

A close-up photograph of a person's hand holding a silver pen, poised to write on a document. The background is a blurred office desk with various papers, including one with a colorful bar chart. A large, semi-transparent blue circle is overlaid on the center of the image, containing the text 'Risk Report'.

Risk Report

Contact details: Investor Relations Office

investor.relations@kbc.com

www.kbc.com

KBC Group NV, Investor Relations Office, Havenlaan 2, 1080 Brussels, Belgium.

Contact details: Press Office

Viviane Huybrecht (General Manager, Group Communication).

+ 32 2 429 85 45

pressofficekbc@kbc.be


KBC Group NV, Group Communication, Havenlaan 2, 1080 Brussels, Belgium.



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Introduction:
Highlights in 2014
and Disclosure
Policy

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

Highlights in 2014

- Continued strong liquidity position at year-end (NSFR at 110% and LCR at 120%).
- Successful issue of an additional tier-1 instrument totalling 1.4 billion euros and of tier-2 instruments worth 0.9 billion euros.
- KBC Financial Product's legacy CDO exposure completely reduced when the remaining transactions were de-risked.
- Successful implementation of the Basel III regulations and the Banking Act.
- Stress test thresholds exceeded in the comprehensive assessment conducted by the ECB and a strong buffer maintained.
- AQR completed and the major recommendations proactively addressed. Impact reflected in the figures for 2014.
- Successful completion of the divestment programme. The sale of KBC Bank Deutschland was completed in September, the activities of Antwerp Diamond Bank were put into run down and the two remaining CDOs in the portfolio were de-risked.
- Common equity ratio (Basel III fully loaded based on Danish Compromise) of 14.3% at year-end.

Disclosure policy

In line with its general communication policy, KBC aims to be as open as possible when communicating to the market about its exposure to risk. Risk management information is therefore provided in a separate section of the 2014 Annual Report of KBC Group NV and – more extensively – in this publication.

The most important regulations governing risk and capital management are the Basel III capital requirements applying to banking entities, and the Solvency I capital framework applying to insurance entities. In 2014, the Basel II capital requirements were replaced by the Basel III framework, which will

gradually enter into effect. Solvency I will be replaced by the fundamentally reformed Solvency II framework, which will officially enter into force in January 2016.

The Risk Report for 2014 is based on Basel III's third pillar and the resulting disclosure requirements of the Capital Requirements Regulation. Although the disclosures mostly refer to the Basel III first pillar risk metrics and focus on banking entities, KBC – as a bank-insurance company – decided to extend the scope to the insurance activities in order to provide an overall view of the KBC group's risk exposure and risk management activities.

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

Disclosures required under Pillar 3 are only incorporated if they are deemed relevant for KBC. Information is disclosed at the highest consolidated level. Additional information, specifically on the material entities, is confined to the capital information in the section on 'Capital adequacy'. For more detailed information, please refer to the local capital disclosures of the entity concerned (for instance, those provided on their websites).

Please note that:

- KBC Bank Deutschland was recognised as a 'disposal group' under IFRS 5 in 2013. In the various tables of this section, this entity has been excluded from the 2013 figures, but, where relevant, summary information has been provided for it separately in the footnotes under these tables. KBC Bank Deutschland was sold in 2014.
- Antwerp Diamond Bank was originally recognised as a 'disposal group' under IFRS 5 in 2013, but was consolidated again in 2014 (the sale of the entity did not go through and was replaced by an orderly run-down of its activities). Consequently, Antwerp Diamond Bank has been included in the 2013 and 2014 figures in the various tables.
- Due to the adoption of IFRS 11 in 2014, the reference figures for 2013 have been restated retroactively. This standard stipulates that joint ventures must be accounted for using the equity method instead of the proportionate consolidation method. For KBC, this only applies to Českomoravská Stavební Spořitelna (ČMSS), a joint venture of ČSOB in the Czech Republic.

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

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

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

In addition, the Risk Report for 2014 was distributed to the Group Executive Committee, the Board of Directors, as well as to the Risk & Compliance Committee to ensure the appropriate approval of the management body as requested under Basel III.

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

CRD III (since the end of 2011) and CRD IV (since 1 January 2014) have also required the disclosure of information on the remuneration policy of financial institutions. More information in this regard can be found in the 'Corporate governance' section of the 2014 Annual Report of KBC Group NV and in a separate disclosure 'KBC Group Compensation Report' which is published along with the Annual Report and the Risk Report at www.kbc.com.

This risk report is available in English on the KBC website and is updated on a yearly basis. KBC's next update is scheduled for the beginning of April 2016. Depending on market requirements, KBC may however decide to provide more frequent updates.



Risk Management
Governance

Our risk governance model is characterised primarily by:

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

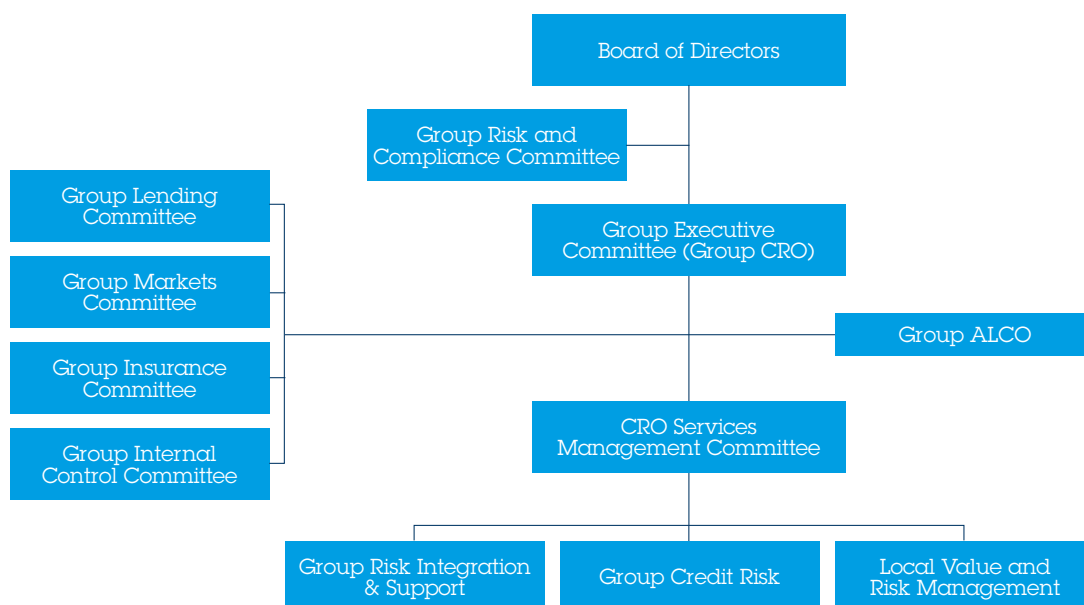
Relevant risk management bodies and control functions:

- Group Executive Committee:
 - makes proposals to the Board of Directors about risk and capital strategy, risk appetite, and the general concept of the KBC Risk Management Framework;
 - decides on the non-strategy-related building blocks of the KBC Risk Management Framework and monitors its implementation throughout the group;
 - allocates capital to activities in order to maximise the risk-adjusted return;
 - acts as the leading risk committee, covering material issues that are channelled via the specific risk committees or the Group Asset/Liability Management Committee (Group ALCO);
 - monitors the group's major risk exposure to ensure conformity with the risk appetite.
- Group ALCO:
 - is a business committee that assists the Group Executive Committee in the domain of (integrated) balance sheet management at group level. It handles matters related to ALM and liquidity risk.
- Risk committees:
 - The CRO Services Management Committee supports the Group Executive Committee in assessing the adequacy of, and compliance with, the KBC Risk Management Framework and defines and implements the vision, mission and strategy for the CRO Services of the KBC group.
 - The Group Lending Committee (GLC) supports the Group Executive Committee in setting, monitoring and following up limits for lending activities (funding, liquidity and ALM issues related to lending activities remain the responsibility of the Group Executive Committee/ Group ALCO).
 - The Group Markets Committee (GMC) supports the Group Executive Committee in setting, monitoring and following up limits for markets activities (trading activity, where there is not only market risk, but also operational and counterparty credit risks).
 - The Group Insurance Committee (GIC) supports the Group Executive Committee in setting, monitoring and following up limits for insurance activities at group level.
 - The Group Internal Control Committee (GICC) supports the Group Executive Committee in monitoring and strengthening the quality and effectiveness of KBC's internal control system.

- Local Chief Risk Officers (LCROs) are situated throughout the group according to a logical segmentation based on entity and/or business unit. Close collaboration with the business is assured since they take part in the local decision-making process. Independence of the LCROs is achieved through a direct reporting line to the Group CRO.
- Group Risk Integration & Support and Group Credit Risk (known collectively as ‘the Group risk function’) have a number of responsibilities, including monitoring risks at an overarching group-wide level, developing risk and capital models (while business models are developed by business), performing independent validations of all risk and capital models, developing risk frameworks and advising/reporting on issues handled by the Group Executive Committee and the risk committees.

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

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





Capital Adequacy

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

Strategy and processes

In order to assess capital adequacy within the group, we use a multi-dimensional approach where the capital situation is assessed and set off against minimum targets at group and local entity level:

- from a regulatory (i.e. pillar 1 of CRR/CRD IV) and an economic (i.e. pillar 2 of CRR/CRD IV) point of view;
- in the current situation and over a three-year time horizon;
- under different macroeconomic and business conditions: likely scenarios (including base case scenario), a recession scenario (which can be one of the likely scenarios) and internally defined stress scenarios.

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

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

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

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

Regulatory solvency disclosures

Scope of solvency disclosures

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

The disclosure templates with regard to own funds – as imposed by Implementing Regulation (EU) No. 1423/2013 – can be found in the annexes published separately with this report.

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

Overview of group solvency in 2014

We report the solvency of the group based on IFRS data and according to the rules imposed by the regulator. For the KBC group, this implies that we calculate our solvency ratios based on Basel III and the corresponding European regulation and directive (CRR/CRD IV). This regulation entered gradually into force on 1 January 2014, and will be fully implemented by 1 January 2022.

The general rule under CRR/CRD IV for insurance participations is that an insurance participation is deducted from common equity at group level, unless the competent authority grants permission to apply a risk weighting instead (Danish compromise). KBC received such permission from the supervisory authority and hence reports its solvency on the basis of a 370% risk weighting being applied to the holdings of own fund instruments of the insurance company, after having deconsolidated KBC Insurance from the group figures.

At 31 December 2014, the total capital ratio amounted to 18.3%.

Moreover, the supervisory authorities (with the NBB as the consolidating supervisor) requested at the end of 2013 that a permanent minimum fully loaded common equity ratio of 9.25%, excluding latent gains, be maintained. According to the latter calculation, this ratio (under the Danish compromise method) stood at 13.6% at year-end 2014, which represented a capital buffer of 4 billion euros relative to the targeted 9.25%.

Regulatory minimum solvency targets were amply exceeded in 2014, not only at year-end, but also throughout the entire financial year.

In mid-March 2015, we received a new target for this ratio from the ECB, which had assumed responsibility from the NBB in November 2014 for supervising KBC under the Single Supervisory Mechanism (SSM). Consequently, KBC Group is required to maintain a minimum fully loaded common equity ratio (including latent gains on available-for-sale securities) of 10.5%. At year-end 2014, this ratio (under the Danish compromise method) was 14.3%, which represented a capital buffer of 3.5 billion

euros relative to the targeted 10.5%.

In addition to the solvency ratios under CRR/CRD IV, KBC – as a financial conglomerate – now also has to disclose its solvency position as calculated in accordance with the Financial Conglomerate Directive (FICOD; 2002/87/EC). Previously, KBC Group NV – as a financial holding company – did not fall under the scope of that directive, but reported on one solvency calculation at group level, the ‘building block’ method, at the request of the NBB. KBC will meet this requirement by aligning the building block method with method 1 (the accounting consolidation method) under FICOD. This implies that available capital will be calculated on the basis of the consolidated position of the group and the eligible items recognised as such under the prevailing sectorial rules, which are CRR/CRD IV for the banking business and Solvency I for the insurance business. To date, available capital had been determined under the building block method solely on the basis of bank capital rules. Nothing will change in the calculation of risk weighted assets. In other words, the capital requirements for the insurance business based on Solvency I will be multiplied by 12.5 to obtain a risk weighted asset equivalent. At year-end 2014, the fully loaded common equity ratio (under FICOD) was 14.6%, which represented a capital buffer of 3.8 billion euros relative to the targeted 10.5%.

Solvency at group level (consolidated; Danish compromise – fully loaded) (in millions of EUR)	31-12-2013	31-12-2014
Total regulatory capital, after profit appropriation	16 258	16 688
Tier-1 capital	11 711	14 476
Common equity¹	11 711	13 076
Parent shareholders’ equity (after deconsolidation KBC Insurance)	11 361	12 592
Non-voting core-capital securities	2 333	2 000
Intangible fixed assets, incl. deferred tax impact (-)	-341	-334
Goodwill on consolidation, incl. deferred tax impact (-)	-950	-769
Minority interests	-3	-3
Hedging reserve, cashflow hedges (-)	497	1 391
Valuation differences in financial liabilities at fair value – own credit risk (-)	-6	-21
Valuation adjustment due to requirements for prudent valuation (-) ²	0	-92
Equalisation reserve (-)	-131	0
Dividend payout (-)	0	-836
Coupon on government securities (-)	0	-171
Coupon on AT1 instruments (-)	0	-2
Deduction with regard to financing provided to shareholders (-)	-176	-159
IRB provision shortfall (-)	-225	-225
Deferred tax assets on losses carried forward (-)	-648	-297
Additional going concern capital²	0	1 400
Grandfathered innovative hybrid tier-1 instruments	0	0
Grandfathered non-innovative hybrid tier -1 instruments	0	0
CRR-compliant AT1 instruments	0	1 400
Minority interests to be included in additional going concern capital	0	0
Tier-2 capital	4 547	2 212
IRB provision excess (+)	342	375
Subordinated liabilities	4 206	1 837
Subordinated loans non-consolidated financial sector entities (-)	0	0
Minority interests to be included in tier-2 capital	0	0
Total weighted risk volume	91 216	91 236

Banking	80 189	80 232
Insurance	11 068	10 897
Holding-company activities	72	191
Elimination of intercompany transactions	-113	-85
Solvency ratios		
Common equity ratio	12.8%	14.3%
Tier-1 ratio	12.8%	15.9%
Total capital ratio	17.8%	18.3%

1 Audited figures (excluding 'IRB provision shortfall' and 'Value adjustment due to requirements for prudent valuation').

2 CRR ensures that prudent valuation is reflected in the calculation of available capital. This means that the fair value of all assets measured at fair value that impact the available capital (by means of fair value changes in P&L or equity) need to be brought back to their prudent value. The difference between the fair value and the prudent value (also called the 'additional value adjustment' or AVA) must be deducted from the CET1 ratio.

Solvency at group level (consolidated; under CRD IV/ CRR, fully loaded versus phased-in approach) (in millions of EUR or %)	31-12-2013 Fully loaded	31-12-2013 Phased-in	31-12-2014 Fully loaded	31-12-2014 Phased-in
Danish compromise method				
Common equity	11 711	12 095	13 076	12 684
Total weighted risk volume	91 216	91 216	91 236	88 382
Common equity ratio	12.8%	13.3%	14.3%	14.4%
Tier-1 ratio	12.8%	15.3%	15.9%	16.0%
Total capital ratio	17.8%	18.4%	18.3%	18.9%

Additional information concerning the calculation of solvency according to CRR/CRDIV (Danish compromise method, fully loaded):

- Parent shareholders' equity: see 'Consolidated statement of changes in equity' in the 'Consolidated financial statements' section of the KBC Group Annual Report.
- Non-voting core-capital securities: see 'Capital transactions and guarantee agreements with the government in 2008 and 2009' in the 'Additional information' section of the KBC Group Annual Report.
- CRR-compliant additional tier-1 instruments: the increase in 2014 was due to the placement in March 2014 of a CRR-compliant additional tier-1 instrument for 1.4 billion euros.
- Total weighted risk volume: since its implementation in 2008, the Internal Rating Based (IRB) approach has primarily been used by KBC to calculate its risk weighted assets. Based on a full application of all the CRR/CRD IV rules, it is used for approximately 80% of the weighted credit risks, approximately 68% of which are calculated according to the Advanced approach and roughly 12% according to the Foundation approach. The remaining weighted credit risks (about 20%) are calculated according to the Standardised approach. The 2013 reference figures for total weighted risk volume have been restated to account for the different treatment of the joint venture ČMSS in the Czech Republic Business Unit (shift from proportionate consolidation to the equity method – for more information, see Note 1a of the 'Consolidated financial statements' section of the KBC Group Annual Report). The increase in weighted risks in 2014 was largely driven by a change in methodology, where the 'carve out' of home-country sovereign bonds (risk weighting these bonds at zero percent) was no longer applied. This change increased risk weighted assets by approximately 4.4 billion euros, as calculated based on positions at the end of 2013.

At year-end 2014, the fully loaded Basel III leverage ratio – based on current CRR legislation – stood

at 6.4% for the KBC group at the consolidated level. This includes the remaining state aid of 2 billion euros (as agreed with regulator) and the requirements for prudent valuation.

Solvency, KBC Bank (consolidated)

The table shows the common equity, tier-1 and CAD ratios calculated under CRR/CRD IV, which entered into force on 1 January 2014. The common equity ratio (fully loaded) of KBC Bank amounts to 12.1% (12.2% based on the phased-in method).

Solvency, KBC Bank (consolidated; CRR/CRD IV – fully loaded) (in millions of EUR)	31-12-2013	31-12-2014
Total regulatory capital, after profit appropriation	14 400	14 154
Tier-1 capital	9 602	11 132
Common equity*	9 602	9 727
Parent shareholders' equity (excluding minorities)	11 662	11 676
Intangible fixed assets, incl. deferred tax impact (-)	-105	-114
Goodwill on consolidation, incl. deferred tax impact (-)	-944	-915
Minority interests	147	15
Hedging reserve, cashflow hedges (-)	522	1 391
Valuation differences in financial liabilities at fair value – own credit risk (-)	-6	-21
Valuation adjustment due to requirements for prudent valuation (-)	-	-92
Dividend payout (-)	-677	-1 574
Remuneration of AT1 instruments (-)	-	-2
Deduction with regard to financing provided to shareholders (-)	-176	-159
IRB provision shortfall (-)	-225	-225
Deferred tax assets on losses carried forward (-)	-595	-254
Limit on deferred tax assets from timing differences relying on future profitability and significant participations in financial sector entities (-)	0	0
Additional going concern capital	0	1 405
Grandfathered innovative hybrid tier-1 instruments	0	0
Grandfathered non-innovative hybrid tier -1 instruments	0	0
CRR-compliant AT1 instruments	0	1 400
Minority interests to be included in additional going concern capital	0	5
Tier-2 capital*	4 797	3 021
IRB provision excess (+)	342	375
Subordinated liabilities	4 456	2 640
Subordinated loans non-consolidated financial sector entities (-)	0	0
Minority interests to be included in tier-2 capital	0	7
Capital requirement		
Total weighted risk volume	79 822	80 232
Solvency ratios		
Common equity ratio	12.03%	12.12%
Tier-1 ratio	12.03%	13.87%
Total capital ratio	18.04%	17.64%
Capital buffer		
Common equity capital (excl. AFS)	9 340	9 049
Required pillar 2 capital (9.25% CET1)	7 384	7 421
Capital buffer vis-à-vis pillar 2 target	1 956	1 628
Common equity tier 1 ratio (excl. AFS)	11.70%	11.28%

* Audited figures.

Solvency, material banking subsidiaries

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

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

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

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

Solvency, material banking subsidiaries (in millions of EUR)		31-12-2013			31-12-2014		
		Total regulatory capital	Total weighted risk	CAD ratio	Total regulatory capital	Total weighted risk	CAD ratio
CBC Banque	Belgian GAAP	433	2 434	17.8%	462	2 690	17.2%
ČSOB (Czech Republic)	IFRS	2 030	13 289	15.3%	1 960	11 766	17.0%
ČSOB (Slovak Republic)	IFRS	555	3 839	14.5%	532	3 179	16.7%
KBC Bank Ireland	IFRS	938	7 333	12.8%	902	579	12.7%
K&H Bank	IFRS	601	4 506	13.3%	579	4 412	13.1%

Solvency, KBC Insurance (consolidated)

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

Some specific elements in the available capital calculation are:

- The equalisation reserve – calculated under Belgian GAAP – which is deducted from available capital.
- The available capital, which includes
 - 80% of net latent gains on bonds held by KBC Insurance NV (excluding latent gains of subsidiaries of KBC Insurance NV; net latent losses are not deducted);
 - 90% of net latent gains on AFS shares held by KBC Insurance NV (excluding latent gains of subsidiaries of KBC Insurance NV; net latent losses are not deducted)

The Solvency I capital ratio amounted to 323% at the end of 2014, comfortably above the minimum regulatory solvency requirement of 100%.

Under Solvency I, the solvency capital requirements are purely volume-based (maximum of a percentage of the premium and a percentage of the claims cost) and do not take into account the asset mix and asset quality. In order to improve the capital regulations, a new EU solvency regime (Solvency II) is being drafted (see separate section on Solvency II).

Solvency, KBC Insurance (in millions of EUR)	31-12-2013	31-12-2014
Available capital	2 721	3 166
Parent shareholders' equity	3 295	3 296
Dividend payout (-)	-252	-50
Minority interests	0	0
Subordinated liabilities	0	0
Intangible fixed assets (-)	-10	-9
Goodwill on consolidation (-)	-150	-150
Revaluation reserve available-for-sale investments (-)	-830	-1 149
Equalisation reserve (-)	-131	-147
Equity guarantee (Belgian State)	3	0
Cashflow hedge	-25	-23
90% of positive revaluation reserve, available-for-sale shares	188	188
Latent gains on bonds	633	1 211
Required solvency margin	968	981
Non-life and industrial accidents – legal lines	207	208
Annuities	7	7
Subtotal, non-life	214	215
Class 21	735	745
Class 23	17	19
Subtotal, life	752	764
Other	2	1
Solvency ratios and surplus		
Solvency ratio (%)	281%	323%
Solvency surplus	1 753	2 185

Comprehensive assessment of the European Central Bank

At the end of October 2014, the European Central Bank (ECB) and the National Bank of Belgium announced the results of the comprehensive assessment carried out by the ECB.

The exercise consisted of a review of the books ending on 31 December 2013 (an asset quality review or AQR) and a stress test over a three-year horizon (2014-2016). The stress test started from the AQR-adjusted balance sheet as of year-end 2013 and hence included conservative adjustments.

The AQR was held to enhance the transparency of banks' balance sheets by reviewing the quality of their assets, including the adequacy of asset and collateral valuations and related provisions.

The stress test was performed in close cooperation with the European Banking Authority (EBA), using a common methodology. It examined the resilience of banks' balance sheets and earning power to stress scenarios. The stress test incorporated the simulated impact over a three-year period of two scenarios, namely a baseline scenario and an adverse scenario. Both scenarios were based on a number of assumptions (e.g., a stable balance sheet) and hence were of a hypothetical nature, which is inherent to any stress test.

Whereas the comprehensive assessment targeted the KBC group, only the consolidated accounts of

KBC Bank were subject to the book review (AQR). The same held true for the stress test, where the impact of scenarios on the banking activities (not the insurance business) was calculated. The capital position (CET1 ratio), however, was measured at the level of the KBC group.

The impact of the stress test on the Common Equity Tier-1 ratio (CET1 ratio) under the adverse scenario in 2016 caused the CET1 ratio to fall by 2.6 percentage points. The impact of the asset quality review (AQR) was limited, reducing the CET1 ratio by 0.6 percentage points.

The combined impact of the repayment of state aid, as agreed with the European Commission, during the three-year stress test horizon (1.8 billion euros including penalties and coupon), the AQR and the pure stress test, resulted in a CET1 ratio of 8.3%, which represents a considerable buffer of 2.8 percentage points (2.8 billion euros) above the ECB-imposed threshold of 5.5%, thus illustrating KBC's resilience.

KBC's management considered all the AQR adjustments and recommendations where relevant for the 2014 financial statements, while taking account of KBC's IFRS valuation rules. During 2014, the main recommendations were proactively addressed and the impact recognised in the results for 2014:

- Our analysis revealed that the AQR adjustments for the sampled credit files in the selected portfolios were largely recorded during 2014 as part of the normal credit process. The additional provisions recorded in 2014 on the sampled files resulted mainly from full implementation of the new forbearance rules by the third quarter of 2014 and from new facts and/or information on the specific files that became available during 2014.
- The AQR adjustments related to collective provisioning (KBC Ireland). The recommendations related to parameters and assumptions in the provisioning model were factored in and reflected in the 2014 accounts, where required by IFRS.
- KBC developed a new CVA model which incorporated the AQR recommendations. This model was implemented in the fourth quarter of 2014 and, therefore, the impact of the AQR adjustment on the CVA is properly reflected in the 2014 accounts.

Economic capital

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

We define economic capital as the amount of capital required to absorb very severe losses, expressed in terms of the potential reduction in the economic value of the group (i.e. the difference between the current economic value and the worst-case economic value over a one-year time horizon and at a certain confidence level), in line with the risk appetite set by the Board of Directors. We calculate economic capital per risk category using a common denominator (the same time horizon of one year and the same confidence interval) and then aggregate them. Since it is extremely unlikely that all risks will materialise at the same time, an allowance is made for diversification benefits when aggregating the individual risks.

Economic capital is used as a major building block for Internal Capital Adequacy Assessment Process (ICAAP). In addition, it provides essential input for risk-adjusted performance measurement (see below).

New guidelines could lead to review of the economic capital and ICAAP methodology.

In accordance with the CRR/CRD IV, pillar 2 requirements, KBC has an ICAAP in place. In addition to the regulatory capital requirements, this process also uses an economic capital model to measure capital requirements based on aggregate group-wide risks, and to compare 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, both regulatory and economic, according to a basic scenario that takes account of anticipated internal and external growth, and according to various alternative scenarios and a recession scenario.

Risk-Adjusted Performance Measurement

In 2011, KBC developed a Risk-Adjusted Performance Measurement (RAPM) policy, whereby risk-adjusted performance metrics (risk-adjusted profit, return on capital, group economic value added) were used for allocating capital and setting variable remuneration. The capital allocation track of this policy is embedded in the strategic planning process. The remuneration policy also includes risk-adjusted features based on RAPM metrics. These risk measures are calculated and reported quarterly.

Risk-adjusted measures calculate profitability using expected losses, i.e. losses that are expected given the risk profile of the portfolio. Using expected losses and hence a longer term view of the profitability of the portfolio not only guarantees that management is aware of risks when times are good, but also avoids disproportionate decisions and actions being taken during adverse economic periods.

The basic idea behind the risk adjustment of the capital base in the RAPM is that regulatory capital has limited coverage in terms of risk types and only partly reflects the specific characteristics of KBC. Economic capital covers a broader scope of risk and reflects KBC's own estimates of the risk profile.



Liquidity Risk Management

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

The principal objective of our liquidity management is to be able to fund the group and to enable the core business activities of the group to continue to generate revenue, even under adverse circumstances. Since the financial crisis, there has been a greater focus on liquidity risk management throughout the industry, and this has been intensified by the minimum liquidity standards defined by the Basel Committee and transposed into European law through CRD IV/CRR for the liquidity coverage ratio. We continue to incorporate these concepts into our liquidity and funding framework, as well as into our financial planning.

Strategy and processes

A group-wide 'liquidity risk management framework' is in place to define the risk playing field.

Liquidity management itself is organised within the Group Treasury function, which acts as a first line of defence and is responsible for the overall liquidity and funding management of the KBC group. The Group Treasury function monitors and steers the liquidity profile on a daily basis and sets the policies and steering mechanisms for funding management (intra-group funding, funds transfer pricing). These policies ensure that local management has an incentive to work towards a sound funding profile. It also actively monitors its collateral on a group-wide basis and is responsible for drafting the liquidity contingency plan that sets out the strategies for addressing liquidity shortfalls in emergency situations.

Our liquidity risk management framework is based on the following pillars:

- Contingency liquidity risk. This risk is assessed on the basis of liquidity stress tests, which measure how the liquidity buffer of the group's bank entities changes under extreme stressed scenarios. This buffer is based on assumptions regarding liquidity outflows (retail customer behaviour, professional client behaviour, drawing of committed credit lines, etc.) and liquidity inflows resulting from actions to increase liquidity ('repoing' the bond portfolio, reducing unsecured interbank lending, etc.). The liquidity buffer has to be sufficient to cover liquidity needs (net cash and collateral outflows) over (i) a period that is required to restore market confidence in the group following a KBC-specific event, (ii) a period that is required for markets to stabilise after a general market event and (iii) a combined scenario, which takes a KBC-specific event and a general market event into account. The overall aim of the liquidity framework is to remain sufficiently liquid in stress situations, without resorting to liquidity-enhancing actions which would entail significant costs or which would interfere with the core banking business of the group.
- Structural liquidity risk. We manage our funding structure so as to maintain substantial diversification, to minimise funding concentrations in time buckets, and to limit the level of reliance on short-term wholesale funding. We manage the structural funding position as part of

the integrated strategic planning process, where funding – in addition to capital, profits and risks – is one of the key elements. At present, our strategic aim for the next few years is to build up a sufficient buffer in terms of the Basel III LCR and NSFR requirements via a funding management framework, which sets clear funding targets for the subsidiaries (own funding, reliance on intra-group funding) and provides further incentives via a system of intra-group pricing to the extent subsidiaries run a funding mismatch.

In the table below, we have illustrated the structural liquidity risk by grouping the assets and liabilities according to the remaining term to maturity (contractual maturity date). The difference between the cash inflows and outflows is referred to as the 'net funding gap'. At year-end 2014, KBC had attracted 26 billion euros' worth of funding on a gross basis from the professional interbank and repo markets.

- Operational liquidity risk. Operational liquidity management is conducted in the treasury departments, based on estimated funding requirements. Group-wide trends in funding liquidity and funding needs are monitored on a daily basis by the Group Treasury function, ensuring that a sufficient buffer is available at all times to deal with extreme liquidity events in which no wholesale funding can be rolled over.

Scope of liquidity risk management

This liquidity risk report covers most material entities of the KBC group that carry out banking activities, i.e. KBC Bank NV, CBC Banque SA, ADB, KBC Lease, KBC Investments Limited (formerly KBC Financial Products), ČSOB Czech Republic, ČSOB Slovak Republic, KBC Bank Ireland, CIBANK, KBC Credit Investments, KBC Finance Ireland, KBC Commercial Finance, IFIMA and K&H Bank. KBC Insurance entities are not included, since they are generally liquidity providers and not liquidity users.

Structural liquidity risk

The table below illustrates structural liquidity risk by grouping the assets and liabilities according to the remaining term to maturity (contractual maturity date). The difference between the cash inflows and outflows is referred to as the 'net funding gap'.

Liquidity risk (excluding inter-company deals)* (in billions of EUR)	<= 1 month	1-3 months	3-12 months	1-5 years	5-10 years	> 10 years	On demand	not defined	Total
31-12-2013									
Total inflows	18	10	18	52	41	33	4	31	206
Total outflows	27	12	20	29	7	2	81	28	206
Professional funding	18	2	2	1	0	0	1	1	25
Customer funding	7	6	12	13	3	1	80	0	123
Debt certificates	0	4	6	15	3	1	0	0	29
Other	2	0	0	0	0	0	0	27	29

Liquidity gap (excl. undrawn commitments)	-10	-2	-2	23	35	31	-77	2	0
Undrawn commitments	-	-	-	-	-	-	-	-25	-
Financial guarantees	-	-	-	-	-	-	-	-10	-
Net funding gap (incl. undrawn commitments)	-10	-2	-2	23	35	31	-77	-33	-35
31-12-2014									
Total inflows	16	8	16	55	45	33	3	35	211
Total outflows	35	9	15	31	8	1	84	27	211
Professional funding	15	3	1	5	0	0	0	0	26
Customer funding	17	5	9	11	4	0	84	0	130
Debt certificates	0	2	4	14	4	1	0	0	26
Other	2	-	-	-	-	-	-	27	30
Liquidity gap (excl. undrawn commitments)	-19	-1	2	24	37	32	-81	7	0
Undrawn commitments	-	-	-	-	-	-	-	-32	-
Financial guarantees	-	-	-	-	-	-	-	-10	-
Net funding gap (incl. undrawn commitments)	-19	-1	2	24	37	32	-81	-34	-42

* Cashflows exclude interest rate flows consistent with internal and regulatory liquidity reporting. Inflows/outflows that arise from margin calls posted/received for MtM positions in derivatives are reported in the 'not defined' bucket. In 2013, KBC Bank Deutschland (see the relevant remark towards the start of this report) had an impact of 1.9 billion euros. 'Professional funding' includes all deposits from credit institutions and investment firms, as well as all repos. Instruments are classified on the basis of their first callable date. Some instruments are reported at fair value (on a discounted basis), whereas others are reported on an undiscounted basis (in order to reconcile them with Note 18 of the 'Consolidated financial statements' section of the Annual Report of KBC Group NV). Due to the uncertain nature of the maturity profile of undrawn commitments and financial guarantees, these instruments are reported in the 'not defined' bucket. The category 'other' under 'Total outflows' contains 'own equity, short positions, provisions for risks and charges, tax liabilities and other liabilities.

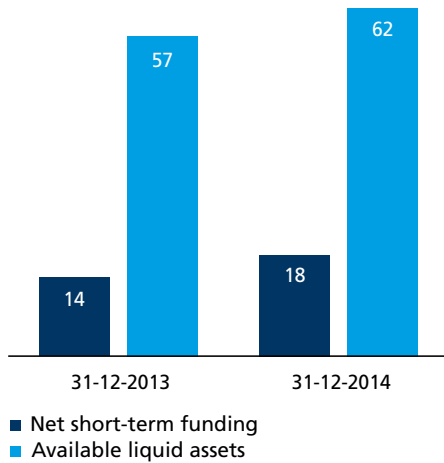
Typical for a banking group, funding sources generally have a shorter maturity than the assets that are funded, leading to a negative net liquidity gap in the shorter time buckets and positive net liquidity gap in the longer term buckets. This creates liquidity risk if KBC would be unable to renew maturing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

Liquid asset buffer

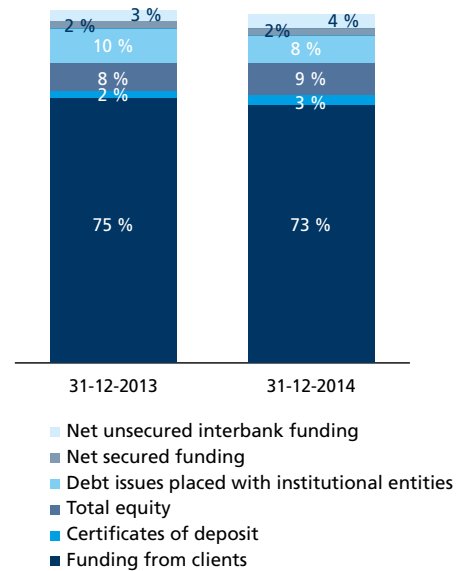
The KBC group has a solid liquidity position. Historically, it has always had a substantial amount of liquid assets. At year-end 2014, the KBC group had 62 billion euros' worth of unencumbered central bank eligible assets, 41 billion euros of which in the form of liquid government bonds (67%). The remaining available liquid assets were other ECB/FED eligible bonds (10%) and pledgeable credit claims (12%). Most of the liquid assets are expressed in euros, Czech koruna and Hungarian forint (all home market currencies).

Unencumbered liquid assets were more than three times the net recourse to short-term wholesale funding, while funding from non-wholesale markets was accounted for by stable funding from core customer segments in our core markets. The liquid asset buffer at year-end is presented in the graph.

Unsecured short term funding compared to liquid assets (in billions of EUR)*



Funding mix by type



Funding information

KBC continues to have a strong retail/mid-cap deposit base in its core markets, resulting in a stable funding mix. A significant portion of the funding is attracted from core customer segments and markets.

The KBC group's funding mix can be broken down as follows (figures relate to 31 December 2014):

- Funding from customers (130 billion euros, 73% of the total figure), consisting of demand deposits, time deposits, savings deposits, other deposits, savings certificates and debt issues placed in the network. Some 62% of the funding from customers relates to private individuals and SMEs.
- Debt issues placed with institutional investors (14 billion euros, 8% of the total figure), mainly comprising IFIMA debt issues (6 billion euros), covered bonds (5 billion euros), the contingent capital notes issued in January 2013 (0.75 billion euros), the additional tier-1 issue (1.4 billion euros) and tier-2 issue (0.9 billion euros).
- Net unsecured interbank funding (7 billion euros, 4% of the total figure).
- Net secured funding (4 billion euros in repo funding, 2% of the total figure) and certificates of deposit (6 billion euros, 3% of the total figure).
- Total equity (16.5 billion euros, 9% of the total figure).

Please note that:

- During 2014, KBC Bank used its EMTN programme to raise 0.3 billion euros in long-term funding.
- In November 2012, we announced our Belgian residential mortgage covered bonds programme. This 10-billion-euro programme was set up following the entry into force of the Act of 3 August

2012 that established a legal framework for Belgian covered bonds. This bond programme gives KBC access to the covered bond market, allowing it to diversify its funding structure and reduce the cost of long-term funding. At the start of December 2012, we launched a first covered bond issue in the amount of 1.25 billion euros. More issues followed in 2013 for a total of 2.7 billion euros and in 2014 for a total of 0.9 billion euros.

- In 2014, we also borrowed 2.8 billion euros from the ECB under the targeted long-term refinancing operations (TLTROs). The maturity of the TLTROs depends on future credit growth, which cannot be specified in advance.
- In 2014, we successfully issued an additional tier-1 instrument totalling 1.4 billion euros and tier-2 instruments worth 0.9 billion euros (0.75 billion of which issued in November 2014). Conversely, the innovative and non-innovative tier-1 debt instruments (totalling 2.3 billion euros) were called for redemption in May-June 2014.

LCR and NSFR

Both the Liquidity Coverage Ratio (LCR) and Net Stable Funding Ratio (NSFR) are defined in the 'Glossary' at the end of this report. At year-end 2014, our NSFR stood at 110% and our LCR at 120%. The LCR was calculated based on KBC's interpretation of CRD IV/CRR. This is well above the minimum regulatory requirements and KBC's internal floors of 105% for both ratios.

Asset encumbrance

KBC is a retail-oriented bank that finances 70% of its assets by means of customer funding. A certain reliance on long-term wholesale funding is tolerated and even desired for funding diversification and cost optimisation purposes. By the end of 2012, KBC had received approval to set up a covered bond programme, which has further diversified the investor base and offers the bank access to funding markets that remain open in times of market stress. The regulator imposed a limit on the programme corresponding to 8% of the balance sheet of KBC Bank NV (stand-alone), or 10 billion euros. When the programme reaches full capacity, it will account for about 50% of all long-term institutional wholesale funding raised by KBC. Covered bonds are not intended to increase the overall size of the balance sheet, as other sources of funding will merely be replaced by covered bonds. As a consequence, covered bonds do not negatively affect the solvency ratios or leveraging of KBC Bank. They improve solvency because the lower funding cost results in higher profit and hence improved solvency.

Besides covered bonds, KBC has also rendered part of its mortgage book liquid via the creation of RMBS notes that are almost fully retained on the balance sheet. Their prime purpose is therefore not to attract funding, but to enhance liquidity.

A relatively small part of the loan book (approximately 13 billion euros, before haircut) is pledged

directly as collateral for intraday liquidity and for TLTROs or other ECB funding. KBC prefers to record non-LCR collateral for these operations, thereby safeguarding the LCR-eligible liquidity buffer. Using this illiquid collateral increases encumbrance in relative terms due to the high haircut used.

KBC has imposed a 25% limit on the share of secured funding in the total funding mix of KBC Bank (consolidated). In this regard, secured funding includes net repo exposure (both long term and short term), covered bonds and securitised exposure amounts issued by KBC and effectively sold on the market.

KBC additionally commits to maintain unencumbered cover assets amounting to at least 5% of the total covered bond programme. This buffer can be used if there are breaches of cover asset tests, breaches of liquidity tests and breaches of committed overcollateralisation levels. The buffer should preferably be composed of mortgage loans, but can also consist of liquid ECB eligible assets. Given the regulatory imposed limit of 8% on cover assets, there should be more than sufficient mortgage assets available for the additional buffer.

The tables below show in more detail the asset encumbrance for KBC Bank (consolidated). The total volume of encumbered assets amounts to 29.5 billion euros, 42% of which debt securities (11.7 billion euros issued by general governments) and 58% loans and advances (8.9 billion euros of which in mortgage loans).

Template A-Assets

	Carrying amount of encumbered assets	Fair value of encumbered assets	Carrying amount of unencumbered assets	Fair value of unencumbered assets
	010	040	060	090
010 Assets of the reporting institution	29 468 290 906		184 748 782 828	
030 Equity instruments	0	0	3 732 368 361	3 732 368 361
040 Debt securities	12 254 596 331	13 023 028 163	37 176 696 349	39 578 781 485
120 Other assets	17 213 694 575		143 839 718 118	

All the collateral received that is encumbered is debt securities issued by general governments for a total amount of 1.2 billion euros.

Template B-Collateral received

		Fair value of encumbered collateral received or own debt securities issued	Fair value of collateral received or own debt securities issued available for encumbrance
		010	040
130	Collateral received by the reporting institution	1 206 915 739	6 873 352 814
150	Equity instruments	0	0
160	Debt securities	1 206 915 739	6 873 352 814
230	Other collateral received	0	0
240	Own debt securities issued other than own covered bonds or ABSs	0	0

The sources of asset encumbrance (i.e. the matching financial liabilities in the table below) total 28.6 billion euros and consist mainly of:

- OTC derivatives (11.2 billion euros, 39% of the total figure)
- Repurchase agreements (9.1 billion euros, 32% of the total figure)
- TLTROs (2.8 billion euros, 10% of the total figure)
- Other secured financing, excl. retail (0.6 billion euros, 2% of the total figure)
- Own covered bonds issued (4.8 billion euros, 17%)

Template C-Encumbered assets/collateral received and associated liabilities

		Matching liabilities, contingent liabilities or securities lent	Assets, collateral received and own debt securities issued other than covered bonds and ABSs encumbered
		010	030
010	Carrying amount of selected financial liabilities	28 574 701 714	29 676 990 111



Credit Risk Management

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

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

Strategy and processes

We have sound acceptance policies and procedures in place for all kinds of credit risk exposure. We are limiting our description below to exposures related to traditional loans to businesses and to lending to individuals, as these account for the largest part of the group's credit risk exposure.

Lending to individuals (e.g., mortgages) is subject to a standardised process, during which the output of scoring models plays an important role in the acceptance procedure. Lending to businesses is subject to a more integrated acceptance process in which relationship management, credit acceptance committees and model-generated output are taken into account.

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

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

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

ranging from PD 10 to PD 12 to a defaulted obligor. PD class 12 is assigned when either one of the obligor's credit facilities is terminated by the bank, or when a court order is passed instructing repossession of the collateral. PD class 11 groups obligors that are more than 90 days past due (in arrears or overdrawn), but that do not meet PD 12 criteria. PD class 10 is assigned to obligors for which there is reason to believe that they are unlikely to pay (on time), but that do not meet the criteria for classification as PD 11 or PD 12. Loans in PD classes 10, 11 and 12 are referred to as 'impaired loans' and are equivalent to 'non-performing loans' under the (new) definition used by the European Banking Authority (EBA).

We review loans to large corporations at least once a year, with the internal rating being updated as a minimum. If ratings are not updated in time, a capital add-on is imposed. Loans to small and medium-sized enterprises and to private individuals are reviewed periodically, with account being taken of any new information that is available (such as arrears, financial data, or a significant change in the risk class). This monthly exercise can trigger a more in-depth review or may result in action being taken towards the client.

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

Credit risk management at portfolio level

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

Whereas some limits are still in notional terms, we also use concepts such as 'expected loss' and 'loss given default'. Together with 'probability of default' and 'exposure at default', these concepts form the building blocks for calculating the regulatory capital requirements for credit risk, as KBC has opted to use the Internal Rating Based (IRB) approach. After receiving the approval of the regulators in 2012, the main group entities adopted the IRB Advanced approach and were joined by a number of smaller entities in 2013 and 2014. Others are scheduled to shift to the IRB Advanced or Foundation approaches in 2015. 'Non-material' entities will continue to adopt the Standardised approach.

Forbearance measures

In order to avoid a situation where an obligor facing financial difficulties ends up defaulting, we can decide to renegotiate its loans and grant forbearance measures in accordance with internal policy guidelines. These internal policies were updated in 2014 to take account of the new (draft)

guidelines on non-performing exposures and forbearance measures laid down by the European Banking Authority (EBA).

Forbearance measures consist of concessions towards a borrower facing, or about to face, financial difficulties.

Forbearance measures may involve:

- declaring a moratorium (temporary principal and/or interest payment holidays);
- lowering or postponing interest or fee payments;
- extending the term of the loan to ease the repayment schedule;
- capitalising arrears;
- providing debt forgiveness.

After a forbearance measure has been decided upon, the modified terms/conditions must be confirmed in writing. A forbearance tag is attached to the file in the credit systems for identification, monitoring and reporting purposes.

A client with a forborne loan will in principle be assigned a PD class that is higher than the one it had before the forbearance measure was granted, given the higher risk of the client.

If the client had not yet defaulted, and after being granted the forbearance measure – based on the bank's assessment of the borrower's revised financial projections/restructuring plans – there is a reasonable chance that the borrower will be able to meet the renegotiated terms of the loan, and the expected loss (in the broad sense) for the bank after renegotiation will be lower than it would have been without renegotiation, the PD class assigned by the model can be applied or overruled according to the existing policies. However, if the PD is overruled, the assigned PD would be higher than the PD assigned to borrowers/files with similar loans but without forbearance measures, reflecting the higher risk of default attached to the forborne facility.

If the forborne facility was non-defaulted prior to the forbearance measures, but becomes defaulted due to these measures, PD class 10 has to be assigned. If the facility had already been classified as 'defaulted' prior to the forbearance measure, the facility/client has to be assigned at least PD class 10 ('unlikely to pay') or worse (PD class 11 if other facilities are more than 90 days past due and default status is assigned at client level) after forbearance has been granted.

Only after at least one year and on the condition that, following the forbearance measures, no amount is past due or there are no concerns regarding full repayment of the exposure according to the post-forbearance conditions, can the client be reclassified as 'non-defaulted'. However, the forbearance tag will stay in place for at least two years after the forbearance measure has been granted, or after the client becomes non-defaulted, and can only be removed when strict extra criteria have been met (non-defaulted, regular payments, etc.). If the conditions are not met at the end of the probation period, the facility will continue to be identified as 'forborne under probation' (i.e. forbearance tag) until the conditions are met. The conditions will be assessed on at least a quarterly basis.

If a client has been granted a forbearance measure, and remains non-defaulted, a default status will be assigned as soon as this forbore loan becomes more than 30 days past due or if an additional forbearance measure (from the second restructuring on) is granted during the probation period.

As forbearance measures constitute an objective indicator (i.e. impairment trigger) that requires assessing whether impairment is needed, all forbearance measures are subject to an impairment test. This means that, when a forbearance measure is granted, an evaluation should always be made as to whether this loss event has an impact on the estimated future cashflows of the financial assets, and if accordingly an impairment loss should be recognised.

From the moment an obligor needs to be classified as 'defaulted' according to KBC's rules, the need for provisioning has to be assessed. It is highly likely that an impairment charge will be recorded.

At the end of 2014, forbore loans accounted for some 6% of the total loan portfolio. A breakdown is provided below.

The fluctuation in exposure to forbore loans was caused mainly by the implementation in 2014 of the new EBA-based policy on forbearance measures. Additionally:

- in Ireland, a substantial proportion of the forbore exposure is included in the total exposure. This proportion increased further in 2014, due to the continued legacy impact of Ireland having been hit severely by the economic and financial crisis, which resulted in a large number of forbearance measures being taken (restructured under the MARS programme).
- in Hungary, the decrease in 2014 was accounted for by the 'Curia' decision on a debtor relief programme, which significantly slowed down restructuring activities.
- in Bulgaria, exposure to forbore loans (which accounts for a substantial proportion of the total portfolio) was mainly concentrated in the (corporate) legacy portfolio, which is being run down. Forborne loans and the legacy portfolio both relate largely to clients that are in default.

Forborne loans (in millions of EUR)	Total outstanding portfolio ¹	Forborne loans						
		Total	(% of out- standing portfolio)	Breakdown by PD class				Specific impair- ment
				PD 1-8	PD 9	PD 10 (impair- ed, less than 90 days past due)	PD 11-12 (impair- ed, 90 days and more past due)	
31-12-2013								
Total	135 364	7 429	5%	581	830	4 307	1 711	1 744
By business unit								
Belgium Business Unit	86 913	2 207	3%	377	446	1 074	311	381
Czech Republic Business Unit	17 716	359	2%	129	25	126	79	77
International Markets Business Unit	25 894	4 845	19%	75	360	3 108	1 303	1 280
Ireland	15 280	3 999	26%	28	281	2 903	787	1 000
Slovakia	4 635	105	2%	23	9	23	49	30
Hungary	5 080	507	10%	9	57	161	281	164
Bulgaria	747	234	31%	15	13	21	185	86
Group Centre	4 840	18	0%	0	0	0	18	8
By client segment								
Private individuals ²	56 583	3 616	6%	278	320	2 312	705	786
SMEs	32 029	474	1%	107	166	102	100	78
Corporations ³	46 752	3 339	7%	196	344	1 893	905	881
31-12-2014								
Total	138 931	7 928	6%	470	551	4 608	2 299	2 095
By business unit								
Belgium Business Unit	89 060	1 288	1%	336	91	783	77	188
Czech Republic Business Unit	18 775	241	1%	36	38	111	56	53
International Markets Business Unit	25 446	6 209	24%	70	378	3 635	2 126	1 817
Ireland	14 498	5 682	39%	33	354	3 453	1 842	1 638
Slovakia	5 065	102	2%	24	8	44	25	25
Hungary	5 089	209	4%	3	10	115	81	73
Bulgaria	794	217	27%	10	7	23	178	82
Group Centre	5 650	190	3%	28	44	78	40	37
By client segment								
Private individuals ²	58 192	4 907	8%	290	360	3 027	1 230	1 040
SMEs	32 089	349	1%	73	57	138	82	69
Corporations ³	48 649	2 671	5%	108	134	1 442	987	986

¹ Gross amounts, before impairment (these amounts therefore differ from the accounting figures used in other sections).

² 99% of the forborne loans total relating to mortgage loans in 2013 and 99% in 2014.

³ 49% of the forborne loans total relating to commercial real estate loans in 2103 and 55% in 2014.

Scope of credit risk disclosures

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

With regard to the timing of and approach to implementing Basel III, KBC has opted for a phased roll-out of the IRB approach at all its material entities. A material entity in this respect is defined as any subsidiary that accounts for more than 1% of the risk-weighted assets for credit risk at KBC Group NV. Compliance with this criterion is checked at least yearly. The first set of material entities started adopting the IRB Foundation approach at the beginning of 2007. As already mentioned above, the main group entities received regulatory approval to switch to the IRB Advanced approach during 2012. The internal target dates for the other material entities to adopt the IRB Foundation or IRB Advanced approach are shown in the table below. Any switchover is of course subject to regulatory approval.

Material entities that had not yet adopted the IRB Foundation or Advanced approach in 2014 are following the Basel III Standardised approach for the time being. This approach will also be adhered to until further notice by the other (non-material) entities of the KBC group and for equity exposures, in accordance with permanent partial use as per Article 150(d) of Regulation (EU) No. 575/2013 (CRR). From 2014 on, KBC will no longer apply permanent partial use for sovereign exposure as required by the Belgian regulator.

The scope of this report is limited to the material entities appearing in the roll-out table below. These entities accounted for 99% of the total credit risk weighted assets of the KBC group in 2014.

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 2014 annual report.

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 III, pillar I.

Roll-out of Basel III pillar 1 approach at end of	2013	2014	2015	2016
IRB Advanced approach	KBC Bank CBC Banque ČSOB Czech Republic KBC Credit Investments KBC Finance Ireland KBC Lease Belgium KBC Commercial Finance KBC Immolease	KBC Bank ³ CBC Banque ČSOB Czech Republic ⁶ KBC Credit Investments KBC Finance Ireland KBC Lease Belgium KBC Commercial Finance KBC Immolease	KBC Bank CBC Banque ČSOB Czech Republic KBC Credit Investments KBC Finance Ireland KBC Lease Belgium KBC Commercial Finance KBC Immolease K&H Bank	KBC Bank CBC Banque ČSOB Czech Republic KBC Credit Investments KBC Finance Ireland KBC Lease Belgium KBC Commercial Finance KBC Immolease K&H Bank
IRB Foundation approach	KBC Bank Ireland KBC Financial Products KBC Bank Deutschland Antwerp Diamond Bank K&H Bank	KBC Bank Ireland KBC Financial Products KBC Bank Deutschland ² Antwerp Diamond Bank K&H Bank ČSOB Slovak Republic	KBC Bank Ireland KBC Financial Products Antwerp Diamond Bank ⁴ ČSOB Slovak Republic	KBC Bank Ireland KBC Financial Products ČSOB Slovak Republic ⁵
Standardised approach	ČSOB Slovak Republic Absolut Bank ¹ Non-material entities	Non-material entities	Non-material entities	Non-material entities

1 Absolut Bank was divested in 2013.

2 KBC Bank Deutschland was divested in the course of 2014 and is no longer included in the data for 2014.

3 KBC Consumer Finance has become part of KBC Bank.

4 Antwerp Diamond Bank will merge with KBC Bank in 2015.

5 Transition from IRB Foundation to IRB Advanced approach for ČSOB Slovak Republic is planned for 2017.

6 The Czech joint-venture ČMSS has ceased to be included in the figures as from 2014, since it is consolidated through the equity method instead of the partial consolidation method.

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 2014. 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 Advanced, IRB Foundation and Standardised) overview of the lending portfolio, (iii) overviews of concentration in the lending portfolio (including a quality analysis), (iv) overviews of impaired credit in the lending portfolio, (v) breakdowns of the counterparty credit risk, (vi) credit risk mitigation and exposure to repo-like transactions and (vii) information on internal modelling.

In the lending portfolio, EAD is the amount that KBC expects to be outstanding should an obligor default. For lending exposure treated under the IRB approach, EAD is composed of the amount outstanding at the time of the calculation (without taking provisions into account), plus a weighted part of the off-balance-

sheet portion of the exposure. For non-retail exposures, this weight can be determined either on a regulatory basis according to the IRB Foundation approach or via internal models according to the IRB Advanced approach. For retail exposures, the weight is always determined via internal models, in line with the IRB Advanced approach for this asset class. For lending exposures treated under the Standardised approach, EAD can be regarded as the amount outstanding at the time of the calculation minus the provisions set aside plus a weighted part of the off-balance-sheet portion of the exposure. EAD can be stated with or without application of eligible collateral, i.e. net or gross.

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

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

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

As regards the group-wide framework for dealing with model uncertainty – as referred to in the section on 'Internal modelling' later on in this report – KBC has taken (and reported under pillar 1) additional RWA for known deficiencies and avoidable uncertainties into account for its PD models since mid-2010, for its LGD models since mid-2012 and for its EAD models since 2013. At year-end 2014, this additional RWA amounted to 2.5 billion euros for PD models, to 0.3 billion euros for LGD models and to 0.4 billion euros for EAD models. Moreover, in 2013, KBC started to capitalise unavoidable uncertainties in the models (EAD, PD and LGD models), which resulted in an additional impact on RWA of 1.4 billion euros in 2014.

The table below provides an overview of how Basel III credit risk EADs and RWA, on a fully loaded basis², for the KBC group changed over 2014. This table shows the overall EAD and RWA figures, including non-material entities, the structured credit portfolio, CVA capital charges, additional RWA for model deficiencies and uncertainties, and regulatory capital add-ons. Please note that, in all other tables in this report, the scope will be limited to the material entities (see table above) and exclude the structured credit portfolio and additional RWA for unavoidable uncertainties.

² Implies full IRB treatment for home country sovereign risk.

Entity	B III approach (at 31-12-2014) ¹	Credit RWA (in millions of EUR)			Exposure [EAD] (in millions of EUR)		
		31-12-2013	31-12-2014	Δ 2014 vs 2013	31-12-2013	31-12-2014	Δ 2014 vs 2013
KBC Bank	IRB Advanced	26 118	30 843	4 725	117 820	135 189	17 369
CBC Banque	IRB Advanced	1 855	2 060	206	10 426	11 135	709
ČSOB Czech Republic	IRB Advanced	9 778	9 681	-96	41 933	32 910	-9 023
KBC Credit Investments	IRB Advanced	1 242	2 737	1 495	7 412	13 195	5 783
KBC Commercial Finance	IRB Advanced	597	844	247	1 908	2 428	520
KBC Lease Belgium	IRB Advanced	1 465	1 346	-119	2 166	2 112	-54
KBC Immolease	IRB Advanced	284	316	32	714	734	20
KBC Finance Ireland	IRB Advanced	610	732	122	1 232	991	-241
KBC Bank Ireland	IRB Foundation	6 754	6 519	-235	16 439	16 289	-150
K&H Bank	IRB Foundation	3 596	6 192	2 596	9 122	8 266	-856
KBC Bank Deutschland ³	IRB Foundation	1 840	-	-1 840	2 781	-	-2 781
ADB	IRB Foundation	1 174	1 173	0	1 731	1 600	-131
KBC Financial Products	IRB Foundation	3 042	149	-2 892	907	576	-331
ČSOB Slovak Republic ⁴	IRB Foundation	-	3 280	3 280	-	7 410	7 410
ČSOB Slovak Republic ⁴	Standardised	3 284	-	-3 284	6 388	-	-6 388
CIBANK	Standardised	572	572	-1	867	1 038	171
KBC Insurance		-	10 897	10 897	-	2 945	2 945
Other entities	Mixed	811	857	46	1 705	1 735	31
Total²		63 022	78 199	15 178	223 551	238 554	15 003

¹ Basel III is the main approach pursued by a legal entity. Some entities report under IRB, but still have sub-portfolios or subsidiaries that are reported under the Standardised approach.

² The figures shown are for the overall scope of credit risk RWA, including structured credit products, counterparty risk, CVA capital charges and other non-credit obligation assets, but excluding bonds in trading books and KBC intra-group exposures.

³ KBC Bank Deutschland was divested in the course of 2014.

⁴ Change in regulatory approach (from Standardised method to IRB Foundation method).

Overall, there was a substantial increase in EAD and to a greater extent in RWA. At KBC group level, credit RWA rose by 15.2 billion euros, up 24% year-on-year. This can be broken down as follows:

- The main driver for this increase was the change in the regulatory approach (from Basel II to Basel III – CRD IV rules). More specifically:
 - KBC Group NV's participation in KBC Insurance was previously calculated using the Building Block methodology (on the basis of Solvency I-based capital requirements) and thus was included in the 'Insurance RWA'. CRD IV states that this participation should be calculated under the Danish compromise method (standardised risk weight of 370% applied to the value of KBC Group NV's equity participation in KBC Insurance) and be included in the 'Credit RWA' (+10.9 billion euros in RWA). Hence, this increase in 'Credit RWA' was offset by the decrease in the 'Insurance RWA'.
 - Under permanent partial use (Article 150 (d) of Regulation (EU) No. 575/2013 (CRR)), banks can use the Standardised approach (where a 0% risk weight is allowed) for the calculation of RWA associated with exposures in local currency or euro to European sovereign debt. At the discretion of the Belgian authorities, this is no longer allowed and the IRB method is used for the sovereign exposure at IRB banks. This resulted in an increase in RWA of 3.6 billion euros (biggest impact at K&H Bank: 2.4 billion euros in RWA).

- CRD rules indicate that the net deferred tax assets (DTAs), which depend on future profitability and arise from temporary differences, should have a risk weight of 250%. DTAs accounted for an increase of 1.4 billion euros in RWA.
- CRD rules give an advantage to credit granted to small and medium-sized enterprises. The advantage is provided by using a supporting factor of 0.7619 on the RWA. This factor reduced RWA by 1.1 billion euros (Article 44 of Regulation (EU) No. 575/2013 (CRR)).
- CRD rules increase the risk weight (correlation multiplier of 1.25) for the exposure to Large and Unregulated Financial Institutions, which generated an increase in RWA of 0.9 billion euros. For a definition of a Large and Unregulated Financial Institution, please refer to Article 142(1)(4) of Regulation (EU) No. 575/2013 (CRR).
- The de-risking of the KBC portfolio was terminated and had in 2014 an estimated impact on RWA of -4.5 billion euros. The figures included a sharp reduction in capital requirements for the legacy structured credit portfolio, due to the de-risking of CDOs and the sale of positions. The remaining decrease in RWA was related to the sale of KBC Bank Deutschland (-1.8 billion euros in RWA).
- The upward effect of model changes (approximately 1.7 billion euros) mainly on the PD model for large corporates and the pooling models for Irish mortgages. The impact of these two changes has been included in the RWA shown in the table above, but not in the tables below, as implementation of the reviewed models is subject to regulatory approval.
- The reduction in RWA (-0.3 billion euros) at ČSOB Slovak Republic following approval of its migration to the IRB Foundation approach in 2014.
- Changes in exposure at KBC Bank (+17 billion euros) and ČSOB Czech Republic (-9 billion euros) were caused mainly by changes in exposure to repos (KBC Bank: +13.3 billion euros, ČSOB Czech Republic: -8.9 billion euros), which – due to their fully secured nature – have a negligible impact on RWA. Another driver for the reduction in exposure at ČSOB Czech Republic was that the Czech joint-venture ČMSS has been consolidated through the equity method instead of the partial consolidation method since 2014.

Total exposure to credit risk

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

- On-balance-sheet assets (On-balance): this category contains assets, including equities in the banking book, whose contract is booked on the balance sheet of the entities in scope excluding securities in the trading book, repo-like instruments and – in the case of this publication – securitisation-related assets. On-balance-sheet assets are dealt with in the 'lending portfolio' sections.
- Off-balance-sheet assets (Off-balance): this category contains assets whose contract is not booked on the balance sheet of the entities in scope. The category excludes most derivative instruments, repo-like instruments and – in the case of this publication – securitisation-related assets. Derivative instruments related to selling credit protection, i.e. CDS that have been sold are

included as off-balance-sheet assets when they do not relate to trading activity. Off-balance-sheet assets are dealt with in the 'lending portfolio' sections.

- Derivatives: this category contains all credit exposure arising from derivative transactions, such as Interest Rate Swaps (IRS), Forex deals, etc. (excluding CDS in the banking book, which are treated as an off-balance-sheet 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 information on these transactions can be found in the section on 'Credit risk mitigation'.

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

Exposure 31-12-2013 ^{1,2} (in billions of EUR)	Lending (on-balance-sheet)	Lending (off-balance-sheet)	Derivatives	Repo-like transactions	Total
Total EAD	182	16	7	15	220
Total RWA	45	5	2	0	53

Exposure 31-12-2014 ² (in billions of EUR)	Lending (on-balance-sheet)	Lending (off-balance-sheet)	Derivatives	Repo-like transactions	Total
Total EAD	190	17	9	19	235
Total RWA	61	5	3	0	69

1 KBC Bank Deutschland only included in the figures for 2013.

2 The securitisation on banking books, the exposure and RWA of the non-material entities, additional RWA for model deficiencies and uncertainties, and regulatory capital add-ons are not included in this table and the tables below.

Credit risk in the lending portfolio

The lending portfolio excludes all derivatives (except for CDS in the banking book) and any repo-like exposure, as these are dealt with in the 'Counterparty credit risk' and 'Credit risk mitigation' sections. As mentioned above, exposure to securities in the trading book is also excluded. In light of the capital calculations, the corresponding issuer risk is included in trading market risk.

Lending portfolio [EAD] 31-12-2013 ² (in millions of EUR)	EAD of main categories	'Other' ¹	Total EAD
Subject to IRB approach	155 002	3 500	158 502
Subject to Standardised approach	39 121	601	39 722
Total	194 124	4 101	198 225

Lending portfolio [EAD] 31-12-2014 (in millions of EUR)	EAD of main categories	'Other' ¹	Total EAD
Subject to IRB approach	193 063	4 100	197 162
Subject to Standardised approach	6 068	3 827	9 895
Total	199 130	7 927	207 057

1 Exposure to 'Other' is given separately and is not included in the disclosures on concentrations and impaired exposure, since the data required to create the breakdowns is often missing. This category contains mostly 'other assets' (e.g., property and equipment, non-assignable accruals, cash balances at central banks), deferred tax assets and participations.

2 KBC Bank Deutschland only included in the figures for 2013.

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

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

Credit exposure subject to the IRB approach

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

- **Sovereign:** this category includes claims on public sector entities, regional governments and local authorities as long as they are categorised as 'Sovereign' by the local regulator. Multilateral development banks attracting a 0% risk weighting are included.
- **Institutions:** this category relates mainly to bank exposure. Claims on public sector entities, regional governments and local authorities that do not qualify as 'Sovereign' are also included in this category.
- **Corporates:** besides ordinary corporate exposure, this category also includes specialised lending exposure (such as project finance and commercial real estate) and non-bank financials.
- **SMEs (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, excluding residential mortgages, such as personal loans and commercial credit to retail SMEs, for which the total exposure of the counterparty (or related group of the counterparty) does not exceed a threshold of 1 million euros. It should be noted that the IRB Foundation approach for retail exposure does not exist and that IRB Advanced is the only approach for this asset class.
- **Residential mortgages:** this category includes home loans to individuals, secured or partly secured by residential mortgages.
- **Other:** besides 'other assets', this category includes the residual value of leasing transactions and the deferred tax assets (DTA).

IRB exposure [EAD] 31-12-2013 ¹ (in millions of EUR)	Sover- eign	Instituti- ons	Corpo- rates	SME Cor- porates	Retail	Residen- tial Mortga- ges	(sub)Total ²	Other	Total
Exposure	14 088	7 771	40 774	19 716	19 151	53 502	155 002	3 500	158 502
RWA	1 928	1 214	18 398	7 475	4 008	9 591	42 613	3 250	45 862

IRB exposure [EAD] 31-12-2014 (in millions of EUR)	Sover- eign	Instituti- ons	Corpo- rates	SME Cor- porates	Retail	Residen- tial Mortga- ges	(sub)Total ²	Other	Total
Exposure	48 016	9 473	39 852	20 979	19 593	55 150	193 062	4 100	197 162
RWA	6 104	2 361	17 866	8 101	3 604	10 014	48 050	4 246	52 297

¹ KBC Bank Deutschland only included in the figures for 2013.

² The (sub)total is accounted for in the section on concentrations in the lending portfolio.

A substantial increase in the IRB exposure can be linked to (i) an increase in the 'Sovereign' exposure caused by the abolishment of permanent partial use (see explanation above), (ii) the calculation for ČSOB Slovak Republic being done by the IRB approach (instead of the Standardised approach), which mainly accounted for an increase in the 'Sovereign', 'Corporates' and 'Residential mortgages' exposure. These increases were slightly offset by the divestment of KBC Bank Deutschland (approximately -2.2 million euros in the 'Corporates' asset class and to a lesser extent in the remaining classes).

The change in RWA in the IRB asset classes was caused mainly by the change in the regulatory approach (CRD IV rules) and to a lesser degree by volume changes in the IRB portfolio. The most important changes were:

- The abolishment of permanent partial use, which led to an increase in 'Sovereign' RWA.
- The higher correlation function for Large and Unregulated Financial Institutions, which accounted for an increase in RWA in the 'Institutions' asset class.
- The rise in the 'Other' asset class due to deferred tax assets.
- The change in the regulatory approach for ČSOB Slovak Republic (from the Standardised approach to the IRB Foundation approach), which impacted RWA mainly in the 'Sovereign', 'Corporates' and 'Residential mortgages' asset classes.
- The divestment of KBC Bank Deutschland, which reduced the 'Corporates' RWA (-1 605 million euros) and to a lesser degree the remaining assets classes.
- The SME supporting factor, which accounted for a decline in RWA in the 'SME Corporates' and 'Retail' asset classes.

Please note that more information concerning these aspects has been provided above.

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 and other assets weighted at 0%, such as Cash and Cash at central banks.
- **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 organisations**: claims on a specific list of organisations (e.g., International Monetary Fund, European Central Bank).
- **Institutions**: claims on banks.
- **Corporates**: claims on all corporate exposure, including small and medium-sized enterprises that are treated as corporate clients.
- **Retail**: claims on retail clients (including SMEs not qualifying for treatment as corporate clients). Most of these claims are related to mortgages and categorised under 'secured by real estate'.
- **Secured by real estate**: claims that are (fully) covered by real estate collateral via mortgages

and including real estate leasing. These are extracted from the above categories (mostly retail or corporate).

- **Past due:** all exposure which is past due, meaning that it is more than 90 days in arrears. All past due exposure is extracted from all the other categories.
- **CIU:** claims on Collective Investment Undertakings.
- **High risk:** exposure that is not collateralised and/or not rated, attracting a risk-weighting equal to or higher than 150% and therefore considered 'high risk'. Past due and equity exposure are excluded.
- **Covered bonds:** exposure for which the credit risk is mitigated by risk positions on very highly rated governments, authorities or institutions. Past due, equity and high-risk claims are excluded.
- **Short term:** exposure (to institutions or to corporates) which is rated and has a maturity of less than three months. Past due, equity and high-risk claims are excluded. This exposure has been assigned to its respective exposure type, namely 'Institutions' or 'Corporates'.
- **Equity:** Shares and Mutual Funds. Previously the equities were reported under the asset class of the issuing entity of the equity instrument. Now all equity exposure is grouped on this single asset class.
- **Other:** all other claims (e.g., other assets).

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

Standardised exposure [EAD] 31-12-2013 (in millions of EUR)	Exposure	RWA
Sovereign	33 079	6
RGLA	135	32
PSE	29	0
MDB	10	1
International organisations	0	0
Institutions	210	109
Corporates	2 276	2 270
Retail	1 528	1 131
Secured by real estate	1 637	628
Past due	218	243
CIU	0	0
(sub)Total ¹	39 121	4 421
High risk	0	0
Covered bonds	0	0
Short term	0	0
Other	601	260
Total	39 722	4 681
Standardised exposure [EAD] 31-12-2014 (in millions of EUR)	Exposure	RWA
Sovereign	3 531	37
RGLA	165	37
PSE	0	0
MDB	11	1
International organisations	0	0
Institutions	107	56
Corporates	803	810
Retail	1 064	755
Secured by real estate	270	156
Past due	117	129

CIU	0	0
(sub)Total ¹	6 068	1 982
High risk	0	0
Covered bonds	0	0
Short term	0	0
Equity ²	3 144	11 356
Other	682	391
Total	9 895	13 729

¹ Accounted for in the section on concentrations in the lending portfolio.

² New asset class. Includes KBC Insurance participation (2.9-billion-euro exposure).

There was a decline in exposure and in the risk weighted assets for the standardised asset classes, linked to:

- the abolishment of permanent partial use, which led to a shift in exposure – and thus RWA – from the ‘Sovereign’ standardised asset class to the ‘Sovereign’ IRB asset class.
- the change in the regulatory approach for ČSOB Slovak Republic (from the Standardised approach to IRB Foundation approach), which reduced the exposure and RWA of the ‘Corporates’ asset class and to a lesser extent the remaining asset classes.

There is a new standardised asset class, namely ‘Equity’, which contains the shares and mutual funds that were previously reported under the asset class of the issuing entity. Furthermore, the participation of KBC Group NV in KBC Insurance is included in the ‘Equity’ asset class. This participation accounted for a rise of 2.9 billion euros in exposure and 10.9 billion euros in RWA.

Concentrations to credit risk in the lending portfolio

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

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

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

From now on, the Standardised exposure types of 'High risk', 'Covered bonds', 'Equity' and 'Short term' will all be mapped to the 'Other' asset class. The other mapping exercises are more straightforward.

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

Unless otherwise stated, all exposure is attributed to the asset class after PD substitution. This implies that if PD substitution is applied to a certain exposure to a borrower guaranteed by another party, the exposure will shift to the region, sector and exposure class of the guaranteeing party in the breakdowns below. For example, when a corporate entity is guaranteed by a bank and PD substitution is applied, this exposure will be incorporated under 'Institutions' in the breakdowns provided. This logic only applies to exposures treated under the Standardised or IRB Foundation approach (under the IRB Advanced approach, the effect of the guarantee is included in the LGD measurement).

Total credit exposure in the lending portfolio per geographic region

Exposure [EAD] 31-12-2013* (in millions of EUR)	Sovereign	Institutions	Corporates	SME Corporates	Retail	Residential Mortgages	Total
Africa	200	368	252	0	3	3	826
Asia	161	2 499	1 199	112	4	36	4 010
Central and Eastern Europe & Russia	13 009	2 004	8 511	5 512	3 443	13 002	45 481
Of which							
Bulgaria	148	11	267	136	134	125	821
Czech Republic	6 560	872	5 263	3 392	2 153	8 796	27 036
Hungary	4 025	47	1 438	1 064	224	1 876	8 674
Poland	195	250	315	8	10	14	791
Russia	0	479	20	3	1	94	596
Slovak Republic	2 072	163	901	907	915	1 993	6 952
Latin America	0	38	31	9	6	2	86
Middle East	1	928	443	18	3	10	1 404
North America	948	289	1 785	83	21	18	3 144
Oceania	0	29	443	0	0	2	474
Western Europe	32 876	1 953	29 677	15 091	16 795	42 306	138 698
Of which							
Belgium	21 909	347	17 966	13 154	16 604	30 071	100 051
Ireland	464	17	2 077	1 017	1	12 128	15 704
Total	47 195	8 109	42 342	20 825	20 274	55 379	194 124

Exposure [EAD] 31-12-2014 (in millions of EUR)	Sovereign	Institutions	Corporates	SME Corporates	Retail	Residential Mortgages	Total
Africa	206	336	235	0	3	0	781
Asia	146	3 092	1 419	71	6	0	4 734
Central and Eastern Europe & Russia	14 406	1 860	8 393	6 175	3 293	11 852	45 979
Of which							
Bulgaria	231	10	266	170	144	128	949
Czech Republic	8 202	772	4 749	3 999	1 761	7 746	27 229
Hungary	3 327	16	1 544	1 167	174	1 635	7 863
Poland	288	255	227	15	11	0	796
Russia	0	581	15	2	1	0	599
Slovak Republic	2 331	88	1 320	817	1 195	2 409	8 159
Latin America	1	30	74	17	7	0	129

Middle East	2	972	396	4	4	0	1 378
North America	511	413	1 419	156	47	0	2 546
Oceania	0	388	353	1	2	0	744
Western Europe	36 276	2 490	28 414	14 945	17 188	43 527	142 839
Of which Belgium	22 447	367	18 715	13 093	16 915	31 307	102 845
Ireland	772	3	2 181	1 015	1	12 105	16 078
Total	51 547	9 580	40 703	21 370	20 550	55 380	199 130

* KBC Bank Deutschland only included in the figures for 2013.

The geographic regions in the above table are those where each borrower (or guarantor) is situated. The table shows that the KBC home markets comprise mainly Belgium (52%) and the four CEE countries (Bulgaria, Czech Republic, Hungary, Slovak Republic) (22%), which combined represented 74% of exposures in 2014. They even represented more than 78% of EAD for the 'Residential Mortgages' exposure class, more than 98% for 'Retail' and more than 90% for 'SME Corporates'. For institutions, exposures outside the home markets were predominantly in Western Europe (mainly Germany, the Netherlands and Spain) and in Asia (mainly China).

The material decrease observed for Czech retail and mortgage exposures was linked to the fact that our Czech joint-venture ČMSS has been consolidated by the equity method instead of the partial consolidation method since 2014.

Total credit exposure in the lending portfolio per sector

Exposure [EAD] 31-12-2013² (in millions of EUR)	Sovereign	Institutions	Corporates	SME Corporates	Retail	Residential Mortgages	Total
Agriculture, Farming & Fishing	0	0	385	1 238	2 241	0	3 864
Authorities	47 158	127	351	3	1	0	47 641
Automotive	0	0	1 637	1 313	507	0	3 458
Building & Construction	0	0	3 394	1 383	1 485	0	6 262
Chemicals	0	0	1 324	464	59	0	1 847
Commercial Real Estate	0	0	7 568	3 094	1 121	0	11 783
Distribution	0	0	5 191	3 962	2 570	0	11 723
Electricity	0	0	2 638	208	18	0	2 863
Finance & Insurance	37	7 982	2 102	240	259	0	10 619
Food Producers	0	0	1 386	444	197	0	2 026
Metals	0	0	1 304	597	238	0	2 139
Oil, Gas & Other Fuels	0	0	1 288	15	4	0	1 307
Private Persons	0	0	1	69	5 917	55 379	61 366
Services	0	0	6 273	4 426	4 004	0	14 703
Other ¹	0	0	7 499	3 369	1 653	0	12 521
Total	47 195	8 109	42 342	20 825	20 274	55 379	194 124
Exposure [EAD] 31-12-2014 (in millions of EUR)	Sovereign	Institutions	Corporates	SME Corporates	Retail	Residential Mortgages	Total
Agriculture, Farming & Fishing	0	0	370	1 290	2 256	0	3 915
Authorities	51 423	0	390	1	1	0	51 815
Automotive	0	0	1 707	1 056	509	0	3 272
Building & Construction	0	0	3 226	1 394	1 473	0	6 093
Chemicals	0	0	1 160	419	65	0	1 645
Commercial Real Estate	0	0	6 440	3 481	1 110	0	11 031
Distribution	0	0	5 172	4 063	2 599	0	11 833
Electricity	0	0	2 140	355	19	0	2 514
Finance & Insurance	124	9 580	3 605	227	275	0	13 811
Food Producers	0	0	1 277	409	191	0	1 877

Metals	0	0	1 218	693	251	0	2 161
Oil, Gas & Other Fuels	0	0	1 168	7	3	0	1 179
Private Persons	0	0	0	73	6 269	55 380	61 721
Services	0	0	6 319	4 494	3 904	0	14 718
Other ¹	0	0	6 512	3 406	1 625	0	11 542
Total	51 547	9 580	40 703	21 370	20 550	55 380	199 130

¹ All sectors with a concentration of less than 0.75% of the total EAD are aggregated into this category.

² KBC Bank Deutschland Bank only included in the figures for 2013.

In view of KBC's substantial retail activities in most markets, 'Private persons' represents a large share of this sector distribution. The exposure to 'Private persons' remained virtually unchanged. The main changes in exposure were: (i) an increase in 'Authorities' due to the purchase of bonds, (ii) a rise in 'Finance & Insurance' due to the purchase of bonds and to the inclusion of some of the undrawn and uncommitted part of the professional limits in exposure (changed EAD model).

Maturity analysis of the total credit exposure in the lending portfolio

Residual maturity 31-12-2013 ² (in millions of EUR)	Sovereign	Institutions	Corporates	SME Corporates	Retail	Residential Mortgages	Total
<1 year	11 206	5 286	18 477	7 827	3 250	682	46 729
=>1 to <5 years	13 967	1 661	9 758	3 636	5 188	1 695	35 905
=>5 to <10 years	15 674	915	4 622	3 357	5 204	26 651	56 424
=>10 years	6 280	124	4 307	3 952	4 353	26 220	45 236
Until Further Notice ¹	68	122	5 179	2 053	2 279	131	9 831
Total	47 195	8 109	42 342	20 825	20 274	55 379	194 124

Residual maturity 31-12-2014 (in millions of EUR)	Sovereign	Institutions	Corporates	SME Corporates	Retail	Residential Mortgages	Total
<1 year	10 375	5 923	17 717	7 846	3 331	731	45 923
=>1 to <5 years	14 729	1 616	8 237	4 112	5 986	1 832	36 513
=>5 to <10 years	18 334	1 380	4 784	3 189	4 533	26 908	59 129
=>10 years	7 725	77	4 433	4 255	4 344	25 786	46 620
Until Further Notice ¹	384	584	5 533	1 968	2 355	123	10 946
Total	51 547	9 580	40 703	21 370	20 550	55 380	199 130

¹ Exposure without a concrete end-date is assigned to the 'Until Further Notice' category.

² KBC Bank Deutschland only included in the figures for 2013.

About 41% of the lending portfolio will mature within five years. Within the 'Institutions' and 'Corporates' exposure classes, this percentage even reached 79% and 64%, respectively. The longest maturities are mainly found in the 'Residential Mortgages' class.

There was a slight shift in credit exposure with a residual maturity of less than 1 year to the other categories. 'Sovereign' exposure with a residual maturity longer than 10 years increased sharply due to new bond purchases.

Total credit exposure in the lending portfolio per product type

Exposure [EAD] 31-12-2013 ² (in millions of EUR)	Sovereign	Institutions	Corporates	SME Corporates	Retail	Residential Mortgages	Total
Guarantee	837	405	4 453	1 366	610	0	7 670
Debt instrument	36 716	1 696	1 281	3	0	0	39 696
Equity	0	20	119	18	0	0	157
Leasing	31	0	1 062	919	1 236	0	3 248
Home loans	0	0	0	0	1 097 ¹	55 379	56 477
Other lending	9 611	5 988	35 428	18 520	17 330	0	86 877
Total	47 195	8 109	42 342	20 825	20 274	55 379	194 124

Exposure [EAD] 31-12-2014 (in millions of EUR)	Sovereign	Institutions	Corporates	SME Corporates	Retail	Residential Mortgages	Total
Guarantee	213	398	4 170	1 410	698	0	6 889
Debt instrument	41 364	2 215	1 429	2	0	0	45 010
Equity	0	21	102	14	0	0	137
Leasing	30	0	1 043	901	1 214	0	3 189
Home loans	0	0	0	0	1 044 ¹	55 380	56 424
Other lending	9 939	6 946	33 959	19 043	17 594	0	87 482
Total	51 547	9 580	40 703	21 370	20 550	55 380	199 130

¹ Home loans to individuals which are not (partly) secured by residential mortgages.

² KBC Bank Deutschland only included in the figures for 2013.

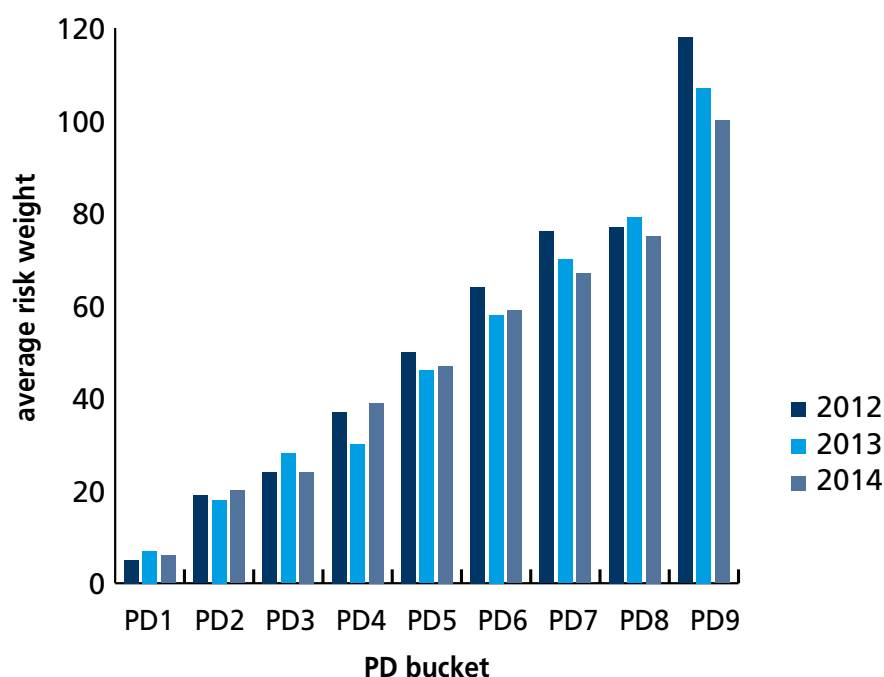
The distribution over the different product types remained unchanged. The 'Other lending' category continued to account for the majority of the lending portfolio. One significant difference can be found in the 'Debt instruments' category due to the purchase of (mainly sovereign and covered) bonds.

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

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

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

IRB exposure - credit quality analysis



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

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

The average risk weight in 2014 was lower than in 2013, due mainly to the composition of the portfolio rather than for model-driven reasons, namely:

- the abolishment of permanent partial use in the 'Sovereign' exposure, which accounted for an exposure shift from the Standardised 'Sovereign class' to the IRB 'Sovereign' class. As the counterparties in the 'Sovereign' asset class have below-average risk weights, their inclusion in the IRB portfolio resulted in a lower EAD-weighted average risk weight for the entire IRB portfolio.
- for the 'Residential mortgages' asset class, the change was driven mainly by volume changes in the portfolio and by PD migration or PD model changes. The average mortgage risk weight fell significantly due to (i) new production in Belgium in the best rating scales and (ii) a shift in exposures from PD bucket 9 to 'non-performing' in Ireland.

The increase in the average risk weight for 'Institutions' was driven by the Basel III correlation factor (= 1.25) for Large and Unregulated Financial Institutions.

In millions of EUR – 31-12-2013²

PD Master scale	Exposure [EAD] RWA Average in %	Sovereign	Institutions	Corporates	SME Corporates	Retail	Residential Mortgages	Total ²
1 [0.00% - 0.10%]	Sum of EAD	12 039	3 941	5 263	560	3 124	22 534	47 460
	Sum of RWA	886	293	740	58	109	1 429	3 515
	weighted average	7%	7%	14%	10%	3%	6%	7%
2 [0.10% - 0.20%]	Sum of EAD	1 168	1 289	4 250	1 528	2 943	4 498	15 677
	Sum of RWA	463	311	1 062	289	191	405	2 720
	weighted average	40%	24%	25%	19%	6%	9%	17%
3 [0.20% - 0.40%]	Sum of EAD	164	676	7 957	3 304	2 653	655	15 409
	Sum of RWA	76	64	3 011	821	325	60	4 358
	weighted average	46%	10%	38%	25%	12%	9%	28%
4 [0.40% - 0.80%]	Sum of EAD	58	824	7 496	3 440	2 905	7 220	21 943
	Sum of RWA	52	98	3 538	1 284	582	1 089	6 643
	weighted average	90%	12%	47%	37%	20%	15%	30%
5 [0.80% - 1.60%]	Sum of EAD	271	663	5 179	3 505	2 454	6 315	18 387
	Sum of RWA	253	259	3 796	1 603	788	1 825	8 524
	weighted average	93%	39%	73%	46%	32%	29%	46%
6 [1.60% - 3.20%]	Sum of EAD	321	89	3 015	2 418	1 928	1 860	9 631
	Sum of RWA	146	27	2 497	1 358	740	848	5 618
	weighted average	46%	31%	83%	56%	38%	46%	58%
7 ¹ [3.20% - 6.40%]	Sum of EAD	32	106	1 953	1 541	1 101	1 531	6 263
	Sum of RWA	32	78	1 869	985	480	943	4 387
	weighted average	100%	74%	96%	64%	44%	62%	70%
8 [6.40% - 12.80%]	Sum of EAD	2	145	670	488	517	367	2 187
	Sum of RWA	0	28	767	389	217	327	1 729
	weighted average	25%	19%	114%	80%	42%	89%	79%
9 [12.80% - 100.00%]	Sum of EAD	30	4	651	567	724	2 206	4 182
	Sum of RWA	19	3	860	544	408	2 597	4 430
	weighted average	0%	74%	132%	96%	56%	118%	106%
Total exposure		14 084	7 737	36 435	17 350	18 348	47 186	141 140
Total risk-weighted assets		1 928	1 161	18 140	7 332	3 839	9 524	41 923
Total weighted average		14%	15%	50%	42%	21%	20%	30%

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

2 KBC Bank Deutschland only included in the figures for 2013.

In millions of EUR – 31-12-2014

PD Master scale	Exposure [EAD] RWA Average in %	Sovereign	Institutions	Corporates	SME Corporates	Retail	Residential Mortgages	Total
1 [0.00% - 0.10%]	Sum of EAD	42 441	4 667	5 879	596	3 460	24 612	81 655
	Sum of RWA	2 677	656	698	73	118	1 563	5 785
	weighted average	6%	14%	12%	12%	3%	6%	7%
2 [0.10% - 0.20%]	Sum of EAD	1 789	1 879	4 559	1 595	3 215	4 075	17 112
	Sum of RWA	622	661	1 222	277	179	366	3 327
	weighted average	35%	35%	27%	17%	6%	9%	19%

3 [0.20% - 0.40%]	Sum of EAD	124	537	7 068	3 577	2 545	4 344	18 195
	Sum of RWA	53	122	2 673	891	273	509	4 520
	weighted average	43%	23%	38%	25%	11%	12%	25%
4 [0.40% - 0.80%]	Sum of EAD	3 310	1 594	6 887	3 919	3 001	5 984	24 695
	Sum of RWA	2 602	555	3 352	1 488	549	959	9 505
	weighted average	79%	35%	49%	38%	18%	16%	38%
5 [0.80% - 1.60%]	Sum of EAD	61	161	5 176	3 671	2 143	4 633	15 846
	Sum of RWA	50	55	3 532	1 778	606	1 406	7 427
	weighted average	82%	34%	68%	48%	28%	30%	47%
6 [1.60% - 3.20%]	Sum of EAD	157	328	3 445	3 025	2 319	2 050	11 323
	Sum of RWA	11	125	2 986	1 652	862	1 050	6 685
	weighted average	7%	38%	87%	55%	37%	51%	59%
7* [3.20% - 6.40%]	Sum of EAD	109	214	1 944	1 353	989	960	5 570
	Sum of RWA	67	122	1 854	840	335	524	3 742
	weighted average	61%	57%	95%	62%	34%	55%	67%
8 [6.40% - 12.80%]	Sum of EAD	9	23	628	441	521	345	1 966
	Sum of RWA	18	14	652	333	202	255	1 474
	weighted average	196%	63%	104%	76%	39%	74%	75%
9 [12.80% - 100.00%]	Sum of EAD	3	52	492	444	620	1 279	2 889
	Sum of RWA	5	14	593	399	315	1 589	2 914
	weighted average	188%	28%	120%	90%	51%	124%	101%
Total exposure		48 002	9 455	36 078	18 620	18 814	48 281	179 251
Total risk-weighted assets		6 104	2 324	17 562	7 732	3 437	8 221	45 379
Total weighted average		13%	25%	49%	42%	18%	17%	25%

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

With reference to EAD and LGD, key data are shown in the table below (i.e. EAD, the outstanding amount, the undrawn amount, the EAD-weighted mean Credit Conversion Factor (CCF %) applicable to the undrawn amount and the EAD-weighted mean LGD percentages). Only exposures where KBC uses own CCF and LGD estimates are shown (IRB Advanced approach).

Further detailed quality information on IRB Advanced exposure, 31-12-2013*
(in millions of EUR)

Asset class	PD	1	2	3	4	5	6	7	8	9	Total*
Sovereign	EAD	11 495	744	81	22	221	259	21	-	18	12 861
	Outstanding amount	10 849	742	80	22	221	255	21	-	5	12 194
	Undrawn amount	904	58	6	8	3	78	2	-	13	1 071
	Average CCF %	71%	3%	23%	5%	15%	5%	6%	-	100%	62%
	LGD %	21%	22%	21%	28%	42%	17%	40%	-	18%	21%
Institutions	EAD	3 748	1 284	674	798	646	88	102	145	1	7 485
	Outstanding amount	3 029	1 199	590	576	431	59	52	108	1	6 046
	Undrawn amount	797	91	85	232	359	31	53	37	0	1 686

	Average CCF %	88%	93%	96%	95%	60%	94%	93%	98%	100%	83%
	LGD %	21%	26%	9%	9%	18%	13%	18%	4%	39%	19%
Corporates	EAD	5 116	4 070	7 381	6 818	4 600	2 407	1 543	467	541	32 944
	Outstanding amount	4 054	2 568	5 149	5 098	3 686	1 790	1 296	391	465	24 498
	Undrawn amount	3 312	3 995	4 967	3 445	1 957	1 137	511	132	105	19 561
	Average CCF %	32%	36%	42%	45%	45%	53%	48%	56%	69%	41%
	LGD %	26%	29%	31%	28%	31%	27%	26%	20%	21%	28%
SMEs	EAD	556	1 521	3 246	3 337	3 371	2 290	1 442	424	514	16 701
	Outstanding amount	510	1 307	2 829	2 842	2 813	1 952	1 241	381	483	14 359
	Undrawn amount	215	578	959	1 181	1 094	628	398	91	91	5 234
	Average CCF %	21%	36%	41%	38%	48%	51%	49%	46%	33%	42%
	LGD %	18%	23%	22%	24%	24%	23%	22%	20%	19%	23%
Retail	EAD	3 124	2 943	2 653	2 905	2 454	1 928	1 101	517	724	18 348
	Outstanding amount	2 526	2 756	2 384	2 645	2 236	1 770	983	488	693	16 483
	Undrawn amount	829	545	603	937	531	480	763	72	61	4 821
	Average CCF %	71%	34%	42%	26%	40%	33%	15%	39%	51%	38%
	LGD %	24%	20%	23%	24%	29%	27%	28%	24%	25%	24%
Residential mortgages	EAD	22 534	4 498	655	7 220	6 315	1 860	1 531	367	2 206	47 186
	Outstanding amount	22 533	4 498	654	7 096	6 098	1 837	1 518	366	2 200	46 800
	Undrawn amount	1	0	1	124	217	23	13	1	6	386
	Average CCF - %	100%	-	59%	100%	100%	100%	100%	100%	100%	100%
	Average LGD - %	13%	14%	17%	18%	20%	21%	20%	19%	21%	16%

* KBC Bank Deutschland only included in the figures for 2013.

Further detailed quality information on IRB Advanced exposure, 31-12-2014
(in millions of EUR)

Asset class	PD	1	2	3	4	5	6	7	8	9	Total
Sovereign	EAD	39 872	1 789	62	14	46	156	108	9	2	42 059
	Outstanding amount	39 285	1 777	59	12	45	155	107	9	1	41 452
	Undrawn amount	794	104	8	6	13	24	22	2	5	978
	Average CCF %	74%	11%	40%	41%	6%	5%	4%	6%	5%	62%
	LGD %	18%	25%	10%	76%	34%	2%	17%	42%	49%	19%
	EAD	4 409	1 804	536	1 572	161	328	194	20	52	9 076
	Outstanding amount	3 257	1 232	415	1 074	90	214	104	14	37	6 435

Institutions	Undrawn amount	1 226	577	125	1 061	72	114	95	10	15	3 295
	Average CCF %	93%	99%	96%	47%	98%	99%	95%	60%	99%	79%
	LGD %	20%	32%	20%	20%	15%	16%	13%	12%	5%	22%
Corporates	EAD	5 798	4 461	6 333	6 331	4 445	2 537	1 636	446	455	32 443
	Out-standing amount	3 825	3 228	4 719	4 747	3 569	2 093	1 376	375	397	24 329
	Undrawn amount	7 383	3 742	5 414	3 805	2 466	1 105	583	183	72	24 753
	Average CCF %	27%	27%	26%	37%	31%	37%	44%	38%	70%	30%
	LGD %	18%	28%	29%	27%	29%	27%	25%	18%	21%	26%
	EAD	592	1 570	3 339	3 511	3 181	2 560	1 100	369	395	16 617
SMEs	Out-standing amount	537	1 419	3 005	3 062	2 697	2 243	991	315	364	14 631
	Undrawn amount	180	442	905	936	941	779	271	107	64	4 626
	Average CCF %	30%	31%	32%	40%	43%	35%	34%	48%	45%	37%
	LGD %	21%	22%	21%	23%	23%	23%	20%	19%	18%	22%
	EAD	3 461	3 215	2 545	3 001	2 143	2 319	990	521	620	18 814
Retail	Out-standing amount	2 789	2 962	2 291	2 645	1 964	2 063	914	475	593	16 696
	Undrawn amount	810	515	494	755	418	1 811	165	252	42	5 260
	Average CCF %	77%	46%	49%	33%	41%	13%	44%	16%	59%	36%
	LGD %	27%	22%	25%	28%	31%	34%	26%	31%	28%	27%
	EAD	24 612	4 075	4 344	5 984	4 633	2 050	960	345	1 279	48 281
Residential mortgages	Out-standing amount	24 567	4 075	4 288	5 913	4 538	1 845	959	344	1 273	47 802
	Undrawn amount	45	0	55	71	94	204	0	1	6	478
	Average CCF - %	69%	-	99%	98%	100%	97%	90%	52%	99%	96%
	Average LGD - %	13%	14%	36%	20%	20%	28%	22%	19%	22%	17%

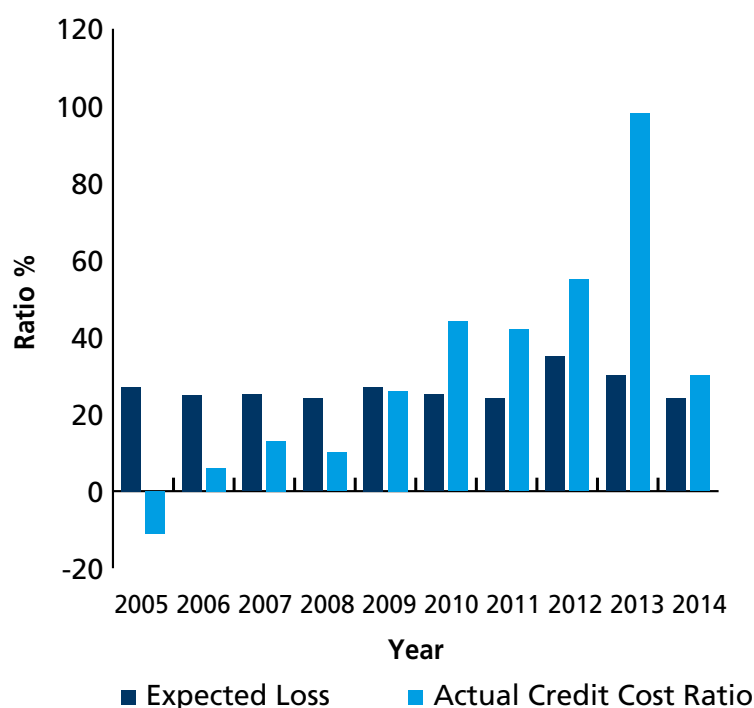
The table shows that LGDs are the lowest for 'Residential mortgages', which by definition have a partly or fully secured nature. Furthermore, LGDs are on average higher for 'Corporates' than for 'SMEs'. The relationship between PDs and LGDs is not a strong one. LGDs are driven by risk mitigators, such as collateral or guarantees, and through a product- or country-specific calibration.

Strictly pursuant to Basel III pillar 3 rules, KBC should disclose a comparison of 'expected losses' with 'actual losses' over a longer period in time and broken down by asset class. Unfortunately, historical loan loss information is generally not available at Basel III asset class level. KBC believes that this disclosure is also less relevant to the extent that, up to 2012, the portfolio was largely made up of exposure subject to the IRB Foundation approach, for which only one underlying parameter of the EL, namely PD, is subject to own estimates/models.

Therefore, KBC has chosen to disclose this comparison only for the total portfolio that is subject to the IRB Advanced approach. The graph compares KBC's EL ratio (EL related to the EAD) with the actual average credit cost percentage. Please note that EL expresses the modelled expectations with a one-year time horizon and thus there is a time lag compared to the credit cost ratio. This implies that the 2014 credit cost ratio shown is the actual ratio over 2014, whereas the EL for 2014 is calculated on the basis of the portfolio at year-end 2014 and is thus a modelled expectation for 2015. Only the normal (i.e. non-default) portfolio is taken into account. Exposures to the low-default 'Sovereigns' and 'Institutions' classes have been excluded from this comparison, which means that the focus lies with the corporate, SME and retail credit portfolio.

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

Comparison historic credit cost and expected loss ratio Exposure subject to IRB Advanced



Due to the regulatory methodology used (the PD is through the cycle combined with a downturn LGD), the EL remains rather stable over time. The credit cost ratio is a point-in-time calculation. In a booming economy (until 2009), actual losses are lower than modelled losses, whereas in a recession (from 2010 on), actual losses are higher than modelled losses.

In 2013, actual losses went up mainly on account of KBC Ireland. In 2014, actual losses were more in line with – but still higher than – the modelled losses.

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

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

KBC uses the regulatory defined risk buckets to assess the quality and linked risk weight for all exposure calculated according to the Standardised approach. It uses external ratings from S&P's, Fitch and Moody's to define the risk bucket of exposures. If there are three external ratings with different risk weights attached to them, the risk weight corresponding with the second best external rating is applied.

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

Much of the exposure is assigned to the unrated bucket. This includes the 'Secured by real estate' exposure, which does not require a rating. Obviously, the 'Retail' exposure is assigned to the unrated bucket. Due to the absence of external ratings, the RWA of the KBC standardised portfolio is primarily volume-driven over time.

Standardised exposure [EAD] 31-12-2013' (in millions of EUR)	Quality steps						Unrated	Total
	1	2	3	4	5	6		
Sovereign	27 581	0	148	0	3 816	0	1 532	33 078
RGLA	0	0	0	0	0	0	135	135
PSE	0	0	0	0	0	0	29	29
MDB	2	0	1	0	0	0	8	10
International organisations	0	0	0	0	0	0	0	0
Institutions	44	114	21	0	0	0	30	210
Corporates	0	0	0	251	1	0	2 024	2 276
Retail	0	0	0	0	0	0	1 528	1 528
Secured by real estate	0	0	0	0	0	0	1 637	1 637
Past due	0	0	0	0	0	0	218	218
High risk	0	0	0	0	0	0	0	0
Covered bonds	0	0	0	0	0	0	0	0
CIU	0	0	0	0	0	0	0	0
Short term	0	0	0	0	0	0	0	0
Other	0	0	0	0	0	0	602	602
Total	27 626	114	171	251	3 818	0	7 743	39 722

Standardised exposure [EAD] 31-12- 2013 (in millions of EUR)	Quality steps						Unrated	Total
	1	2	3	4	5	6		
Sovereign	3 238	235	0	58	0	0	0	3 531
RGLA	0	0	0	0	0	0	165	165
PSE	0	0	0	0	0	0	0	0

MDB	10	0	0	0	0	0	1	11
International organisations	0	0	0	0	0	0	0	0
Institutions	33	10	40	0	0	0	24	107
Corporates	0	3	0	36	0	0	764	803
Retail	0	0	0	0	0	0	1 064	1 064
Secured by real estate	0	0	0	47	0	0	223	270
Past due	0	0	0	0	0	0	117	117
High risk	0	0	0	0	0	0	0	0
Covered bonds	0	0	0	0	0	0	0	0
CIU	0	0	0	0	0	0	0	0
Short term	0	0	0	0	0	0	0	0
Equity*	0	2 945	0	0	0	0	199	3 144
Other	0	0	0	0	0	0	682	682
Total	3 282	3 193	40	140	0	0	3 240	9 895

* New asset class also containing the participation of KBC Group NV in KBC Insurance (2.9-billion-euro exposure).

The exposure in the different asset classes declined mainly because of

- the abolishment of permanent partial use, which led to a shift in exposure – and thus RWA – from the ‘Sovereign’ Standardised class to the ‘Sovereign’ IRB class.
- the transition from the Standardised approach to the IRB Foundation approach for ČSOB Slovak Republic. This change accounted for a decrease mainly in the ‘Corporates’ (-1.2 billion euros), ‘Sovereign’ (-1.5 billion euros), ‘Secured by real estate’ (-1.4 billion euros) and ‘Past due’ (-0.1 billion euros) asset classes.
- the new Standardised asset class, ‘Equity’, which accounted for an increase of 3.1 billion euros mainly due to the participation of KBC Group NV in KBC Insurance (2.9-billion euro-exposure).

Impaired credit exposure in the lending portfolio

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

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

Impaired exposure per geographic region [EAD] (in millions of EUR)	31-12-2013 ¹	31-12-2014
Africa	1	0
Asia	66	74
Central and Eastern Europe & Russia	2 194	2 035
Latin America	4	3

Middle East	15	5
North America	315	290
Oceania	244	132
Western Europe	11 307	11 420
Of which Belgium	2 891	2 721
Of which Ireland	7 175	7 761
Total	14 145	13 959
Impaired exposure per sector [EAD] (in millions of EUR)	31-12-2013¹	31-12-2014
Agriculture, Farming & Fishing	115	125
Automotive	144	72
Building & Construction	695	547
Chemicals	123	69
Commercial Real Estate	2 608	2 500
Distribution	1 032	1 049
Electrotechnics	32	35
Finance & Insurance	176	76
Hospitality	426	415
IT	93	100
Machinery & Heavy Equipment	68	59
Metals	160	137
Private Persons	6 063	7 092
Services	965	895
Shipping	111	109
Textile & Apparel	112	60
Other ²	1 223	617
Total	14 145	13 959

¹ KBC Bank Deutschland only included in the figures for 2013.

² All sectors with a concentration of less than 1% of the total EAD are aggregated into the 'Other' category.

Overall, there was a decrease in the impaired portfolio except for Ireland and in the 'Private Persons' sector. This can be linked to the shift of exposures in PD bucket 9 to the defaulted PD buckets.

For all data on impairment, provisions and value adjustments, reference is made to the 'Consolidated financial statements' section of the 2014 Annual Report for KBC Group NV.

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, repo-like transactions are not covered in this part of the report, but instead are dealt with in the section on 'Credit risk mitigation'.

No distinction is made between counterparty credit risk arising from exposures subject to the IRB approach or to the Standardised approach, nor from the banking or trading book.

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

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

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

Transaction type 31-12-2013 (in millions of EUR)	Marked-to-market	Add-on	Counterparty risk [EAD]	Notional value of contracts	Regulatory capital*
CDS bought -Trading	85	910	995	11 928	23
CDS sold - Trading	47	110	156	13 084	1
Other	0	0	0	0	0
Total credit derivatives	132	1 020	1 152	25 012	24
Interest Rate Swaps (IRS)	4 268	882	5 151	192 840	95
Caps/Floors	613	209	822	25 596	11
Other	394	290	684	28 672	9
Total interest-related transactions	5 276	1 382	6 657	247 107	115
FX forward	196	137	333	10 943	10
FX swap	488	594	1 083	51 755	5
Cross Currency IRS	616	580	1 195	29 918	10
Other	82	103	185	7 666	3
Total currency-related transactions	1 382	1 414	2 796	100 281	27
Equity swaps	1 721	1 489	3 210	40 692	24
Equity options	224	135	359	2 350	1
Total equity-related transactions	1 945	1 624	3 569	43 042	26
Total commodity transactions	29	50	79	493	0
Gross counterparty risk	8 763	5 489	14 252	415 935	
Netting benefit (-)			-7 035		
Total counterparty risk after netting			7 218		
Collateral benefit (-)			-1 830		
Total net Counterparty risk			5 387		192

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

Transaction type 31-12-2014 (in millions of EUR)	Marked-to-market	Add-on	Counterparty risk [EAD]	Notional value of contracts	Regulatory capital*
CDS bought -Trading	5	242	247	4 201	3
CDS sold - Trading	18	24	42	4 100	0
Other	0	0	0	0	0
Total credit derivatives	23	266	289	8 301	3
Interest Rate Swaps (IRS)	6 486	1 218	7 971	191 005	121

Caps/Floors	592	179	774	23 235	13
Other	640	333	982	30 498	20
Total interest-related transactions	7 718	1 729	9 727	244 737	153
FX forward	239	185	441	13 356	9
FX swap	1 239	828	2 081	76 309	14
Cross Currency IRS	666	1 110	1 803	27 107	22
Other	133	163	299	14 461	3
Total currency-related transactions	2 277	2 286	4 624	131 234	49
Equity swaps	2 115	1 523	3 638	39 960	35
Equity options	185	117	302	2 041	2
Total equity-related transactions	2 300	1 640	3 941	42 001	36
Total commodity transactions	50	58	109	573	1
Gross counterparty risk	12 367	5 980	18 691	426 846	
Netting benefit (-)			-9 751		
Total counterparty risk after netting			8 940		
Collateral benefit (-)			-2 612		
Total net Counterparty risk			6 328		242

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

In 2014, the exposure to counterparty risk increased. More specifically, gross counterparty risk went up by 31% and the net counterparty risk (after netting and collateral) by 17% on a year-to-year basis. The change was mainly situated in the marked-to-market exposure and to a lesser extent in the add-on exposure. This implies that this increase in the counterparty risk was primarily marked-to-market driven and not volume driven.

The increase in the counterparty risk was slightly offset by the divestment of KBC Bank Deutschland (-40 million euros).

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

Net derivative exposure per geographic region [EAD] ¹ (in millions of EUR)	31-12-2013	31-12-2014
Africa	0	2
Asia	84	169
Central and Eastern Europe & Russia	724	755
Latin America	0	0
Middle East	20	40
North America	214	109
Oceania	21	36
Western Europe	4 323	5 217
Total	5 387	6 328
Net derivative exposure per rating band ² [EAD] ¹ (in millions of EUR)	31-12-2013	31-12-2014
AAA	0	24
AA	1 184	1 070
A	2 149	2 658

BBB	1 093	1 321
BB	475	788
B and below	384	174
No rating	102	292
Total	5 387	6 328

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

2 For instance, rating band AA incorporates ratings AA+, AA and AA-. If multiple ratings are available, the second best is used. If no external rating is available, the internal rating is mapped to the corresponding external rating.

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

Credit risk mitigation

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

Netting

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

Based on figures for the end of December 2014, the netting impact on derivative exposure amounted to 10 billion euros. Intra-group netting is not included in this figure.

Collateral in repo transactions

KBC engages in the following types of repo transaction:

- **Reverse repos and 'buy and sell-back' transactions:** These transactions are considered deposits made by KBC, with KBC lending cash against securities until the cash is repaid. The difference between reverse repos and buy and sell-backs is technical and relates to the way coupon payments are handled during the transaction.

The securities underlying the reverse repo transactions are almost entirely government securities, with the underlying issuers of the remaining securities being mainly banks and corporate entities. In order to conclude such transactions, a standard General Master Repurchase Agreement (GMRA) needs to be concluded with the counterparty, and legal certainty must exist for all relevant jurisdictions. Transactions also need to be compliant with KBC's repo policies for all relevant entities.

- **Repos and 'sell and buy-back' transactions:** These transactions are considered funding, as

KBC receives cash in exchange for securities provided as collateral until the cash is repaid. Here too, the difference between repos and sell and buy-backs is a technical one.

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

31-12-2013 (in millions of EUR)	Exposure [EAD]	Covered exposure [EAD]	Covered exposure [%]
Reverse repos/buy and sell-back ¹	9 518	3 532	37% ³
Repos/sell and buy-back ²	5 296	5 266	99%
Total	14 814	8 798	59%

31-12-2014 (in millions of EUR)	Exposure [EAD]	Covered exposure [EAD]	Covered exposure [%]
Reverse repos/buy and sell-back ¹	8 209	8 043	98%
Repos/sell and buy-back ²	10 744	10 666	99%
Total	18 953	18 710	99%

1 The covered exposure is lower than the exposure, as the security amount is corrected for regulatory haircuts and mismatches.

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

3 This low percentage is mainly due to transactions at ČSOB Czech Republic, where the reverse repo counterparty and the counterparty of the securities is the same entity, namely the Czech National Bank. Therefore, the collateral is not eligible for capital purposes and thus not included in the coverage percentage.

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, 29.2% (2.6 billion euros of 8.9 billion euros) was classified as collateralised at the end of 2014. A breakdown of covered exposure values by exposure classes and type of collateral is provided in the table below. Both debt securities and cash collateral were taken into account for credit risk mitigation of counterparty risk exposure. In this respect, it should be noted that, according to the applicable policy, equity collateral is not eligible.

Covered exposure ^{1,2} [EAD] 31-12-2013 (in millions of EUR)	LGD % applied under IRB Foundation	Sovereigns	Institutions	Corporates	SME Corporates	Total
Cash	0%	0	1 263	54	0	1 318
Debt securities	0%	0	89	424	0	513
Total		0	1 352	478	0	1 830

Covered exposure ^{1,2} [EAD] 31-12-2014 (in millions of EUR)	LGD % applied under IRB Foundation	Sovereigns	Institutions	Corporates	SME Corporates	Total
Cash	0%	3	1 723	43	0	1 769
Debt securities	0%	0	115	728	0	844
Total		3	1 838	771	0	2 612

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

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

Lending portfolio

Exposures and collateral subject to the Standardised and IRB Advanced approaches are excluded from the table below. Collateral applying to lending exposure subject to the Standardised approach has a direct effect by lowering the EAD, which in turn has a direct effect on RWA and on capital. Since LGD is irrelevant for these exposures, the collateral is not included in the table. Collateral applying to lending exposure subject to the IRB Advanced approach affects RWA only indirectly as collateral is included in LGD modelling (see 'IRB Quality analysis' and 'Internal modelling').

Of the lending EAD subject to the IRB Foundation approach, 0.6 billion euros was classified as collateralised at the end of 2014, 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 collateralised³ EAD to which an LGD percentage of 0%, 35% or 40% has been applied in the capital requirement calculations (compared to an LGD of 45% as used for un-collateralised amounts). The exact percentages depend on the type of collateral concerned as indicated in the table below. Additional information on the extent to which collateral was taken into account in the internal LGD estimation under this approach is provided in the 'Internal modelling' section.

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

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

³ After the application of haircuts, mismatch corrections and collateralisation floors.

Covered IRB Foundation lending exposure [EAD] ¹ 31-12-2013 (in millions of EUR)	LGD applied under IRB Foundation ²	Sovereign	Institutions	Corporates	SME Corporates	Total
Cash	0%	6	0	104	71	181
Debt securities	0%	0	51	0	0	51
Equity collateral	0%	0	0	0	0	0
Total financial collateral		6	51	104	71	232
Real estate ³	35%	10	0	184	518	712
Receivables	35%	0	0	14	1	15
Lease collateral	35%	0	0	0	0	0
Other physical collateral	40%	0	0	0	0	0
Total physical collateral		10	0	198	519	727
General total		16	51	302	590	959

Covered IRB Foundation lending exposure [EAD] ¹ 31-12-2014 (in millions of EUR)	LGD applied under IRB Foundation ²	Sovereign	Institutions	Corporates	SME Corporates	Total
Cash	0%	5	0	31	73	109
Debt securities	0%	0	13	0	0	13
Equity collateral	0%	0	0	0	0	0
Total financial collateral		5	13	31	73	122
Real estate ³	35%	9	0	41	379	429
Receivables	35%	0	0	0	0	0
Lease collateral	35%	0	0	0	0	0
Other physical collateral	40%	0	0	0	0	0
Total physical collateral		9	0	41	379	429
General total		15	13	72	451	551

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.

There was a significant decrease in collateral caused by the divestment of KBC Bank Deutschland and volume changes in the lending portfolio secured by real estate collateral.

The table shows that the bulk of the collateralised amounts relates to physical collateral (0.4 billion euros), while financial collateral, which has a bigger impact on capital as it attracts a LGD of 0%, was limited to 0.1 billion euros. 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.

Unfunded credit protection

Unfunded credit protection is provided mainly through guarantees and – to a much lesser extent – credit derivatives entered into for hedging purposes. For guarantees, the impacted exposure (i.e. amounts receiving a better rating through PD substitution, resulting in lower capital requirements) significantly

decreased to 0.1 billion euros at the end of 2014. This relates solely to exposures treated under the Standardised and IRB Foundation approaches.

This significant decrease can be linked to the divestment of KBC Bank Deutschland and changes in the volumes. Unfunded credit protection applying to lending exposure under the IRB Advanced approach affects RWA only indirectly as guarantees are included in LGD modelling. Additional information on how unfunded credit protection was taken into account in the internal LGD estimation under this approach can be found in the 'Internal modelling' section.

Covered exposure [EAD] ^{1, 2, 3} 31-12-2013 (in millions of EUR)	Sovereign	Institutions	Corporates	SME Corporates	Total
Credit derivatives	0	0	0	0	0
Guarantees	126	413	988	169	1 696
Total	126	413	988	169	1 696

Covered exposure [EAD] ^{1, 2, 3} 31-12-2014 (in millions of EUR)	Sovereign	Institutions	Corporates	SME Corporates	Total
Credit derivatives	0	0	0	0	0
Guarantees	1	0	69	77	147
Total	1	0	69	77	147

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

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

3 The scope of the table includes the Standardised and IRB Foundation approaches.

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

Internal modelling

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

These models are used in the credit process for:

- defining the delegation level for credit approval (e.g., PD models, LGD models, EAD 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;
- generating 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 European regulations. 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 corporate customers, for example.
- Statistical expert-based models: Rankings are based on quantitative and qualitative input, but due to the small number of observed default events, regression is applied to predict expert assessments of the creditworthiness of the clients, rather than their default/non-default behaviour. At KBC, this method is used to rank borrowers in the 'Commercial real estate and site financing' segment, for example.
- Generic flexible rating tool: This is a template that is used by 'graders' to justify and document the given rating class. In this template, the most relevant risk indicators are given a score and ranked in order of importance as a basis for a final rating.

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

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

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

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

Loss Given Default models

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

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

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

The LGD models currently used at KBC are all workout LGDs. The models developed are (methodologically) based on historical recovery rates and cure rates⁴ 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 'downturn' recovery rates than the macroeconomic conditions that led to the higher number of defaults.

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

⁴ 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 incentive for corrective actions.
- Unavoidable uncertainties are similar to avoidable uncertainties, except that in this case the uncertainty is inherent and hence not rectifiable. An example is a new credit portfolio for which no relevant historical data can be found. To raise awareness, estimates of potential errors are made for unavoidable uncertainties. For PD, EAD and LGD models, a portion of these

uncertainties is also covered by means of capital penalties. The estimated overall level of uncertainty (avoidable + unavoidable) is clearly communicated to any stakeholder that uses the model outputs.

This framework was adopted in the last quarter of 2013, replacing a similar one that had been in place from the second quarter of 2010.

Overview of credit risk models

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

PD models used under the IRB approach, 31-12-2014 ¹ (in billions of EUR)	Exposure granted [EAD]	Central tendency ²	Historical default rate ³	Average model PD (excl. over- rulings) ⁴
PD models for government and public sector segments				
(Worldwide) model for central governments	60.57	0.70%	0.58%	0.83%
(Worldwide) model for sub-national governments (Belgium – UK – USA)	2.41	0.06%	0.00%	0.08%
Czech municipalities ⁵	0.32	0.30%	0.27%	0.27%
Hungarian municipalities	0.02	1.31%	0.97%	0.94%
PD models for corporate and institutional segments				
Large corporates				
<i>of which non-Irish</i>	16.38	1.64%	1.65%	1.63%
<i>of which Irish</i>	0.09	6.08%	7.50%	3.59%
Czech corporates	0.93	1.20%	1.17%	1.20%
Hungarian corporates	2.14	2.08%	2.08%	1.88%
Slovak corporates ⁶	1.39	2.46%	2.42%	2.30%
(Worldwide) model for banks				
<i>of which developed</i>		0.30%	0.09%	0.63%
<i>of which others</i>		1.13%	0.42%	1.58%
(Worldwide) model for project finance	2.75	1.36%	1.91%	1.14%
(Worldwide) model for commercial real estate				
<i>of which non-Irish</i>	3.91	2.27%	2.27%	1.99%
<i>of which Irish</i>	0.25	9.73%	4.07%	9.60%
(Worldwide) model for management buy outs	0.85	4.04%	3.75%	5.14%
PD models for SME segments				
Models for Belgian professionals				
<i>of which members of liberal professions⁶</i>	0.20	0.44%	0.46%	0.42%
<i>of which self-employed⁶</i>	0.95	1.84%	1.90%	1.75%
<i>of which private persons⁶</i>	0.41	1.56%	1.51%	1.57%
<i>of which self-employed farmers⁶</i>	2.03	0.55%	0.58%	0.52%
Belgian farmers ⁶	1.24	1.58%	1.48%	1.49%
Belgian SMEs				
<i>of which small businesses⁶</i>	15.45	1.96%	2.03%	1.86%
Belgian legal entities & SPOS				
<i>of which legal entities⁶</i>	1.08	1.97%	1.97%	2.02%
<i>of which hospitals⁶</i>	1.85	0.19%	0.19%	0.26%

<i>of which schools⁶</i>	0.37	0.25%	0.25%	0.45%
<i>of which homes for elderly⁶</i>	0.77	0.67%	0.67%	1.01%
Czech large and mid SMEs	0.36	3.30%	3.40%	3.71%
Hungarian upper SMEs	0.01	2.86%	2.86%	2.50%

1 Non-exhaustive list of models used under the IRB approach, and excluding all retail pooling models.

2 The central tendency (CT) is the long-term (through-the-cycle) expected average default probability of a portfolio. The historical average observed default rate is a good starting point for determining the CT, but does not necessarily equal it, as forward looking information and expert judgement also needs to be taken into account.

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

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

5 The reported CTs are those proposed in the latest model review. These reviews have already been internally approved, but they contain material changes. Hence, in line with the new Commission Delegated Regulation (EU) No 529/2014 on this topic, these changes were submitted to the regulators for their approval. Until regulatory approval is received, these new models will not be implemented.

6 Central tendency, default rate and average model PD values can differ from entity to entity. The values shown here are those for KBC Bank NV.

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

LGD models used under the IRB-Advanced approach 31-12-2014 In billions of EUR	Exposure granted [EAD]	Average LGD non-defaulted exposures (PD 1-9)	Average LGD defaulted exposures (uncertain, PD 10-11)	Average LGD defaulted exposures (irrecoverable, PD 12)	Exposure covered by financial collateral	Exposure covered by physical collateral	Exposure covered by guarantees	Exposure covered by credit derivatives
LGD models for government and public sector segments								
(Worldwide) model for central governments	41.6	18.38%	19.23%	-	0%	0%	6%	-
LGD models for corporate and financial segments ¹								
(Worldwide) financial institutions ²	11.9	19.83%	3.72%	-	0%	0%	3%	-
(Worldwide) corporates	18.1	31.90%	28.79%	66.12%	3%	22%	7%	-
(Worldwide) commercial real estate project finance	3.8	20.21%	35.82%	-	1%	49%	5%	-
(Worldwide) project finance ³	2.3	19.29%	15.19%	-	0%	1%	16%	-
LGD models for SME segments								
Belgian SME	26.9	20.98%	12.25%	26.73%	1%	57%	9%	-
Czech corporates and SME	7.9	23.81%	31.00%	58.16%	3%	16%	11%	-
LGD pooling models for retail ⁴								
LGD pooling model for Belgian regulated retail	35.2	15.02%	19.80%	50.09%	-	-	-	-
LGD pooling model for Irish mortgage loans	12.1	17.44%	31.15%	64.66%	-	-	-	-
LGD pooling models for Czech retail	8.1	24.15%	13.88%	31.28%	-	-	-	-
LGD pooling model for Slovak mortgage loans	2.1	11.70%	11.70%	63.30%	-	-	-	-
LGD pooling model for Hungarian retail	1.8	29.04%	0.00%	0.00%	-	-	-	-

1 No specific LGD model exists for irrecoverable (PD 12) exposure to financials, commercial real estate or project finance. Instead, the generic irrecoverable LGD model for worldwide corporates is used.

2 The LGD model for financial institutions is also used for non-bank financials that are treated as corporates under Basel II. Hence, the scope should not be confused with 'Institutions' in this report.

3 No collateral or guarantee information available for the worldwide project finance model.

4 No collateral or guarantee information provided for retail pooling models, as LGDs are determined based on the allocation of transactions to predefined pools and not on the level of risk mitigation at a transactional level.

In terms of credit risk mitigation, there is a significant presence of physical collateral, a material presence of guarantees and a more modest presence of financial collateral. For the worldwide corporate model, physical collateral mostly comprises mortgage registrations (1.1 billion euros), powers of attorney to create a mortgage (0.7 billion euros), pledges (1.1 billion euros), powers of attorney to establish a pledge (0.3 billion euros) and leased objects (0.7 billion euros), while guarantees are issued by governments (0.2 billion euros) and insurance agents (0.6 billion euros). For the worldwide commercial real estate project finance model, physical collateral is almost exclusively mortgage registrations (0.7 billion euros) and powers of attorney to create a mortgage (0.4 billion euros). For the Belgian SME model, the bulk of credit risk mitigation comes in the form of physical collateral. The most material collateral types are mortgage registrations (5.5 billion euros), powers of attorney to create a mortgage (7.4 billion euros), pledges (1.1 billion euros), powers of attorney to establish a pledge (0.4 billion euros) and leased objects (0.9 billion euros). The guarantees are mostly issued by governments (1.4 billion euros) or sureties provided by private persons (0.7 billion euros).

Credit risk related to KBC Insurance

Notwithstanding the fact that KBC Insurance is not subject to Basel III 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

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

Investment portfolio of KBC group insurance entities (in millions of EUR, market value) ¹	31-12-2013	31-12-2014
Per balance sheet item		
Securities	19 284	21 282
Bonds and other fixed-income securities	18 003	19 935
Held to maturity	6 731	6 982
Available for sale	11 266	12 952
At fair value through profit or loss and held for trading	1	1
As loans and receivables	5	0
Shares and other variable-yield securities	1 262	1 345
Available for sale	1 260	1 340
At fair value through profit or loss and held for trading	3	5
Other	19	3
Property and equipment and investment property	354	373
Investment contracts, unit-linked ²	12 745	13 425
Other	701	1 074
Total	33 084	36 155
Details for bonds and other fixed-income securities		
By rating ^{3,4}		
Investment grade	96%	96%
Non-investment grade	3%	2%
Unrated	1%	2%
By sector ³		
Governments	64%	65%
Financial ⁵	21%	13%
Other	15%	22%
By currency ³		
Euro	94%	95%
Other European currencies	6%	5%
US dollar	0%	0%
By remaining term to maturity ³		
Not more than 1 year	15%	12%
Between 1 and 3 years	20%	18%

Between 3 and 5 years	19%	20%
Between 5 and 10 years	29%	30%
More than 10 years	18%	20%

1 The total carrying value amounted to 32 576 million euros at year-end 2013 and to 34 716 million euros at year-end 2014.

2 Representing the assets side of unit-linked (class 23) products and completely balanced on the liabilities side. No credit risk involved for KBC Insurance.

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

4 External rating scale.

5 Including covered bonds and non-bank financial companies.

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

Credit exposure to (re)insurance companies by risk class ¹ : Exposure at Default (EAD) and Expected Loss (EL) ² (in millions of EUR)	EAD 2013	EL 2013	EAD 2014	EL 2014
AAA up to and including A-	141	0.05	190	0.06
BBB+ up to and including BB-	147	0.13	123	0.12
Below BB-	0	0	0	0
Unrated	3	0.07	6	0.65
Total	291	0.24	341	0.83

1 Based on internal ratings.

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

Credit risk related to sovereign bond exposures

We hold a significant portfolio of government bonds, primarily as a result of our considerable excess liquidity position and for the reinvestment of insurance reserves into fixed instruments. A breakdown per country is provided in the table below.

Overview of exposure to sovereign bonds at year-end 2014, carrying value ¹ (in millions of EUR)								
Total (by portfolio)	Available for sale	Held to maturity	Designated at fair value through profit or loss	Loans and receivables	Held for trading	Total	For comparison purposes: total at year-end 2013	Economic impact of +100 basis points ³
Southern Europe and Ireland								
Greece	0	0	0	0	0	0	0	0
Portugal	46	36	0	0	1	83	77	-6
Spain	1 606	0	0	0	3	1 609	348	-92
Italy	2 018	93	0	0	11	2 123	865	-123
Ireland	465	308	0	0	2	775	462	-42
KBC core countries								
Belgium	7 123	16 535	93	0	794	24 545	24 586	-1 343
Czech Rep.	1 390	5 305	0	23	869	7 587	8 970	-455

Hungary	464	1 431	0	8	171	2 073	2 267	-68
Slovakia	1 448	1 274	0	0	69	2 792	2 395	-163
Bulgaria	263	15	0	0	0	279	16	-9
Other countries								
France	1 634	2 460	0	0	120	4 214	3 312	-342
Poland	522	55	12	0	36	624	398	-29
Germany	356	482	0	0	23	861	942	-57
Austria	407	396	379	0	0	1 182	894	-67
Netherlands	182	422	265	0	36	905	797	-38
Rest ²	1 543	1 528	315	0	257	3 643	4 400	-221
Total carrying value	19 469	30 342	1 063	31	2 391	53 298	50 876	-
Total nominal value	16 807	28 562	933	31	2 314	48 646	47 978	-

1 Including entities classified as 'disposal groups' under IFRS 5 (accounted for an aggregate 0.2 billion euros at year-end 2013 and 0.0 billion euros at year-end 2014).

Excluding exposure to supranational entities of selected countries. No material impairment on the government bonds in portfolio.

2 Sum of countries whose individual exposure is less than 0.5 billion euros at year-end 2014.

3 Theoretical economic impact in fair value terms of a parallel 100-basis-point upward shift in the spread over the entire maturity structure (in millions of euros). Only a portion of this impact is reflected in profit or loss and/or equity. Figures relate to banking book exposure only (impact on trading book exposure was very limited and amounted to -36 million euros at year-end 2014).

Main changes in 2014:

- The carrying value of the total sovereign bond exposure increased slightly by 2.4 billion euros, due primarily to the higher exposure to Spanish, Italian and French government bonds (+1.3 billion euros, +1.3 billion euros, +0.9 billion euros, respectively), but partly offset by a decrease in exposure to Czech government bonds (-1.4 billion euros).



Structured Credit Products

This section deals with KBC's structured credit activities at year-end 2014. 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. The securities from certain ABS issues can also be held/retained by KBC to create collateral for funding transactions.
- **CDOs** are a type of asset-backed security and a structured finance product in which a distinct legal entity, a Special Purpose Vehicle (SPV), issues bonds or notes against an investment in an underlying asset pool. Pools may differ with regard to the nature of their underlying assets and can be collateralised either by a portfolio of bonds, loans and other debt obligations, or be backed by synthetic credit exposures through use of credit derivatives and credit-linked notes.

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

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

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

- structured credit programmes where KBC acts as the originator;
- KBC's investments in structured credit products at year-end 2014, 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 a view on the results of stress tests;
- the capital charges corresponding to the structured credit exposures.

Strategy and processes

Since 2007, KBC has had a tight strategy in place related to structured credit products and has gradually imposed a moratorium on originating and investing in CDOs and ABS. Before then, KBC had acted as *an originator* and *investor* in structured credit transactions ('legacy exposure' in the tables).

In 2013, KBC decided to lift the strict moratorium on investments in ABS and to allow treasury investments in relatively liquid senior European cash ABS ('treasury ABS exposure' in the tables), part of which are accepted as eligible collateral by the ECB. This allows for further diversification in the investment portfolios. In 2014, a limited amount of investments in senior cashflow CLOs was also approved. It should be noted that the moratorium on CDOs is still in place.

A credit review is performed each quarter on ABS, in which both the first line risk (front office) and second line risk (credit risk department) is involved.

In 2014, KBC turned the page on KBC Financial Product's legacy CDO exposure when the remaining transactions were de-risked. Hence, no further information on these transactions has been included in this report as they no longer represent a risk for KBC.

For the record, KBC wishes to point out that it is the counterparty to and issuer of a further 0.3 billion euros' worth of CDO notes held by investors that will remain outstanding until year-end 2017. This effectively means that KBC is now a net buyer of credit risk protection, which is valued at fair value. Consequently, negligible movements may yet be recorded in KBC's income statement in the coming quarters based on changes in the value of these notes (due primarily to credit spread movements on the underlying portfolio and reducing time value).

Scope of structured credit activities

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

Structured credit programmes for which KBC acts as originator

The structured credit transactions in which KBC entities have an originating role are summarised under this heading. These operations are now limited to structured credit with underlying assets arising directly from KBC's credit-granting activities.

The main objective of such structured credit is to optimise the balance sheet and to provide

additional sources of bank funding. The following structured credit transactions fall under this heading:

Structured credit transactions whose underlying assets arise directly from KBC's credit-granting activities, 31-12-2014 (in millions of EUR)				
Programme	Role	Type of underlying exposure	Notional amount of the underlying	Notes outstanding
Home Loan Invest 2007	Originator	Mortgage loans	2 049	1 678
Home Loan Invest 2009	Originator	Mortgage loans	-	0
Home Loan Invest 2011	Originator	Mortgage loans	2 241	1 866
Phoenix Funding 2 (2008)	Originator	Mortgage loans	5 798	5 864
Phoenix Funding 3 (2008)	Originator	Mortgage loans	2 388	2 429
Phoenix Funding 4 (2009)	Originator	Mortgage loans	628	645
Phoenix Funding 5 (2012)	Originator	Mortgage loans	786	788

All Phoenix Funding notes are being retained by KBC Bank Ireland plc.

Home Loan Invest 2007

Home Loan Invest 2007 is a 'Residential Mortgage-Backed Securities' (RMBS) issue where KBC Bank acts as the originator. An SPV acquired a pool of Belgian residential mortgages granted by KBC and raised funds through the issuance of notes (Class A and Class B Notes, rated 'AAA' and 'Aaa' by Fitch and Moody's, respectively) and KBC's subscription to a subordinated loan of 376 million euros. The notes are eligible as collateral for the European Central Bank (ECB), and thus provide KBC Bank with a liquidity buffer. The portfolio of mortgages is a revolving facility where the number of loans and total amount can vary. In July 2012, the portfolio started to amortise and as such comprised 59 148 loans totalling 2 049 million euros, with 1 678 million euros in notes outstanding at year-end 2014. Since KBC holds the first loss piece in the form of the subordinated loan and all notes, after the successful tender of the outstanding notes in July 2012, the Basel III 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 2009

In April 2009, KBC Bank set up its third securitisation transaction. Home Loan Invest 2009 securitised a portfolio comprising 6 667 million euros' worth of Belgian mortgage loans and set aside a reserve of 60 million euros on account. In January 2011, this deal was restructured to allow the addition of a Fitch rating. The SPV issued notes in the amount of 6 000 million euros. The notes reached their first optional redemption date on 15 October 2014 and were called at that time. The amount outstanding is thus zero.

Home Loan Invest 2011

In October 2011, KBC Bank set up its fourth securitisation transaction in the HLI series. Home Loan Invest 2011 securitised a portfolio comprising 4 351 million euros' worth of Belgian mortgage loans and set aside a reserve of 50 million euros on account. The SPV issued notes in the amount of 3 500 million euros. At issuance, approximately 175 million euros' worth of notes was placed with external

investors, while the rest was retained by KBC Bank. The notes are eligible as collateral for the ECB and thus provide an added liquidity buffer for KBC Bank. The Basel III securitisation framework does not apply, as here too an insufficient amount of the risk incurred has been transferred. This issue amortises over the tenor of the transaction. At 31 December 2014, the outstanding notes amounted to 1 866 million euros (the notional amounts are shown in the table above). The subordinated loan amount remained unchanged. The transaction was called on 15 January 2015 and, therefore, the amount outstanding is zero.

Phoenix Funding 2

On 16 June 2008, a residential mortgage backed securitisation (RMBS) transaction called Phoenix Funding 2 was set up as a source of contingent funding. The SPV has a remaining underlying pool of residential mortgages originated by KBC Bank Ireland plc (a fully owned subsidiary of KBC Bank NV), with corresponding note balances amounting to 5 864 million euros. KBC Bank Ireland has retained all of the notes, which implies that the Basel III securitisation framework does not apply, as an insufficient amount of the risk incurred has been transferred. The outstanding notes are divided into two classes, i.e. 63% in class A (Moody's 'Aa3'* / Fitch 'A+' ratings / DBRS 'A' ratings) and 37% in class B (these notes are not rated), maturing in 2050. The Class A notes are eligible for placement with the ECB.

*Moody's rating effective on 23 January 2015 ('Aa3' to 'Aa1').

Phoenix Funding 3

Phoenix Funding 3, which is similar to Phoenix Funding 2, was set up in November 2008. The SPV has a remaining underlying pool of residential mortgages originated by KBC Bank Ireland, with corresponding note balances amounting to 2 429 million euros. KBC Bank Ireland plc has retained all of the notes, which implies that the Basel III securitisation framework does not apply, as an insufficient amount of the risk incurred has been transferred. The outstanding notes are split into two classes, i.e. 61.4% in class A (Moody's 'Aa3'* / Fitch 'A+' ratings) and 29.6% in class B (the class B notes are not rated), maturing in 2050. The class A notes are eligible for placement with the ECB.

*Moody's rating effective on 23 January 2015 ('Aa3' to 'Aa1').

Phoenix Funding 4

Phoenix Funding 4 was set up on 4 August 2009. The SPV has a remaining underlying pool of residential mortgages originated by KBC Bank Ireland plc with corresponding note balances amounting to 645 million euros. KBC Bank Ireland plc has retained all of the notes. The outstanding notes are split into two classes, i.e. 68.8% in class A (Moody's 'Aa3'* / Fitch 'A+' ratings) and 31.2% in class B (these notes are not rated), maturing in 2046. The class A notes of Phoenix Funding 4 are eligible for placement with the ECB.

*Moody's rating effective on 23 January 2015 ('Aa3' to 'Aa1').

Phoenix Funding 5

Phoenix Funding 5 was set up on 6 June 2012. The SPV has a remaining underlying pool of residential mortgages originated by KBC Bank Ireland plc with corresponding note balances amounting to 788 million euros. KBC Bank Ireland plc has retained all of the notes. The outstanding assets are split into three classes of A notes totalling 68.4% (Fitch 'A+' and DBRS A (h) ratings) and an unrated class Z loan of 31.6%. The class A notes of Phoenix Funding 5 are eligible for placement with the ECB.

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

(Figures exclude all expired, unwound or terminated CDO positions)

Under this heading, information is provided on KBC group structured credit investments booked in both the banking and trading portfolios and covering investments in CDOs and other ABS (both legacy and treasury).

In the next paragraphs, an overview is given of the overall exposure and of the credit quality of the securities. Further on, the valuation principles and the accounting principles are examined.

Overall net exposure

Since mid-2013, KBC has presented the net exposure instead of original notional amounts of its remaining investment in CDOs or other ABS.

KBC investments in structured credit products (CDOs and ABS) (in millions of EUR)	31-12-2014
Total net exposure	1 750
of which legacy CDO exposure protected with MBIA	0
of which other legacy CDO exposure	64
of which legacy ABS exposure	684
of which treasury ABS exposure	1 002
Cumulative value markdowns (mid-2007 to date)*	-112
Value markdowns	-112
for other legacy CDO exposure	-28
for other legacy ABS exposure	-62
for treasury ABS exposure	-22
Credit Value Adjustment (CVA) on MBIA cover	0

* Mainly includes AFS reserves and specific/collective impairments on ABS or other (non-KBC Financial Products) CDOs which have been reclassified to L&R.

Over 2014, there was a significant reduction (-5.8 billion euros) in KBC's CDO and ABS exposure, due mainly to:

- the de-risking of the remaining KBC Financial Products CDOs in 2014 (a reduction of -6.3 billion euros);
- redemptions in the other legacy ABS portfolio to the tune of -182 million euros;

- partly offset by new investments in treasury ABS (670 million euros net of 2014 redemptions).

In KBC's treasury portfolio, 727 million euros was invested in new structured credit products, in high quality European RMBS and other ABS assets in 2014. Furthermore, 287 million euros in RMBS assets were transferred from the legacy ABS portfolio to the treasury portfolio. Please note that, in January 2015, the European legacy ABS portfolio ceased to exist following the transfer of all assets to the treasury ABS portfolio.

CDO exposure protected with MBIA

As stated above, KBC bought credit protection from MBIA for a large part of the (super senior) CDOs it originated.

Moreover, the remaining risk related to MBIA's insurance coverage was to a large extent mitigated, as it was included in the scope of the Guarantee Agreement that was agreed with the Belgian State on 14 May 2009. Following the de-risking actions, there is no longer any exposure to MBIA and the Portfolio Protection Agreement entered into with the Belgian Federal Government has ended.

Other KBC group investments in structured credit products (year-end 2014)

This heading relates to the CDOs which KBC bought as investments and which were not insured by credit protection from MBIA (or any other external credit insurer), as well as other ABS held by the KBC group.

Detailed overview of the securities held (31-12-2014)

The next table provides more detailed information on KBC's structured credit exposure.

Structured credit exposure

ABS exposure broken down by type and quality, based on Moody's rating class, 31-12-2014, amounts at notional value (in millions of EUR)										
Moody's rating class*		Aaa	Aa	A	Baa	Ba	B	Caa	<Caa3	Total
Legacy CDO exposure		-	-	58	6	-	-	-	-	64
Legacy ABS exposure										
CMBS		-	-	1	-	-	-	-	-	1
RMBS		12	5	254	221	75	-	-	-	567
Region	United States	4	4	3	-	-	-	-	-	11
	of which Prime (<2005 vintage)	-	-	3	-	-	-	-	-	3
	of which Subprime (<2005 vintage)	4	4	-	-	-	-	-	-	8
	Spain	-	-	191	82	26	-	-	-	299
	Portugal	-	-	6	131	49	-	-	-	186
	Italy	-	-	54	8	-	-	-	-	62
	United Kingdom	8	-	-	-	-	-	-	-	8
	Belgium	-	1	-	-	-	-	-	-	1
Other ABS		97	-	12	8	-	-	-	-	117
Type	CLO	92	-	-	-	-	-	-	-	92
	SME loans	-	-	10	-	-	-	-	-	10

	Student loans	5	-	-	4	-	-	-	-	9
	Lease	-	-	2	4	-	-	-	-	6
Total legacy ABS		109	5	267	229	75	-	-	-	684
Treasury ABS exposure										
	RMBS	484	112	205	82	-	-	-	-	883
Region	Netherlands	434	-	-	-	-	-	-	-	434
	Italy	-	88	144	-	-	-	-	-	232
	Spain	-	24	60	82	-	-	-	-	166
	France	50	-	-	-	-	-	-	-	50
Included in the above:	Total RMBS not rated by Moody's	125	112	17	-	-	-	-	-	255
Moody's equivalent	Netherlands	125	-	-	-	-	-	-	-	125
rating class for RMBS	Italy	-	88	-	-	-	-	-	-	88
not rated by Moody's	Spain	-	24	17	-	-	-	-	-	42
Other ABS	CLO (multiple countries for all assets)	119	-	-	-	-	-	-	-	119
Total treasury ABS		603	112	205	82	-	-	-	-	1 002
Grand total		712	117	529	316	75	-	-	-	1 750

* Moody's rating class: if a security is not rated by Moody's, the Bloomberg composite rating (average of all ratings) is used to determine the equivalent Moody's rating class.

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

Regulatory capital requirements for structured credit positions are held against credit and market risks related to such products and positions. Market risk (trading) regulatory capital requirements are determined through the new CRD III requirements. Under Basel III, there are different approaches available to determine the required capital for credit risk. The treatment used for the different structured credit programmes is described throughout this report. The investment positions are dealt with under the Rating-Based Approach (RBA).

As regards the investments in structured credit products (i.e. this section of the report), the risk weightings applied for regulatory capital calculations are linked directly to the rating of the structured credit products invested in. A further distinction is made depending on their classification as securitisation or re-securitisation (see CRD III, implemented at year-end 2011) and whether they are senior or non-senior positions. Since these risk weightings rise sharply when ratings fall, downgrades of the structured credit invested in have a serious impact on the capital charge. The exposure amount to which the risk weights are applied, depends on the IFRS classification.

Regulatory capital only has to be held by banking entities. Insurance entities are not required to hold this capital, but this situation will change when the Solvency II regulations are implemented. The following table refers to the regulatory capital charges for the ABS and retained CDO exposure held by the KBC group under the CRD III (re)securitisation framework.

Please note that the 19 million euros relating to the re-securitisation capital requirement referred to in the 'Market risk' section is also included in the following table (under the 233 million euros in risk-weighted assets in the below table).

Structured credit products – details of capital charges under the CRD III (re)securitisation framework, 31-12-2014 (in millions of EUR)									
	Notional amount for securitisation	Not. amount for re-securitisation	Total not. amount for CRD III	Of which 6 – 18%	Of which 20 – 35%	Of which 50 – 100%	Of which 250 – 850%	Of which 1250%	RWA 31-12-2014
Banking entities									
Trading book	-	251	251	-	-	-	-	251	233
CDO exposure	-	251	251	-	-	-	-	251	233
<i>of which senior positions</i>	-	-	-	-	-	-	-	-	-
<i>of which non-senior positions¹</i>	-	251	251	-	-	-	-	251	233
Banking book	1 738	-	1 738	1 307	156	164	111	-	689
CDO exposure	64	-	64	48	6	9	-	-	14
<i>of which senior positions</i>	64	-	64	48	6	9	-	-	14

	<i>of which non-senior positions</i>	-	-	-	-	-	-	-	-	-
	Other legacy ABS exposure	672	-	672	257	150	155	111	-	592
	<i>of which senior positions</i>	647	-	647	257	150	130	111	-	579
	<i>of which non-senior positions</i>	25	-	25	-	-	25	-	-	13
	Other treasury ABS positions	1 002	-	1 002	1 002	-	-	-	-	83
	<i>of which senior positions</i>	1 002	-	1 002	1 002	-	-	-	-	83
Total for banking entities		1 738	251	1 989	1 307	156	164	111	251	922
Insurance entities										
	CDO exposure	-	-	-	-	-	-	-	-	-
	Other ABS exposure	12	-	-	-	-	-	-	-	-
Total for insurance entities		12	-	-	-	-	-	-	-	-
Total net exposure for KBC Group		1 750	251	-	-	-	-	-	-	-
Client credit facility ²		N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	32
ABS protection at KBC Financial Products ³		-	0.3	0.3	-	-	-	-	0.3	4
Total RWA										959

1 Including the capital charge for the de-risked deals as the structures themselves still attract capital as long as they have not been fully terminated. The trading book RWA is calculated on the net MtM value of 18.6 million euros.

2 For historical reasons, this credit facility (with receivables as collateral) is provided to a single client in the form of commercial paper, all of which is held by KBC. It is therefore subject to the Supervisory Formula Approach for the purpose of capital adequacy calculations and is included in this table for the sake of completeness.

3 This protection is retained at KBC Financial Products to facilitate the de-risking process, but does attract Regulatory Capital.



Market Risk
Management
(non-trading)

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

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

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

Strategy and processes

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

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

KBC group non-trading market risk (VaR 99.93%, 1-year time horizon) (in billions of EUR)*	31-12-2013	31-12-2014
Total	3.84	4.89

* Excluding a number of small group companies. Cyclical prepayment options embedded in mortgage loans have not been captured. In 2013, KBC Bank Deutschland (see the relevant remark towards the start of this report) had an impact of 0.7 million euros. VaR is measured using the VaR-CoVaR approach. The increase in 2014 was due primarily to the wider spread risk after additional investments had been made in (mainly Italian, Spanish and French) sovereign bonds.

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, credit spread risk, real estate risk, inflation risk and foreign exchange risk are also briefly addressed below.

Interest rate risk

Interest rate risk for the banking activities

We use two main techniques to measure interest rate risks: 10 BPV and VaR (see above). The 10 BPV measures the extent to which the value of the portfolio would change if interest rates were to go up by ten basis points across the entire curve (negative figures indicate a decrease in the value of the portfolio). We set 10 BPV limits in such a way that interest rate positions combined with the other structural exposures (equity, real estate, etc.) remain within the overall VaR limits. We also use other techniques such as gap analysis, the duration approach, scenario analysis and stress testing (both from an economic value perspective and from an income perspective).

Impact of a parallel 10-basis-point increase in the yield curve for the KBC group ¹ (in millions of EUR)	Impact on value ²	
	31-12-2013	31-12-2014
Banking	-22	-57
Insurance	10	16
Total	-11	-41

¹ In 2013, KBC Bank Deutschland (see the relevant remark towards the start of this report) had an impact of 0.8 million euros.

² Full market value, regardless of accounting classification or impairment rules.

We manage the ALM interest rate positions of the banking entities via a system of market-oriented internal pricing for products with a fixed maturity date, and via a replicating portfolio technique – reviewed on a dynamic basis – for products without a fixed maturity date (e.g., current and savings accounts).

The bank takes interest rate positions mainly through government bonds, with a view to acquiring interest income, both in a bond portfolio used for reinvesting equity and in a bond portfolio financed with short-term funds. The table shows the bank's exposure to interest rate risk in terms of 10 BPV.

BPV of the ALM book, banking activities* (in millions of EUR)	31-12-2013	31-12-2014
Average for 1Q	-33	-55
Average for 2Q	-28	-61
Average for 3Q	-21	-71
Average for 4Q	-22	-57
As at 31 December	-22	-57
Maximum in year	-41	-71
Minimum in year	-21	-55

* At year-end 2013, KBC Bank Deutschland (see the relevant remark towards the start of this report) had an impact of -0.1 million euros. The year-on-year change in BPV was due in part to the change in non-maturity deposit modelling.

In line with the Basel guidelines, we conduct a 200-basis-point stress test at regular intervals. It sets off the total interest rate risk in the banking book (given a 2% parallel shift in interest rates) against total capital and reserves. For the banking book at KBC group level, this risk came to 14.9% of total capital and reserves at year-end 2014. This is well below the 20% threshold (where a bank is considered an 'outlier bank' and which can lead to a higher regulatory capital charge).

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

Interest sensitivity gap of the ALM book (including derivatives), banking activities* (in millions of EUR)	≤ 1 month	1–3 months	3–12 months	1–5 years	5–10 years	> 10 years	Non-interest-bearing instruments	Total
31-12-2013	13 787	78	-1 641	-3 170	6 852	766	-16 672	0
31-12-2014	-13 126	-2 961	5 099	20 560	9 205	-2 172	-16 606	0

* In 2014, a change in the modelling of non-maturity deposits led to a different distribution of cashflows over time. In 2013, KBC Bank Deutschland (see the relevant remark towards the start of this report) had the following impact:

31-12-2013	5	126	60	6	0	0	-198	0
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The interest sensitivity gap shows our overall long position in interest rate risk. Generally, assets reprice over a longer term than liabilities, which means that KBC's net interest income benefits from a normal yield curve. The economic value of the KBC group is predominantly sensitive to movements at the long-term end of the yield curve.

Interest rate risk for the insurance activities

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

The non-unit-linked life activities (class 21) combine a guaranteed interest rate with a discretionary

participation feature (DPF) fixed by the insurer. The main risks to which the insurer is exposed as a result of such activities are a low-interest-rate risk (the risk that return on investments will drop below the guaranteed level) and a risk that the investment return will not be sufficient to give customers a competitive profit-sharing rate. The risk of low interest rates is managed via a cashflow-matching policy, which is applied to that portion of the life insurance portfolios covered by fixed-income securities. Unit-linked life insurance investments (class 23) are not dealt with here, since this activity does not entail any market risk for KBC.

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

Expected cashflows (not discounted), life insurance activities (in millions of EUR)						
	0–5 years	5–10 years	10–15 years	15–20 years	> 20 years	Total
31-12-2013						
Fixed-income assets backing liabilities, guaranteed component	10 725	4 098	2 310	626	765	18 525
Liabilities, guaranteed component	10 086	3 123	1 844	1 311	1 779	18 142
Difference in expected cashflows	640	975	466	-685	-1 014	383
Mean duration of assets						4.90 years
Mean duration of liabilities						6.03 years
31-12-2014						
Fixed-income assets backing liabilities, guaranteed component	10 466	4 639	2 332	865	1 050	19 351
Liabilities, guaranteed component	10 282	3 303	1 994	1 402	1 986	18 967
Difference in expected cashflows	184	1 336	338	-537	-936	384
Mean duration of assets						5.85 years
Mean duration of liabilities						6.72 years

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

Breakdown of the reserves for non-unit-linked life insurance by guaranteed interest rate, insurance activities	31-12-2013	31-12-2014
5.00% and higher*	3%	3%
More than 4.25% up to and including 4.99%	10%	11%
More than 3.50% up to and including 4.25%	4%	5%
More than 3.00% up to and including 3.50%	27%	22%
More than 2.50% up to and including 3.00%	22%	22%
2.50% and lower	32%	35%
0.00%	2%	2%
Total	100%	100%

* Contracts in Central and Eastern Europe.

Aggregate interest rate risk for the KBC group

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

Interest Rate Risk – Economic BPV in thousands of EUR – 31-12-2013									
	Overall	EUR	CHF	USD	GBP	CZK	HUF	PLN	Other
Banking activities	-21 631	-20 054	-59	2 514	53	-2 433	-1 541	3	-116
Insurance activities	10 481	10 060	-15	-13	0	877	-127	1	-301
Total	-11 150	-9 994	-74	2 502	53	-1 556	-1 668	5	-418

Interest Rate Risk –Economic BPV in thousands of EUR – 31-12-2014									
	Overall	EUR	CHF	USD	GBP	CZK	HUF	PLN	Other
Banking activities	-56 727	-57 843	-52	2 286	52	1 769	-3 208	-3	273
Insurance activities	15 946	13 945	-31	-17	0	2 201	-155	1	2
Total	-40 781	-43 898	-83	2 269	52	3 971	-3 363	-2	274

Credit spread risk

We manage the credit spread risk for the sovereign portfolio by monitoring the extent to which the value of the sovereign bonds would change if credit spreads were to go up by 100 basis points across the entire curve. The economic sensitivity of the main sovereign positions to changes in spreads is dealt with in the 'Credit risk' section.

Equity risk

The main exposure to equity is within our insurance business, where the ALM strategies are based on a risk-return evaluation, account taken of the market risk attached to open equity positions. Please note that a large part of the equity portfolio is held for the DPF of insurance liabilities (especially profit-sharing in the Belgian market). Apart from the insurance entities, smaller equity portfolios are also held by other group entities, e.g., KBC Bank and KBC Asset Management. We have provided more information on total non-trading equity exposures at KBC in the tables below.

Equity portfolio of the KBC group (breakdown by sector, in %)	Banking activities		Insurance activities		Group	
	31-12-2013	31-12-2014	31-12-2013	31-12-2014	31-12-2013	31-12-2014
Financial	60%	68%	20%	18%	25%	23%
Consumer non-cyclical	1%	1%	10%	10%	8%	9%
Communication	0%	0%	0%	2%	0%	2%
Energy	0%	0%	7%	5%	6%	4%
Industrial	27%	17%	38%	40%	37%	37%
Utilities	0%	0%	3%	2%	3%	2%
Consumer cyclical	1%	0%	15%	12%	13%	11%
Basic materials	0%	0%	5%	8%	4%	7%

Other and not specified	12%	13%	3%	4%	4%	5%
Total	100%	100%	100%	100%	100%	100%
In billions of EUR	0.2	0.2	1.3	1.3	1.4	1.5*
of which unlisted	0.0	0.1	0.0	0.0	0.1	0.1

* The main differences between the 1.5 billion euros in this table and the 2.1 billion euros for 'Equity instruments' in the table appearing in Note 18 of the 'Consolidated financial statements' section of the KBC Group Annual Report – besides a number of minor differences in the scope of consolidation – are that:

(a) Shares in the trading book (0,3 billion euros) are excluded above, but are included in the table in Note 18.

(b) Real estate participations that are not consolidated are classified as 'investments in building' in this table, but classified as 'shares' in the table in Note 18 (as they are not consolidated).

(c) Most 'investments in funds' are treated on a 'look-through' basis (according to the underlying asset mix of the fund and therefore also partially classified as 'fixed-income instruments'), whereas they are classified as 'shares' in the table in Note 18.

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

Impact of a 12.5% drop in equity prices (in millions of EUR)	Impact on value	
	31-12-2013	31-12-2014
Banking activities	-21	-20
Insurance activities	-158	-166
Total	-179	-186

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

Non-trading equity exposure (in millions of EUR)	Net realised gains (in income statement)		Net unrealised gains on year-end exposure (in equity)	
	31-12-2013	31-12-2014	31-12-2013	31-12-2014
Banking activities	85	2	73	108
Insurance activities	44	84	252	261
Total*	130	86	335	385

* The total figure includes gains from some equity positions directly attributable to the KBC group. Gains from joint participations involving the banking and insurance entities of the KBC group have been eliminated, since these participations are consolidated at group level.

Real estate risk

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

Impact of a 12.5% drop in real estate prices* (in millions of EUR)	Impact on value	
	31-12-2013	31-12-2014
Bank portfolios	-59	-51
Insurance portfolios	-28	-30
Total	-86	-81

* The figures for 2013 have been restated. Some buildings used by KBC Insurance for its own activities were excluded from the scope of risk, which reduced the impact of a 12.5% drop in real estate prices by 12 million euros.

Inflation risk

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

Foreign exchange risk

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



Market Risk
Management
(trading)

Market risk is defined as the potential negative deviation from the expected value of a financial instrument (or portfolio of such instruments) due to changes in the level or in the volatility of market prices, e.g., interest rates, exchange rates and equity or commodity prices. Market risk also covers the risk of price fluctuations in negotiable securities as a result of credit risk, country risk and liquidity risk. This section focuses on the trading positions. The interest rate, foreign exchange and equity risks of the non-trading positions in the banking book and of the insurer's positions are all included in ALM exposure.

Strategy and processes

The objective of market risk management (trading) is to measure, report and advise on the market risk of the aggregate trading position at group level, taking into account the main risk factors and specific risk in order to ensure that activities are consistent with the Group Risk Appetite. The Group Risk Appetite, including the strategic objectives with regard to (trading) market risk tolerance, is determined by the Board of Directors by means of an annual review. The Group Markets Committee (GMC) decides upon and periodically reviews a framework of limits and policies on trading activities that is consistent with this Group Risk Appetite. This framework is submitted to the Board of Directors for approval.

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

The centralisation of trading risk management implies close co-operation between all value and risk management units at both group and local level. This close co-operation allows consistent reporting to group senior management through the GMC, which is chaired by the Group CRO and includes senior representatives from line management, risk management and other top management. It manages market risk and addresses the operational and counterparty risks of the dealing rooms. It keeps track of structural trends, monitors group-wide and local risk limits and may decide to impose corrective actions. The GMC, which receives relevant reports on an *ad hoc* and biweekly basis, meets formally every four weeks in order to enable the KBC group to take decisions regarding trading risk on the basis of accurate and up-to-date information.

Scope of market risk management

We are exposed to market risk via the trading books of our dealing rooms in Belgium, the Czech Republic, Slovakia and Hungary, as well as via a minor presence in the UK and Asia. The traditional dealing rooms, with the dealing room in Belgium accounting for the lion's share of the limits and risks, focus on trading in interest rate instruments, while activity on the FX markets has traditionally been limited. All dealing rooms focus on providing customer service in money and capital market products and on funding the bank activities.

There is also a limited market risk in the four legacy business lines of KBC Investments Limited (formerly KBC Financial Products), namely the CDO, fund derivatives, reverse mortgages and insurance derivatives businesses.

Regarding the CDO business – and as mentioned in other parts of this report – KBC has now fully scaled down its CDO portfolio. However, the position pertaining to the remaining 0.3 billion euros of CDO notes held by investors is located in the trading books of KBC Investments Limited.

Consequently, the market risk regulatory capital for this position is recorded under the re-securitisation column (19 million euros) in the 'Trading regulatory capital requirements' table. The remaining three legacy business lines, which represent less than 2% of market risk regulatory capital charges for trading activities, continue to be monitored and wound down by dedicated teams. The most significant progress made in 2014 regarding these other legacy business lines was in the fund derivatives business, with most of the portfolio being sold in June, which left a portfolio book value of about 1 million euros.

The VaR model

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

VaR is defined as an estimate of the amount of economic value that might be lost on a given portfolio due to market risk over a defined holding period, with a given confidence level. The measurement only takes account of the market risk of the current portfolio and does not attempt to capture possible losses due to counterparty default or operational losses nor does it capture the effects of further trading or hedging.

The risk factors used in the VaR calculations cover all the main market risk drivers for the trading books, namely interest rates, interest rate volatility, basis risk, credit spreads, exchange rates, exchange rate volatility, equity, equity volatility and inflation rates. To compute shifts in the risk factors, the historical method is used (HVaR). This means that the actual market performance is used in order to simulate how the market could develop going forward, i.e. this method does not rely on assumptions regarding the distribution of price fluctuations or correlations, but is based on patterns of experience in the past.

KBC's current HVaR methodology is based on a 10-day holding period and a 99% confidence level, with historical data going back 500 working days i.e. it equals the fifth worst outcome (1% of 500 scenarios). The 500 day historical data set is updated once a week by omitting the five oldest scenarios and adding the five most recent ones. The most recent scenario in the new data set corresponds to the historical change observed one week earlier (this lag serves as a data cleaning buffer). The outcome for a 10-day holding period is calculated in two steps. The historical daily movements in the risk factors used in the VaR calculations are first multiplied by the square root of 10, then these shifts in the risk factors are applied to the current market situation and the corresponding P&Ls computed to produce the outcome for that scenario.

The management HVaR and the HVaR calculated for regulatory capital requirements use the same holding period and confidence level (i.e. 10-day holding period and 99% confidence level). An HVaR is calculated for each specialised subsidiary and for all trading entities worldwide on a daily basis.

As with any model, there are a certain number of uncertainties/deficiencies. However, the model is subject to regular review and improvements. During 2014, the main improvement to the model was the use of Overnight Index Swap (OIS) curves for discounting future cashflows for derivative transactions, as this has now become the market standard.

The table below shows the Historical Value-at-Risk (HVaR; 99% confidence interval, ten-day holding period, historical simulation) for the linear and non-linear exposure of all the dealing rooms of the KBC group (including KBC Securities from April 2013 onwards). To allow a year-on-year comparison, the HVaR for KBC Investments Limited (relating to KBC's discontinued CDO business) is also shown.

Market risk (VaR) (in millions of EUR)	10-day HVaR for KBC group		10-day HVaR for KBC Investments Limited	
	2013	2014	2013	2014
Holding period: 10 days				
Average for 1Q	37	24	1	-
Average for 2Q	37	19	1	-
Average for 3Q	34	15	1	-
Average for 4Q	29	15	-	-
As at 31 December	28	15	-	-
Maximum in year	50	29	5	-
Minimum in year	26	11	0	-

A breakdown of the risk factors (averaged) in KBC group's HVaR model is shown in the table below. Please note that the equity risk stems from the European equity business, and also from KBC Securities (from April 2013).

Breakdown by risk factor of trading HVaR for KBC group (in millions of EUR)	Average for 2013	Average for 2014
Interest rate risk	33.3	18.7
FX risk	2.9	2.3
FX option risk	1.8	1.8
Equity risk	1.9	1.4
Diversification effect	-5.6	-6.2
Total HVaR	34.3	18.1

Regulatory capital

Both KBC Bank and KBC Investments Limited have been authorised by the Belgian regulator to use their respective HVaR models to calculate regulatory capital requirements for part of their trading activities (Approved Internal Models or AIM). ČSOB (Czech Republic) has also received approval from the local regulator to use its HVaR model for capital requirement purposes. These models are also used for the calculation of Stressed VaR (SVaR), which is one of the CRD III Regulatory Capital charges that entered into effect at year-end 2011. The SVaR, like the HVaR, measures the maximum loss from an adverse market movement within a given confidence level (99%) and for a given holding period (10 days). However, the 500 scenarios which are used for calculating the SVaR are not based on the most recent past, but consist of 250 'regular' historical scenarios from the period which resulted in the most negative VaR figure for that entity (the 'stressed' period), and 250 antithetic ('mirror') scenarios, obtained by reversing these 250 regular scenarios. The stressed period which is used for calculating the SVaR has to be calibrated at least on a yearly basis. As at the date of preparation of this report, the period relevant to the measurement of SVaR for 2014 and the period that will be used from 2015 on are shown in the table below:

Approved Internal Model	2014	2015
KBC Bank NV AIM	May 2011 – Apr 2012	Jul 2008 – Jun 2009
KBC Investments Limited AIM	May 2007 – May 2008	Jul 2008 – Jun 2009
ČSOB (Czech Republic) AIM	Jul 2009 – Jun 2010	Feb 2009 – Jan 2010

The resulting capital requirements for trading risk at year-end 2013 and year-end 2014 are shown in the table below. The regulatory capital requirements for the trading risk of local KBC entities that did not receive approval from their respective regulator to use an internal model for capital calculations, as well as the business lines not included in the HVaR calculations, are measured according to the Standardised approach. This approach sets out general and specific risk weightings per type of market risk (interest risk, equity risk, foreign exchange risk and commodity risk). Note that, as mentioned earlier in this section, the re-securitisation regulatory capital for 2014 (19 million euros) emanates from the counterposition for the 0.3 billion euros of CDO notes held by investors (the counterposition is located in the trading books of KBC Investments Limited).

Trading regulatory capital requirements, by risk type (in millions of EUR)		Interest rate risk	Equity risk	FX risk	Commodity risk	Re-securitisation	Total
31-12-2013							
Market risks assessed by internal model	HVaR SVaR	83 100	2 6	13 22	- -	-	226
Market risks assessed by the Standardised approach		39	7	12	2	59	119
Total		222	15	47	2	59	345
31-12-2014							
Market risks assessed by internal model	HVaR SVaR	38 56	2 3	11 17	- -	-	126
Market risks assessed by the Standardised approach		27	4	14	3	19	68
Total		120	9	43	3	19	194

Stress testing

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

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

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

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

Events	Period (start to end)
Financial crisis after collapse of Lehman Brothers	01-07-2007 to 01-07-2009
2 nd Gulf War	01-09-2002 to 30-04-2003
11 September 2001	10-09-2001 to 12-12-2001
Increase in long-term interest rates	18-01-1999 to 14-10-1999
Brazilian crisis	18-01-1999 to 14-10-1999
LTCM fund collapse	25-09-1998 to 17-11-1998
Large swing in exchange rates	17-08-1998 to 17-11-1998

Russia crisis	15-06-1998 to 17-11-1998
Southeast-Asian crisis	01-01-1997 to 01-08-1998
Kobe earthquake (Japan)	16-01-1995 to 16-04-1995
Mexico crisis	15-12-1994 to 30-04-1995
Increase in long-term interest rates	31-12-1993 to 05-10-1994
ERM crisis	28-12-1992 to 31-08-1993
1 st Gulf War	02-08-1990 to 31-03-1991
Stock market decline	25-08-1987 to 31-03-1988

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

Back-testing

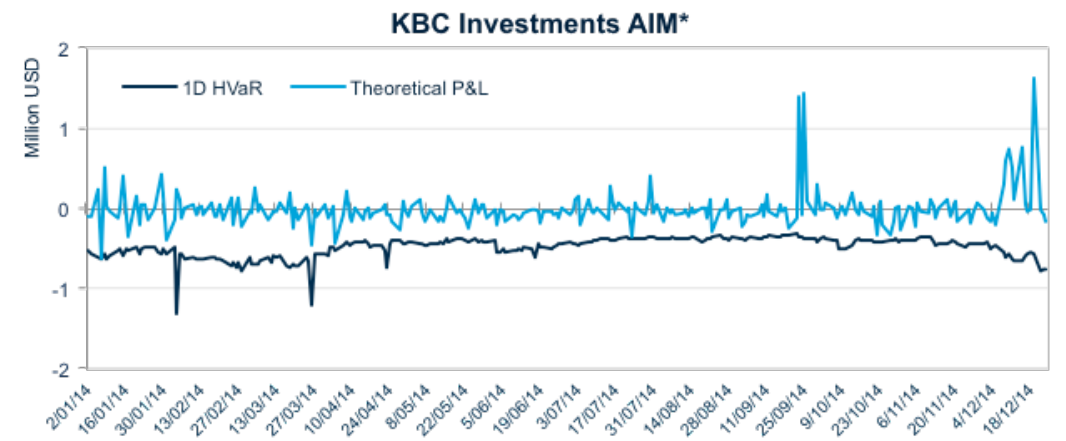
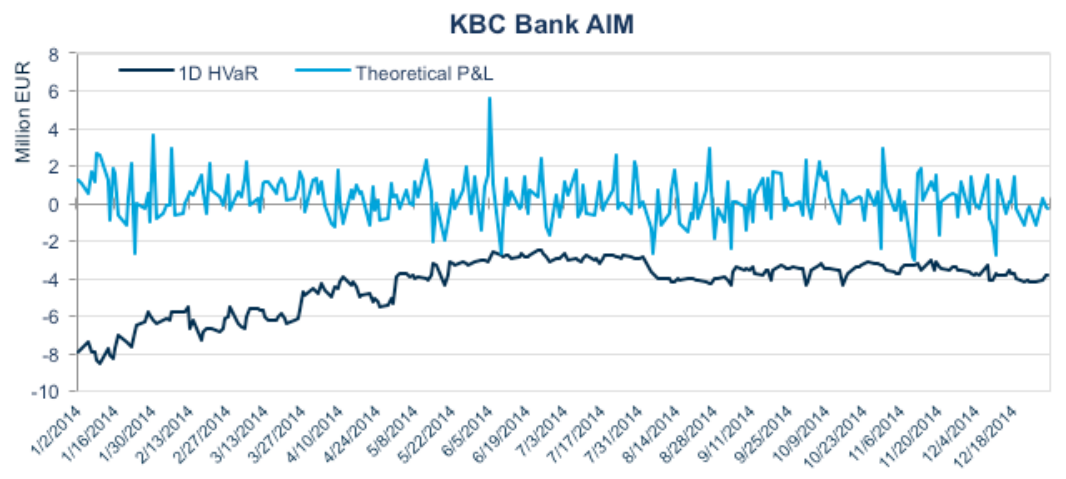
Back-testing plays a crucial role in assessing the quality and accuracy of the HVaR model, as it compares model-generated risk measures to daily P&L figures.

In line with regulatory requirements, a daily theoretical back-test procedure is in place, consisting of three steps. Firstly, a 'no action P&L' is generated. This is the P&L that the portfolio produces if all positions remain unchanged, but the market data changes to the next day's data. This P&L excludes non-trading components such as commissions and fees, and P&L from intraday trading. Secondly, the 'no action P&L' is compared with the VaR calculated (99%, one-day holding period). The last step entails reporting negative exceptions to the relevant risk committees (both on an *ad-hoc* and a quarterly basis), i.e. when the negative P&L result exceeds the one-day VaR. These negative exceptions are also referred to as outliers.

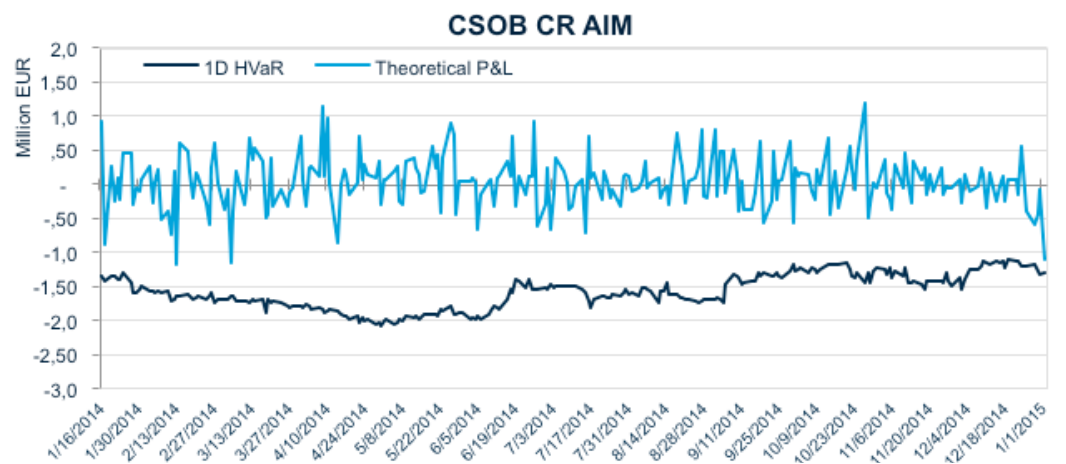
The number of outliers in 2014 and, for comparative purposes, 2013 is shown in the table below. The 2014 theoretical back tests produced no outliers for all three of the market risk HVaR Approved Internal Models of the KBC group. The 2013 theoretical back tests at Approved Internal Model (AIM) level resulted in one outlier for KBC Bank AIM, none for KBC Financial Products AIM and four for ČSOB Czech Republic AIM. The 2013 outlier for KBC Bank AIM, and the two outliers at ČSOB Czech Republic AIM in June 2013, occurred when announcements from the Fed concerning 'tapering of Quantitative Easing' caused considerable volatility on the financial markets. The other two outliers for ČSOB Czech Republic AIM were in January 2013 and were caused mainly by sharp yield increases in Czech government bonds, when market data was showing indications of a recovery on the EU market.

	KBC Bank AIM	KBC Investments Limited AIM	ČSOB CR AIM
Number of outliers for theoretical back-testing of the Approved Internal Models of the KBC group			
2013	1	0	4
2014	0	0	0

Graphs comparing the 1-day HVaR with the daily theoretical P&L results during 2014 at AIM level:



* The figures for four dates have been removed because the P&L results for those days cannot be considered to be a test of the performance of the HVaR model as they were due to bookings that relate to multi-day movements.



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

Validation and reconciliation

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

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

Valuation

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

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

Examples of observable inputs are the risk-free rate, exchange rates, stock prices and implied volatility. Valuation techniques based on observable inputs can include discounted cashflow analysis, reference to the current or recent fair value of a similar instrument, or third-party pricing, provided that the third-party price is in line with alternative observable market data. Unobservable inputs reflect KBC's own assumptions about the assumptions that market participants would use in pricing the asset or liability (including assumptions regarding the risks involved). Unobservable inputs reflect a market that is not active. For example, proxies and correlation factors can be considered to be unobservable in the market.

The KBC valuation methodology of the most commonly used financial instruments is summarised in Note 24 of the 2014 Annual Report of KBC Group NV.

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



Operational Risk
Management
and other
Non-Financial
Risks

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

This definition is in line with the one given in the Basel II Capital Accord and the Capital Requirements Directive.

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

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

Information on legal disputes is provided in Note 36 of the 'Consolidated financial statements' section of the 2014 Annual Report of KBC Group NV.

Strategy and processes

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

Scope of operational risk management

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

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

Operational risk governance

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

The Group risk function is primarily responsible for defining the operational risk management

framework for the entire group. The development and implementation of this framework is supported by an extensive operational risk governance model covering all entities of the group.

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

Toolbox for the management of operational risks

We use a number of building blocks for managing operational risks, which cover all aspects of operational risk management.

Between 2011 and 2015, specific attention is being given to the structured set-up of process-based Group Key Controls, which are gradually replacing the former Group Standards. These Controls are policies containing top-down basic control objectives and are used to mitigate key and killer risks inherent in the processes of KBC entities. As such, they are an essential building block of both the operational risk management framework and the internal control system.

- A first set was approved in 2011 for the Credit, Life, Non-life, Personal Financial Advice, Legal, Tax, Business Continuity Management and Risk & Capital Management processes.
- A second set was approved in 2012 for the Cash, Current Account, Savings Account, Lease, Trading and Sales (part 1), Portfolio Management, Customer Administration, Human Resources, Corporate Communication and Accounting and External Financial Reporting processes.
- A third set was approved in 2013 for the Balance Sheet Management, Collections (Cheque and Direct Debits), Corporate Governance, Custody, Distribution of Customer Information Output, Funds Transfer, Information Security, Marketing: Commercial Communication, Marketing: New and Active Product Process, Reinsurance, Fixed-Term Savings Products, Retail Brokerage and Information Technology processes.
- A fourth set was approved in 2014 for the Clearing and Settlement for Securities and Derivatives, Collateral Management Services for Third Parties, Debt Issues for Own Account, Debt and Equity Capital Market Activities, Facility Management, Independent Intermediaries, Procurement and Trade Finance processes.
- The final set of process-based Group Key Controls will be set up and approved in 2015.

The business and (local) control functions assess these Group Key Controls. The risk self-assessments are consolidated at the Group risk function and ensure that there is a consistent relationship between (i) processes, (ii) risks, (iii) control activities and (iv) assessment scores. KBC created an objective management tool to evaluate its internal control environment and to benchmark the approach across its entities. Each year, we report the assessment results to the National Bank of Belgium in our Internal Control Statement.

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

- **The Loss Event Database.** All operational losses of 1 000 euros or more have been recorded in a central database since 2004. This database also includes all legal claims filed against group companies. Consolidated loss reports are regularly submitted to the Group Internal Control Committee, the Group Executive Committee and the RCC.
- **Risk Scans** (bottom-up and top-down). These self-assessments focus on the identification of key operational risks at critical points in the process/organisation that are not properly mitigated, and on new or emerging operational risks that are relevant at (sub)group level.
- **Case-Study Assessments.** These are used to test the effectiveness of the protection afforded by existing controls against major operational risks that have actually occurred elsewhere in the financial sector. Case studies are discussed on a quarterly basis in the Group Internal Control Committee.
- **Key Risk Indicators.** A limited set of KRIs are used to monitor the exposure to certain operational risks and track the existence and effectiveness of the internal controls.
- **Maturity Model.** In 2014, the group operational risk function developed a maturity model to support KBC entities build a mature control environment in which process improvements, control monitoring and remedial actions are embedded even more deeply into day-to-day business practices.

The quality of the internal control environment and related risk exposure as identified, assessed and managed by means of these building blocks is reported to KBC's senior management via a management dashboard and to the National Bank of Belgium and the FSMA via the annual Internal Control Statement. Information on the internal control and risk management systems can be found in the 'Corporate governance statement' section of the 2014 Annual Report of KBC Group NV.

New and Active Products Process (NAPP)

Through the Group Key Control New and Active Products Process (NAPP), business has to consider the main risks related to all new, modified or reviewed products and services. In addition, the advice from support functions (Risk, Compliance, Legal, Tax, Finance, Credit, Business Architecture) has to be sought. If the risks related to a product or service are deemed too great, the business proposal will be rejected or subjected to conditions.

Operational risk capital charge

KBC uses the Standard approach to calculate operational risk capital under Basel II. Operational risk capital for KBC Bank at the consolidated level totalled 849 million euros at the end of 2014, compared with 847 million euros at the end of 2013.

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

Other non-financial risks

Business risk

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

Business risk is assessed using structured risk scans, but also on an ongoing basis by reporting 'risk signals' to top management.

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

Reputation risk

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

We redesigned the Reputation Risk Management Framework in 2012 to take account of the KBC Risk Management Framework. The pro-active and re-active management of reputation risk is the responsibility of the business, supported by many specialist units (e.g., Group Communication, Investor Relations).

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

Business Continuity Management (BCM)

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

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



Insurance Risk Management

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

Strategy and processes

The Group risk function develops and rolls out a group-wide framework for managing insurance risks. It is responsible for providing support for local implementation and for the functional direction of the insurance risk management process of the insurance subsidiaries.

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

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

Scope of insurance risk management

The following entities are in scope, viz. KBC Insurance (Belgium), Maatschappij voor Brandverzekering, Sepia, KBC Group Re, K&H Insurance, ČSOB Pojišť'ovna (Czech Republic), ČSOB Poist'ovňa (Slovak Republic) and DZI Insurance.

Insurance risk classification

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

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

- **Life insurance risks** are further split up into catastrophe risks and non-catastrophe risks. Life non-catastrophe risks cover the biometric risks (longevity, mortality and disability-morbidity risk), revision risk, expense risk and lapse risk related to life insurance contracts.

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

The various subtypes of insurance risk, linked to the different insurance categories (Life, Non-life and Health) are defined as follows:

- **Catastrophe risk:** the risk that a single damaging event, or series of correlated events, of major magnitude, usually over a well-defined, short time period leads to a significant deviation in actual claims from the total expected claims. A distinction is made between natural catastrophes (e.g., wind storms, floods, earthquakes) and man-made catastrophes (e.g., terrorist attacks like 9/11). Not only the non-life, but also the life insurance business can be exposed to catastrophes, such as the pandemic threat of bird flu or accidental events.
- **Lapse risk:** the risk that the actual rate of policy lapses (i.e. premature full or partial termination of the contract by the policyholder) differs from those used in pricing.
- **Expense risk:** the risk that the cost assumptions used in pricing or valuing insurance liabilities in terms of acquisition costs, administration costs or internal settlement costs, turn out to be too optimistic.
- **Revision risk:** the potential negative deviation from the expected value of an insurance contract or a portfolio thereof due to unexpected revisions of claims. Only to be applied to annuities where the amount of the annuity may be revised during the next year.
- **Biometric risk:** the potential negative deviation from the expected value of an insurance contract or a portfolio thereof due to unexpected changes related to human life conditions.
 - **Longevity risk:** the risk that the mortality rates used in pricing annuity products (or other products with negative capital at risk) turn out to be too high, i.e. people live longer than expected.
 - **Mortality risk:** the risk that the mortality rates used in pricing will turn out to be too low, i.e. people die earlier than expected.
 - **Disability-morbidity risk:** the risk that the part of the premium charged to cover hospitalisation or disability claims is not sufficient, due to a higher number of claims or more expensive claims than expected.
- **Premium risk:** the risk that the premium that will be earned next year will not be enough to cover all liabilities resulting from claims in this portfolio, due for instance to the fact that the number of claims will be higher than expected (frequency problem) or the severity of the claims will be higher than expected (severity problem)
- **Reserve risk:** the risk that the liabilities stemming from claims, which have occurred in the past, but have still to be finally settled, will turn out to be more expensive than expected.

Insurance risk measurement

We develop models 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. We use these models to steer the group's insurance entities towards creating more shareholder value, by means of applications to calculate economic capital, support decisions on reinsurance, calculate the *ex post* profitability of specific sub-portfolios and set off economic capital requirements against the relevant return in pricing insurance policies.

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

Best estimate valuations of insurance liabilities

As part of its mission to independently monitor insurance risks, the Group risk function regularly carries out in-depth studies. These confirm that there is a high degree of probability that the non-life technical provisions at subsidiary level are adequate. Adequacy is checked per business line at subsidiary level and the overall adequacy is assessed at subsidiary level for all business lines combined.

In addition, various group companies conduct Liability Adequacy Tests (LAT) that meet local and IFRS requirements for the life technical provisions. We make calculations using prospective methods (cashflow projections that take account of lapse rates and a discount rate that is set for each insurance entity based on local macroeconomic conditions and regulations), and build in extra market-value margins to deal with the factor of uncertainty in a number of parameters. Since no deficiencies were identified by year-end 2014, there was no need for a deficiency reserve to be set aside within the KBC group.

The techniques used to perform these best estimate valuations will become the foundation of future group-wide insurance liabilities' valuation frameworks to be used within Solvency II and IFRS 4/2.

Technical provisions and loss triangles, non-life business

The table shows claims settlement figures in the non-life business over the past few years and includes KBC Insurance NV, ČSOB Pojišť'ovna (Czech Republic), ČSOB Poist'ovňa (Slovak Republic), DZI Insurance (from financial year 2008), K&H Insurance, and KBC Group Re. All provisions for claims to be paid at the close of 2014 have been included. The claims-settlement figures incorporate all amounts that can be allocated to individual claims, including the Incurred But Not Reported (IBNR) and Incurred But Not Enough Reserved (IBNER) provisions, and the external handling expenses for settling claims, but do not include internal claims settlement expenses and provisions for amounts expected to be recovered. The figures included are before reinsurance and have not been adjusted to eliminate intercompany amounts.

The first row in the table shows the total claims burden (claims paid plus provisions) for the claims that occurred during a particular year, as estimated at the end of the year of occurrence. The following rows indicate the situation at the end of the subsequent calendar years. We restated the amounts to reflect exchange rates at year-end 2014.

Loss triangles, KBC Insurance (in millions of EUR)	Year of occurrence	Year of occurrence	Year of occurrence	Year of occurrence	Year of occurrence	Year of occurrence	Year of occurrence	Year of occurrence	Year of occurrence	Year of occurrence
	2005	2006	2007	2008*	2009	2010	2011	2012	2013	2014
Estimate at the end of the year of occurrence	578	631	686	793	824	871	806	849	917	996
1 year later	506	537	621	757	724	773	714	743	770	–
2 years later	484	511	588	728	668	725	656	707	–	–
3 years later	483	500	567	714	652	720	638	–	–	–
4 years later	474	486	561	710	635	715	–	–	–	–
5 years later	461	478	557	702	627	–	–	–	–	–
6 years later	462	464	550	677	–	–	–	–	–	–
7 years later	458	458	550	–	–	–	–	–	–	–
8 years later	454	455	–	–	–	–	–	–	–	–
9 years later	446	–	–	–	–	–	–	–	–	–
Current estimate	446	455	550	677	627	715	638	707	770	996
Cumulative payments	382	403	470	596	524	601	511	511	507	420
Current provisions	64	52	79	80	103	114	127	196	263	576

* From financial year 2008, the figures for 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): 475 for 2005; 501 for 2006; and 587 for 2007.

Insurance risk mitigation by reinsurance

The insurance portfolios are protected against the impact of serious claims or the accumulation of losses (due, for instance, to a concentration of insured risks) by means of reinsurance. We divide these reinsurance programmes into three main groups, i.e. property insurance, liability insurance and personal insurance, and re-evaluate and renegotiate them every year.

Most of our reinsurance contracts are concluded on a non-proportional basis, which provides cover against the impact of serious claims or loss events. The independent insurance risk management function is also responsible for advising on the restructuring of the reinsurance programmes, especially with a view to creating shareholder value. This approach has resulted in optimising the retention of the KBC group particularly in respect of its exposure to natural catastrophe risk. In view of reducing P&L volatility, KBC Insurance Belgium has concluded a multi-line multi-year reinsurance agreement covering the most important non-life business lines for three years.

More information on the insurance activities of the group can be found under Notes 9, 10, 11 and 35 of the 'Consolidated financial statements' section of the 2014 Annual Report of KBC Group NV. A breakdown by business unit of earned premiums and technical charges is provided in the notes dealing with segment reporting.



Glossary

ABS (Asset Backed Securities)

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

Add-On

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

ALM (Asset and Liability Management)

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

Alt-A

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

Asset class

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

Asset quality review (AQR)

The asset quality review is part of the ECB's comprehensive assessment, an exercise to deliver greater transparency on bank's balance sheets, to prompt the repair of impaired balance sheets and to rebuild confidence in banks. It took place for the first time in 2014. The asset quality review was based on balance sheets at year-end 2013, the assessment covered credit and market, on- and off-balance-sheet, domestic and non-domestic exposures.

Banking book

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

Basel III

Basel III is a global regulatory standard on bank capital adequacy, stress testing and market liquidity risk agreed upon by the members of the Basel Committee on Banking Supervision in 2010.

Basel III was developed in response to the deficiencies in financial regulation revealed by the late-2000s financial crisis.

BIS (Bank for International Settlements)

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

BPV (Basis Point Value)

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

Business risk

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

CAD ratio

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

CDO (Collateralised Debt Obligation)

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

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

CDS (Credit Default Swap)

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

Central Tendency

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

CLO (Collateralised Loan Obligation)

CDO holding only loans as underlying assets.

CP (Commercial Paper)

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

CRD (Capital Requirements Directive)

European-Union-specific interpretation of the general Basel II regulations. The CRD is in turn transposed into the national legislation and regulations of the EU Member States.

Credit risk

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

CSMC (CRO Services Management Committee)

Overarching and integrated risk committee at KBC group level that supports the Group Executive Committee in assessing the adequacy of, and compliance with, the KBC Risk Management Framework and defines and implements the vision, mission and strategy for the CRO Services of the KBC group.

Cure rate

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

Downturn LGD

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

DPF (Discretionary Participation Feature)

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

EAD (Exposure At Default)

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

EBA (European Banking Authority)

The successor to the CEBS (Committee of European Banking Supervisors).

A committee comprised of high level representatives from the banking supervisory authorities and central banks of the European Union. It gives advice to the European Commission on banking policy issues and promotes co-operation and convergence of supervisory practice across the European Union. The committee also fosters and reviews common implementation and consistent application of Community legislation.

ECAP (Economic Capital)

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

EIOPA (European Insurance and Occupational Pensions Authority)

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

EL (Expected Loss)

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

Fair value

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

FSMA (Financial Services and Markets Authority)

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

GRIS (Group Risk Integration & Support)

The Group Risk Integration & Support (GRIS) division supports the CRO of KBC Group NV, KBC Bank and KBC Insurance and business entities at group level. GRIS designs the KBC Risk Management Framework (RMF) and most of its underlying building blocks.

GMRA (General Master Repurchase Agreement)

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

Haircuts

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

HVaR (Historical Value at Risk)

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

ICAAP (Internal Capital Adequacy Assessment Process)

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

Insurance risk

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

Interest rate risk

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

IRB (Internal Ratings-Based)

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

ISDA Master Agreements

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

Lapse risk

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

LCR (Liquidity Coverage Ratio)

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

LGD (Loss Given Default)

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

Liquidity risk

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

Market risk

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

Market value

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

Mark-to-Market

The act of assigning a market value to an asset

MVA (Market Value Adjustment)

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

NBB (National Bank of Belgium)

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

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

Netting

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

NSFR (Net Stable Funding Ratio)

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

Operational risk

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

ORSA (Own Risk and Solvency Assessment)

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

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 bank (or an investment bank) and its clients. It contrasts with exchange trading.

PD (Probability of Default)

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

PIT PD (Point-In-Time PD)

PD reflecting the expected default rate in the next year, based on current economic conditions (contrast with Through-the-Cycle PD).

RAPM (Risk-Adjusted Performance Measurement)

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

RAROC

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

RBA (Ratings-Based Approach)

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

RMBS (Residential Mortgage-Backed Security)

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

RWA (Risk-Weighted Asset)

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

SFA (Supervisory Formula Approach)

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

Solvency II

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

SPV (Special Purpose Vehicle)

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

SSS (Super Senior Swap)

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

SVaR (Stressed Value At Risk)

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

(Core) Tier-1 ratio

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

Trading book

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

TTC PD (Through-The-Cycle PD)

PD reflecting the one-year expected default rate averaged out over a longer period (contrast with Point-in-Time PD).

VaR (Value At Risk)

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