Pillar III Risk Report

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Introduction: Highlights in 2013 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

Unwinding the past…

- In 2013 we reduced the net legacy CDO and ABS exposure by 7.3 billion euros. In the first quarter of 2014, another reduction of some 2 billion euros of the net legacy CDO exposure was achieved thanks to the continued collapsing of CDO exposures.
- We repaid 1.17 billion euros (and paid a 50% penalty) in 2013 and 0.33 billion euros (and a 50% penalty) at the beginning of 2014 to the Flemish Regional Government. This repayment effectively reduced the outstanding state aid to 2 billion euros.
- The shareholder loans (to CERA and KBC Ancora) were substantially reduced (by 1 billion euros).
- KBC made considerable progress in the divestment plan agreed with the European Commission in 2009 when another three entities were successfully divested in 2013 (Absolut Bank, KBC Banka and the minority shareholding in Nova Ljubljanska banka).
- Agreements to divest KBC Bank Deutschland and Antwerp Diamond Bank were also signed in 2013 and are expected to be closed in 2014.
- Sovereign bond exposure to GIIPS countries were confined to low levels.

… to strengthen ourselves for the challenges ahead

- In 2013, important steps were taken to prepare ourselves for the regulatory challenges lying ahead (Basel III, Asset Quality Review, Banking Act).
- We reassessed our loan book which led to one-off impairment charges for KBC Ireland and K&H. The impact of this thorough screening was immaterial for all other entities.
- The new and more stringent capital requirements under Basel III and Solvency II were amply exceeded at the end of 2013.
- Our liquidity position was strengthened due to continuous solid growth in customer deposits at different entities. KBC Ireland, where concerted efforts to build a retail deposit base have helped to signifcantly reduce KBC Bank Ireland's funding dependence, merits particular mention.
- In the wake of roadshows throughout Europe and Asia from 10 to 12 March 2014, KBC Group issued 1.4 billion euros in non-dilutive, CRD IV-compliant Additional Tier-1 (AT1) securities. More information can be found in the press release of 13 March 2014, available on www.kbc.com. Subject to market conditions, KBC may call some of its outstanding stock of classic tier-1 securities on their next possible call date.

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 2013 annual report and – more extensively – in this publication.

The most important regulations governing risk and capital management are the Basel II capital requirements applying to banking entities, and the Solvency I capital framework applying to insurance entities. In 2014, the Basel II capital requirements will be gradually replaced by the Basel III framework, which will gradually enter into effect. Solvency I will be replaced by the fundamentally reformed Solvency II framework, whose official entry into force has now been confirmed as January 2016.

This Risk Report for 2013 is based on Basel II's third pillar and the resulting disclosure requirements of the Capital Requirements Directive (as transposed into Belgian law). Although the disclosures are set up according to the first Basel II pillar and focus on banking entities, KBC – as a bank-insurance company preparing for the disclosure requirements of Solvency II – decided to extend the scope for the insurance activities in order to provide an overall view of the KBC group's risk exposure and risk management activities.

Since the end of 2011, CRD III has 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 2013 annual report of KBC Group NV and in a separate disclosure 'KBC Group Compensation Report' which will be published in the second quarter of 2014 at www.kbc.com.

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).

Remark:

Please note that, unless otherwise stated, KBC Bank Deutschland (in 2012 and 2013), Antwerp Diamond Bank (in 2012 and 2013), Absolut Bank (in 2012; sold in 2013), KBC Banka (in 2012; sold in 2013), and the minority shareholding in Nova Ljubljanska banka (in 2012; sold in 2013), which have all been recognised as 'disposal groups' under IFRS 5, have been excluded from the various tables in order to maintain consistency with their treatment in the balance sheet. Where relevant, we have provided summary information for these entities separately in the footnotes under these tables.

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.

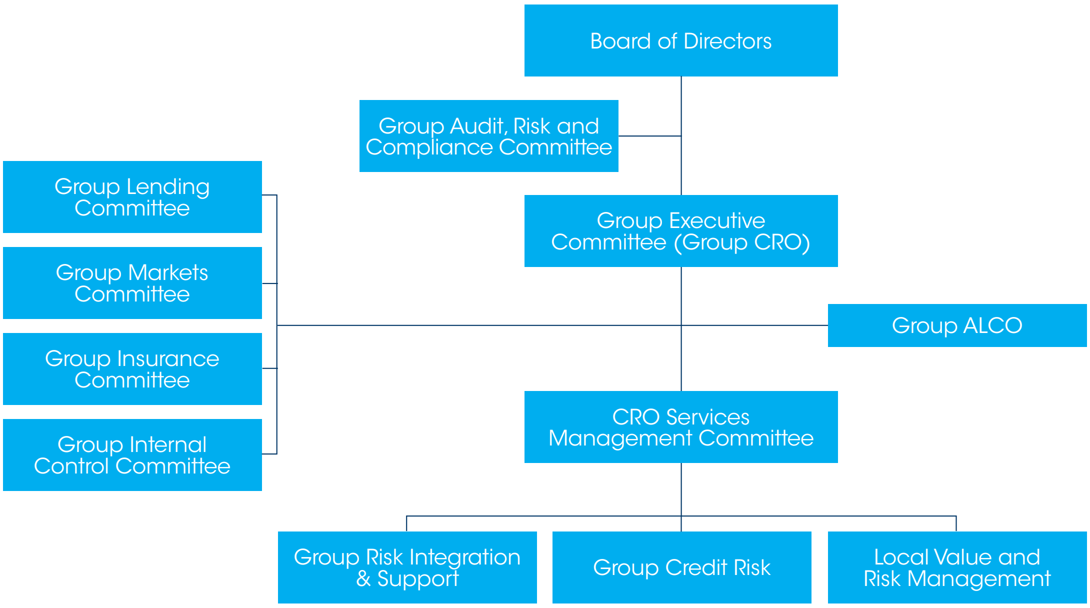
The information provided in this document has not been subject to an external audit. However, the disclosures have been checked for consistency with other existing risk reports and were subjected to a final screening by authorised risk management representatives to ensure quality.

Information disclosed under IFRS 7, which has been audited, is presented in KBC's annual report. Broadly speaking, the information in the annual report coincides 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 II. In order not to compromise on the readability of this document, relevant parts of the annual report have been reproduced here.

This risk report is available in English on the KBC website and is updated on a yearly basis. KBC's next update is scheduled for the beginning of April 2015. Depending on market requirements, KBC may however decide to provide more frequent updates.

Risk Management Governance

At the start of 2013, a new risk governance model was put in place to take account of changes in the organisational structure of KBC.



This model is characterised primarily by:

- the Board of Directors, assisted by the Audit, Risk and Compliance (ARC) Committee, 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 exposures 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 Commitee/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.

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 Basel II) and an economic (i.e. pillar 2 of Basel II) point of view;
- in the current situation and over a 3-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 Basel II accord. 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 Audit Risk and Compliance Committee and its Board of Directors. ICAAP as such is also subject to regulatory examination by the National Bank of Belgium, 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 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.

Further on in this section, a distinction is made between regulatory solvency disclosures – linked to pillar 1 of Basel II – and economic capital disclosures – linked to pillar 2 of Basel II. A brief reference is also made to the expected impact of regulatory adjustments.

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).

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 2013

Under Basel II, we use the so-called 'building block' method for group solvency. This entails comparing group regulatory capital (i.e. parent shareholders' equity adjusted for a number of items (see table)), with the sum of the separate minimum regulatory solvency requirements for KBC Bank and the holding company (after deduction of intercompany transactions between these entities) and KBC Insurance. The total risk-weighted volume of insurance companies is calculated as the required solvency margin under Solvency I divided by 8%. Regulatory minimum solvency targets were amply exceeded in 2013, not only at year-end, but also throughout the entire year. At 31 December 2013, the tier-1 ratio amounted to 15.8%.

The scope of consolidation used in the solvency calculation is identical to the scope used in the financial statements, as determined by IFRS rules.

Solvency at group level (consolidated; under Basel II) (in millions of EUR)	**31-12-2012**	**31-12-2013**
Total regulatory capital, after profit appropriation	**16 113**	**17 169**
Tier-1 capital[1]	**14 062**	**14 286**
Parent shareholders' equity	12 099	11 826
Non-voting core-capital securities	3 500	2 333
Intangible fixed assets (-)	-356	-341
Goodwill on consolidation (-)	-987	-950
Innovative hybrid tier-1 instruments	419	409
Non-innovative hybrid tier-1 instruments	1 692	1 693
Direct and indirect funding of investments in own shares	-250	0
Minority interests	-5	-3
Equity guarantee (Belgian State)	276	22
Revaluation reserve, available-for-sale assets (-)[6]	-1 263	-1 094
Hedging reserve, cashflow hedges (-)[6]	834	497
Valuation differences in financial liabilities at fair value – own credit risk (-)[6]	-22	25
Minority interests in available-for-sale reserve and hedging reserve, cashflow hedges (-)[6]	0	0
Equalisation reserves (-)[6]	-111	-131
Dividend payout (-)[2]	-960	0
IRB provision shortfall (50%) (-)[3]	0	0
Limitation of deferred tax assets	-227	0
Items to be deducted (-)[4]	-577	0
Tier-2 and tier-3 capital	**2 051**	**2 883**
Perpetuals (including hybrid tier-1 instruments not used in tier-1 capital)	0	0
Revaluation reserve, available-for-sale shares (at 90%)	185	290
Minority interests in revaluation reserve, available-for-sale shares (at 90%)	0	0
IRB provision shortfall (50%) (-)[3]	0	0
IRB provision excess (+)[3]	130	342
Subordinated liabilities	2 268	2 237
Tier-3 capital	44	15
Items to be deducted (-)[4]	-577	0
Total weighted risks	**102 148**	**90 541**
Banking[7]	89 532	78 486
Insurance[5]	12 386	12 096
Holding-company activities	304	72
Elimination of intercompany transactions between banking and holding-company activities	-74	-113
Solvency ratios		
Tier-1 ratio	13.8%	15.8%
Core tier-1 ratio	11.7%	13.5%
CAD ratio	15.8%	19.0%

1 Audited figures (except for 'IRB provision shortfall/excess').

2 Includes the dividend on ordinary shares and the coupon on non-voting core-capital securities sold to the Belgian State and Flemish Region.

3 Excess/shortfall is defined as the (positive/negative) difference between the actual loan loss impairment recognised and the 'expected loss' calculation.

4 Items to be deducted, which are split 50/50 over tier-1 and tier-2 capital, include mainly participations in and subordinated claims against financial institutions in which KBC has between a 10% and 50% share (at year-end 2012, mainly the minority shareholding in Bank Zachodni in Poland).

5 Weighted risks for insurance are calculated by multiplying capital under Solvency I by a factor of 12.5 (8% rule similar to the relationship between RWA and capital for banking).

6 Relates to the filtering of these items from shareholders' equity. For example, a negative amount for 'Revaluation reserve, available-for-sale assets' means that a positive revaluation reserve (part of consolidated equity) is filtered out in the solvency calculation table.

7 Until year-end 2014, weighted risks include an amount that decreases annually for residual operational risks related to KBL EPB (sold in 2012).

During 2013:

- We reimbursed 1.17 billion euros (and paid a 50% penalty) to the Flemish Regional Government. As a result, the remaining core-capital securities fell to 2.33 billion euros at the end of 2013 (the additional repayment of 0.33 billion euros at the beginning of 2014 has not been included in this calculation).
- We issued 1 billion US dollars' worth of contingent capital notes in January 2013 (included in tier-2 capital).
- We further divested a number of entities, including Absolut Bank, the remaining stake in the merged Bank Zachodni-Kredyt Bank entity, Nova Ljubljanska banka and KBC Banka, all of which had a positive impact on the solvency ratios.
- The shareholder loans (to Cera and KBC Ancora) were substantially reduced (by 1 billion euros).
- We further reduced our CDO exposure (see section on 'Structured credit products').

Taking into account the effects of the repayment of 0.5 billion euros (including a 50% penalty) in state aid to the Flemish Regional Government in early 2014 and of the remaining divestments for which sale agreements have been signed but not yet completed, the *pro forma* tier-1 ratio would have been 15.6% at year-end 2013.

At the beginning of March 2014, KBC Group NV announced its intention to issue a euro-denominated, non-dilutive, Additional Tier-1 (AT1) instrument (compliant with CRD IV regulations). This AT1 security represents a 5-year, non-call perpetual instrument with a temporary write-down trigger at 5.125% CET1. KBC's target capital structure includes 1.5% of RWA in the form of AT1 instruments, to be issued throughout the CRD IV implementation period. In the wake of roadshows throughout Europe and Asia from 10 to 12 March 2014, KBC Group issued 1.4 billion euros in non-dilutive, CRD IV-compliant Additional Tier-1 (AT1) securities. More information can be found in the press release of 13 March 2014, available on www.kbc.com. Subject to market conditions, KBC may call some of its outstanding stock of classic tier-1 securities on their next possible call date.

In the following table, we have shown the tier-1 and CAD ratios calculated under Basel II for KBC Bank, as well as the solvency ratio of KBC Insurance. More detailed information on the solvency of KBC Bank and KBC Insurance can be found in their consolidated financial statements.

Solvency, KBC Bank (consolidated)

The table shows the tier-1 and CAD ratios calculated under Basel II. It should be noted that Basel II rules have been implemented throughout the group since 2008. In June 2012, KBC Bank, CBC Banque, KBC Lease, KBC Finance Ireland, KBC Credit Investments and KBC Real Estate received regulatory approval to implement the IRB Advanced approach. ČSOB (Czech Republic) received its approval in September 2012. A number of small entities followed in 2013. As a consequence, the IRB Advanced approach (under Basel II) has become the primary method for calculating risk weighted assets within KBC.

Solvency, KBC Bank (consolidated) (in millions of EUR)	31-12-2012 Basel II	31-12-2013 Basel II
Total regulatory capital, after profit appropriation	**14 390**	**15 537**
Tier-1 capital	**12 235**	**12 631**
Parent shareholders' equity	11 255	11 662
Intangible fixed assets (-)	-89	-105
Goodwill on consolidation (-)	-969	-944
Innovative hybrid tier-1 instruments	419	409
Non-innovative hybrid tier-1 instruments	1 692	1 693
Direct and indirect funding of investments in own shares	-250	0
Minority interests	351	294
Equity guarantee (Belgian State)	240	19
Revaluation reserve available-for-sale assets (-)	-335	-264
Hedging reserve, cashflow hedges (-)	863	522
Valuation differences in financial liabilities at fair value own credit risk (-)	-22	25
Minority interest in AFS reserve & hedging reserve, cashflow hedges (-)	-1	0
Dividend payout (-)	0	-677
IRB provision shortfall (50%) (-)	0	0
Limitation of deferred tax assets	-342	0
Items to be deducted (-)	-577	0
Tier-2 and tier-3 capital	**2 154**	**2 906**
Perpetuals (including hybrid tier-1 instruments not used in tier-1 capital)	250	250
Revaluation reserve, available-for-sale shares (at 90%)	39	63
Minority interests in revaluation reserve, available-for-sale shares (at 90%)	0	0
IRB provision excess (+)	130	342
Subordinated liabilities	2 268	2 237
Tier-3 capital	44	15
Items to be deducted (-)	-577	0
Total weighted risks	**88 927**	**78 120**
Credit risk	69 149	63 073
Market risk	8 733	4 308
Operational risk	11 045	10 738
Solvency ratios		
Tier-1 ratio	13.8%	16.2%
Core tier-1 ratio	11.4%	13.5%
CAD ratio	16.2%	19.9%

The regulatory minimum under Basel II for the CAD ratio amounts to 8%. However, the regulatory floor of 80% is still applicable, which means that the capital required under Basel II should not be less than 80% of the capital required under Basel I. If the floor is not respected, the regulator may increase the minimum capital ratio of 8% to cover the capital requirements below 80%. At present, the Basel II capital requirements for KBC Bank at consolidated level are slightly above 80% of Basel I.

In Belgium, banks may issue both innovative and non-innovative hybrid capital instruments that may account for a maximum 35% of tier-1 capital (with additional limits for the innovative hybrid component). To be classified as non-innovative, the instrument must have a number of features, viz. it needs to be subordinated, should not provide for any step-up in dividends, should be perpetual (no general redemption right for investors) and may be converted to ordinary shares subject to certain limits and approvals.

In order to strengthen the solvency ratios of KBC Bank and with a view to optimising the use of hybrid instruments allowed by the regulator, KBC Bank issued so-called non-innovative hybrid tier-1 capital instruments in 2008.

On 31 December 2010, new rules entered into effect with respect to the characteristics and proportion of hybrid instruments that may be included in pillar I tier-1 capital ('CRD II'). The instruments issued by KBC are not yet fully compliant with these new requirements. The European Directive and Belgian regulations allow for a transition period, during which instruments that are no longer compliant may still be included in tier-1 capital. During the first ten years, there would be no additional cap on these grandfathered instruments. However, implementation of the Basel III regime will affect this grandfathering regime. Non-compliant government-subscribed instruments will be fully grandfathered in an initial phase. As from 2018, they will no longer qualify. The amount of other non-compliant hybrid instruments that can be taken into account will decrease from 90% of the outstanding amount in 2013 to 0% of the outstanding amount in 2022.

As announced in December 2012, KBC Bank NV placed 1 billion US dollars' (approximately 750 million euros) worth of tier-2 contingent capital notes in January 2013 to create an extra capital buffer. The notes were placed with a wide range of institutional and high-net-worth investors in Asia and Europe. They carry a coupon of 8% per annum and have a maturity of 10 years, with an optional call in year 5. Furthermore, the notes are subordinated and qualify as tier-2 capital under Basel III standards (based on the draft CRD IV of 20 July 2011). A Write-Down trigger event has been added to the terms and conditions of the instruments, which means that if the Common Equity tier-1 capital ratio falls below 7%, the principal amount of each security will be written down to zero and the notes cancelled. The Holders will no longer have any rights against the KBC group with respect to interest and repayment of the aggregate principal amount written down.

The table below gives an overview of the main hybrid tier-1 instruments.

Overview of main hybrid tier-1 instruments					
Issuer	Description	Original nominal amount	Nominal amount at 31-12-2013	Start date	First call date
KBC Bank	directly issued perpetual debt securities	525 million GBP (200+175+150)	45 million GBP	December 2003	December 2019
KBC Bank	directly issued perpetual debt securities	1 250 million EUR	1 250 million EUR	May 2008	May 2013
KBC Bank	directly issued perpetual debt securities	700 million EUR	700 million EUR	June 2008	June 2013
KBC Bank Funding Trust II	perpetual non-callable 10-year preferred securities	280 million EUR	118 million EUR	June 1999	June 2009
KBC Bank Funding Trust III	non-cumulative guaranteed trust preferred securities	600 million USD	169 million USD	November 1999	November 2009
KBC Bank Funding Trust IV	non-cumulative guaranteed trust preferred securities	300 million EUR	117 million EUR	November 1999	November 2009

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)		31-12-2012			31-12-2013		
		Total regulatory capital	Total weighted risk	CAD ratio	Total regulatory capital	Total weighted risk	CAD ratio
CBC Banque	Belgian GAAP	485	2 303	21.0%	433	2 434	17.8%
ČSOB (Czech Republic)	IFRS	2 074	13 612	15.2%	2 030	13 289	15.3%
ČSOB (Slovak Republic)	IFRS	576	3 973	14.5%	555	3 839	14.5%
KBC Bank Ireland	IFRS	912	8 181	11.1%	938	7 333	12.8%
K&H Bank	IFRS	650	4 985	13.0%	601	4 506	13.3%

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 until the third quarter of 2013:
  - 90% of the net positive revaluation reserve for available-for-sale shares and 100% of the net positive revaluation reserve for available-for-sale bonds.
  - Unrealised gains on property and equipment, investment property and held-to-maturity instruments.

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

At year-end 2013, the available capital included:

- 80% of latent gains on bonds held by KBC Insurance NV (previously 100% and also including latent gains of subsidiaries of KBC Insurance NV) (net latent losses are not deducted);
- 100% of net latent gains on AFS shares held by KBC Insurance NV (previously also including latent gains of subsidiaries of KBC Insurance NV; net latent losses are not deducted) and excluding latent gains on real estate.

The Solvency I capital ratio amounted to 281% at the end of 2013, comfortably above the minimum regulatory solvency requirement of 100%. The drop in available capital of KBC Insurance was caused primarily by the application of more stringent rules imposed by the regulator regarding partial inclusion of latent gains in the available capital.

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 (consolidated) (in millions of EUR)	31-12-2012	31-12-2013
Available capital	**3 190**	**2 721**
Parent shareholders' equity	3 292	3 295
Dividend payout (-)	-286	-252
Minority interests	0	0
Subordinated liabilities	10	0
Intangible fixed assets (-)	-9	-10
Goodwill on consolidation (-)	-162	-150
Revaluation reserve available-for-sale investments (-)	-920	-830
Equalisation reserve (-)	-111	-131
Equity guarantee (Belgian State)	36	3
Cashflow hedge reserve	-28	-25
90% of positive revaluation reserve, available-for-sale shares	142	188
Latent gains on bonds	1 173	633
Latent gains on real estate	52	0
Limitation of latent gains on shares and real estate	0	0
Required solvency margin	**991**	**968**
Subtotal, non-life insurance	208	214
Non-life and industrial accident (legal lines)	201	207
Annuities	7	7
Subtotal, life insurance	767	752
Class-21 life insurance	752	735
Class-23 life insurance	15	17
Other	15	2
Solvency ratio and surplus		
Solvency ratio (%)	322%	281%
Solvency surplus (in millions of EUR)	2 199	1 753

Basel III and Solvency II

The Basel III proposals and corresponding European Directive and Regulation (CRD IV/CRR) introduce new, more stringent capital requirements for financial institutions. The new Regulation will enter gradually into force, starting on 1 January 2014, and be fully implemented by 1 January 2022.

The legal minimum tier-1 ratio will be increased from 4% under Basel II to 6% under CRD IV/CRR. At least 4.5 percentage points of this tier-1 ratio has to consist of core capital (common equity tier-1 capital, or 'common equity'). On top of this minimum common equity, a number of additional buffers have been put in place, including a capital conservation buffer of 2.5%, a countercyclical buffer in times of excessive credit growth (between 0% and 2.5%, to be determined by the regulator) and a systemic buffer (likewise to be determined by the regulator). Moreover, the quality of the items of the available capital increases, as higher eligibility criteria are defined for instruments to be included in the calculation of regulatory capital.

For KBC, the main impact of the shift from Basel II to CRD IV/CRR is the treatment of deferred tax assets and the removal of the filter for unrealised gains and losses on available-for-sale instruments. Additionally, the building block method will be replaced by the so-called Danish compromise method (the general rule in CRD IV/CRR with regard to insurance participations for (mixed) financial holdings and financial conglomerates is that own funds in that entity are deducted from the common equity tier-1 capital. However, national regulators can grant a waiver, permitting institutions to apply a 370% weighting instead (the Danish compromise)). KBC received a waiver from the National Bank of Belgium, but it is still not clear whether this waiver will be granted once the ECB becomes the competent supervisory authority.

KBC's internal minimum target for the common equity ratio is 10% on a fully loaded basis (presuming full implementation of all CRD IV/CRR rules, and including the remaining financial support provided by the Flemish Regional Government until 2018). On 31 December 2013, the fully loaded common equity ratio (Danish compromise method) stood at 12.8% (13.2% on a phased-in basis), well above the in-house target. Taking into account the effects of the repayment of 0.5 billion euros in state aid to the Flemish Regional Government in early 2014 and of the remaining divestments for which sale agreements have been signed but not yet completed, the *pro forma* fully loaded common equity ratio would have been 12.5% at year-end 2013.

Moreover, the supervisory authorities (with the National Bank of Belgium as the consolidating supervisor) have taken their Joint Home-Host Capital Decision for KBC Group NV: KBC has been informed of the request to maintain a permanent minimum fully loaded common equity ratio of 9.25%, excluding latent gains. According to this calculation, this ratio stood at 12.5% at year-end 2013, well above the regulatory minimum.

Solvency at group level (consolidated; under CRD IV/CRR (Basel III), Danish compromise method) (in millions of EUR)	31-12-2013 Fully loaded
Total regulatory capital, after profit appropriation	**16 258**
Tier-1 capital	**11 711**
Common equity	11 711
Parent shareholders' equity (excluding non-voting core-capital securities and minority interests)	11 361
Non-voting core-capital securities	2 333
Intangible fixed assets (-)	-341
Goodwill on consolidation (-)	-950
Minority interests	-3
Hedging reserve, cashflow hedges (-)	497
Valuation differences in financial liabilities at fair value – own credit risk (-)	-6
Equalisation reserve (-)	-131
Dividend payout (-)	0
Remuneration of government securities (-)	0
Deduction with regard to financing provided to shareholders (-)	-176
IRB provision shortfall (-)	-225
Deferred tax assets on losses carried forward (-)	-648
Limit on deferred tax assets from temporary differences relying on future profitability and significant participations in financial sector entities (-)	0
Additional going concern capital	0
Grandfathered innovative hybrid tier-1 instruments	0
Grandfathered non-innovative hybrid tier-1 instruments	0
CRR-compliant AT1 instruments	0
Minority interests to be included in additional going concern capital	0
Tier-2 capital	**4 547**
IRB provision excess (+)	342
Subordinated liabilities	4 206
Subordinated loans non-consolidated financial sector entities (-)	0
Minority interests to be included in tier-2 capital	0
Total weighted risk volume	**91 426**
Banking	80 399
Insurance	11 068
Holding-company activities	72
Elimination of intercompany transactions	-113
Solvency ratios	
Common equity ratio	12.8%
Tier-1 ratio	12.8%
CAD ratio	17.8%

Solvency at group level (consolidated; under CRD IV/CRR (Basel III), 'building block' method)	31-12-2013 Fully loaded
Common equity ratio	13.2%
Tier-1 ratio	13.2%
CAD ratio	18.1%

Solvency at KBC Bank (consolidated; under CRD IV/CRR (Basel III)) (in millions of EUR)	31-12-2013 Fully loaded
Total regulatory capital, after profit appropriation	**14 400**
Tier-1 capital	**9 602**
Common equity	9 602
Parent shareholders' equity (excluding non-voting core-capital securities and minorities)	11 662
Intangible fixed assets (-)	-105
Goodwill on consolidation (-)	-944
Minority interests	147
Hedging reserve, cashflow hedges (-)	522
Valuation differences in financial liabilities at fair value – own credit risk (-)	-6
Dividend payout (-)	-677
Deduction with regard to financing provided to shareholders (-)	-176
IRB provision shortfall (-)	-225
Deferred tax assets on losses carried forward (-)	-595
Limit on deferred tax assets from timing differences relying on future profitability and significant participations in financial sector entities (-)	0
Additional going concern capital	0
Grandfathered innovative hybrid tier-1 instruments	0
Grandfathered non-innovative hybrid tier-1 instruments	0
CRR-compliant AT1 instruments	0
Minority interests to be included in additional going concern capital	0
Tier-2 capital	**4 797**
IRB provision excess (+)	342
Subordinated liabilities	4 456
Subordinated loans non-consolidated financial sector entities (-)	0
Minority interests to be included in tier-2 capital	0
Total weighted risk volume	**80 003**
Solvency ratios	
Common equity ratio	12.0%
Tier-1 ratio	12.0%
CAD ratio	18.0%

Solvency II is the new regulatory solvency regime for all EU insurance and reinsurance companies. Whereas the current insurance solvency requirements (Solvency I) are volume-based, Solvency II pursues a risk-based approach. It aims to implement solvency requirements that better reflect the risks that companies face and deliver a supervisory system that is consistent across all EU Member States. The official entry into force of Solvency II – previously scheduled for January 2013 – is now confirmed to be January 2016. Based on the most recent draft version of the Solvency II regulations, the Solvency II ratio of the KBC Insurance Group in 2013 amply exceeded the minimum requirements. In 2011, KBC invested in a Solvency II solution, which allows us to follow up our key metrics on a regular basis, with a central Solvency II solution performing the calculations for all insurance entities.

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 ARC 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.

As mentioned previously, economic capital is used as a major building block for ICAAP (Basel II, pillar 2). In addition, it provides essential input for risk-adjusted performance measurement.

The breakdown of KBC's economic capital per risk type is provided in the following table.

Economic capital distribution, KBC group*	2012	2013
Credit risk	56%	55%
Non-trading market risk	25%	28%
Trading market risk	1%	1%
Business risk	8%	8%
Operational risk	6%	5%
Technical insurance risk	3%	3%
Funding cost and bid/offer spread risk	0%	0%
Total	**100%**	**100%**

* All percentages relate to figures at the end of December. Excluding entities classified as 'disposal groups' under IFRS 5 (see 'Remark' at the start of this section) and whose contribution to KBC's economic capital was around 3% in 2013 and 6% in 2012.The figures for the end of December 2012 are significantly different than those for the end of September 2012 in the 2012 report (i.e. non-trading market risk has increased significantly whereas credit risk has decreased owing to the improvements made to the model).

Risk-Adjusted Performance Measurement

In 2011, KBC developed a Risk-Adjusted Performance Measurement (RAPM) policy, whereby risk-adjusted performance metrics 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. 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 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 an increased focus on liquidity risk management throughout the industry, and this has been intensified by the minimum liquidity standards defined by the Basel Committee.

We continue to incorporate these Basel III 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.

Representing the second line of defence, the risk department consists of the Group Chief Risk Officer (Group CRO), local CROs and group and local risk functions. Some of the tasks that fall within the remit of the risk functions are monitoring risks at portfolio/entity level, creating risk measurements, developing frameworks and advising/reporting on issues handled by the group and local Executive Committee/Risk Committees.

Lastly, the third line of defence comprises the audit function, responsible for auditing the efficiency and effectiveness of the risk management system and its compliance with the risk management framework, as well as the way in which line management handles risks outside this formal framework.

The liquidity management framework and group liquidity limits are set by the Group Executive Committee and Board of Directors. By approving the framework, a risk appetite is chosen as the framework describes which measures are subject to limits. Decisions on setting maximum or minimum values for the different measures are taken in the financial planning process.

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 2013, KBC had attracted 25 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, KBC Lease, KBC Financial Products, ČSOB Czech Republic, ČSOB Slovak Republic, KBC Bank Ireland, CIBank, KBC Credit Investments, KBC Finance Ireland, Commercial Finance, IFIMA and K&H. 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 at year-end (excluding intercompany 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**
31-12-2012									
Total inflows	29	12	17	50	44	34	0	39	225
Total outflows	31	20	14	36	5	1	79	39	225
Professional funding	13	12	2	1	0	0	0	0	29
Customer funding	13	5	7	15	4	1	79	0	124
Debt certificates	1	4	4	20	1	1	0	1	32
Other	3	0	0	0	0	0	0	38	40
Liquidity gap (excl. undrawn commitments)	-2	-8	2	15	39	33	-79	1	0
Undrawn commitments	–	–	–	–	–	–	–	-28	–
Financial guarantees	–	–	–	–	–	–	–	-11	–
Net funding gap (incl. undrawn commitments)	-2	-8	2	15	39	33	-79	-38	-39
31-12-2013									
Total inflows	17	10	18	53	42	34	0	32	205
Total outflows	27	11	20	29	7	2	84	25	205
Professional funding	17	2	2	1	0	0	1	1	25
Customer funding	7	6	12	13	3	1	83	0	126
Debt certificates	0	4	6	15	3	1	0	0	29
Other	2	0	0	0	0	0	0	23	25
Liquidity gap (excl. undrawn commitments)	-10	-2	-2	24	35	32	-84	7	0
Undrawn commitments	–	–	–	–	–	–	–	-25	–
Financial guarantees	–	–	–	–	–	–	–	-10	–
Net funding gap (incl. undrawn commitments)	-10	-2	-2	24	35	32	-84	-28	-35

* 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. Entities classified as 'disposal groups' under IFRS 5 (see 'Remark' at the start of this section) have also been excluded (balance sheet total of 3.9 billion euros for 2013). '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). 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 'Other' category under 'Total outflows' contains own equity, short positions, provisions for risks and charges, tax liabilities and other liabilities.

In line with the activities of a banking group, funding sources generally have a shorter maturity than the assets that are funded, leading to a net liquidity gap in the shorter time buckets and a liquidity excess 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

KBC Bank has a solid liquidity position. Historically, we have always had a substantial amount of liquid assets. At year-end 2013, KBC Bank (at the consolidated level) had 57.1 billion euros' worth of unencumbered central bank eligible assets, 33.5 billion euros of which in the form of liquid government bonds (59%). The remaining available liquid assets were other ECB/FED eligible bonds (29%) 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 four 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 (below).

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.

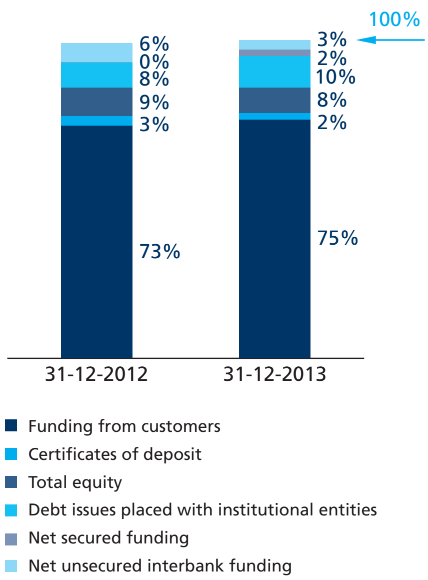
KBC Group's funding mix can be broken down as follows (figures relate to 31 December 2013):

- Funding from customers (132.9 billion euros, 75% of the total figure), consisting of demand deposits, time deposits, savings deposits, other deposits, savings certificates and debt issues placed in the network. Some 63% of the funding from customers relates to private individuals and SMEs.

Short-term unsecured funding compared to liquid assets
(KBC Bank, in billions of EUR)*

* Excluding divestments that have not yet been completed. Available liquid assets have been derived from the treasury management report.

Funding mix



- Senior unsecured debt placed with institutional investors (17.1 billion euros, 10% of the total figure), mainly comprising IFIMA debt issues (12.4 billion euros), covered bonds (3.9 billion euros) and the contingent capital notes issued in January 2013 (0.75 billion euros).
- Net unsecured interbank funding (4.8 billion euros, 3% of the total figure).
- Net secured funding (3.2 billion euros in repo funding, 2% of the total figure) and certificates of deposit (3.5 billion euros, 2% of the total figure).
- Total equity (14.5 billion euros, 8% of the total figure).

Please note that:

- We recorded continuous solid growth in customer deposits at different entities, especially in Ireland, where concerted efforts to build a retail deposit base have helped increase KBC Bank Ireland's funding independence. Deposits from customers in KBC Ireland increased from 2.7 billion euros as at end 2012 to 3.5 billion euros at year-end 2013.
- During 2013, KBC Bank used its EMTN programme to raise 1.1 billion euros in long-term funding, 0.75 billion euros of which was raised through wholesale benchmark issues.
- 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 new 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 2.67 billion euros.
- In 2013, we also repaid 8.3 billion euros borrowed from the ECB under the long-term refinancing operations (LTROs), thanks to the vastly improved state of the wholesale funding market and KBC's solid liquidity position. At year-end 2013, only 470 million euros in LTRO loans remained outstanding at KBC Deutschland, an entity for which a divestment agreement has already been signed.

LCR and NSFR

Both the Liquidity Coverage Ratio (LCR) and Net Stable Funding Ratio (NSFR) are defined in the 'Glossary'. At year-end 2013, our NSFR stood at 111% and our LCR at 131%, both calculated based on KBC's interpretation of current Basel Committee guidance and CRD IV/CRR. This is well above the minimum regulatory requirements and KBC's own targets of 105% and 100% for 2015, respectively.

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.

Credit risk can occur both in the banking entities and in the insurance entities of the group. As regards banking activities, credit risk occurs mainly in lending activities (including leasing and factoring). However, it can also arise through trading activities and in treasury activities.

Credit risk arising from insurance activities stems mostly from the investment portfolios, which, for instance, include investments in debt securities.

Strategy and processes

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 (based on parameters such as internal risk class, type of counterparty) 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.

Credit risk management at transactional level

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.

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 as well as to private individual, are reviewed periodically, with account being taken of any new information that is available (such as arrears, financial data, a significant change in the risk class). This monthly exercise can trigger a more in-depth review or may result in action also being taken towards the client.

For credit linked to defaulted borrowers in PD classes 10, 11 and 12 (impaired loans), 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.

In order to avoid a situation where an obligor facing financial difficulties ends up defaulting, we can decide to renegotiate its loans in accordance with internal policy guidelines. Distressed renegotiated loans are loans whose original payment terms have been altered, due to a deterioration in the borrower's financial condition.

Renegotiation 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;
- writing off part of the debt and providing debt forgiveness.

The negotiated changes must be reflected in a new, or an amended, and duly signed loan agreement. A renegotiation tag is attached to the file in the credit systems for identification, monitoring and reporting purposes.

A client with a distressed renegotiated loan will in principle be assigned PD class 9 or higher.
If – 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 credit committee will assign/confirm PD 9. Some exceptions to the PD 9 principle exist for certain retail portfolios. In such cases, the PD class to be assigned is determined on the basis of the behavioural score and may end up being lower than 9. However, a higher PD than the one assigned to borrowers without restructured loans is the usual outcome, as the behavioural score takes into account any irregularity in payments.
If a distressed renegotiated loan is approved and the credit committee is of the opinion that it is unlikely that the borrower will be able to meet the renegotiated terms – or if a loan to a counterparty was (partially) charged off – PD class 10 (or higher) will be assigned. In this case, an obligor needs to be classified as 'defaulted' according to KBC's rules and the need for provisioning has to be assessed. It is highly likely that an impairment charge will be recorded.
If, one year after the loan has been renegotiated, the credit committee is of the opinion that the borrower is showing signs of improvement and that the loan's renegotiated terms are likely to be met, then – in the case of PD 9 – a better classification may be assigned to the borrower and the renegotiation tag can be removed. If a borrower is classified as PD 10 (or higher), PD 9 (only) may in principle be assigned for one year and the renegotiation tag kept in place. If the credit committee decides that the existing PD class 9 (or higher) should remain unchanged or that a worse rating should be assigned, the renegotiation tag may not be removed for the time being (i.e. at least until the next review takes place).

At the end of 2013, distressed renegotiated loans accounted for some 5.5% of the total loan portfolio (amount outstanding, excluding entities classified as 'disposal groups' under IFRS 5). A breakdown is provided below.

Distressed renegotiated loans, 31-12-2013 (in millions of EUR)	Total outstanding portfolio[1]	Distressed renegotiated loans						
		Total	(% of outstanding portfolio)	Breakdown by PD class				Specific impairment
				PD 1-8	PD 9	PD 10 (impaired, less than 90 days past due)	PD 11-12 (impaired, 90 days and more past due)	
Total	**136 525**	**7 448**	**5%**	**581**	**830**	**4 309**	**1 727**	**1 751**
By business unit								
Belgium Business Unit	86 913	2 207	3%	377	446	1 074	311	381
Czech Republic Business Unit	20 234	378	2%	129	25	128	96	83
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	3 483	18	1%	0	0	0	18	8
By client segment								
Private individuals[2]	59 014	3 635	6%	278	320	2 314	722	792
SMEs	32 045	474	1%	107	166	102	100	78
Corporations[3]	45 466	3 339	7%	196	344	1 893	905	881

1 Gross amounts, before impairment (these amounts therefore differ from the accounting figures used in other sections).
2 99% of the renegotiated loans total relates to mortgage loans.
3 49% of the renegotiated loans total relates to commercial real estate loans.

In line with the new (draft) guidelines on non-performing exposures and forbearance measures laid down by the European Banking Authority, KBC has made preparations to adopt the policies on restructured loans and on the definition of default, which are to be implemented in 2014. When a final decision is reached, new/changed criteria will be put in place to define forborne loans and to reclassify PD 10 as 'non-performing' (instead of 'performing' at present).

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 Basel II 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. Others are scheduled to shift to the IRB Advanced or Foundation approaches in 2014. 'Non-material' entities will continue to adopt the Basel II Standardised approach.

Scope of credit risk disclosures

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

With regard to the timing of and approach to implementing Basel II, KBC has opted for a phased roll-out of the IRB 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 2013 are following the Basel II Standardised approach for the time being. This approach will also be adhered to until further notice by the other (non-material) entities of the KBC group.

The scope of this report is limited to the material entities appearing in the roll-out table below. These entities accounted for 95% of the total credit risk weighted assets of the KBC group in 2013.

Because of this limitation in scope, and also because another definition of exposure[1] is used in the accounting figures, a one-to-one comparison cannot be made with similar disclosures in KBC Bank's 2013 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 II, pillar I.

Roll-out of Basel II pillar 1 approach at end of	2012	2013	2014	2015
IRB Advanced approach	KBC Bank CBC Banque ČSOB Czech Republic KBC Credit Investments KBC Finance Ireland KBC Lease Belgium KBC Real Estate[1]	KBC Bank CBC Banque ČSOB Czech Republic KBC Credit Investments KBC Finance Ireland KBC Lease Belgium KBC Commercial Finance[4] KBC Immolease[4]	KBC Bank[5] CBC Banque ČSOB Czech Republic KBC Credit Investments KBC Commercial Finance KBC Finance Ireland KBC Lease Belgium KBC Immolease K&H Bank	KBC Bank CBC Banque ČSOB Czech Republic KBC Credit Investments KBC Commercial Finance KBC Finance Ireland KBC Lease Belgium KBC Immolease K&H Bank ČSOB Slovak Republic
IRB Foundation approach	KBC Bank Ireland KBC Financial Products KBC Bank Deutschland[3] Antwerp Diamond Bank[3] K&H Bank	KBC Bank Ireland KBC Financial Products KBC Bank Deutschland[3] Antwerp Diamond Bank[3] K&H Bank	KBC Bank Ireland KBC Financial Products KBC Bank Deutschland[3] Antwerp Diamond Bank[3] ČSOB Slovak Republic	KBC Bank Ireland KBC Financial Products
Standardised approach	ČSOB Slovak Republic Absolut Bank[2] Non-material entities	ČSOB Slovak Republic Absolut Bank[2] Non-material entities	Non-material entities	Non-material entities

1 Although KBC Real Estate is not a material entity according to KBC's definition above, it also uses the IRB approach as it operates on a shared IT platform. During 2012, the activities of KBC Real Estate were integrated into KBC Bank and the company dissolved.
2 Absolut Bank was divested in the course of 2013 and is no longer included in the data for 2013.
3 Antwerp Diamond Bank and KBC Bank Deutschland will be divested in 2014.
4 KBC Immolease and KBC Commercial Finance are only included in the data for 2013.
5 KBC Consumer Finance will become part of KBC Bank.

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 2013. 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 if and when an obligor were to default. For lending exposure treated under the IRB approach, EAD is composed of the amount outstanding at the time of the calculation (without taking provisions into account), plus a weighted part of the off-balance-sheet portion of the exposure. For non-retail exposures, this weight 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 2013, this additional RWA amounted to 0.6 billion euros for PD models, to 0.01 billion euros for LGD models and to 0.6 billion euros for EAD models. Moreover, in 2013, KBC started to capitalise unavoidable uncertainties in the models (EAD, PD and LGD models) with an additional RWA impact of 1.4 billion euros at year-end 2013.

The table below provides an overview of how Basel II credit risk EADs and RWA for the KBC group changed over 2013. This table shows the overall EAD and RWA figures, including non-material entities, the structured credit portfolio and the additional RWA for model deficiencies and uncertainties. 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.

Entity	BII approach (at 31-12-2013)[1]	Credit RWA (in millions of EUR)			Exposure [EAD] (in millions of EUR)		
		31-12-2012	31-12-2013	Δ 2013 vs 2012	31-12-2012	31-12-2013	Δ 2013 vs 2012
KBC Bank	IRB Advanced	28 726	26 118	-2 607	122 535	117 820	-4 715
CBC Banque	IRB Advanced	1 642	1 855	213	10 954	10 426	-528
ČSOB Czech Republic	IRB Advanced	10 526	9 778	-749	41 980	41 933	-46
KBC Credit Investments	IRB Advanced	1 260	1 242	-18	5 747	7 412	1 665
KBC Commercial Finance[3]	IRB Advanced	0	597	597	0	1 908	1 908
KBC Lease Belgium	IRB Advanced	1 329	1 465	136	2 151	2 166	15
KBC Immolease[3]	IRB Advanced	0	284	284	0	714	714
KBC Finance Ireland	IRB Advanced	936	610	-326	1 637	1 232	-405
KBC Bank Ireland	IRB Foundation	7 402	6 754	-649	17 250	16 439	-811
K&H Bank	IRB Foundation	4 131	3 596	-535	8 720	9 122	402
KBC Deutschland[4]	IRB Foundation	2 105	1 840	-265	3 463	2 781	-682
ADB[4]	IRB-Foundation	1 385	1 174	-212	1 893	1 731	-162
KBC Financial Products	IRB-Foundation	1 105	3 042	1 936	1 473	907	-566
Absolut Bank	Standardised	1 669	-	-1 669	2 610	-	-2 610
Cibank	Standardised	516	572	56	811	867	56
ČSOB Slovak Republic	Standardised	3 353	3 284	-68	5 999	6 388	389
KBC Commercial Finance[3]	Standardised	1 149	-	-1 149	1 271	-	-1 271
Other entities[5]	Mixed	2 133	811	-1 322	2 910	1 705	-1 205
Total[2]		69 369	63 022	-6 348	231 404	223 551	-7 853

1 Basel II 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 and other non-credit obligation, assets but excluding bonds in trading books and KBC intra-group exposures.
3 In 2013, KBC Commercial Finance and KBC Immolease ceased to use the standardised approach and moved to the IRB Advanced approach.
4 To be divested in 2014.
5 The figures for 2012 include KBC Immolease.

Overall, there was a substantial decrease in EAD and to a greater extent in RWA. At KBC group level, credit RWA fell by 6.3 billion euros, down 9%, year-on-year. This can be broken down as follows:

- Divestments account for part of the reduction in EAD and RWA, i.e. due to the deconsolidation in 2013 of Absolut Bank (-1.7 billion euros in RWA), and some smaller subsidiaries (-0.3 billion euros in RWA).
- The further de-risking of the KBC portfolio continued in 2013 and had an estimated impact on RWA of -3.8 billion euros. This figure includes a sharp reduction in capital requirements for the legacy structured credit portfolio, due to the de-risking of CDO's and the sale of positions. The remaining fall in RWA is related to the decrease in lending in portfolios (for instance in KBC Bank's corporate branches abroad). This led to a decrease in the volume of products with a high risk weighting and resulted in RWA decreasing even more than EAD.

- The renewed focus on retail and SME lending in core countries continued in 2013.
- The decision of the NBB to impose an additional risk weight of 5% on the exposure to Belgian mortgages pushed up the level of RWA (+1.5 billion euros).
- There was an exceptional +2.7-billion-euro RWA item for retained CDO notes at KBC Financial Products. These notes, which are held in the banking books, were transferred from market RWA to credit RWA and have been reported in credit RWA as from 2013. This re-allocation has had no effect on the calculation of total RWA. There was a sharp increase in RWA in respect of these notes due to higher valuations resulting from narrowing credit spreads.
- Lower RWA (-1.2 billion euros in RWA) at KBC Commercial Finance, KBC Immolease and ČSOB Leasing following approval of their migration to the IRB Advanced approach in 2013.
- Substantial risk reduction on the loans to Cera and KBC Ancora, due to the sale of a KBC Ancora loan and the repayment of loans granted to Cera and KBC Ancora. (total decrease in RWA of 1 billion euros)
- In previous years, the counterparties of distressed renegotiated loans in KBC Ireland (specifically Homeloans and the corporate portfolio) had been assigned PD class 9 but were reclassified as PD 10 (unlikely-to-pay) in 2013, reflecting new insights in expected losses (in the broad sense) on these counterparties. The shift from PD class 9 to PD class 10 is responsible for an overall decrease in RWA (-0.6 billion euros RWA) as it is now mostly covered by additional impairment.
- Overall, the model reviews had only a limited effect on RWA. Their consolidated impact was to increase RWA, primarily on account of the more conservative estimates for the models related to the Belgian SME and Irish mortgage portfolios.
- Changes in RWA were attributable to currency effects on FX lending (-1.1 billion euros in RWA, due in particular to the depreciation of the Czech koruna (-8%) and the US dollar (-4%)).

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 details 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 31-12-2012[2] (in billions of EUR)	**Lending (on-balance-sheet)**	**Lending (off-balance-sheet)**	**Derivatives**	**Repo-like Transactions**	**Total**
Total EAD	188	18	9	11	225
Total RWA	52	5	4	0	62
Exposure 31-12-2013[1] (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

1 KBC Commercial Finance and KBC Immolease only included in the figures for 2013.
2 Absolut Bank only included in the figures for 2012.

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] 31-12-2012[3] (in millions of EUR)	**EAD of main categories**	**'Other'[1]**	**Total EAD**
Subject to IRB approach	160 092	3 749	163 842
Subject to Standardised approach	40 684	920	41 603
Total	200 776	4 669	205 445
Lending portfolio [EAD] 31-12-2013 (in millions of EUR)	**EAD of main categories**	**'Other'[1]**	**Total EAD**
Subject to IRB approach[2]	155 002	3 500	158 502
Subject to Standardised approach	39 121	601	39 722
Total	194 124	4 101	198 225

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).
2 KBC Commercial Finance and KBC Immolease only included in the figures for 2013.
3 Absolut Bank only included in the figures for 2012.

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, viz.:

- *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.
- *SME (treated as) Corporates:* these are exposures fulfilling the necessary conditions (total annual sales of under 50 million euros) for determining the minimum capital requirements according to the capital weighting formula for corporate SMEs.
- *Retail:* this includes all types of retail exposure, 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 one 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.

IRB exposure [EAD] 31-12-2012 (in millions of EUR)	Sovereign	Institutions	Corporates	SME Corporates	Retail	Residential Mortgages	(sub) Total[2]	Other	Total
Exposure	16 881	7 766	44 098	18 719	18 893	53 734	160 092	3 749	163 842
RWA	1 726	1 592	23 669	8 091	3 602	8 417	47 097	3 741	50 838
IRB exposure [EAD] 31-12-2013[1] (in millions of EUR)	**Sovereign**	**Institutions**	**Corporates**	**SME Corporates**	**Retail**	**Residential Mortgages**	**(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

1 KBC Commercial Finance and KBC ImmoLease are only included in the 2013 data.
2 The (sub)Total is accounted for in the section on concentrations in the lending portfolio.

There was an increase in the 'SME Corporates' and 'Retail' exposure and a decrease in the other asset classes with an exception of the asset class 'Institutions' which remained virtually unchanged.

There was a material reduction in 'Corporates' exposure. This is related to (i) the decrease in the non-core-portfolio, such as KBC Bank's branches abroad, the project finance portfolio of KBC Finance Ireland, etc., (ii) to the repayment of the loans granted to Cera and KBC Ancora (-829 million euros) and (iii) to a downwards impact on the exposure and RWA, owing to the effect of FX rates on lending in currencies other than the euro, in particular the depreciation of the Czech koruna and US dollar.

The reduction in 'Sovereign' exposure is explained by a change in the bonds portfolio of ČSOB Czech Republic with fewer bonds being treated under the IRB approach and more under the Standardised approach ('permanent partial use' principle).

Credit exposure subject to the Standardised approach

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

- *Sovereign:* claims on central authorities and governments.
- *RGLA:* claims on Regional Governments and Local Authorities independently if these qualify as 'Sovereign' under the IRB approach.
- *PSE:* claims on Public Sector Entities.
- *MDB:* claims on Multilateral Development Banks independently if these qualify as 'Sovereign' under the IRB approach.
- *International 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'.
- *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] 31-12-2012[2] (in millions of EUR)	Exposure	RWA
Sovereign	31 817	133
RGLA	146	40
PSE	0	0
MDB	9	1
International organisations	0	0
Institutions	566	272
Corporates	3 448	3 449
Retail	2 149	1 607
Secured by real estate	2 315	870
Past due	233	265
CIU	0	0
(sub)Total[1]	40 684	6 638
High risk	0	0
Covered bonds	0	0
Short term	31	15
Other	889	437
Total	41 603	7 090
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

1 Accounted for in the section on concentrations in the lending portfolio.
2 Absolut Bank only included in the figures for 2012.

The increase in exposure in the 'Sovereign' category related to a shift in the bond exposure of ČSOB Czech Republic due to application of 'permanent partial use'.

The divestment of Absolut Bank triggered a decrease in various categories. In the first quarter of 2013, Absolut Bank accounted for 324 million euros in EAD for the 'Institutions' exposure class, 767 million euros for 'Corporates' class, 234 million euros for the 'Retail' class and 892 million euros for the 'Secured by real estate' class. 'Sovereign RWA' decreased significantly on account of this divestment (-133 million euros).

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.

The Standardised exposure types of 'High risk', 'Covered bonds' and 'Short term' are all mapped to the 'Other' asset class, due to their immateriality. The other mapping exercises are rather 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] 31-12-2012[2] (in millions of EUR)		Sovereign	Institu-tions	Corporates	SME Corporates	Retail	Residential Mortgages	Total
Africa		199	361	105	122	2	0	788
Asia		163	1 416	1 262	121	0	0	2 962
Central and Eastern Europe & Russia		13 219	2 693	10 153	5 440	4 078	14 157	49 740
Of which	Bulgaria	149	8	234	141	127	105	765
	Czech Republic	7 834	1 004	5 660	3 193	2 685	9 627	30 002
	Hungary	3 411	38	1 531	1 042	309	1 980	8 312
	Poland	114	694	389	140	2	1	1 342
	Russia	290	513	1 205	54	169	822	3 054
	Slovak Republic	1 302	116	1 044	865	777	1 609	5 718
Latin America		0	61	84	0	1	0	146
Middle East		0	707	628	9	0	0	1 345
North America		1 020	413	2 417	25	2	0	3 876
Oceania		0	21	617	2	0	1	640
Western Europe		33 734	2 826	31 856	14 053	16 680	42 128	141 278
Of which	Belgium	24 290	761	19 033	12 347	16 609	29 676	102 716
	Ireland	403	19	2 347	1 042	0	12 446	16 256
Total		48 335	8 498	47 122	19 773	20 762	56 287	200 776
Exposure [EAD] 31-12-2013[1] (in millions of EUR)		**Sovereign**	**Institu-tions**	**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

1 KBC Commercial Finance and KBC Immolease only included in the the figures for 2013.
2 Absolut Bank only included in the figures for 2012.

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%), Ireland (8%) and the remaining four CEE countries (Bulgaria, Czech Republic, Hungary, Slovak Republic) (22%), which combined represented 82% of exposures in 2013. They even represented more than 99% of EAD for the ‘Residential Mortgage’ exposure class, more than 98% for ‘Retail’ and more than 94% for ‘SME Corporates’. For corporates and institutions, exposures outside the home markets were predominantly in Western Europe (mainly Germany, France, the Netherlands, Spain and France), in North America and in Asia (mainly China, Hong Kong and Singapore).

The decrease in exposure to ‘Residential Mortgages’ is explained by firstly the lower volumes at KBC Ireland and in the Czech Republic (depreciation of the Czech koruna against the euro) and secondly, by the divestment of Absolut Bank in 2013.

Total credit exposure in the lending portfolio per sector

Exposure [EAD] 31-12-2012[3] (in millions of EUR)	Sovereign	Institu-tions	Corpo-rates	SME Corpo-rates	Retail	Residen-tial Mortgag-es	Total
Agriculture, Farming & Fishing	0	0	399	1 129	2 252	0	3 781
Authorities	48 313	133	421	9	0	0	48 877
Automotive	0	0	1 478	1 048	505	0	3 031
Building & Construction	0	0	3 784	1 422	1 426	0	6 631
Chemicals	0	0	1 398	412	55	0	1 865
Commercial Real Estate	0	0	8 453	2 904	1 146	0	12 504
Distribution	0	0	5 512	3 684	2 517	0	11 713
Electricity	0	0	2 984	410	18	0	3 412
Finance & Insurance	22	8 365	3 650	290	374	0	12 701
Food Producers	0	0	1 423	436	195	0	2 054
Metals	0	0	1 451	569	223	0	2 243
Oil, Gas & Other Fuels	0	0	1 290	61	5	0	1 356
Private Persons	0	0	2	79	6 100	56 287	62 467
Services	0	0	6 281	4 288	3 868	0	14 438
Other[1]	0	0	8 595	3 031	2 077	0	13 703
Total	48 335	8 498	47 122	19 773	20 762	56 287	200 776
Exposure [EAD] 31-12-2013[2] (in millions of EUR)	**Sovereign**	**Institu-tions**	**Corpo-rates**	**SME Corpo-rates**	**Retail**	**Residen-tial Mortgag-es**	**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

1 All sectors with a concentration of less than 0.75% of the total EAD are aggregated into this category.
2 KBC Commercial Finance and KBC Immolease only included in the figures for 2013.
3 Absolut Bank only included in the figures for 2012.

In view of KBC's substantial retail activities in most markets, 'Private Persons' represent a large share of this sector distribution. The exposure to 'Private Persons' decreased slightly due to lower volumes and an FX effect. The decrease in 'Finance & Insurance' was caused by the repayment of the loans granted to Cera and KBC Ancora.

Maturity analysis of the total credit exposure in the lending portfolio

Residual maturity 31-12-2012[3] (in millions of EUR)	Sovereign	Institu-tions	Corpo-rates	SME Cor-porates	Retail	Residen-tial Mortgag-es	Total
<1 year	10 584	5 265	20 778	7 345	3 122	608	47 701
=>1 to <5 years	15 193	2 132	10 799	3 444	5 563	1 561	38 692
=>5 to <10 years	16 613	736	4 476	3 176	5 388	27 142	57 531
=>10 years	5 733	147	4 672	3 942	4 370	26 848	45 712
Until Further Notice[1]	211	218	6 397	1 866	2 321	127	11 140
Total	48 335	8 498	47 122	19 773	20 762	56 287	200 776
Residual maturity 31-12-2013[2] (in millions of EUR)	**Sovereign**	**Institu-tions**	**Corpo-rates**	**SME Cor-porates**	**Retail**	**Residen-tial Mortgag-es**	**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

1 Exposure without a concrete end-date is assigned to the 'Until Further Notice' category.
2 KBC Commercial Finance and KBC Immolease only included in the figures for 2013.
3 Absolut Bank only included in the figures for 2012.

About 43% of the lending portfolio will mature within five years. Within the 'Institutions' and 'Corporates' exposure classes, this percentage even reached 86% and 67%, respectively. The longest maturities are mainly found in the 'Retail' and 'Residential Mortgages' classes.

Total credit exposure in the lending portfolio per product type

Exposure [EAD] 31-12-2012[3] (in millions of EUR)	Sovereign	Institu-tions	Corpo-rates	SME Cor-porates	Retail	Residen-tial Mortgag-es	Total
Guarantee	669	499	4 939	1 210	498	0	7 816
Debt instrument	37 390	1 797	954	3	0	0	40 145
Equity	0	7	121	17	0	0	146
Leasing	33	1	1 460	794	1 714	0	4 002
Home loans	0	0	0	0	1 171[1]	56 287	57 457
Other lending	10 242	6 193	39 648	17 749	17 379	0	91 210
Total	48 335	8 498	47 122	19 773	20 762	56 287	200 776
Exposure [EAD] 31-12-2013[2] (in millions of EUR)	**Sovereign**	**Institu-tions**	**Corpo-rates**	**SME Cor-porates**	**Retail**	**Residen-tial Mortgag-es**	**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	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

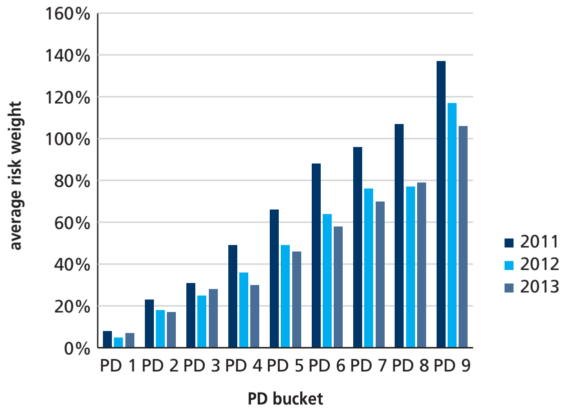
1 Home loans to individuals which are not (partly) secured by residential mortgages.
2 KBC Commercial Finance and KBC Immolease only included in the figures for 2013.
3 Absolut Bank only included in the figures for 2012.

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.

In 2012, the average risk weight decreased substantially, from 38% to 31%, due to the transition from the IRB Foundation to the IRB Advance approach.

The average risk remained virtually unchanged in 2013, going from 31% to 30%, due to the de-risking of the KBC portfolio which led to a decrease in the volume of products with a high risk weight offset by a 5% increase in the risk weight for exposures to Belgian mortgages (decision of the Belgian regulator) de-risking of the KBC portfolio which results in a decrease in the volume of the products with a high risk weight.

In millions of EUR – 31-12-2012[2]

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	15 145	4 109	5 490	576	3 232	21 786	50 339
	Sum of RWA	804	349	782	68	127	291	2 421
	weighted average	5%	8%	14%	12%	4%	1%	5%
2 [0.10% - 0.20%]	Sum of EAD	641	1 380	4 937	1 663	2 730	4 509	15 859
	Sum of RWA	330	240	1 449	391	189	208	2 807
	weighted average	52%	17%	29%	24%	7%	5%	18%
3 [0.20% - 0.40%]	Sum of EAD	150	549	6 965	3 301	3 244	4 552	18 761
	Sum of RWA	88	102	2 604	1 107	392	387	4 680
	weighted average	59%	19%	37%	34%	12%	9%	25%
4 [0.40% - 0.80%]	Sum of EAD	285	530	8 181	3 005	2 760	8 338	23 098
	Sum of RWA	227	110	4 985	1 215	512	1 152	8 202
	weighted average	80%	21%	61%	40%	19%	14%	36%
5 [0.80% - 1.60%]	Sum of EAD	222	849	6 590	3 267	2 334	4 597	17 860
	Sum of RWA	114	407	4 799	1 605	711	1 089	8 725
	weighted average	51%	48%	73%	49%	30%	24%	49%
6 [1.60% - 3.20%]	Sum of EAD	347	52	3 320	2 278	1 712	909	8 617
	Sum of RWA	64	17	3 102	1 336	621	355	5 496
	weighted average	18%	32%	93%	59%	36%	39%	64%
7[1] [3.20% - 6.40%]	Sum of EAD	13	144	2 215	1 491	851	999	5 713
	Sum of RWA	7	87	2 415	979	318	533	4 338
	weighted average	54%	61%	109%	66%	37%	53%	76%
8 [6.40% - 12.80%]	Sum of EAD	7	86	839	586	621	1 029	3 167
	Sum of RWA	7	41	1 046	459	235	658	2 446
	weighted average	101%	47%	125%	78%	38%	64%	77%
9 [12.80% - 100.00%]	Sum of EAD	44	20	1 117	629	627	3 510	5 946
	Sum of RWA	84	11	2 076	717	308	3 743	6 940
	weighted average	0%	57%	186%	114%	49%	107%	117%
Total exposure		16 853	7 718	39 655	16 794	18 110	50 229	149 361
Total risk-weighted assets		1 726	1 364	23 258	7 877	3 413	8 417	46 055
Total weighted average		10%	18%	59%	47%	19%	17%	31%

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

2 Absolut Bank only included in the figures for 2012.

In millions of EUR – 31-12-2013[2]

PD Master scale	Exposure [EAD] RWA Average in %	Sover-eign	Institu-tions	Corpo-rates	SME Corpo-rates	Retail	Residen-tial Mortgag-es	Total
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 Commercial Finance and KBC Immolease only included in the figures for 2013.

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). As of 2013, the exposure of KBC Immolease and KBC Commercial Finance has been included as it is also treated under the IRB Advanced approach. Furthermore, the calculation strategy of the table has changed, applicable for 2012 and 2013.

Further detailed quality information on IRB Advanced exposure, 31-12-2012*

(in millions of EUR)

Asset class	PD	1	2	3	4	5	6	7	8	9	Total
Sovereign	EAD	14 402	279	32	50	72	246	6		16	15 104
	Out-standing amount	13 713	277	31	50	71	221	5		1	14 370
	Undrawn amount	1 234	5	7	1	12	98	1		15	1 373
	Average CCF %	55.9%	22.9%	5.1%	11.7%	9.2%	26.0%	15.8%		95.7%	53.4%
	LGD %	19.3%	21.1%	39.7%	19.9%	18.1%	3.7%	23.0%		15.9%	19.1%
Institutions	EAD	3 766	1 339	541	524	796	52	139	83	20	7 260
	Out-standing amount	2 989	1 250	401	205	583	26	64	66	13	5 597
	Undrawn amount	842	102	144	345	339	26	75	18	6	1 898
	Average CCF %	87.5%	81.2%	96.7%	92.1%	62.8%	98.6%	97.6%	85.6%	98.8%	84.7%
	LGD %	31.2%	43.8%	20.0%	17.2%	22.4%	13.8%	20.4%	11.6%	11.1%	30.1%
Corporates	EAD	5 284	4 533	6 097	7 116	5 583	2 392	1 624	650	799	34 079
	Out-standing amount	4 067	2 709	4 027	5 411	4 401	1 883	1 300	560	680	25 038
	Undrawn amount	3 863	4 698	4 476	3 299	2 433	1 088	589	127	181	20 753
	Average CCF %	31.2%	37.5%	44.1%	48.3%	46.9%	45.3%	54.3%	69.7%	65.5%	41.9%
	LGD %	33.8%	33.1%	27.8%	35.1%	30.5%	30.7%	31.1%	25.1%	32.6%	31.8%
SME	EAD	571	1 655	3 241	2 783	2 864	1 814	1 155	486	441	15 010
	Out-standing amount	521	1 482	2 804	2 329	2 384	1 608	997	429	405	12 960
	Undrawn amount	239	622	1 021	1 099	1 015	542	384	116	81	5 118
	Average CCF %	20.8%	27.4%	41.6%	39.4%	44.5%	37.1%	40.7%	48.0%	42.4%	38.7%
	LGD %	23.1%	27.5%	27.6%	26.1%	24.6%	22.8%	19.7%	19.4%	19.4%	24.9%
Retail	EAD	3 232	2 730	3 244	2 760	2 334	1 712	851	621	627	18 110
	Out-standing amount	2 687	2 512	3 004	2 558	2 000	1 567	784	583	602	16 297
	Undrawn amount	811	720	750	578	610	328	164	89	54	4 104
	Average CCF %	65.9%	27.9%	30.6%	34.6%	53.6%	43.9%	40.6%	41.9%	45.1%	43.3%
	LGD %	24.7%	21.1%	22.3%	22.4%	27.1%	26.3%	24.2%	22.2%	21.3%	23.6%
Residential mortgages	EAD	21 786	4 509	4 552	8 338	4 597	909	999	1 029	3 510	50 229
	Out-standing amount	21 786	4 509	4 552	8 227	4 387	897	982	1 028	3 503	49 871
	Undrawn amount	0	0	0	111	210	11	17	1	6	358
	Average CCF - %			100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%
	Average LGD - %	11.8%	12.9%	14.2%	16.3%	17.3%	17.5%	16.2%	14.4%	18.1%	14.1%

* Absolut Bank only included in the figures for 2012.

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
	Out-standing 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%	3.4%	23.3%	4.7%	14.5%	5.4%	6.0%		100.0%	62.2%
	LGD %	20.9%	22.2%	21.1%	27.9%	42.0%	16.8%	40.3%		18.4%	21.3%
Institutions	EAD	3 748	1 284	674	798	646	88	102	145	1	7 485
	Out-standing 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 %	88.3%	92.8%	96.3%	95.1%	59.7%	93.6%	92.8%	98.0%	99.7%	83.4%
	LGD %	21.3%	26.2%	9.0%	8.5%	18.2%	12.7%	18.0%	4.4%	38.9%	18.6%
Corporates	EAD	5 116	4 070	7 381	6 818	4 600	2 407	1 543	467	541	32 944
	Out-standing 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 %	31.7%	35.5%	42.1%	45.2%	45.0%	53.0%	47.9%	56.3%	69.1%	40.7%
	LGD %	26.2%	29.4%	31.2%	28.0%	30.8%	27.1%	26.1%	20.2%	20.7%	28.2%
SME	EAD	556	1 521	3 246	3 337	3 371	2 290	1 442	424	514	16 701
	Out-standing 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 %	20.9%	35.9%	40.9%	38.8%	47.7%	51.3%	48.8%	46.3%	33.2%	42.3%
	LGD %	18.4%	22.7%	21.5%	24.4%	23.8%	23.3%	22.4%	19.5%	18.5%	22.6%
Retail	EAD	3 124	2 943	2 653	2 905	2 454	1 928	1 101	517	724	18 348
	Out-standing 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 %	71.1%	34.2%	42.4%	26.3%	40.2%	32.7%	15.1%	39.0%	50.8%	37.5%
	LGD %	24.4%	20.0%	23.2%	23.6%	28.5%	27.3%	28.4%	24.3%	24.5%	24.4%
Residential mortgages	EAD	22 534	4 498	655	7 220	6 315	1 860	1 531	367	2 206	47 186
	Out-standing 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 - %	100.0%	-	58.5%	100.0%	99.9%	100.0%	100.0%	100.0%	100.0%	100.0%
	Average LGD - %	13.1%	14.0%	17.1%	17.8%	20.3%	21.4%	19.5%	19.2%	21.2%	15.9%

* KBC Commercial Finance and KBC Immolease only included in the figures for 2013.

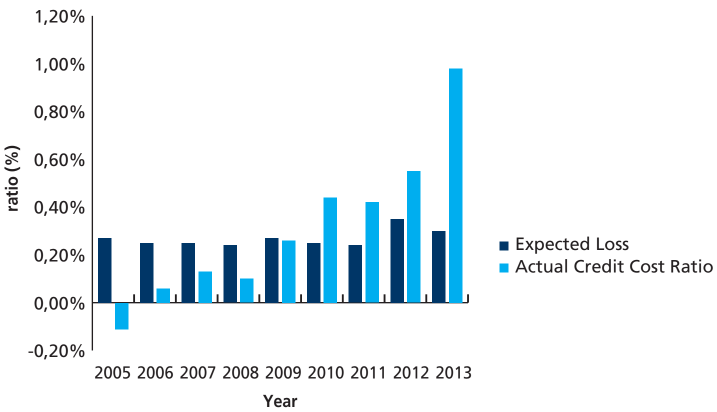
The table shows that LGDs are the lowest for residential mortgages, which by definition have a partly or fully secured nature. Furthermore, LGDs are on average higher for 'Corporates' than for the 'Retail' and 'SME' classes. The relationship between PDs and LGDs is not a strong one. LGDs are driven by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

Strictly pursuant to Basel II pillar 3 rules, KBC should disclose a comparison of 'expected losses' with 'actual losses' over a longer period in time and broken down by asset class. Unfortunately, historical loan loss information is generally not available at Basel II 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 which 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. 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 2013 credit cost ratio shown is the actual ratio over 2013, whereas the EL for 2013 is calculated on the basis of the portfolio at year-end 2013 and is thus a modelled expectation for 2014. 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



The credit cost ratio increased significantly due to substantial additional impairment at KBC Ireland. After excluding KBC Ireland residential mortgages, the expected loss came to 0.23% and the credit cost ratio was equal to 0.42% (in 2012, the expected loss came to 0.27% and the credit cost ratio was equal to 0.33%).

Due to the point of cycle calculation methodology (PD is calculated through the cycle approach and LGD is calculated by the downturn approach) the EL stays stable over time. The credit cost ratio is a point of time calculation. In a booming economy, the actual losses are lower than the modelled losses. In a recession, the actual losses are higher than the modelled losses. Note that the credit cost ratio is influenced by some specific large cases.

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. Even for the 'Corporates' exposure, unrated debtors account for 99% of the portfolio, as can be expected for a portfolio with a focus on Central and Eastern European midcaps (over half of the unrated corporate exposure originates from ČSOB Slovak Republic). Due to the absence of external ratings, the RWA of the KBC standardised portfolio is primarily volume-driven over time.

Standardised exposure [EAD] 31-12-2012* (in millions of EUR)	Quality steps							
	1	2	3	4	5	6	Unrated	Total
Sovereign	27 147	3	416	0	3 103	0	1 148	31 817
RGLA	0	0	6	0	0	0	140	146
PSE	0	0	0	0	0	0	0	0
MDB	2	0	1	0	0	0	7	9
International organisations	0	0	0	0	0	0	0	0
Institutions	84	197	266	0	0	0	18	566
Corporates	0	0	34	10	0	0	3 404	3 448
Retail	0	0	0	0	0	0	2 149	2 149
Secured by real estate	0	0	0	0	0	0	2 315	2 315
Past due	0	0	0	0	0	0	233	233
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	31	0	0	31
Other	0	0	0	0	0	0	889	890
Total	27 233	200	724	10	3 134	0	10 303	41 603

Standardised exposure [EAD] 31-12-2013 (in millions of EUR)	Quality steps							
	1	2	3	4	5	6	Unrated	Total
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

* Absolut Bank only included in the figures for 2012.

The overall decrease in exposures, especially in the unrated quality step, is due to the divestment of Absolut Bank in 2013.

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)	**31-12-2012[2]**	**31-12-2013[1]**
Africa	0	1
Asia	71	66
Central and Eastern Europe & Russia	2 401	2 194
Latin America	4	4
Middle East	30	15
North America	301	315
Oceania	328	244
Western Europe	8 341	11 307
Of which Belgium	2 589	2 891
Ireland	4 387	7 175
Total	11 477	14 145

Impaired exposure per sector [EAD] (in millions of EUR)	**31-12-2012[2]**	**31-12-2013[1]**
Agriculture, Farming & Fishing	98	115
Automotive	152	144
Building & Construction	717	695
Chemicals	122	123
Commercial Real Estate	2 638	2 608
Distribution	948	1 032
Electrotechnics	48	32
Finance & Insurance	181	176
Horeca	376	426
IT	101	93
Machinery & Heavy Equipment	57	68
Metals	174	160
Private Persons	3 424	6 063
Services	813	965
Shipping	252	111
Textile & Apparel	132	112
Other[3]	1 245	1 223
Total	11 477	14 145

1 KBC Commercial Finance and KBC Immolease only included in the figures for 2013.
2 Absolut Bank only included in the figures for 2012.
3 All sectors with a concentration of less than 1% of the total EAD are aggregated into the 'Other' category

The exposure increases in ‘Private Persons’ and ‘Ireland’ due to the reclassification of PD 9 loans to impaired (PD 10) in view of the local economic conditions at KBC Ireland Homeloans.

For all data on impairment, provisions and value adjustments, reference is made to the consolidated annual accounts section of KBC’s Annual Report for 2013.

Counterparty credit risk

KBC defines counterparty credit risk as the credit risk resulting from over-the-counter transactions (i.e. where there is no formal Exchange), which are in the main Credit Default Swaps (CDS), interest-related transactions (e.g., Interest Rate Swaps), currency-related transactions (e.g., FX swap), equity-related transactions or commodity transactions. In principle, it includes repo-like transactions, which are measured in-house and managed like other over-the-counter transactions. However, in this report, repo-like transactions are not covered here, but instead are dealt with in the section on ‘Credit risk mitigation’.

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 31-12-2012 (in millions of EUR)	Marked-to-market	Add-on	Counterparty risk (EaD)	Notional value of contracts	Regulatory capital*
CDS bought -Trading	354	1 482	1 836	18 762	71
CDS sold - Trading	51	193	244	18 970	2
Other	0	1	1	15	0
Total credit derivatives	405	1 676	2 080	37 747	73
Interest Rate Swaps (IRS)	7 024	1 038	8 063	206 635	158
Caps/Floors	692	234	926	28 794	14
Other	519	319	838	30 389	8
Total interest-related transactions	8 235	1 591	9 827	265 819	179
FX forward	148	165	313	12 720	8
FX swap	497	718	1 215	66 287	6
Cross Currency IRS	761	760	1 521	40 341	14
Other	64	109	173	7 973	2
Total currency-related transactions	1 470	1 752	3 222	127 320	30
Equity swaps	1 938	1 503	3 441	43 389	18
Equity options	319	157	476	2 939	1
Total equity-related transactions	2 257	1 659	3 916	46 327	19
Total commodity transactions	19	34	52	313	0
Gross counterparty risk	12 386	6 711	19 097	477 527	
Netting benefit (-)			-10 068		
Total counterparty risk after netting			9 031		
Collateral benefit (-)			-1 912		
Total net Counterparty risk			7 118		301

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

Transaction type 31-12-2013[2] (in millions of EUR)	Marked-to-market	Add-on	Counterparty risk (EaD)	Notional value of contracts	Regulatory capital[1]
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

1 Based on the net counterparty risk of the transaction type.
2 KBC Commercial Finance only included in the figures for 2013.

In 2013, KBC significantly reduced its exposure to counterparty credit risk. Gross counterparty risk decreased by 25% and net counterparty risk (after netting and collateral benefit) by 24% on an annual basis. This decrease was primarily marked-to-market driven and to a lesser extent volume driven, as illustrated by the fact that the marked-to-market exposure fell by 29% (impact of the credit spread narrowing for super senior swaps) and the notional value of contracts by 13%.

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 82% of the total counterparty credit risk is exposure to investment-grade counterparties. There was a decrease in net derivative exposure in the lower rating bands.

Net derivative exposure per geographic region [EAD][1] (in millions of EUR)	**31-12-2012**	**31-12-2013[3]**
Africa	1	0
Asia	100	84
Central and Eastern Europe & Russia	953	724
Latin America	0	0
Middle East	65	20
North America	412	214
Oceania	61	21
Western Europe	5 526	4 323
Total	7 118	5 387
Net derivative exposure per rating band[2] [EAD][1] (in millions of EUR)	**31-12-2012**	**31-12-2013[3]**
AAA	9	0
AA	1 841	1 184
A	2 618	2 149
BBB	1 138	1 093
BB	615	475
B and below	630	384
No rating	267	102
Total	7 118	5 387

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.
3 KBC Commercial Finance only included in the figures for 2013.

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 2013, the netting impact on derivative exposure amounted to 7 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 solely 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.

31-12-2012[5] (in millions of EUR)	Exposure (EAD)	Covered exposure (EAD)	Covered exposure (%)
Reverse repos/'buy and sell-back'[1]	5 308	1 486	28%[3]
Repos/'sell and buy-back'[2]	5 294	5 251	99%
Total	10 602	6 737	64%
31-12-2013[4] (in millions of EUR)	**Exposure (EAD)**	**Covered exposure (EAD)**	**Covered exposure (%)**
Reverse repos/'buy and sell-back'[1]	9 518	3 532	37%
Repos/'sell and buy-back'[2]	5 296	5 266	99%
Total	14 814	8 798	59%

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.
4 KBC Commercial Finance only included in the figures for 2013.
5 Figures exclude the LTRO repo with the ECB at KBC Bank Ireland (exposure of 3.8 billion euros, 3.6 billion euros of which covered), which was repaid at the beginning of 2013.

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, 25.4% (1 830 million euros of 7 218 million euros) was classified as collateralised at the end of 2013. 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) 31-12-2012 (in millions of EUR)	LGD % applied under IRB Foundation	Sovereigns	Institutions	Corporates	SME Corporates	Total
Cash	0%	0	1 383	120	0	1 503
Debt securities	0%	0	116	293	0	409
Total		0	1 499	413	0	1 912
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

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 have a direct effect by lowering the EAD, which in turn has a direct effect on RWA and on capital. Since LGD is irrelevant for these exposures, the collateral is not included in the table. 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, 1.0 billion euros was classified as collateralised at the end of 2013, 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 collateralised[2] EAD to which an LGD percentage of 0%, 30%, 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.

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

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).

Covered IRB Foundation lending exposure [EAD][1] 31-12-2012 (in millions of EUR)	LGD applied under IRB Foundation[2]	Sovereign	Institutions	Corporates	SME Corporates	Total
Cash	0%	3	0	93	71	166
Debt securities	0%	0	33	0	0	33
Equity collateral	0%	0	0	0	0	0
Total financial collateral		3	33	93	71	200
Real estate[3]	30%	10	0	184	601	795
Receivables	35%	0	0	18	2	20
Lease collateral	35%	0	0	0	0	0
Other physical collateral	40%	0	0	2	8	10
Total physical collateral		10	0	204	610	825
General total		13	33	297	681	1 025
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]	30%	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

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 is a slight decrease in the collateral which is caused by the light decrease in the loan volume.

The table shows that the bulk of the collateralised amounts relates to physical collateral (0.7 billion euros), while financial collateral, which has a bigger impact on capital as it attracts a LGD of 0%, is limited to 0.2 billion. 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) amounted to 1.7 billion euros at the end of 2013. This relates solely to exposures treated under the Standardised and IRB Foundation approaches. 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] 31-12-2012 (in millions of EUR)	Sovereign	Institutions	Corporates	SME Corporates	Total
Credit derivatives	0	0	0	0	0
Guarantees	95	436	1 373	227	2 131
Total	95	436	1 373	227	2 131
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

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;
- input for other credit risk models (e.g., behavioural scores as pooling criteria for the retail portfolio).

Probability of Default models

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

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

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

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

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

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

Step 4: The probability of default is mapped to a rating class. There is a unique rating scale at KBC for all segments, the so-called KBC 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 might be improved.
- The soundness of model implementation and policies, more specifically as regards system access, system security, integrity of data input, etc.
- The available documentation (user manual, technical reports, etc.).

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 rates[3] 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 cyclicality 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.

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

Market LGD is based entirely on information one month after default. In downturn economic conditions, the market will be hit by a large supply of defaulted bonds, depressing prices. The classic market mechanism based on supply and demand may prove to be a stronger driver for the 'downturn' recovery rates than the macroeconomic conditions that led to the higher number of defaults.

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

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 here 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, 31-12-2013[1] (in billions of EUR)	Exposure granted (EAD)	Central tendency[2]	Historical default rate[3]	Average model PD (excl. overrulings)[4]
PD models for government and public sector segments				
(Worldwide) model for central governments	14.03	0.70%	0.71%	0.62%
(Worldwide) model for sub national governments (Belgium – UK – USA)	0.92	0.034%	0.034%	n/a
Czech municipalities	0.33	0.30%	0.21%	0.24%
Hungarian municipalities	0.12	1.31%	0.97%	0.94%
PD models for corporate and institutional segments				
Large corporates[6]				
of which non-Irish	14.69	1.64%	1.60%	1.56%
of which Irish	0.20	4.50%	6.15%	2.91%
Czech corporates and large SMEs[7]	2.85	1.80%	1.86%	1.77%
Czech Corporates[7]	2.45	1.20%	1.11%	n/a
Hungarian corporates	1.87	2.47%	2.40%	2.78%
(Worldwide) model for banks				
of which developed	9.24	0.30%	0.10%	0.41%
of which others	11.29	1.13%	0.46%	1.00%
(Worldwide) model for project finance	2.98	1.54%	2.37%	0.98%
(Worldwide) model for commercial real estate				
of which non-Irish	4.34	2.44%	2.28%	1.84%
of which Irish	1.89	8.89%	8.85%	10.37%.
(Worldwide) model for management buy outs	1.06	4.04%	4.78%	4.36%
PD models for SME segments				
models for Belgian professionals				
of which members of liberal professions[5]	0.18	0.44%	0.45%	0.44%
of which self-employed[5]	0.99	1.84%	1.84%	1.79%
of which private persons[5]	0.40	1.56%	1.56%	1.34%
Belgian farmers[5]	1.29	1.58%	1.43%	1.52%
Belgian SMEs – small businesses[5]	16.85	1.96%	1.96%	1.73%
Czech large and mid SMEs[7]	0.31	2.60%	2.54%	n/a
Hungarian upper SMEs	0.08	3.34%	3.27%	3.21%

1 Non-exhaustive list of models used under the IRB approach, and excluding all retail pooling models.
2 The central tendency is the average through-the-cycle default probability of a portfolio.
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 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.
6 Large Corporates PD model is a new model that combines the scope of 3 previously existing models (Asia-Pacific corporates, US corporates and Western European corporates).
7 The previously existing models for Czech corporates and large SMEs on the one hand and Czech mid SMEs on the other hand are gradually being replaced by the models for Czech corporates on the one hand and Czech large and mid SMEs on the other hand.

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, 31-12-2013 (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	12.1	20.31%	-[1]	-[1]	0%	0%	0%	0%
LGD models for corporate and financial segments[2]								
(Worldwide) financial institutions[3]	8.5	20.75%	29.44%	n/a	0%	0%	4%	0%
(Worldwide) corporates	17.7	31.73%	21.24%	58.03%	2%	21%	6%	0%
(Worldwide) commercial real estate project finance	3.7	23.37%	33.11%	n/a	1%	54%	7%	0%
(Worldwide) project finance[4]	2.4	18.41%	-	n/a	0%	1%	0%	0%
LGD models for SME segments								
Belgian SMEs	27.2	20.98%	12.55%	24.63%	11%	56%	8%	0%
Czech corporates and SMEs	6.1	23.65%	25.63%	-	6%	21%	19%	0%
LGD pooling models for retail segments[5]								
LGD pooling model for Belgian regulated retail	33.5	15.36%	30.38%	52.45%	-	-	-	-
LGD pooling model for Irish mortgage loans	12.1	19.14%	30.56%	-	-	-	-	-
LGD pooling models for Czech retail	9.4	20.82%	17.49%	35.88%	-	-	-	-
LGD pooling model for Hungarian retail	2.0	27.43%	46.21%	-	-	-	-	-

1 At year-end 2013, KBC had no defaulted exposures using the LGD model for central governments.
2 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.
3 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.
4 No collateral or guarantee information available for the worldwide project finance model.
5 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 an important 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 (0.6 billion euros), while guarantees are issued by governments (0.1 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 (1.0 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 (7.2 billion euros), pledges (1.2 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 (1.2 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 II capital requirements, it holds financial instruments that attract a credit risk. This risk stems primarily from the investment portfolio (i.e. issuers of debt instruments).
Credit risk also arises due to insurance or reinsurance contracts concluded mainly by KBC Insurance. In some cases, however, other entities are also involved.

Credit risk in the investment portfolio of KBC Insurance

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]	**31-12-2012[5]**	**31-12-2013[5]**
Per balance sheet item		
Securities	19 634	19 284
Bonds and other fixed-income securities	18 983	18 003
Held to maturity	5 788	6 731
Available for sale	13 190	11 266
At fair value through profit or loss and held for trading	0	1
As loans and receivables	5	5
Shares and other variable-yield securities	633	1 262
Available for sale	630	1 260
At fair value through profit or loss and held for trading	3	3
Other	18	19
Property and equipment and investment property	408	354
Investment contracts, unit-linked[2]	11 847	12 745
Other	89	701
Total	31 978	33 084
Details for bonds and other fixed-income securities		
By rating[3, 4]		
Investment grade	95%	96%
Non-investment grade	1%	3%
Unrated	4%	1%
By sector[3]		
Governments	63%	64%
Financial[6]	26%	21%
Other	11%	15%
By currency[3]		
Euro	94%	94%
Other European currencies	6%	6%
US dollar	0%	0%
By remaining term to maturity[3]		
Not more than 1 year	13%	15%
Between 1 and 3 years	19%	20%
Between 3 and 5 years	15%	19%
Between 5 and 10 years	33%	29%
More than 10 years	20%	18%

1 The total carrying value amounted to 32 576 million euros at year-end 2013 and to 31 277 million euros at year-end 2012.
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 Excluding entities classified as 'disposal groups' under IFRS 5. There were no insurance entities in that classification at year-end 2013. In 2012, the relevant entities (see 'Remark' at the start of this section) had an investment portfolio of 0.2 billion euros.
6 Including covered bonds and non-bank financial companies.

Credit risk due to insurance or reinsurance contracts

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 2012	EL 2012	EAD 2013	EL 2013
AAA up to and including A-	179	0.03	141	0.05
BBB+ up to and including BB-	111	0.10	147	0.13
Below BB-	0	0	0	0
Unrated	10	0.22	3	0.07
Total	299	0.35	291	0.24

1 Based on internal ratings.

2 EAD figures are audited, whereas EL figures are not.

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. While most credit risk tables are expressed in terms of gross exposure [EAD], this is not possible for the table below, as the Basel II EAD concept cannot be applied to insurance entities. Therefore, exposure is reported in terms of carrying value.

Overview of exposure to sovereign bonds at year-end 2013, carrying value[1] (in millions of EUR)

Total (by portfolio)								Total (by remaining term to maturity)			Economic impact of +100 basis points[3]
	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 2012*	Maturing in 2014	Maturing in 2015	Maturing in 2016 and later	
Southern Europe and Ireland											
Greece	0	0	0	0	0	0	0	0	0	0	0
Portugal	40	36	0	0	0	77	94	0	10	66	-5
Spain	348	0	0	0	0	348	230	0	0	348	-27
Italy	783	80	0	0	1	865	911	5	1	859	-66
Ireland	153	308	0	0	1	462	451	0	0	462	-23
KBC core countries											
Belgium	8 011	15 445	213	0	917	24 586	27 925	3 739	2 678	18 168	-1 092
Czech Rep.	2 309	5 573	66	29	993	8 970	9 503	976	2 318	5 676	-442
Hungary	235	1 677	8	88	258	2 267	2 603	34	448	1 785	-64
Slovakia	1 053	1 269	0	0	73	2 395	1 751	83	96	2 216	-125
Bulgaria	146	16	0	0	0	162	161	8	7	147	-8
Other countries											
France	1 058	2 251	0	0	3	3 312	3 091	333	263	2 716	-227
Germany	364	532	16	0	30	942	1 206	104	38	800	-60
Austria	243	440	211	0	0	894	553	43	6	845	-44
Netherlands	239	453	100	0	5	797	530	66	68	663	-37
Rest[2]	2 918	1 623	155	0	102	4 798	3 180	521	1 530	2 747	-175
Total carrying value	17 900	29 703	771	118	2 385	50 876	52 191	5 912	7 464	37 499	–
Total nominal value	16 691	28 065	728	127	2 366	47 978	48 615	–	–	–	–

1 Including entities classified as 'disposal groups' under IFRS 5 (accounted for an aggregate 0.4 billion euros at year-end 2013 and 0.5 billion euros at year-end 2012). 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 2013 and also including 1.3 billion euros in deposits at the National Bank of Hungary.

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 part of this impact is reflected in profit or loss and/or equity.

Main changes in 2013:

- The carrying value of the total sovereign bond exposure decreased by 1.3 billion euros, due primarily to the lower exposure to Belgian government bonds (-3.3 billion euros, mainly on account of OLOs that had either been sold or reached maturity), partly offset by increases in

Slovakia (+0.6 billion euros) and in other countries (see 'Rest' in the table; this heading also includes a 0.5-billion-euro increase in deposits at the National Bank of Hungary).

- In the past few years, KBC has managed to lower considerably its exposure to GIIPS sovereign bonds (bonds issued by Greece, Italy, Ireland, Portugal and Spain, see graph). At the end of 2013, the combined exposure to these bonds was 1.8 billion euros.

Structured Credit Products

This section deals with KBC's structured credit activities at year-end 2013. These activities relate to Asset-Backed Securities (ABS) and Collateralised Debt Obligations (CDOs), which are defined as follows:

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

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

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

KBC was active in the field of structured credits both as an originator and an investor. 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 2013, 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, 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 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 liquid senior European cash ABS ('treasury ABS exposure' in the tables), which are accepted as eligible collateral by the ECB. This allows for further diversification in the investment portfolios. It should be noted that the moratorium on CDOs is still in place.

A dedicated risk department focuses exclusively on the legacy structured credit positions for the entire KBC group. This department serves as a direct counterpart to the de-risking focused managers of structured credit positions. It analyses, identifies and advises – from a risk and capital perspective – on proposals made by these portfolio managers to reduce the exposure to structured credit positions in the KBC group. It is also responsible for producing consolidated reports on both securitised and re-securitised positions and for submitting them to senior management of KBC and the regulators. In producing these reports, there is no specific or different approach between securitisation and re-securitisation positions, though members of the dedicated risk department have in-depth knowledge about the specific risk drivers. This dedicated team not only reports on positions, but also monitors overall governance to ensure that appropriate decision authorities and business processes are in place at all levels of the organisation. Since 2012, the risk management of structured credits has been further enhanced by processes centred on KBC's continued de-risking strategy for structured credit exposures. These de-risking activities have significantly lowered the sensitivity of P&L to movements in credit spreads.

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 structured credit operations can be broken down into the following categories:

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

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

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

Structured credit transactions whose underlying assets arise directly from KBC's credit-granting activities, 31-12-2013 (in millions of EUR)

Programme	Role	Type of underlying exposure	Nominal amount of the underlying
Home Loan Invest 2007	Originator	Mortgage loans	2 927
Home Loan Invest 2008	Originator	Mortgage loans	0
Home Loan Invest 2009	Originator	Mortgage loans	3 119
Home Loan Invest 2011	Originator	Mortgage loans	3 071
Phoenix 2 Funding 2008	Originator	Mortgage loans	6 236
Phoenix 3 Funding 2008	Originator	Mortgage loans	2 582
Phoenix 4 Funding 2009	Originator	Mortgage loans	691
Phoenix 5 Funding 2012	Originator	Mortgage loans	847

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 74 845 loans totalling 2 927 million euros, with notes outstanding 3 553 million euros at year-end 2013. 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 II securitisation framework does not apply to this structured credit programme, as an insufficient amount of the risk incurred has been transferred. Assets are held as regular assets on the balance sheet of KBC Bank and treated accordingly for capital adequacy calculation purposes.

Home Loan Invest 2008

Home Loan Invest 2008, which is similar to Home Loan Invest 2007, was set up as a revolving transaction in November 2008. The Notes reached their first optional redemption date on 15 October 2013 and were called at that time. The amount outstanding is thus zero.

Home Loan Invest 2009

In April 2009, KBC Bank set up its third securitisation transaction. Home Loan Invest 2009 securitised a portfolio of 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. KBC Bank holds the subordinated loan of 727 million euros. The SPV issued notes in the amount of 6 000 million euros. At issuance, approximately 350 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 II 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 2013, the outstanding notes amounted to 2 451 million euros (the notional amounts of the underlying loans are shown in the table above). The subordinated loan amount remained unchanged.

Home Loan Invest 2011

In October 2011, KBC Bank set up its fourth securitisation transaction. Home Loan Invest 2011 securitised a portfolio of 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 II 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 2013, the outstanding notes amounted to 2 531 million euros (the notional amounts are shown in the table above). The subordinated loan amount remained unchanged.

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 6 236 million euros. KBC Bank Ireland has retained all of the notes, which implies that the Basel II securitisation framework does not apply, as an insufficient amount of the risk incurred has been transferred. The notes are divided into two classes, i.e. 77.4% in class A (Moody's 'A3' / Fitch 'A+' ratings / DBRS 'A' ratings) and 22.6% in class B (these notes are not rated), maturing in 2050. The Class A notes are eligible for placement with the ECB, thus providing KBC Bank Ireland plc with a liquidity buffer.

Phoenix Funding 3

Phoenix Funding 3, which is similar to Phoenix Funding 2, was set up in November 2008. The SPV has a remaining underlying pool of residential mortgages originated by KBC Bank Ireland, with corresponding note balances amounting to 2 582 million euros. KBC Bank Ireland plc has retained all of the notes, which implies that the Basel II securitisation framework does not apply, as an insufficient amount of the risk incurred has been transferred. The notes are split into two classes, i.e. 77.5% in class A (Moody's 'A3' / Fitch 'A+' ratings) and 22.5% in class B (the class B notes are not rated), maturing in 2050. The class A notes are eligible for placement with the ECB, thus providing KBC Bank Ireland plc with a liquidity buffer.

Phoenix Funding 4
Phoenix Funding 4 was set up on 4 August 2009. The SPV has a remaining underlying pool of residential mortgages originated by KBC Bank Ireland plc with corresponding note balances amounting to 691 million euros. KBC Bank Ireland plc has retained all of the notes. The notes are split into two classes, i.e. 82.1% in class A (Moody's 'A3' / Fitch 'A+' ratings) and 17.9% 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.

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 847 million euros. KBC Bank Ireland plc has retained all of the notes. The assets are split into three classes of A notes totalling 72% (Fitch 'A+' and DBRS A (h) ratings) and an unrated class Z loan of 28%. The class A notes of Phoenix Funding 5 are eligible for placement with the ECB.

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

Via its subsidiary KBC Financial Products, KBC acted as an originator when structuring CDO deals, based on third party assets. The credit risk related to the underlying assets is transferred to investors. The original notional underlying pools generally consist of corporate reference names (on average 85%) and ABS (on average 15%). The purpose of this business line was to generate fee income for KBC as an originator of structured credit.

The CDOs structured by KBC Financial Products are managed CDOs, whereby the manager has the option to conclude substitutions in the underlying asset portfolios of the CDOs. There were no such substitutions in 2013.

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

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

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

(figures exclude all expired, unwound or terminated CDO positions and after settled credit events)

Under this heading, information is provided on KBC group structured credit investments booked in both the banking and trading portfolios and covering CDOs protected with MBIA, other CDOs, and other ABS exposure (both legacy and treasury). Firstly, an overview is given of the overall exposure, followed by an overview of the credit quality of the securities, an amortisation schedule and details on the credit quality of the underlying assets of the securities. Lastly, the valuation principles, accounting principles and stress tests are examined.

Overall net exposure

As from mid 2013, KBC presents the net exposure instead of original notional amounts of its remaining investment in CDOs or other ABS. With regard to CDOs this means that all impact of settled credit events and all fully de-risked (i.e. riskless) positions are excluded (in total an effect of -3.1 billion euros). For other ABS exposure there was no effect.

Further on, over 2013 there was a significant reduction to the tune of -6.5 billion euros in KBC's CDO and ABS exposure mainly due to

- the de-risking of several CDOs in the first half of 2013 (a reduction of -6.1 billion euros)
- redemptions in the other legacy ABS portfolio to the tune of -0.5 billion euros

slightly offset by the investment (in the 4th quarter of 2013) in treasury ABS (two RMBS assets totalling 45 million euros of net exposure).

In the first quarter of 2014, the net legacy CDO exposure decreased further by some 2 billion euros thanks to the further collapsing of CDO exposure.

In this context, it should also be mentioned that only a few credit events occurred in the first half of 2013 for the names underlying the KBC Financial Products' CDOs, while none occurred in the second half of 2013. The credit events settled over 2013 (for less than 0.1 billion euros worth of events have been settled) have had no impact on P&L because complete value markdowns for the tranches affected had already been absorbed in the past.

KBC investments in structured credit products (CDOs and ABS) (in millions of EUR)	31-12-2013
Total net exposure	7 524
o/w legacy CDO exposure protected with MBIA	5 251
o/w other legacy CDO exposure	1 075
o/w legacy ABS exposure	1 153
o/w treasury ABS exposure	45
Cumulative value markdowns (mid-2007 to date)[1]	-355
Value markdowns	-301
for other legacy CDO exposure	-181
for other legacy ABS exposure	-119
Credit Value Adjustment (CVA) on MBIA cover[2]	-54
Cumulative value markdowns for treasury ABS exposure	7 524

1 Value adjustments to KBC's CDOs are accounted for via profit or loss instead of directly via shareholders' equity, since the group's CDOs are mostly of a synthetic nature (meaning that the underlying assets are derivative products such as credit default swaps on corporate names). Their synthetic nature is also the reason why KBC's CDOs are not eligible for accounting reclassification under IFRS in order to neutralise their impact.

2 The provisioning rate for MBIA was reduced from 80% to 60% as of June 2013.

In 2013, there was a total reduction in net legacy CDO and ABS exposure of 7.3 billion euros, which was due mainly to the de-risking of several CDOs and some redemptions in the other legacy ABS portfolio (an impact of -0.5 billion euros). In the first quarter of 2014, the net legacy CDO exposure was further reduced by some 2 billion euros thanks to the further collapsing of CDO exposures.
In KBC's treasury portfolio 45 million euros was invested in two RMBS assets over (the fourth quarter of) 2013.

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 is to a large extent mitigated, as it is included in the scope of the Guarantee Agreement that was agreed with the Belgian State on 14 May 2009. This agreement has a remaining nominal value of 5.9 billion euros, down from 20.0 billion euros at inception, 5.3 billion euros of which relates to the exposure insured with MBIA (after the further collapsing of CDO exposures in early 2014, the figure of 5.9 billion euros was cut to 3.8 billion euros, 3.2 billion euros of which relates to the exposure insured with MBIA). It should be noted that the provisioning rate of MBIA was reduced from 80% to 60% at the end of June 2013, based on a fundamental internal analysis and was maintained at 60% at year-end 2013. The remaining 0.7 billion euros of exposure covered by the agreement with the Belgian State relates to part of the 'Other legacy CDO exposure'. Of this portfolio (i.e. other legacy CDO exposure not covered by credit protection with MBIA), the super senior assets have also been included in the scope of the Guarantee Agreement with the Belgian State.

Details for CDO exposure protected with MBIA (in millions of EUR)	31-12-2013
Total insured amount (notional amount of super senior swaps)[1]	5 251
Details for MBIA insurance coverage	
- Fair value of insurance coverage received (modelled replacement value, after taking the Guarantee Agreement into account)	91
- CVA for counterparty risk, MBIA	-54
(as a % of fair value of insurance coverage received)	60%[2]

1 The amount insured with MBIA is included in the Guarantee Agreement with the Belgian State (14 May 2009).
2 The provisioning rate for MBIA was lowered from 80% to 60% in June 2013.

The super senior portions of CDOs originated by KBC Financial Products are mostly hedged via swap contracts with MBIA, a US monoline insurer. The value of this insurance coverage is adjusted by a Credit Value Adjustment intended to reflect the creditworthiness of MBIA, as shown in the table above.

Moreover, the remaining risk related to MBIA's insurance coverage is largely mitigated, as it is included in the scope of the Guarantee Agreement (PPA) signed with the Belgian State.

KBC has not granted any straightforward credit facilities to MBIA, but is exposed to reinsurance cover received for CDOs.

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

Other KBC Group investment in structured credit products (year-end 2013)

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

Please note that a portion of the risk attached to KBC group investments in CDOs is mitigated, due to the fact that the super senior CDO tranches are fully covered by the Guarantee Agreement (PPA) signed with the Belgian State.

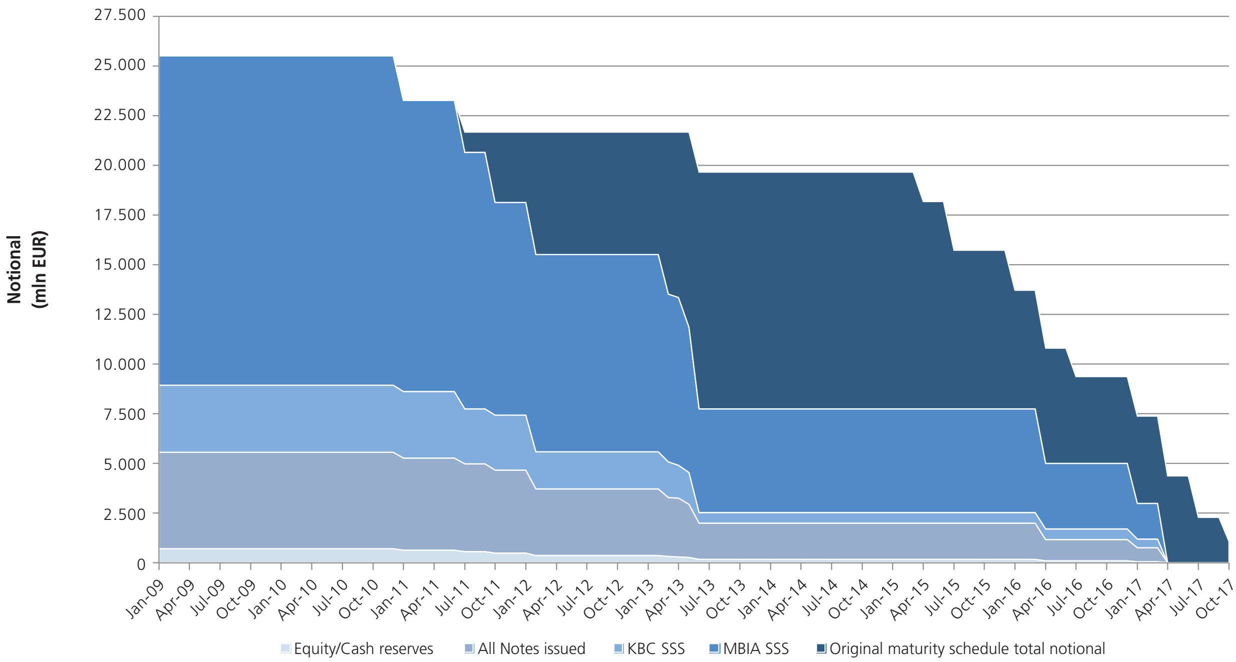
Credit quality of securities held (year-end 2013)

An overview of the quality of the notes and super senior swaps held at year-end 2013 is shown in the table below.

Credit quality of securities held – based on Moody's ratings, 31-12-2013 Net exposure (in millions of EUR)	Super Senior (SS)	Aaa	Aa	A	Baa	<Baa3	Unrated	Total
Legacy CDO exposure protected by MBIA	5 251	-	-	-	-	-	-	5 251
Other legacy CDOs (FP CDOs)*	-	2	21	138	479	287	87	1 015
Other legacy CDOs (non-FP CDOs)	-	-	-	29	23	9	-	60
Other legacy ABS	-	243	8	220	430	196	56	1 153
Other treasury ABS	-	45	-	-	-	-	-	45
Total for 2013	5 251	290	29	387	932	492	143	7 524

* All Super Senior positions fall within the scope of the Guarantee Agreement signed with the Belgian State (see the 'Additional information' section of the 2013 Annual Report of KBC Group NV (see *www.kbc.com*)).

Maturity schedule for CDOs issued by KBC Financial Products



The above graph shows how the CDOs originated by KBC Financial Products amortise over the next number of years. It should be noted that KBC is continuing to look at reducing ABS and CDO exposure and thus further de-risking would affect the maturity schedule. The first drop in the maturity schedule is in April 2016. By October 2017, all CDOs issued by KBC Financial Products are expected to have matured.

Overview of the underlying collateral of the securities held (31-12-2013)

The next few tables provide a breakdown of the underlying assets of the CDO reference portfolios (both those insured and those not insured by MBIA) and the other ABS portfolio. They contain more detailed information on KBC's subprime exposure, on the quality of the underlying collateral and on the breakdown of corporate reference names according to sector and region. The figures are net of provisions for equity and junior CDO pieces. Settled credit events, prepayments and all fully de-risked (riskless) positions are excluded.

Legacy CDO exposure protected by MBIA

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

Credit quality of securities held – based on Moody's ratings 31-12-2013 Amounts at nominal value (in millions of EUR)		Aaa	Aa	A	Baa	Ba	B	Caa	<Caa3	Unrated	Total
Corporates		**2**	**104**	**714**	**2 473**	**763**	**478**	**110**	**100**	**405**	**5 149**
Sector	Buildings & Real Estate	-	-	64	538	138	52	23	18	22	857
	Banking	-	58	191	254	65	43	3	-	67	682
	Insurance	-	35	114	146	33	38	27	-	-	393
	Finance	-	-	22	112	94	-	-	23	42	293
	Mining, Steel, Iron & Nonprecious Metals	-	-	49	133	75	20	-	-	13	290
	Printing & Publishing	-	-	-	34	96	63	25	-	29	248
	Retail Stores	-	-	21	106	28	52	22	-	11	240
	Utilities	-	2	27	177	10	-	-	1	4	221
	Telecommunications	-	1	76	71	20	27	3	-	19	217
	Automobile	-	-	23	108	30	45	-	4	5	214
	Oil & Gas	2	5	10	156	27	-	-	-	11	211
	Electronics	-	-	16	39	39	3	2	0	50	150
	Other	-	4	101	598	107	135	4	53	131	1 134
Region	US	2	15	283	1 487	508	315	91	72	76	2 849
	EU	-	32	148	529	198	112	15	10	146	1 190
	Asia	-	53	139	230	26	19	4	19	146	636
	Latin America	-	2	3	20	-	-	-	-	12	37
	Other		2	141	208	31	31	-	-	25	438
CMBS		**-**	**1**	**0**	**-**	**-**	**-**	**-**	**-**	**1**	**3**
RMBS		**-**	**-**	**-**	**3**	**3**	**0**	**6**	**10**	**-**	**22**
Origin	Prime	-	-	-	-	-	-	-	1	-	1
	ALT-A	-	-	-	-	-	-	-	1	-	1
	ALT-A (<2005 vintage)	-	-	-	-	-	-	-	-	-	-
	ALT-A (2005-2008 vintage)	-	-	-	-	-	-	-	*1*	-	*1*
	Subprime	-	-	-	3	3	0	6	9	-	21
	Subprime (<2005 vintage)	-	-	-	-	-	-	*4*	*5*	-	*9*
	Subprime (2005-2008 vintage)	-	-	-	*3*	*3*	*0*	*2*	*4*	-	*11*
Region	US	-	-	-	3	3	0	6	10	-	22
Other ABS		**-**	**-**	**-**	**-**	**-**	**-**	**-**	**8**	**-**	**8**
CDO		**8**	**5**	**3**	**6**	**1**	**2**	**1**	**2**	**43**	**70**
Total		**10**	**109**	**717**	**2 481**	**768**	**480**	**117**	**120**	**449**	**5 251**

Other legacy CDO exposure

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

Credit quality of underlying collateral of CDO held – based on Moody's ratings 31-12-2013 (in millions of EUR)

		Aaa	Aa	A	Baa	Ba	B	Caa	<Caa3	Unrated	Total
Corporates		**0**	**20**	**138**	**478**	**147**	**92**	**21**	**19**	**78**	**995**
Sector	Buildings & Real Estate	-	-	12	104	27	10	5	4	4	166
	Banking	-	11	37	49	13	8	1	-	13	132
	Insurance	-	7	22	28	6	7	5	-	-	76
	Finance	-	-	4	22	18	-	-	5	8	57
	Mining, Steel, Iron & Nonprecious Metals	-	-	9	26	14	4	-	-	3	56
	Printing & Publishing	-	-	-	7	19	12	5	-	6	48
	Retail Stores	-	-	4	20	5	10	4	-	2	46
	Utilities	-	0	5	34	2	-	-	0	1	43
	Telecommunications	-	0	15	14	4	5	1	-	4	42
	Automobile	-	-	4	21	6	9	-	1	1	41
	Oil & Gas	0	1	2	30	5	-	-	-	2	41
	Electronics	-	-	3	8	8	1	0	0	10	29
	Other	-	1	20	116	21	26	1	10	25	219
Region	US	0	3	55	287	98	61	18	14	15	550
	EU	-	6	29	102	38	22	3	2	28	230
	Asia	-	10	27	44	5	4	1	4	28	123
	Latin America	-	0	4	-	-	-	-	-	2	7
	Other	-	0	27	40	6	6	-	-	5	85
CMBS		**-**	**0**	**-**	**-**	**-**	**-**	**-**	**-**	**0**	**0**
RMBS		**-**	**-**	**-**	**0**	**1**	**0**	**1**	**2**	**-**	**4**
Origin	Prime	-	-	-	-	-	-	-	0	-	0
	ALT-A	-	-	-	-	-	-	-	0	-	0
	ALT-A (<2005 vintage)	-	-	-	-	-	-	-	-	-	-
	ALT-A (2005-2008 vintage)	-	-	-	-	-	-	-	*0*	-	*0*
	Subprime	-	-	-	0	1	0	1	2	-	4
	Subprime (<2005 vintage)	-	-	-	-	-	-	*1*	*1*	-	*2*
	Subprime (2005-2008 vintage)	-	-	-	*0*	*1*	*0*	*0*	*1*	-	*2*
Region	US	-	-	-	0	1	0	1	2	-	4
Other ABS		**-**	**-**	**-**	**-**	**-**	**-**	**-**	**2**	**-**	**2**
CDO		**2**	**1**	**1**	**1**	**0**	**0**	**0**	**0**	**8**	**14**
Total		**2**	**21**	**138**	**479**	**148**	**93**	**23**	**23**	**87**	**1 015**
Other CDO exposure (non FP CDOs)		**-**	**-**	**38**	**23**	**-**	**-**	**-**	**-**	**-**	**60**

Other ABS exposure

Other ABS exposure broken down by type and quality, based on Moody's ratings 31-12-2013 amounts at nominal value (in millions of EUR)

Other legacy ABS exposure		Aaa	Aa	A	Baa	Ba	B	Caa	<Caa3	Unrated	Total
CMBS		**14**	**1**	-	-	-	-	-	-	-	**15**
RMBS		**73**	**7**	**198**	**425**	**196**	-	-	-	**56**	**955**
Origin	Prime	66	2	195	425	196				56	940
	Prime (<2005 vintage)	-	*2*	*22*	*53*	*40*	-	-	-	*56*	*118*
	Prime (2005-2008 vintage)	*66*	-	*172*	*372*	*156*	-	-	-	-	*822*
	ALT-A	-	-	3	-	-	-	-	-	-	3
	ALT-A (<2005 vintage)	-	-	*3*	-	-	-	-	-	-	*3*
	ALT-A (2005-2008 vintage)	-	-	-	-	-	-	-	-	-	-
	Subprime	7	5	-	-	-	-	-	-	-	13
	Subprime (<2005 vintage)	*7*	*5*	-	-	-	-	-	-	-	*12*
	Subprime (2005-2008 vintage)	-	*0*	-	-	-	-	-	-	-	*0*
Region	United States	7	5	3	5	-	-	-	-	-	21
	Spain	-	-	46	379	28	-	-	-	47	500
	Portugal	-	-	-	32	168	-	-	-	-	200
	Italy	-	-	146	9	-	-	-	-	9	164
	Netherlands	56	-	-	-	-	-	-	-	-	56
	United Kingdom	10	-	-	-	-	-	-	-	-	10
	Other	-	2	3	-	-	-	-	-	-	5
	Belgium	-	*2*	-	-	-	-	-	-	-	*2*
	Western Europe	-	-	*3*	-	-	-	-	-	-	*3*
Other ABS		**155**	-	**22**	**5**	-	-	-	-	-	**182**
Type	CLO	149	-	-	-	-	-	-	-	-	149
	Leases	-	-	7	5	-	-	-	-	-	12
	SME loans	-	-	15	-	-	-	-	-	-	15
	Consumer loans	7	-	-	-	-	-	-	-	-	7
	Auto loans/leases	-	-	-	-	-	-	-	-	-	-
	Other	-	-	-	-	-	-	-	-	-	-
Total		**243**	**8**	**220**	**430**	**196**	-	-	-	**56**	**1 153**
Other treasury ABS exposure		**45**	-	-	-	-	-	-	-	-	**45**
Region	Netherlands	45	-	-	-	-	-	-	-	-	45
Type	RMBS Prime (vintage 2013)	45	-	-	-	-	-	-	-	-	45

Valuation and accounting principles

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

For CDOs, KBC applies a level-3 valuation technique. The Gaussian Copula model models the distribution of default times of the underlying corporate and ABS names in the reference portfolios of the CDO transactions. The asset default trigger in the model is derived from the credit default swap spreads in the market. The correlation between the default times is modelled through Gaussian Copulas[4] and can as such be simulated. By discounting the cashflows resulting from the default time curves on the underlying assets, a value for a specific CDO tranche is determined. The model also ensures that the inner tranches are valued in line with the market, through the calibration with CDX and iTraxx credit spread indices. Please refer to Note 26 in the 2013 Annual Report of KBC Group NV for more information on the methodology we use to value CDOs.

It should be noted that value adjustments to KBC's CDOs are accounted for via profit and loss (instead of directly via shareholders' equity), since the group's CDOs are mostly of a synthetic nature (meaning that the underlying assets are derivative products such as credit default swaps on corporate names). Their synthetic nature is also the reason why KBC's CDOs are not eligible for accounting reclassification under IFRS in order to neutralise their impact.

Securitisation activities are accounted for under IFRS according to the guidelines provided by 'IAS 39 Financial Instruments: Recognition and Measurement' and 'SIC 12 Consolidation – Special Purpose Entities'.

The derecognition rules of IAS 39 determine when the securitised assets may be derecognised from the balance sheet. This is the case when the contractual rights to receive the cashflows of the financial asset are transferred or retained but 'passed through' and substantially all the risk and rewards of ownership of the asset are transferred.

In many cases, structured entities (the new name for Special Purpose Entities) are set-up for securitisation activities. IFRS 10 determines that a company should consolidate such an entity if it has:
(i) power over the structured entity;
(ii) exposure, or rights, to variable returns from its involvement with the structured entity;
(iii) the ability to use its power over the structured entity to affect the amount of its return.

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

Stress-test results for KBC group investments in structured credits (31-12-2013)

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

(i) Stress tests with an effect on credit default

Since mid-2008, KBC has used the concept of 'fundamental value' for the CDOs issued by KBC Financial Products. This aims to estimate how (expected) credit events – when claimed, verified and settled – would affect the principal amounts of the CDO tranches, according to the waterfall structure (reversed seniority). It serves as a reasonable prediction of the redemption value of the CDOs originated by KBC Financial Products at or around the respective expected maturity dates. The calculation of the fundamental value (referred to as the fundamental value scenario in the table below) is based on a 5.6% loss in the underlying corporate portfolio (which also includes credit events actually claimed and expected cumulative losses; the realised percentage loss stands at 2.7%) and on a 85.9% loss in ABS (the realised percentage loss stands at 84.6%). This fundamental value analysis is performed on a quarterly basis (or more frequently if required by market conditions).
In addition, a further stressed fundamental analysis was performed under the following test assumptions:

- *Stress scenario 1:* ABS credit events actually claimed and expected losses on ABS amounting to a loss of 88.1%, and a 5.7% loss in the underlying corporate portfolio (which also includes credit events actually claimed and expected cumulative losses).
- *Stress scenario 2:* ABS credit events actually claimed and expected losses on ABS amounting to a loss of 88.9%, and a 6.5% loss in the underlying corporate portfolio (which also includes credit events actually claimed and expected cumulative losses).

The results of these scenarios are summarised in the table[1]

Stress test results for credit default[1]

In millions of EUR – 31-12-2013		Notional	Estimated loss	MtM-loss[2]
Fundamental value scenario	CDO protected with MBIA	5 251	-	87
	Other retained positions	1 015	152	156
Stress scenario 1	CDO protected with MBIA	5 251	-	87
	Other retained positions	1 015	165	156
Stress scenario 2	CDO protected with MBIA	5 251	-	87
	Other retained positions	1 015	196	156

1 Account taken of the Guarantee Agreement with the Belgian State.
2 According to Gaussian Mixture Model minus uncertainties.

(ii) Stress tests with an effect on P&L

KBC has calculated the impact of two stress test scenarios in terms of changes in credit spreads (an increase or decrease by 10%, 20% and 50%, respectively) on the portfolio of CDOs originated by KBC Financial Products (net exposure in scope of 6.3 billion euros). As can be seen from the table below, the de-risking activities undertaken during 2012 have significantly reduced the sensitivity of P&L to movements in credit spreads.

The calculations take into account the impact of the Guarantee Agreement (PPA) signed with the Belgian State, which reduces the volatility of the super senior positions in scope on P&L. The provisioning rate of 60% for MBIA has also been taken into account. It should be noted that KBC decided to decrease the provisioning rate from 80% to 60% end June 2013 based on a fundamental internal analysis.

Stress test results for the market sensitivity of CDOs

In millions of EUR – 31-12-2013 (pre-tax)		
	Market valuation sensitivity	Stress test result
Test assumptions	Credit spreads in December x 1.10	-19
	Credit spreads in December x 1.20	-37
	Credit spreads in December x 1.50	-92
Test assumptions	Credit spreads in December x 0.90	19
	Credit spreads in December x 0.80	38
	Credit spreads in December x 0.50	92

Further de-risking in early 2014 has reduced the sensitivity of P&L even more. Measured as the impact of a 50% increase in credit spreads, it decreased to 67 million euros after the collapsing of CDO exposures.

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 II, 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 59 million euros relating to the re-securitisation capital requirement referred to in the ‘Market risk’ section is also included in the following table.

Structured credit products – details of capital charges under the CRD III (re)securitisation framework, 31-12-2013 (in millions of EUR)

		Securiti-sation	Re-secu-ritisation	Net exposure	Total EAD for CRD III	Of which 6 – 18%	Of which 20 – 35%	Of which 50 – 100%	Of which 250 – 850%	Of which 1250%	RWA 31-12-2013
Banking entities											
Trading book		-	5 256	5 256	3	-	-	-	-	3	641
	CDO exposure	-	5 256	5 256	3	-	-	-	-	3	641
	of which senior positions	-	*5 251*	*5 251*	-	-	-	-	-	-	-
	of which non-senior positions[1]	-	*5*	*5*	*3*	-	-	-	-	*3*	*641*
Banking book		1 242	329	1 571	1 571	657	241	272	71	329	3 331
	CDO exposure	60	329	389	389	29	52	9	-	329	2 787
	of which senior positions	*60*	-	*60*	*60*	*29*	*52*	*9*	-	-	*18*
	of which non-senior positions	-	*329*	*329*	*329*	-	-	-	-	*329*	*2 770*
	Other legacy ABS exposure	1 137	-	1 137	1 137	583	189	264	71	-	541
	of which senior positions	*1 107*	-	*1 107*	*1 107*	*583*	*189*	*264*	*71*	-	*530*
	of which non-senior positions	*30*	-	*30*	*30*	-	*30*	-	-	-	*10*
	Other treasury ABS positions	45	-	45	45	45	-	-	-	-	3
	of which senior positions	*45*	-	*45*	*45*	*45*	-	-	-	-	*3*
Total for banking entities		**1 242**	**5 585**	**6 827**	**1 575**	**657**	**241**	**272**	**71**	**332**	**3 972**
Insurance entities		-	681	697	-	-	-	-	-	-	3
	CDO exposure	-	681	681	-	-	-	-	-	-	3 972
	Other ABS exposure	16	-	16	-	-	-	-	-	-	-
Total for insurance entities		**16**	**681**	**697**	**-**	**-**	**-**	**-**	**-**	**-**	**-**
Total net exposure for KBC Group		**1 258**	**6 266**	**7 524**	**-**	**-**	**-**	**-**	**-**	**-**	**-**
Client credit facility[2]		N/A	N/A	337	N/A	N/A	N/A	N/A	N/A	N/A	32
ABS protection at KBC Financial Products[3]		27	8	35	35	-	-	-	-	35	51
Total capital charge											**4 056**

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.
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 Group. 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, 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)*	31-12-2012	31-12-2013
Total	3.81	3.83

* Excluding a number of small group companies. Cyclical prepayment options embedded in mortgage loans have not been captured. Excluding entities classified as 'disposal groups' under IFRS 5. In 2013, the impact of these entities (see 'Remark' at the start of this report) on the group's ALM VaR was 6.3 million euros. In 2012, the impact of the relevant entities (see 'Remark' at the start of this report) on the group's ALM VaR was 11.2 million euros. KBC Pension Fund has been excluded (its impact on the group's ALM VaR was 278 million euros in 2013 and 193 million euros in 2012). The VaR at year-end 2012 was restated from 1.06 billion euros to 1.34 billion euros after the 99% confidence interval was brought into line with the 99.93% used in internal economic capital modelling, and from 1.34 billion euros to 3.81 billion euros after including credit spread risk in VaR. VaR is measured using the VaR-CoVaR approach.

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).

In addition, we report the group-wide IFRS sensitivity to interest rate movements on a regular basis, including both the banking and insurance activities.

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)	**31-12-2012**	**31-12-2013**
Average for 1Q	-52	-33
Average for 2Q	-49	-27
Average for 3Q	-49	-21
Average for 4Q	-47	-22
As at 31 December	-39	-22
Maximum in year	-57	-40
Minimum in year	-39	-21

* Excluding entities classified 'as disposal groups' under IFRS 5 (see 'Remark' at the start of this report). Including these entities would lead to an overall BPV for the banking activities of -22 million euros at year-end 2013 and -44 million euros at year-end 2012.

In line with the Basel II 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 11.7% of total capital and reserves at year-end 2013. 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
31-12-2012	3 731	3 904	-1 251	-7 095	4 450	2 039	-5 778	0
31-12-2013	13 665	323	-1 653	-3 146	6 730	788	-16 706	0

* Excluding a number of small group companies. Entities classified as 'disposal groups' under IFRS 5 have also been excluded (figures for these entities are given below). Non-maturity contracts were isolated in the 'non-interest bearing' category in 2013, whereas they had been included in the '≤ 1 month' bucket in 2012.

	≤ 1 month	1–3 months	3–12 months	1–5 years	5–10 years	> 10 years	Non-interest-bearing instruments	Total
31-12-2012	633	-74	-220	128	258	258	-981	0
31-12-2013	182	-88	46	41	14	0	-196	0

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
31-12-2012						
Fixed-income assets backing liabilities, guaranteed component	10 747	5 236	1 745	1 240	810	19 778
Liabilities, guaranteed component	10 131	3 409	1 742	1 209	1 584	18 075
Difference in expected cashflows	616	1 828	3	31	-774	1 703
Mean duration of assets						5.29 years
Mean duration of liabilities						6.11 years
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

* Excluding a number of small group companies and entities classified as 'disposal groups' under IFRS 5. In 2013 and 2012, entities classified as 'disposal groups' under IFRS 5 (see 'Remark' at the start of this report) did not have any insurance liabilities.

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[1]	31-12-2012	31-12-2013
5.00% and higher[2]	3%	3%
More than 4.25% up to and including 4.99%	10%	10%
More than 3.50% up to and including 4.25%	5%	4%
More than 3.00% up to and including 3.50%	30%	27%
More than 2.50% up to and including 3.00%	24%	22%
2.50% and lower	27%	32%
0.00%	2%	2%
Total	100%	100%

1 Excluding a number of small group companies and entities classified as 'disposal groups' under IFRS 5. In 2013 and 2012, entities classified as 'disposal groups' under IFRS 5 (see 'Remark' at the start of this report) did not have any nominal exposure.
2 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 - BPV in thousands of EUR – 31-12-2012[1]									
	Overall	EUR	CHF	USD	GBP	CZK	HUF	PLN	Other
Banking activities	-39 272	-28 396	-171	181	63	-9 520	-1 676	142	103
Insurance activities	8 174	8 243	21	-26	0	411	-201	4	-279
Total[2]	-22 145	-11 157	-150	151	63	-9 109	-1 876	135	-203
Interest Rate Risk - BPV in thousands of EUR – 31-12-2013[1]									
	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[2]	-11 150	-9 994	-74	2 502	53	-1 556	-1 668	5	-418

1 The entities classified as 'disposal group' under IFRS 5 had a total BPV of -5 million euros at year-end 2012 and -0,3 mln EUR at year-end 2013.
2 KBC Pension Fund excluded in 2013. The BPV of KBC Pension Fund at year-end 2013 was 21.8 million euros.

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

Impact on net profit (IFRS) of an increase/decrease in the yield curve for the KBC group[1] (in millions of EUR)				
		Increase by 1%[2]		Decrease by 1%[2]
	31-12-2012	31-12-2013	31-12-2012	31-12-2013
Banking activities	-44	87	55	50
Insurance activities	10	24	-12	-28
Total	-34	110	43	22

1 Excluding entities classified as 'disposal groups' under IFRS 5 (see 'Remark' at the start of this report). In 2013, a 100-basis-point increase in the yield curve would have had an impact of 0,.05 million euros on net profit and an impact of -2.2 million euros on the market value of these entities. In 2012, the corresponding figures would have been 0.7 million euros and -51 million euros, respectively.

2 Full market value, regardless of accounting classification or impairment rules. Excluding KBC Pension Fund (impact of 7 million euros on net profit and 12 million euros on value in 2013).

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[1, 2] (breakdown by sector, in %)	Banking activities		Insurance activities		Group	
	31-12-2012	31-12-2013	31-12-2012	31-12-2013	31-12-2012	31-12-2013
Financial	23%	60%	26%	20%	25%	25%
Consumer non-cyclical	11%	1%	12%	10%	12%	8%
Communication	0%	0%	1%	0%	1%	0%
Energy	3%	0%	7%	7%	6%	6%
Industrial	21%	27%	9%	38%	12%	37%
Utilities	2%	0%	3%	3%	3%	3%
Consumer cyclical	4%	1%	4%	15%	4%	13%
Basic materials	3%	0%	11%	5%	9%	4%
Other and not specified	33%	12%	27%	3%	28%	4%
Total	100%	100%	100%	100%	100%	100%[2]
In billions of EUR	0.2	0.2	0.5	1.3	0.7	1.4
of which unlisted	0.1	0.0	0.1	0.0	0.2	0.0

1 Excluding a number of small group companies and entities classified as 'disposal groups' under IFRS 5. In 2013 and 2012, entities classified as 'disposal groups' (see 'Remark' at the start of this report) did not have an equity portfolio. The equity portfolio of KBC Pension Fund is not included (0.7 billion euros at year-end 2013 and 0.7 billion euros at year-end 2012).

2 The main differences between the 1.4 billion euros in this table and the 1.9 billion euros for 'Equity instruments' in the table appearing in Note 18 of the 'Consolidated financial statements' section of the 2013 Annual Report for KBC Group NV – 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 net profit (IFRS)		Impact on value	
	31-12-2012	31-12-2013	31-12-2012	31-12-2013
Banking activities	-12	-11	-22	-21
Insurance activities	-4	-1	-54	-158
Total	-17	-12	-74	-179

* Excluding entities classified as 'disposal groups' under IFRS 5 (see 'Remark' at the start of this report). At year-end 2013 and 2012, the entities classified as 'disposal groups' under IFRS 5 (see 'Remark' at the start of this report) did not have any equity exposure. Excluding the equity portfolio of KBC Pension Fund (year-end 2013: impact of -1.8 million euros on net profit and -92 million euros on value). Equity positions were increased at KBC Insurance, leading to a heightened economic sensitivity to equity shocks.

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

Non-trading equity exposure[1] (in millions of EUR)	Net realised gains (in income statement)		Net unrealised gains on year-end exposure (in equity)	
	31-12-2012	31-12-2013	31-12-2012	31-12-2013
Banking activities	11	80	47	73
Insurance activities	143	44	160	252
Total[2]	156	126	215	335

1 Excluding a number of small group companies and entities classified as 'disposal groups' under IFRS 5. In 2013 and 2012, the entities with this classification (see 'Remark' at the start of this report) did not have any equity exposure.

2 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 with a view to realising capital gains over the long term. KBC Insurance also holds a diversified real estate portfolio, which is held as an investment for non-life reserves and long-term life activities. 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	
	31-12-2012	31-12-2013
Bank portfolios	-66	-59
Insurance portfolios	-37	-40
Total	-102	-99

* Excluding a number of small group companies. Entities classified as 'disposal groups' under IFRS 5 have also been excluded (see 'Remark' at the start of this report); they had no impact in 2013 and 2012. Excluding the real estate portfolio of KBC Pension Fund (an impact of -18 million euros on value at year-end 2013 and -17 million euros at year-end 2012).

Inflation risk

KBC's exposure to inflation is primarily 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. For the 2013 reporting period, the Group Markets Committee (GMC) decide 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 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

KBC is exposed to market risk via the trading books of the dealing rooms in Western Europe, Central and Eastern Europe, and Asia. The traditional dealing rooms, with the dealing room in Brussels accounting for the lion's share of the limit exposures 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.

At KBC Financial Products, the only ongoing activity – European Equity Derivatives – has been managed directly from Brussels since March 2012. The market risk of the legacy CDO portfolio is managed stringently, with a number of de-risking trades having taken place during the year. These trades have significantly lowered risk and the sensitivity of P&L to credit spread movements.

The remaining legacy business lines at KBC Financial Products, namely Fund Derivatives, Reverse Mortgages and Insurance Derivatives, 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 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 further trading or hedging, counterparty default or operational losses.

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. Past movements in market parameters are transformed into scenarios that are applied to the current market situation and the corresponding P&Ls are computed. 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). This is in compliance with regulatory requirements.

We calculate an overall VaR for each specialised subsidiary and for all trading entities worldwide based on a 10-day holding period.

In the following table, the VaR for KBC Bank includes both the linear and non-linear exposure of the traditional dealing rooms, as well as KBC Securities (from April 2013 onwards). KBC Financial Products' HVaR, which comprises the single names credit derivatives portfolio and the remaining correlation portfolio, is also shown in the table until the third quarter of 2013. As of October 2013 the HVaR for KBC Financial Products' credit derivatives had fallen to zero due to a series of trades with an external counterpartythat generated and exact match of the offsetting positions in the scope of KBC Financial Products' VaR model (perfect match, Back-to-Back). As a result, and due to the above-mentioned inclusion of KBC Securities in the HVaR for KBC Bank, all trading activity for the KBC group measured by HVaR has been included in the '10-day HVaR for KBC Bank' figure from that point on.

Market risk (VaR) (in millions of EUR)	10 day HVaR KBC Bank		10 day HVaR KBC Financial Products	
	2012	2013	2012	2013
Holding period: 10 days				
Average for 1Q	30	37	12	1
Average for 2Q	34[1,2]	37	2[3]	1
Average for 3Q	30	34	2	1
Average for 4Q	30	29	1	-
As at 31 December	37	28	2	-
Maximum in year	39	50	18	5
Minimum in year	23	26	1	0

1 Change in scope as of 1 March 2012: European Equity Derivatives moved from KBC Financial Products to KBC Bank.
2 KBL EPB included until the second quarter of 2012.
3 Large decrease in the use of average HVaR for KBC Financial Products due to simplification of the credit event settlement process.

A breakdown of the risk factors (averaged) in KBC Bank's HVaR model from 1 March 2012 (when the scope changed and the European equity derivatives business was included) to 31 December 2012 and for full-year 2013 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 the trading HVaR for KBC Bank (in millions of EUR)	Average last 10 months 2012	Average 2013
Interest rate risk	31.0	33.3
FX risk	2.2	2.9
FX Option Risk	2.0	1.8
Equity risk	1.6	1.9
Diversification effect	-5.7	-5.6
Total HVaR	31.1	34.3

Regulatory capital

Both KBC Bank and KBC Financial Products 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 anti-thetic ('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 2013 and the period that will be used from 2014 on are shown in the table below:

Approved Internal Model	2013	2014
KBC NV AIM	Jan 2008 – Dec 2008	May 2011 – Apr 2012
KBC FP AIM	June 2008 – June 2009*	May 2007 – May 2008
ČSOB (Czech Republic) AIM	Mar 2008 – Mar 2009	Jul 2009 – Jun 2010

* The period shown for 2013 is different from the 2012 Risk Report as there was a recalibration of the SVaR period in April 2013. This recalibration took place because further portfolio derisking had changed the risk profile of the position, which meant that a different stressed period was more relevant to the remaining positions.

In addition, KBC Financial Products has implemented models (as required by CRD III) to calculate and report an Incremental Risk Charge (IRC) for the credit risk positions that carry default and migration risks (i.e. the single name corporate CDS) and a Comprehensive Risk Measure (CRM) that covers all price risks in the bespoke CDO tranches. However, as mentioned above, because the offsetting positions in the scope of KBC Financial Products' VaR model matched exactly as from October 2013, the IRC and CRM charges fell to zero. It should be noted that the risk attached to ABS and retained CDO positions follows the (re)securitisation framework (for further information, please refer to the 'Structured credit products' section of this risk report).

The resulting capital requirements for trading risk at year-end 2012 and year-end 2013 are shown in the table below. The trading regulatory capital requirements of local KBC entities not receiving 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).

Trading regulatory capital requirements, by risk type (in millions of EUR)		Interest rate risk	Equity risk	FX risk	Commodity risk	Incremental Risk Charge	Comprehensive Risk Measure	Re-securitisation	Total
31-12-2012									
Market risks assessed by internal model	HVaR SVaR	88 114	3 4	10 20	- -	1	34	-	274
Market risks assessed by the Standardised Approach		60	12	11	2	-	-	340	425
Total		263	18	42	2	1	34	340	698
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

* The scope represented by this figure is different than in 2012 because the retained CDO positions on the banking book in 2013 have been included under 'credit risk' and no longer under 'market risk' (as was the case until 2012). If the scope had remained the same, the trading regulatory capital requirements for re-securitisation would have fallen from 340 million euros in 2012 to 274 million euros in 2013.

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 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
2nd 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
1st Gulf War	02-08-1990 to 31-03-1991
Stock market decline	25-08-1987 to 31-03-1988
ERM crisis	28-12-1992 to 31-08-1993

For the CDO portfolio, stress tests on credit spreads are performed biweekly. Every quarter, comprehensive stress tests are performed by stressing the correlation and the level of credit spreads as well as by simulating losses in the underlying collateral pool, based on the current level of the credit spreads.

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

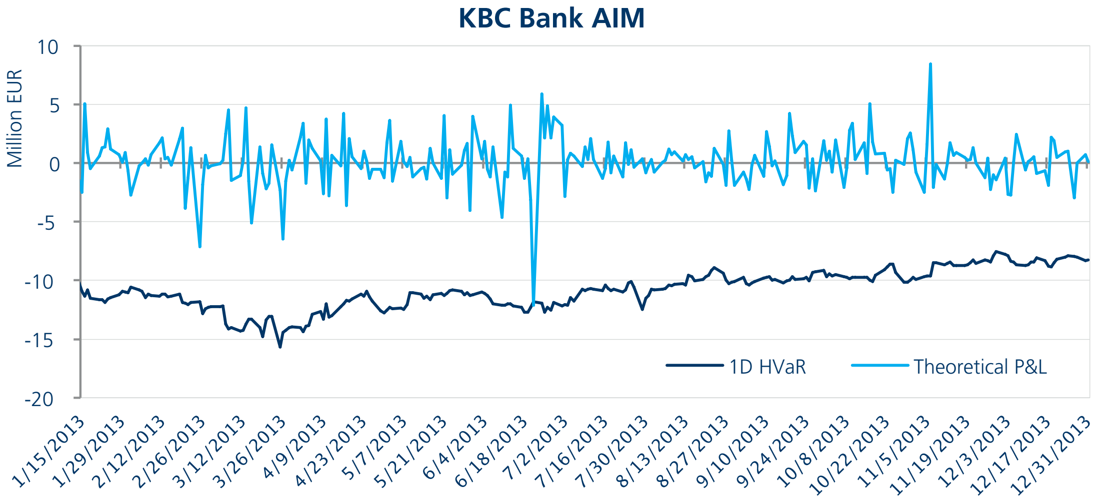
Back-testing plays a crucial role in assessing the quality and accuracy of the HVaR model, as it compares model-generated risk measures to daily P&L figures.

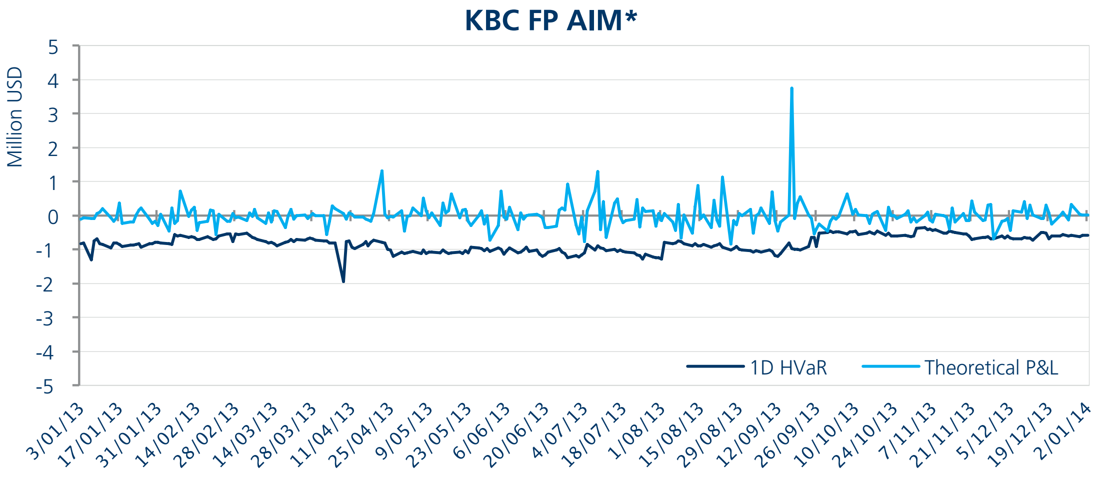
In line with regulatory requirements, a daily theoretical back-test procedure is in place, consisting of three steps. Firstly, a 'no action P&L' is generated. This is the P&L that the portfolio produces if all positions remain unchanged, but the market data changes to the next day's data. This P&L excludes 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 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 (see graphs below). The outlier for KBC Bank AIM, and the two outliers at ČSOB Czech Republic AIM in June, 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.

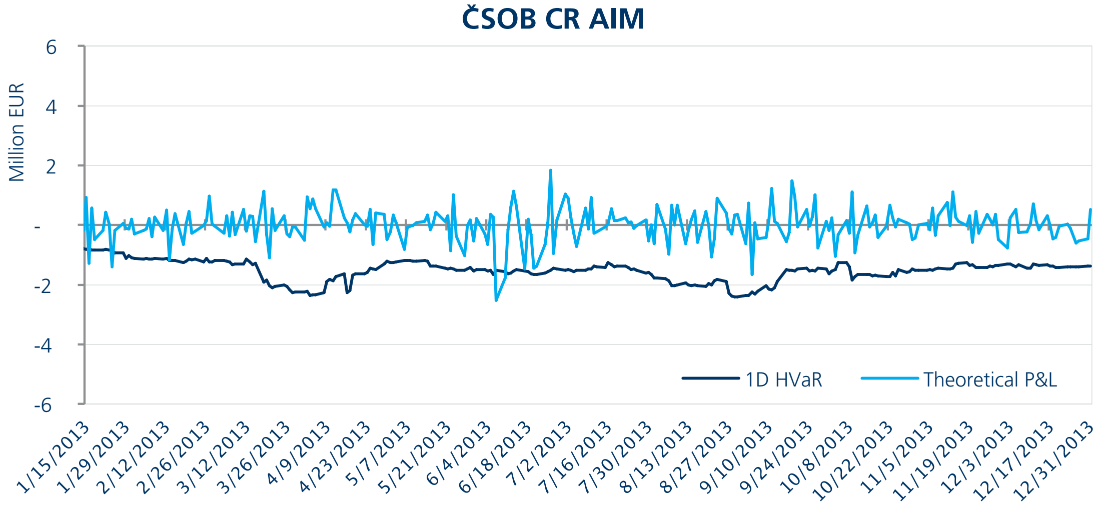
	KBC Bank AIM	KBC FP AIM	ČSOB CR AIM
Number of outliers for theoretical back-testing of the Approved Internal Models of the KBC group			
2012	1	2	2
2013	1	0	4

Graphs comparing the 1-day HVaR with the daily theoretical P&L results during 2013 at AIM level:





* The figures for six 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: four were related to quarterly bookings and two were due to bookings that relate to multi-day movements. For these six dates, the average is taken of the previous and next data point.



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 cash flow 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 are summarised in Note 24 of the 2013 Annual Report for 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 CDO Revaluation Policy, 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, input parameters) or deviations from group policies for financial instruments measured at fair value. The GVC consists of members of the Group Finance, Risk Markets IPF, and Middle Office units.

Operational Risk Management

Operational risk is the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events. Operational risks include the risk of fraud, and legal, compliance and tax risks.

This definition is similar to 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 2013 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. This framework was redesigned in 2012 in line with the KBC Risk Management Framework and will gradually be implemented (with full implementation in 2015).

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 value and 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 will gradually replace 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.

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 ARC Committee.
- *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.

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 2013 Annual Report of KBC Group NV (see www.kbc.com).

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 847 million euros at the end of 2013, compared with 884 million euros at the end of 2012.

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

Other non-financial risks

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.

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 customers, 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, in line with 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 the operational risk governance. Via the local value and 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 natural catastrophe, 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 Brandherverzekering, Sepia, KBC Group Re, K&H Insurance, ČSOB Pojišt'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 natural hazards. This model measures most material natural catastrophe risks for all group insurance and reinsurance companies, with account being taken of outward reinsurance (external and intra group). 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 Integration & Support Directorate regularly carries out in-depth studies. 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, 'Liability Adequacy Tests' (LAT) that meet local and IFRS requirements are conducted by the various group companies for the life technical provisions. Calculations are made using prospective methods (cashflow projections that take account of lapse rates and a discount rate that is set for each insurance entity based on local macroeconomic conditions and regulations), and extra market-value margins are built in to deal with the factor of uncertainty in a number of parameters.

Since no deficiencies were recorded by year-end 2013, 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 Pojišťovna (Czech Republic), ČSOB Poisťovňa (Slovakia, from financial year 2008), DZI Insurance (from financial year 2008), K&H Insurance and KBC Group Re (from financial year 2005). All provisions for claims to be paid at the close of 2013 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 2013.

Loss triangles, KBC Insurance (in millions of EUR)	Year of occurrence 2004	Year of occurrence 2005[1]	Year of occurrence 2006	Year of occurrence 2007	Year of occurrence 2008[2]	Year of occurrence 2009	Year of occurrence 2010	Year of occurrence 2011	Year of occurrence 2012	Year of occurrence 2013
Estimate at the end of the year of occurrence	547	578	631	686	793	824	871	806	849	917
1 year later	483	506	537	621	757	724	773	714	743	-
2 years later	454	484	511	588	728	668	725	656	-	-
3 years later	448	483	500	567	714	652	720	-	-	-
4 years later	444	474	486	561	710	635	-	-	-	-
5 years later	445	461	478	557	702	-	-	-	-	-
6 years later	441	462	464	550	-	-	-	-	-	-
7 years later	433	458	458	-	-	-	-	-	-	-
8 years later	431	454	-	-	-	-	-	-	-	-
9 years later	427	-	-	-	-	-	-	-	-	-
Current estimate	427	454	458	550	702	635	720	656	743	917
Cumulative payments	376	377	398	464	589	515	588	495	484	347
Current provisions	51	77	60	86	113	119	133	161	259	570

1 From financial year 2005, KBC Group Re's figures have been included. If these figures had not been taken into account, the following amounts would have been arrived at for financial year 2005 (amount and year of occurrence): 455 for 2004.

2 From financial year 2008, the figures for ČSOB Poisťovňa (Slovak Republic) and DZI Insurance (Bulgaria) have been included. If these figures had not been taken into account, the following amounts would have been arrived at for financial year 2008 (amount and year of occurrence): 432 for 2004; 453 for 2005; 485 for 2006; and 573 for 2007.

Stress testing and scenario analysis

In 2012, the sensitivity of technical insurance risks to extreme events was analysed in a number of ways, including the IMF stress test. The purpose of these tests was to identify and quantify the impact of different stress scenarios on the financial position of the insurance group and included catastrophic and severe insurance events for both the life (e.g., mass lapse shock) and non-life insurance businesses (e.g., Maximum Probable Loss for either a natural or man-made catastrophe event, whichever is largest).

In addition to the regulatory required stress tests, we perform internal stress tests. For the non-life business, KBC's internal natural catastrophe models are able to estimate the anticipated claim costs, should natural catastrophes that have been observed in the past occur again today. Moreover, they can determine the expected impact on bottom-line economic profit of natural catastrophe events, which are expected to occur on average only once within a given time frame (e.g., 100 or 250 years).

For the life insurance business, a sensitivity analysis is typically performed within the framework of the annual calculation of the market consistent embedded value. The results for three types of sensitivity to insurance risk are reported, viz. 'mortality rate: plus and minus 5%', 'lapses: plus and minus 10%', 'expenses: plus and minus 10%'.

Other stress testing exercises are performed on an *ad hoc* basis.

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 we 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 2013 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.

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, 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, people and systems or from sudden man-made or natural external events. 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 (1) allocating capital and (2) 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

[tier-1 capital] / [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.

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