KBC Group
ECB Comprehensive Assessment 2014
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KBC exceeds ECB's AQR and stress test thresholds and maintains strong buffer

The impact of the stress test on the Common Equity Tier-1 ratio (CET1 ratio) under the adverse scenario in 2016 causes the CET1 ratio to fall by 2.6 percentage points. The impact of the Asset Quality Review (AQR) is 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 3-year stress test horizon (1.8 billion EUR including penalties and coupon), the AQR and the pure stress test, results in a CET1 ratio of 8.3%, which represents a considerable buffer of 2.8 percentage points (2.8 billion EUR) above the ECB-imposed threshold of 5.5 %, showing KBC's resilience.

The following slides explain the main results of the comprehensive assessment and the most relevant building blocks:

- ✓ Main results of the comprehensive assessment (slide 2)
- ✓ AQR: scope, overview of adjustments and comments in respect of Irish mortgages (slides 3-4-5-6)
- ✓ Stress test scenario combined with AQR: CET1 ratio for 2016 (slides 7-8)
- ✓ Adverse stress test scenario excluding AQR: main impacts, P&L and RWA (slides 9-10-11-12-13)

Main results of the comprehensive assessment

CRR / CRDIV DEFINITION OF CAPITAL Basel III Phased in CET1-ratio, applying Danish compromise	As of 31/12/2013	AQR adj.	As of 31/12/2013 post AQR	Baseline Scenario As of 31/12/2014	Baseline Scenario As of 31/12/2015	Baseline Scenario As of 31/12/2016	Adverse Scenario As of 31/12/2014	Adverse Scenario As of 31/12/2015	Adverse Scenario As of 31/12/2016
COMMON EQUITY TIER 1 CAPITAL (in mln EUR) (net of deductions and after applying transitional adjustments)	**12,277**	**-500**	**11,777**	**11,180**	**11,652**	**11,635**	**10,425**	**9,632**	**8,490**
Of which Transitional adjustments due to grandfathered CET1 Capital instruments (+/-)	*2,333*		*2,333*	*2,000*	*1,667*	*1,333*	*2,000*	*1,667*	*1,333*
TOTAL RISK EXPOSURE AMOUNT (in mln EUR)	**92,543**	**330**	**92,873**	**92,993**	**93,368**	**93,636**	**96,087**	**100,680**	**102,697**
Common Equity Tier 1 Capital ratio	**13.3%**		**12,7%**	**12.0%**	**12.5%**	**12.4%**	**10.9%**	**9.6%**	**8.3%**

AQR: 7 loan portfolios were selected

- **7 loan portfolios** were **selected** for review
  - 3 ‘Belgian’ portfolios *(KBC Bank, CBC Banque)*
    - Retail SMEs - Corporate - Commercial Real Estate
  - 3 Irish portfolios *(KBC Bank Ireland)*
    - Mortgages - Corporate/SME - Commercial Real Estate
  - 1 Hungarian portfolio *(K&H)*
    - Mortgages
- Together, these portfolios account for **50.1%** of credit risk exposure
  - Gross prudential adjustment shown on next slide
- Prudential gross adjustment in respect of **Irish mortgages** is 0.3 billion EUR
  - Context is given on slide 5
- Prudential gross adjustment for the **6 other loan portfolios** is 0.2 billion EUR
  - KBC will use the ECB review information to re-assess files, case-by-case
  - We expect a non-material impact on provisions

AQR: Irish mortgages account for more than half of AQR adjustments to loan portfolios

AQR adjustment (Gross, EUR million)	File review	Projection of findings	Collective provisioning	**Total**
Total	**139**	**56**	**358**	**552**
Retail (mortgages)	*0*	*0*	*324*	*324*
Corporates	*139*	*56*	*35*	*229*

Additional information (key contributions)

AQR adjustment (Gross, EUR million)	File review	Projection of findings	Collective provisioning	**Total**
Irish Mortgages	*0*	*0*	*324*	*324*
Corporates (Belgium incl. foreign branches)	*76*	*35*	*13*	*124*
Corporates (Ireland)	*23*	*17*	*6*	*45*

AQR: Context for Irish Retail Mortgages

Limitations of ECB Challenger Model in the Irish context

The ECB Challenger Model is a prudential measure to enable a quantitative challenge of banks' individual models. It is by necessity a 'simple' generic model, based on only a 12-month interval (2013) and assuming only two outcomes:

- 'Cure' – return to normal, performing status
- 'Exit' – recovery of collateral, subsequent to repossession

KBC Ireland (KBCI) has enhanced its own provisioning methodology to accurately reflect the specific risk and cashflow profile of its portfolio, a significant proportion of which is currently on a long-term sustainable forbearance arrangement. This is in line with KBCI's Mortgage Arrears Resolution Strategy (MARS), in conformance with Central Bank of Ireland framework to address the problem of mortgage arrears.
As MARS was implemented during the observation period, a substantial proportion of forborne borrowers will not meet KBCI's strict Cure Criteria for some time. However, they will continue to pay contracted payments in the meantime and should not simply be assumed to 'exit'.
KBC is confident in its impairment methodologies and calculation of provisions for its portfolio.

2014 Changes in the Portfolio

KBCI has continued to apply its definition of Default & Cure, which was first implemented in 4Q13 and substantially reflects the draft EBA Technical Standards published in October 2013. Over 700 million EUR worth of loans were migrated to Default status in the first half 2014, as individual impairment triggers were met (for example, on receipt of multiple forbearance).
KBCI has evidenced continued reduction in arrears in 2014. There has also been a strong improvement in underlying economic fundamentals in Ireland over the year to date, including strong GDP growth; improvements in domestic spending and strong house price growth of c.10% in 2014 to date.

Given the above, KBC is able to confirm its prior total Irish loan loss provisioning i.e. at the high end of the 150-200 million EUR range and at 50 to 100 million EUR for both 2015 and 2016.

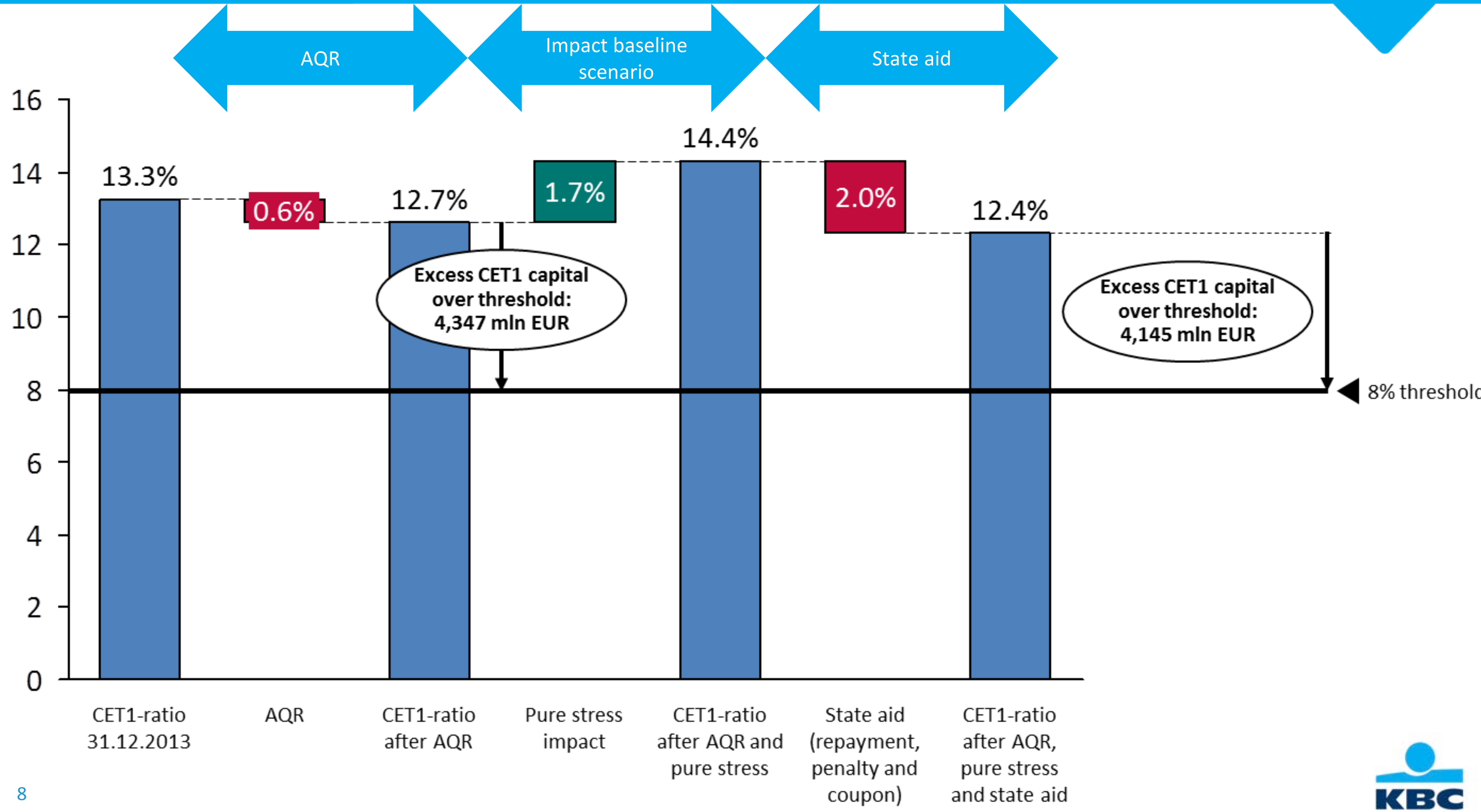
AQR: review covered more than just loan portfolios

- ‘**Level 3* fair valued assets**’ were screened, too *(group wide)*
  - Only 29 banks were subject to such an ECB review
    - One of the triggers to select KBC: CDO legacy, now fully collapsed
  - The after tax ‘prudential’ impact of the review was negligible
    - KBC models thus deemed robust and conservative
    - For non-derivatives, gross adjustment was zero – for derivatives 7 million EUR

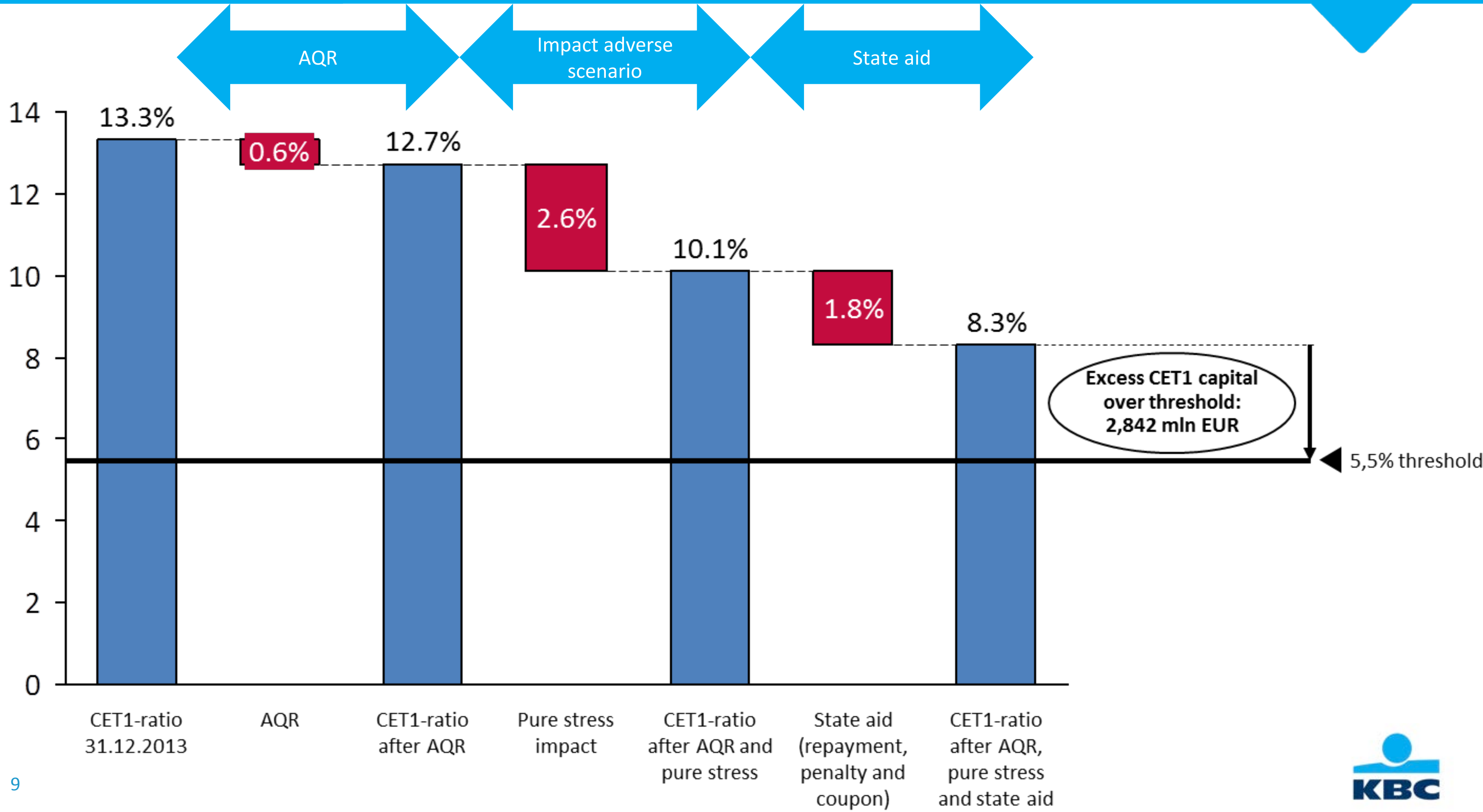
- Finally, **Credit Value Adjustments** (CVA) were subject to review *(group wide)*
  - i.e. the adjustment of the valuation of OTC derivatives to reflect the credit risk of the counterparty
  - a 72 million EUR gross adjustment was made on a prudential basis. No impact accounting-wise

* One of the 3 techniques to arrive at a ‘fair value’ is via a model which makes use of non-observable parameters. This is called ‘level 3 fair value’

Stress test combined with AQR: baseline scenario – CET1-ratio 2016

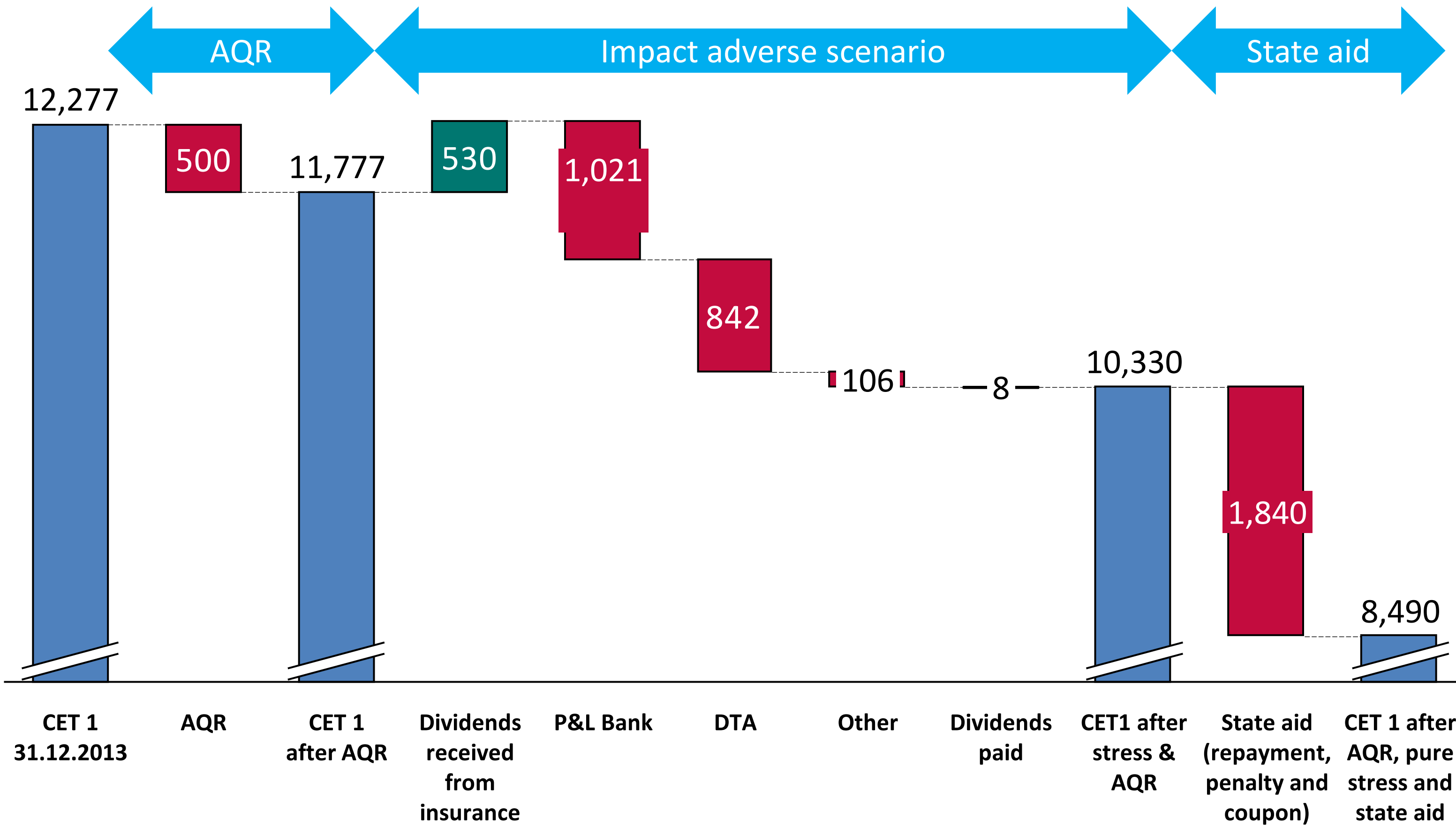


Stress test combined with AQR: adverse scenario – CET1 ratio for 2016



Stress impact – adverse scenario CET1 capital

CET1 2013 – 2016 (in millions of EUR)



(AFS = Available For Sale / IRB = Internal Rating Based / DTA = Deferred Tax Assets)

Stress impact – adverse scenario P&L

(in million €)	*2013*	*AQR adj.*	*2013 post AQR*	*2014*	*2015*	*2016*	*Cumul 2014-2016*
Net Interest Income	3,456		3,456	3,052	2,841	2,666	8,559
Net Trading Income	717	-79	638	-443	-172	-37	-652
Net Fee & Commission Income	1,699		1,699	1,513	1,458	1,403	4,374
Impairments on L&R	-1,715	-552	-2,267	-2,000	-1,245	-1,243	-4,488
Other income & expenses	-3,440	+131	-3,309	-2,826	-3,020	-2,968	-8,814
Result after tax	**717**	**-500**	**217**	**-703**	**-138**	**-180**	**-1,021**

Includes a 671 million EUR one-off impairment charge in Ireland

This is 6.5 billion EUR lower than analyst consensus (+5.5 billion EUR) for the 3 year period (2014-2016)

Net Interest Income (NII):
- Funding costs contributing negatively to the NII outcome
- Defaulted loans increase by more than 12 billion EUR
  → the loss on income puts material pressure on NII
- Hefty depreciation of CZK (-15 %) & HUF (-25 %) has a strong impact

Net Trading Income (NTI):
- Based on stressed NTI, adjusted for:
  - the state guarantee fee paid for CDOs in 2009 (given that this fee is considered as an insurance premium);
  - 73% of the other impact of CDOs on P&L (i.e. excl. the state guarantee fee) given that the CDO-positions have been de-risked substantially since 2009 (net exposure has been downsized from 23.2 billion EUR to 6.3 billion EUR at the end of 2013, or a reduction of 73%).

  This is a conservative stand given the 2014 full collapse of the CDO's
- Positive effect of interest rate swaps moving towards par on maturity date has not been taken into account
  → A positive impact of EUR 0.4 billion EUR has been excluded from the stress scenario and replaced by a severe negative contribution to the comprehensive market risk approach

Net Fee & Commission Income (NF&CI):
- Negative impact from lower equity prices and decline in value of money market funds on the Net Asset Value of the mutual funds.
- Negative impact from the weakening of the CZK and HUF and the trend of nominal GDP.

Impairments on Loans & Receivables
- Pure stress impact: impairment flow 2014-2016 = -4,508 million EUR (See next slide for more details)
- Including 20 million EUR AQR adjustment ('join-up'): impairment flow 2014 -2016 = -4,488 million EUR

Stress impact – adverse scenario Impairment flow for 2013-2016

Impairment flow for 2013-2016 (excluding the minor EUR 20 million AQR adjustment)

Impairment flow **sharply increases in 2014** as the upward shift in the Default Rate (DR) and Loss Rate (LR) causes (i) an increased impairment flow from new defaulted assets and (ii) an almost equally high provision flow from old defaulted assets. The upward shift in LR causes an increase in the provisioning level of the stock of old defaulted assets.

Thereafter (2015-2016) the impairment flow decreases again.

- The 2013 amount includes a large one-off impairment for Ireland (671 million EUR)
- The impairment flow from new defaulted assets does not increase much more after 2014: the further increase in DR and - to a lesser extent - LR is partially offset by the decrease in volume of the performing portfolio in the static balance sheet
- The impairment flow from old defaulted assets decreases as the further shift in LR is rather limited after 2014.

Impairments on loans & receivables per country evolution 2013 - 2016 (in million EUR)

	Belgium	Czech Rep.	Slovakia	Hungary	Ireland	Rest of the world	Total
2014	442	178	64	164	817	328	1 993
2015	390	159	57	95	298	258	1 257
2016	433	159	52	84	268	261	1 258
Total	**1 265**	**496**	**173**	**344**	**1 384**	**847**	**4 508**

Credit Cost Ratio per country (approximated by the ratio 'impairment flow / EAD')

	Belgium	Czech Rep.	Slovakia	Hungary	Ireland	Rest of the world	Total
2013	0.20%	0.23%	1.06%	0.83%	6.44%	1.20%	0.94%
2014	0.46%	0.68%	1.02%	2.21%	5.38%	1.25%	1.12%
2015	0.40%	0.61%	0.91%	1.28%	1.96%	0.99%	0.71%
2016	0.45%	0.61%	0.83%	1.13%	1.76%	1.00%	0.71%

Impairments on loans & receivables per country & asset class changes 2013 -2016 (in million EUR)

	Belgium	Czech Rep.	Slovakia	Hungary	Ireland	Rest of the world	Total
Sovereign	11	1	0	35	2	2	51
Financials	2	0	0	0	0	319	321
Corporate	620	170	101	48	218	473	1 630
Mortgages	279	153	31	249	1 164	39	1 915
Retail Other	353	173	41	11	0	13	591
Total	**1 265**	**496**	**173**	**344**	**1 384**	**847**	**4 508**

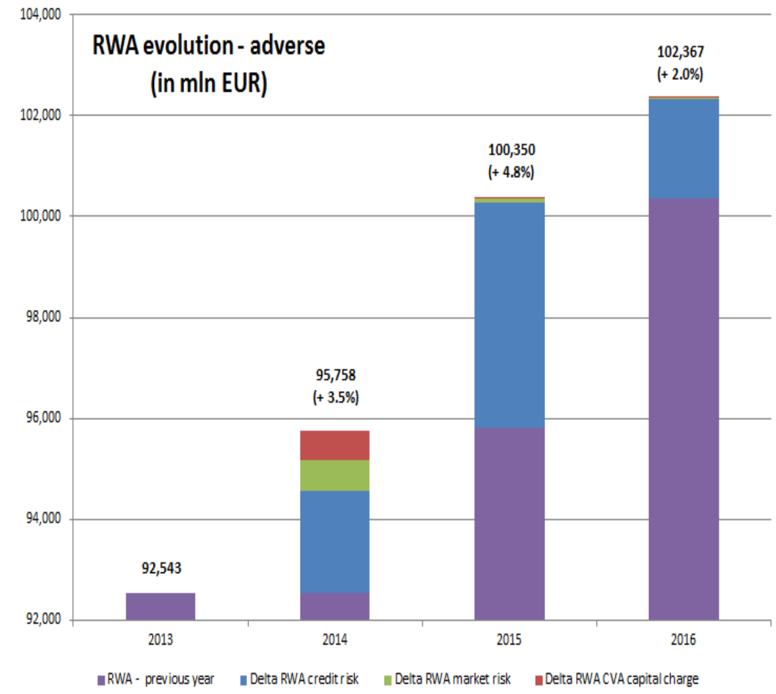
- Impairment estimates reflect either KBC's internal stress test models or (EBA) benchmarks
  - Sometimes KBC's outcome was higher than the benchmark, sometimes the benchmark was higher
  - If KBC's outcome was (materially) lower than the benchmark, then the benchmark was adopted (i.e. the worst of both outcomes)
  - This produces an overall outcome which is (more) conservative (than what full use of KBC's model outcome would have been)
  - Combined with the large prudential (AQR) adjustment for Irish Mortgages, a double counting of 'adjustment' is suspected

- Significant 473 million EUR cumulative impairment for Corporate (Rest of World) impacted by an atypically high 2013 impairment (starting point) and static balance sheet assumption (⇔ strategy for this portfolio = reduction)

- Hefty 319 million EUR cumulative impairment for Financials (Rest of World) stemming from mechanical projection of one-off impairment in 2013 for prior strategic participation in NLB

Stress impact – adverse scenario
Risk Weighted Assets (RWA)

in million €		Adverse scenario		
	2013	**2014**	**2015**	**2016**
Pure stress impact				
RWA transactional credit risk *	*53 559*	*54 907*	*58 703*	*60 226*
Adjustment for RWA 2013 floor	*0*	*0*	*0*	*0*
RWA securitisation	*3 277*	*3 952*	*4 637*	*5 084*
RWA other assets	*8 182*	*8 182*	*8 182*	*8 182*
RWA credit risk	65 018	67 041	71 522	73 492
RWA market risk	4 306	4 902	4 969	5 015
RWA CVA capital charge	1 344	1 939	1 939	1 942
RWA operational risk	10 848	10 848	10 892	10 892
RWA insurance	*11 068*	*11 068*	*11 068*	*11 068*
RWA holding-company activties	*72*	*72*	*72*	*72*
Intercompany elimination (bank/holding company)	*-113*	*-113*	*-113*	*-113*
Total RWA - pure stress impact	**92 543**	**95 757**	**100 350**	**102 367**
AQR adjustment	330	330	330	330
Total RWA - stress impact & AQR adjustment	**92 873**	**96 087**	**100 680**	**102 697**



** Detailed analysis of transactional RWA credit risk: see next slide.*

Stress impact - adverse scenario
Risk Weighted Assets (RWA)

Transactional RWA for 2013 – 2016, in million EUR:

	Belgium	Czech Republic	Slovakia	Hungary	Ireland	Rest of the world	Total
Sovereign	392	191	15	600	97	1 680	**2 975**
Financials	8	-4	3	5	0	-135	**-123**
Corporate	1 308	678	78	-475	-315	119	**1 393**
Mortgages	1 560	1 102	153	453	-1 178	-27	**2 063**
Other	265	-25	31	73	0	17	**361**
Total	**3 532**	**1 942**	**279**	**656**	**-1 396**	**1 653**	**6 667**

Sovereigns: increase of 3.0 billion EUR over 2014-2016

- Increase of 47% versus 2013 starting point (6.3 billion EUR) results from downgrades of sovereigns
- The 2013 starting point used in the stress test is based on KBC's own PD and LGDs (as required by ECB)
    - Meaning: no zero weights (no 'carve-out')
    - This 'fully loaded' IRB approach corresponds with management reporting as from Q1 2014
    - 4.4 billion EUR (out of 6.3 billion EUR) stems from 'home sovereigns ' (e.g., Belgium, Czech Rep., ..)

Corporates: increase of 1.4 billion EUR over 2014-2016

- Increase of 5% (compared with 2013) results mostly from an increase of 1.3 billion EUR in Belgium and 0.7 billion EUR in the Czech Republic and a decrease in Ireland (-0.3 billion EUR) and in Hungary (-0.5 billion EUR).
- In all countries, the downgrade leads to a relative increase in RWA, but due to high default rates in Ireland and Hungary, the effect in these countries is more than offset by the decrease in the volume of the performing portfolio.

Mortgages: increase of EUR 2.1 billion EUR

- Increase of 17% (compared with 2013) results from a considerable increase in Belgium and the Czech Republic, and a decrease in Ireland.
- In Belgium, we see the highest absolute increase in RWA, amounting to +1.6 billion EUR. This was due to the heavy downward shock on house prices (-27% cumulative over 2014-2016 period), which results in a relative shift in PD of +21% and in LGD of +72%
- Czech mortgages account for an increase in RWA of 1.1 billion EUR, caused by a house price shock of -10%
- For Irish mortgages, the further decline in house prices also leads to a worse PD. On balance, however, RWA decrease by 1.2 billion EUR, as the performing part of the portfolio decreases sharply due to the very high stressed default rates (up to 17 %) and the static portfolio assumption.