insurance alone: 1,1 million)
- 1,6 billion euros in technical provisions and liabilities under investment contracts

Slovakia

Market environment

- At 4,1%, GDP grew at a faster pace than in 2017 and was much higher than the EMU
- Inflation continued to rise, with the average annual increase in consumer prices coming to 2,5%
- Even though lending increased at a slower rate than in 2017, it still remained robust. Deposits also grew sharply for the year as a whole
- Forecast real GDP growth in 2019 of 3,7%

KBC Group in Slovakia

- Main brand: ČSOB
- Various distribution channels for insurance, electronic channels
- Estimated 4% share of the markets for life insurance and 3% for Non-Life insurance
- 0,6 million clients (insurance alone: 0,3 million)
- 0,3 billion euros in technical provisions and liabilities under investment contracts

Hungary

Market environment

- Real GDP growth picked up slightly to 4,5%, much higher than the EMU average
- Inflation rose further to 2,9%, virtually in the middle of the one-percentage-point band either side of the 3% target set by the Hungarian National Bank. Monetary policy remained accommodative
- Business loans and home loans grew sharply, as did deposits
- Forecast real GDP growth in 2019 of 3,5%

KBC in Hungary

- Main brand: K&H
- Various distribution channels for insurance, electronic channels
- Estimated 3% share of the market for life insurance and 7% for Non-Life insurance
- 1,6 million clients (insurance alone: 1,1 million)
- 0,5 billion euros in technical provisions and liabilities under investment contracts

Bulgaria

Market environment

- Bulgarian real GDP growth eased to 3,5%, but remained well above the euro-area average
- The average annual increase in Bulgarian consumer prices shot up to 2,6%, due in part to strong wage growth caused by the increasingly tighter labour market
- Lending continued to gather pace, as did deposits
- Forecast real GDP growth in 2019 of 3,4%

KBC in Bulgaria

- Main brands: UBB and DZI Insurance.
- Various distribution channels for insurance, electronic channels
- Estimated 24% share of the market for life insurance and 11% for Non-Life insurance
- 1,3 million clients (insurance alone: 0,6 million)
- 0,3 billion euros in technical provisions and liabilities under investment

2.2 Consolidated income statement

The consolidated income statement of the KBC Insurance Group was as follows:

in millions of EUR	2018 (IFRS 9)	2017 (IAS 39)	Change in amount	Change in %
Net interest income	507	564	-57	-10%
Interest income	559	610	-52	-9%
Interest expense	- 52	- 47	-5	11%
Non-life insurance (before reinsurance)	775	722	53	7%
Earned premiums	1 601	1 510	91	6%
Technical charges	- 826	- 788	-38	5%
Life insurance (before reinsurance)	- 20	- 60	40	-67%
Earned premiums	1 361	1 273	88	7%
Technical charges	- 1 382	- 1 334	-48	4%
Ceded reinsurance result	- 41	- 8	-33	435%
Dividend income	53	58	-5	-8%
Net result from financial instruments at fair value through profit or loss	63	- 2	65	
of which resuly on equity instruments (overlay approach)	51	-	51	
Net realised result from available-for-sale assets	-	84	-84	
Net realised resul from debt instruments at fair value though OCI	1	-	1	
Net fee and commission income	- 341	- 312	-29	9%
Fee and commission income	142	165	-24	-15%
Fee and commission expense	- 483	- 477	-5	1%
Other net income	78	63	14	23%
TOTAL INCOME	1 074	1 108	-34	-3%
Operating expenses	- 476	- 463	-13	3%
Staff expenses	- 232	- 231	-1	1%
General administrative expenses	- 230	- 215	-14	7%
Depreciation and amortisation of fixed assets	- 14	- 17	3	-18%
Impairment	- 2	- 12	11	-87%
on loans and receivables	-	0	0	
on financial assets at AC and at FVOCI	3	-	3	
on available-for-sale-assets	-	- 11	11	
on goodwill	0	0	0	
on other	- 5	- 2	-3	202%
Share in results of associated companies and joint ventures	19	19	-1	-3%
RESULT BEFORE TAX	615	652	-37	-6%
Income tax expense	- 145	- 187	41	-22%
RESULT AFTER TAX	470	465	4	1%
Attributable to minority interest	0	0	0	
of which relating to discountinued operataions	0	0	0	
Attributable to equity holders of the parent	**469**	**465**	**4**	1%

Net result

The consolidated result of the KBC Insurance Group came to 469 million euros in 2018, as opposed to a year-earlier figure of 465 million euros.

This 4-million-euros increase came about primarily because of a higher technical result in both the life and Non-Life businesses and lower taxes, largely offset by lower net interest income, a decline in net fee and commission income, higher impairment on shares and a lower reinsurance result:

- ✓ Overall, earned premiums in Non-Life insurance went up by 6%, with all entities recording an increase. Technical charges rose in line with premiums but remained at a low level, due to the absence of any major natural disasters and limited large claims. In addition, the ceded reinsurance result was more negative than in 2017 (fewer recoveries due to fewer large claims). These items were instrumental in achieving the healthy combined ratio of 88.2% (87,8% for financial year 2017).
- ✓ Earned premiums in life insurance amounted to 1 361 million euros in 2018. However, in compliance with IFRS, certain types of life insurance (i.e. Unit-Linked products) have been excluded from this figure. If the premium income from such products is included, premium income from the life insurance business totalled over 1.8 billion euros, 3% lower than in 2017. Broadly speaking, guaranteed-rate products went up by 8%, with all countries recording an increase. Unit-Linked products fell sharply on their 2017 level (-18%) mainly on account of persistent turbulence on the markets, which kept the number of placements low.
- ✓ The rise in claims incurred was attributable primarily to higher life insurance provisions being set aside as a result of the increase in premiums collected for guaranteed-rate products, offset in part by lower 'uprenting' costs due to scaling back the Life Capital portfolio in Belgium.
- ✓ Investment income was down on its level for 2017, which reflected primarily the decline in interest income (falling return on bonds linked to the general financial climate of low interest rates, combined with the lower volume of bonds on the balance sheet) and higher impairment on shares stemming from the negative trend on the stock markets.
- ✓ Operating expenses were up 3% on their 2017 level, due to the increase in general administrative expenses (including for strategic and regulatory projects and the integration of UBB Life) and, to a lesser extent, to higher staff expenses (including indexation and additional staff required for strategic and regulatory projects).

2.3 Underwriting performance

Although insurance underwriting is not performed at group level, the KBC Group control functions nevertheless play an important role as regards underwriting performance. More specifically, the KBC Group Risk Management function and the Actuarial function closely monitor the underwriting rules and underwriting performance, or the profitability calculations that are performed for all the insurance and reinsurance entities.

Adequate procedures are in place to ensure that the quality of underwriting is high and overall profitability sound, within the prescribed retention limits and in line with the group and local risk appetite:

- ✓ The Risk Appetite Statement describes the level of risk that can be accepted for each risk type, defines the risk limits and how this is to be translated into business operations.
- ✓ A limits framework defines the maximum exposures that can be borne by the group and, based on those limits, more detailed ones are specified for the local entities. This limits framework is reviewed on a yearly basis. Compliance checks are conducted annually to see whether these retention limits are adhered to.
- ✓ A uniform, group-wide ‘New and Active Product Process’ (NAPP) screens and formally decides on each product before it can be launched in the market.
- ✓ The performance indicators and adequacy of the technical provisions are constantly monitored.

Overall, as seen in the consolidated income statement (see section 2.2.):

Results from the Non-Life insurance business

- ✓ At 255 million euros, the results generated by the Non-Life insurance business were in line with those posted in 2017 (262 million euros).
- ✓ In 2018, earned premiums in Non-Life insurance totalled 1 601 million euros, a considerable increase of 6% on the year-earlier figure. They grew by 3% in Belgium, by 15% in the Czech Republic, and by 14% in the three other Central and Eastern European markets combined. The increase was recorded primarily in (both third-party and comprehensive) 'car insurance' and in 'fire insurance'. These classes of insurance – along with 'general third-party liability', 'accident' and 'health' – accounted for 86% of earned Non-Life premiums.
- ✓ Technical charges in the Non-Life business came to -826 million euros in 2018, rising in line with the increase in premiums but still remaining at a low level, due to the absence of any major natural disasters and limited large claims. Moreover, 2017 had been characterised by a number of reversals of provisions, including the release of the indexation provision (26 million euros) due to a change in accounting policy.
- ✓ General administrative expenses went up by 1%.
- ✓ Thanks to higher earned premiums and the limited increases in technical charges, the combined ratio at group level came to an excellent 88,2% (as opposed to 87,8% in 2017). The combined ratio in all markets was well below 100%.

Results from the life insurance business

- ✓ At 308 million euros, the results generated by the life insurance business were 3% lower than those posted for 2017 (317 million euros).
- ✓ In 2018, earned premiums in life insurance totalled 1 361 million euros, up 7% on the year-earlier figure.
- ✓ Sales of life insurance (including Unit-Linked products) were down 3% on the previous year, with guaranteed-rate products rising by 8% (despite less-attractive guaranteed interest rates and thanks to the integration of UBB Life), but Unit-Linked products falling by 18%. This trend was observed mainly in Belgium (guaranteed-rate products up 8%, Unit-Linked products down 27%) and to a lesser extent in the Czech Republic (guaranteed-rate products up 5%, Unit-Linked products down 1%), whereas there was a more mixed picture in our other Central and Eastern European markets, with sales of Unit-Linked products in Hungary down on their year-earlier level, but up in Slovakia and Bulgaria. Overall, products offering guaranteed rates accounted for just over 61% of sales in 2018 and Unit-Linked Life insurance for 39% (whereas the share was 54% guaranteed-rate and 46% Unit-Linked in 2017).
- ✓ The rise in claims incurred was attributable primarily to higher Life insurance provisions being set aside as a result of the increase in premiums collected for guaranteed-rate products, offset in part by lower 'uprenting' costs due to scaling back the Life Capital portfolio in Belgium.

- ✓ Investment income was down on its level for 2017, which reflected primarily the decline in interest income (falling return on bonds linked to the general financial climate of low interest rates, combined with the lower volume of bonds on the balance sheet) and higher impairment on shares arising from the negative trend on the stock markets.

Non-technical result

The non-technical result (51 million euros) in 2018 was down on its year-earlier level and did not include any exceptional items.

More information on the ‘underwriting performance of the Group’ can be found in the Quantitative Reporting Templates:

- ✓ S.05.01.02 – Premiums, claims and expenses by line of business
- ✓ S.05.02.01 – Premiums, claims and expenses by country

Because of classification differences between IFRS and Solvency II, QRTs S.05.01.02 and S.05.02.01 differ slightly from the figures relating to earned premiums in the table above.

2.4 Investment performance

in millions of EUR	Life	Non-life	Non-technical account	TOTAL
2018 (IFRS 9)				
Earned premiums, insurance (before reinsurance)	1 361	1 601		2 962
Technical charges, insurance (before reinsurance)	- 1 382	- 826		- 2 208
Net fee and commission income	- 30	- 311		- 341
Ceded reinsurance result	- 2	- 39		- 41
General administrative expenses	- 147	- 249	- 3	- 399
Internal claims settlement expenses	- 9	- 59		- 67
Indirect acquisition costs	- 31	- 70		- 100
Administrative expenses	- 108	- 120		- 228
Investment management fees	0	0	- 3	- 3
Technical result	- 199	176	- 3	- 26
Net interest income			507	507
Net dividend income			53	53
Net result from financial instruments at fair value through profit or loss			63	63
Net realised result from debt instruments at fair value through OCI			1	1
Other net income			0	0
Impairment			- 2	- 2
Allocation to the technical accounts	508	79	- 586	0
Technical-financial result	308	255	33	596
Share in results of associated companies and joint ventures			19	19
RESULT BEFORE TAX	308	255	51	615
Income tax expense				- 145
RESULT AFTER TAX				470
Attributable to minority interest				0
Attributable to equity holders of the parent				469
2017 (IAS 39)				
Earned premiums, insurance (before reinsurance)	1 273	1 510	0	2 784
Technical charges, insurance (before reinsurance)	- 1 334	- 788	0	- 2 122
Net fee and commission income	- 20	- 292	0	- 312
Ceded reinsurance result	1	- 9	0	- 8
General administrative expenses	- 140	- 247	- 3	- 389
Internal claims settlement expenses	- 8	- 56	0	- 65
Indirect acquisition costs	- 31	- 73	0	- 103
Adminstrative expenses	- 100	- 118	0	- 218
Investment management fees	0	0	- 3	- 3
Technical result	- 219	175	- 3	- 47
Net interest income			564	564
Dividend income			58	58
Net result from financial instruments at fair value through profit or loss			- 2	- 2
Net realised result from avialable-for-sale assets			84	84
Other net income			- 10	- 10
Impairment			- 12	- 12
Allocation to the technical accounts	536	87	- 623	0
Technical-financial result	317	262	24	634
Share in results of associated companies and joint ventures			19	19
RESULT BEFORE TAX	317	262	73	652
Income tax expense				- 187
RESULT AFTER TAX				465
Attributable to minority interest				0
Attributable to equity holders of the parent				465

The figures relating to earned premiums do not include investment contracts without DPF, which largely correspond to Unit-Linked contracts. The margin on these products is included in the net fee and commission income.

The table gives an overview of the technical accounts for 2018 and 2017:

Investment income decreased, which reflected primarily the decline in interest income, falling return on bonds linked to the general financial climate of low interest rates, combined with the lower volume of bonds on the balance sheet) and higher impairment on shares stemming from the negative trend on the stock markets.

More information on net interest income can be found in the table below.

Net interest income

in millions of EUR	2018 (IFRS 9)	2017 (IAS 39)
Total	**507**	**564**
Interest income	559	610
Interest income on financial instruments calculated using the effective interest rate method		
Loans and receivables		70
Held-to-maturity investments		199
Financial assets at AC	212	
Available-for-sale assets		302
Financial assets at FVOCI	312	
Hedging derivatives	1	2
Other assets not at fair value	28	16
Interest income on other fiancial instruments		
Financial assets MFVPL other than held for trading	0	0
Financial assets held for trading	5	22
Of which economic hedges	5	22
Other financial assets at FVPL	0	0
Interest expense	-52	-47
Interest expense on financial instruments calculated using the effective interest rate method		
Financial liabilities at AC	-9	-8
Hedging derivtives	-11	-3
Other	-9	-4
Interest expense on other financial instruments		
Financial liabilities held for trading	-22	-30
Of which economic hedges	-22	-30
Other fiancial liabilities at FVPL	0	0
Net interest expense relating to defined benefit plans	0	-1

2.5 Performance of other activities

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

System of governance

3 System of governance

3.1 Governance of the KBC Insurance Group

3.1.1 Main insurance companies of the KBC Insurance Group

The main entities of the KBC Insurance Group are:

- ✓ KBC Insurance NV (Belgium) and
- ✓ Its subsidiaries:
  - ČSOB Pojišťovna a.s. (Czech Republic)
  - ČSOB Poisťovňa a.s. (Slovak Republic)
  - K&H Insurance Zrt. (Hungary)
  - DZI Life Insurance Jsc (including DZI General Insurance Jsc) (Bulgaria)
  - KBC Group Re (Luxembourg)

The activities of the main entities of the KBC Insurance Group are operationally organised in business units:

- ✓ The Belgian activities of KBC Insurance NV are included under the Belgium Business Unit and organised in the KBC Insurance Products Directorate
- ✓ ČSOB Pojišťovna a.s. is part of the Czech Republic Business Unit
- ✓ ČSOB Poisťovňa a.s., K&H Insurance Zrt., DZI Life Insurance Jsc (including DZI General Insurance Jsc) are part of the International Markets Business Unit
- ✓ KBC Group Re is part of Group Centre

3.1.2 Shareholder structure and corporate bodies of KBC Insurance NV

3.1.2.1 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%**

3.1.2.2 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*.

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. It also contains the tasks and the rules of procedure for the Remuneration Committee and the Nomination Committee:

- ✓ 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.

3.1.3 Internal governance of Belgian activities of KBC Ins and KBC Ins Group

3.1.3.1 General remarks

All entities mentioned in 3.1.1 have their own governance structure.

The subsidiaries of the KBC Insurance Group – ČSOB Pojišt'ovna, a.s. (Czech Republic), ČSOB Poist'ovňa a.s. (Slovakia), K&H Insurance Zrt., DZI Life Insurance Jsc (including DZI General Insurance Jsc, and KBC Group Re) – are autonomous legal entities. Each one is:

- ✓ Managed on a day-to-day basis by an executive body
- ✓ Supervised by a supervisory body and committees (such as and depending on the country specifics): an Audit, Risk & Compliance Committee, a Remuneration Committee, a Remuneration and Nomination Committee

All the entities develop their strategy and activities within the strategy of the country in which they are active. This country strategy is drawn up in line with the strategy of KBC Group NV and KBC Insurance NV, under the leadership of the Country CEO. The country and insurance strategy, activities and results are reported to:

- ✓ The CEO of their respective business units
- ✓ The Executive Committee and Board of Directors of KBC Insurance and KBC Group NV

Mechanisms are in place to ensure that the insurance companies are integrated within their country, their business unit, the KBC Insurance Group and the KBC group, that they cooperate and that their activities are monitored.

These mechanisms relate among other things to:

- ✓ The role of the management committees at the level of the Business Units (BU BE and BU IM)
- ✓ The role of the Country Teams
- ✓ The role of Group Communities & Insurance Division
- ✓ The representation of the shareholders in the supervisory bodies
- ✓ The role of the control functions and their reporting requirements

Role of the Country Teams

A Country Team is established in every country (except BU BE) to, among other things, foster cooperation between the bank and the insurance companies. Each Country Team operates as an advisory body and discusses strategic topics relevant to the entities in each specific country. In addition, it discusses and challenges financial plans and monitors performance.

Role of the Group Communities & Insurance Division

Within KBC's operational management structure, the Group Communities & Insurance Division falls under the general operational support unit "Innovation and Digital Transformation" (IDT).

Together with the CEO of the International Markets Business Unit, this division represents KBC Insurance on the various Supervisory Bodies and Audit, Risk & Compliance Committees of all insurance entities (except KBC Insurance). It supports the CEO of the International Markets Business Unit and manages cooperation between KBC's insurance entities via the transnational insurance communities (all countries, including the Czech Republic and Belgium), as well as the cooperation between KBC's banking entities.

The role of the control functions at group level and their reporting requirements

Group Risk, Group Compliance and the Group Actuarial Function Holder (at the level of the KBC insurance Group and the KBC group) include the findings of insurance subsidiaries - second line of defence functions in their reports, which are submitted to :

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

3.1.3.2 Governance of the Belgian activities of KBC Insurance NV ("KBC Insurance Products")

Management Committees at the level of the Belgium Business Unit

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

- ✓ The Belgium Business Unit Management Committee is accountable for designing and proposing the strategy and for managing the execution of the strategy in Belgium Business Unit (BU), fitting 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 and 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 Belgium Business Unit is a member of these committees.

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

3.1.3.3 Governance & corporate bodies of the foreign subsidiaries of the KBC Insurance Group

3.1.3.3.1 ČSOB Pojišt'ovna a.s –Czech Republic Business Unit

Representatives of the shareholders in ČSOB Pojišt'ovna, a.s

KBC Insurance NV, the sole shareholder of ČSOB Pojišt'ovna a.s, has one representative on the Supervisory Body and one on the Nomination & Remuneration Committee. This representative is the Senior General Manager in charge of the Group Communities and Insurance division.

ČSOB Bank has three representatives in the Supervisory Board, one on the Audit Risk and Compliance Committee and one on the Nomination & Remuneration Committee. The representatives of ČSOB Bank in the Supervisory Board foster cooperation between ČSOB Bank and the insurance company, in particular by aligning their respective strategies.

Management committees of the insurance company

ČSOB Pojišt'ovna a.s has the following management committees to assist its executive body:

- ✓ New & Active Product Process Committee
- ✓ Investment Committee
- ✓ Local Risk & Capital Oversight Committee
- ✓ Reserving and Parameter Committee

Reporting by the local control functions

The local risk function, compliance function and actuarial function (known as the second line of defence), and the local audit function (known as the third line of defence) report their findings on the activities of ČSOB Pojišt'ovna a.s. to:

- ✓ The Board of Directors of the insurance company
- ✓ The Audit, Risk and Compliance Committee of the insurance company

3.1.3.3.2 ČSOB Poist'ovňa a.s. (Slovakia), K&H Insurance Zrt. (Hungary) and DZI Life Insurance Jsc (including DZI General Insurance Jsc) (Bulgaria) – International Markets Business Unit

Representation of KBC Insurance NV

KBC Insurance NV, the sole shareholder of ČSOB Poist'ovňa a.s., has one representative on the Supervisory Board, i.e. the Senior General Manager in charge of the Group Communities and Insurance Division.

It has two representatives on the Remuneration Committee: the CEO of the International Markets Business Unit (member of the Executive Committee of KBC Insurance) and the Senior General Manager in charge of the Group Communities & Insurance Division.

It has one representative on the Audit, Risk & Compliance Committee, i.e. the Senior General Manager in charge of the Group Communities & Insurance Division.

KBC Insurance NV, the sole shareholder of K&H Insurance Zrt., has two representatives in the Supervisory Board, the Remuneration Committee and the Audit, Risk & Compliance Committee: the CEO of the International Markets Business Unit and the Senior General Manager in charge of the Group Communities & Insurance Division. The CEO of K&H Bank is also a member of the Supervisory Board and the Audit, Risk & Compliance Committee.

KBC Insurance NV, the sole shareholder of DZI Life Insurance Jsc, has two representatives in the Supervisory Board and in the Remuneration Committee (the CEO of the International Markets Business Unit and the Senior General Manager in charge of the Group Communities and Insurance Division), and one representative in the Audit, Risk & Compliance Committee (the Senior General Manager in charge of the Group Communities & Insurance Division) . The CEO of UBB is also a member of the Remuneration Committee. They have the same mandates in DZI General Insurance Jsc (DZI Life Insurance Jsc being sole shareholder of this company).

Management committees of the insurance subsidiaries

The insurance subsidiaries have their own management committees, which assist their respective executive bodies. These committees consist of:

- ✓ New & Active Product Process committees
- ✓ Investment committees
- ✓ Local Risk & Capital Oversight committees. In Hungary, this committee is organised at country level; in Slovakia, this role is performed by the Country Team.

Reporting by the local control functions

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

- ✓ The management of the insurance subsidiary
- ✓ The Audit, Risk & Compliance Committee (ARCC) of the insurance subsidiary

3.1.3.3.3 Governance & corporate bodies of KBC Group Re

KBC Group Re SA is the internal reinsurance subsidiary belonging to the KBC group. The company specializes in protecting the KBC group's bank and insurance entities. It provides (protection) reinsurance for insurers being part of the KBC Group while diversifying and optimizing the group’s overall risk retention.

Management structure of KBC Group Re

KBC Group Re is managed by a Board of Directors. The Board of Directors is responsible for developing and approving the strategy and general policy for the company, including a risk, compliance and audit framework, and monitoring their implementation. The Board is also responsible for the appointment of the Managing Director. The Managing Director does also assume the responsibilities and role of ‘Dirigeant agréé’ as defined in the Luxembourg regulation ‘Loi modifiée du 6 décembre 1991 sur le secteur des assurances’.

The Board also acts as Audit, Risk and Compliance Committee (see further).

The Board is composed of at least 3 members (currently 4) appointed by the General Meeting. It consists of 3 non-executive members, i.e. the Senior General Manager responsible for the insurance activities of the Belgium Business Unit, the Senior General Manager in charge of the Group Communities and Insurance Division, a senior manager of the KBC Insurance Products Directorate (BU BE) and the Managing Director.

The Managing Director is the sole Executive Director.

Audit Risk and Compliance Committee

The Audit, Risk and Compliance Committee is not set up as a separate committee: the Board directly exercises its responsibilities regarding those topics within the audit, risk and compliance domains, i.e. the integrity of the financial reporting, the effectiveness of the internal control measures and risk management processes, and the implementation of the compliance rules.

Following persons, or their representative, participate as permanent guests during these Audit Risk and Compliance Committee meetings:

- ✓ The Internal auditor
- ✓ The Chief Risk Officer (CRO) of the Business Unit Belgium of KBC
- ✓ The Compliance Officer

The external auditors are invited at least once a year.

Reporting of the local control functions

The local risk function, compliance function and actuarial function, and the group audit function report on their findings to the Board of Directors when acting as Audit Risk and Compliance Committee.

Overview of the legal and operational structure

1. KBC Group level

KBC Insurance Board of Directors

KBC Insurance Audit Committee

KBC Insurance Risk & Compliance Committee

KBC Group Nomination Committee

KBC Group Remuneration Committee

KBC Insurance Executive Committee

Group Insurance Committee

Asset Liability Committee (ALCO)

2. Business Unit level

CSOB P CZ	CSOB P SK	K&H Ins	DZI Ins/DZI Gen Ins	KBC Ins	KBC Group Re
CZ BU Management Committee	International Markets BU Management Committee			Belgium BU Management Committee	
				Insurance ALM Committee	
				Belgium BU Risk, ALM & Capital Committee (RACC)	
				Maatschappij voor Brandherverzekering	
				see Governance Memorandum MvBH	

3. Legal structure

CSOB P CZ	CSOB P SK	K&H Ins	DZI Ins/DZI Gen Ins	KBC Ins	KBC Group Re
General Meeting	General Meeting	Founder	General Meeting / Single Owner of Capital (SOC)	Cf. KBC Group level	General Meeting
Supervisory Board	Supervisory Board	Definitive Supervisory Board	Supervisory Board		Board of Directors
Audit Committee	Audit, Risk & Compliance Committee	Audit, Risk & Compliance Committee	Audit, Risk & Compliance Committee		Managing Director
Nomination & Remuneration Committee	Nomination & Remuneration Committee	Nomination & Remuneration Committee	Nomination & Remuneration Committee		
Board of Directors	Board of Directors	Board of Directors	Management Board		

4. Management structure

Committees within Insurance entity

CSOB P CZ	CSOB P SK	K&H Ins	DZI Ins/DZI Gen Ins	KBC Ins	KBC Group Re
NAPP	NAPP	NAPP	NAPP	Insurance Products Management Committee	
Investment Committee	Investment Committee	Investment Council	Investment Committee	Non-Life Insurance NAPP Committee	Investment Committee
Local Risk & Capital Oversight Committee			Local Risk & Capital Oversight Committee	Non-Life Insurance Risk Management Committee	
				Non-Life Insurance Operational Management Committee	
				Life Insurance NAPP Committee	
				Life Insurance Risk Management Committee	
				Life Insurance Operational Management Committee	

Committees at Country level

CSOB P CZ	CSOB P SK	K&H Ins	DZI Ins/DZI Gen Ins	KBC Ins	KBC Group Re
Country team	Country team	Country team	Country team		
		Local Risk & Capital Oversight Committee			

5. Group Communities & Insurance (part of the general operational unit Innovation and Digital Transformation ("IDT").

Group Communities & Insurance Division

3.1.4 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.

3.1.5 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

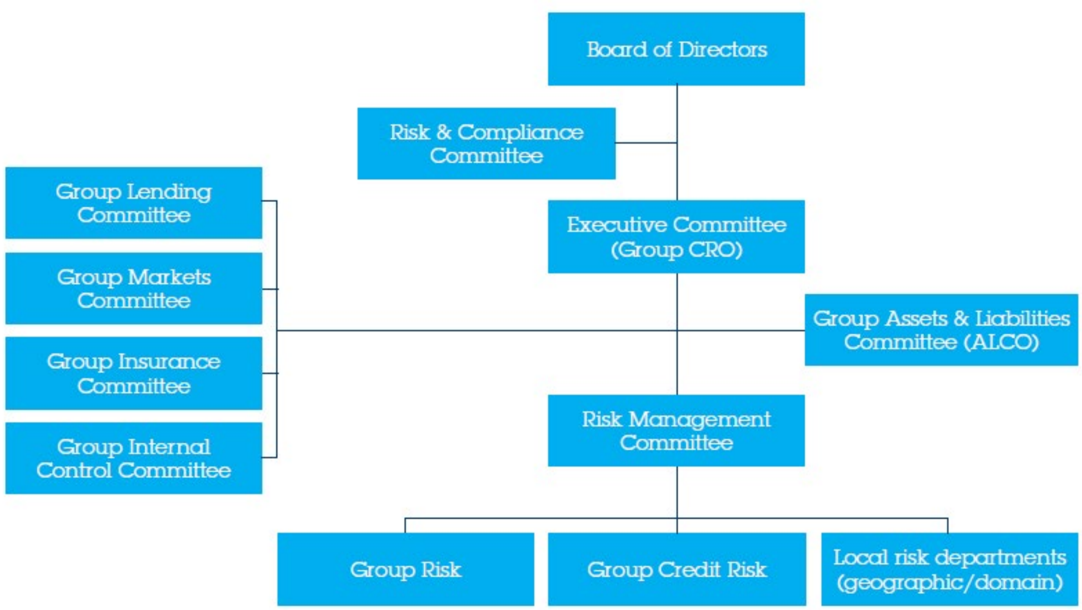
4. In order to strengthen the voice of the risk function and to ensure that the decision-making bodies of the business entities are appropriately challenged on matters of risk management and receive expert advice, KBC has deployed independent Chief Risk Officers (CROs) throughout the group according 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 (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 pertaining to KBC group are in scope of the ORSA. A differentiated but coherent, consistent and proportionate approach is applied, based on the materiality of the entity. The ORSA processes and reporting are implemented with a high degree of consistency in all material entities of KBC Insurance Group who will have a local or individual ORSA report.

KBC does not require that the non-material entities (i.e. NLB Vita and Maatschappij voor Brandherverzekering) run the KBC ORSA processes or write an ORSA report. However, the local regulator can impose the need for an ORSA process and reporting.

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 can 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, taking into account the underpinning of the regulatory capital. 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 accountability 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 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 **Group 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

- ✓ <u>Third line of defence</u>: 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 among other things:

- ✓ 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.

3.4.4 Critical or important operational functions or activities outsourced to external parties

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).

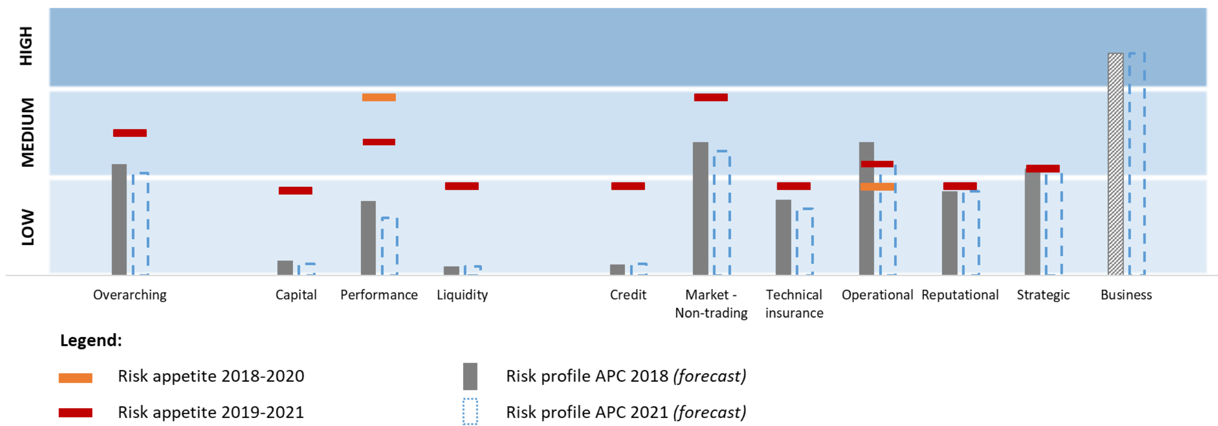
Risk profile

4 Risk profile

The KBC Insurance Group is exposed to a number of typical industry-specific risks such as movements in interest rates, insurance underwriting risk, business risk, operational risks, ... In this section, we focus on the most material risks we face.

The KBC Insurance Group Risk Appetite Statement reflects the view of the Board of Directors and top management on risk-taking in general and on the acceptable level and composition of risks in coherence with the desired return, in particular. 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.

For the KBC Insurance Group specifically, this leads to the following risk appetite and risk profile:



KBC Insurance Group risk profile vs risk appetite

The **overarching risk appetite and risk profile of KBC Insurance Group remain within the 'medium' range**. The risk profile is even expected to decrease by 2021 mainly driven by a decrease in market risk, operational risk and technical insurance risk. The risk profile hence remain comfortably within the risk appetite during the APC planning horizon.

The risk profile of capital is low. Indeed, the solid capital ratio of 217% at year-end 2018 reflects KBC's low risk appetite in terms of capital. The capital position also remains strong in a going forward view. Further improvements have been made to align group and local stress tests to test the resilience of the Solvency II ratio. Various stress tests confirmed the comfortable liquidity positions of KBC Insurance Group. Thorough underpinning of the Solvency Capital Requirement (SCR) demonstrating that the Solvency II SCR adequately reflects the risk profile of KBC Insurance Group and is assessed as appropriate for internal capital monitoring.

Market risk, strategic risk and operational risk (all 'medium') are important drivers in the risk profile of KBC Insurance Group. It is the ambition to gradually achieve the 'low' risk profile for operational risk by 2023, after finalization of the large scale internal transformation programs. The decrease of the risk profile is confirmed by APC, however achieving this over the APC planning horizon remains challenging.

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

No risk appetite is set for business risk as it is driven by external factors. 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.

Based on the outcome of the risk scan, the risk profile, the Solvency II SCR materiality and the SCR underpinning exercise, the following ranking of 5 top risks are identified at the level of KBC Insurance Group at year-end 2018:

1. Business risk[5]
2. Market risk – spread risk
3. Market risk – equity risk
4. Market risk – interest rate risk
5. Operational risk

4.1 Technical insurance risk

The '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.
The management of the technical insurance risk strategy is the responsibility of the Executive Committee of KBC Insurance, assisted by the Group Insurance Committee (GIC), which has representatives from both the business side and the risk function.

Adequate procedures are enforced throughout the KBC Insurance Group to ensure sound, quality underwriting is provided with good overall profitability, within the prescribed retention limits, and in adherence to the group and local risk appetite (see section '2.3. Underwriting performance').

The insurance entities focus mainly on the segments of retail and small enterprises i.e. Private Persons, the Self-Employed and Small & Medium-Sized Enterprises (SMEs). Through the wide range of insurance products that are offered to these clients, an important degree of diversification is reached. Where larger risks are taken in portfolio, or when risks could accumulate to a larger scale, risk mitigation is achieved through the purchase of reinsurance cover.

The Group Risk function develops and rolls out a group-wide framework for managing insurance risks within all insurance entities. Group Risk is responsible for providing support with regard to local implementation and the functional direction of the insurance risk management process of the insurance subsidiaries.

The Insurance Risk Management Framework is designed primarily around the following building blocks:

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

[5] Remark that in contrast to last year's top 5 risks, strategic risk is not included anymore because business & strategic risk has been split up into a contextual/non-manageable part (business risk) and an internal/manageable part (strategic risk).

The following risk aspects have an important impact on the underwriting risk profile of an insurance company:

- ✓ Concentration risk:
  Main concentration risk that can be observed for the underwriting risk:
  - Natural catastrophe risks (storms, floods, earthquakes, ...).
  - Non-natural catastrophe risks or 'man-made' catastrophe risks (e.g., pandemic events, big losses, ...).
  - Concentration risks linked to specific activities (e.g., nuclear risk, terrorism risks).

  The possible concentration risk at KBC Insurance Group level is also assessed. Exposure can be aggregated at group level in different ways:

  - Via accumulation exposure across different entities (e.g., a storm hitting several domestic KBC markets).
  - Via internal reinsurance when direct entities cede important parts of their exposure to KBC Group Re, which keeps the risk in own retention or further cedes the pooled risk to the external reinsurance market.
  - Via credit exposure to reinsurance counterparties (see section '4.3. Credit risk').

  KBC Group risk management has developed a model for assessing the group-wide exposure to all Non-Life insurance risks, including natural hazards. This model measures the most material Non-Life insurance risks (catastrophe and premium & reserve risk) for all group insurance and reinsurance companies, taken into account also the outward reinsurance (external and intra group). The resulting concentration risk exposures are used to check compliance with the limit frameworks (Group and local level) based upon which adequate reinsurance coverage can be bought.

- ✓ Risk mitigation:
  Besides strict underwriting guidelines that should guarantee sound underwriting, reinsurance is bought to support the strategic objectives as formulated in the Risk Appetite Statement. In order to achieve the objectives, the reinsurance policy of the KBC Insurance Group stipulates that every material insurance entity has to acquire reinsurance protection to ensure that its net exposure remains within the bounds of the risk retention limit framework.

  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. The independent insurance risk management function is also responsible for advising on the restructuring of the reinsurance programmes. This approach has resulted in optimising the retention of the KBC group particularly in respect of its exposure to natural catastrophe risk, but also in respect of other lines of business.

  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.

Best estimate valuations of insurance liabilities

As part of its mission to independently monitor insurance risks, the Group risk function regularly carries out in-depth studies. These indicate that the technical provisions at subsidiary level are sufficient. The value of technical provisions must equal the sum of a Best Estimate and a Risk Margin. The Best Estimate corresponds to the discounted future cashflows of the insurance obligations. A Risk Margin is added to ensure that the value of the technical provisions is equivalent to the amount an insurance company would require to take on the obligations of the insurance company. The adequacy of provisions is checked per business line at subsidiary level and the overall adequacy is assessed at subsidiary level for all business lines combined.

In addition, the main group companies conduct Liability Adequacy Tests (LAT) that meet local and IFRS requirements for the Life technical provisions. We make calculations using prospective methods (cashflow projections that take account of lapse rates and a discount rate that is set for each insurance entity based on local macroeconomic conditions and regulations), and build in extra market-value margins to deal with the factor of uncertainty in a number of parameters.

For Life business also the Value of New business (VNB)/Value of Business In force (VBI) are calculated which are both widely used industry standards to measure the profitability of the Life insurance operations. With this group-wide methodological framework a reference throughout KBC Insurance Group was provided.

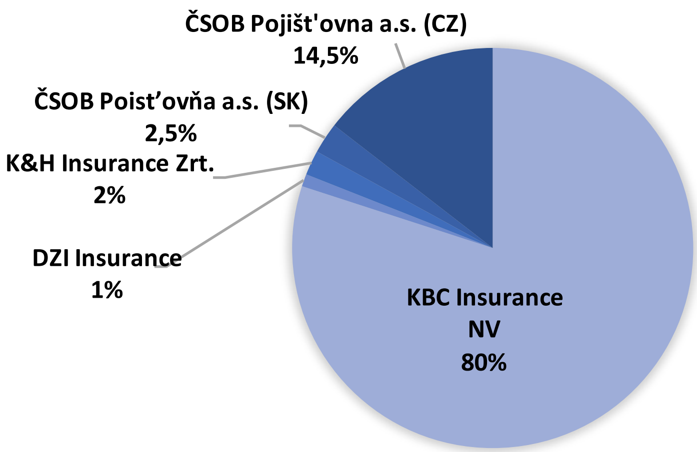
4.1.1 Life risk

In the tables below, an overview is provided of the KBC Insurance Group's best estimate provisions for the Life business at 31 December 2018.

Line of business (in millions of EUR)	Best Estimate *(gross of reinsurance recoverables)*	%
Total Best Estimate Life excluding Health and Unit Linked	14 906	51%
Total Best Estimate Health similar to Life	478	2%
Total Unit linked Best Estimate and value as a whole	13 603	47%
Total Best Estimate provision Life (incl, Health similar to Life and Unit Linked)	**28 987**	**100%**

Life business – Best Estimates

Compared with last year (total best estimate provision for the Life business, including health similar to Life and Unit-Linked: 30 234,1 million euros), the Life business' risk exposure has decrease with 4% at group level. The majority of the premium volume is still written in Belgium (including both the guaranteed-rate and Unit-Linked businesses).



Gross written premium Life insurance – split per entity 2018

Premium volume increased in 2018 for Non-Unit-Linked products, as shown in the table below. This was mainly driven by KBC Insurance NV and DZI Insurance. For the Unit-Linked products there was a decrease in KBC Insurance NV, ČSOB Pojišt'ovna a.s. (CZ) and in K&H Insurance Zrt..

	2018			2017		
In millions of EUR	Unit-Linked	Non Unit-Linked	Total	Unit-Linked	Non Unit-Linked	Total
KBC Verzekeringen NV	423	999	1 422	570	926	1 495,9
ČSOB Pojišt'ovna a.s. (CZ)	206	53	259	216	52	268
ČSOB Poist'ovňa a.s. (SK)	28	21	48	24	22	46
K&H Insurance Zrt.	27	12	39	29	12	41
DZI Insurance		17	18		14	14
Total	**684**	**1 102**	**1 786**	**838**	**1 027**	**1 865**

Premium volumes Life insurance

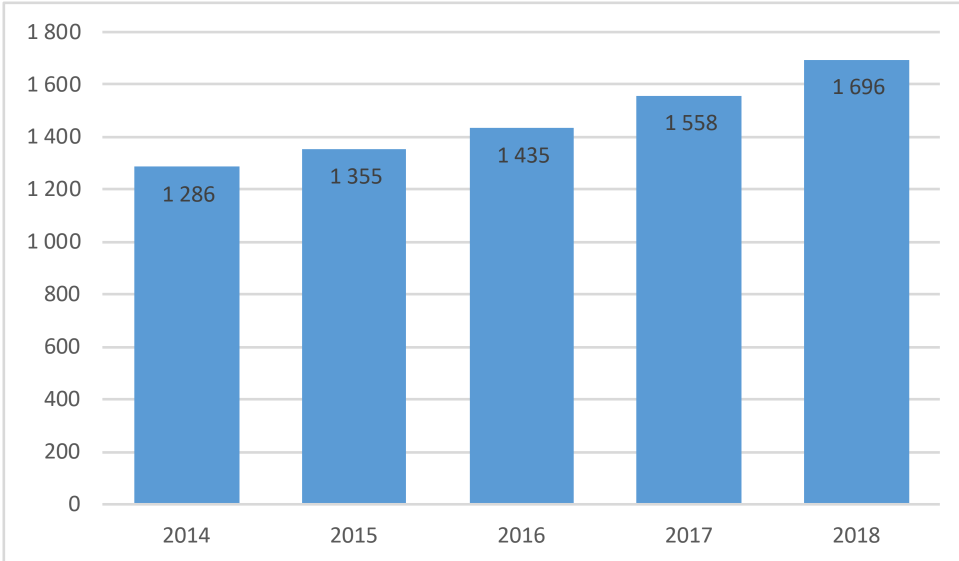
4.1.2 Non-Life risk

An overview of the KBC Insurance Group's best estimate provisions for the Non-Life business at 31 December 2018 is provided in the tables below.

Line of business (in millions of EUR)	Best Estimate *(gross of reinsurance recoverables)*	%
Total Best estimate excluding Health non similar to Life	1 513	88%
Total Best estimate Health non similar to Life	215	12%
Total Best Estimate provision Non-Life (incl, Health non similar to Life)	**1 728**	**100%**

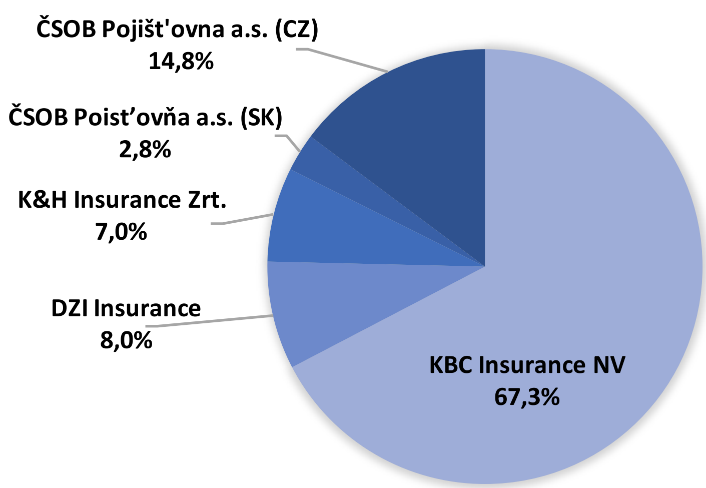
Non-Life business – Best Estimates

The graph below shows how the gross written premium (GWP) volume has developed over the past few years. The steady increase in Non-Life GWP volumes is in line with expectations, i.e. a stable moderate growth that is expected to continue in the coming years.



Evolution gross written premium

The graph below illustrates the premium split per entity for the Non-Life portfolio.



Gross written premium Non-Life – split per entity

4.2 Market risk

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).

'Structural exposure' encompasses all exposure inherent to our commercial activity or to our long-term positions. Trading activities are consequently not included. Structural exposure can also be described as a combination of:

- ✓ Mismatches in the insurance activities between liabilities in the Non-Life and Life businesses and the corresponding covering assets.
- ✓ The risks associated with holding an investment portfolio for the purpose of (re)investing shareholders' equity (the so-called strategic position).
- ✓ The structural currency exposure stemming from the activities abroad (investments in foreign currency, results posted at branches or subsidiaries abroad, foreign exchange risk linked to the currency mismatch between the insurer's liabilities and its corresponding investments).

The management of the ALM risk strategy at KBC is the responsibility of the Group Executive Committee, assisted by the Group ALCO, which has representatives from both the business side and the risk function.

Managing the ALM risk on a daily basis starts in the first line 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. KBC's ALM limits are approved at two levels. Primary limits for interest rate risk, equity risk, and real estate risk for the entities are approved by the Board of Directors. Secondary limits for interest rate risk, equity risk, real estate risk and foreign exchange risk are approved for each entity by the Executive Committee. Together this forms the playing field for KBC's solid first line of defence for ALM risk.

KBC's second line of defence is the responsibility of Group Risk and the local risk departments. Their main task is to measure ALM risks and flag up current and future risk positions. A common ALM Risk Management Framework (Non-Trading Market Risk Management Framework), an ALM rulebook and shared group measurement infrastructure ensures that these risks are measured consistently throughout the group. The ALM Risk Management Framework and Rulebook has been drawn up centrally by Group Risk and is applicable for all entities.

The main building blocks of KBC's ALM Risk Management Framework are:

- ✓ A broad range of risk measurement methods such as Basis-Point-Value (BPV), gap analysis and economic sensitivities.
- ✓ Net interest income simulations performed under a variety of market scenarios. Simulations over a multi-year period are used in budgeting and risk processes.
- ✓ Capital sensitivities arising from investment book positions that impact available regulatory capital (e.g., bonds that are classified as fair value through other comprehensive income).
- ✓ Stress testing and sensitivity analysis.

The risk appetite of the KBC Insurance Group for market risk is defined based on three primary limits which are set at solo and insurance group level, i.e.

- A primary BPV limit
- A primary equity limit (nominal)
- A primary real estate limit (nominal)

Given that no limit breaches were observed in 2018 and given the materiality of market risk within the Solvency II results, the risk profile has been assessed as 'Medium'.

4.2.1 Interest rate risk

One of the most important risks for insurance companies in the current low yield environment is interest rate risk. The negative impact of low yields on available capital is rather straightforward, given the longer tenor of liabilities compared to assets and the increased impact of the convexity effect[6] following from these persistent low yields.

The main technique used to measure interest rate risks is the 10 BPV method, which measures the extent to which the value of the portfolio would change if interest rates were to go up by 10 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 interest rate gap analysis, the duration approach, scenario analysis and stress testing (both from a regulatory capital perspective and from a net income perspective).

Impact of a parallel 10-basis-point increase in the swap curve for the KBC Insurance Group (in millions of EUR)	Impact on value[1]	
	2018	2017
KBC Insurance Group	16	12

1 Full market value, regardless of accounting classification or impairment rules.

Impact of a parallel 10-basis-point increase in the swap curve for KBC Insurance Group

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

Unit-Linked Life insurance investments are not dealt with here, since this activity does not entail any market risk for KBC.

The Non-Unit-Linked Life activities combine a guaranteed interest rate with a discretionary participation feature (DPF or profit sharing). 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 clients a competitive profit sharing rate. The risk of low interest rates is managed via a cashflow-matching policy, which is applied to that portion of the Life insurance portfolios covered by fixed-income securities.

In the table below, we have summarised the exposure to interest rate risk in our Life insurance activities. The Life insurance assets and liabilities relating to products with fixed guaranteed interest rates are grouped according to the expected timing of cashflows.

[6] 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.

Expected cashflows (not discounted), life insurance activities (in millions of EUR)	0–5 years	5–10 years	10–15 years	15–20 years	> 20 years	Total
31/12/2018						
Fixed-income assets backing liabilities, guaranteed component	6 978	4 388	1 679	1 597	799	15 442
Liabilities, guaranteed component	5 513	3 923	2 338	2 008	2 606	16 389
Difference in expected cashflows	1 465	465	-659	-411	-1 807	-947
Mean duration of assets						6,55 years
Mean duration of liabilities						9,20 years
31/12/2017						
Fixed-income assets backing liabilities, guaranteed component	8 118	4 943	2 548	1 766	1 079	18 453
Liabilities, guaranteed component	7 675	3 800	2 385	1 799	2 841	18 500
Difference in expected cashflows	443	1 143	163	-33	-1 763	-47
Mean duration of assets						6,28 years
Mean duration of liabilities						7,39 years

Expected cashflows (not discounted), Life insurance activities

As mentioned above, 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. 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.

Breakdown of the reserves for non-unit-linked life insurance by guaranteed interest rate, insurance activities	31/12/2018	31/12/2017
5,00% and higher	2,7%	3,0%
More than 4,25% up to and including 4,99%	9,4%	8,9%
More than 3,50% up to and including 4,25%	5,4%	5,0%
More than 3,00% up to and including 3,50%	10,1%	10,2%
More than 2,50% up to and including 3,00%	9,9%	6,0%
2,50% and lower[2]	60,1%	65,1%
0,00%	2,5%	1,7%
Total	100,0%	100,0%

Breakdown of the reserves for Non-Unit-Linked Life insurance by guaranteed interest rate, insurance activities

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. The small increase in the higher guaranteed interest rates is explained by production in Central and Eastern Europe.

4.2.2 Credit spread risk

We manage the credit spread risk for, among other things, 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. This economic sensitivity is illustrated in the table below together with a breakdown for the core countries of KBC.

	At amortised cost	At fair value through other comprehensive income (FVOCI)	Total	For comparison purposes: total at year end 2017	Economic impact of +100 basis points
KBC core countries					
Belgium	1 323	2 829	4 152	4 481	-320
Czech Republic	288	432	721	658	-44
Hungary	78	104	182	181	-8
Slovakia	163	214	377	398	-25
Bulgaria	15	150	166	181	-9
Ireland	39	77	116	133	-4
Other countries	1.710	3.335	5.045	5.549	-346
Total carrying value	3 616	7 141	10 759	11 580	

The carrying amount refers to the amount at which an asset or liability is recognised in the company's books, i,e, the fair value amount for instruments categorised as available for sale, designated at fair value through profit or loss and held for trading and the amortised cost amount for instruments categorised as held to maturity, The table exludes exposure to supranational entities of selected countries, No material impairment on the government bonds in portfolio,

Exposure to sovereign bonds at year-end 2018, carrying value

Main changes in 2018:

- ✓ The carrying value of the total sovereign bond exposure decreased by 0,8 billion euros. There was a limited increase in exposure to sovereign bonds in Czech Republic (+63 million euros) and a generalized decrease in exposure to other sovereign , of which Belgium (-0,3 billion euros).

Portfolio of Belgian government bonds:

- ✓ Despite the decline, Belgian sovereign bonds accounted for 39% of our total government bond portfolio at the end of 2018, reflecting the importance to KBC of Belgium, the group's primary core market.
- ✓ At year-end 2018, the credit ratings assigned to Belgium by the three main international agencies were 'Aa3' from Moody's, 'AA' from Standard & Poor's and 'AA-' from Fitch.
- ✓ Apart from interest rate risk, the main risk to our holdings of Belgian sovereign bonds is a widening of the credit spread. To assess the potential impact of a 100-basis-point upward shift in the spread (by year-end 2018) we apply two approaches:
  - Theoretical full economic impact approach. This approach assumes a potential full sale of the portfolio at market prices. The impact of a 100-basis-point shift would then amount to a change in value of 320 million euros
  - IFRS approach: the impact on IFRS profit or loss is marginal since the most important part of the portfolio of Belgian sovereign bonds was classified as 'At amortised cost'.

4.2.3 Equity risk

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

Equity portfolio of the KBC Insurance Group (breakdown by sector, in %)	Insurance activities	
	31/12/2018	31/12/2017
Financials	24%	24%
Consumer non-cyclical	10%	8%
Communication	3%	2%
Energy	6%	6%
Industrials	38%	39%
Utilities	2%	1%
Consumer cyclical	12%	15%
Materials	5%	6%
Other and not specified	0%	0%
Total	100%	100%
In billions of EUR	1,33	1,47
of which unlisted	,01	0

Equity portfolio of the KBC Insurance Group (breakdown by sector)

In the total equities amount above (1,33 billion euros), 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').

4.2.4 Real estate risk

The KBC Insurance Group's real estate businesses hold a limited real estate investment portfolio. KBC Insurance Group also holds a diversified real estate portfolio, which is held as an investment for Non-Life reserves and long-term Life activities. The real estate exposure is viewed as a long-term hedge against inflation risks and as a way of optimising the risk/return profile of these portfolios. The table provides an overview of the sensitivity of economic value to fluctuations in the property markets.

Impact of a 25% drop in real estate prices (in millions of EUR)	Impact on value	
	2018	2017
	-81	-67

impact of a 25% drop in real estate prices

Note that the above shock has been calculated based on the IFRS value of property including real estate certificates.

4.2.5 Foreign exchange or currency risk

As currency risk is measured against the local reporting currency, it is important to understand that the currency risk at the level of the KBC Insurance Group is perceived differently than the currency risk at the level of the solo insurance entities, which are reporting in a non-euro currency, i.e.:

- ✓ DZI Life Insurance Jsc → BGN
- ✓ DZI General Insurance Jsc → BGN
- ✓ ČSOB Pojišt'ovna a.s. (CZ) → CZK
- ✓ K&H Insurance Zrt. → HUF

We pursue a prudent policy as regards our structural currency exposure, essentially seeking to avoid currency risk through FX hedging.

The current FX hedging strategy makes a distinction between three sources of FX risk, i.e.:

- ✓ FX risk stemming from participations
  The participations are hedged, based on the accounting Net Asset Value (NAV) and realised profits, in line with the Group FX Policy.
- ✓ FX risk stemming from the equity portfolio
  The equity positions (excl. participations) are not hedged, but the FX expected return, risk and volatility is an inherent part of the assessment to invest in non-euro equities. Based on historical analysis, no strong economic reasons were found to systematically hedge FX risk.
- ✓ FX risk stemming from the remaining portfolio (primarily fixed-income securities such as bonds). All of the remaining portfolio is cashflow hedged via cross currency swaps.

4.2.6 Inflation risk

Inflation – as an economic parameter – indirectly affects the life of companies in many respects, in much the same way as other parameters do (f.e. economic growth or the rate of unemployment). It is not easily quantifiable as a market risk concept. However, certain financial products or instruments have a direct link with inflation and their value is directly impacted by a change in market expectations.

At KBC Insurance Group, it relates specifically to workmen's compensation insurance, where particularly in the case of permanent or long-term disabilities, an annuity benefit is paid to the insured person (with the annuity being linked to inflation by law). KBC Insurance Group partly mitigates the risks by investing in inflation-linked bonds so that any increase in liabilities arising from mounting inflation is offset by an increase in the value of the bonds. However, these liabilities are long-dated and significantly exceed the investment horizon of such index-linked bonds. Therefore, KBC Insurance Group complements its inflation hedging programme by investing in real estate and shares, as these assets are traditionally correlated with inflation and do not have a maturity date.

In 2018, the undiscounted value of the inflation-sensitive cashflows was estimated at 608 million euros, for which a 387 million euros portfolio of indexed bonds was held. In the years ahead, investments in inflation-linked bonds will be increased further.

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 transactional and portfolio level. Managing credit risk at the transactional level means that we have sound practices, processes and tools in place to identify and measure the risks before and after accepting individual credit exposures. Limits and delegations are set to determine the maximum credit exposure allowed and the level at which acceptance decisions are taken. Managing the risk at portfolio level encompasses, *inter alia*, periodic measuring and analysing of risk embedded in the consolidated loan and investment portfolios and reporting on it, monitoring limit discipline, conducting stress tests under different scenarios and taking risk mitigating measures.

From a KBC group perspective, the (re)insurance entities are limited in the amount of credit concentration risk they take in their portfolios by the Portfolio Limit System (PLS). Limits are monitored per asset class.

For the following four asset classes, concentrations are limited for the (re)insurance entities within the KBC group:

- *PLS Sovereigns*: limits are set on the nominal amount of credit exposure (direct credit lending, as well as bond investments) to central and federal country authorities, central banks and government-sponsored export credit agencies.
- *PLS Sub-National Governments*: limits are set on the nominal amount of credit exposure (direct credit lending, as well as bond investments) to regional authorities, provincial authorities, cities, municipalities, public welfare bodies, inter-municipal associations and other entities for which the Sub-National Government is financially responsible (e.g., a hospital controlled/managed by a municipality is in scope, while other hospitals are out of scope). A ratings-based approach is followed, i.e. decreasing nominal limits for more risky credit ratings. Besides these single name concentration limits (i.e. PLS), limits on the maximum allowed Sub-National Government exposure per country are also in place.
- *PLS Financial Institutions*: limits are set on the Loss Given Default (LGD) amount of any type of investment in a financial institution by the (re)insurance entities. Again a ratings-based approach is followed, i.e. decreasing LGD limits for lower credit (more risky) ratings. These LGD limits are further translated into nominal limits for operational purposes in the business.
- *PLS Corporates and Non-Bank Financial Institutions*: limits are set on the Loss Given Default irrecoverable (LGD(irr)) amount of all credit-risk-bearing assets (bonds and their equivalent). Here, too, a ratings-based approach is followed, i.e. decreasing LGD(irr) limits for lower external credit ratings (with a zero limit for non-investment grade counterparties).

PLS limit breaches are monitored on a quarterly basis.

For insurance activities, credit exposure exists primarily in the investment portfolio (to issuers of debt instruments) and to reinsurance companies. We have guidelines in place for the purpose of controlling credit risk within the investment portfolio: for instance, with regard to portfolio composition and ratings.

We are also exposed to a credit risk in respect of (re)insurance companies, since they could default on their commitments under (re)insurance contracts concluded with us. We measure this particular type of credit risk by means of a nominal approach (the maximum loss) and expected loss, among other techniques. Name concentration limits apply. PD – and by extension – expected loss is calculated using internal or external ratings.

Credit exposure to (re)insurance companies by risk class[1]: Exposure at Default (EAD) and Expected Loss (EL)[2] (in millions	EAD 2018	EL 2018	EAD 2017	EL 2017
AAA up to and including A-	188	,08	191	,08
BBB+ up to and including BB-	11	,01	14	,02
Below BB-	0	0	0	0
Unrated	1	,02	2	,04
Total	200	,11	206	,13

1 Based on internal ratings,

2 EAD figures are audited, whereas EL figures are unaudited,

Credit exposure to (re)insurance companies by risk class

Exposure to sovereign bonds

We hold a significant portfolio of government bonds for the reinvestment of insurance reserves into fixed-income instruments. A breakdown per country together with the economic impact of a 100-basis-point upward shift in the spread is provided under 'Credit spread risk'.

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 KBC Insurance Group to continue to generate revenue, even under adverse circumstances.

An insurance entity's liquidity is managed by matching cashflows but is also managed through monitoring the Investment Policy amongst others by ensuring that sufficient investments are made in liquid assets. As a result, insurance entities are less sensitive for 'real' liquidity risk.

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 tenors than the corresponding liabilities. Insurance activities typically have assets that are shorter and much more liquid than the corresponding liabilities.

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

4.4.1 Non-Life liquidity risk

Within the Non-Life insurance business, liquidity risk could arise if a catastrophe (f.e. natural disaster) would take place leading to huge claims and thus large cash demands. The cash outflows will typically take place over a longer time horizon (i.e. assessment of damage, legal procedures, …) and certain levels of claims are covered by reinsurance 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 as much as possible restricted. 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, ...).

4.4.2 Life liquidity risk

The Life insurance business could be confronted with liquidity risk as a result of:

- ✓ Changing market circumstances (e.g., movement in rates, competition, ...) 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 creditworthiness and reduce their exposure.
- ✓ A pandemic-like scenario.
- ✓ A combination of the above (combined scenario).

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, ...) to cope with these cash outflows. Apart from the idiosyncratic scenario, the time horizon in which the cashflows will take place, is expected to be rather long (i.e. longer than one month), hence reducing 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). Furthermore and especially in the case of KBC Insurance NV, clients will lose their fiscal advantage in case of early surrender. Surrender risk is therefore partially mitigated through fiscal rules. The liquidity risk attached to Life insurance activities is assessed by an internal stress test ratio, as defined in the Liquidity Risk Management Framework.

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 Group.

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.

Managing operational risk

We have a single, global framework for managing operational risk across the entire group. The Group risk function is the primary responsible for defining the operational risk management framework. The development and implementation of this framework is supported by an extensive operational risk governance model covering all entities of the group.

The main tasks of the Competence Centre for Operational Risk are to:

- ✓ Define the operational risk management framework and the minimum standards for operational risk management processes for the group;
- ✓ Inform senior management and oversight committees of the operational risk profile;
- ✓ Plan and perform independent risk investigations and challenges of the internal control environment;
- ✓ Provide oversight and advice on the effectiveness of controls executed to reduce operational risk;

- ✓ Create an environment where risk specialists (in various areas, including information risk management, business continuity and disaster recovery, compliance, anti-fraud, legal, tax and accounting matters) can work together (setting priorities, using the same language and tools, uniform reporting, etc.). The Competence Centre for Operational risk consists of independent risk experts both at group and local level.

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, ..., 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 & strategic risk

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

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.

Business and strategic risks are assessed as part of the strategic planning process starting with a structured risk scan that identifies the top financial and non-financial risks. Exposure to the identified business and strategic risks, is monitored on an ongoing basis. Besides the risk scan, business and strategic risks are continually monitored by means of risk signals being reported to top management. In addition, these risks are discussed during the aligned planning process and are quantified under different stress test scenarios and long-term earnings assessments.

4.6.3 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 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.

KBC Group actively monitors external stakeholders' confidence and expectations. GExCo monitors Net Promoter Scores (NPS), reputation and employee engagement metrics versus internal targets.

4.7 Other information

Sensitivity analyses and stress testing

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

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 and limit setting, ...). As such, stress testing is an integral part of our risk management framework, and an important building block of ORSA (the Own Risk and Solvency Assessment).

Stress tests are performed internally within the insurance group or at local entity level or are initiated on a regular basis by the regulator (EIOPA[7] or local regulators). KBC also performs *ad hoc* integrated stress tests to test its vulnerability for specific risks and potential adverse conditions that may arise.

[7] European Insurance and Occupational Pensions Authority

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 accounting (IFRS) 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	IFRS value	Difference
Goodwill & intangible assets	0	130	- 130
Deferred tax assets	0	7	- 7
Property (other than for own use)	241	143	98
Equity instruments	1 211	1 211	-
Bonds	17 970	17 024	945
Assets held for index-linked and unit-linked funds	13 685	13 685	0
Deposits other than cash equivalents	652	520	132
Loans & mortgages	2 479	2 295	184
Reinsurance recoverables	69	122	- 53
Own shares	203	0	203
Other	983	1 065	- 82
Total assets	**37 492**	**36 202**	**1 290**
Technical provisions - Non-Life	2 036	2 686	- 650
Technical provisions - Life (excl. Index-Linked and Unit-Linked)	15 757	14 544	1 213
Technical provisions - Index-Linked and Unit-Linked	13 699	13 840	- 141
Deferred tax liabilities	376	201	176
Other	2 198	2 203	- 5
Total liabilities	**34 066**	**33 474**	**593**
Excess assets over liabilities	**3 425**	**2 728**	

The table below gives a clear overview of how the IFRS 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.

IFRS equity	2 728
Valuation differences between IFRS and Solvency II	
of which: deduction intangible assets (after tax)	- 124
of which: valuation difference participations	- 20
of which: valuation difference real estate at fair value (after tax)	85
of which: valuation difference fair value loans & receivables (after tax)	237
of which: valuation difference fair value amortised cost bonds (after tax)	714
of which: valuation difference reinsurance recoverables	- 41
of which: valuation difference technical liabilities (after tax)	- 634
of which: volatility adjustment	313
of which: treasury shares	203
of which: other	- 35
Assets over liabilities Solvency II	**3 425**

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).*

5.1.1.3 Bonds, Equity Instruments and Loans & mortgages

- ✓ 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 at 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 distressed 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 the 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 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 reliable 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 at 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 ‘6.2.1. Basic own funds’.

5.1.1.8 IFRS value

To determine the IFRS value, reference can be made to the IFRS valuation rules applicable within KBC as included in the Annual Report of KBC Group Consolidated – Notes on the accounting policies – Note 1 2: Summary of significant accounting policies.

5.1.1.9 Goodwill

Goodwill is defined as any excess of the cost of the acquisition over the acquirer’s interest in the fair value of the identifiable assets acquired and liabilities and contingent liabilities assumed at the date of acquisition. It is recognised as an intangible asset and is carried at cost less impairment losses. Goodwill is not amortised, but is tested for impairment at least once a year or if there is either internal or external evidence for doing so. An impairment loss is recognised if the carrying amount of the cash-generating unit to which the goodwill belongs exceeds its recoverable amount. Impairment losses on goodwill cannot be reversed. For each new business combination, KBC has to choose whether to measure minority interests at fair value or as their proportionate share of the acquiree’s net identifiable assets. This choice determines the amount of goodwill recognised.

5.1.1.10 Deferred taxes

Deferred tax assets are recognised for all deductible temporary differences between the carrying value of assets and liabilities and their tax base, and for carry forward of unused tax losses and for carry forward unused tax credits, to the extent that it is probable that taxable profit will be available against which the deductible temporary differences can be utilised. KBC calculates deferred tax assets for carry forward unused tax losses. When estimating the period over which tax losses can be used against future taxable profits, KBC uses projections for a period between eight to ten years.

5.1.1.11 Bonds, Loans & Mortgages, Equity Instruments and Derivatives

KBC applies all the requirements of IFRS 9 as from 1 January 2018, except for the hedge accounting transactions which continued to be accounted for in accordance with IAS 39.

On initial recognition of a financial asset, KBC first assesses the contractual terms of the instrument in order to classify it as an equity or debt instrument. An equity instrument is defined as any contract that evidences a residual interest in another entity’s net assets. In order to satisfy this condition, KBC reviews whether the instrument includes no contractual obligation for the issuer to deliver cash or exchange financial assets or financial liabilities with another entity under conditions that are potentially unfavourable to the issuer.

Any instruments which do not meet the criteria of equity instruments are classified as debt instruments by KBC.

Debt instruments

When KBC concludes that the financial asset is a debt instrument, then on initial recognition, it can be categorised in one of the following categories:

- ✓ Mandatorily measured at fair value through profit or loss (**FVPL**)
- ✓ Designated at initial recognition at fair value through profit or loss (**FVO**)
- ✓ Fair value through other comprehensive income (**FVOCI**)
- ✓ Amortised cost (**AC**)
- ✓ Fair value through profit or loss – overlay approach (only possible for debt instruments held in an activity connected with the insurance activity which do not pass the SPPI test) (**FVI**)

Debt instruments have to be classified in the **FVPL** category when (i) they are not held in business model whose objective is to hold assets to collect contractual cash flows or within a business model whose objective is achieved by both collecting contractual cash flows and selling financial assets or alternatively (ii) they are held in such business model but the contractual terms of the instrument give rise on specified dates to cash flows that are not solely payments of principal and interest on the principal amount outstanding.

Further, KBC may in some cases, on initial recognition, irrevocably designate a financial asset that otherwise meets the requirements to be measured at AC or at FVOCI as at fair value (**FVO**) if doing so eliminates or significantly reduces an accounting mismatch that would otherwise arise.

A debt instrument is measured at **FVOCI** only if it meets both of the following conditions and is not designated as at FVO:

- ✓ The asset is held within a business model whose objective is achieved by both collecting contractual cash flows and selling financial assets
- ✓ And the contractual terms of the financial asset give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding

A debt instrument is measured at AC only if it meets both of the following conditions and is not designated as at FVO:

- ✓ The asset is held within a business model whose objective is to hold assets to collect contractual cash flows; and
- ✓ The contractual terms of the ***financial*** asset give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding

A debt instrument is categorised as FVI when it is held in respect of a business activity that is connected to contracts in scope of IFRS 4 and if it is measured at fair value through profit or loss applying IFRS 9 but would not have been measured at fair value through profit or loss in its entirety in accordance with IAS 39 and for which KBC elected using the overlay approach. Regarding the application of the overlay approach more information is provided in section *"Overlay approach"* below.

Loans and advances are debt instruments held by the institutions that are not securities and are in general measured at amortised cost.

Equity instruments

Financial equity instruments are categorised in one of the following categories:

- ✓ Mandatorily measured at fair value through profit or loss (**FVPL**).
- ✓ Equity instruments elected for fair value through other comprehensive income (**FVOCI**).

- ✓ Equity instruments held under an activity connected with the insurance activity, KBC applies the fair value through profit or loss – overlay (**FVI**).

KBC can designate equity instruments of the insurance activity in the FVI category, until the effective date of IFRS 17, 1 January 2021. The equity investments that KBC insurance activity classifies as FVI shall meet both of the following criteria:

- ✓ It is measured at fair value through profit or loss applying IFRS 9 but would not have been measured at fair value through profit or loss in its entirety applying IAS 39; and
- ✓ It is not held in respect of an activity that is unconnected with insurance contracts.

Regarding the application of the overlay approach more information is provided in section "*Overlay approach"* below.

Derivatives

KBC can recognise derivative instruments either for trading purpose or as hedging derivatives. Derivatives can have asset or liability positions depending on their actual market value.

- ✓ **Trading derivatives**
  Derivative instruments are always measured at fair value and KBC makes a distinction as follows:
  - Derivatives that are held with a hedging intent but for which hedge accounting cannot be or is not applied (economic hedge): hedging instruments can be acquired with the intention of economically hedging an external exposure but without the application of hedge accounting. The interest component on these derivatives is recognised under *"Net Interest Income"* while all other fair value changes are recognised under *"Net result from financial instruments at fair value through profit or loss".*
  - Derivatives held without hedging intent (trading derivative): KBC entities can also enter into a derivative position without any intention to hedge economically a position. Such activity can relate to closing/selling an external position in the near term or for short-term profit taking purposes. All fair value changes on such derivatives are recognised under *"Net result from financial instruments at fair value through profit or loss".*
- ✓ **Hedging derivatives**
  Hedging derivatives are derivatives which are specifically designated in a hedge relationship.

Overlay approach

In accordance with the amendment to IFRS 4 issued in September 2016, KBC decided to use the overlay approach to overcome the temporary consequences of the different effective dates of IFRS 9 and IFRS 17 (replacing IFRS 4). Accordingly, KBC uses the overlay approach which reclassifies from the income statement to OCI the extra volatility related to the adoption of IFRS 9. The reclassified amounts are recognised in the overlay reserve within equity.

The overlay approach is applied for the financial assets of KBC's insurance activity that are eligible. The eligibility is based on the following criteria:

- ✓ Assets that are measured at FVPL applying IFRS 9 which would not have been measured at FVPL in its entirety applying IAS 39
- ✓ All assets except those held in respect of an activity that is unconnected with contracts within the scope of IFRS 4

Financial assets can be designated under the overlay approach until the instrument:

- ✓ Is derecognised
- ✓ When it is no longer held in respect of an activity that is connected with insurance contracts; or

- ✓ When at the beginning of any annual period KBC decides not applying the overlay approach for that particular instrument
- ✓ Until IFRS 17’s effective date (1 January 2021)

The application of the overlay approach requires retaining certain IAS 39 accounting policies for financial assets which are the following:

- ✓ Impairment on equity instrument: equity instruments held by the insurance activity of KBC were typically classified as AFS under IAS 39, under IFRS 9 they are classified at FVPL. The designation under the overlay approach requires applying the IAS 39 impairment on equity instruments. By using the overlay approach, all fair value changes are recognised in the overlay reserve but when the decline is significant (more than 30%) or prolonged (more than one year) compared to the acquisition cost then the fair value loss is recognised in the income statement. Any further decrease is also recognised directly in the income statement while increases are recognised in the overlay reserve.
- ✓ Recognition of gain and losses in the income statement upon disposal of equity instruments: by designating the equity instruments connected to KBC’s insurance activity under the overlay approach upon the sale of the equity instruments the accumulated overlay reserve in OCI is recycled to the income statement ensuring same results as under IAS 39.
- ✓ Impairment on debt instrument: the KBC methodology for the calculation of Incurred But Not Reported (IBNR) impairments on non-defaulted debt securities booked at amortized cost (HTM and L&R) is based on the Basel II IRB Advanced models with an emergence period of 1,5 months (no PIT factor is applied). No IBNR impairments are calculated for debt securities at fair value (AFS).

5.1.2 Property (other than for own use)

Property other than for own use or investment property is defined as a real estate property either built, purchased or acquired under a finance lease by KBC, which is held to earn rentals or capital appreciations rather than used by KBC for the supply of services or for administrative purposes.

Investment property is initially recognised at cost (including directly attributable costs). KBC subsequently measures investment property at initial cost minus accumulated depreciation and impairment losses.

5.1.3 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.

5.1.4 Deposits other than cash equivalents

Deposits other than cash equivalents are measured at amortised cost.

5.1.5 Own shares

If an entity reacquires its own equity instruments, those instruments (‘treasury shares’) are not recognised as an asset on the balance sheet but should be deducted from equity instead.

5.2 Technical provisions

5.2.1 Solvency II value

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 groups 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.

5.2.2 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:

- ✓ <u>Surrender value optio</u>n: the policyholder has the right to fully or partially surrender the policy and receive a pre-defined lump sum amount.
- ✓ <u>Paid-up policy</u>: 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.
- ✓ <u>Dormancy option</u>: the policyholder has the right to partially or completely stop paying premiums, but with the option to reactivate the payments in the future.
- ✓ <u>Annuity conversion option</u>: the policyholder has the right to convert a lump-sum survival benefit into an annuity at a pre-defined minimum rate of conversion.
- ✓ <u>Policy conversion option</u>: the policyholder has the right to convert from one policy to another at pre-determined terms and conditions.
- ✓ <u>Extended coverage option</u>: 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:

- ✓ <u>Guaranteed invested capital</u>: 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.
- ✓ <u>Guaranteed minimum investment return</u>: minimum interest rate is guaranteed.
  e.g., investment insurance with a guaranteed minimum return plus a variable – but not guaranteed – profit sharing amount.
- ✓ <u>Minimum guaranteed benefits</u>: 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 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	**14 906**	**51%**
30 Insurance with profit participation	14 911,6	51%
32 Other Life insurance	- 20,6	0%
34 Annuities stemming from NL not related to health	14,7	0%
Total Best Estimate Health similar to Life	**478**	**2%**
29 Health reinsurance	139,9	0%
33 Annuities stemming from NL related to health	338,3	1%
Total Unit linked Best Estimate and value as a whole	**13 603**	**47%**
31 Index-linked and unit linked insurance	13 603,3	47%
Total Best Estimate provision Life (incl. Health similar to Life and Unit Linked)	**28 987**	**100%**

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

5.2.3 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.

It should be noted that provisions for annuities stemming from Non-Life contracts form part of the Life technical provisions.

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.

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	**1 513**	**88%**
4 Motor vehicle liability insurance	758	44%
5 Other Motor Insurance	66	4%
6 Marine, aviation and transport insurance	6	0%
7 Fire and other damage to property insurance	171	10%
8 General liability insurance	394	23%
9 Credit and suretyship insurance	1	0%
10 Legal Expenses insurance	89	5%
11 Assistance	8	0%
12 Miscellaneous financial loss	6	0%
16 Proportional Motor Vehicle Liability reinsurance		0%
18 Proportional Marine, aviation and transport reinsurance		0%
19 Proportional Fire and other damage to property reinsurance	1	0%
20 Proportional General liability reinsurance	6	0%
21 Proportional Credit and suretyship reinsurance		0%
22 Proportional Legal Expenses reinsurance		0%
24 Proportional Miscellaneous financial loss reinsurance		0%
26 Non-Proportional Casualty reinsurance	8	0%
28 Non-Proportional Property reinsurance		0%
27 Non-Proportional Marine, aviation and transport reinsurance	1	0%
Total Best estimate Health non similar to Life	**215**	**12%**
1 Medical Expense insurance	12	1%
2 Income Protection insurance	4	0%
3 Workers' Compensation insurance	196	11%
13 Proportional Medical expense reinsurance		0%
14 Proportional Income Protection reinsurance	1	0%
15 Proportional Workers' compensation reinsurance	1	0%
25 Non-Proportional Health Reinsurance	1	0%
Total Best Estimate provision Non-Life (incl. Health non similar to Life)	**1 728**	**100%**

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

5.2.4 Technical provisions (total)

The following table presents the gross best estimate, the risk margin and the reinsurance recoverables of the KBC Insurance group, 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	**1 728**	**308**	**86**
Non-life (excl. Health)	1 513	251	84
Health (similar to Non-life)	215	56	1
Technical provisions - Life (incl. Index-Linked & Unit-Linked)	**28 987**	**469**	**- 17**
Life (excl. Health and Index-Linked & Unit-Linked)	14 906	328	- 13
Health (similar to Life)	478	45	- 4
Index-Linked & Unit-Linked	13 603	96	
Total technical provisions	**30 715**	**777**	**69**

Technical provisions gross of ceded reinsurance & reinsurance recoverables, situation at 31/12/18

5.2.5 IFRS value

5.2.5.1 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.

5.2.5.2 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. 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.

5.2.5.3 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.

5.2.5.4 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.

5.2.5.5 Liability adequacy test

A liability adequacy test is performed to evaluate current liabilities, detect possible deficiencies and recognise them in profit or loss.

5.2.5.6 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).*

5.3.2 IFRS value

To determine the IFRS value reference can be made to the IFRS valuation rules applicable within KBC, as included in the Annual Report of KBC Group Consolidated – Notes on the accounting policies – Note 1 2: Summary of significant accounting policies.

5.3.2.1 Deferred taxes

Deferred tax liabilities are recognised for all taxable temporary differences between the carrying amount of an asset or liability and its tax base. They are measured using the tax rates that are substantially enacted at the reporting date and expected to be in effect on realisation of the assets or settlement of the liabilities to which they relate and which reflects the tax consequences that would follow from the manner in which the entity expects to recover or settle the carrying amount of the underlying asset or liability at the balance sheet date.

5.3.2.2 Financial Liabilities

Financial instruments or their component parts are classified as liabilities or as equity in accordance with the substance of the contractual arrangements on initial recognition and the definitions of financial liabilities and equity instruments. A financial instrument is classified as a liability if:

- ✓ KBC has a contractual obligation to deliver cash or another financial asset to the holder or to exchange another financial instrument with the holder under conditions that are potentially unfavourable to KBC; or
- ✓ KBC has a contractual obligation to settle the financial instrument in a variable number of its own equity instruments

A financial instrument is classified as an equity instrument if both of the conditions are not met and in that case is covered under the section *"Equity".*

- ✓ **Financial liabilities held for trading**
  Held-for-trading liabilities are those incurred principally for the purpose of generating a profit from short-term fluctuations in price or dealer's margin. A liability also qualifies as a trading liability if it belongs to a portfolio of financial instruments held for trading separately by the trading desk and for which there is a recent pattern of short-term profit-taking.
  Trading liabilities can include derivative liabilities, short positions in debt and equity instruments, time deposits and debt certificates. In connection with derivative liabilities KBC makes similarly distinction between trading and hedging derivatives as in case for derivative assets.
  Initially, held-for-trading liabilities are measured at fair value. At the end of the reporting date, trading liabilities are measured at fair value. Fair value adjustments are always recorded in the income statement.
- ✓ **Financial liabilities upon initial recognition designated by the entity at fair value through profit or loss**
  IFRS 9 allows measuring a (group of) financial liability(s) on initial recognition at fair value, whereby fair value changes are recognized in profit or loss except for fair value changes related to the changes in own credit risk which are presented separately in OCI. The fair value designation is used by KBC for the following reasons:
  - Managed on a FV basis: KBC designates a financial liability or group of financial liabilities at fair value when these are managed and their performance are evaluated on a fair value basis. It is used to account for (unbundled) deposit components (i.e. financial liabilities not including a discretionary participation feature)

- Accounting mismatch: fair value option can be used when the use eliminates or significantly reduces a measurement or recognition inconsistency that would otherwise arise from measuring assets or liabilities or recognising the gains and losses on them on different bases.
- Hybrid instruments: a financial instrument is regarded as a hybrid instrument when it contains one or more embedded derivatives that are not closely related to the host contract. The fair value option can be used when it is not possible to separate the non-closely related embedded derivative from the host contract and then the entire hybrid instrument can be designated at fair value. This results that both the embedded derivative and the host contract are measured at fair value. KBC uses this option when, for example, structured products contain non closely related embedded derivatives, in which case both the host contract and the embedded derivative are measured at fair value.

✓ **Financial liabilities measured at amortised cost**
KBC classifies most of its financial liabilities under this category, also those used to fund trading activities, when the trading intent is not present in the financial liabilities (e.g.: issued bonds).
These financial liabilities are initially measured at cost, which is the fair value of the consideration received including transaction costs. Subsequently they are measured at amortised cost, which is the amount at which the funding liability was initially recognised minus principal repayments and plus or minus the cumulative amortisation of any difference between that initial amount and the maturity amount. The difference between the amount made available and the nominal value is recorded on an accruals basis as an interest expense. Interest expenses accrued, but not yet paid, are recorded under accruals and deferrals.

5.4 Alternative methods for valuation

Not applicable to the KBC Insurance group.

Capital management

6 Capital Management

The solvency of KBC Insurance Group is calculated on the basis of Solvency II conform the pillar 1 requirements. KBC is subject to the Solvency II regime as regards all its insurance subsidiaries. To determine solvency at group level, the accounting consolidation method is used. An overview of all undertakings in the scope of the group can be found in QRT 32.01.22.

A solvency ratio of 100% is required as a minimum by the regulator. Within KBC, 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, both at group level and towards our subsidiaries.

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.

6.1 Solvency II ratio

As also stated in the 'Capital adequacy' section of the Annual Report, the Solvency II ratio of KBC Insurance Group NV amounted to 217% at the end of 2018, which is an increase of 5 percent points compared to year-end 2017. KBC Insurance Group 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:

- ✓ Lower equity markets leading to a decrease in the value of equity and 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 Group including volatility adjustment (Solvency II, in millions of EUR)	31/12/2018	31/12/2017
Own funds	**3 590**	**3 865**
Tier 1	3 090	3 365
IFRS parent shareholders' equity	2 728	3 051
Dividend payout	- 132	- 8
Deduction of intangible assets and goodwill (after tax)	- 124	- 128
Valuation differences (after tax)	341	403
Volatility adjustment	313	43
Other	- 35	3
Tier 2	500	500
Subordinated liabilities	500	500
Solvency capital requirement (SCR)	1 651	1 823
Solvency II ratio	217%	212%
Solvency surplus above SCR	1 939	2 042

6.2 Own funds

6.2.1 Basic own funds

The total available capital of KBC Insurance Group amounted to 3 590 million euros 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.23.01.22.

in millions of EUR	31/12/2018	31/12/2017
Share capital	65	65
Share premium	1 086	1 086
Reconciliation reserve	1 939	2 214
Excess assets over liabilities	3 425	3 576
Divident payments	- 132	- 8
Own shares	- 203	- 203
Other owne fund items	- 1 151	- 1 151
Tier 1 capital	**3 090**	**3 365**
Tier 2	500	500
Tier 2 capital	**500**	**500**
Total available baisc own funds	**3 590**	**3 865**

Tier-1 capital amounted to 3 090 million euros at year-end 2018, down 275 million euros on its year-earlier level, due a decrease in excess of assets over liabilities (-151 million euros) and due to the difference in dividend pay-out (-125 million euros).

Tier-2 capital consists of a 10-year, subordinated, Solvency II-compliant tier-2 loan granted by KBC Group to KBC Insurance for a nominal amount of 500 million euros on 18 March 2015.

6.2.2 Ancillary own funds

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

6.2.3 Material differences between equity

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

Reconciliation IFRS equity & assets over liabilities Solvency II (in millions of EUR)		31/12/2018
Share capital		65
Share premium		1 086
Treasury shares		- 203
Revaluation reserve debt securities (FVOCI)		422
Revaluation reserve equity instruments (FVOCI)		10
Revaluation reserve equity instruments (overlay approach)		159
Hedging reserve		1
Remeasurement of defined benefit obligations (after tax)		- 25
Reserves		737
Translation differences		7
Net profit of the year IFRS		469
IFRS parent shareholder's equity		**2 728**
Minority Interests		-
IFRS equity		**2 728**
Valuation differences between IFRS and Solvency II		
	of which: deduction intangible assets (	- 124
	of which: valuation difference participa	- 20
	of which: valuation difference real esta	85
	of which: valuation difference fair valu	237
	of which: valuation difference fair valu	714
	of which: valuation difference technica	- 634
	of which: valuation difference reinsura	- 41
	of which: treasury shares	203
	of which: other	- 35
Assets over liabilities Solvency II		**3 113**
Volatility Adjustment (VA)		313
Assets over liabilities Solvency II, incl. VA		**3 425**

The reason for the valuation differences between IFRS 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 ‘ Valuation for solvency purposes’.

6.3 Diversification effects

The calculation of the Solvency II capital requirement for the KBC Insurance Group is based on the accounting-consolidation based method. In this method, the standard formula for the calculation of the Solvency Capital Requirement (SCR) is applied to the consolidated assets and liabilities. The following table shows the total SCR for the KBC Insurance Group as the sum of the SCR for its underlying material entities[8], compared to the result of the group SCR calculated according to the accounting-consolidation based method.

[8] In order to avoid double counting, the SCR of KBC Insurance NV and DZI Insurance already excludes the value of participations in other insurance undertakings part of KBC Insurance Group

in millions of EUR	31/12/2018
KBC Insurance NV	1 421
KBC Group Re	61
DZI Insurance	44
ČSOB Poist’ovňa a.s. (SK)	23
ČSOB Pojišt'ovna a.s. (CZ)	115
K&H Biztosító	41
Stand-alone SCR	**1 705**
KBC Insurance Group	**1 651**
Diversification effect	54

Due to the composition of the KBC Insurance Group, where KBC Insurance NV accounts for most of the overall risk profile and capital requirements, the potential sources for diversification (such as geographical diversification) are limited (54 million euros) and do not manifest themselves in a material way in the group calculation.

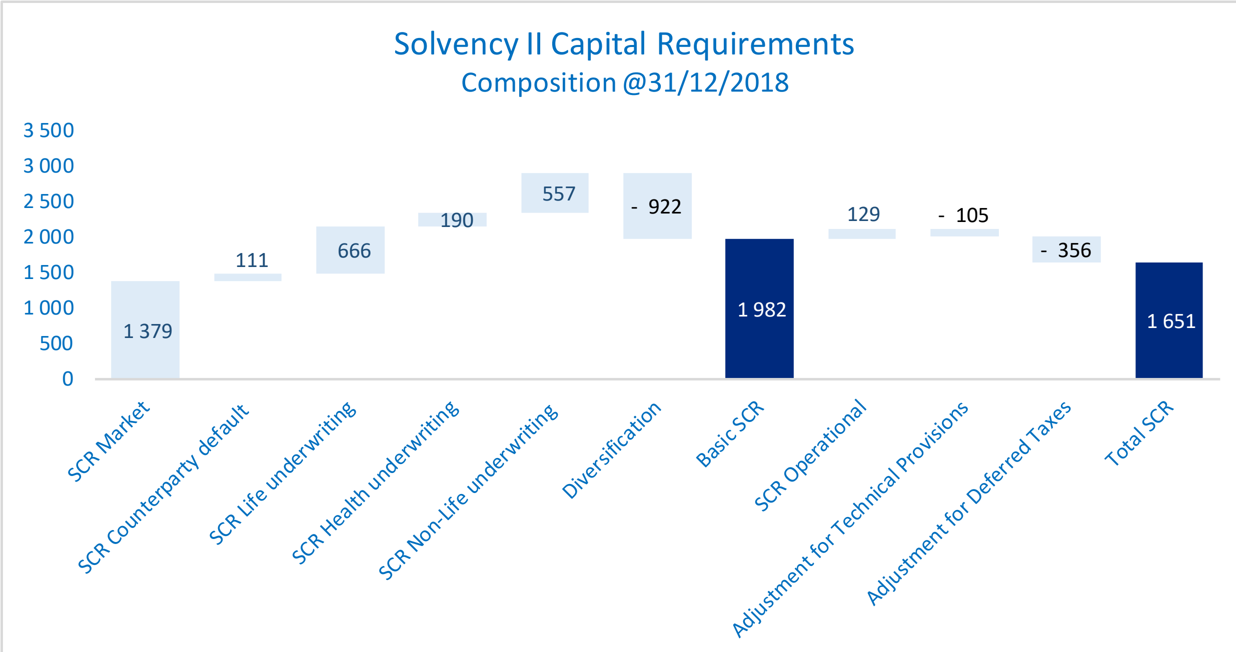
6.4 Solvency Capital Requirement & Minimum Capital Requirement

In the standard formula, the SCR is calculated as the sum of different components. The KBC Insurance Group 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 NBB circular NBB_2017_14. The methodology of LAC DT is however currently being discussed within EIOPA working groups and general principles were addressed in the 2018 Solvency II review.

The waterfall chart below shows the major components of the SCR, which stands at 1 651 million euros. The SCR Market Risk (1 379 million euros) is clearly the biggest contributor to the SCR. SCR Life Underwriting Risk (666 million euros) and SCR Non-Life underwriting Risk (557 million euros) are second and third, respectively. It should be noted that the total SCR for the underwriting risk accounts for 49% of undiversified basic Solvency II Pillar 1 capital.

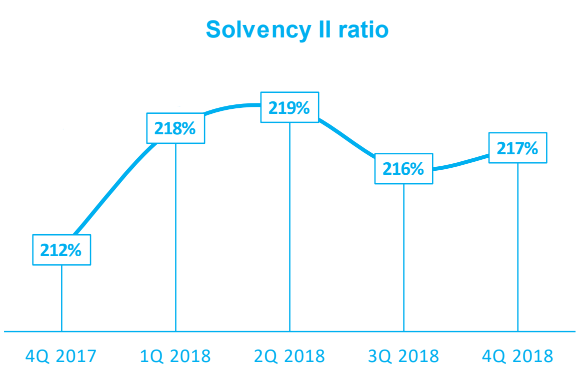
More information on this matter can be found in Quantitative Reporting Template (QRT) S.25.01.22.

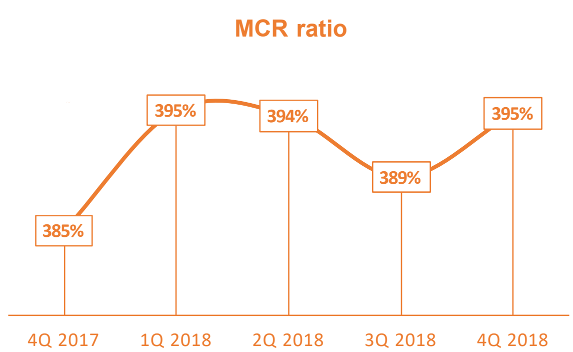


Total eligible own funds to meet the group SCR amounted to about 3 590 million euros, which gives a Solvency II ratio of about 217%. This ratio is well above the minimum 100% required by the Delegated Regulations 2015-35.

The Minimum Capital Requirement (MCR) at group level is equal to the sum of the MCRs of the entities. At 31/12/2017, 3 out of 7 local entities reached the cap of the MCR, being 45% of their own SCR, including the two most material entities (KBC Insurance NV and ČSOB P CZ). At 31/12/2018, this number increased to 5 out of 7 entities which reached the cap of the MCR. Therefore, the evolution of the MCR will mainly follow the evolution of the SCR of the local entities.

At the KBC Insurance Group, the focus is more on the SCR than the MCR in follow-up, because it is the most stringent risk measure of the two:



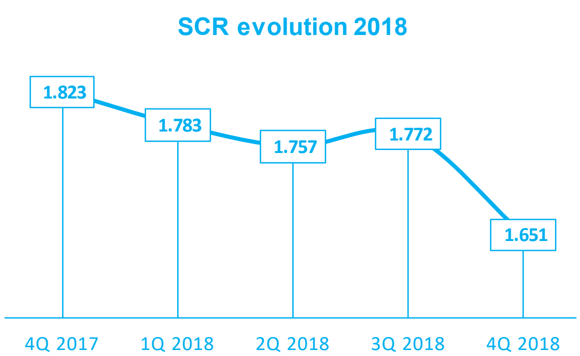


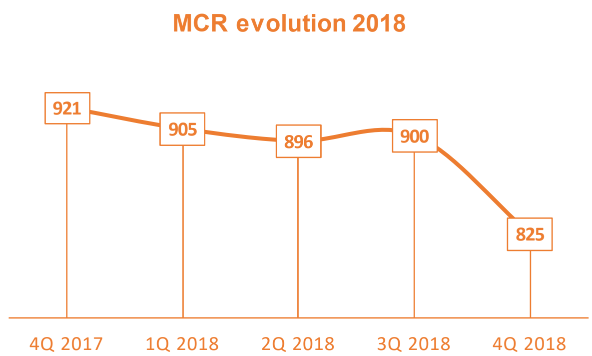
The charts above illustrate the Solvency II and MCR ratios per quarter. As can be seen, the Solvency II and MCR ratios remained relatively stable over 2018. The main drivers of the year-on-year evolution are:

- ✓ **Q42017-Q12018:** the Solvency II ratio increased to 218%. Although there was a decrease in equity markets, the Solvency II ratio increased due to the compensation effect of the symmetric adjustment.

- ✓ **Q12018-Q22018:** a small increase in the Solvency II ratio to 219% mainly driven by lower risk on the investment portfolio, increase in technical provisions and lower bond value.
- ✓ **Q22018-Q32018:** a decrease in the Solvency II ratio to 216% driven by an increase in spreads and equity markets combined with net buys in equity portfolio.
- ✓ **Q32018-Q42018:** a small increase in the Solvency II ratio to 217% due to lower equity markets and higher volatility adjustment.

The charts below focus on how the Solvency Capital Requirement (SCR) and Minimum Capital Requirement (MCR) change over time. The figures are in millions of euros:





The main reasons for movements in the SCR/MCR were:

- ✓ **Q42017-Q12018:** a decrease in SCR (to 1 783 million euros) mainly driven by a drop in equity markets and the re-allocation of management fees.
- ✓ **Q12018-Q22018:** a decrease in SCR (to 1 757 million euros) and in MCR (to 896 million euros) driven by a decrease in SCR Market Risk (lower risk on the investment portfolio).
- ✓ **Q22018-Q32018:** an increase in SCR (to 1 772 million euros) and in MCR (to 900 million euros) driven by an increase in SCR Market Risk (higher equity risk given the effect of the net buys in the equity portfolio).
- ✓ **Q32018-Q42018:** a decrease in SCR to 1 651 million euros and in MCR (to 825 million euros) driven primarily by a decrease in SCR Market Risk (decrease in equity markets leads to a drop in SCR Equity).

6.5 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.

6.6 Differences between the standard formula and any internal model used

The KBC Insurance Group 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. Therefore, further information has not been included here.

6.7 Non-compliance with the MCR and non-compliance with the SCR

As the KBC Insurance Group 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.

List of abbreviations

7 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
NSL	Non similar to Life
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

8 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.

Annex

9 Annex

9.1 Transactions with related parties

Transactions with related parties, excluding key management (in millions of EUR)	2018 Parent entities with joint control	2018 Subsisdiaries and entities of the KBC Group	2018 Associated Companies	2018 Joint ventures	2018 Other	2018 Total	2017 Parent entities with joint control	2017 Subsisdiaries and entities of the KBC Group	2017 Associated Companies	2017 Joint ventures	2017 Other	2017 Total
Assets	4	622	14	46	2	687	0	675	32	48	7	762
Loans and advances	0	497	0	0	0	497	0	561	0	0	0	562
Equity instruments (including investments in associated comapnies and joint ventures	0	50	14	46	2	112	0	85	32	47	7	172
Other	4	75	0	0	0	79	0	28	0	0	0	29
Liabilities	501	1 150	0	0	0	1 651	508	1 594	0	0	0	2 102
Deposits	0	1 034	0	0	0	1 034	0	1 450	0	0	0	1 450
Other financial liabilities	500	0	0	0	0	500	500	0	0	0	0	500
Other	0	116	0	0	0	117	8	145	0	0	0	152
Income statement	- 107	28	0	- 5	0	- 84	- 111	- 94	0	- 4	1	- 208
Net interest income	- 8	146	0	0	0	138	- 8	75	0	0	0	66
Interest income	0	154	0	0	0	154	0	76	0	0	0	76
Interest expense	- 8	- 8	0	0	0	- 16	- 8	- 1	0	0	0	- 10
Earned premiums, insurance (before reinsurance)	0	0	0	0	0	0	0	0	0	0	0	0
Technical insurance charges (before reinsurance)	0	0	0	0	0	0	0	0	0	0	0	0
Dividend income	0	2	0	0	0	2	0	2	0	0	1	3
Net fee and commission income	0	- 122	0	- 5	0	- 127	0	- 152	0	- 4	0	- 156
Fee and commission income	0	50	0	0	0	50	0	1	0	0	0	1
Fee and commission expense	0	- 172	0	- 5	0	- 177	0	- 153	0	- 4	0	- 157
Other net income	2	34	0	0	0	36	3	5	0	0	0	9
General administrative expenses	- 101	- 32	0	0	0	- 133	- 106	- 24	0	0	0	- 130
Undrawn portion of loan commitments, financial guarantees an other commitments												
Given by the group	0	0	0	0	0	0	0	0	0	0	0	0
Received by the group	0	0	0	0	0	0	0	0	0	0	0	0

9.2 Transactions with key management

Trancactions with key management (members of the Board of Directors and Executive Committee of KBC Insurance NV (in millions of EUR)*	2018	2017
Total*	0,4	0,4
Breakdown by type of remuneration		
Short-term employee benefits	0,4	0,4
Post-employment benefits	0,0	0,0
Defined benefit plans	0,0	0,0
Defined contribution plans	0,0	0,0
Other long-term employee benefits	0,0	0,0
Termination benefits	0,0	0,0
Share-based payments	0,0	0,0
Stock options(units)		
At the beginning of the period	0,0	0,0
Granted	0,0	0,0
Exercised	0,0	0,0
Composition-related changes	0,0	0,0
At the end of the period	0,0	0,0
Advances and loans granted to key management and partners	0,0	0,0

*Remuneration to key management or partners of the consolidating company on the basis of their activity in that comany, its subsidaries and associated companies, including the amount of retirement pensions granted to former key management staff on that basis.