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KBC Group
Risk Report 2009



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Glossary

ABS (Asset Backed Securities)

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

Add-On

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

ALCO (Asset and Liability Management Committee)

Committee in the governance process responsible for the development (and follow-up of implementation) of the ALM framework. The activities of the ALCO entail asset allocation, setting internal limits, decision-taking on investments for the ALM positions, the use of ALM opportunities to stimulate specific commercial initiatives, the monitoring of the impact on and of the policies of the business units, and reporting on the ALM profile.

ALM (Asset and Liability Management)

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

Alt-A

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

ANAV (Adjusted Net Asset Value)

The tangible net assets on a marked-to-market-value basis derived from adjusting the consolidated IFRS balance sheet.

Asset class

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

Banking book

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

Beta factor

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

BIS (Bank for International Settlements)

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

BPV (Basis Point Value)

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

Business risk

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

CAD ratio

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

CDO (Collateralised Debt Obligation)

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

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

CDS (Credit Default Swap)

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

CEBS (Committee of European Banking Supervisors)

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

Central Tendency

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

CLO (Collateralised Loan Obligation)

CDO holding only loans as underlying assets.

CP (Commercial Paper)

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

CRD (Capital Requirements Directive)

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

Credit risk

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

Cure rate

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

Downturn LGD

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

DPF (Discretionary Participation Feature)

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

EAD (Exposure At Default)

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

ECAP (Economic Capital)

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

EL (Expected Loss)

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

Fair value

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

GCRC (Group Credit Risk Committee)

Committee in KBC's governance process that supervises the composition and quality of the loan portfolio (including credit risk in respect of (re)insurance).

GMC (Group Model Committee)

A cross-risk, cross-business and cross-border advisory body that provides independent advice on model validation prior to endorsement by the Executive Committee sub-panel, and that follows up on the implementation of review/validation recommendations. It ensures operational risk aspects are embedded in the advisory/decision-making process.

GMRA (General Master Repurchase Agreement)

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

GTRC (Group Trading Risk Committee)

Committee at KBC's group level that controls all risk in the group associated with trading activities.

GVRM (Group Value and Risk Management)

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

Haircuts

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

HVAR (Historical Value At Risk)

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

ICAAP (Internal Capital Adequacy Assessment Process)

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

Insurance Risk

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

Interest rate risk

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

IRB (Internal Ratings-Based)

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

ISDA Master Agreements

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

LAPA (Liquidity Asset Purchase Agreement)

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

Lapse risk

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

LGD (Loss Given Default)

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

Liquidity risk

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

Market risk

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

Market value

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

Mark-to-Market

The act of assigning a market value to an asset

MMF (Model Management Framework)

Generic framework for managing model-related aspects of all types of risk (market risk, credit risk, operational risk, ALM and insurance risk) and value and capital (for example economic capital). The Model Management Framework covers portfolio models as well as transactional models.

MVA (Market Value Adjustment)

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

Netting

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

ODR (Observed Default Rate)

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

Operational Risk

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

OTC (Over The Counter)

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

PD (Probability of Default)

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

PIT PD (Point-In-Time PD)

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

RAROC

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

RBA (Ratings-Based Approach)

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

RMBS (Residential Mortgage-Backed Security)

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

RWA (Risk-Weighted Asset)

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

SFA (Supervisory Formula Approach)

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

Solvency Risk

Solvency risk is the risk that the firm will become insolvent, i.e. that the value of the liabilities will exceed the value of the assets. This entails checking solvency against the regulatory and in-house minimum solvency ratios (for a specific rating target).

SPV (Special Purpose Vehicle)

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

SSS (Super Senior Swap)

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

Trading book

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

TTC PD (Through-The-Cycle PD)

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

VAR (Value At Risk)

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

VBI (Value of Business in Force)

The VBI expresses the market consistent value of the life insurance portfolio in scope. It is defined as the present value of future profits, taking into account the time value of financial options and guarantees, and the market value margin for non-hedgeable risks.

VNB (Value of New Business)

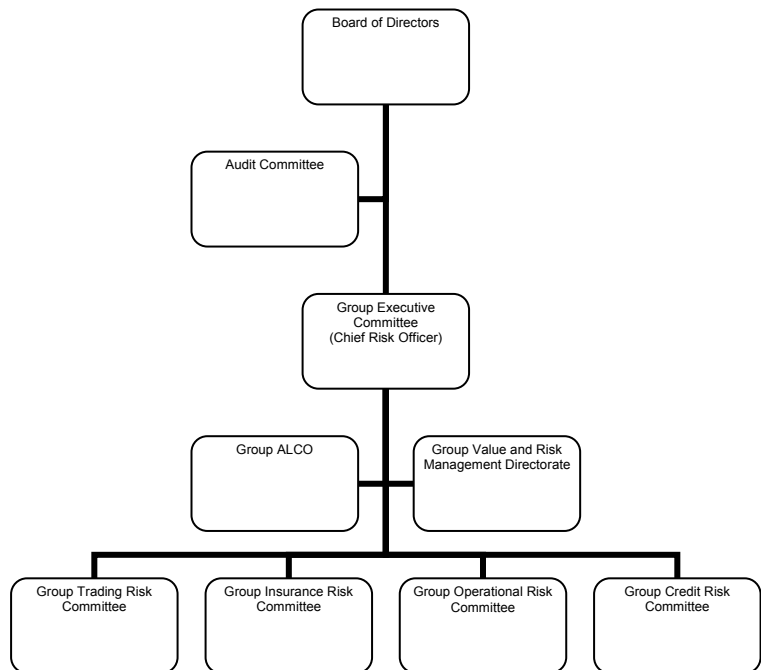
Present value of the additional value to shareholders created through the activity of writing new business during the year under consideration.

Risk management principles

Vision and principles

At KBC, the essential characteristics of value and risk management are as follows:

- Value, risk and capital management are inextricably linked to one another. Every company's aim is to create value. To achieve this aim, decisions are taken and activities developed, even though there is no certainty as to where they will lead. To ensure its own continuity, a company must have adequate capital to be able to deal with any unforeseen consequences of adverse developments.
- Risk management is approached from a comprehensive, group-wide angle, taking into account all the risks a company is exposed to and all the activities it engages in.
- Primary responsibility for value and risk management lies with line management, while a separate Group Value and Risk Management Directorate, operating independently of line management, performs an advisory, supporting and supervisory role.
- The group's risk governance model is also, where relevant, duplicated at the level of the business units and subsidiaries.



General risk governance model

KBC's risk governance model defines the responsibilities and tasks required to manage value creation and all the associated risks.

The governance model is organised in different tiers:

- *The Board of Directors (assisted by the Audit Committee), the Group Executive Committee and the Group Asset/Liability Management Committee (ALCO).* These committees concentrate on global risk management and on monitoring value creation and capital adequacy for the entire group. Regular reporting to the Audit Committee ensures that there is an ample flow of information to the relevant members of the Board of Directors. Each year, the full board sets the risk tolerance limits. The Group Executive Committee is responsible for the implementation of the value, risk and capital management strategy defined by the Board of Directors and outlines the structure of such management. The Chief Risk Officer (CRO); a member of the Group Executive Committee, supervises risk management (in 2009, KBC split the position of Chief Finance and Risk Officer (CFRO) into two separate positions, viz. Chief Risk Officer and Chief Finance Officer). The Group ALCO defines the strategic investment and funding mixes and also monitors the relevant risk exposure. Tactical investment decisions are entrusted to an investment committee.
- *Specialised group risk committees.* These committees concentrate on developing a group-wide framework for one particular type of risk or cluster of activities and monitor the associated risk management process. Chaired by the CRO, the risk committees are composed of representatives from line management and the Group Value and Risk Management Directorate. The various group committees are shown in the schematic. Depending on the materiality of specific risk types, local risk committees and local value and risk management units have been put in place at a lower level (e.g., business unit, country and subsidiary), to roll out the risk management framework.
- The Group Model Committee (GMC) uses reports drawn up by independent validation units to decide on the validity of quantitative and operational risk aspects (such as model usage, monitoring activities, etc.) of all the risk models developed and/or used within the group.
- The Group Internal Audit division is responsible for audit planning and thus audits the compliance of the risk management framework with legal and regulatory requirements, the efficiency and the effectiveness of the risk management system and its compliance with the risk management framework, as well as the way in which line management handles risks outside this formal framework.
- Line management has primary responsibility for value and risk management. It ensures that the risk management framework relating to the business is embedded in the business through policies and procedures. It is also entrusted with the task of developing transactional models.

- The Group Value and Risk Management Directorate measures risks, economic capital and value creation for all business entities and reports its findings to line management. It is also responsible for developing portfolio models, as well as for validating all models (both transactional and portfolio models). In this respect, there is a clear segregation of responsibilities within this directorate, as *validating staff* is different from *modelling staff*.

In the wake of the major financial crisis, the KBC group set up a programme to analyse and further improve the readiness of the group to deal with major economic events in the future. This resulted in the launch of a full-scale programme aimed at creating a new comprehensive, integrated model that aligns all dimensions of risk, capital and value management. This model is characterised primarily by:

- Risk-oriented business people, who have the awareness and skill to make the right risk-return trade-offs and who act as the first line of defence for conducting sound risk management in the group.
- An integrated, Executive-Committee-centred architecture that links risk appetite, strategy and performance goal setting via capital allocation to limits and targets. Along with a consequential monitoring process, this creates the parameters for the business to take risks autonomously within the overall strategic choices of the group.
- A single, independent, group-wide risk function that comprises the group CRO, local CROs, group and local risk functions and the risk committees.

The programme is organised around 12 action points, most of which were or will be dealt with in 2009 and 2010. The implementation of organisational changes to the risk function and the risk committees is expected to be finalised by the end of 2010. The full roll-out of the principles and philosophy of the new risk, capital and value management model throughout the KBC group will most likely take until the end of 2012.

Model management framework

In order to move from a 'project style' approach to an 'ongoing concern' approach for modelling purposes, KBC group developed a Model Management Framework (MMF). This generic framework addresses all types of risk (trading market risk, credit risk, operational risk, non-trading market risk (ALM) and insurance risk) and encompasses value and capital issues (for example, economic capital models). The MMF covers portfolio models as well as transactional models.

The key elements of the MMF are:

- The 'Model Life Cycle' describing the different stages to be followed (request, design and implementation);
- The 'MMF roles' defining the roles and responsibilities of all parties involved in the model life cycle (model owner, policy manager, validator, etc.);
- The 'Model Guidelines' (Methodology, Policy, Implementation and Review Guidelines);
- The 'Model inventory'.

The framework is implemented for a specific risk type under the responsibility of the relevant Group Risk Committee.

For insurance risk, implementation of the MMF for the main portfolio models started in 2008, with transactional insurance models still to be brought in line with MMF requirements.

For the main models used in ALM, implementation continued in 2009.

The major principles embedded in the MMF are as follows:

- The transactional models are developed by the business;
- The portfolio models are developed by a central or local 'Value and Risk Management' unit;
- The responsibilities regarding the design and validation of models are strictly separated. The models are validated by an independent unit in the local and/or central Value and Risk Management unit;
- The review and validation process is characterised by an end-to-end approach (from the request for a model to its implementation and monitoring);
- All models are monitored and subject to periodic review and validation;
- All models are approved by the Group Model Committee (GMC) and endorsed by an Executive Committee (EC) sub-panel (CRO and the EC member responsible for the business unit where the model is to be implemented). The internal audit department has a permanent member (as observer) in the GMC.

Market disclosure policy and scope

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

As can be seen from the balance sheet of the KBC group, a wide variety of assets and liabilities arises from the different activities KBC engages in as a *bancassurance* company.

The main tasks of risk management are to identify, to measure and to monitor the risks that affect all these assets and liabilities. These can be classified as 'financial risks' and include *inter alia* credit risk, market risks (interest rate risk, foreign exchange risk, etc. in the trading book or in the banking/investment book), liquidity risk and insurance risk.

Besides these financial risks, KBC is exposed to non-financial risks, such as operational risk and business risk.

The most important regulations governing risk and capital management are the Basel II capital requirements, applicable to banking entities, and the Solvency I capital framework, applicable to insurance entities. The latter will be replaced in 2012 by a fundamentally reformed framework, namely Solvency II, which is based on Basel II principles. Depending on the approach and framework (or part thereof) adopted, risks will be expressed, measured, segmented or disclosed differently. For instance, expressing risk solely according to the first pillar of Basel II would imply that only the credit risk, market risk linked to trading activities and operational risk borne by banking entities are taken into account.

The origin of this risk report lies with the third pillar or disclosure requirements of the Capital Requirements Directive (as transposed into Belgian legislation), which is segmented mainly according to the first pillar, and focuses on banking entities. Notwithstanding the origin, KBC – as a *bancassurance* company looking ahead to the disclosure requirements of Solvency II – is of the opinion that, by extending this document to become a more comprehensive risk report, it will offer the reader an overall view of KBC's risk exposure and risk management activities.

Therefore, credit risk inherent to KBC Insurance has also been presented in the section on credit risk management. Furthermore, as they are managed in an overarching group-wide fashion, the disclosures on structured credit, non-trading market risks (i.e. Asset and Liability Management), liquidity risk and non-financial risks have been drawn up to include detailed information at the level of KBC group (banking and insurance together). Detailed information on the technical insurance risk borne by KBC Insurance has also been included. By creating one comprehensive risk report, KBC aims to meet the market's requirements as much as possible and to make the report as reader-friendly as possible.

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

This risk report is available in English on the KBC website and is updated on a yearly basis. Consequently, KBC's next update is scheduled for the beginning of April 2011. Depending on market requirements, KBC may however decide to provide more frequent updates.

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 subjected to a final screening by an authorised committee to ensure quality.

When applicable, a comparison with the previous year is provided. This depends in part on equality of scope and methodology.

As regards pillar 3 requirements, disclosures are incorporated if they are deemed relevant for KBC. Accordingly, in order to focus on what is relevant for the market, requirements that are not applicable are not referred to in this document.

Since the materiality of subsidiaries of KBC can vary per topic, entities can be included or excluded depending on whether they are deemed important or unimportant for that topic. The scope will be clearly communicated whenever figures are given. KBC ensures that a representative picture is given at all times in its disclosures. With regard to pillar 3, information in this report is disclosed at the highest consolidated level. Additional information on the material entities is confined to the capital information in the 'Solvency, economic capital profile and embedded value' section. However, for more detailed information, please refer to the local capital disclosures of the entity concerned.

Solvency, economic capital profile and embedded value

Solvency risk is the risk that the capital base of the group, the bank or the insurer might fall below an acceptable level. In practice, this entails checking solvency against the minimum regulatory and in-house solvency ratios.

Managing solvency

KBC reports its solvency at group, banking and insurance level, calculating it on the basis of IFRS figures and the relevant guidelines issued by the Belgian regulator.

For group solvency, the so-called 'building block' method is used. This entails comparing group regulatory capital (i.e. parent shareholders' equity less intangible assets and a portion of the revaluation reserve for available-for-sale assets, plus subordinated debt, etc.) with the sum of the separate minimum regulatory solvency requirements for KBC Bank, KBL EPB and the holding company (after deduction of intercompany transactions between these entities) and KBC Insurance. The total risk-weighted volume of insurance companies is calculated as the required solvency margin under Solvency I divided by 8%. The internal target for the group solvency is set at 10% for the tier-1 ratio.

Regulatory minimum solvency targets were amply exceeded, not only at year-end, but also throughout the entire year, except for the insurance solvency ratio which amounted to less than 100% in a certain period during the first half of 2009 and for which appropriate measures were taken.

In the second half of 2008 and the first half of 2009, a number of capital-strengthening measures were taken (see below), including the issuance of non-voting core-capital securities to the Belgian State and the Flemish Region, as well as a Guarantee Agreement with the Belgian State relating to the remaining CDO risks.

In accordance with Basel II, pillar 2 requirements, KBC has developed an Internal Capital Adequacy Assessment Process (ICAAP). This process uses an economic capital model (see below) to measure capital requirements based on aggregate group-wide risks, and compares these requirements with the capital available to cover risks. The ICAAP examines both the current and future capital situation. To assess the latter situation, a three-year forecast is drawn up for required and available capital, according to a basic scenario that takes account of anticipated internal and external growth, and according to various alternative scenarios. In addition, contingency plans are chartered that might improve KBC's solvency under more difficult circumstances.

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

Overview of capital transactions with the government

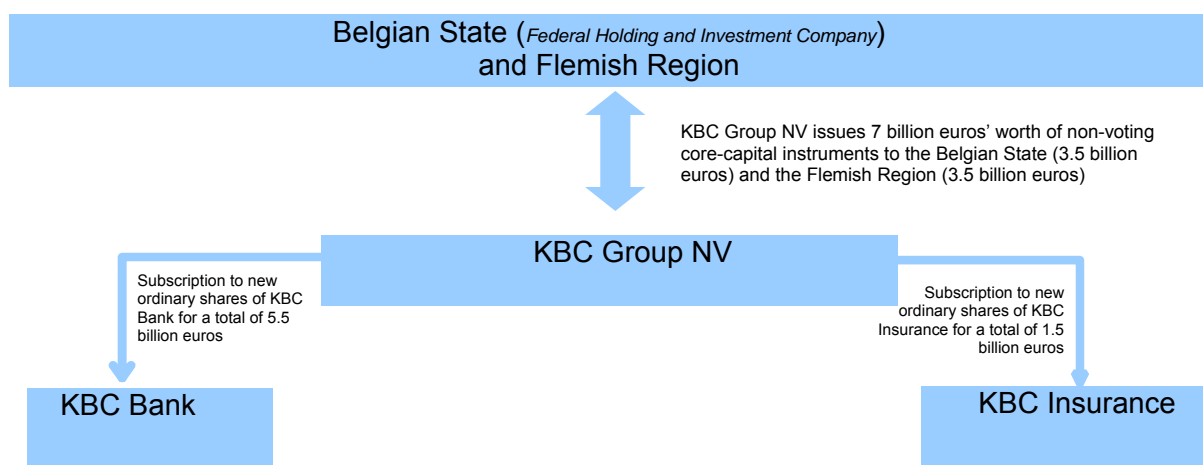
KBC's solvency position was considered to be exceptionally strong until just before the crisis. However, the market's demand for higher capital buffers, combined with substantial valuation losses on the structured credit portfolio, meant that in order to maintain its capital base at a sufficiently high level, the group was obliged to bolster its capital structure by issuing securities to the Belgian Federal Government and to the Flemish Regional Government. This comprised a total of 7 billion euros in core-capital securities, 3.5 billion euros' worth of which were purchased by the Belgian State and 3.5 billion euros by the Flemish Region, together with a guarantee agreement for 20 billion euros in respect of CDO and MBIA-related exposure.

7 billion euros' worth of core-capital securities sold to the Belgian State and the Flemish Region

Since the end of 2008, the KBC group has issued 7 billion euros in perpetual, non-transferable, non-voting core-capital securities that have equal ranking (*pari passu*) with ordinary shares upon liquidation. These have been subscribed by the Belgian State (the Federal Holding and Investment Company) and the Flemish Region (each in the amount of 3.5 billion euros). The transaction with the Belgian State was concluded in December 2008, while the agreement with the Flemish Region was signed in July 2009.

The KBC group used the proceeds of these transactions to strengthen the core capital of its banking activities by a total of 5.5 billion euros (via an ordinary capital increase at KBC Bank) and to raise the solvency margin of its insurance activities by 1.5 billion euros (via an ordinary capital increase at KBC Insurance).

Overview of capital transactions with the Belgian State and the Flemish Region



Other features of the transactions:

- Issue price: 29.50 euros per security.
- Coupon: the higher of (i) 2.51 euros per security (corresponding to an interest rate of 8.5%), and (ii) 120% of the dividend paid on ordinary shares for 2009 (coupon payment in 2010) and 125% for 2010 and subsequent years (coupon payments in 2011 and later). No coupon will be paid if there is no dividend.
- Buyback option: subject to the approval of the financial regulator, KBC may at any time repurchase all or some of the securities at 150% of the issue price (44.25 euros), payable in cash.
- Exchange option (only applies to the transaction with the Belgian State): after three years (i.e. in December 2011), KBC may at any time exchange the securities for ordinary shares on a one-for-one basis. Should KBC decide to do this, the State may choose to receive payment in cash for the securities. The cash amount will be equal to 115% of the issue price as of the fourth year, and will increase each subsequent year by 5 percentage points (with a cap at 150%).

On 30 September 2009, KBC submitted a detailed plan to the European Commission in respect of this government support. In addition to the renewed strategy, the plan included a repayment schedule for these core-capital securities. The European Commission approved the plan on 18 November 2009. Further details in this regard can be found in the annual report of KBC Group NV, under 'Maintaining a strong capital base and redeeming the core-capital securities sold to the government' in the chapter 'Overview of capital transactions with the government'.

Guarantee agreement for 20 billion euros in respect of CDO and MBIA-related exposure

On 14 May 2009, KBC Group NV signed a guarantee agreement with the Belgian State regarding a substantial part of its structured credit portfolio.

The plan basically comprises a notional amount totalling 20 billion euros, with 5.5 billion euros in unhedged super senior CDO investments and 14.4 billion euros in counterparty exposure to MBIA. KBC has paid a fee to purchase the State guarantee which covers 90% of the risk of default, after a first-loss tranche in which KBC bears any loss in full.

The transaction is structured as follows:

- First tranche of 3.2 billion euros: KBC bears any credit losses in full.
- Second tranche of 2.0 billion euros: KBC bears any credit losses. It has the option of asking the Belgian State to subscribe to newly issued KBC shares at market value, for 90% of the loss in this tranche (KBC continues to bear 10% of the risk).
- Third tranche of 14.8 billion euros: 90% of any credit losses will be compensated in cash by the State (KBC continues to bear 10% of the risk).

This agreement largely mitigates the potential negative impact of the relevant MBIA and CDO exposure. On commencement of the agreement, the remaining *downside* risk related primarily to the parts of the guarantee structure where KBC bore the risk of loss. Since then, the results will remain volatile to a certain degree in the

future, since rising market values, for instance, could lead to existing valuation losses being reversed (which would have a positive impact on the results). If, however, the market value of the products in question were then to decline once again, fresh valuation losses would have to be recorded. Whatever the case, the guarantee agreement will cap the cumulative total of valuation losses.

Guarantee agreement with the Belgian State relating to the portfolio of structured credit (simplified)

Tranches*	Guarantee structure	Commitment to subscribe to capital increase
First-loss tranche of 3.2 billion euros	KBC bears the loss in full up to 5.2 billion euros.	–
Second-loss tranche of 2 billion euros		If KBC so requests, the Belgian State will subscribe to new KBC shares for an amount equal to 90% of the losses in the second-loss tranche, i.e. 1.8 billion euros
Third-loss tranche of 14.8 billion euros	The Belgian State reimburses 90% of the losses (KBC continues to bear 10% of the risk).	–

* The CDO portfolio consists of several different CDOs. The guarantee structure applies to each CDO; the figures stated in the table refer to the sum of all CDOs covered by the plan.

Solvency disclosures

Scope of solvency disclosures

The capital profile is disclosed for KBC group as a whole, i.e. fully consolidated, as well as for the major activities of the group, i.e. banking (KBC Bank consolidated and KBL European Private Bankers (KBL EPB)) and insurance (KBC Insurance).

Solvency information is also disclosed for each of the significant banking subsidiaries. Significance in this respect is defined by KBC as set out in the Committee of European Banking Supervisors (CEBS) guidelines on co-operation between consolidating supervisors and home supervisors. It therefore takes into account:

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

Since Absolut Bank, CBC Banque, Centea, ČSOB (Czech Republic), ČSOB (Slovak Republic), KBC Bank, KBC Bank (Ireland), KBL EPB, Kredyt Bank and K&H Bank have been identified as significant banking subsidiaries, summary information is provided below for each of these companies (see below).

Solvency in 2009, group overview

Solvency at group level In millions of EUR	31-12-2008	31-12-2009
Total regulatory capital, after profit appropriation	19 370	20 414
Tier-1 capital*	13 810	15 426
Parent shareholders' equity	10 710	9 662
Non-voting core-capital securities	3 500	7 000
Intangible fixed assets (-)	-387	-398
Goodwill on consolidation (-)	-3 479	-2 918
Innovative hybrid tier-1 instruments ¹	1 420	554
Non-innovative hybrid tier-1 instruments	1 262	1 642
Minority interests	154	159
Equity guarantee (Belgian State)	0	601
Revaluation reserve, available-for-sale assets (-)	1 068	-457
Hedging reserve, cashflow hedges (-)	351	374
Valuation differences in financial liabilities at fair value – own credit risk (-)	-245	-151
Minority interests in available-for-sale reserve and hedging reserve, cashflow hedges (-)	-4	-1
Equalisation reserves (-)	-123	-131
Dividend payout (-)	0	0
IRB provision shortfall (50%) (-)	0	-77
Items to be deducted (-) ²	-417	-433
Tier-2 and tier-3 capital	5 560	4 988
Perpetuals (including hybrid tier-1 instruments not used in tier-1 capital)	1 039	321
Revaluation reserve, available-for-sale shares (at 90%)	0	348
Minority interests in revaluation reserve, available-for-sale shares (at 90%)	0	0
IRB provision excess (+)	209	0
Subordinated liabilities	4 586	4 685
Tier-3 capital	144	145
Items to be deducted (-) ²	-417	-510
Total weighted risks	155 291	143 359
Banking	141 370	128 303
Insurance	14 084	15 022
Holding company activities	35	86
Elimination of intercompany transactions between banking and holding activities	-197	-52
Solvency ratios		
Tier-1 ratio	8.9%	10.8%
Core tier-1 ratio	7.2%	9.2%
CAD ratio	12.5%	14.2%

1 In the third quarter of 2009, KBC initiated a programme to buy back a number of outstanding tier-1 securities at 70% of their nominal value. For further detail, see annual report of KBC Group, 'Consolidated balance sheet in the chapter 'Consolidated annual accounts'.

2 Items to be deducted, which are split 50/50 over tier-1 and tier-2 capital, include mainly participations in and subordinated claims on financial institutions in which KBC has between 10% to 50% share (predominantly NLB).

The table below gives a more detailed view on the hybrid instruments incorporated into tier-1 capital.

Overview of main hybrid Tier-1 instruments

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

Solvency, banking activities (KBC Bank and KBL EPB combined)

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

The regulatory minimum under Basel II for the CAD ratio is 8%. Besides this, the capital requirements are still calculated according to Basel I rules, with the 80% floor being applicable until the end of 2011. The floor calculation implies that, if the capital requirements for KBC under Basel II are lower than 80% of the capital requirement under Basel I, the regulatory minimum of 8% can be increased in order to cover the capital requirements below this 80%. Currently, the Basel II capital requirements for KBC Bank at consolidated level are around 80% of Basel I.

In order to strengthen the solvency ratios of KBC Bank and with a view to optimising the use of those hybrid instruments allowed by the regulator, KBC Bank issued so-called non-innovative hybrid tier-1 capital instruments worth 2 billion euros in the second quarter of 2008, and none in 2009. In Belgium, banks may issue both innovative and non-innovative hybrid capital instruments which qualify for a maximum 25% of tier-1 capital (with additional limits for the innovative hybrid component). To be classified as non-innovative, the instrument must have a number of features, viz. they need to be subordinated, should not provide for any step-up in dividends, should be perpetual (no general redemption right for investors) and may be converted to ordinary shares subject to certain limits and approvals.

Solvency, banking activities In millions of EUR	31-12-2008	31-12-2009
	Basel II	Basel II
Total regulatory capital, after profit appropriation	19 028	18 939
Tier-1 capital	13 643	14 144
Parent shareholders' equity	11 576	13 165
Intangible fixed assets (-)	- 169	-162
Goodwill on consolidation (-)	- 2 451	-1 986
Innovative hybrid tier-1 instruments ¹	1 652	507
Non-innovative hybrid tier-1 instruments	1 793	1 945
Minority interests	599	492
Equity guarantee (Belgian State)	0	462
Tier 2 instruments (-)	- 18	-18
Revaluation reserve available-for-sale assets (-)	946	11
Hedging reserve, cashflow hedges (-)	352	374
Valuation diff. in fin. liabilities at fair value - own credit risk (-)	- 245	-151
Minority interest in AFS reserve & hedging reserve, cashflow hedges (-)	1	0
Dividend payout (-)	0	0
IRB provision shortfall (50%) (-)		-77
Items to be deducted (-)	- 395	-419
Tier-2 and tier-3 capital	5 385	4 794
Mandatorily convertible bonds	0	0
Perpetuals (including hybrid tier-1 instruments not used in tier-1 capital)	820	313
Revaluation reserve, available-for-sale shares (at 90%)	29	149
Minority interests in revaluation reserve, available-for-sale shares (at 90%)	-7	-1
IRB provision excess (+)	209	0
Subordinated liabilities	4 586	4 685
Tier-3 capital	144	145
Items to be deducted (-)	-395	-496
Total weighted risks	141 370	128 303
Credit risk	108 038	104 472
Market risk	20 333	11 995
Operational risk	12 999	11 835
Solvency ratios		
tier-1 ratio	9.7%	11.0%
of which core tier-1 ratio	7.2%	9.1%
CAD ratio	13.5%	14.8%

¹ In the third quarter of 2009, KBC initiated a programme to buy back a number of outstanding tier-1 securities at 70% of their nominal value. For further detail, see annual report of KBC Bank, 'Consolidated balance sheet in the chapter 'Consolidated annual accounts'.

Solvency in 2009, significant banking subsidiaries

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

Solvency, significant banking subsidiaries
In millions of EUR

		31-12-2008			31-12-2009		
		Total regulatory capital	Total weighted risks	CAD ratio	Total regulatory capital	Total weighted risks	CAD ratio
Absolut Bank	IFRS	594	4 549	13.05%	459	2 980	15,41%
CBC Banque	Belgian GAAP	498	3 341	14.90%	520	2 934	17,72%
Centea	Belgian GAAP	484	4 253	11.39%	484	4 360	11,10%
ČSOB (Czech Republic)	IFRS	1 553	15 060	10.31%	2 081	13 907	14,96%
ČSOB (Slovak Republic)	IFRS	488	4 282	11.40%	606	3 994	15,17%
KBC Bank	IFRS	17 941	135 557	13.24%	17 760	123 074	14,43%
KBL EPB	IFRS	1 086	7 559	14.37%	1 179	6 055	19,47%
KBC Bank Ireland	IFRS	1 106	10 214	10.83%	1 107	10 765	10,28%
Kredyt Bank	IFRS	646	7 249	8.92%	812	6 592	12,32%
K&H Bank	IFRS	682	6 878	9.91%	722	5 863	12,32%

Solvency, insurance activities (KBC Insurance)

KBC Insurance applies the latest rules for the calculation of the solvency ratio, in accordance with the regulator's guidelines. The main new elements in the calculation are:

- The equalisation reserve – calculated under Belgian GAAP – which is deducted from available capital (in the past, the equalisation reserve was not deducted).
- The available capital now also includes:
 - 90% of the *net positive* revaluation reserve for shares and 100% of the *net positive* revaluation reserve for bonds. In the past, the full net revaluation reserve was included.
 - Unrealised gains on property and equipment, investment property and held-to-maturity instruments (in the past, these unrealised gains were not included).

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

In millions of EUR	31-12-2008	31-12-2009
Available capital	2 117	3 130
Parent shareholders' equity	2 525	3 331
Dividend payout (-)	0	0
Minority interests	56	74
Subordinated liabilities	0	0
Intangible fixed assets (-)	-32	-20
Goodwill on consolidation (-)	-485	-401
Revaluation reserve available-for-sale investments (-)	176	-540
Equalization reserve (-)	-123	-131
Equity guarantee (Belgian State)	0	139
90% of positive revaluation reserve, available-for-sale shares	0	264
Latent gains on bonds	0	346
Latent gains on real estate	81	67
Limitation of latent gains on shares and real estate	-81	0
Required solvency margin	1 127	1 202
Non-life and industrial accident (legal lines)	341	322
Annuities	8	8
Subtotal, non-life insurance	349	330
Class-21 life insurance	756	845
Class-23 life insurance	14	16
Subtotal, life insurance	770	861
Other	8	10
Solvency ratio and surplus		
Solvency ratio (%)	188%	260%
Solvency surplus (in millions of EUR)	990	1 928

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

In the first half of 2009, KBC launched a programme to implement Solvency II regulations in the KBC Insurance group. It led to several projects at group level (reporting process, fair value technical provisions, solvency capital requirement, pillar 2, group issues and impact of Solvency II on strategy) and a multitude of sub-programmes in the various local insurance entities.

At present, the draft Solvency II regulations are being analysed in detail in order to obtain a clear picture of the 'to-be' situation and to challenge the current architecture against the formulated requirements. From 2010 on, the programme will focus on the necessary steps required to move from the current situation to Solvency II compliance in 2012.

Economic capital

An economic capital model is used to measure the overall risk KBC is exposed to through its various activities, taking the different risk factors into consideration. The estimates generated by this model are reported regularly at meetings of the Executive Committee, the Audit Committee and once a year to the Board of Directors.

KBC defines economic capital as the amount of capital required to cover unexpected losses in fair value that the group might incur over a one-year period, in line with the risk appetite set by the Board of Directors. Economic capital is calculated per risk category using a common denominator (the same time horizon of one year and the same confidence interval) and then aggregated. Since it is extremely unlikely that all risks will materialise at the same time, an allowance is made for diversification benefits when aggregating the individual risks.

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

The breakdown of KBC's economic capital per risk type is provided in the table. The noticeable evolutions in the distribution of economic capital across the different risk types are only partly related to changes in risk exposures. For the largest part, the differences are the result of changes in the economic capital model. Indeed, being the result of an internal assessment, the economic capital model is periodically reviewed. Over 2009, one additional risk type was identified, viz. the funding cost. For the other risk types, the underlying models were reviewed. These model reviews are the primary reason for the larger share for credit risk economic capital. The evolution of non-trading market risk is however mainly caused by a change in the risk exposures.

Economic capital distribution, KBC group*	2008	2009
Credit risk	45%	64%
Market risk in non-trading activities	27%	14%
Market risk in trading activities	4%	3%
Business risk	11%	8%
Operational risk	8%	6%
Insurance risk	5%	3%
Funding cost risk	-	2%
Total	100%	100%

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

Embedded value

The value of the life insurance portfolio is expressed by embedded value. This is the sum of the Adjusted Net Asset Value, or ANAV, of KBC Insurance and the present value of all future cashflows coming in from the existing portfolio (Value of Business in Force or VBI), account taken of the risk-based capital required for this activity. Any form of goodwill – or value of future business – is not taken into account.

KBC applies the 'Market-Consistent Embedded Value' technique, which results in a valuation of the insurance portfolio that is consistent with the market and takes into account such factors as the cost of the embedded options provided to the customer. This calculation method is also being used to analyse the added value of new contracts (Value of New Business or VNB) and to check the profitability of products under development (Profit Testing).

Detailed embedded value information can be found in the 'Embedded value report for 2009' which is available on www.kbc.com under Investor relations>Presentations.

Credit risk management

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

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

Credit risk, including counterparty credit risk, arising at the banking entities is dealt with under the Basel II (regulatory capital) requirements directive and presented as such in this risk report.

Credit risk exposure related to KBC Insurance is reported separately at the end of this section (see 'Credit risk related to KBC Insurance'). This means that, up to and including the 'Internal modelling' section, all disclosures deal with credit risk at KBC's banking entities.

Strategy and processes

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

Credit risk management at transactional level

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

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

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

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

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

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

time), yet are still performing and do not meet the criteria for classification as PD 11 or PD 12. For the larger loans, an overview of all obligors in default is submitted to the Group Executive Committee every quarter.

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

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

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

In order to avoid a situation where an obligor facing financial difficulties ends up defaulting, a decision can be taken to renegotiate its loans. Renegotiation may involve changing the contractual repayment schedule, lowering or postponing interest or fee payments, or some other appropriate measure. In early 2009, KBC adopted a new policy for such renegotiations and its method for evaluating the risk and hence the classification of the obligor. If a renegotiation stems from a deterioration in the obligor's financial situation and the payment terms are altered, a PD class 9 or higher will be assigned. In cases where renegotiation includes a (full or partial) charge-off of the financial asset, a PD class of at least 10 will be assigned. For the retail portfolio, the assigned PD class is determined on the basis of the behavioural score. In such cases, the resulting PD may be lower than 9. After renegotiation, the obligor's situation will be re-assessed one year later (in principle) and the obligor can return to a better class than PD 9 if the assessment turns out to be positive. In this case, the obligor is no longer considered as being in 'renegotiated status'.

In 2008, when account was taken of a materiality threshold of 1% of the entity's outstanding portfolio, renegotiations occurred mostly at Absolut Bank, where an estimated amount of 176 million euros was restructured. In 2009, KBC resorted much more frequently to this solution, with some 2.2% of the total loan portfolio, or 3.7 billion euros, being renegotiated to avoid impairment. The table below shows the share of the total renegotiated exposure outstanding of each business unit. As regards the Merchant Banking Business Unit, most of the renegotiated exposure is accounted for by KBC Bank Ireland, where 5.8% or 1 045 million euros of its total portfolio (approximately 18.0 billion euros) was renegotiated.

Credit renegotiations avoiding impairment, (as a % of the global portfolio of renegotiations)	31-12-2009
Belgium Business Unit	16.0%
CEER Business Unit	30.6%
Czech Republic	2.7%
Slovakia	2.7%
Hungary	9.6%
Poland	1.0%
Russia	7.3%
Bulgaria	7.2%
Serbia	0.0%
Merchant Banking Business Unit	53.4%
European Private Banking Business Unit	0.1%
Total	100.0%

Credit risk management at portfolio level

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

As part of the credit function, the portfolio management desk actively manages and monitors the loan portfolio. Using a model, this unit pinpoints risk concentrations and enhances the diversification of the loan portfolio.

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

Scope of credit risk disclosures

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

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

Material entities that had not yet adopted the IRB Foundation approach in 2009 are following the Basel II Standardised approach for the time being. This approach will also be adhered to until further notice by the other (non-material) entities of KBC group.

For its material entities, KBC envisages a phased roll-out of the IRB Advanced approach. For a first set of entities, the switch from the IRB Foundation approach to the IRB Advanced approach is planned to start in 2011. Other entities will follow suit from 2013 on.

The scope is limited to these material entities, which accounted for roughly 93% of the total weighted credit risk of KBC group in 2009.

Because of this limitation in scope, and also because another definition of exposure¹ is used in the accounting figures, a one-to-one comparison cannot be made with similar disclosures in KBC Bank's 2009 annual report.

Roll-out of Basel II pillar 1 approach	2009	2010	2011
IRB Advanced approach			KBC Bank CBC Banque ČSOB Czech Republic KBC Bank Ireland ³ KBC Credit Investments KBC Finance Ireland KBC Bank Deutschland ⁵ KBC Real Estate ² KBC Lease Belgium
IRB Foundation approach	KBC Bank CBC Banque ČSOB Czech Republic KBC Bank Ireland ³ KBC Credit Investments KBC Financial Products KBC Finance Ireland KBC Bank Deutschland ⁵ KBC Real Estate ² KBC Lease Belgium Antwerp Diamond Bank ⁵	KBC Bank CBC Banque ČSOB Czech Republic KBC Bank Ireland ³ KBC Credit Investments KBC Financial Products KBC Finance Ireland KBC Bank Deutschland ⁵ KBC Real Estate ² KBC Lease Belgium Antwerp Diamond Bank ⁵	KBC Financial Products Antwerp Diamond Bank ⁵ Kredyt Bank K&H Bank Centea ^{4, 5} ČSOB Slovak Republic (non-retail)
Standardised approach	Kredyt Bank K&H Bank Centea ⁵ Kredietbank SA Luxembourgise ⁵ ČSOB Slovak Republic Absolut Bank ⁵ Non-material entities	Kredyt Bank K&H Bank Centea ⁵ Kredietbank SA Luxembourgise ⁵ ČSOB Slovak Republic Absolut Bank ⁵ Non-material entities	Kredietbank SA Luxembourgise ⁵ ČSOB Slovak Republic (retail) Absolut Bank ¹ Non-material entities

¹ Absolut Bank will not apply to use the IRB Foundation approach and will continue to apply the Standardised approach until a switch to the IRB Advanced approach is implemented.

² Although KBC Real Estate is not a material entity according to KBC's definition above, it also uses the IRB Foundation approach as it operates on a shared IT platform

³ KBC Bank Ireland includes the former KBC Homeloans entity, which merged with KBC Bank Ireland in 2009.

⁴ Depending on regulatory approval, Centea may move to the IRB Advanced approach in the same year.

⁵ Centea, Antwerp Diamond Bank, KBC Bank Deutschland, Kredietbank SA Luxembourgise and Absolut Bank have been targeted for divestment under the KBC strategic plan approved by the EU. In this respect, Kredietbank SA Luxembourgise will no longer be switching to the IRB Foundation approach but will continue to apply the Standardised approach instead. It should be noted that the roll-out to Centea remains unaffected.

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

Exposure to credit risk

The tables in this section provide an overview of the overall credit risk expressed in terms of Exposure At Default (EAD) and are based on the figures for the end of December 2009. Exposure to securities in the trading book and to structured credit products is excluded. Information on securities in the trading book is reported in the credit risk section of KBC's annual report and the related risks are taken up in the trading market risk VAR. For structured credit exposure, reference is made to the detailed information in the 'Structured credit products' section in this document.

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

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

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

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

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

Total and average aggregate exposure to credit risk

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

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

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

- *Derivatives*: this category contains all credit exposure arising from derivative transactions, such as Interest Rate Swaps (IRS), Forex deals, etc. (excluding CDS in banking book, which are treated as an Off-balance instrument). Derivatives are dealt with in the section on 'Counterparty credit risk' and not in the 'lending portfolio' sections.
- *Repo-like transactions (Repo-like)*: this category contains all credit exposure arising from repo-, reverse repo and tri-party repo transactions in scope. More details on these transactions can be found in the section on 'Credit risk mitigation'.

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

In billions of EUR – 31-12-2008²

Exposure [EAD]	On-balance	Off-balance	Derivatives	Repo-like	Total
Gross total	211	29	28	35	303
Gross average ¹	213	32	23	63	330
Net total	203	28	10	4	244
Net average ¹	206	28	9	4	247
Total RWA	83	16	5	1	105

In billions of EUR – 31-12-2009

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

¹ In 2008 the average and total exposure of Absolut Bank was equalled.

² In 2008 the exposure of KBC FP was not yet included in this table. Also, the shown EAD for derivatives was determined without taking netting into account.

Credit risk in the lending portfolio

The lending portfolio excludes all derivatives (except for CDS in banking book) and any repo-like exposure as these are dealt with in the 'Counterparty credit risk' and 'Credit risk mitigation' sections. As mentioned above, exposure to securities in the trading book is also excluded. The securities in trading book carry issuer risk, and total 0.8 billion euros, 0.1 billion euros of which stems from KBC FP and 0.7 billion euros from other entities. In light of capital calculations the risks are included in the trading market risk VAR.

In millions of EUR – 31-12-2008

Lending portfolio [EAD]	Gross EAD of main categories	'Other'*	Total Gross EAD
Subject to IRB approach	183 838	6 459	190 297
Subject to Standardised approach	47 204	2 073	49 286
Total	231 042	8 532	239 583

In millions of EUR – 31-12-2009

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

* Exposure to 'Other' is given separately and not included in the disclosures on concentrations and impaired exposure, since the data required to create the breakdowns is often missing. This category contains mostly 'other assets' (e.g., property and equipment, non-assignable accruals). The significant year-to-year increase is due to a cash balance at KBC New-York with the FED for an amount of approximately 5 billion dollar.

Overall information on the lending portfolio is divided into two tables below. One for a total overview of the exposure subject to the IRB approach and one for the overview of the exposure treated via the Standardised approach. Each approach has its own (regulatory) breakdown by type of exposure/asset class.

In the tables relating to concentrations, both are aggregated to provide a total overview of concentrations in the lending portfolio. This is done at the expense of best-efforts mapping into the mainstream asset classes. As regards the quality analysis, however, both the IRB and Standardised approaches are presented separately again, since the manner for indicating quality is not equal.

Credit exposure subject to the IRB approach

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

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

In millions of EUR - 31-12-2008

IRB exposure [EAD]	Sovereign	Institutions	Corporates	SME Corporates	Retail ¹	(sub)Total ³	Other	Total
Gross Exposure	39 085	11 362	57 324	16 004	60 063	183 838	6 459	190 297
Net Exposure	39 080	11 339	52 668	11 956	60 063	175 106	6 457	181 563
RWA	1 306	3 491	43 551	11 126	10 236	69 711	3 799	73 510

In millions of EUR - 31-12-2009

IRB exposure [EAD]	Sovereign	Institutions	Corporates	SME Corporates	Retail ²	(sub)Total ³	Other	Total
Gross Exposure	45 877	7 339	47 422	16 037	61 913	178 590	12 608	191 197
Net Exposure	45 675	7 361	43 044	11 495	61 913	169 489	12 608	182 097
RWA	1 328	1 978	34 997	11 303	12 182	61 787	3 631	65 418

¹ In 2008 the EAD of the retail class consisted of 42 625 million euros in mortgages and 17 438 million euros in other retail. The related RWA amounts to 6 698 million euros and 3 538 million euros respectively.

² In 2009 the EAD of the retail class consists of 45 419 million euros in mortgages and 16 494 million euros in other retail. The related RWA amounts to 8 899 million euros and 3 283 million euros respectively.

³ The (sub)Total is accounted for in the section on concentrations in the lending portfolio.

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

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

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

Credit exposure subject to the Standardised approach

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

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

- *Short term*: exposure (to institutions or to corporates) which is rated and has a maturity less than three months. Past due, equity and high-risk claims are excluded. This exposure has been assigned to its respective exposure type, namely 'Institutions' or 'Corporates'.
- *Other*: all other claims (e.g., other assets).

In millions of EUR – 31-12-2008

Standardised exposure [EAD]	gross Exposure	net Exposure	RWA
Sovereign	12 316	12 316	507
RGLA	412	412	158
PSE	105	101	57
MDB	59	59	1
International Organisations	0	0	0
Institutions	2 604	2 604	907
Corporates	12 135	11 969	11 803
Retail	7 227	7 215	5 459
Secured by real estate	11 724	11 285	5 182
Past due	463	439	563
CIU	159	159	159
(sub)Total*	47 204	46 559	24 797
High risk	8	8	12
Covered bonds	0	0	0
Other	2 073	2 073	1 154
Total	49 286	48 640	25 963

In millions of EUR – 31-12-2009

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

* The (sub)Total is accounted for in the section on concentrations in the lending portfolio.

Concentrations to credit risk in the lending portfolio

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

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

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

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

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

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

Total credit exposure in the lending portfolio per geographic region

In millions of EUR – 31-12-2008

Gross exposure [EAD]	Sovereign	Institutions	Corporates	SME Corporates	Retail	Total
Africa	14	116	139	1	14	284
Asia	1 032	1 451	2 648	141	32	5 304
Central and Eastern Europe & Russia	12 297	3 589	13 746	7 840	17 305	54 776
Latin America	282	308	663	0	7	1 261
Middle East	25	804	456	0	9	1 294
North America	2 370	1 910	7 716	88	18	12 103
Oceania	0	120	714	0	6	840
Western Europe	35 381	6 402	42 574	11 368	59 455	155 181
Total	51 401	14 701	68 656	19 438	76 846	231 042

In millions of EUR – 31-12-2009

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

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

Total credit exposure in the lending portfolio per sector

In millions of EUR – 31-12-2008

Gross exposure [EAD]	Sovereign	Institutions	Corporates	SME Corporates	Retail	Total
Agriculture, Farming & Fishing	0	0	675	908	2 405	3 989
Authorities	50 446	1 750	0	0	0	52 196
Automotive	0	0	1 869	832	675	3 376
Building & Construction	0	0	4 040	1 623	1 550	7 214
Chemicals	0	0	3 028	581	60	3 670
Commercial Real Estate	0	0	10 925	2 125	674	13 724
Distribution	0	0	6 671	3 906	3 315	13 893
Electricity	0	0	2 633	149	2	2 784
Finance & Insurance	949	12 579	8 417	561	165	22 670
Food Producers	0	0	2 241	691	231	3 164
Machinery & Heavy Equipment	0	0	1 450	462	103	2 016
Metals	0	0	1 991	598	272	2 861
Oil, Gas & Other Fuels	0	0	2 150	107	3	2 260
Private Persons	0	0	332	162	62 305	62 799
Services	0	40	8 942	3 340	3 539	15 862
Shipping	0	0	1 346	327	103	1 776
Telecom	0	0	1 925	81	13	2 019
Other*	6	332	10 020	2 986	1 428	14 773
Total	51 401	14 701	68 656	19 438	76 846	231 042

In millions of EUR – 31-12-2009

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

* All sectors with a concentration of less than 0.75% of the total EAD are aggregated into the other category.

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

Maturity analysis of the total credit exposure in the lending portfolio

In millions of EUR – 31-12-2008

Residual maturity	Sovereign	Institutions	Corporates	SME Corporates	Retail	Total
<1 year	8 167	5 916	26 573	6 871	4 073	51 599
=>1 to <5 years	20 361	5 709	22 446	5 105	6 974	60 596
=>5 to <10 years	10 303	1 656	8 176	2 949	29 460	52 545
=>10 years	5 197	936	8 101	3 535	33 057	50 826
Until Further Notice*	7 373	484	3 359	978	3 282	15 477
Total	51 401	14 701	68 656	19 438	76 846	231 042

In millions of EUR – 31-12-2009

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

* Exposure without a concrete end-date is assigned to the 'Until Further Notice' category.

About 50% of the lending portfolio will mature within five years. The longest maturities are mainly found in the retail asset class and relate primarily to mortgage loans to private persons.

Total credit exposure in the lending portfolio per product type

In millions of EUR – 31-12-2009

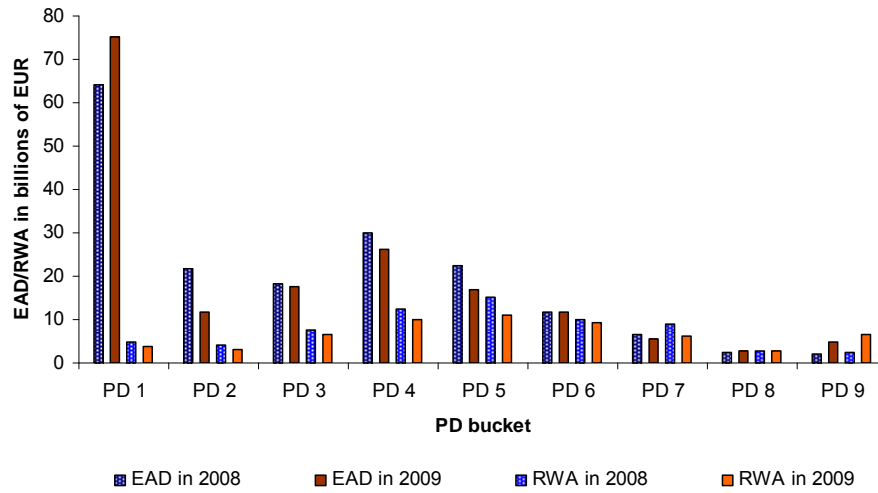
Gross exposure [EAD]	Sovereign	Institutions	Corporates	SME Corporates	Retail	Total
Guarantee	849	566	4 608	1 130	311	7 464
Debt instrument	49 317	3 329	2 686	1	87	51 549
Equity	0	211	327	7	0	4 416
Leasing	12	6	1 947	1 013	1 583	4 561
Mortgage loans	12	4	376	400	59 164	59 956
Other lending	9 577	5 682	45 979	16 786	18 900	96 924
Total	59 767	9 799	55 922	19 336	80 045	224 870

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

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

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

IRB exposure - credit quality analysis



As can be witnessed from the above table, KBC has been scaling down its exposure in general. The increase in the rating class PD 1, is mainly due to an increase in exposure to governments (for the largest part the Belgian government). For more detailed figures, please refer to the table below.

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

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

In millions of EUR – 31-12-2008

PD Masterscale	gross Exposure [EAD] RWA Average in %						Total
		Sovereign	Institutions	Corporates	SME Corporates	Retail	
1 [0.00% - 0.10%]	Sum of EAD	35 482	7 998	8 905	655	11 246	64 287
	Sum of RWA	657	1 670	2 224	148	208	4 906
	weighted average	2%	21%	25%	23%	2%	8%
02 [0.10% - 0.20%]	Sum of EAD	99	1 157	7 878	1 229	11 362	21 724
	Sum of RWA	41	359	3 044	422	476	4 342
	weighted average	41%	31%	39%	34%	4%	20%
03 [0.20% - 0.40%]	Sum of EAD	159	584	9 377	2 842	5 263	18 226
	Sum of RWA	100	239	5 342	1 339	588	7 607
	weighted average	62%	41%	57%	47%	11%	42%
04 [0.40% - 0.80%]	Sum of EAD	12	214	10 618	3 576	15 565	29 985
	Sum of RWA	3	111	7 904	2 292	2 223	12 533
	weighted average	22%	52%	74%	64%	14%	42%
05 [0.80% - 1.60%]	Sum of EAD	6	1 001	10 111	3 638	7 585	22 342
	Sum of RWA	1	703	9 756	2 909	1 894	15 262
	weighted average	11%	70%	96%	80%	25%	68%
06 [1.60% - 3.20%]	Sum of EAD	56	177	5 507	1 798	4 211	11 748
	Sum of RWA	2	137	6 629	1 736	1 446	9 950
	weighted average	4%	77%	120%	97%	34%	85%
07 ¹ [3.20% - 6.40%]	Sum of EAD	188	148	4 155	1 223	994	6 708
	Sum of RWA	315	162	6 561	1 463	461	8 962
	weighted average	167%	109%	158%	120%	46%	134%
08 [6.40% - 12.80%]	Sum of EAD	0	42	890	356	1 203	2 491
	Sum of RWA	0	32	1 626	520	508	2 686
	weighted average	-	76%	183%	146%	42%	108% ²
09 [12.80% - 100.00%]	Sum of EAD	0	19	294	175	1 491	1 979
	Sum of RWA	0	11	675	314	1 302	2 302
	weighted average	-	57%	230%	180%	87%	116% ²
Total gross exposure		36 002	11 341	57 736	15 492	58 919	179 490
Total risk-weighted assets		1 117	3 423	43 761	11 144	9 104	68 548
Total weighted average		3%	30%	76%	72%	15%	38%

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

2 The counter-intuitive drop in the weighted average compared to PD bucket 7 is due to the sharp decrease in the relative weighting of the 'Corporate' and 'SME Corporates' exposure, which has a relatively high weighted average.

In millions of EUR – 31-12-2009

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

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

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

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

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

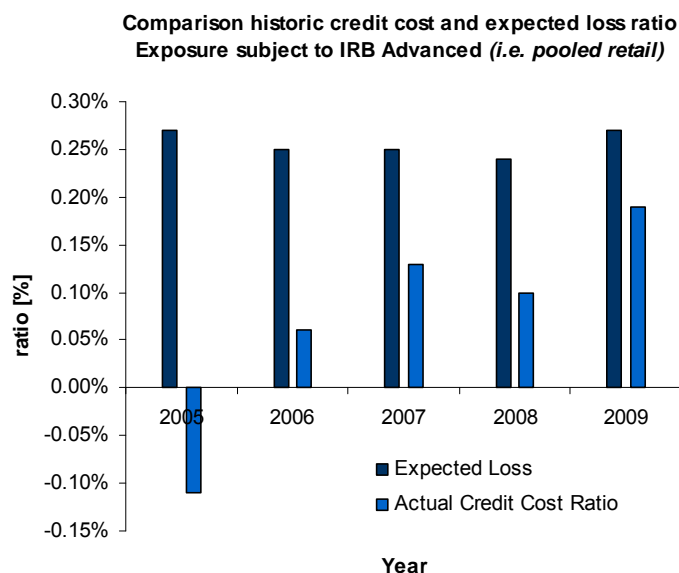
Strictly pursuant to Basel II pillar 3 rules, KBC should disclose a comparison of 'expected losses' with 'actual losses' over a longer period in time and broken down by asset class. KBC believes that this disclosure is less relevant for a portfolio that is largely made up of exposure subject to the IRB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

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

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

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

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

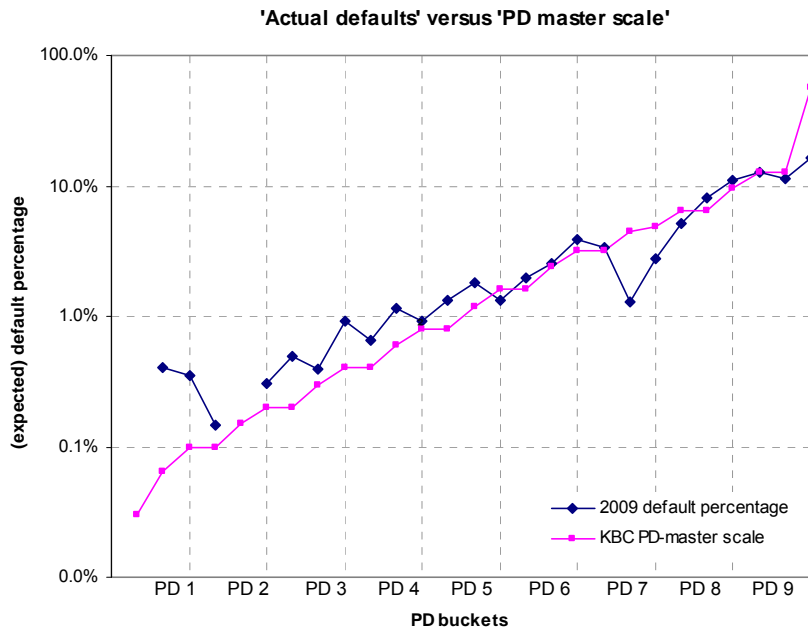


The graph clearly shows that KBC's models are prudent, since the EL ratio is consistently higher than the eventual credit cost ratio in a certain year for the depicted years.

This prudence is partly driven by a prudent approach towards determination of PDs and partly by the fact that KBC's Advanced models include the notion of downturn LGD.

An economic downturn, like currently experienced, is responsible for an increasing number of defaults and higher losses given these defaults, and is thus reflected by the fact that the EL ratio and the credit cost ratio shown in the graph become more aligned.

With reference to the portfolio subject to the IRB Foundation approach (i.e. non-retail), the predictiveness of KBC's models is presented via a comparison between the percentage of defaults expected at year-end 2008, according to KBC's PD-Masterscale and the actual outcome (measured in observed defaults over the past year) in the table below. It should be noted that every bucket of the PD scale from PD 1 to PD 9 is further subdivided into three intervals resulting in a total of 27 data points. The IRB Foundation portfolio of ČSOB Czech Republic and KBC FP are not included in the scope of the table below.



No defaults were observed in the first interval of bucket PD 1, neither in the middle interval of bucket PD 2, which explains the missing data points.

The fact that the actual default percentage at most sample points is higher than what was predicted according to the masterscale, can be explained by the financial crisis.

The downward spike in the PD 7 bucket is related to unrated and not timely re-rated (i.e. more than 18 months) counterparties. For these counterparties KBC implements an expected PD of 4.53%, corresponding to PD 7, which is higher than the observed default percentage for PD 7.

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

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

KBC uses the regulatory defined risk-buckets to assess the quality and linked risk weight for all exposure calculated according to the Standardised approach. It uses external ratings from S&P, Fitch and Moody's to define the risk bucket of exposures.

The table below shows credit risk exposure calculated according to the Standardised approach broken down by type of exposure and risk bucket. Unlike previous indications, the gross exposure appearing in this table is not only before the application of eligible collateral, but also before the application of guarantees, which means that substitution effects are not taken into account.

Much of the exposure is assigned to the unrated bucket. This includes the 'secured by real estate' exposure, which does not require a rating. Obviously, the retail exposure is assigned to the unrated bucket.

In millions of EUR – 31-12-2008

Standardised exposure [EAD]		Quality steps							Unrated	Total
		1	2	3	4	5	6			
Sovereign	gross	2 577	1 813	4 473	88	6	0	3 358	12 316	
	net	2 577	1 813	4 473	88	6	0	3 358	12 316	
RGLA	gross	55	82	0	0	12	8	256	412	
	net	55	82	0	0	12	8	256	412	
PSE	gross	0	40	0	0	0	0	64	105	
	net	0	40	0	0	0	0	60	101	
MDB	gross	9	0	0	0	0	0	50	59	
	net	9	0	0	0	0	0	50	59	
International Org.	gross	0	0	0	0	0	0	0	0	
	net	0	0	0	0	0	0	0	0	
Institutions	gross	1 759	478	90	35	58	0	183	2 604	
	net	1 759	478	90	35	58	0	183	2 604	
Corporates	gross	82	299	316	20	62	0	11 355	12 135	
	net	82	301	316	20	62	0	11 187	11 969	
Retail	gross	0	0	0	0	0	0	7 227	7 227	
	net	0	0	0	0	0	0	7 215	7 215	
Secured by real estate	gross	0	6	0	0	0	0	11 718	11 724	
	net	0	6	0	0	0	0	11 278	11 285	
Past due	gross	0	0	0	0	0	0	459	463	
	net	0	0	0	0	0	0	435	439	
High risk	gross	0	0	0	0	0	5	3	8	
	net	0	0	0	0	0	5	3	8	
Covered bonds	gross	0	0	0	0	0	0	0	0	
	net	0	0	0	0	0	0	0	0	
CIU	gross	0	0	0	0	0	0	159	159	
	net	0	0	0	0	0	0	159	159	
Other	gross	0	0	0	0	0	0	2 073	2 073	
	net	0	0	0	0	0	0	2 073	2 073	
Total	gross	4 482	2 719	4 880	143	138	13	36 905	49 286	
	net	4 482	2 721	4 880	143	138	13	36 257	48 640	

In millions of EUR – 31-12-2009

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

Impaired credit exposure in the lending portfolio

The tables show impaired credit risk exposure per geographic region and per sector based on figures as at 31 December 2009.

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

In millions of EUR

Impaired gross exposure per geographic region [EAD]	31-12-2008	31-12-2009
Africa	8	0
Asia	87	139
Central and Eastern Europe & Russia	504	1 830
Latin America	37	43
Middle East	16	15
North America	415	474
Oceania	22	2
Western Europe	3 640	5 106
Total	4 731	7 609

In millions of EUR

Impaired gross exposure per sector [EAD]	31-12-2008	31-12-2009
Agriculture, Farming & Fishing	114	157
Automotive	126	315
Building & Construction	211	279
Chemicals	108	160
Commercial Real Estate	389	1 206
Distribution	635	897
Electrotechnics	106	102
Finance & Insurance	446	278
Food Producers	65	94
Horeca	84	163
IT	155	137
Machinery & Heavy Equipment	59	184
Metals	50	115
Private Persons	895	2 047
Services	357	493
Shipping	45	135
Textile & Apparel	220	221
Traders	53	66
Other*	613	561
Total	4 731	7 609

* All sectors with a concentration of less than 1% of the total EAD in 2009 are aggregated into the other category.

For all data on impairment, provisions and value adjustments, reference is made to the consolidated annual accounts section of KBC's annual report for 2009 (Notes 14 and 24).

Counterparty credit risk

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

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

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

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

In millions of EUR – 31-12-2008

Transaction type	Marked-to-market	Add-on	Gross counterparty risk [EaD]	Notional value of contracts	Regulatory capital*
CDS bought -Trading	20 501	7 655	28 156	124 868	284
CDS sold - Trading	265	5 006	5 272	123 306	48
Other	5	5	10	107	0
Total credit derivatives	20 771	12 667	33 438	248 280	332
Interest Rate Swaps (IRS)	8 529	2 577	11 105	541 708	162
Caps/Floors	439	237	676	26 443	7
Other	1 231	346	1 577	82 583	12
Total interest-related transactions	10 199	3 160	13 358	650 733	181
FX forward	2 137	808	2 944	72 753	46
FX swap	1 319	619	1 937	58 768	14
Cross Currency IRS	3 036	3 581	6 617	76 274	50
Other	841	215	1 055	18 157	37
Total currency-related transactions	7 332	5 222	12 554	225 952	147
Equity swaps	4 983	3 361	8 344	90 556	52
Equity options	2 574	1 358	3 932	32 550	11
Total equity-related transactions	7 557	4 719	12 276	123 107	63
Total commodity transactions	26	69	96	573	1
Gross counterparty risk	45 885	25 837	71 722	1 248 645	
- Netting benefit			-48 332		
Total counterparty risk after netting			23 390		
- Collateral benefit			-1 655		
Total net Counterparty risk			21 734		668

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

In millions of EUR – 31-12-2009

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

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

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

In millions of EUR

Net derivative exposure per geographic region [EAD] ¹	31-12-2008	31-12-2009
Africa	12	5
Asia	425	294
Central and Eastern Europe & Russia	1 770	844
Latin America	100	4
Middle East	106	91
North America	4 657	2 668
Oceania	78	38
Western Europe	14 586	12 109
Total	21 734	16 055
Net derivative exposure per rating band ² [EAD] ¹	31-12-2008	31-12-2009
AAA	1 925	350
AA	6 406	5 828
A	7 663	6 158
BBB	1 391	1 061
BB	3 089	718
B and below	209	317
No rating	1 051	1 622
Total	21 734	16 055

¹ After collateral and netting benefits have been taken into consideration.

² For instance, rating band AA incorporates ratings AA+, AA and AA-. If multiple ratings are available, the second best is used.

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

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

Credit risk mitigation

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

Netting

At the end of December 2009, KBC did not engage in on-balance-sheet-netting (i.e. the offsetting of balance-sheet products such as loans and deposits).

Close-out netting, on the other hand, is applied in order to manage the counterparty risk arising from derivative transactions. For netting to apply, such transactions need to be documented under ISDA-92 or ISDA-2002 Master Agreements. In addition, nettability rules have been established for all relevant jurisdictions and all relevant products, based on legal opinions published by the ISDA. Accordingly, close-out netting is only applied if legal effectiveness and enforceability is assured.

Based on figures for the end of December 2009, the netting impact on derivative exposure amounted to 27.5 billion euros. Intra-group netting is not included in this figure.

Collateral in repo transactions

KBC engages in the following types of repo transaction:

- *Reverse repos and 'buy and sell-back' transactions:* These transactions are considered deposits made by KBC, with KBC lending cash against securities, which are the credit risk mitigant, until the cash is repaid. The difference between reverse repos and buy and sell-backs is technical and relates to the way coupon payments are handled during the transaction. The securities underlying the reverse repo transactions are mainly government securities (10.0 billion of the 11.2 billion euros, or about 93%), with the underlying issuers of the remaining securities being mainly banks and corporate entities. In order to conclude such transactions, a standard General Master Repurchase Agreement (GMRA) contract needs to be concluded with the counterparty, and legal certainty must exist for all relevant jurisdictions. Transactions also need to be compliant with KBC's repo policies for all relevant entities.
- *Repos and 'sell and buy-back' transactions:* These transactions are considered funding, as KBC receives cash in exchange for securities provided as collateral until the cash is repaid. Here too, the difference between repos and sell and buy-backs is a technical one.
- *Tri-party repo transactions:* These transactions are a specific type of reverse repo, where KBC lends cash and receives securities as collateral but, unlike regular reverse repos, the collateral is managed by a third party and more types of collateral can be used as stipulated in the tri-party repo contracts.

In millions of EUR – 31-12-2008

	Exposure [EAD]	Covered exposure [EaD]	Covered exposure [%]
Reverse repos/'buy and sell-back' ¹	10 592	9 939	93.8%
Repos/'sell and buy-back' ²	20 269	19 831	97.8%
Tri-party repo ¹	3 954	3 352	84.8%
Total	34 815	33 122	95.1%

In millions of EUR – 31-12-2009

	Exposure [EAD]	Covered exposure [EaD]	Covered exposure [%]
Reverse repos/'buy and sell-back' ¹	15 268	11 172	73.2%
Repos/'sell and buy-back' ²	22 958	22 219	96.8%
Tri-party repo ¹	0	0	-
Total	38 226	33 392	87.4%

1. The covered exposure is lower than the exposure, as the security amount is corrected for regulatory haircuts and mismatches. The impact of the latter two is bigger on the collateral linked to tri-party repo transactions, which results in a relatively lower coverage percentage.

2. The exposure of repo transactions, which is based on the market value of the securities in the transaction, is higher than the coverage by cash (covered exposure), which is also due to the notion of haircuts. These haircuts are added to the securities leg of the transaction.

3. This low percentage is due to transactions at ČSOB Czech Republic where the reverse repo counterparty and the counterparty of the securities is the same, namely the Czech National Bank (CNB). Therefore the collateral is not eligible for capital purposes, and thus not included in the coverage percentage. There is however no capital impact since the CNB carries a zero PD rating. Without taking into account these transactions the coverage would be approximately 94%.

Other collateral

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

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

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

Of the total counterparty risk exposure after netting and before collateral, 9.3% (1 647 million out of 17 702 million euros) was classified as collateralised at the end of 2009. A breakdown of covered exposure values by exposure classes and type of collateral is provided in the table below. At the end of 2009, only cash collateral was taken into account for credit risk mitigation of counterparty risk exposure. In this respect, it is noted that according to the applicable policy, equity collateral is not eligible, whereas debt securities are acceptable collateral, but none were provided.

In millions of EUR – 31-12-2008

Covered exposure ^{1,2} [EaD]	LGD % applied under IRB Foundation	Sovereigns	Institutions	Corporates	SME Corporates	Total
Cash	0%	0	584	1 071	0	1 655

In millions of EUR – 31-12-2009

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

1. Covered EAD is the EAD amount (after netting) on which a reduced LGD percentage is applied due to collateralisation.

2. The exposure only relates to the covered counterparty risk arising from derivative transactions.

At the end of December 2009, an exercise was carried out within KBC Bank (excl. KBC FP) to determine the impact on additional collateral to be posted in the event that KBC's long-term ratings were downgraded. At that time, KBC Bank has a long-term ratings of 'A', 'A', 'Aa3' from Standard and Poor's, Fitch and Moody's, respectively. The exercise measured the impact for a downgrade to 'A-', 'BBB+' and 'BBB' (reflected on all three rating agencies), and provided the following result: A rating downgrade to 'A-' would mean that 22 million euros' worth of collateral having to be posted, a downgrade to 'BBB+' 210 million euros and a downgrade to 'BBB' 216 million euros.

Taking into account a total amount of collateral posted of 3.0 billion euros at that time, the impact of such a downgrade can be considered relatively limited, accounting for 0.7% of the downgrade to 'A-' scenario, 7% of the 'BBB+' scenario and 7.2% of the 'BBB' scenario. It was also noted that the above impact predominantly stems from a decrease in the minimum transfer amounts and from the reduction of some threshold amounts.

A similar exercise (one notch downgrade on the lowest rating) at KBC FP results in an additional 40 million euros to be posted by KBC FP.

Lending portfolio

The retail segment is not included in the exposure classes in the table below, as it is irrelevant in a collateral context of exposure subject to the IRB approach, because retail is handled through the IRB Advanced approach and collateral is included in LGD modelling (See 'IRB Quality analysis').

Collateral applying to lending exposure subject to the Standardised approach have a direct effect by lowering the EAD, which in turn has a direct effect on RWA and on capital. Since, LGD is irrelevant for these exposures, the collateral is not included in the table and only the total aggregate collateralised EAD is given.

Of the non-retail lending EAD, 7.8% (9.1 billion euros of 116.7 billion euros) was classified as collateralised at the end of 2009 implying that a lower LGD percentage is applied to this portion of exposure in the capital calculations. The impacted exposure is to be interpreted as the total collateralised² EAD to which an LGD percentage of 0%, 30%, 35% or 40% has been applied in the capital requirement calculations (compared to an

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

LGD of 45% as used for un-collateralised amounts). The exact percentages depend on the type of collateral concerned as indicated in the table below.

It is clear that credit risk mitigation is only applied when the necessary policies and procedures are in place. Only the collateral meeting the eligibility criteria and minimum requirements (as imposed by the CRD) to qualify for credit risk mitigation has been included in the figures. Hence, bearing in mind that the figures refer to collateralised EAD as described in the previous paragraph, the effective amount of collateral obtained in KBC is much higher than the figure taken into account for risk mitigation purposes. Real estate collateral obtained for KBC's commercial real estate financing activities is not taken into account for credit risk mitigation purposes, for instance. It does not meet the conditions for credit risk mitigation, since the impact is already partially reflected in the PD rating under the IRB approach.

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

In millions of EUR – 31-12-2008

Covered IRB lending exposure [EAD] ¹	LGD applied under IRB Foundation ²	Sovereign	Institutions	Corporates	SME Corporates	Total	
Cash	0%		0	13	293	89	396
Debt securities	0%		0	0	30	15	46
Equity collateral	0%		1	0	253	65	320
Total financial collateral			2	1	577	170	761
Real estate ³	30%		4	10	2 667	2 259	4 939
Receivables	35%		0	0	1 302	1 441	2 744
Lease collateral	35%		0	0	0	0	0
Other physical collateral	40%		0	0	109	177	287
Total physical collateral			4	10	4 079	3 877	7 970
General total			6	23	4 656	4 047	8 731

In millions of EUR – 31-12-2009

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

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

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

3 Including real estate leasing.

The table shows that the bulk of the collateralised amounts relates to physical collateral (8.3 billion euros or 7.1% of the total non-retail EAD), while financial collateral, which has a bigger impact on capital as it attracts a LGD of 0%, is limited to 0.8 billion (0.7% of the total non-retail EAD). Furthermore, as financial collateral is predominantly cash collateral and non-cash financial collateral is amply diversified, issuer concentration risk in respect of financial collateral is negligible.

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

Collateralised amounts in the lending portfolio subject to the Standardised approach came to 0.2 billion euros of financial collateral and 0.5 billion euros of other physical collateral.

Unfunded credit protection

Unfunded credit protection is provided mainly through guarantees and – to a lesser extent – credit derivatives entered into for hedging purposes. For guarantees, the impacted exposure (i.e. amounts receiving a better rating through substitution, resulting in lower capital requirements) amounted to 5.9 billion euros at the end of 2009, or 4.1% of total non-retail lending EAD (144.8 billion euros). For credit derivatives, this impact is limited, as they only mitigate credit risk for an amount of 96 million euros.

In millions of EUR – 31-12-2008

Covered exposure [EAD] ^{1,2,3}	Sovereign	Institutions	Corporates	SME Corporates	Total
Credit derivatives	0	0	105	0	105
Guarantees	203	1 116	3 126	408	4 854
Total	203	1 116	3 231	408	4 959

In millions of EUR – 31-12-2009

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

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

2 The breakdown refers to the exposure classes before substitution is applied.

3 The scope of the table includes the Standardised and the IRB approach.

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

Internal modelling

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

These models are used in the credit process for:

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

Probability of Default models

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

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

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

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

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

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

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

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

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

In 2009, the cyclicity of PD models was focussed upon. In order to correctly interpret a PD rating, it is important to know to what degree the corresponding PD model adheres to the point-in-time (PIT) or the through-the-cycle (TTC) rating philosophy. For that purpose, a PIT metric was devised that quantifies the extent to which a PD model is a pure PIT model.

Loss Given Default models

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

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

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

The LGD models currently used at KBC are all workout LGDs. The models developed are (methodologically) based on historical recovery rates and cure rates³ per collateral type or per pool (segmentation-based approach).

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

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

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

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

Exposure At Default (EAD) models

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

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

Pooling models

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

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

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

Group-wide framework for dealing with model uncertainty

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

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

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

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

Overview of credit risk models

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

PD models used under the IRB Foundation approach ¹	Exposure granted [gross EAD] In billions of EUR	Central Tendency ²	Historical default rate ³	Average Model PD (excl. overrulings) ⁴
PD models for government and public sector segments				
(Worldwide) model for central governments	41.9	0.70%	0.78%	0.64%
PD models for corporate and institutional segments				
Asia-Pacific corporates	1.4	2.33%	2.03%	2.33%
US corporates	2.1	1.30%	1.68%	1.30%
Western-European corporates	18.7	1.68%	1.43%	1.68%
Czech corporates	6.1	1.80%	1.25%	1.80%
Large Czech household cooperatives	0.4	0.26%	0.00%	0.22%
Small Czech household Cooperatives	0.5	0.34%	0.00%	0.31%
(Worldwide) model for banks				
<i>o/w Developed</i>	24.5	0.10%	0.09%	0.20%
<i>o/w Others</i>	2.7	1.50%	0.45%	2.46%
(Worldwide) model for project finance	3.1	1.54%	1.33%	1.42%
(Worldwide) model for management buy outs	2.0	2.70%	3.38%	2.70%
PD models for SME segments				
models for Belgian professionals				
<i>o/w liberal professions</i>	0.0	0.58%	0.52%	0.55%
<i>o/w self-employed professionals</i>	0.1	1.47%	1.42%	1.61%
<i>o/w private persons</i>	0.1	1.29%	1.22%	1.42%
Belgian farmers	0.7	0.90%	0.78%	0.87%
Czech Municipalities	0.4	0.26%	0.06%	0.30%

1 Non exhaustive list of models used under the IRB Foundation approach, and excluding all (pooling) models used in the IRB advanced approach.

2 The central tendency is the average through-the-cycle default probability of a segment.

3 The default rate is the observed number of defaulted obligors during a certain time period as a percentage of total non-defaulted obligors at the beginning of the period (this result is scaled to a one-year period).

4 The average model PD is the mean PD of all obligors rated according to the model. The value at the time of the latest review is shown.

Credit risk related to KBC Insurance

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

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

Credit risk in the investment portfolio of KBC Insurance

Managing the investment portfolio of KBC Insurance – and thus the inherent credit risk – is done by setting limits and standards on what assets to invest in and how to hedge them. This is implemented by the ALM function, which monitors the investment portfolio of the insurance entities, and by the Group ALCO, which assumes final responsibility.

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

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

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

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

The table below gives the market value of these instruments.

Investment portfolio of KBC group insurance entities In millions of EUR	Market value ²	
	31-12-2008	31-12-2009
Per balance sheet item		
Securities	18 249	22 242
Bonds and other fixed-income securities	15 709	20 746
Shares and other variable-yield securities	2 385	1 463
Other	155	33
Loans and advances to customers	203	203
Loans and advances to banks	3 204	2 898
Property and equipment and investment property	472	523
Investments in associated companies	18	23
Other	97	103
Investment contracts, unit-linked	6 948	7 957
Total	29 192	33 949
Bonds and other fixed-income securities, portfolio details		
By rating ^{1, 3}		
AA- and higher	66%	68%
A- and higher	97%	94%
BBB- and higher	100%	100%
By sector ¹		
Governments ²	65%	62%
Financial	24%	20%
Other	11%	18%
Total	100%	100%
By remaining tenor ¹		
Not more than 1 year	6%	4%
Between 1 and 3 years	15%	19%
Between 3 and 5 years	26%	24%
Between 5 and 10 years	31%	34%
More than 10 years	22%	18%
Total	100%	100%

¹ Excluding investments for unit-linked life insurance. In certain cases, based on extrapolations and estimates.

² The total carrying value amounted to 28 904 million euros in December 2008 and to 33 598 million euros in December 2009.

³ External rating scale

Credit risk due to insurance or reinsurance contracts

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

Credit exposure to (re)insurance companies by risk class, in exposure at default (EAD) and Expected Loss (EL)

In millions of EUR	EAD	EL	EAD	EL
	2008	2008	2009	2009
AAA up to and including A-	311.5	0.05	352.7	0.07
BBB+ up to and including BB-	164.2	0.08	111.2	0.16
Below BB-	1.4	0.05	0.0	0.00
Unrated	13.9	0.28	15.5	0.35
Total	491.1	0.46	479.3	0.59

Structured credit products

This section deals with KBC's structured credit activities as per year-end 2009. These activities relate to Asset-Backed Securities (ABS) and Collateralised Debt Obligations (CDOs), which are defined as follows:

- *ABS* are bonds or notes backed by loans or accounts receivables originated by providers of credit, such as banks and credit card companies. Typically, the originator of the loans or accounts receivables transfers the credit risk to a trust, which pools these assets and repackages them as securities. These securities are then underwritten by brokerage firms, which offer them to the public.
- *CDOs* are a type of asset-backed security and a structured finance product in which a distinct legal entity, a Special Purpose Vehicle (SPV), issues bonds or notes against an investment in an underlying asset pool. Pools may differ with regard to the nature of their underlying assets and can be collateralised either by a portfolio of bonds, loans and other debt obligations, or be backed by synthetic credit exposures through use of credit derivatives and credit-linked notes.

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

KBC was active in the field of structured credits both as an originator and an investor. KBC acts as an originator when structuring credit deals for itself or for third parties. As an originator, KBC also takes on other roles such as sponsor, when it provides liquidity support to the related SPVs. KBC also invested in structured credit products. These investments appear on KBC's balance sheet.

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

- structured credit programmes where KBC acts as the originator;
- KBC's investments in structured credit products as per year-end 2009, together with information on the credit quality of the securities, an amortisation schedule of the investments, a view on the quality of the underlying collateral, a discussion on valuation and accounting principles and results of stress tests;
- the capital charges corresponding to the structured credit exposures.

Strategy and processes

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

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

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

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

KBC continued to wind down its structured credit business in 2009 as part of its increased focus on core activities.

Scope of structured credit activities

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

Structured credit programmes for which KBC acts as originator

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

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

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

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

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

In millions of EUR – 31-12-2009

Programme	Role	Type of underlying exposure	Nominal amount of the underlying
Home Loan Invest 2007	Originator	Mortgage loans	3 874
Home Loan Invest 2008	Originator	Mortgage loans	2 778
Home Loan Invest 2009	Originator	Mortgage loans	6 338
Phoenix 2 Funding 2008	Originator	Mortgage loans	6 958
Phoenix 3 Funding 2008	Originator	Mortgage loans	3 017
Phoenix 4 Funding 2009	Originator	Mortgage loans	836

Home Loan Invest 2007

Home Loan Invest 2007 is a 'Residential Mortgage-Backed Securities' (RMBS) issue where KBC Bank acts as the originator. An SPV acquired a pool of Belgian residential mortgages granted by KBC and raised funds through the issuance of notes (Class A and Class B Notes, rated 'AAA' and 'Aaa' by Fitch and Moody's, respectively) and KBC's subscription to a subordinated loan of 376 million euros. The notes are eligible as collateral for the European Central Bank (ECB), and thus provide KBC Bank with a liquidity buffer. The portfolio of mortgages comprises 83 319 loans totalling 3 874 million euros. Since KBC holds notes worth 2 billion euros, the Basel II securitisation framework does not apply to this structured credit programme, as an insufficient amount of the risk incurred has been transferred. Assets are held as regular assets on the balance sheet of KBC Bank and treated accordingly for capital adequacy calculation purposes.

Home Loan Invest 2008

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

Home Loan Invest 2009

Home Loan Invest 2009 is KBC Bank's third outstanding securitisation transaction. It was set up in April 2009, and like its predecessors Home Loan Invest 2007 and Home Loan Invest 2008, is an RMBS issue, whereby a portfolio of 6 667 million euros' worth of Belgian mortgage loans has been securitised and a reserve of 60 million euros is held on account. KBC Bank holds the subordinated loan of 727 million euros. The SPV issued notes in the amount of 6 000 million euros. Approximately 350 million euros' worth of notes were placed with external investors, while the rest were retained by KBC Bank. The notes are eligible as collateral for the ECB and thus provide an added liquidity buffer for KBC Bank. The Basel II securitisation framework does not apply, as here too an insufficient amount of the risk incurred has been transferred. Unlike Home Loan Invest 2008 and 2007, this issue amortises, i.e. non-revolving, over the tenor of the transaction (legal final maturity date: April 2041). The outstanding notes amounted to 5 671 million euros at 31 December 2009 and the subordinated loan amount remained equal.

Phoenix Funding 2

On 16 June 2008, a programme called Phoenix Funding 2 was set up as a source of contingent funding. The SPV has a remaining underlying pool of residential mortgages amounting to 6 958 million euros, originated by KBC Homeloans⁴ (which – via its parent KBC Bank Ireland – is indirectly a fully owned subsidiary of KBC Bank). KBC Bank Ireland has retained all of the notes, which implies that the Basel II securitisation framework does not apply, as an insufficient amount of the risk incurred has been transferred. The notes are divided into two classes, i.e. 95% in class A (Moody's 'Aaa' rating) and 5% in class B (Moody's 'A1' rating), maturing in 2050. A liquidity facility has been provided to the vehicle equalling 3.7% of the outstanding amount of notes, which would be triggered if KBC Bank NV ceased to hold a Prime-1 rating from Moody's. The Class A notes are eligible for placement with the ECB, thus providing KBC Bank Ireland with a liquidity buffer.

Phoenix Funding 3

Phoenix Funding 3, which is similar to Phoenix Funding 2, was set up in November 2008. The SPV has a remaining underlying pool of residential mortgages originated by KBC Homeloans⁴ worth 3 017 million euros. KBC Bank Ireland has retained all of the notes, which implies that the Basel II securitisation framework does not apply, as an insufficient amount of the risk incurred has been transferred. The notes are split into two classes, i.e. 95% in class A (Moody's 'Aaa' rating) and 5% in class B (Moody's 'A1' rating), maturing in 2050. A liquidity facility has been provided to the vehicle equalling 3.7% of the outstanding amount of notes, which would be triggered if KBC Bank NV ceased to hold a Prime-1 rating from Moody's. The class A notes are eligible for placement with the ECB, thus providing KBC Bank Ireland with a liquidity buffer.

Phoenix Funding 4

Phoenix Funding 4 was set up on 4 August 2009. The SPV has a remaining underlying pool of residential mortgages originated by KBC Bank Ireland plc worth 836 million euros. KBC Bank Ireland plc has retained all of the notes. The notes are split in two classes, i.e. 88% in class A (Moody's 'Aaa' rating) and 12% in class B (the class B notes are not rated), maturing in 2046. A liquidity facility has been provided to the vehicle equalling 3.7% of the outstanding amount of notes, which is triggered if KBC Bank NV ceases to hold a Prime-1 and A-3 rating from Moody's. The class A notes of Phoenix Funding 4 are eligible for placement with the ECB.

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

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

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

In millions of EUR – 31-12-2009

Programme	Roles	Type of underlying exposure	Nominal amount of the underlying
KBCFP CDO deals with ABS	Originator	Corporate reference names and/or ABS	20 793
KBCFP CDO deals without ABS	Originator	Corporate reference names	4 050

⁴ In 2009 KBC Homeloans merged with KBC Bank Ireland.

KBC FP has structured synthetic Collateralised Debt Obligation (CDO) deals. These CDOs relate to a pool of reference entities that are selected and monitored by KBC FP. The underlying pools generally consist of either corporate reference names (on average 82%) and ABS (on average 18%, part of which entails exposure to subprime loans), or are made up entirely of corporate reference names.

The CDOs structured by KBC FP are managed CDOs, whereby the manager has the option to conclude substitutions in the underlying asset portfolios of the CDOs. There were no such substitutions in 2009.

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

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

Structured credit involving third party assets for which KBC acts as sponsor

The purpose of this business line is to assist some of KBC's corporate clients to meet their funding needs. Economically, this activity can be considered as an extension of KBC's corporate lending activities that is similar to factoring, though in this case funding is provided to corporate clients through the commercial paper market via an SPV, which pools receivables from these clients. The risk involved for KBC boils down to liquidity support and credit enhancement provided via its role as a sponsor of these SPVs. As is the case with factoring, the risk ultimately hinges on the quality of the underlying receivables in the SPV. Quality is assured by diversification requirements and – to some extent – by credit insurance for the receivables, as well as by an over-collateralisation percentage applied to the pool of receivables based on an assessment of the risk they entail. The following structured credit programmes fall under this heading:

Structured credit programmes involving third party assets for which KBC acts as sponsor

In millions of EUR – 31-12-2009

Programme	Role	Type of underlying exposure	Nominal amount of the underlying
Rosy Blue Int	Sponsor	Structured pool of trade receivables	68
Quasar	Originator/Sponsor	Structured pool of receivables	458

Rosy Blue International (1999):

Rosy Blue International SA is an SPV that purchases non-interest-bearing trade receivables that satisfy eligibility criteria specified in advance by Rosy Blue NV. The purchase of the receivables is financed by the issuance of euro commercial paper denominated in USD and EUR with maturities of 1 month, 3 months and 6 months (rated 'P-1' and 'F1' by Moody's and Fitch, respectively). KBC acts as its issuing and paying agent. Should Rosy Blue be unable to attract sufficient funding in the commercial paper market to repay maturing commercial paper, it can make drawings under a liquidity facility agreement with KBC. Rosy Blue has also entered into a swing-line facility agreement with KBC under which Rosy Blue International SA can make drawings should a timing mismatch lead to a situation where it has insufficient funds available to pay funding costs and/or operating expenses. Both the amount of commercial paper that Rosy Blue International SA can issue and the amount that it can borrow under the liquidity facility agreement are limited to a total of 80 million USD. These credit enhancements are subject to the Supervisory Formula Approach (SFA) for the purpose of capital adequacy calculations.

Quasar (2001):

Quasar Securitisation Company ('Quasar') is an SPV set up to invest in structured pools of receivables. At year-end 2009, Quasar had four clients selling receivables on a revolving basis to the SPV, through which they are transferred to KBC. Funding is obtained in the euro commercial paper market by issuing commercial paper denominated in EUR, GBP and USD. The quality of the commercial paper issued by Quasar is reflected in the short-term rating of 'A-1' by S&P and of 'P-1' by Moody's. KBC also acts as a sponsor by extending a liquidity line to cover the entire transaction-specific liquidity risk and by issuing a programme-wide letter of credit (5% of the total outstanding notes). Both are subject to the Supervisory Formula Approach (SFA) for the purpose of capital adequacy calculations.

At 31 December 2009, all Commercial Paper issued by Quasar was held by the KBC group.

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

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

Overview

In millions of EUR

KBC investments in structured credit products (CDOs and other ABS)	31-12-2008	31-12-2009
Total nominal amount		
o/w hedged CDO exposure	16 444	14 830
o/w unhedged CDO exposure ¹	9 505	9 752
o/w other ABS ²	6 439	5 177
Initial write-downs of junior and equity CDO pieces ³	- 779	- 775
Subtotal	31 609	28 984
Impact since the beginning of the crisis (mid-2007 to date)	- 5 721	- 6 790 ⁴
	o/w value markdowns	- 4 962
	o/w other financial impact	- 759
		- 1 364 ⁴

¹ Amortisations, sales of CDOs, effect of principal losses and paydowns are offset by an increase in notional amounts following out-of-court settlements with clients.

² Year-on-year decrease due mainly to sales of ABS and amortisation.

³ The initial write-down of junior and equity CDO pieces had already been recognised through P/L when the CDOs were issued. The nominal reduction results from the settlement of credit events in the underlying asset portfolios of the CDOs.

⁴ Excluding 1 409 millions euros for the fee paid for the Guarantee Agreement with the Belgian State.

The year-on-year decrease in hedged CDO-linked exposure is due mostly to the winding down of the CDO exposure that was hedged by the swap contract with Lloyds TSB. KBC wound down this exposure (notional amount of 1.58 billion euros) in December 2009, and the hedge contract was duly cancelled.

Hedged CDO exposure

In millions of EUR – 31-12-2009

Programme	Type	Nominal amount of the underlying hedged	Mark-to-Model value of hedge protection received
MBIA	Monoline Insurer	14 389	1 949
Channel	Credit Derivatives Products Company	441	9
Total		14 830	

Details on MBIA insurance coverage

- Total insured amount (notional amount of the super senior swap)	14.389
- Fair value of insurance coverage received (modelled replacement value, after taking the Guarantee Agreement ¹ into account)	1 949
- Credit value adjustment of counterparty risk MBIA	-1 364
(in % of fair value of insurance coverage received ²)	70%

¹ The MBIA-insured amount is included in the Guarantee Agreement with the Belgian State - see chapter on 'Solvency, economic capital profile and embedded value'.

² Account Taken of translation differences accrued over time.

The super senior portions of CDOs originated by KBC FP are mostly hedged through credit insurers via swap contracts. The bulk of the insurance is bought from MBIA Insurance Corp, a US monoline insurer which was initially rated 'AAA', but whose creditworthiness has declined gradually over time (leading to the booking of negative value adjustments at KBC on the credit protection received). In February 2009, MBIA Inc unveiled a restructuring plan,

which included a spin-off of valuable assets, provoking a steep decline in its credit quality. Following this increased counterparty risk on MBIA Insurance Corp, significant additional negative value adjustments were booked at KBC. Moreover, the remaining risk related to MBIA's insurance coverage has been largely mitigated, as it is included in the scope of the Guarantee Agreement agreed with the Belgian State (see the section 'overview of capital transactions with the government' in the chapter on 'Solvency, economic capital profile and embedded value').

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

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

Unhedged KBC group investment in structured credit, 31-12-2009

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

Part of the risks attached to unhedged KBC group investments in CDOs are mitigated, due to the fact that the unhedged super senior CDO tranches are fully included in the Asset Protection Plan concluded with the Belgian State (see the section 'overview of capital transactions with the government' in the chapter on 'Solvency, economic capital profile and embedded value').

Unhedged CDO exposure and other ABS Amounts in million of EUR - 31-12-2009	Unhedged CDO exposure	other ABS
Total nominal amount	9 752	5 177
Initial write-down of junior and equity pieces	775	-
Total nominal amount, net of provisions for equity and junior pieces	8 977	5 177
- super senior tranches (included in the Guarantee Agreement with Belgian State – see above)	5 493	-
- non super senior tranches	3 484	-
Cumulative market value adjustments	-4 089	-1 337
Of which cumulative impairment on other ABS	-	-505

In 2009, KBC concluded several out-of-court settlement agreements with clients in Belgium, Slovakia and Hungary, who invested in CDOs issues by KBC FP.

Credit quality of securities held, 31-12-2009

An overview of the quality of the notes and super senior swaps held at year-end 2009 is shown in the table below.

Credit quality of securities held – based on Moody's ratings

Amounts at nominal value, net of provisions for equity and junior CDO pieces (in millions of EUR) – 31-12-2009

	Super Senior (SS)	Aaa	Aa	A	Baa	<Baa3	Unrated	Total
Hedged CDO exposure	14 830 ¹	-	-	-	-	-	-	14 830
Unhedged CDOs	5 493 ²	30	130	16	70	3 110	128	8 977
Other ABS	-	3 373	806	204	40	755	-	5 177
Total	20 324	3 403	936	220	110	3 365	128	28 984

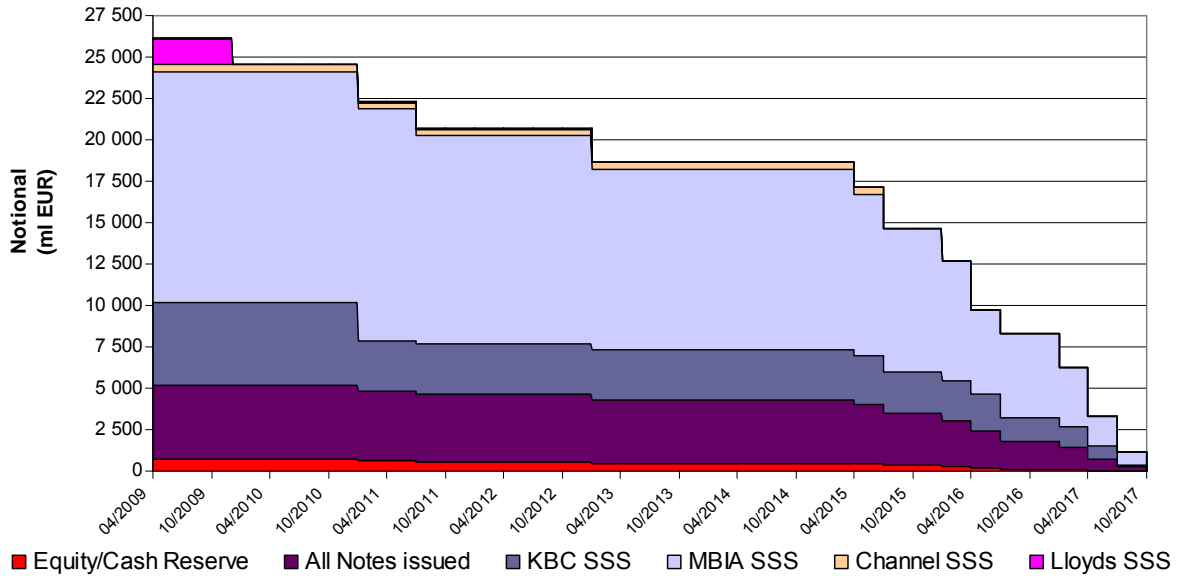
¹ Positions hedged by MBIA and Channel.

² All unhedged positions in the scope of the Guarantee Agreement signed with the Belgian State (see above).

Amortisation schedule of the hedged and unhedged CDO portfolio

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

Maturity schedule CDOs issued by KBC FP



A notional amount of 3.9 billion EUR of CDOs issued by KBC FP will reach their expected maturity date in 2011 (2.3 billion EUR in January and 1.6 billion EUR in July). By end 2017, all CDOs issued by KBC FP (excl the CDOs in run off) are expected to have matured.

Overview of the underlying collateral of the securities held, 31-12-2009

The next tables provide a breakdown of the underlying collateral of the CDO portfolio (both hedged and unhedged) and the other ABS portfolio (excluding CDO exposure). They contain more detailed information on KBCs subprime exposure, on the quality of the underlying collateral and on the breakdown of corporate reference names according to sector and region.

Type and quality breakdown of the underlying of the hedged CDOs held – based on Moody's ratings
Amounts at nominal value - in millions of EUR – 31-12-2009

		Aaa	Aa	A	Baa	Ba	B	Caa	<=Caa3	NR	Total
Corporates		4	346	2 079	4 905	2 779	1 316	625	558	12	12 625
Sector	Real Estate	-	-	83	1 249	336	358	14	24	-	2 063
	Banking	-	79	802	268	84	2	88	153	-	1 476
	Finance	4	56	233	205	242	195	110	110	-	1 155
	Insurance	-	21	244	343	3	242	-	-	-	854
	Publishing	-	-	20	77	318	183	48	3	-	649
	Retail Stores	-	-	28	204	214	71	63	-	-	580
	Automobile	-	-	44	146	208	48	35	-	-	480
	Monoline	-	175	7	66	83	-	-	147	-	478
	Telecom	-	1	134	225	78	6	-	-	-	445
	Oil & Gas	-	1	18	323	88	-	-	-	9	439
	Utilities	-	6	111	284	23	1	7	-	-	431
	Electronics	-	-	26	80	125	78	61	-	1	371
	Other	0	6	330	1 434	978	132	199	121	2	3 203
Region	US	4	261	682	2 488	1 787	762	366	487	9	6 846
	EU	-	76	637	1 158	517	350	79	-	2	2 819
	Asia	0	3	504	490	287	97	181	-	1	1 563
	Latin America	-	3	53	101	8	38	-	-	-	203
	Other	-	3	203	669	180	68	-	72	-	1 194
CMBS		-	-	3	-	-	-	-	-	-	4
RMBS		-	4	68	65	114	64	76	1 351	3	1 745
Origin	Prime	-	-	-	-	-	-	-	-	-	-
	ALT-A	-	-	-	3	13	15	14	482	-	527
	<i>Alt-A (<2005 vintage)</i>	-	-	-	3	1	4	-	1	-	9
	<i>Alt-A (2005-2007 vintage)</i>	-	-	-	-	13	11	14	481	-	519
	Subprime	-	4	68	62	101	49	62	869	3	1 217
	<i>subprime (<2005 vintage)</i>	-	4	43	52	50	19	9	40	3	219
	<i>subprime (2005-2007 vintage)</i>	-	-	25	11	51	30	53	829	-	998
Region	US	-	4	68	65	114	64	76	1 351	3	1 745
Other ABS		-	-	7	1	-	-	-	4	27	39
CDO		6	8	34	21	46	17	35	225	26	417
Total		10	358	2 190	4 993	2 938	1 398	737	2 138	68	14 830

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

Type and quality breakdown of the underlying of the unhedged CDOs held – based on Moody's ratings
 Amounts at nominal value - in millions of EUR – 31-12-2009

		Aaa	Aa	A	Baa	Ba	B	Caa	<=Caa3	NR	Total
Corporates		2	209	1 258	2 969	1 682	796	378	338	7	7 640
Sector	Real Estate	-	-	50	756	203	217	9	14	-	1 249
	Banking	-	48	486	162	51	1	53	92	-	893
	Finance	2	34	141	124	147	118	67	67	-	699
	Insurance	-	13	148	208	2	147	-	-	-	517
	Publishing	-	-	12	47	192	111	29	2	-	393
	Retail Stores	-	-	17	123	130	43	38	-	-	351
	Automobile	-	-	26	89	126	29	21	-	-	291
	Monoline	-	106	4	40	50	-	-	89	-	289
	Telecom	-	1	81	136	47	4	-	-	-	269
	Oil & Gas	-	1	11	195	53	-	-	-	5	266
	Utilities	-	4	67	172	14	0	4	-	-	261
	Electronics	-	-	15	49	75	47	37	-	1	224
	Other	0	4	200	868	592	80	120	73	1	1 938
Region	US	2	158	413	1 506	1 082	461	222	294	5	4 143
	EU	-	46	386	701	313	212	48	-	1	1 706
	Asia	0	2	305	296	173	59	109	-	1	946
	Latin America	-	2	32	61	5	23	-	-	-	123
	Other	-	2	123	405	109	41	-	43	-	723
CMBS		-	-	2	-	-	-	-	-	-	2
RMBS		-	2	41	39	69	39	46	817	2	1 056
Origin	Prime	-	-	-	-	-	-	-	-	-	-
	ALT-A	-	-	-	2	8	9	9	292	-	319
	<i>Alt-A (<2005 vintage)</i>	-	-	-	2	0	2	-	1	-	5
	<i>Alt-A (2005-2007 vintage)</i>	-	-	-	-	8	7	9	291	-	314
	Subprime	-	2	41	38	61	30	38	526	2	737
	<i>subprime (<2005 vintage)</i>	-	2	26	31	30	12	5	24	2	133
	<i>subprime (2005-2007 vintage)</i>	-	-	15	6	31	18	32	502	-	604
Region	US	-	2	41	39	69	39	46	817	2	1 056
Other ABS		-	-	4	1	-	-	-	3	16	24
CDO		3	5	20	13	28	10	21	136	16	252
Total		6	216	1 326	3 022	1 778	846	446	1 294	41	8 975

Type and quality breakdown of the underlying of the other ABSs held – based on Moody's ratings

Amounts at nominal value - in millions of EUR - 31-12-2009

			Aaa	Aa	A	Baa	<Baa3	NR	Total
Corporates									
		CMBS	89	13	22	16	-	-	139
		RMBS	2 549	269	103	50	667	1	3 638
	Origin	Prime	2 489	257	63	-	-	1	2 809
		<i>prime (<2005 vintage)</i>	1 533	116	1	-	-	1	1 650
		<i>prime (2005-2007 vintage)</i>	956	141	62	-	-	-	1 159
		ALT-A	7	-	36	37	406	-	487
		<i>Alt-A (<2005 vintage)</i>	7	-	15	-	-	-	22
		<i>Alt-A (2005-2007 vintage)</i>	-	-	21	37	406	-	464
		Subprime	53	12	4	13	261	-	343
		<i>subprime (<2005 vintage)</i>	26	-	4	-	3	-	34
		<i>subprime (2005-2007 vintage)</i>	26	12	-	13	258	-	309
	Region	US	183	12	41	50	667	-	955
		Spain	791	117	62	-	-	-	970
		Italy	553	5	-	-	-	-	558
		Netherlands	430	38	-	-	-	-	468
		Portugal	363	25	-	-	-	-	388
		UK	30	43	-	-	-	-	73
		Other	199	28	-	-	-	-	227
		Other	792	464	130	10	3	-	1 399
	Type	CLO	217	384	119	-	-	-	720
		Leases	129	52	7	-	-	-	188
		SME loans	118	-	-	-	-	-	118
		Consumer Loans	60	10	3	-	-	-	73
		Auto Loans/Leases	134	13	-	-	-	-	147
		Other	134	5	1	10	3	-	153
		Total	3 430	745	254	76	670	1	5 177

Valuation and accounting principles

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

For other ABS

Since 31 December 2008, most of KBC's exposure to ABS has been classified as 'Loans and Receivables', which means that they are valued at amortised cost. The positions are included in the scope of the impairment procedure for the loan portfolio (which clearly impacts P/L). For the remaining ABS that are classified as 'Available for Sale', a level-2 valuation technique based on third-party pricing is applied.

For CDOs, KBC applies a level-3 valuation technique.

In order to correctly reflect the impact of credit events in the underlying asset portfolios on the capital structure of the CDOs originated by KBC FP, KBC changed the valuation methodology in 2009 in favour of a Gaussian Copula model. The Gaussian Copula model models the distribution of default times of the underlying corporate and ABS names in the reference portfolios of the CDO transactions. The asset default trigger in the model is derived from the credit default swap spreads in the market. The correlation between the default times is modelled through Gaussian Copulas⁵ and can as such be simulated. By discounting the cashflows resulting from the default time curves on the underlying assets, a value for a specific CDO tranche is determined. The model also ensures that the inner tranches are valued in line with the market, through the calibration with CDX and iTraxx credit spread indices.

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

Apart from the initial write-down on junior and equity CDO pieces (775 million euros at year-end 2009), the total impact of the financial crisis on the value of the investments in structured credit products between mid-2007 and the end of 2009 amounted to 8.2 billion euros (see table below for more detailed information).

It should be noted that value adjustments to KBC's CDOs are accounted for via profit or loss, since the group's CDOs are largely of a synthetic nature (i.e. the underlying assets are derivative products such as credit default swaps on corporate names). The synthetic nature is also the reason why KBC's CDOs – unlike the situation at many other financial institutions – are *not* eligible for accounting reclassification under IFRS in order to neutralise their impact.

Details on the impact of the financial crisis
In millions of EUR – 31-12-2009 (pre-tax)

	during 2007	during 2008	during 2009	Total up to 31-12-2009
Value markdowns	-308	-4 771	-347	-5 426
o/w on CDOs (through P/L)	-165	-3 234	-690	-4 089
o/w on CDOs (through Equity)	-	-	-	-
o/w on ABS (through P/L)	-13	-162	-391	-566
o/w on ABS (through Equity)	-130	-1 375	734	-771
Other financial impact	-39	-603	-2 131	-2 773
o/w CDO-related monoline counterparty risk	-39	-603	-722	-1 364
o/w other impact on CDO*	-	-	-1409	-1 409
o/w other on ABS	-	-	-	-
Total impact of financial crisis	-347	-5 374	-2 478	-8 199
o/w through P/L	-217	-3 999	-3 212	-7 428
o/w through Equity	-130	-1 375	734	-771

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

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

Stress-test results for KBC group investments in structured credits, 31-12-2009

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

Stress tests with an effect on credit default

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

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

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

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

The results of these scenarios are summarised in the table.

Stress test results on the effect of credit defaults in the underlying assets of the CDOs^{1,2}
In millions of EUR – 31-12-2009

Current situation	Value of CDOs	Value loss	Loss as % of nominal
Nominal value unhedged portfolio	7 918	- 3 704	47%
Nominal value hedged portfolio	14 333	-1 055	7%
Stress-test results on credit default		Actual loss	
Fundamental value scenario			
Unhedged portfolio	7 918	3 403	43.0 %
Hedged portfolio	14 333	562	3.9 %
Stress scenario 1			
Unhedged Portfolio	7 918	3 560	45.0 %
Hedged portfolio	14 333	843	5.9 %
Stress scenario 2			
Unhedged Scenario	7 918	3 958	50.0 %
Hedged Scenario	14 333	2 052	14.3 %

¹ Excluding CDOs in run-off, which explains the different nominal value in previous tables, and excluding junior and equity CDO pieces, where the initial write-down had already been recognised through P/L when the CDOs were issued.

² Account taken of the Guarantee Agreement with the Belgian State.

Stress tests with effect on P/L

KBC has calculated the impact of two stress test scenarios in terms of changes in credit spreads (an increase or decrease by 10%, 20% and 50%, respectively) on the hedged and unhedged portfolio of CDOs originated by KBC FP. The calculations take into account the impact of the Guarantee Agreement signed with the Belgian State, which reduces the volatility of the super senior positions in scope on P/L.

Stress test result on the market sensitivity of CDOs

In millions of EUR – 31-12-2009 (pre-tax)

	Market valuation sensitivity	Stress-test result
Test assumptions	Credit spreads in December x 1.10	-165
	Credit spreads in December x 1.20	-317
	Credit spreads in December x 1.50	-702
Test assumptions	Credit spreads in December x 0.90	180
	Credit spreads in December x 0.80	378
	Credit spreads in December x 0.50	1 108

Scope includes all CDOs originated by KBC FP that have been invested in, whether hedged or unhedged, excluding the CDOs in run-off (nominal value in scope of 22.3 billion euros, > 90% of total investments in CDOs). The impact of the Guarantee Agreement concluded with the Belgian State and a provisioning rate at 70% for MBIA have been taken into account

Structured credit exposure - capital charges

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

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

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

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

Details on capital charges for structured credit products

In millions of EUR – 31-12-2009

Programme	Invested amount	Size of liquidity facility/credit enhancements	Exposure (EAD) by risk weight class				RWA 2009
			6 - 18%	20 - 650%	1250%	Total	
KBC as Sponsor	0	98					46
Quasar	0	30					11
Rosy Blue	0	68					35
KBC as Investor	10 131	0	3 545	1 053	905	5 503	8 769
Atomium ²	93	0	0	0	145	145	530
KBC Bank ³	6 111	0	3 545	376	706	4 627	7 425
ČSOB CZ	435	0	0	0	45	45	560
K&H	73	0	0	0	0	0	0
KBC USA branche	117	0	*1	*1	*1	*1	*1
KBC FP	2 279	0	*1	*1	*1	*1	*1
KBL	1 023	0	0	677	9	686	254
Total KBC banking entities	10 131	98	3 545	1 053	905	5 503	8 815
Total KBC insurance entities	4 798	0	not applicable				0
Total KBC Group	14 929	98	3 545	1 053	905	5 503	8 815

¹ indicates that capital charges cannot be reported separately as they are incorporated into the capital requirements for market risk as measured using the VAR models.

² During 2009 most of the assets of Atomium were transferred to KBC Bank.

³ KBC Bank includes KBC Credit Investments.

Trading (market) risk management

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

Market risk also covers the risk of price fluctuations in negotiable securities as a result of credit risk, country risk and liquidity risk.

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

Strategy and processes

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

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

Through its specialised subsidiaries (KBC Financial Products (KBC FP) and KBC Securities (including KBC Peel Hunt since 1 April 2009)), the group also engages in trading in equities and their derivatives. At KBC FP, the proprietary trading and Alternative Investment Management business lines have been closed down and most of the risks eliminated. The remaining business lines are being wound down, i.e. primarily the management of the credit derivatives business, the business of providing secured advances to hedge funds, the life insurance business, involvement in the US reverse mortgage market (portfolio sold in February 2010) and trading activity in exotic equity derivatives.

Market risk tolerance is determined by the Board of Directors by means of an annual limit review. The Group Value and Risk Management Directorate and the Group Trading Risk Committee (GTRC) advise on limits before they are submitted to the Board.

Trading risk management decisions are taken by the GTRC which is chaired by the Group CRO and includes representatives from line management, risk management, internal audit and top management. It manages market risk and addresses counterparty and operational risk related to the trading activities. It keeps track of structural trends, monitors group-wide risk limits and may decide to impose corrective actions.

The development of portfolio models, the measurement of the risk position, monitoring and reporting are all performed centrally at group level.

The centralisation of trading risk management implies close cooperation between all value and risk management units at both the group and local level. In the Group Value and Risk Management Directorate, risk co-ordinators are the first contact point for the group's local trading entities when they have questions relating to market risk. The responsibilities of the risk co-ordinators are clearly set out in risk protocols. Local risk management policy and procedures are described in the risk management framework document.

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

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

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

VAR model and characteristics

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

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

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

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

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

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

KBC's global treasury activities (referred to as 'KBC Bank' in the table below) and KBC FP account for the largest part of (trading risk) HVAR exposure within KBC group. Their respective quarterly average HVAR outcomes in 2009, compared with 2008, are displayed in the table below.

The HVAR for KBC FP comprises all trading business lines. Business lines and exposures that are more illiquid and have more of a credit character, such as the fund derivatives and insurance derivatives businesses, fall outside the scope of HVAR.

Market risk (VAR, 1-day holding period) In millions of EUR	KBC Bank ^{1,2}	KBC Financial Products ³
Average, 1Q 2008	5	15
Average, 2Q 2008	7	11
Average, 3Q 2008	7	15
Average, 4Q 2008	13	24
31-12-2008	10	15
Maximum in 2008	17	30
Minimum in 2008	3	9
Average, 1Q 2009	10	14
Average, 2Q 2009	8	15
Average, 3Q 2009	6	9
Average, 4Q 2009	6	10
31-12-2009	5	11
Maximum in 2009	13	21
Minimum in 2009	5	6

¹ Excluding 'specific interest rate risk', which is measured using other techniques.

² Integrated HVAR, including KBL EPB.

³ Including the impact of the Guarantee Agreement with the Belgian State.

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

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

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

Both KBC Bank and KBC Financial Products have been authorised by the Belgian regulator to use their respective VAR models to calculate regulatory capital requirements for trading activities. ČSOB Czech Republic has also obtained approval from the local regulator to use its VAR Model for its capital calculations.

The resulting capital requirements for trading risk at year-end 2008 and year-end 2009 are shown in the table below. The regulatory trading risk capital requirements of local KBC entities that did not receive approval from their respective regulator to use an internal model for capital calculations are measured according to the Standardised approach. The Standardised approach sets out general and specific risk weightings per type of market risk (interest risk, equity risk, FX risk and commodity risk)

In millions of EUR

BASEL II – 31-12-2008	Interest risk ¹	Equity risk	FX risk ²	Commodity risk	Total
KBC Bank consolidated	459	193	217	3	872
KBL EPB	22	8	11	0	41
BASEL II – 31-12-2009					
KBC Bank consolidated	212	127	59	4	402
KBL EPB	18	9	12	0	39

1. The decrease in capital requirements for interest rate risk are mainly attributed to reduced trading activity and more refined calculations of exposure that is subject to the Standardised method at KBC Bank.

2. The decrease in FX capital requirements is owed mainly to the conversion from SKK to EUR as of 1 January 2009. This led to a substantial drop in capital requirements for FX risk at ČSOB Slovak Republic. To a lesser extent, more refined calculations of exposure that is subject to the standardised method at KBC Bank contributed to this decrease.

Stress testing

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

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

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

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

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

The results generated by worst-case stress testing are presented to the GTRC every fortnight. In addition, a more in-depth report on stress test results and on historical stress tests, is presented to the GTRC on a quarterly basis.

Back testing

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

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

Validation and reconciliation

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

Furthermore, the VAR method is reviewed and subjected to a validation exercise by KBC's independent Model Committee at least once a year. In addition, the VAR model is audited on a regular basis.

Non-trading market risk management

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

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

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

Strategy and processes

The main purpose of ALM is to optimise the risk/return profile of the group, subject to the risk appetite limits set by the Board of Directors. The Group ALCO is responsible for establishing a group-wide framework for identifying, measuring and overseeing ALM activities and for taking strategic investment decisions for the entire group. At the subsidiaries outside the euro area, this is carried out by local ALCOs.

A team in the Group Value and Risk Management Directorate provides support to the Group ALCO and helps to develop ALM. Similar teams exist at the subsidiaries outside the euro area. Risk management responsibilities for the life insurance business (including the tasks of the certifying actuary for the life insurance business and embedded value modelling) are also included in the scope of ALM.

The ALM strategy is co-ordinated by a central investment function and implemented locally by front-office units.

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

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

The overall decrease in VAR is due to decreases in the equity and interest rate positions.

KBC group ALM risk, by risk category (VAR 99%, 1-year time horizon, marginal contribution of various risk types to VAR)¹

In billions of EUR	31-12-2008	31-12-2009
Interest rate risk	1.41	0.85
Equity risk	1.03	0.84
Real estate risk	0.15	0.14
Other risks ²	0.17	0.08
Total diversified VAR (group)	2.76	1.91

¹ Excluding a number of small group companies

² Foreign exchange rate risk, inflation risk, etc.

Scope of non-trading market risk disclosures

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

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

Interest rate risk

Interest rate risk for the banking activities

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

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

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

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

The table below shows how the bank's exposure to interest rate risk developed over the course of 2008 and 2009.

BPV of the ALM book, banking activities*
In millions of EUR

Average, 1Q 2008	59
Average, 2Q 2008	74
Average, 3Q 2008	76
Average, 4Q 2008	76
31-12-2008	84
Maximum in 2008	84
Minimum in 2008	48
Average, 1Q 2009	89
Average, 2Q 2009	94
Average, 3Q 2009	85
Average, 4Q 2009	67
31-12-2009	62
Maximum in 2009	98
Minimum in 2009	62

* Excluding a number of small group companies

In line with the Basel II guidelines, a 2% stress test is carried out at regular intervals. It sets off the total interest rate risk in the banking book (given a 2% parallel shift in interest rates) against capital and reserves. At the level of the banking book of KBC Group, this risk came to 5% at year-end 2009 (well below the 20% threshold, where a bank is considered an 'outlier bank' and which can lead to a higher regulatory capital charge).

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

The significant increase in the Non-interest-bearing bucket is for a large part related to the capital increases by the government. Decreases in the 5 to 10y bucket and the > 10y bucket, are due to reduced interest rate positions over 2009.

Interest sensitivity gap of the ALM book (including derivatives), banking activities*
In millions of EUR

	≤ 1 month	1–3 months	3–12 months	1–5 years	5–10 years	> 10 years	Non-interest-bearing	Total
31-12-2008	-4	2 581	-2 822	-3 828	8 507	5 220	-9 654	0
31-12-2009	1 363	7 884	-3 629	1 590	5 874	3 275	-16 358	0

* Excluding a number of small group companies

Interest rate risk for the insurance activities

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

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

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

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

Expected cashflows (not discounted), life insurance activities*
In millions of EUR

	0–5 years	5–10 years	10–15 years	15–20 years	> 20 years	Total
31-12-2008						
Fixed-income assets backing liabilities, guaranteed component	9 401	6 102	1 952	1 399	979	19 833
Liabilities, guaranteed component	7 114	4 947	1 817	1 621	2 521	18 020
Difference in expected cashflows	2 287	1 155	134	-222	-1 542	1 813
Mean duration of assets						6.58 years
Mean duration of liabilities						7.70 years
31-12-2009						
Fixed-income assets backing liabilities, guaranteed component	11 447	7 154	2 313	1 605	1 243	23 763
Liabilities, guaranteed component	9 229	4 982	1 876	1 549	2 306	19 942
Difference in expected cashflows	2 218	2 172	437	57	-1 063	3 821
Mean duration of assets						5.38 years
Mean duration of liabilities						5.94 years

* Excluding a number of small group companies

As mentioned above, the main interest rate risk for the insurer is at the downside of interest rates. KBC adheres to a policy that takes into account the possible negative consequences of a sustained decline in interest rates, and has built up sizeable supplementary reserves, primarily for products that are most susceptible to interest rate risk. For instance, in Belgium (which accounts for the bulk of the life insurance reserves), technical provisions for products with a guaranteed rate of interest of 4.75% are calculated at a discount rate of 4%. In addition, supplementary provisions have been accumulated under a 'flashing light' system since 2000. This system requires KBC Insurance and Fidea to set aside extra provisions if the guaranteed interest rate on a contract exceeds the 'flashing light' threshold by more than 0.1% (this threshold is equal to 80% of the average interest rate over the past five years on ten-year government bonds). During 2009, KBC filed for an exemption for the further build-up of this reserve. After having proven that the current available reserves were sufficient to cover the potential economic value loss triggered by a decrease in interest rates, this exemption was partially obtained.

Breakdown of the reserves for non-linked life insurance by guaranteed interest rate, insurance activities ¹	31-12-2008	31-12-2009
5.00% and higher ²	3%	3%
More than 4.25% up to and including 4.99%	14%	12%
More than 3.50% up to and including 4.25%	10%	17%
More than 3.00% up to and including 3.50%	41%	31%
More than 2.50% up to and including 3.00%	12%	25%
2.50% and down to 0.00%	15%	9%
0.00%	4%	4%
Total	100%	100%

¹ Excluding a number of small group companies

² Contracts in Central and Eastern Europe.

The various group companies conduct 'liability adequacy tests' (LAT) that meet local and IFRS requirements. Calculations are made using prospective methods (cashflow projections that take account of lapse rates and a discount rate that is set for each insurance entity based on local macroeconomic conditions and regulations), and extra market value margins are built in to deal with the factor of uncertainty in a number of parameters. Since no deficiencies were recorded by the year-end of 2009, there was no need for a deficiency reserve to be set aside within KBC Group.

Aggregate interest rate risk for KBC Group

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

Interest Rate Risk for KBC Group* - BPV in thousands of EUR –
31-12-2008

	Overall	EUR	CHF	USD	GBP	CZK	HUF	PLN	other
Bank	84 188	73 554	-1 348	641	-119	7 751	460	1 200	2 049
Insurance	8 128	9 364	0	-60	1	-479	57	-757	2
KBC Group	92 316	82 918	-1 348	581	-118	7 272	517	443	2 051

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

	Overall	EUR	CHF	USD	EUR	CZK	HUF	PLN	other
Bank	62 280	52 718	462	-182	-84	7 992	-545	1 284	635
Insurance	7 938	7 183	0	24	5	279	215	27	205
KBC Group	70 218	59 900	462	-158	-79	8 271	-330	1 311	840

* Excluding a number of small group companies

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

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

	Increase by 1%		Decrease by 1%	
	2008	2009	2008	2009
Insurance	-8	-8	-25	8
Banking	-37	-110	56	171
Total KBC Group	-45	-118	31	179

* Excluding a number of small group companies

Equity risk

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

Accounting techniques and the impairment procedure for equity are described in Note 1b of KBC's annual report for 2009. Each quarter, an impairment committee meets to determine whether impairment charges need to be recognised, with the decision it takes being based on a set of coherent indicators. The annual report also provides figures for impairment during the accounting period.

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

The tables below present more information on the total non-trading equity exposures at KBC. All minority shareholdings are treated as equity exposures (e.g., the participation in NLB Bank). The first table provides an overview of the exposures, subdivided into listed and non-listed equity exposures.

Non-trading equity exposure¹

In millions of EUR

	31-12-2008		31-12-2009	
	Total	Listed equity	Non-listed equity	
KBC group ²	3 617	1 934	694	
banking entities (KBC Bank)	1 212	533	559	
insurance entities (KBC Insurance)	2 203	1 246	60	

¹ Excluding a number of small group companies.

² The total figure includes the equity exposure of KBL EPB (not shown separately) and some equity positions directly attributable to KBC group. Joint participations involving the banking and the insurance entities of KBC group have been eliminated.

The second table provides an overview of the total equity portfolio of KBC group, broken down by sector to present more information on the sector concentration of the equities invested in.

Equity portfolio of KBC group* Breakdown by sector, in %	Banking activities		Insurance activities		Group	
	31-12-2008	31-12-2009	31-12-2008	31-12-2009	31-12-2008	31-12-2009
Financials	19%	17%	16%	26%	17%	23%
Consumer non-cyclical	15%	22%	16%	17%	16%	19%
Communication	9%	4%	11%	6%	11%	5%
Energy	6%	8%	9%	9%	8%	9%
Industrial	9%	8%	12%	8%	11%	8%
Utilities	4%	4%	11%	5%	9%	5%
Consumer cyclical	11%	8%	8%	8%	9%	8%
Basic materials	4%	5%	7%	8%	6%	7%
Other	23%	24%	9%	12%	13%	17%
Total	100%	100%	100%	100%	100%	100%

* Excluding a number of small group companies

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

Impact of a 12.5% drop in equity prices*

In millions of EUR

	Impact on net profit (IFRS)		Impact on value	
	2008	2009	2008	2009
Insurance activities	-243	-3	-246	-120
Banking activities	-44	-29	-222	-165
Total	-287	-33	-468	-285

* Excluding a number of small group companies

The last table provides an overview of the realised and unrealised gains on the equity portfolio during 2008 and 2009.

Non-trading equity exposure¹

In millions of EUR	31-12-2008		31-12-2009	
	Net realised gains (in income statement)	Net unrealised gains in year-end exposure (in equity)	Net realised gains (in income statement)	Net unrealised gains in year-end exposure (in equity)
KBC group ²	107	-63	95	387
banking entities	-5	11	34	121
insurance entities	101	-86	58	293

¹ Excluding a number of small group companies.

² The total figure includes gains from KBL EPB (not shown separately) and some equity positions directly attributable to KBC group. Gains from joint participations involving the banking and insurance entities of KBC group have been eliminated.

Real estate risk

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

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

Impact of a 12.5% drop in real estate prices*
In millions of EUR

	Impact on value	
	2008	2009
Bank portfolios	-106	-93
Insurance portfolios	-45	-21
Total	-151	-114

* Excluding a number of small group companies

Inflation risk

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

Foreign exchange risk

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

Liquidity risk management

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

Strategy and processes

The principal objective of KBC's liquidity management is to be able to fund the group and to enable the core business activities of the group to continue to generate revenue, even under adverse circumstances.

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

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

- Contingency liquidity risk

This risk is assessed on the basis of liquidity stress tests, which measure how the liquidity buffer of the group's bank entities changes under extreme stressed scenarios. This buffer is based on assumptions regarding liquidity outflows (retail customer behaviour, professional client behaviour, drawing of committed credit lines, etc.) and liquidity inflows resulting from actions to increase liquidity ('repoing' the bond portfolio, reducing unsecured interbank lending, etc.).

The liquidity buffer has to be sufficient to cover liquidity needs (net cash and collateral outflows) over (i) a period that is required to restore market confidence in the group following a KBC-specific event, (ii) a period that is required for markets to stabilise after a general market event and (iii) a combined scenario, which takes into account a KBC-specific event as well as a general market event. The overall aim of the liquidity framework is to remain sufficiently liquid in stress situations, without resorting to liquidity-enhancing actions which would entail significant costs or which would interfere with the core banking business of the group.

- Structural liquidity risk

The group's funding structure is managed so as to maintain substantial diversification, to minimise funding concentrations in time buckets, and to limit the level of reliance on wholesale funding. Therefore, the forecast structure of the balance sheet is reviewed regularly and the appropriate funding strategies and options developed and implemented.

- Operational liquidity risk

Operational liquidity management is conducted in the treasury departments, based on estimated funding requirements. The most volatile components of the balance sheet are monitored on a daily basis by the Group Treasury unit, ensuring that a sufficient buffer is available at all times to deal with extreme liquidity events in which no wholesale funding can be rolled over.

Scope of liquidity risk management

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

Structural liquidity risk

The table below illustrates structural liquidity risk by grouping the assets and liabilities according to the remaining term to maturity (contractual maturity date). The difference between the cash inflows and outflows is referred to as the 'net liquidity gap'. On position end of 2009, KBC attracted 59 billion euros' worth of funding from the professional market. When interbank lending is also taken into account, net funding attracted through the professional market fell to 31 billion euros.

Liquidity risk at year-end (excluding intercompany deals)¹

In billions of EUR	<= 1 month	1-3 months	3-12 months	1-5 years	5-10 years	> 10 years	not defined	Total
31-12-2008								
Total inflows	66	23	26	69	40	45	55	323
Total outflows ²	88	32	25	27	7	10	135	323
Professional funding	49	12	4	1	-	1	0	68
Customer funding	26	12	15	6	1	6	76	142
Debt certificates	5	7	6	20	6	3	0	47
Other ³	7						59	66
Liquidity gap (excl. undrawn commitments)	-21	-9	0	42	33	35	-80	0
Undrawn commitments							-43	
Financial guarantees							-18	
Net liquidity gap (incl. undrawn commitments)	-21	-9	0	42	33	35	-141	-61
31-12-2009								
Total inflows	55	13	23	70	42	40	45	288
Total outflows ²	69	22	23	29	7	3	136	288
Professional funding	34	9	13	1	0	1	0	59
Customer funding	22	7	7	6	1	1	91	135
Debt certificates	9	6	3	21	6	1	0	46
Other ³	4	0	0	0	0	0	45	49
Liquidity gap (excl. undrawn commitments)	-14	-8	-1	41	35	37	-91	0
Undrawn commitments							-34	
Financial guarantees							-17	
Net liquidity gap (incl. undrawn commitments)	-14	-8	-1	41	35	37	-142	-51

¹ The 2008 figures have been restated to include outflow of financial guarantees.

² Professional funding includes all deposits from credit institutions and investment firms, as well as all repos with other customers. Savings certificates are included in the 'Customer funding' category, whereas they are included under 'Debt certificates' in Note 18 of the 2009 annual report.

³ MtM derivatives are reported in the not defined bucket. The 2008 figures have been restated to shift MtM on derivatives from the <= 1 month bucket to the not defined bucket.

Operational risk management and other non-financial risks

Operational risk in the KBC group is defined as 'the risk of loss resulting from inadequate or failed internal procedures, people and systems or from external events'. This definition is similar to the one given in the Basel II Capital Accord and the Capital Requirements Directive.

Operational risks at KBC include the risk of fraud, as well as legal, compliance and tax risks. The impact of incidents on the group's reputation is taken into consideration when establishing vulnerability to operational risk incidents.

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

Strategy and processes

KBC uses a single global framework (referred to below as 'the framework') to manage operational risk throughout the group. This framework consists of a governance model, a uniform methodology, a single set of concepts and tools, and centrally developed ICT applications to support reporting and monitoring. The framework covers all aspects of the end-to-end management of operational risks, ranging from risk identification to monitoring and reporting. The framework is being implemented throughout KBC under the direct supervision of the Group Operational Risk Committee (GORC).

Scope of operational risk management

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

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

Operational Risk Governance

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

The GORC advises the Group Executive Committee on the group-wide framework for managing operational risks and monitors the implementation of this framework throughout the group – including at the new group entities – and oversees the main operational risks. The Group Chief Operating Officer chairs the GORC.

Besides the GORC, there are a variety of Operational Risk Committees (ORC) at business-unit level and at various group companies. They keep close track of the practical implementation of the operational risk management framework and also take concrete measures either directly or via line management. All departments that are involved in one way or another in managing operational risks can gain access to the ORCs whenever they feel it is necessary. In addition, representatives from the internal audit, legal and compliance divisions sit on the ORCs as observers.

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

Group Value and Risk Management creates an environment where risk specialists (Information Risk Management, Business Continuity and Disaster Recovery, Compliance, Anti-Fraud, Legal, Tax, etc) work together (setting priorities, using the same language and tools, uniform reporting, etc.). Assisting this directorate are the local value and risk management units – which are likewise independent of the business – in the main bank and insurance subsidiaries.

Toolbox for the management of operational risks

KBC uses a number of tools for the actual management of operational risk. These include:

The Loss Event Database. KBC has been uniformly recording all operational losses of 1 000 euros or more in a central database since 2004. This database includes all legal claims filed against group companies. Twice a year, a consolidated loss report is submitted to the GORC, the Executive Committee and the Audit Committee.

Risk Self-Assessments. These assessments focus on actual (= residual) key operational risks at critical points in the process/organisation that are not yet properly mitigated. The assessments are forward-looking and allow future developments to be taken into account. They can be organised as brainstorming sessions or as structured interviews (e.g., with senior management). KBC organises not only bottom-up risk self-assessments that zero in on the operational risks in specific processes or parts thereof, as they are seen by the officers involved in the actual processing, but also 'top-down' assessments that aim to identify the operational risks from a management perspective.

Group Standards. KBC has defined some 40 group standards to ensure that important operational risks are managed uniformly throughout the group. Each group entity has to translate these group standards into specific local procedures. The various operational risk committees monitor the proper implementation of group standards and may allow exceptions (subject to the observance of a strict waiver procedure). Adherence to group standards is subject to reviews by GVRM and internal audit.

Recommended Practices. These help sharpen the internal controls against key risks that (i) were identified during risk self-assessments, (ii) are inherent in new activities started by a group entity, (iii) have manifested themselves through a significant loss event, or (iv) were identified by internal audit during an audit assignment.

Case Study Assessment. This is the process of testing the level of protection afforded by the current control environment against severe operational risk events that have actually happened in the banking and insurance industry. The aim is to make businesses assess the adequacy of their current internal controls in light of actual severe operational risk events that they did not readily identify during risk self-assessments (blind spot for internal fraud, extreme risks, etc.).

Key Risk Indicators. These track the exposure to potential incidents. Key risk indicators inform the management of the current level of risk exposure and/or the effectiveness of the controls in place. They may be relevant for the whole organisation or just parts of it.

Operational Risk Capital Charge

In 2002, KBC decided to apply the Standardised Approach for calculating regulatory operational risk capital.

KBC wants to focus in the first place on the (qualitative) management of operational risks, rather than concentrate on the optimisation of operational risk capital by using a financial model. However, KBC applies the same strict qualitative standards as required under the Advanced Measurement Approach. The current KBC approach does not preclude a switch to the Advanced Measurement Approach.

Under the Standardised Approach, the total capital requirement for operational risk is the simple sum of the capital requirements calculated per 'Basel Business Line'. The capital for each business line is calculated by multiplying the three-year average for eligible gross income by the beta factor assigned by the CRD to that business line.

The consolidated operational risk capital numbers are submitted for approval to the GORC.

Beta factors, operational risk

Basel Business Lines	Beta Factor	Basel Business Lines	Beta Factor
Corporate Finance	18%	Payment and Settlement	18%
Trading & Sales	18%	Agency Services	15%
Retail Banking	12%	Asset Management	12%
Commercial Banking	15%	Retail Brokerage	12%

Capital charge, operational risk

KBC group consolidated operational capital charge
In millions of EUR – applicable in 2010¹

Banking activities (CRD)	956	85%
Insurance activities (QIS 4) ²	164	15%
Total ²	1 120	100%

¹ The capital charge for 2010 is determined at year-end 2009 and based on eligible gross income for 2007, 2008 and 2009.

² The total result and the result for the insurance activities are *pro forma*, since they are not yet subject to operational risk regulations, but have already been calculated.

Other non-financial risks

Business risk

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

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

KBC reserves a separate pillar 2 capital charge specifically for business risk. Business risk capital is based on the operating expenses for the various KBC Group entities. The portion of operating expenses to be set aside as economic capital for business risk depends on the level of risk level attached to the activities of each entity.

Reputation risk

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

The pro-active and re-active management of reputation risk is the responsibility of the business, supported by many specialist units (Press Office, Investor Relations, etc.). A dedicated competence centre for reputation risk management is being established to further develop the current framework for management of reputation risk across the group.

KBC does not reserve a separate pillar 2 capital for reputation risk. The impact of reputation risk on the current business is principally covered by the capital charge for the primary risks (such as credit or operational risk). It is also covered by the capital reserved for business risk.

Business continuity management

A dedicated competence centre for Business Continuity Management (BCM) is responsible for developing a group-wide framework to ensure the continuity of operations. This framework is submitted to the Group Business Continuity Committee and the Executive Committee for approval. The unit is also responsible for overseeing the practical implementation of this framework by line management. In addition, it supervises the quality of the risk management process, analyses the main risk data and reports to the GORC.

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

Technical insurance risk management

Technical insurance risks stem from uncertainty regarding how often insured losses will occur and how extensive they will be. This is relevant primarily for losses that will arise in the future in existing insurance portfolios ('premium risk'). Premium risk can therefore be considered as the risk that the premium charged is not sufficient to cover all cash outflows resulting from the policies underwritten by the insurance company.

For losses that have already occurred, i.e. related to policies underwritten by the insurance company in the past, it is the magnitude and timing of future claims payments, in particular, that are uncertain ('reserve risk'). This is mainly the case for claims related to liability insurance. When a claim is reported, an insurance company sets up a reserve which it will use to compensate the victim for the loss or damage suffered. However, due to uncertainties, such as the evolution of the medical condition of the victim, determining the liable party, taking account of court rulings, etc., it can take some time before certain claims are settled and all payments are made to the victim.

The technical insurance risks inherent in the life insurance business can be separated from those related to the non-life insurance business. A further breakdown is often made of both categories into catastrophe (accumulation or concentration) risks and non-catastrophe risks. An important characteristic of the former is that potentially they can affect a substantial part of the portfolio at the same time, leading to an accumulation of losses. Examples of such catastrophe risks are natural disasters (e.g., windstorm, flood) in the non-life business and a pandemic threat (e.g., swine flu) in the life insurance business. Man-made catastrophes (e.g., terrorist attack) have an impact on both the life and non-life businesses.

All these risks are kept under control through appropriate acceptance, pricing, claims reserve, reinsurance and claims control policies of line management and through independent insurance risk management.

Strategy and processes

The mission of the insurance risk management within Group Value and Risk Management is to develop a group-wide framework for managing insurance risks. The insurance companies have local value and risk management entities that report to the member of the local executive committee in charge of value and risk management.

At group level, insurance risk management is responsible for providing support for local implementation and organisation processes and for the functional direction of the insurance risk management process of these subsidiary entities. Since risk management responsibilities overlap to a considerable extent with the assignments given by legislators or regulators to actuaries, whether in their capacity of certifying actuary, appointed actuary or otherwise, these actuaries are generally (but not always) employed in the central or local risk management unit.

Scope of insurance risk management

KBC's insurance risk management framework covers all material insurance entities, which implies that they have to comply fully with KBC's requirements regarding:

- governance, i.e. setting up an insurance risk committee and an insurance risk management department that is independent of the business;
- insurance risk management methodology;
- insurance risk reporting requirements.

For non-material entities, Group Value and Risk Management and the Group Insurance Risk Committee (GIRC) take over the tasks.

Internal Modelling

KBC develops models gradually, from the bottom up, for all material group-wide insurance liabilities, i.e. (i) future claims that will occur over a predefined time horizon, as well as the claims settlement pattern, (ii) the future settlement of claims (whether already reported to the insurer or not) that have occurred in the past, but have not yet been fully settled, and (iii) the impact of the reinsurance programme on these claims.

These models are/will be used to steer the group's insurance entities towards creating more shareholder value, by means of applications to calculate economic capital, support decisions on reinsurance, calculate the *ex post*

profitability of specific sub-portfolios and set off economic capital requirements against the relevant return in pricing insurance policies.

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

Best estimate process

The Insurance Risk Management Division developed a best estimate framework that was validated by the independent validation unit. This framework is an important tool in assessing the reserve risk and governs the process (data gathering, data reconciliation, methodology, reporting) of the best estimate analyses concerning the non-life technical provisions of the different non-life businesses at KBC. The best estimate analyses provide an estimation of the total claim cost per accident year⁶. These expected claim costs are then used to measure the economic profitability of the different lines of business and to comply with the IFRS 4 Liability Adequacy Test.

By developing the guidelines of the process, this document creates a common ground for best estimate analyses across KBC and prepares subsidiaries for the upcoming Solvency II and IFRS 4 Phase 2 regulations. Although currently still in a transition phase, these analyses are performed by the local business and validated afterwards by the local insurance risk management.

Stress testing & scenario analysis

Stress testing is considered as a necessary and relevant risk management tool whereby appropriate stress tests are developed in line with the development of internal models. These tests include both model risk and risk profile stress tests. The former are performed in order to assess the uncertainty inherent in the model used. The latter are performed to give management a better insight into the developed models and encompass, among other things, 'as-if' calculations of historic events. For example, KBC's internal natural catastrophe models are able to estimate the anticipated claim costs, should natural disasters that have been observed in the past occur again today. Moreover, they can determine the expected impact on bottom-line economic profit of natural catastrophe events, which are expected to occur on average only once within a given time frame (e.g., every 100 or 250 years).

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

In addition to these stress tests, scenario analysis is performed to assess the possible impact of certain extreme events.

(Technical) insurance risk mitigation

The insurance portfolios are protected against the impact of serious claims by means of reinsurance. These reinsurance programmes are divided up into three main groups: property insurance, liability insurance and personal insurance, which are re-evaluated and re-negotiated every year.

Most of the reinsurance contracts are concluded on a non-proportional basis, which provides cover against the impact of serious claims or loss events. The reinsurance programmes of the individual subsidiaries have to be

⁶ Accident year refers to the year in which the claim occurred.

determined in such a way that the retained insurance risks remain within the limits determined each year by the GIRC.

The independent insurance risk management function is also responsible for advising on the restructuring of the reinsurance programmes, especially with a view to creating shareholder value. This approach has resulted in optimising the retention of KBC particularly in respect of its exposure to natural catastrophe risk.

Technical provisions and loss triangles, non-life

As part of its mission to independently monitor insurance risks, the Group Value and Risk Management Directorate regularly carries out in-depth studies. They confirm that there is a high degree of probability that the technical provisions at subsidiary level are adequate. These liability adequacy tests are performed per business line at subsidiary level and the overall adequacy is assessed at subsidiary level for all business lines combined.

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

The first row in the table shows the total claims burden (claims paid plus provisions) for the claims that occurred during a particular year, as estimated at the end of the year of occurrence. The following rows indicate the situation at the end of the subsequent calendar years. The amounts were restated to reflect exchange rates at year-end 2009.

Loss triangles, KBC Insurance - In millions of EUR

	Year of occurrence								
	2001	2002	2003	2004 ¹	2005 ^e	2006	2007	2008 ³	2009
Estimate at the end of the year of occurrence	811	924	772	1 070	1 100	1 182	1 254	1 387	1 464
1 year later	755	813	790	972	1 003	1 071	1 163	1 332	-
2 years later	705	821	757	928	968	1 044	1 120	--	-
3 years later	724	815	738	914	967	1 030	-	-	-
4 years later	716	805	722	905	948	-	-	-	-
5 years later	704	790	694	900	-	-	-	-	-
6 years later	710	784	686	-	-	-	-	-	-
7 years later	706	779	-	-	-	-	-	-	-
8 years later	709	-	-	-	-	-	-	-	-
Current estimate	709	779	686	900	948	1 030	1 120	1 332	1 464
Cumulative payments	-578	-653	-554	-712	-706	-718	-755	-759	-555
Current provisions	131	126	132	188	243	312	366	572	909

¹ From the 2004 financial year, WARTA's figures have been included. If this company had not been taken into account, the following amounts would have been arrived at for financial year 2004 (amount and year of occurrence): 691 for 2001; 773 for 2002; and 688 for 2003.

² From the 2005 financial year, Assurisk's figures have been included. If these figures had not been taken into account, the following amounts would have been arrived at for financial year 2005 (amount and year of occurrence): 710 for 2001; 807 for 2002; 755 for 2003; and 943 for 2004.

³ From the 2008 financial year, the figures for ČSOB Poist'ovňa (Slovak Republic) and DZI Insurance (Bulgaria) have been included. If these figures had not been taken into account, the following amounts would have been arrived at for financial year 2008 (amount and year of occurrence): 705 for 2001; 783 for 2002; 692 for 2003; 903 for 2004; 950 for 2005; 1 027 for 2006 and 1 120 for 2007.