

KBC Group

Embedded Value Report 2008



Management Summary

The Market Consistent Embedded Value (MCEV) 2008 of KBC's life insurance operations is an estimate of the economic value of KBC's current (covered) life insurance business as at 31/12/2008. An estimation is also made of the Value of the New Business (VNB) acquired during 2008.

KBC uses the MCEV as a management tool for its life operations. Applications derived from the MCEV model such as profit testing and VNB analysis are integrated into the everyday operations of the life business.

KBC applies a market consistent valuation methodology compliant with the European Embedded Value principles.

The 2008 scope of KBC's MCEV model is the life insurance business of following KBC subsidiaries: KBC Insurance Belgium, Fidea, Vitis Life Luxembourg, CSOB Pojištovna CZ and Warta TUnZ PL.

For 2008 the covered business lines account for 98% of the life provisions and 96% of the premium inflow (including unit-linked) of the life insurance business within KBC Group.

As at 31/12/2008, the MCEV stood at EUR 2 786 million (EUR 8,20 per share).

Notwithstanding the drop in the Value of Business In force (VBI) the total MCEV remained stable compared to the restated MCEV at the end of 2007, following a capital increase of EUR 1,3 billion. Without the capital increase, the effect of the deteriorated market environment and the resulting asset markdowns would have lowered the MCEV by 45%.

To calculate the MCEV, the Value of Business In force (VBI) is added to the Adjusted Net Asset Value (ANAV). The ANAV of the life business in scope amounted to EUR 2 315 million while the VBI came to EUR 471 million.

The MCEV was adversely impacted by the prevailing financial market context, especially the markdowns on the CDO portfolio and the equity portfolio, which forms part of the ANAV.

The VNB of 2008 amounted to EUR 100 million. The new business margin on an Annualized Premium Equivalent basis came to 32%, while it stood at 3,5% when compared to the Present Value of New Business Premiums.

Contents

Introduction.....	4
1. MCEV results of KBC Group	5
2. Value of New Business (VNB) results	8
3. Movement analysis.....	9
4. Sensitivities.....	11
5. Review statement.....	13
Appendix A. Restatement MCEV 2007	14
Appendix B. Detailed Business Unit results	15
B.1. BU Belgium (KBC Insurance Belgium and Fidea)	15
B.2. BU CEER (CSOB Pojištovna CZ and Warta TUnZ PL)	17
Appendix C. Methodology and assumptions	19
C.1. Methodology	19
C.2. Economic assumptions.....	23
C.3. Non-economic assumptions	25
Appendix D. Time series	26
Appendix E. Glossary and abbreviations	27
Disclaimer.....	30



Introduction

In this report, an analysis is made of the Market Consistent Embedded Value (MCEV) of KBC's life insurance business.

The 2008 scope of KBC's MCEV model is the life insurance business of following KBC subsidiaries: KBC Insurance Belgium, Fidea, Vitis Life Luxembourg, CSOB Po'jistovna CZ and Warta TUnZ PL.

For 2008 the covered business lines account for 98% of the life provisions¹ and 96% of the premium inflow (including unit-linked) of the life insurance business within KBC Group.

For calculating the MCEV, we use a valuation of both the assets and the liabilities of the company in a way that is consistent with prices in the financial markets. The value of unquoted assets and liabilities is equivalent to the value that would be placed on the cash flows generated by these assets and liabilities in a deep and liquid market. It is, in a sense, simply an application of standard valuation principles by insurance companies which is also consistent with modern financial valuation theory applied in the financial markets and hence also with the replication concepts used in ALM.

Therefore the MCEV can be interpreted as the economic value of our current (covered) in-force business. It is defined as the sum of the Adjusted Net Asset Value (ANAV) and the Market Consistent Value of Business In force (MC VBI).

The ANAV corresponds to the shareholders' equity from an economic point of view, with relation to the life insurance business in scope. It is the value of our life insurance company that is not related to the current portfolio.

The MC VBI expresses the market consistent value of the existing life insurance portfolio in scope.

A description of the methodology and the parameter assumptions can be found in Appendix C.

¹ An overview of the life insurance provisions per BU within KBC Group can be found in Appendix D.

1. MCEV results of KBC Group

1.1 Overview

Table 1 shows a high level overview of the MCEV results.

Table 1

Embedded Value ('000 EUR)	2007 restated ²	2008	% change 2007 - 2008
ANAV	1 475 617	2 314 941	+56,88%
MC VBI	1 264 307	470 676	-62,77%
Total MCEV	2 739 925	2 785 617	+1,67%

The total MCEV 2008 remained at about the same level as in 2007.

The ANAV is negatively impacted by the decrease/increase in unrealized capital gains/losses and the accounting losses over 2008. The loss arose mainly from asset impairments, especially on equities and CDOs. This decrease was more than offset by additional capital increases.

Also the MC VBI is negatively impacted by the adverse market conditions. Its decrease is mainly due to the decrease/increase of unrealized capital gains/losses on the assets that are counted as a part of the VBI and the increase in implied volatilities. The latter resulted in a higher Time Value of Financial Options and Guarantees (TV FOG). During 2008, we also noticed higher lapse rates, leading to lower future profits, especially for unit-linked products.

Around 8% of the total MCEV is generated by KBC Asset Management via the management of unit-linked funds.

The changes in the ANAV and VBI are fully detailed in the movement analysis in Section 3.

² The MCEV figures of 2007 were restated to take into account:

- the extension of the scope with CSOB Po'jistovna CZ and Warta TUnZ PL; and
- some model improvements with relation to the VBI of the covered life insurance business.

For more information about this restatement we refer to Appendix A.

1.2 Adjusted Net Asset Value (ANAV)

Starting from the shareholders' equity on consolidated IFRS accounts of the life insurance business in scope, the ANAV is derived. Table 2 shows the adjustments that lead to this ANAV.

Table 2

Adjusted Net Asset Value ('000 EUR)	31/12/2008
Shareholders' equity after capital increase allocated to the covered life insurance business	1 944 010
Adding minority interests and unrealized capital gains/losses not recognized in IFRS	106 120
Elimination of intangible assets/goodwill	-111 793
Allocation of unrealized capital gains/losses to VBI	148 656
Reserves adjustments	227 949
ANAV after capital increase	2 314 941

We start from the shareholders' equity on consolidated IFRS accounts of the life insurance business in scope, after capital increase.

We add minority interests and the unrealized capital gains/losses that are not yet reflected in the IFRS balance sheet, e.g. unrealized capital gains on HTM bonds.

The intangible assets (mainly goodwill) are eliminated.

The unrealised capital gains/losses on the assets that are counted as a part of the MC VBI are deducted.

From an economic viewpoint, some additional reserves (e.g. reserve for low interest rate risk) on the IFRS balance sheet are part of the shareholders' equity. Therefore these reserves are added to the ANAV.

Tax adjustments relative to the above changes in capital are taken into account in the different items.

After these adjustments, the shareholders' equity reflects the full economic (market consistent) value.

1.3 Market Consistent Value of Business In force (MC VBI)

The MC VBI expresses the market consistent value of the life insurance portfolio in scope. It is defined as the Certainly Equivalent Present Value of Future Profits (CE PVFP), taking into account the Time Value of Financial Options and Guarantees (TVFOG) and a Market Value Margin (MVM) for non-hedgeable risks.

Table 3 shows the composition of the MC VBI as at 31/12/2008 and the comparison with the restated MC VBI figures of 2007. Table 3 also shows the evolution of the VBI expressed as a percentage of the technical provisions of the covered life insurance portfolios, exclusive of extra reserves for low interest rate risk.

Table 3

Value of Business In force ('000 EUR)	2007 restated	2008
CE PVFP after tax	1 495 993	1 033 934
TVFOG	-97 316	-431 088
MVM	-134 370	-132 170
MC VBI	1 264 307	470 676
Technical provisions	21 855 031	21 744 050
VBI / TP	5,78%	2,16%

- The CE PVFP decreased significantly during 2008, mainly because of
 - an increase in the intrinsic value (for the policyholders) of financial options and guarantees due to lower interest rates;
 - higher lapse rates in the unit-linked products leading to lower future profits; and
 - declining equity markets, resulting in unrealized capital losses on equities.
- The higher implied equity and interest rate volatilities led to an increase of the TVFOG.
- The MVM remained at around the same level as at 2007.

2. Value of New Business (VNB) results

The Value of New Business (VNB) accounts for the value of the new policies written during 2008 and is measured at date of sale (whereas in the VBI, this is included at year-end value). The value of new premiums in 2008 on existing business is not recognised as VNB.

Expected future new business is also not taken into account in the VNB (or VBI figures).

The methodology used for the VNB is the same as the one used for the valuation of existing business. For the non-economic parameters we use year-end assumptions. The economic assumptions are based on the quarter the products were sold.

As it is a measure of the VNB at date of sale, the reported VNB includes the initial income and expenses incurred at the inception of the policies involved.

Table 4 shows the total VNB at date of sale and the ratios of the VNB compared to

- the Present Value of New Business Premiums (PVNBP); and
- the Annualized Premium Equivalent (APE)
= recurrent premiums + 1/10th of single premiums.

Table 4

Value of New Business (‘000 EUR)	2007 ³	2008 ³	2008
VNB	81 684	83 275	99 674
PVNBP	1 874 544	1 910 114	2 865 959
VNB/PVNBP	4,4%	4,4%	3,5%
APE	203 125	215 701	312 832
VNB/APE	40,2%	38,6%	31,9%

Looking at the scope of last year (without CEER) the VNB increased slightly.

Due to the inclusion of our CEER companies, the VNB increased further to almost EUR 100 million.

The PVNBP and APE ratios decreased respectively to 3,5% and 31,9%. The most important reason for this decrease is the product mix of Warta TUnZ PL. This company has sold a high amount of Warta Gwarancja, a short-term insurance product. Due to its short term character, this product has a low VNB compared to the premium income.

Without this specific product the PVNBP and APE ratios would be 4,4% and 39,7% respectively.

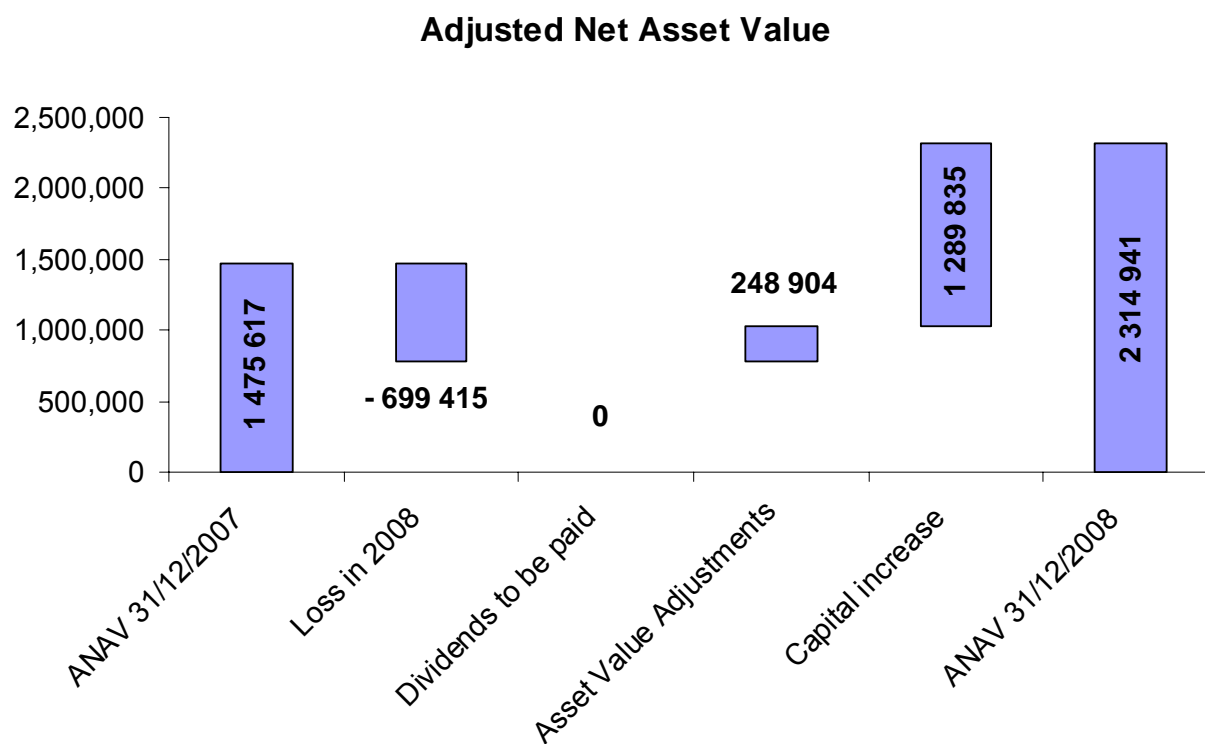
Around 7% of the total VNB is generated by KBC Asset Management via the management of unit-linked funds.

³ Without CEER

3. Movement analysis

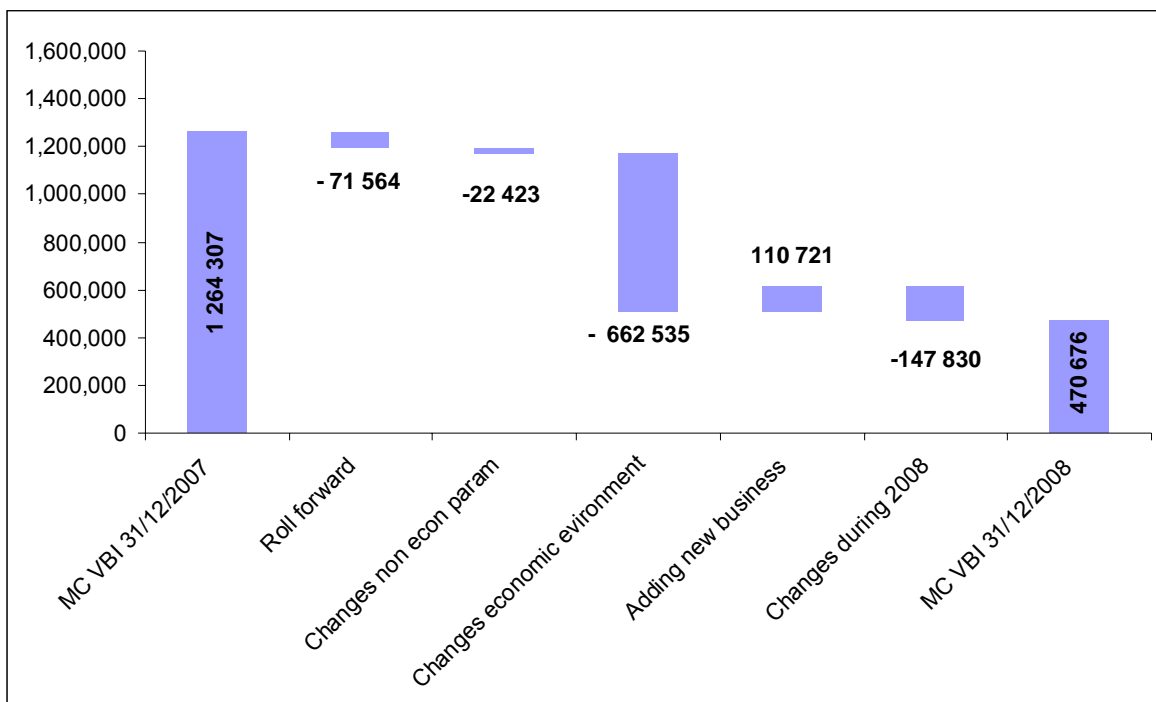
The movement analysis explains the movement from the MCEV 2007 to the MCEV 2008. This evolution is depicted in Figure 1 and Figure 2, which analyse the changes in the ANAV and the VBI, respectively.

Figure 1



- The loss in 2008 is largely due to asset impairments, especially on equities and CDOs.
- No dividend has been paid for 2008.
- The asset value adjustments account for the impact of declining equity markets and decreasing interest rates on the value of the equities and bonds transferred to the MC VBI. As we had losses on the equities, we have a positive asset value adjustment in the ANAV movement.
- During 2008 capital increases were made to ensure the solvency capital of KBC Insurance.

Figure 2



Major drivers of changes in the MC VBI 2008 are:

- The roll forward, which contains the modelled profits over 2008 that are released from the MC VBI and transferred to the ANAV.
- Changes in non-economic parameters:
The negative impact is mainly due to an increase in lapse rate assumptions (based on more recent experience), especially for certain unit-linked products.
- Changes in the economic environment:
The prevailing financial market context had a high adverse impact on the MC VBI. Also the TVFOG increased significantly due to higher implied equity and interest rate volatilities.
- Adding New Business:
At the end of 2008 a value of EUR 111 million is added through the sale of new policies. This is the year-end value of the new business of 2008⁴.
- Changes during 2008:
These consist of the value created by additional premiums paid by policyholders under existing single premium contracts and the value created/lost by the difference between parameter assumptions and experienced data in 2008. The two main reasons for the net negative change during 2008 are the higher experienced lapses especially for certain unit-linked products and the decrease of reserves of unit-linked contracts because of the decrease of unit prices (which leads to a decrease of the future profits).

⁴ This value equals the VNB of 2008 based on year-end assumptions and exclusive of the new business strain. The new business strain is the loss on initial expenses and commissions that is already recognized in the profit and loss account of 2008.

4. Sensitivities

The calculation of the MCEV relies upon the current market conditions and several best estimate assumptions. This section assesses the impact of changes in these assumptions.

4.1 Non-economic sensitivities

Three groups of sensitivities are calculated for the non-economic parameters:

- Expenses +/-10%. All non-commission expense figures throughout the projection are multiplied by 1,1 and 0,9 respectively. Expense inflation is kept at the level of the basic calculation.
- Lapses and dormancy +/-10%. Lapse and dormancy assumption rates throughout the projection are multiplied by 1,1 and 0,9 respectively.
- Mortality rate +/-5%. All mortality experience rates throughout the projection are multiplied by 1,05 and 0,95 respectively.

Table 5 and Table 6 reflect the impact of changing the underlying assumptions on the MC VBI⁵ and the VNB, respectively.

Table 5

Non-economic sensitivities on MC VBI ('000 EUR)	
MC VBI	470 676
Expenses +10%	-4,77%
Expenses -10%	4,77%
Lapses & Dormancy +10%	-4,55%
Lapses & Dormancy -10%	5,40%
Mortality + 5%	-1,34%
Mortality – 5%	1,35%

Table 6

Non-economic sensitivities on VNB ('000 EUR)	
VNB	99 674
Expenses +10%	-8,72%
Expenses -10%	8,72%
Lapses & Dormancy +10%	-2,99%
Lapses & Dormancy -10%	2,90%
Mortality + 5%	-2,41%
Mortality – 5%	2,41%

Because of the different portfolio compositions, the impacts on the VNB and VBI figures are different. The inclusion of the initial expenses in the VNB is the main factor accounting for the higher sensitivities relative to expenses.

⁵ Since these sensitivities impact the MCEV only through the MC VBI, the impact is expressed as a percentage of the MC VBI.

4.2 Economic sensitivities

Also three groups of economic sensitivities are calculated:

- upward and downward parallel shifts of 50 Bp and 100 Bp in the risk-free interest rate (IR) yield curve;
- a 10% increase and decrease in the value of equity markets at the start of the projection;
- a 25% increase in implied volatilities for both interest rates and equities. All implied volatilities are multiplied by 1,25.

Table 7 and Table 8 reflect the impact of changing the underlying assumption on the MCEV and the VNB, respectively. These sensitivity shocks have an impact on the value of the portfolios, as well as on the other assets covering the ANAV of the business in scope. The impact of these shocks is therefore expressed as a percentage of the total MCEV.

Table 7

Economic sensitivities on MCEV ('000 EUR)	
Base case MCEV	2 785 618
IR +50 Bp	-2,88%
IR -50 Bp	2,53%
IR +100 Bp	-7,15%
IR -100 Bp	2,98%
Equity +10%	3,67%
Equity -10%	-3,73%
IR volatilities +25%	-4,08%
Equity volatilities +25%	0,59%

Table 8

Economic sensitivities on VNB ('000 EUR)	
Base case VNB	99 674
IR +50 Bp	17,14%
IR -50 Bp	-20,59%
IR +100 Bp	31,66%
IR -100 Bp	-45,67%
Equity +10%	-2,32%
Equity -10%	2,22%
IR volatilities +25%	-9,73%
Equity volatilities +25%	1,78%

5. Review statement

Watson Wyatt NV (“Watson Wyatt”) has reviewed the calculation of the embedded value of KBC as at 31 December 2008 and the value of its new business written during 2008. The covered business included all life insurances business lines written in the group insurance companies KBC Insurance Belgium, Fidea, Vitis Life Luxembourg, CSOB Pojistovna CZ and Warta TUnZ PL.

Watson Wyatt has concluded that the methodology and assumptions used comply with the European Embedded Value Principles and with the European Embedded Value Guidance. The risks to shareholder profits in the embedded value were evaluated using a market consistent approach, but mainly due to the inclusion of a liquidity premium this approach was not entirely consistent with ‘The European Insurance CFO Forum Market Consistent Embedded Value Principles’ published by the CFO Forum in June 2008.

Watson Wyatt has performed limited checks on the results of the calculations and has discovered no material issues. Watson Wyatt has not, however, performed detailed checks on the models and processes used.

In arriving at these conclusions, Watson Wyatt has relied on the accuracy and completeness of data and information supplied by KBC. KBC is responsible for the embedded value calculations and attention is drawn to the cautionary statements made in the disclosure document.

To the fullest extent permitted by law, Watson Wyatt does not accept or assume responsibility to anyone other than KBC for its work or for the opinions it has formed.

Appendix A. Restatement MCEV 2007

Table 9 shows the restated MCEV 2007 figures taking into account:

- the extension of the scope with CSOB Pojištovna CZ and Warta TUnZ PL, which had a positive effect on the MCEV; and
- some model improvements w.r.t. the MC VBI of the covered life insurance portfolios, as a result of a technical review of our models. These improvements had a small negative effect on the MC VBI.

Table 9

Embedded Value (‘000 EUR)	2007	2007 restated
ANAV	1 426 047	1 475 617
MC VBI	1 228 116	1 264 307
MCEV	2 654 163	2 739 925

Appendix B. Detailed Business Unit results

B.1. BU Belgium (KBC Insurance Belgium and Fidea)

B.1.1. MCEV results

Table 10 shows the composition of the MCEV at 31/12/2008 and the comparison with the MCEV figures of 2007. Table 11 contains the evolution of the VBI expressed as a percentage of the technical provisions of the covered life insurance portfolios, exclusive of extra reserves for low interest rate risk.

Table 10

Embedded Value ('000 EUR)	2007 restated	2008
ANAV	1 392 329	2 223 094
CE PVFP after tax	1 372 418	928 048
TVFOG	-93 638	-412 438
MVM	-94 389	-91 316
MC VBI	1 184 391	424 294
MCEV	2 576 720	2 647 388

Table 11

Value of Business In force ('000 EUR)	2007 restated	2008
MC VBI	1 184 391	424 294
Technical provisions	19 277 705	19 254 001
VBI / TP	6,14%	2,20%

The total MCEV 2008 increased slightly with 2,7%.

The ANAV is negatively impacted by the decrease/increase in unrealized capital gains/losses and the accounting losses over 2008. The loss arose mainly from asset impairments, especially on equities and CDOs. This decrease was largely offset by additional capital increases.

Also the MC VBI is negatively impacted by the adverse market conditions, mainly due to the decrease/increase of unrealized capital gains/losses on the assets that are counted as a part of the VBI and an increase in implied volatilities. The latter resulted in a higher Time Value of Financial Options and Guarantees (TV FOG).

During 2008, we also noticed higher lapse rates, leading to lower future profits, especially for unit-linked products.

B.1.2. Value of New Business (VNB) results

Table 12 shows the total VNB at date of sale together with the ratios of the VNB compared to the PVNBP and the APE.

Table 12

Value of New Business (‘000 EUR)	2007	2008
VNB	76 956	78 929
PVNBP	1 645 074	1 713 845
VNB/PVNBP	4,68%	4,61%
APE	183 487	198 235
VNB/APE	41,94%	39,82%

The VNB of 2008 increased with 2,6%. The PVNBP ratio remained at the same level and the APE ratio decreased slightly.

B.2. BU CEER (CSOB Po'jistovna CZ and Warta TUnZ PL)

B.2.1. MCEV results

Table 13 shows the composition of the MCEV as at 31/12/2008 and the comparison with the MCEV figures of 2007. Table 14 contains the evolution of the VBI expressed as a percentage of the technical provisions of the covered life insurance portfolios, exclusive of extra reserves for low interest rate risk.

Table 13

Embedded Value ('000 EUR)	2007 restated	2008
ANAV	49 570	68 703
CE PVFP after tax	103 996	97 819
TVFOG	-4 126	-7 002
MVM	-34 068	-38 413
MC VBI	65 802	52 404
MCEV	115 373	121 107

Table 14

Value of Business In force ('000 EUR)	2007 restated	2008
MC VBI	65 802	52 404
Technical provisions	1 056 195	1 398 536
VBI / TP	6,23%	3,75%

For BU CEER the total MCEV increased slightly with 5%. Also this MC VBI is negatively impacted by the adverse market conditions. However, the impact is smaller than for BU Belgium due to a smaller equity portfolio, resulting in lower unrealised capital losses.

B.1.2. Value of New Business (VNB) results

Table 15 shows the total VNB at date of sale together with the ratios of the VNB compared to the PVNBP and the APE.

Table 15

Value of New Business (‘000 EUR)	2008
VNB	16 399
PVNBP	955 845
VNB/PVNBP	1,72%
APE	97 131
VNB/APE	16,88%

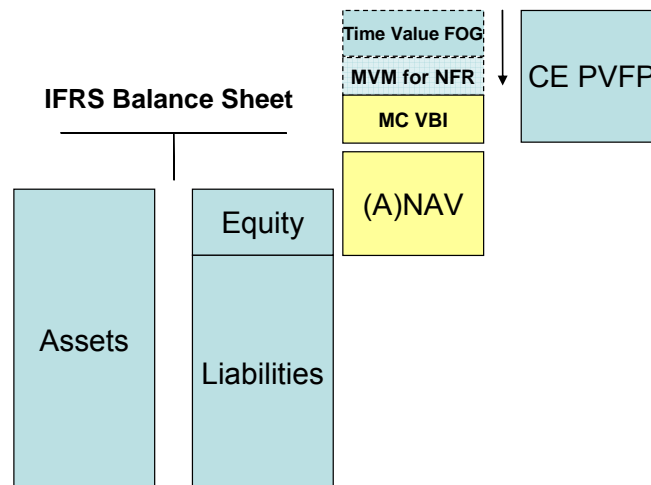
Since this is the first year that we included BU CEER, we do not have VNB figures for 2007. The PVNBP and APE ratios for BU CEER are strongly impacted by Warta Gwarancja. This is a short-term insurance product, sold by Warta TUnZ, that generates a high premium income, but a relative smaller VNB (due to its short term character). Without taking account of this specific product the PVNBP and APE ratios would be 4,9% and 46,9%, respectively.

Appendix C. Methodology and assumptions

C.1. Methodology

A market consistent valuation is a valuation of both the assets and the liabilities of the company in a way that is consistent with prices in the financial markets. The value of unquoted assets and liabilities is equivalent to the value that would be placed on the cash flows generated by these assets and liabilities in a deep and liquid market. It is, in a sense, simply an application of standard valuation principles by insurance companies which are also consistent with modern financial valuation theory applied in the financial markets and hence also with the replication concepts used in ALM.

Several methods exist to present the market consistent value of the life insurance business. KBC has opted to present the figures in a way that is intuitively close to the traditional way of presenting embedded values and in line with the EEV principles.



The KBC MCEV consists of the following elements:

$$\begin{aligned}
 \text{MCEV} &= \text{Adjusted Net Asset Value} \\
 &+ \text{Certainty Equivalent Present Value of Future Profits} \\
 &- \text{Time Value of Financial Options and Guarantees} \\
 &- \text{Market Value Margin for non-hedgeable risks}
 \end{aligned}
 \left. \vphantom{\begin{aligned} \text{MCEV} \\ &+ \\ &- \\ &- \end{aligned}} \right\} = \text{Value of Business In force}$$

ANAV methodology

Starting from the shareholders' equity on consolidated IFRS accounts of the life insurance business in scope, the net tangible assets are derived. The following main adjustments are made to arrive at the ANAV:

- Unrealized capital gains/losses that are not yet reflected in the IFRS balance sheet are added, e.g. the unrealized capital gains/losses on the held-to-maturity (HTM) bonds.
- Some intangible assets (mainly goodwill) are eliminated, since they conceptually represent a book value of what is in principle taken into account in the VBI. Note however that some acquired life insurance portfolios within the BU CEER are not yet in scope of the VBI and that in general no value is attributed for future new business.
- Some additional reserves on the IFRS balance sheet are considered to be part of the ANAV from an economic viewpoint. These reserves are added to the ANAV.
- Unrealised capital gains/losses that will be included in the VBI as part of the portfolios' value need to be subtracted from the ANAV in order to preclude double-counting.
- Tax adjustments relative to the above changes in capital are taken into account.

After these adjustments, the shareholders' equity reflects the full economic (market consistent) value.

VBI methodology

The different building blocks used to calculate a market consistent VBI are described in detail below.

Certainty Equivalent Present Value of Future Profits (CE PVFP) after tax

The CE PVFP is the base value of the business without taking into account risk margins on the expected investment returns. This CE PVFP can be calculated using the traditional EV models, excluding all risk margins from the projections and discounting at the risk-free rates. This value takes the expected or intrinsic value of the financial options and guarantees in the portfolio into account, but ignores the time value of options and guarantees, which is valued separately.

We add the unrealised capital gains/losses on the assets linked to the life insurance liabilities to this part of the VBI.

Tax adjustments are taken into account.

Time Value of Financial Options and Guarantees (TVFOG)

The TVFOG is disclosed explicitly to place a market consistent value on the asymmetry of shareholder profits around their expectations as a result of financial options and guarantees embedded in the insurance cash flows.

This TVFOG needs to be deducted from the basic CE PVFP.

The options and guarantees, in respect of which an explicit time value is calculated, are:

- the interest rate guarantees that are given under policies in the portfolio; and
- profit-sharing in addition to the interest rate guarantees.

At this time, KBC has chosen not to model other policyholder behaviour options, such as lapses, on a stochastic basis. Including this will require further study and an extension of the models.

The TVFOG is calculated as the difference between a stochastic valuation of the shareholders' margins (calculated by using 1000 risk-neutral scenarios on the basis of a KBC proprietary economic scenario generator) and a single deterministic valuation based on the central scenario at the time of projection (current market conditions also used in the CE PVFP valuation).

Market Value Margin (MVM) for non-hedgeable risks

Where the market consistent value of future liability cash flows can be determined as the cost of setting up a replicating portfolio, the price can be determined from observable market prices. In order to determine the full market value of the liabilities, an explicit MVM for non-hedgeable risks needs to be deducted. In this way, an investor is compensated for the cost of taking on non-hedgeable risks.

KBC models the MVM for non-hedgeable risks according to a cost-of-capital approach. This approach is supported by the CRO Forum and is in line with approaches taken in Solvency 2 and the Swiss Solvency Test. The basic premise of the cost-of-capital approach is that sufficient capital is needed to cover these non-hedgeable risks during the run-off of the business.

The non-hedgeable risks that are taken into account as the basis for the MVM calculations are life insurance risks (mortality and longevity), operational risks and non-hedgeable ALM risks. The capital required for these risks is estimated using KBC's internal Economic Capital model. This Economic Capital model is based on the capital requirements for an AA solvency rating for the life business.

In line with the proposals elaborated in the Quantitative Impact Studies for Solvency 2 and the approach taken in the Swiss Solvency Test, a cost-of-capital risk premium (above the risk-free rate) of 6% is used to determine the MVM.

KBC believes that this cost-of-capital approach to estimate the cost of non-hedgeable risks is the most transparent, easily verifiable and understandable technique currently available.

VNB methodology

The Value of New Business (VNB) includes only the value of the new policies written in 2008. The value of new premiums on existing business is not recognised as VNB.

Expected future new business is not taken into account in the VNB or VBI figures.

The methodology used for the VNB is the same as the one used for the valuation of existing business and is calculated at date of sale. For the non-economic parameters we use year-end assumptions. The economic assumptions are based on the end of the relevant quarter. For Warta TUnZ PL year-end assumptions are used for all parameters. The reported VNB includes the initial income and expenses incurred at the inception of the policies involved.

Modelling of participating (or with profit) business

Participating business is typically characterised by:

- a minimum guaranteed interest rate; and
- profit sharing on top of this minimum guaranteed interest rate. The models reflect profit sharing according to past practice, reflecting the link with the performance of the financial markets, competition and taking into account management actions.

The nature of this business makes stochastic modelling necessary in order to capture the variation in value that stems from changing economic environments.

The TVFOG will reflect the likelihood of additional payment to the policyholders. It is the value on top of the intrinsic value of those options, which is captured in the CE PVFP. The nature of the profit sharing policy leads to asymmetric results, since it is likely that part of the returns will be paid out to policyholders if the market performs well, while, conversely, shareholders will bear part, if not all, of the negative returns if the market does not perform well.

C.2. Economic assumptions

- **Yield curve**

The swap yield curve as at 31/12/2008 plus an allowance for a liquidity premium (see below) is adopted as the basis for the risk-free investment assumptions. The following table shows the swap yield curves as at 31/12/2008. For comparison purposes, the swap yield curve as at 31/12/2007 is also shown.

Rates beyond 30 years were derived under the assumption of a flat forward curve.

This yield curve (after inclusion of a liquidity premium) is used to derive stochastic economic scenarios, risk-free discount factors and forward reinvestment yields in the CE PVFP.

maturity	EUR		PLN		CZK	
	2007	2008	2007	2008	2007	2008
1	4.63%	2.42%	6.42%	3.79%	4.21%	2.78%
2	4.53%	2.68%	6.19%	4.31%	4.22%	2.33%
3	4.50%	2.90%	6.11%	4.19%	4.25%	2.67%
5	4.55%	3.25%	5.99%	4.15%	4.30%	2.82%
7	4.64%	3.50%	5.89%	4.25%	4.41%	2.93%
10	4.75%	3.74%	5.75%	4.41%	4.53%	3.19%
15	4.87%	3.87%	5.68%	4.39%	4.74%	3.37%
20	4.94%	3.83%	5.62%	4.17%	4.74%	3.37%
25	4.98%	3.70%	5.62%	4.17%	4.74%	3.37%
30	5.01%	3.54%	5.62%	4.17%	4.74%	3.37%

- **Liquidity premium**

In anticipation of a review by the CFO Forum of its MCEV principles and, in particular, the issuance of guidance on the inclusion of a liquidity premium in the reference rates, KBC decided to apply a liquidity premium of 50 Bp above the swap rates. This liquidity premium reflects the ability, in current market conditions, to earn risk-free returns in excess of swap rates.

- **Implied volatilities**

The volatilities in a risk-neutral model are calibrated to the implied volatilities of market prices for different asset classes. For the Benelux subsidiaries the Economic Scenario Generator is calibrated to volatilities of at-the-money 10-year swaptions and at-the-money equity options for the Eurostoxx 50. For CSOB Pojistovna CZ the euro data for swaptions market have been used since CZK swaptions market practically does not exist. For Warta TUnZ PL, the implied volatilities of a 5% cap for PLN are used to calibrate the model.

The applied volatilities for 2007 and 2008 are shown in the following tables.

EUR Swaption volatilities		
Year	2007	2008
1	13,00%	31,70%
3	12,20%	24,10%
5	11,70%	20,80%
10	11,00%	18,30%
20	10,30%	25,50%
30	9,90%	25,30%

EUR Equity volatilities		
Year	2007	2008
1	20,30%	35,00%
3	21,75%	35,20%
5	23,20%	33,95%
10	25,20%	33,75%
20	24,13%	34,02%
30	23,57%	35,02%

PLN Cap volatilities		
Year	2007	2008
1	13%	13%
3	15%	17%
5	15%	17%
10	14%	15%

- **Inflation**

The inflation rates are adjusted according to KBC's most recent forecasts.

BU Belgium	2007		2008	
	Wage	CPI	Wage	CPI
2008	3,0%	2,4%	3,9%	4,5%
2009	2,6%	1,9%	1,5%	0,2%
2010	2,5%	2,0%	2,0%	1,7%
>=2011	2,5%	2,0%	2,5%	2,0%

CSOB	2007		2008	
	Wage	CPI	Wage	CPI
2008	7,0%	4,7%	7,0%	4,7%
2009	6,0%	2,8%	6,0%	2,8%
2010	6,0%	2,6%	6,0%	2,6%
>=2011	5%	2,2%	5%	2,2%

Warta	CPI	
	2007	2008
2008	3,7%	2,7%
2009	2,9%	2,7%
2010	2,5%	2,2%
>=2011	2,5%	2,5%

C.3. Non-economic assumptions

- ***Mortality and lapse rates***

Cash flows are based on best estimate assumptions in order to reflect the obligations to the policyholders.

- For Belgium, the mortality experience rates are based on the Belgian mortality experience tables that are published by Assuralia (the Belgian professional organization of insurance companies) and updated each year. For CEER we use local data to determine the best estimate mortality rates.
- Lapses and dormancy rates are based on yearly experience studies performed by the life actuaries of each subsidiary. Based on historical figures and management judgement of future best estimates, lapse and dormancy figures are derived for the following years. The lapse and dormancy assumptions are set at product level and take into account several aspects, such as the sales channel, age of policyholder(s), lifetime of the policy, fiscal treatment, etc.

- ***Tax assumptions***

Tax is modelled on a top-down basis. The appropriate tax rates are applied to all items that are recognised as (future) profits.

- ***Expenses***

For KBC Insurance Belgium, the extraordinary expenses due to the special arrangements for the employees (EUR 8,5 million) were kept outside the projections. All other expenses of the covered life insurance business are included in the projections by means of a detailed Activity-Based Costing model.

For Fidea, an expense amount of EUR 2,2 million concerning the integration and administration of the life insurance portfolio of OVMB was kept outside the cost allocation model as it concerns one-off development costs.

Projected expenses are expected to grow at the same rate as expected future wage inflation. There is no allowance made for future productivity gains.

The other subsidiaries have used their own allocation system to derive their expenses.

Appendix D. Time series

KBC Group gross provisions for life insurance 31/12/2004-31/12/2008 per Business Unit

('000 EUR)		2004	2005	2006	2007	2008	Δ'07-08
Belgium	Unit Linked	3 588 268	7 214 680	8 175 106	7 574 587	5 812 227	-23,27%
	Non Linked	8 361 750	9 618 530	10 445 791	12 019 892	13 777 037	14,62%
	Total	11 950 018	16 833 210	18 620 897	19 594 479	19 589 264	-0,03%
EPB	Unit Linked	274 493	364 119	795 932	952 899	579 598	-39,18%
	Non Linked	644 602	611 286	601 376	568 233	511 915	-9,91%
	Total	919 095	975 404	1 397 308	1 521 132	1 091 513	-28,24%
CEER	Unit Linked	68 488	198 707	395 966	571 369	626 491	9,65%
	Non Linked	556 839	669 780	778 229	886 887	1 246 709	40,58%
	Total	625 327	868 487	1 174 195	1 458 256	1 873 190	28,46%
KBC	Total	13 494 440	18 677 101	21 192 401	22 573 867	22 553 988	-0,09%

EPB = Business Unit European Private Banking

CEER = Business Unit Central and Eastern Europe and Russia

Appendix E. Glossary and abbreviations

Glossary

Adjusted Net Asset Value (ANAV)	The tangible net assets on a marked-to-market-value basis derived from adjusting the consolidated IFRS balance sheet.
Best estimate	The expected outcome from the range of possible outcomes for future experience. In practice, the realization will differ from the best estimate forecast because we can not predict the future with certainty. However, best estimates imply that the expected value of future deviations in performance is zero, so that the Embedded Value is neither overestimated nor underestimated.
Certainty Equivalent Present Value of Future Profits (CE PVFP)	The present value of future statutory after tax profits over the remaining duration of liabilities in a scenario where all investments are assumed to earn the risk-free rates and cash flows are discounted at the same risk-free rate.
Cost of capital	The cost related to having to hold required capital that will constrain distributions to shareholders. The cost relates to the fact that after-tax income earned on the assets backing this capital is lower than the discount rate.
Covered business	The contracts to which the MCEV methodology has, in line with the Principles, been applied.
Discount rate	The rate at which future cash flows are discounted back to valuation date.
European Embedded Value (EEV)	Embedded Value calculated under the EEV Principles (see below).
European Embedded Value Principles	A consistent framework published in May 2004 by the CFO Forum for the calculation and reporting of embedded value to improve comparability and transparency in embedded value reporting across Europe.
In-force business	Policies that are in effect as at the valuation date.
Market Consistent Embedded Value (MCEV)	The value that would be placed on the cash flows generated by the assets and liabilities in a deep and liquid market. It is thus a value based on objective market prices, without subjective decisions on discount rates or other financial parameters.
Market Consistent Embedded Value Principles	A consistent framework published in June 2008 by the CFO Forum for the calculation and reporting of Market Consistent Embedded Value.

Movement analysis	Analysis of the change in MCEV from one reporting year to the next.
Market Value Margin (MVM) for non-hedgeable risks	An estimation of the costs of the non-hedgeable risks in the portfolio. This value is added to the fair value of the insurance liabilities to obtain a market price that would be paid in a transaction at arm's length.
Non-hedgeable risks	Risks for which no deep and liquid capital market in which to hedge them exists.
Present value	Value of a future cash flow at the valuation date, discounted at the appropriate discount rate.
Stochastic techniques	Techniques that incorporate the potential future variability in assumptions affecting their outcome.
Time value and intrinsic value	An option feature has two elements of value, the time value and intrinsic value. The intrinsic value is that of the most valuable benefit under the option under conditions at the valuation date. The time value is the additional value ascribable to the potential for benefits under the option to increase in value prior to expiry.
Valuation date	The date at which all items of the Market Consistent Embedded Value and movement analysis are valued.
Value of Business in Force (VBI)	Present value of all expected future distributable earnings for the business in force discounted at the company's discount rate, i.e., taking into account the cost of holding required capital.
Time Value of Financial Options and Guarantees (TVFOG)	Features of the covered business conferring potentially valuable guarantees underlying, or options to change, the level or nature of policyholder benefits and exercisable at the discretion of the policyholder, whose potential value is impacted by the behaviour of financial variables.
Value of New Business (VNB)	Present value of the additional value to shareholders created through the activity of writing new business during the year under consideration.

Abbreviations

ALM	Asset Liability Management
ANAV	Adjusted Net Asset Value
APE	Annualized Premium Equivalent
Bp	Basis point
BU	Business Unit
CDO	Collateralized Debt Obligation
CE PVFP	Certainty Equivalent Present Value of Future Profits
CEER	Business Unit Central and Eastern Europe and Russia
CPI	Consumer price index
EEV	European Embedded Value
EPB	Business Unit European Private Banking
HTM	Held-to-maturity
IFRS	International Financial Reporting Standards
IR	Interest rate
MC	Market Consistent
MCEV	Market Consistent Embedded Value
MVM	Market Value Margin
NHR	Non-hedgeable risks
PVNB	Present Value of New Business Premiums
TP	Technical Provisions
TVFOG	Time Value of Financial Options and Guarantees
VBI	Value of Business In Force
VNB	Value of New Business

Disclaimer

Embedded Value is the result of cash-flow projections based on underlying assumptions and expectations.

Many assumptions made with regard to general economic conditions, the performance of financial markets, taxes, changes in legislation, the frequency and severity of insured loss events, mortality and morbidity levels and trends, etc., are beyond KBC's control. If an assumption is altered, this can result in a significantly different Embedded Value. Deviations from assumed experience are normal and are to be expected. Even without any change in the parameters, actual results will vary from those projected, due to normal random fluctuations.

Embedded Value cannot be considered as an absolute value. Embedded Value, together with a sensitivity analysis, provides an idea of the magnitude of the expected value created by insurance activities.

Under no circumstances should the inclusion of the projections (including the relevant underlying assumptions and expectations) be regarded as a representation, warranty or prediction that the business will achieve or is likely to achieve any particular results.