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Reshaping the merchant banking unit

L. Popelier, *CEO Market Activities*

Welcome to the New Normal

Business plan for the years ahead

KBC

KBC Investor Day 2009

Important information for investors

This legend was added on 11DEC09

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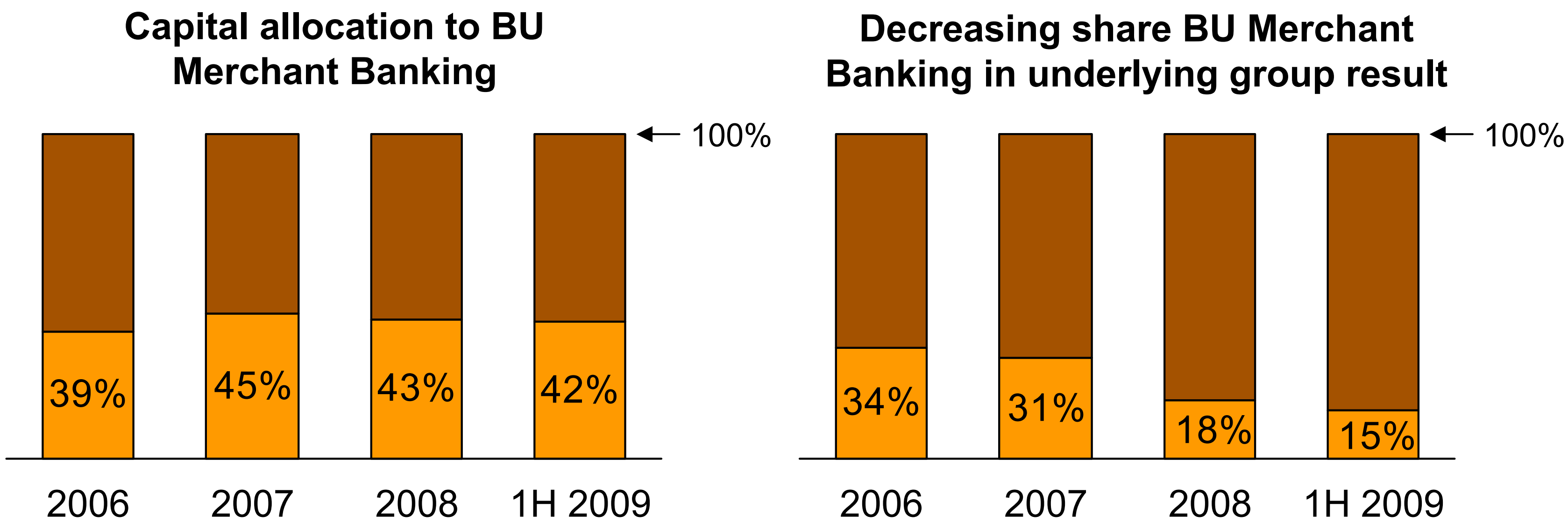
Speakers' *curriculum vitae*

1988	Various functions in corporate banking, Kredietbank
1995	Associate Director Credit Risk Management, Warburg Dillen Read, London
1996	Director Corporate Finance, Leveraged Finance Group, SBC Warburg
1999	Executive Director Corporate Finance, KBC Securities
2002	General manager Strategy and Expansion Division, KBC Group
2008	General manager Trade Finance Division, KBC Bank
2009	Member of the Executive Committee of KBC Asset Management
2009	Member of the Executive Committee of KBC Group; CEO of the market activities of the Merchant Banking Business Unit

Today's messages

- Strategic review includes major reduction of scope and risk profile of merchant banking operations
- Measures are in place to ensure a timely and orderly exit of non-core activities
- Remaining merchant banking activities have strategic fit with home market activities

Substantial impact of strategy review on merchant banking business unit

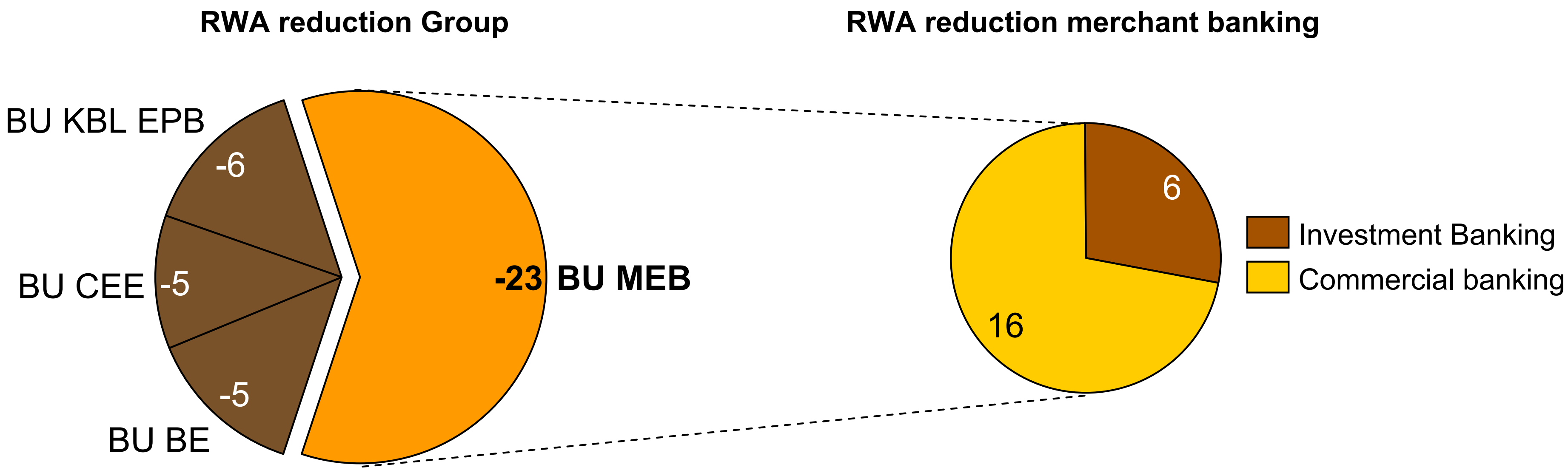


- Strategic need at group level to reduce risk and free up capital sources
- Significant tie up of capital in MB, including some above-average risk areas
- Higher capital charges expected going forward
- Return on capital over time lower than for other activities which means that balance sheet reduction in this area will 'mechanically' lead to overall higher Group ROE

Merchant Banking - YTD 9M09	
Revenues	1.9bn
Risk-weighted assets	70.6bn
Allocated capital	4.6bn
Profit contribution	413m
ROAC	11.4%

Reduction of scope and risk profile of the merchant banking business unit

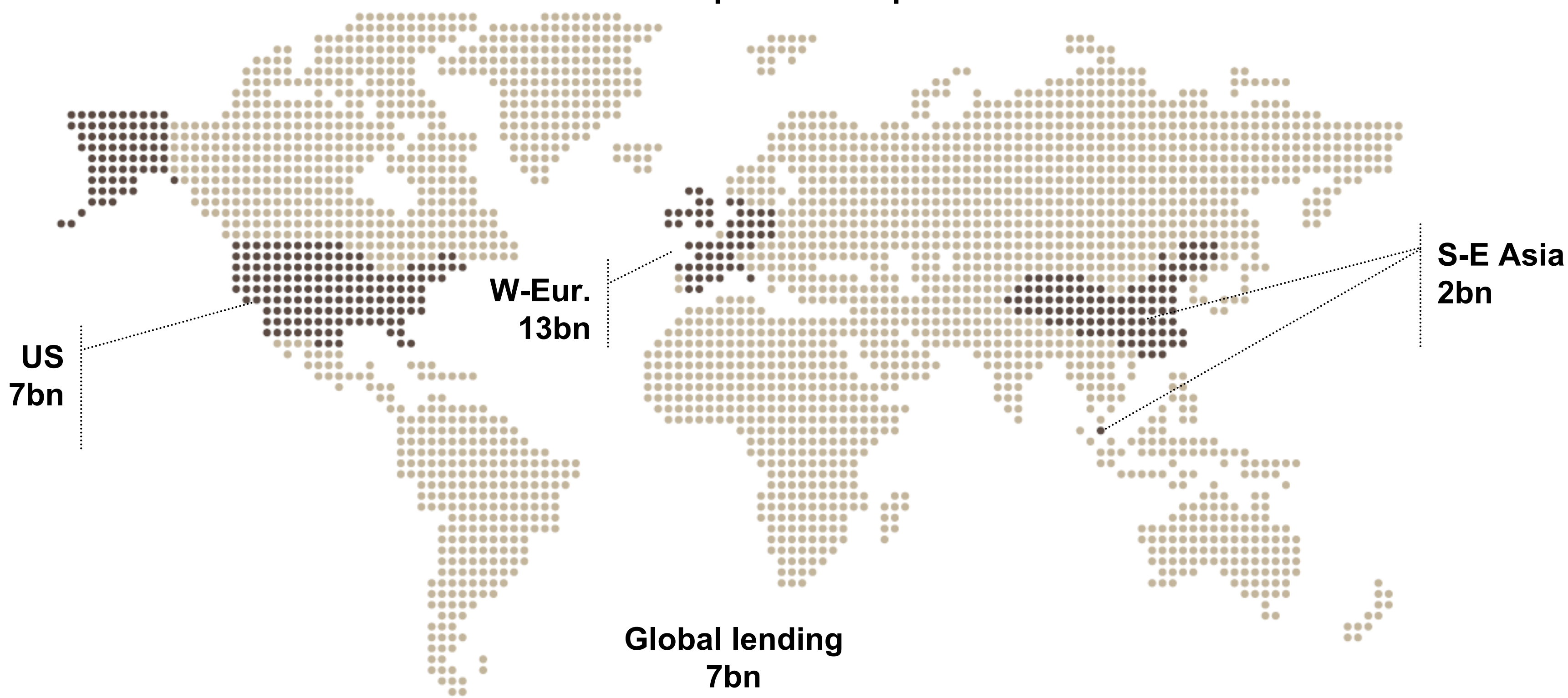
- Objective to exit in an orderly manner lending and investment banking activities that have no clear synergies with Belgium and CEE markets
  - Investment banking activities, especially KBC Financial Products
  - International corporate banking outside home markets
- Activities with risk-weighted assets of 23 bn to be discontinued over 5 years period (starting from year end 2008 position)



Reduction of commercial banking

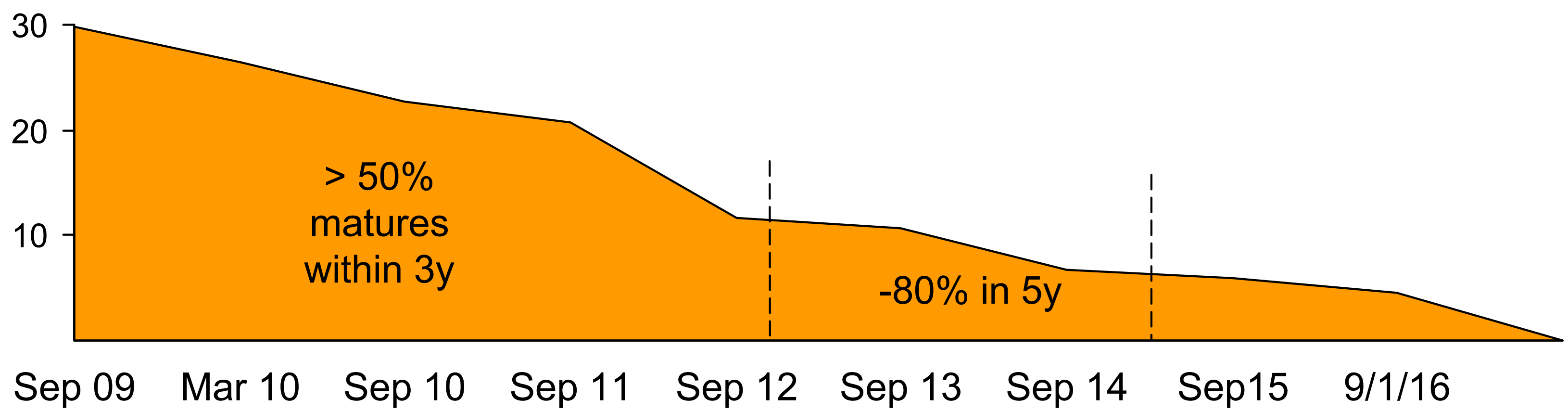
- International corporate lending activity outside home markets
  - Network of corporate branches and corporate banking subsidiaries
  - Total corporate loan portfolio of ca 30 bn
  - Will only be maintained for servicing home market customers abroad

International corporate loan portfolio



Reduction of commercial banking

- Orderly and timely exit
  - Combination of run-off upon maturity (in many cases, KBC is not the lead lender) and sale of parts of the portfolio
  - Credit rating migration might be a headwind for RWA reduction for 2010, but will become ‘tailwind’ later on
  - International network to be optimised in order to service financial needs of domestic corporate customers abroad



Reduction of investment banking

RUN-OFF

- Structured derivatives business
  - Structured credit, credit derivatives, fund derivatives, equity derivatives, Life insurance settlement, US reverse mortgages, alternative investment management
  - Less liquid positions
  - Run-off process started 4Q08
  - No remaining goodwill outstanding

SALES PROCESS STARTED

- Other investment banking activities with lower strategic fit
  - Sales and trading of convertibles and equity derivatives, non-home market related corporate finance and equity brokerage
  - Sound business with adequate through-the-cycle return
  - Sales process started 4Q09
  - No remaining goodwill outstanding; moreover, we do not anticipate a sales transaction to occur at levels below (tangible) book value

Run-off of structured derivatives business (details)

Reverse mortgages

Activity	Mainly US retail loans regulated and guaranteed by US government
Volume	0.8bn (excl. 0.9 bn loans sold to FNMA or guaranteed by CNMA and sold to market)
Risks	Main risk is operational risk given strict regulations of government agencies involved
Comfort	Government guaranteed loans
Duration	Estimated average time to maturity around 8 years

Life insurance settlement

Activity	Investment in or funding of life insurance contracts
Volume	0.4bn
Risks	Main risk is life expectancy risk
Comfort	Regulated life insurance companies as counterparty
Duration	Average residual life expectancy estimated at 11 years

Run-off of structured derivatives business (details)

- **Hedge fund derivatives**

Activity	Provide leverage to hedge funds via synthetic loans where hedge fund serves as collateral
Volume	Down from 7bn to 1 bn (underlying collateral still 2.9bn)
Risks	Most remaining funds have illiquid assets as collateral
Comfort	No asset can be disposed of without KBC approval; LTV of 35%
Duration	Up to 5 years

- **Alternative investments**

Activity	Establishment, trading, management and sale of hedge funds
Volume	Market value remaining positions: 0.1bn
Risks	Most illiquid positions remain; market risks
Comfort	Exposure strongly reduced
Duration	Position specific

Run-off of structured derivatives business (details)

Structured credit / credit derivatives business

Activity	Mainly securitisation of corporate credit risk on synthetic basis
Volume	27.1 bn of CDOs issued, of which 16.4bn hedged, 8.9bn unhedged and 1.7bn sold to clients; 1.6bn 'Atomium portfolio (mainly US RMBS)
Risks	Illiquid structures with long duration
Comfort	Non super senior CDO risk mainly written down; super senior CDO risk covered by State Guarantee
Duration	15% of the CDOs matures within 2 years, 22% within 5 years…

Structured equity derivatives

Activity	Issuance of long term debt securities with embedded options
Volume	2.3 bn
Risks	Market risks, especially quanto risk
Comfort	Improved market conditions make hedges available
Duration	62% matures within 4 years, 92% within 7 years…

Run-off of structured derivatives business - governance

- We will not be a forced seller
  - Restructuring plan includes gradual wind-down over mid-term
  - Active management of the portfolio in view of value preservation (opportunistic choice for temporary stand still vs. early liquidation, vs. hedging, vs. unwinding, …)

- Separate governance structure in place for the unwinding of KBC FP
  - Intensive care given size, duration, complexity and lack of market liquidity
  - Measures to lock in competences and minimise operational risks
  - Concentrations of operations in London (incl. some relocation from NY)
  - Dedicated expert team of ca. 20 FTE added to the 'legacy team'; additional support from expert restructuring team of Oliver Wyman (10 FTE)
  - Direct steering/reporting from Brussels head office / ExCo

Strategic fit of the remaining business

- Focus on home market customers
  - SME
  - Midcap
- Full financial service offering
  - Commercial banking
    - Lending, cash management and payments, trade finance, leasing, …
  - Investment banking
    - treasury services, equity and debt capital market products, equity brokerage, corporate finance, sales trading, …

Special topic Ireland

- No core activity, but no strategic decision today since a potential exit at acceptable conditions is highly unlikely in the current difficult local economic environment
- KBC Ireland profile:
  - Total assets: 21.2 bn
  - Loan book: 18 bn of which 13bn mortgage book
  - Book value: 1 bn, no goodwill

	2005	2006	2007	2008	9M 09
Profit contribution (in m EUR)	90.2	107.2	118.1	83.9	41.8
Cost income ratio	35%	32%	31%	30%	20%
Credit cost (in m EUR)	0	0	4	55	101
Credit cost ratio	0bp	0bp	3bp	31bp	74bp

Special topic
European credit investments

- Investments in European RMBS (ca 4 bn, nominal)
- Separate from the US RMBS portfolio (‘Atomium’), that is part of the ‘to be discontinued’ business
- Obviously, this is a non-core activity but we have an opportunistic approach as to winding down this book (“only sale when price is attractive relative to expected loss”), since:
  - No major credit quality concerns (98% AAA/AA-rated)
  - No major amount of capital tied (15% risk-weighting, on average)
  - In most cases, sale would result in larger loss than amount of unlocked regulatory capital
  - Use of deferred tax assets
- Natural amortisation: ca. 15% per year

Going forward

- Business earmarked for run-off and divestment contributed on average some 150m p.a. in the last 5 years
- Going forward, the business will be run at a
  - Cost income ratio of ca. 50%
  - Low single digit organic growth
- Depending on the economic scenario PD rating migration might, on balance, have a net positive downward impact on RWA by 2013
- Although visibility is low, we also expect RWA impact from:
  - Shift towards IRB Advanced RWA calculation (positive downward impact)
  - Optimisation of RWA recognition and modelling (positive downward impact)
  - Upward RWA pressure from new regulatory capital requirements for market risk (negative upward impact)

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