First Report to Society

May 2012

Society's confidence in the financial sector took a serious blow in 2008. At KBC, we are determined to win back that confidence through our words and deeds, and we hope this report will be another first step in that direction.

Table of contents


Emportez KBC partout.
• Mobile Banking : transactions bancaires de base toujours et partout
• Assistance : assistance rapide en cas d'accident ou de panne
• Home Project : infos, tools et simulations pour votre projet d'habitation
• Permis de conduire : préparez-vous à l'examen théorique.
KBC. Nous parlons la même langue.
Téléchargez nos apps

Dear Reader,

It's our great pleasure to introduce you to our very first Report to Society. In general terms, this is a report in which we give a concise but clear summary of who we are, our contribution to society, our challenges and our goals. Most of all, we want this report to provide answers to the questions we most frequently receive from the general public.

2011 was another highly turbulent year on both the economic and financial fronts. The turmoil generated by the sovereign debt crisis, the uncertainty surrounding the euro, the falling stock markets and the deteriorating economic situation all had a significant impact on our results. Even so, we ended the year in profit, albeit a very modest one.

More importantly, we made decisive progress in implementing our strategic plan, much of which has already been completed. The goal of this plan is to make us an even more focused, European player with a significantly lower risk profile. What is more, it includes the measures required to enable us to repay the aid provided by the Belgian State and the Flemish Region within a reasonable time frame. We began that process in early 2012, when we repaid 500 million euros of the loan (plus a penalty of 75 million euros) to the Belgian State.

However, KBC is interested in more than just the profit or loss for the previous quarter, or year. In our business operations we always endeavour to be mindful of our role in the economy and in society. We wish to make a positive contribution in all of the home markets where we operate. First and foremost, this involves granting loans to individuals and companies (including in difficult times) and supporting the local economies by using the funds entrusted to us by our customers judiciously and by paying our taxes meticulously. It is also reflected in the numerous initiatives taken in the past year with regard to our involvement in the community and fostering a better environment.

We are a company of people for people, backed by our reference shareholders, who share our long-term vision and opt for sustainability.

Once you have read this report, we hope you will be surprised at everything KBC is and can be, that you feel good about considering or choosing us as your partner, investment or employer, and that as a taxpayer you know that we intend to repay our debt to the government in full, and with interest. We will show you what KBC achieved in 2011 and share our plans for the future. And we hope that you will get to know and understand us better. Although we are good in many areas, we know that there is always room for improvement. We are aware of our responsibility as the only remaining major, independent bancassurer in our home country, Belgium.

Society's confidence in the financial sector took a serious blow in 2008. At KBC, we are determined to win back that confidence through our words and deeds, and we hope this report will be another step in that direction.

Thomas Leysen   Johan Thijs   Jan Vanhevel

1 KBC IN A NUTSHELL

We believe that as a bancassurer, we are an important part of the social and economic fabric and must be a driver for creating prosperity. We therefore believe it is essential to take a truly central role in society and make a difference by being easily accessible to our customers. We want to understand what is important to our customers and how we can help them achieve their goals.

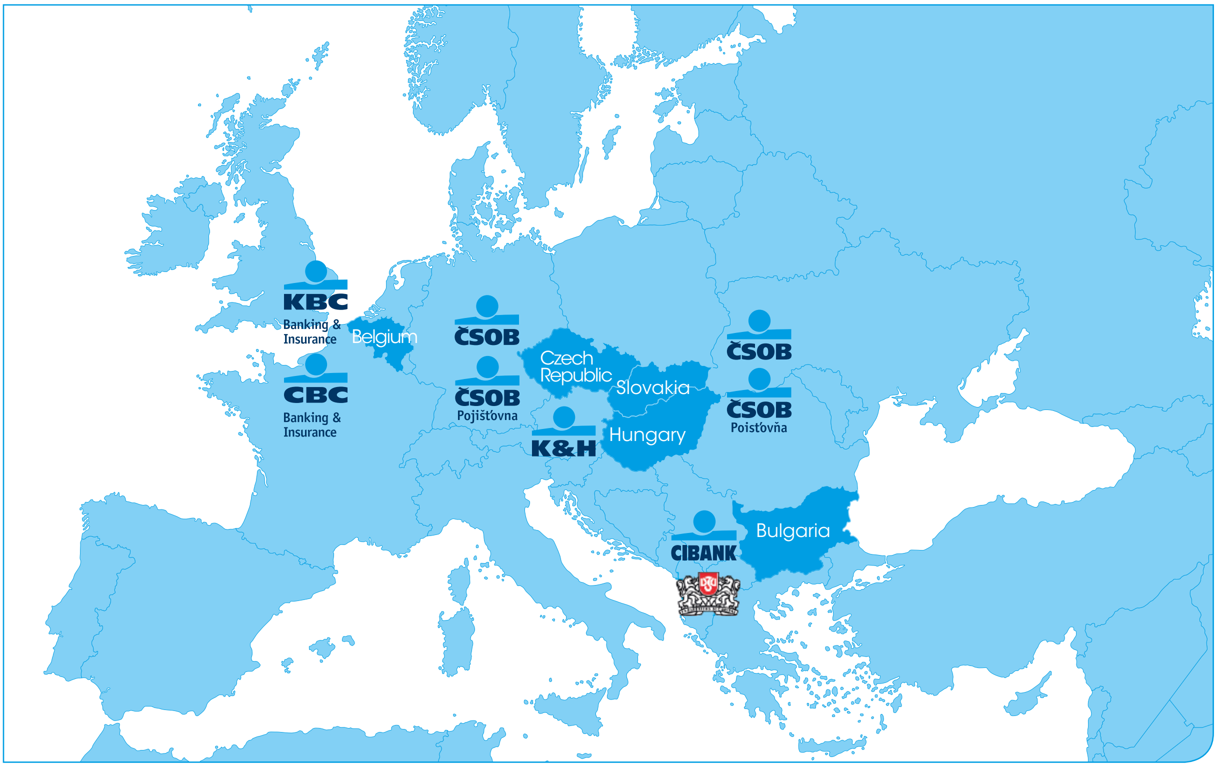
Consequently, we do not have a product-driven approach but an approach that is tailored to our customers' needs. We have developed extensive networks on all of our home markets, where competent staff take the time to get to know their customers and provide appropriate solutions based on a comprehensive, innovative range of banking and insurance products.

KBC is an integrated bancassurer

- with banking and insurance products and services best geared to one another because they are offered together in a single network, and banking and insurance businesses that are run by the same management team;
- with a focus on individuals, small and medium-sized enterprises (SMEs) and large companies;
- with a focus on the home markets of Belgium, the Czech Republic, Slovakia, Hungary and Bulgaria;
- with an international network that exists to serve our home-market customers;
- with a differentiated approach for each country and market, which is geared to the customers in the country or market concerned;
- which strives to achieve the highest level of efficiency within the group through considered choices between local and centralised solutions;
- where the distribution channels (bank branches and insurance agencies) and product developers (asset management, lease, payments, consumer finance) work together seamlessly using a partnership model;
- that uses its available capital responsibly within the limits of an overall, conservative risk profile.

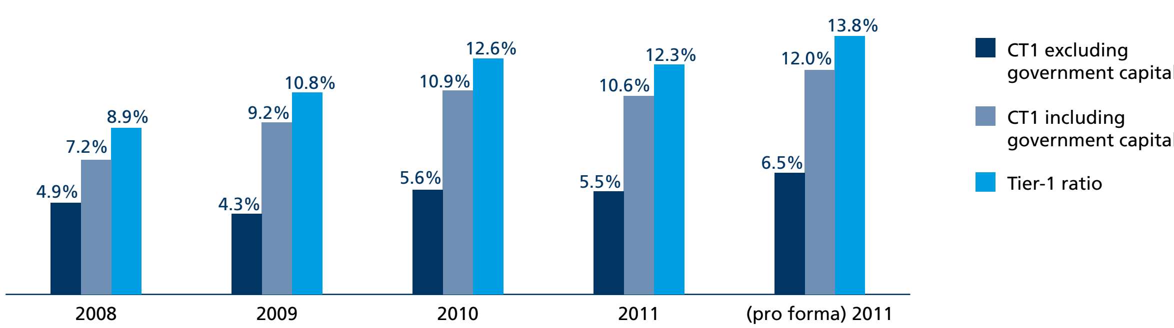
KBC group key figures (as at 31 December 2011)

Number of customers (estimates for Belgium and CEE-4, which consists of the Czech Republic, Bulgaria, Hungary and Slovakia)	9 million
Staff in FTE (full-time equivalent)	47 530
Number of bank branches in Belgium	844
Number of bank branches in CEE-4	806
Insurance network in Belgium	492 (tied agencies)
Insurance network in CEE-4	Various distribution channels
Underlying result	1.1 billion euros
Net result (i.e. underlying result excluding exceptional items)	13 million euros
Loans and advances to customers	138 billion euros



This map shows the home markets where KBC is developing its bancassurance activities. Elsewhere, the group has a selective presence in specific countries and regions, such as France, the Netherlands, Germany, the UK, the United States, China, Hong Kong and Singapore.

Comfortable capital base



Further information on the tier-1 ratio is given in the boxed text in Chapter 4 of this report.

CT1 stands for core tier-1 capital ratio.
The pro forma CT1 ratios for 2011 allow for the impact of the divestments for which an agreement has already been signed.

2 HOW IS KBC REPAYING ITS DEBTS TO THE GOVERNMENTS?

KBC's survival as an independent financial group during the severe financial crisis in recent years is due to a large extent to the aid received in various phases from the Belgian Federal and Flemish Regional governments. Through recapitalisation operations involving loans totalling 7 billion euros – with each government contributing 3.5 billion euros – they helped ensure that KBC could have the sound capital base required.

Jan Vanhevel, former CEO and President of the Executive Committee of KBC Group

We are very grateful to the Belgian and Flemish governments and, therefore, to Belgian taxpayers for this assistance. We will do all we can to duly repay the loans received in accordance with the deadlines and conditions agreed with the European Commission. The aim is still to repay 4.7 billion euros (principal, plus penalties on top of this amount) by the end of 2013, as set out in the plan agreed with the Commission.

We repaid a first tranche of 500 million euros (plus a penalty of 75 million euros) at the beginning of this year, and intend to make further repayments to the Federal government in 2012. The exact timing and amount of repayments will depend on the market conditions and the advice and approval of the supervisory authority. Our primary goal is to ensure that we maintain a strong capital base at all times. Subsequently we will also repay the aid received from the Flemish Regional government. KBC is a group that intends to continue under its own steam.

KBC pays **annual interest of 8.5%** on the principal of the loans (7 billion euros) in years when it also pays a dividend. **In 2011,** KBC paid a total of **595 million euros** in interest to the Belgian Federal and Flemish Regional governments.

KBC has agreed with the European Commission – which had to grant its approval of the recapitalisation operations (loans) of the governments – that a **penalty** of between 15% and 50% will be paid to the Federal government (depending on when repayment is made) and of 50% to the Flemish Regional government, on top of the interest. The aim of the penalty is to provide the governments, and indirectly taxpayers, with a fair remuneration for the risk assumed. **For the 7 billion euros loaned to KBC, the governments will therefore ultimately be repaid between a minimum of 9.3 billion euros and a maximum of 10.5 billion euros, depending on the repayment term, with an additional amount of more than 2 billion euros in interest.** This means that KBC is paying a high price for the aid received.

On top of this, KBC also paid 145 million euros in bank taxes in its various home markets in 2011.

In the past, KBC was involved in the structured credit market (repackaged home or corporate loans, known as Collateralised Debt Obligations or CDOs) and itself invested in these structured credit products. Like many other financial institutions, KBC underestimated the risk associated with these products and their impact on its accounting results.

KBC took out insurance for various CDO transactions with MBIA, an American reinsurer. However, MBIA announced a restructuring plan in early 2009, which seriously dented its creditworthiness. KBC then entered into a **guarantee agreement with the Federal government** in order to obtain additional protection for a large part of its structured loan portfolio. This agreement significantly mitigates the potential negative impact of the MBIA and CDO exposure. Since May 2009, KBC has paid premiums of 852 million euros to the government for these guarantee arrangements. Nevertheless, our results remain volatile due to factors such as rising or falling market values. In the meantime, we continue to reduce our exposure to CDOs and structured loans (from some 20 billion euros – notional amount in 2009 for CDOs covered by the CDO guarantee agreement – to around 13.9 billion euros at the beginning of 2012), which has also meant a significant reduction in the risk for the government and taxpayers.

To enable us to repay the government aid within a reasonable time frame and at the conditions described above, we have drafted a strategic restructuring plan that has been approved by the European Commission. Lessons learned from the past have been incorporated in this plan through the systematic reduction of the riskiest business lines.

KBC's European Plan

The plan should enable KBC to duly repay the governments (principal, interest and penalties), as well as ensuring that it remains an independent and sound financial group. That means that KBC offers its customers a competitive range of products and services and generates added value for its staff, shareholders and society. In addition, KBC wishes to maintain a capital buffer at all times that is large enough to satisfy the more rigorous capital requirements imposed by the regulators on all financial institutions to counter any future shocks.

KBC is fully focused on implementing the plan and freeing up capital by:

- focusing as much as possible on generating sustainable profits on the core activities that were always its strength, namely providing bancassurance services for retail, SME and mid-cap customers in the home markets of Belgium and Central Europe (the Czech Republic, Slovakia, Hungary and Bulgaria).

- divesting and/or scaling down various entities, subsidiaries and non-core activities in non-core markets. In the past two and a half years, KBC has already made considerable progress in this area (see summary on the next page);

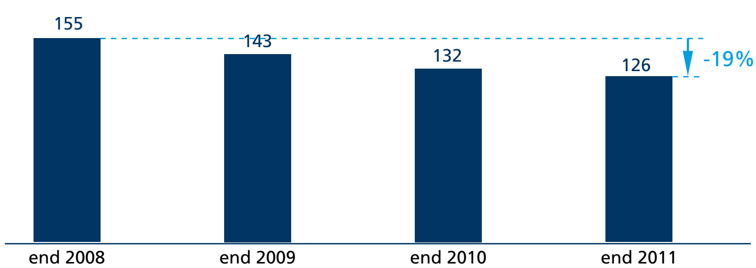
- reducing its risk profile considerably. For instance, the portfolio of CDOs (structured loans and complex products which put the group in difficulties) has been substantially reduced or sold and the portfolio of outstanding government bonds involving riskier Southern European countries has been reduced.

Simplified summary of implementation of the divestment programme

Project	Detailed information
Sale of complementary distribution channels in Belgium	Centea sold mid-2011. Agreement for the sale of Fidea signed in October 2011.
Sale, termination or run-down of various specialised non-core activities (chiefly investment banking)	Sold in 2010: Secura, KBC Peel Hunt, KBC Securities Baltic Investment Company, KBC Asset Management's British and Irish operations, KBC Business Capital, many of KBC Financial Products' activities. Sold in 2011 and at the start of 2012: stake in KBC Concord Asset Management (Taiwan) and in KBC Goldstate (China), KBC Securities' Romanian and Serbian operations. Awaiting divestment: Antwerp Diamond Bank, KBC Bank Deutschland and a number of other activities.
Run-down of a significant proportion of the loan portfolios outside the home markets	Largely completed. The risk-weighted assets of the corporate banking operations have been reduced by more than 9 billion euros in the space of two years.
Sale of the European private banking network	Agreement for the sale of KBL EPB reached in October 2011.
Divestment of Polish subsidiaries Kredyt Bank and WARTA	Beginning of 2012: agreement was reached for the sale of WARTA. End of February 2012: announcement that KBC had concluded an agreement with Banco Santander with regard to the merger of the two groups' respective Polish subsidiaries, Bank Zachodni WBK and Kredyt Bank. KBC ultimately aims to sell its stake in the merged bank.
Sale of the activities in Russia, Serbia and Slovenia	Planned for 2012/2013.
Sale or run-down of certain CDO and ABS assets	CDO and ABS exposure reduced by a nominal amount of almost 10 billion euros since the end of 2009, ahead of the figure set out in the plan.

The graph below shows the reduction in the KBC group's risks through the risk-weighted assets (RWA). This reduction in the RWA relates primarily to the divestments, scaling down of activities and reduction of the international loan portfolio already implemented, without implying a decrease in lending on the group's home markets (Belgium, the Czech Republic, Hungary, Bulgaria and Slovakia), which went up by 5.2% between the end of 2009 and the end of 2011. This trend was also influenced by other factors, including changes in the activities to be retained and the impact of new regulations (CRD III, etc.).

Changes in the group's RWA (Basel II, in billions of EUR)



The principal divestments still to be carried out concern Absolut Bank (Russia), KBC Banka (Serbia), NLB Vita and the minority interest in Nova Ljubljanska banka (Slovenia), Antwerp Diamond Bank (Belgium), KBC Bank Deutschland (Germany) and a number of other activities (private equity, property development). Preparatory work has already started for most of these projects, and some are in the process of implementation.

Once this plan has been implemented, KBC will be a slimmed-down but more focused European bancassurer with a lower risk profile. KBC will continue to build on its past strengths, more particularly the successful bancassurance model for individuals, the self-employed, members of the liberal professions, local businesses, SMEs and larger companies, and its presence in its five home markets of Belgium, the Czech Republic, Slovakia, Hungary and Bulgaria.

3 HOW DOES KBC FINANCE THE ECONOMY?

Luc Gijsens, CEO of the Merchant Banking Business Unit and member of the Executive Committee of KBC Group

We have not changed our rules for granting credit in the last few years. Nor have we applied the existing rules any differently. The rules were drafted in such a way that they can be implemented in both good and bad economic times. In percentage terms, the number of loans refused by the credit committees has therefore not increased. However, in 2011, the existing rules take account of the crisis and the difficult economic situation. Indeed, a fair, responsible and sustainable credit policy is also in the interests of our customers. A loan that feels like a burden rather than a help is a bad thing for the customer and KBC alike.

We are fully aware that we have an important economic role to play on our home markets. We therefore ensure that there is always sufficient capital available to maintain lending in our five core markets at an adequate level, and even increase it in difficult economic times. There is always capital available to fund sound business plans and projects, as the figures illustrate.

Stories often appear about banks tightening up on lending, imposing more stringent conditions on granting loans and increasing the cost of credit.

Lending is a highly capital-intensive business for financial institutions. Banks have to reserve part of their capital for every euro lent to customers to fund their projects or day-to-day business. The precise amount depends on factors such as the risk the loan involves. As a rule of thumb: the greater the risk, the higher the amount of capital that must be earmarked. As a result of the increasingly stringent international regulations, banks have to set aside greater amounts of capital for certain loans, which means they sometimes have to be more selective. But customers, too, have become more cautious about taking out credit, due no doubt to the uncertain economic situation.

Loans to customers	**2010** (in billions of EUR)	**2011** (in billions of EUR)	
Group	141.2	136.9	-3.1%
Belgium	52.0	55.3	+6.3%
CEE home markets	24.9	25.6	+2.8%
Merchant Banking	42.8	42.4	-0.8%

Figures do not include reverse repos and, for Belgium and the Central and Eastern European home markets, exclude divestments and exchange-rate differences.

Firstly, there is a decrease in lending at group level and in corporate banking as a result of the implementation of the strategic plan agreed with the European Commission:

- divestment (as part of the implementation of the strategic plan agreed with the European Commission) of, for instance, Centea in Belgium and Kredyt Bank in Poland;
- the pronounced, deliberate reduction in lending to foreign companies in non-core markets in order to focus more on lending to corporate customers from the home markets;
- lower demand for loans due to the difficult macroeconomic situation. Because of this, many households and companies are putting off planned investments and focusing more on saving.

Secondly, these figures confirm KBC's renewed focus on its home markets. In difficult economic circumstances, lending in Belgium, the Czech Republic, Slovakia, Hungary and Bulgaria was actually higher in 2011 than in 2010.

In countries such as Hungary and Ireland, where the economies are really struggling, KBC therefore assumed its responsibility by making a significant contribution to the government initiatives to help reduce the debt burden of individuals.

As well as lending to individuals and companies, KBC also finances the government:

- through investing in government bonds. At the end of 2011, KBC had reinvested almost 23 billion euros' worth of deposits not used for lending and insurance reserves in Belgian government bonds. In this way, KBC helps fund Belgium's sovereign debt.
- by making its network of branches and staff available during the successful sale of state notes in Belgium. In December 2011, KBC Bank and CBC Banque sold an aggregate of almost one billion euros' worth of state notes, which was another way of helping fund Belgium's sovereign debt.
- or directly through projects. For instance, as a major Belgian bank, KBC is increasingly involved in Public Private Initiatives (PPI). Examples include participation in the construction of the world's biggest lock, the Deurganckdok lock in Antwerp, and a number of medium-sized projects, such as the building of regional road links. KBC was also previously involved in similar PPIs to fund the construction of schools in the Flemish and German-speaking communities in Belgium.
- Recently KBC Insurance (together with a number of other insurance companies) also entered into insurance contracts with the Flemish community for liability and property cover for a period of three years. The Flemish community enterprises concerned include De Lijn, UZ Gent, VRT and Syntra.

The Deurganckdok lock will improve access to the docks on the left bank of the river Scheldt in Antwerp. It will be equal in size to the existing Berendrecht lock – currently the world's largest – but the new lock will be deeper. KBC is jointly funding its construction.

4 WHAT HAS CHANGED SINCE THE FINANCIAL CRISIS?

It has often been said that banks have still not learned their lesson, even after the recent crisis, giving the impression that they are continuing just as they were before. But that is far from the reality.

First and foremost, in direct response to the crisis, regulation and supervision of the financial sector have been tightened up very considerably in the last few years. Supervisory authorities everywhere have, quite rightly, become much more demanding – think, for instance, of the MiFID rules to protect investors or the Foreign Account Tax Compliance Act whereby European banks are obliged to provide the US tax authorities with financial information on US citizens who are their customers – and controls are more stringent and more frequent.

Secondly, financial institutions are required to keep a much larger capital buffer than ever before (Basel capital requirements for banks and Solvency II capital adequacy tests for insurers). These requirements, rules and controls have had a fundamental impact on the organisation and operations of financial institutions. The number of controls by the supervisory authorities is now therefore many times greater than a few years ago.

Basel II – tier 1, liquidity and capital adequacy

KBC is one of the stronger European financial groups in terms of its liquidity. This is due to factors such as its strong customer deposit base. Thanks in part to government assistance, KBC now also has a comfortable solvency position and a strong tier-1 capital ratio of 12.3% at group level at the end of 2011.

Although this is perfectly clear to financial analysts, you may want to know what this means exactly and why KBC scores well in this respect.

Basically, **liquidity** provides an idea of the resources a company has at its disposal (in the short term) to cover its accounts and day-to-day operation. Thanks to the amounts that millions of individuals and business customers have deposited with the bank in Belgium and its other home markets, KBC has a sound loan-to-deposit (LTD) ratio of 94. That means that the group holds more in deposits than it grants in loans. KBC therefore has much less need than some of its competitors to seek out day-to-day funding (on the financial markets).

A financial institution's **capital adequacy** refers to the ratio between its equity and its risk-weighted assets (RWA). The higher the company's equity in relation to its RWA, the stronger its capital adequacy (solvency). Outside investors tend to have more confidence in banks with a healthy ratio of assets to the risks taken with regard to those assets.

Basel II is a set of rules based on three pillars. The principal pillar sets a minimum capital requirement (in relation to the risks: credit, operational and market) that a financial institution must satisfy. Each risk is assigned a particular weighting and the quantity of capital that must be maintained depends on that weighting. The minimum capital required according to Basel II is 8% of the total risk-weighted assets and the tier-1 capital must account for at least half of that.

A new set of even more stringent rules – Basel III – is to come into effect soon, but KBC is prepared for this, too.

What Basel III will be for banks, **Solvency II** is for insurers. Solvency II is the new regulatory solvency framework for all insurance and reinsurance companies in the European Union. Whereas the current solvency requirements for insurers (Solvency I) are based on volume, Solvency II is based on risks. The intention is to introduce solvency requirements that better reflect corporate risks and a uniform control system for all EU member states. The precise date for implementation is not yet known.

Legislation, statutory requirements, Basel III standards/capital requirements and robust capital buffers are of prime importance, because they provide the framework in which KBC develops its business. But equally important is how KBC as a company itself deals with risks and what lessons it has learned from the past.

How does KBC incorporate risk management in its operations?

Managing risks is at the heart of what we do to serve our customers and create value for all our stakeholders. Customers look to KBC to join with them as they seek to invest and build for the future, for example, by helping families invest in a home or helping businesses expand and grow. Customers also look to KBC to provide protection for risks they face, for example, by providing insurance for property or by helping to manage savings for the future.

Given the uncertainty and complexity of the Global Economy, and its impact on customers, we need to ensure that we have a comprehensive and effective approach to risk management. We do this through a dedicated and expert risk function which supports the business leaders centrally and locally. By this means we aim to equip and inspire all colleagues to serve their customers in a risk aware manner.

Important in this process is to clearly identify and measure the risks which need to be managed. These risks include the ability of customers to repay loans, movements in interest rates and exchange rates, changes in the value of shares and investments, ensuring we always have resources to meet the needs of our customers, maintaining systems which execute customer requests promptly, safely and accurately, the various risks faced by our customers for which they look to us for protection, changing economic conditions, changing legal and regulatory requirements.

In seeking to identify and measure these risks we draw heavily on our experience in the past. Modern technology enables us to do this with increasing accuracy. Yet we also know that the past is not always the key to the future. Therefore we need to identify new trends and to model what impact these may have on our own operations and on our customers. This forward looking approach is increasingly important in the fast changing Global Economy.

The risk function has the prime responsibility for identifying and measuring risks. The business colleagues at all levels have the prime responsibility for managing these risks, supported and equipped by the risk function. This process begins by defining in advance what is our appetite for risk. The Board of Directors approves annually a risk appetite statement which is proposed by the Executive Committee and advised by the Audit Risk and Compliance Committee.

Based on this risk appetite statement, the Executive Committee defines limit frameworks within which the business operates and which form the foundation of our planning process. It is important that these frameworks are comprehensive and well understood by all colleagues. The risk function and the compliance function monitor these frameworks and report on exposure within these frameworks. The audit function monitors the effectiveness of these frameworks and of the internal control system as a whole.

John Hollows, Chief Risk Officer and member of the Executive Committee of KBC Group

In the past two years we have rebuilt our risk function with support from consultants and with reference to industry best practice. We have built, and will continue to build, an expert team which is technically competent and practically effective in helping our business colleagues to be accountable for, expert in and driven by risk-adjusted performance. Our vision is a group which succeeds in creating sustainable value for all its stakeholders by serving its customers and avoiding excessive volatility in its results. This is an inspiring vision for us. Our aim is not to do less in the future. We intend to constantly develop our expertise, including in the area of risk management. I am pleased to report that we have the full encouragement and engagement of our business colleagues in this regard. Accordingly I never say that I am the 'risk manager' in our group. We have 47 000 'risk managers' in our group who are committed to the risk agenda.

Risk management is a topical issue in the financial sector. So much so that the University of Antwerp and KBC have teamed up to establish the **KBC Chair in Risk Management**, which started in February 2011.

KBC focuses attention on financial education, both in Belgium and its other home markets. In Belgium, we provide financial education packages free of charge to teachers and pupils in primary and secondary schools. Our businesses in the Czech Republic also run projects promoting financial education. And in Hungary, K&H Bank organises 'K&H Ready, Steady, Money', a nationwide competition to test students' financial knowledge.

KBC intends to allocate even more resources to, and focus more attention on, financial education and improved information going forward. Because it is in our interest, as much as that of our customers, that more people reach a higher level of financial literacy, that they are better informed and better equipped to assess the opportunities and risks and to identify and understand which financial products and services they need to satisfy their requirements.

In addition, the 'New and Active Product Process' establishes a smooth, but robust and transparent, process for approving new products and (regularly) reviewing existing products, whereby commercial issues are balanced against risk and operational issues.

Sound risk management is essential for a financial institution. However, as John Hollows has pointed out, this does not mean that all risks can be excluded. Every type of investment inherently involves a certain level of risk.

5 HOW DOES KBC GO ABOUT SOCIALLY RESPONSIBLE INVESTMENT (SRI)?

What is the External Advisory Board for Sustainability Analysis?

The External Advisory Board for Sustainability Analysis oversees the screening of the socially responsible nature of the SRI funds offered by KBC Asset Management. The Board is made up of a number of academics, all of whom are experts in their field, which may be human rights, the environment or business ethics.

This Board:

- approves the methodology and approach for assessing and selecting issuers used by KBC Asset Management;
- approves the themes, criteria and sub-indicators upon which the sustainability analysis is based, concerning both the countries and the companies;
- indicates the aspects and themes that are socially questionable and issues advice on these;
- verifies the exhaustiveness, thoroughness and accuracy of the results of the sustainability research;
- monitors the transparency policy concerning the approach to, and results of, the research;
- issues advice on compliance of the SRI funds with KBC Group's in-house sustainability policy.

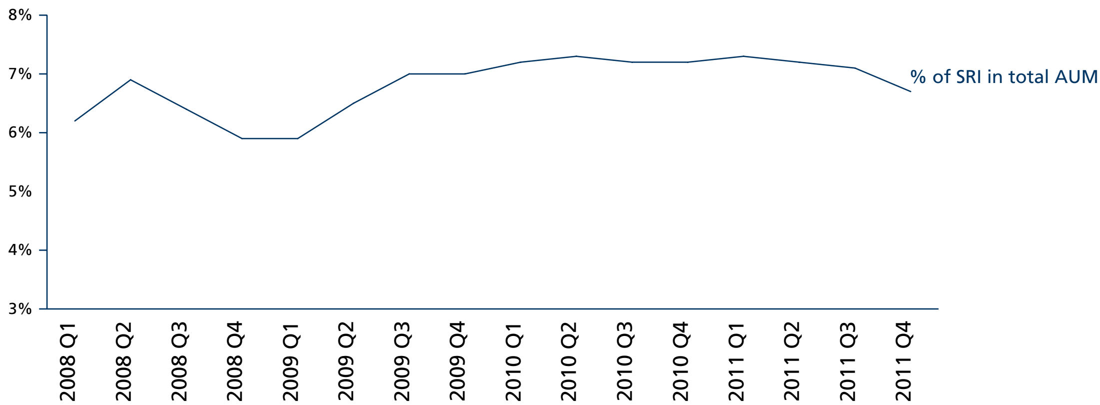
Details of the precise composition of the Board are available at **www.kbcam.be**.

An enterprise's social responsibility is judged not only on its conduct in the community, but also on the products and services it offers its customers. In addition to encouraging lending for sustainable projects, KBC also focuses on sustainable investment products, known as **Socially Responsible Investments (SRI)**. KBC has developed an extensive range of SRI products since 2002, which it offers to customers with the most diverse investor profiles.

KBC stands out from its competitors with its transparent approach in terms of definitions, screening criteria and results. For instance, the website (www.kbcam.be) of KBC Asset Management, the group's asset manager, shows the sustainability scores of more than 2 000 listed companies. KBC Asset Management's range of investments includes shares, bonds and balanced funds. Sustainable equity funds include specific sustainable themes (e.g. Eco Funds) and global, best-in-class funds. These funds aim to provide a return consistent with the market return within the strict sustainability framework set by the External Advisory Board for Sustainability Analysis.

The take-up of SRI equity funds with capital protection was far lower in 2011 than in previous years, due to the more negative investment climate and poor market conditions. In spite of this, KBC remains a leading provider of SRI products in Belgium, with a market share of more than 60% (5.6 billion euros' worth of assets under management). We believe in the potential of SRI and do not see this as a passing trend, but as a long-term strategy offering a genuine combination of return and sustainability.

Share of SRI funds in KBC AM's* total assets under management (AUM)



* KBC Asset Management is the asset manager of the KBC group.

Eric Tollens,
Prof. Em. Dr. Ir. KU Leuven and Chairman of the External Advisory Board

At the beginning of 2012, the KBC Group Executive Committee decided that the External Advisory Board for Sustainability Analysis should no longer only advise KBC Asset Management. It will in future provide advice and support for the whole KBC group with its group-wide sustainability policy. The intention is to better embed SRI in KBC's overall strategy and operations.

6 WHAT WERE KBC'S RESULTS IN 2011?

2011 was a highly turbulent year on both the economic and financial fronts. The turmoil concerning the sovereign debt crisis, uncertainty about the euro, significant fluctuations on the financial markets and the fall in the prices of many financial stocks (including KBC's share) and the worsening economic situation had a major impact, including on KBC's results.

Which exceptional items affected the results?

Some examples:

- **Results on divestments.** The price obtained when selling or running down certain activities may be lower or higher than the value in the group's accounts. KBC may accordingly record a gain or loss. In 2011, this entailed a loss on the sale of KBL EPB and Fidea (-640 million euros).
- **Gains/losses relating to CDOs.** KBC's structured credit portfolio is actively managed and recorded in the accounts at the prevailing market price. As a result, the market value of these instruments may change from one moment to another (-416 million euros in 2011).

The group closed 2011 with a small profit of 13 million euros, which was well down on the figure for 2010. This profit was the result of a combination of reasonably good results from our profitable, sound *bancassurance* business on our home markets and a number of negative, but exceptional, non-recurring items. The underlying result from the *bancassurance* business in 2011 came to 1.1 billion euros, with a good return on capital employed of 27% for retail activities in Belgium and 11% for the Central and Eastern European retail and corporate activities. The underlying results were affected by sizeable amounts being written down on our Greek government bonds and a guarantee given to our customers with regard to financial instruments associated with Greece. Write-downs on problem loans in Hungary and Ireland are also included in the underlying result of 1.1 billion euros. Losses on the sale of a number of assets disposed of or reduced as part of the European Plan, losses on CDOs and specific write-downs on our portfolio of government bonds were the main items that further depressed the underlying result to 13 million euros.

Luc Popelier, Chief Financial Officer and member of the Executive Committee of KBC Group

Considering the volatile external factors and the fact that we had to further the implementation of our European Plan in difficult circumstances, that is an acceptable result overall. The underlying profit of 1.1 billion euros also shows that our bancassurance business model is and remains sound. And a reasonable return also ensures we have the required capital. Were it not for the impact of Greece and the new Hungarian legislation on the repayment of foreign-currency home loans (as a result of which we had to post higher write-downs than normal on our loan portfolio), our underlying net profit would have been the same as in 2010.

In 2011, KBC won the **'Best Bank in Belgium'** award from **Global Finance** magazine. ČSOB won that award in the Czech Republic. K&H Bank, meanwhile, was named **'Bank of the Year in Hungary'** by **The Banker**.

The group's insurers also pick up awards on a regular basis. In Bulgaria, for instance, DZI was named 2011 **'Insurer of the Year'** for non-life insurance in a competition organised by the Higher School of Insurance and Finance, the Association of Bulgarian Insurers, the Bulgarian Association of Supplementary Pension Insurance Companies, and the Professor Veleslav Gavriiski Foundation. **World Finance** magazine awarded ČSOB Poist'ovňa the title of **'2011 Insurance Company of the Year'** in Slovakia.

KBC assumes its responsibility in 5-5-5 file

The 2011 results were also negatively affected because KBC decided, proactively and on its own initiative, to set aside funds to compensate customers who had invested in two bond issues offered by KBC a couple of years ago.

What is involved exactly?

In 2008, KBC issued bonds known as 5-5-5 bonds. The three fives refer to the product's main features, which were a link to the value of the government bonds of 5 countries (Belgium, France, Spain, Italy and Greece), the 5% gross coupon paid each year and the term of 5 years.

At the time of issue, all these countries enjoyed high credit ratings. Sovereign risks, certainly of established EU countries, were at the time generally assessed to be very low, and both bonds were recognised as defensive investments. As a result of the unforeseen, radical changes in market circumstances since early 2010 (the Greek crisis), the product's risk profile changed very suddenly in May 2010.

According to the products' terms and conditions, the issues would be repaid in full at maturity unless a credit event were to occur in one of the underlying countries. If that happened, the bonds would be repaid early at a price below the initially anticipated repayment value and no further coupons would be paid.

KBC worked out an arrangement for its private retail customers in early 2011, offering them the certainty that they would recoup the initial capital less coupons already received (before taxes and charges).

However, the protection mechanism was only to be triggered if a credit event occurred in one of the five countries concerned. An official credit event did indeed occur in Greece at the beginning of 2012, and KBC honoured the promise it had made in early 2011, compensating the customers concerned and bearing the vast majority of the losses on this investment.

Customers got back their entire initial investment because KBC paid them the difference between the sum of the early redemption price and coupons already received and the amount they had originally invested (before taxes and charges).

7 WHAT ABOUT KBC AND ITS EMPLOYEES?

Employees are the heart of the company

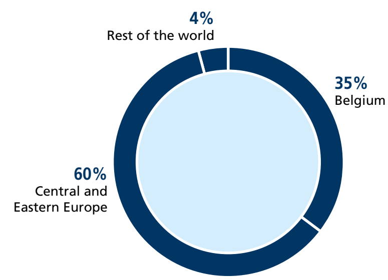
In order to provide its customers with the best possible service, KBC has a global **workforce of 47 530**. The average age of staff is 40. KBC employs more women than men (59% and 41% respectively of the total workforce).

Staff of different ages and generations work closely together within KBC. One of KBC's basic principles is that staff should be able to develop and stay their whole career within the group. Employee satisfaction is a major factor in this, both in attracting and retaining motivated staff.

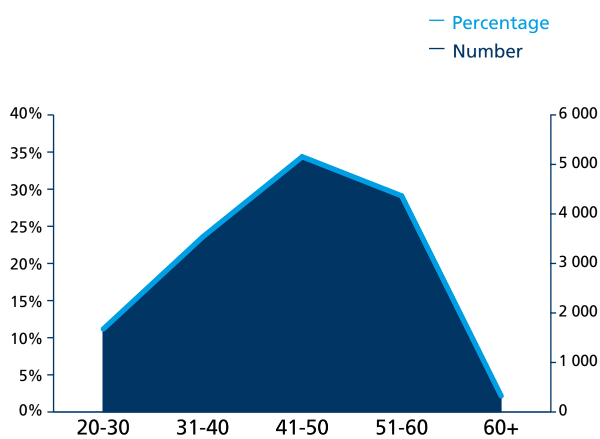
Employees are the heart of the company.

Breakdown of staff by region

(in full time equivalents, end of 2011)



Age pyramid of KBC employees in Belgium



BEST EMPLOYER BELGIUM 2006-2011

KBC was named as one of the ten **Best Employers in Belgium** in 2011 for the sixth year in a row. The survey on which this award is based is organised by the Great Place to Work® Institute, in collaboration with the Vlerick Leuven Gent Management School. The research is based on a survey of a group of 750 employees chosen at random and a file submitted by KBC. The survey assesses employees' perception of their relationship with management, their own job (pride and financial reward) and other employees.

KBC received the **Award for Lifelong Learning** for its educational programmes to enhance life-long learning within the company.

The group also runs its own annual employee satisfaction survey, and obtains very good scores. Specific actions are sometimes implemented based on the results. For example, a new appraisal and reward policy was recently introduced that takes account of remarks made during the survey.

Danny De Raymaeker,
Chief Operating Officer and member of the Executive Committee of KBC Group and Chairman of the Works Council

At KBC, we take pride in a strong consultation model between employer and employees. After all, we are partners with the same goal, which is to create added value for customers, shareholders, society and ourselves. This mutual respect and trust that has been built up over many years is one of the reasons why KBC and all our customers could count on the commitment and loyalty of our staff even during the crisis. KBC was one of the few companies that managed to avoid redundancies during the crisis, because all of our staff, regardless of grade, agreed to make their contribution and waive part of their pay to help KBC weather the storm. Even though staff have had to make sacrifices in the last few years they have remained loyal to the company. They have continued to work hard in order to return KBC to calmer waters. We are very grateful to them for that. And it was not always easy when they had to hear or read how the general public sometimes view the financial sector.

Good employees deserve due remuneration that keeps them motivated

KBC pays its staff, most of whom have followed higher education, in line with the Belgian market, and conducts comparative market studies at regular intervals to achieve this. The size of the company and the countries in which it is present are also factors in determining remuneration policy. What is more, KBC is the only large international financial institution that still has its decision-making centre in Belgium. That ensures stable employment.

KBC employees' total salary package is divided into a fixed salary (about 85% of the total salary) that is guaranteed and a variable component (about 15% of the total salary) that is linked to KBC's results and to performance objectives, where both the achievement of the objectives and the way in which they are achieved are important (team work, professional conduct, effort, keeping to arrangements, customer-friendliness and loyalty).

The variable component is genuinely variable, and is linked to both financial and sustainability goals. For instance, payment of part of the variable component for 2012 depends on a collective sustainability goal, i.e. changes in electricity consumption, CO_2 emissions (including the firm's own leased car fleet), heating oil consumption, paper consumption and the replacement of certain products by environmentally-friendly alternatives. If performance in these respects does not reach a predetermined standard, that portion of variable pay will not be paid for 2012.

If the business targets are not reached (for example, if there is no profit), the collective labour agreement for the sector in Belgium guarantees a minimum of the equivalent of a thirteenth month's salary (unlike most other Belgian companies, KBC does not pay a 'thirteenth month' per se). If the results are very poor, KBC employees will suffer significantly because there will be no profit-sharing bonus. During the crisis, in 2009, every employee took an average salary cut of 15% in exchange for job security.

The pay of senior management (top 400, excluding the group's Executive Committee) is also made up of a fixed and variable component, where the variable component may not exceed the fixed component. KBC is obliged to comply with the European CEBS guidelines, which mainly apply to staff that have a significant impact on the company (known as 'key identified staff'), for the variable component. When calculating the total remuneration package, the local market and specific market segments are always taken into account. It is generally true that the variable component of pay is (considerably) lower than previously, due to the financial crisis and KBC's weaker results.

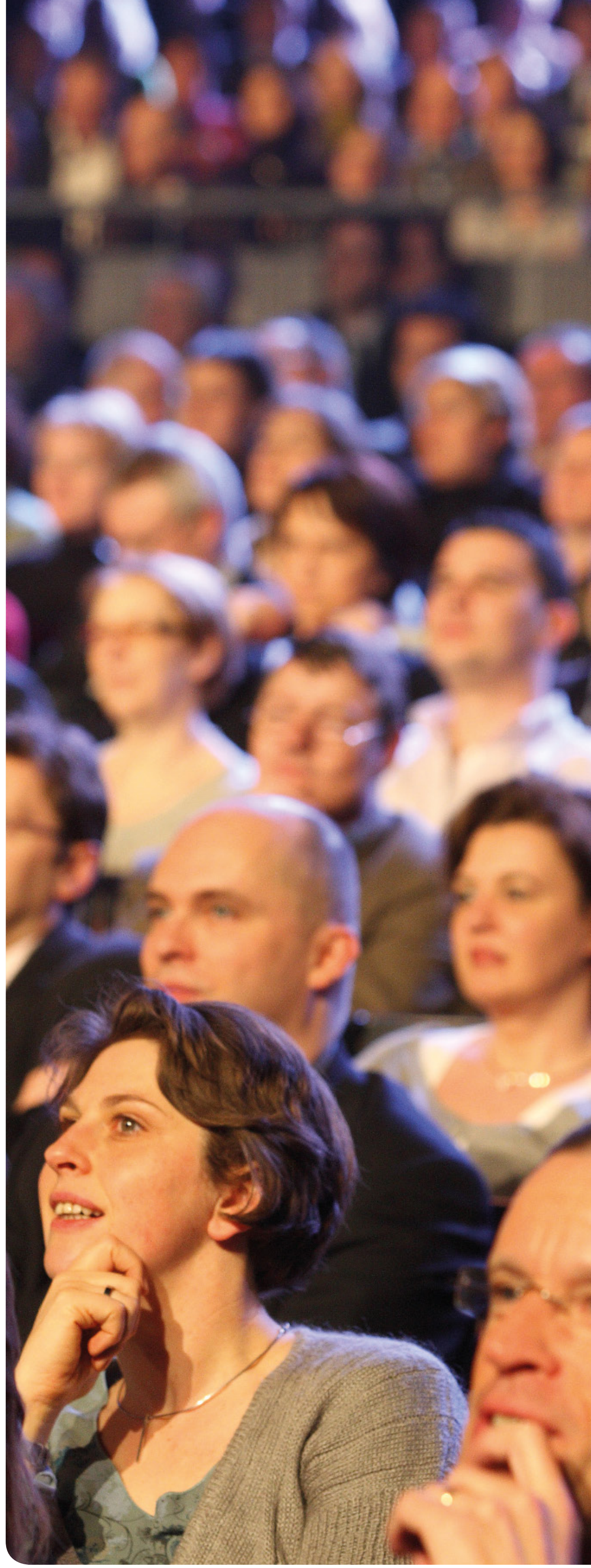
KBC is also aware of its employees' mobility problems. This is taken into account by projects such as the option of working locally and at home, free shuttle buses between train stations and head offices, car pooling schemes, use of bicycles and public transport, and a green car fleet. In this way, KBC ensures that all staff can at all times achieve the best possible balance between their working and private life.

KBC boasts a healthy balance of male and female employees, different nationalities and a huge range of skills. But there are still a number of challenges ahead, such as operating on an international scale, having different generations work together and better advancement of women to management positions. Although women account for more than 50% of the workforce, they only make up 14% of senior management (compared with 9% in 2006). Targeted campaigns aim to boost that figure to at least 25% by 2016. The present figures are 9% in Belgium and 19% in Central Europe.

In its staff regulations, its selection and promotion policy, as well as in its performance appraisal systems, the group does not make any distinction whatsoever on the grounds of gender, religion, ethnic background or sexual orientation. Equal treatment of employees is also addressed in the *KBC Code of Conduct* and in the various anti-discrimination manifestos and charters KBC has endorsed.

Dirk de Backere,
Secretary of the Works Council

KBC is a company with a strong consultation culture, something that is greatly appreciated by all the social partners. But there is still work to be done. Employees feel that KBC's traditionally strong corporate culture has been eroded somewhat in recent years. It is important that employees and employer return to joint consideration of our company's identity and what we wish to stand for. As far as Belgium is concerned, KBC being strong and independent, but with a central role in the community immediately springs to mind.



brs

Microfinancing and microinsurance in the southern hemisphere.

8 WHAT DOES KBC DO FOR THE ENVIRONMENT?

KBC attaches great importance to the social aspects of its business. This is evidenced, among other things, by the respect shown to customers and staff and various projects confirming its involvement with the community. KBC does not aim to be a company that stands above or alongside the community in which it operates, but at the very heart of that community. This means that the group's involvement goes well beyond *merely doing business*. All KBC-group entities support, launch and monitor many projects, large and small, that should contribute to a better society. At the same time, these projects should increase KBC's value in the eyes of society and contribute to greater employee satisfaction.

In Belgium, for example, social sponsorship extends to projects contributing to health and road safety, with the focus on prevention. KBC has been a partner of *Kom op tegen kanker* (an anti-cancer drive), and the road-safety campaigns of Levenslijn and Mobiel 21 for many years. In 2011, KBC also became the partner of 'Velocitie' – a new cycling project initiated by Stichting Vlaamse Schoolsport that encourages youngsters to use their bikes actively and safely.

Marko Voljč,
CEO of the Central & Eastern Europe and Russia Business Unit and member of the Executive Committee of KBC Group

The 'Foundation Programme of Education' at ČSOB supports a number of projects to promote financial literacy. In 2011, one million Czech koruna was distributed among eleven projects based on this theme. In Hungary, the K&H MediMagic programme for sick children and children's hospitals has been running for several years. In addition, KBC supports many smaller projects at home and abroad to provide assistance to the most vulnerable members of society.

Financial support is one thing, but voluntary efforts by staff say a lot more

The KBC4Society project was launched in Belgium last year. To strengthen team spirit, KBC's departments and branches in Belgium organise an annual team event. As from September 2011, rather than organising the usual type of event, they can now dedicate their allocated time and budget to a project offering added social, cultural or ecological value. For this campaign, KBC works in partnership with Time4Society, a non-profit organisation that brings together companies and projects of social value. KBC staff in Central and Eastern Europe have been taking part in similar initiatives for a number of years. In this way, KBC staff contribute to a better, more caring society.

KBC4Society

Kom op tegen Kanker

levenslijn

Mobiel 21

VELOCITIE

ZORG VOOR NIEUW BLOED

As in previous years, KBC again collaborated with the Red Cross in a blood donation campaign (Give blood, give life), organising a number of blood donation sessions at its head offices in Belgium.

With the *Belgische Raiffeisen Stichting* (Belgian Raiffeisen Foundation, BRS), a non-profit organisation set up by Cera (a Belgian co-operative with more than 400 000 members) in 1992 that focuses on microfinancing and microinsurance enterprises in the southern hemisphere, KBC helps to make all kinds of financial services more easily accessible to local people. BRS provides local start-up savings, credit and insurance enterprises with the support required to really make a difference, which includes appropriate advice along with subsidies. BRS can call upon the know-how and experience of both Cera and KBC. Every year, KBC sends staff with the appropriate skills and experience to the southern hemisphere to provide coaching for projects undertaken by small banks and insurers. This is greatly appreciated, so we will be extending it in the future.

More information in this regard is available at
www.kbc.com/csr.

KBC also actively sponsors many cultural and sporting events, such as, in Belgium, the *Ronde van Vlaanderen* (a cycling tour of Flanders) and the *KBC-Nacht van de Atletiek* (an athletics event) and a number of summer rock festivals such as Rock Werchter. As a result of the financial and economic crisis, the public at one time doubted whether it was appropriate for a company that had called upon public assistance to continue to sponsor certain sporting and cultural events. However, we are keeping to our sponsorship policy, because many small sports and cultural organisations would not survive without our support. Making drastic cuts to our sponsorship budget would have a serious impact on the local social fabric. We ensure that all events that we sponsor, regardless of size, fit with the general guidelines established by KBC in this regard. We enter into a long-term partnership with those we support, a commitment that continues through good times and bad.

9 WHAT IS KBC'S ENVIRONMENTAL POLICY?

ČSOB's head office in Prague is a leading example of ecologically responsible construction.

KBC has had an integrated environmental policy since 2003. As a result, we not only support environmentally-friendly investments (such as tailor-made green loans for both individuals and companies), but also constantly monitor our own *ecological footprint* and endeavour to minimise it. We also try to make all our 47 530 staff aware of this at all times.

Our environmental performance is mainly seen at KBC in Belgium. We have set up an environmental management system, for which we obtained an ISO 14001 certificate in 2009. The main focus is on monitoring compliance with environmental laws and regulations, continuously improving environmental performance and increasing the involvement of all members of staff. Helped by input from our environmental expert, consumption of electricity (generated entirely by green sources) has fallen by 14.8% in Belgium since 2006, CO2 emissions by 44.12%, paper consumption by 18.55% and water consumption by 40.88%.

KBC in Belgium has been rated among the world's 100 greenest companies, standing at number 98 in *Newsweek's* 'Green Rankings 2011', making it the highest ranked Belgian company.

In Belgium, KBC has also worked for many years in partnership with ARGUS, a non-profit organisation set up by KBC and Cera that aims to use awareness campaigns and information to encourage society in general to always seek out and implement the most ecological solutions at work and in day-to-day life.

Marko Voljč, CEO of the Central & Eastern Europe and Russia Business Unit and member of the Executive Committee of KBC Group

KBC uses Green Building Guidelines, so that all the group's buildings will become sustainable over time. The new Arteveldetoren in Ghent and, more particularly, the new head offices in Prague and Budapest are good examples of this. The ČSOB head office in Prague, which was opened in 2006, is both an inspiring working environment and an example of ecologically responsible construction. Environmental-friendliness and sustainability were the cornerstones of the project as a whole. The building was awarded a silver LEED certificate. LEED (Leadership in Energy and Environmental Design) is an internationally recognised rating system for the design and construction of high-performance green buildings. And the head office in Budapest is even in line for a gold LEED certificate.

Hildegard Deweerdt, KBC Environmental Specialist

At KBC Belgium, we are particularly proud of what we have all achieved thus far in terms of environmental protection and socially responsible business. We also realise that there is still much to be done and there are many projects to bring to fruition. For instance, detailed reports on our environmental performance are only available for Belgium at present. We wish to develop more detailed environmental reports and set objectives for our home markets in Central and Eastern Europe, which will enable us to better identify and assess what still needs to be done.

More information on KBC's environmental performance can be found at **www.kbc.com/csr** and **www.argusmilieu.be**.

At the end of 2011, KBC approved a group-wide climate change policy, so confirming its commitment to reducing its impact on the environment. Among other things, we aim to focus in our daily operations on energy efficiency, managing emissions of greenhouse gases through active management of our leased car fleet for commuting, monitoring research into new scientific and technological developments and increasing employees' environmental awareness. We also want to devote more attention to our impact on climate change through our choice of suppliers and the offering of products and services, including the car fleet. The full *Climate Change Policy* is available to view or download at **www.kbc.com/csr**.

In 2012, part of the variable salary component (the non-recurrent results-based bonus) will only be paid if certain environmental goals are achieved.

20 March 2012. KBC and Argus launch the 'Tree means life' project.

As from the beginning of 2012, KBC will automatically donate one euro to the ARGUS **Boom doet Leven** (Trees means life) **project** for every current and savings account opened in the name of someone aged up to 25. In this way, KBC will contribute to reducing CO2 emissions.

With this project, ARGUS is supporting the planting of two forests, and is working in partnership with two organisations:

- The *Vereniging voor Bos in Vlaanderen* (*Flanders forest association*) with which it is planting trees in a green zone in Knesselare. It will be a seven-hectare wooded area with a variety of indigenous trees.
- The WWF, which is managing the second project in Congo (in the equatorial rain forest), which involves planting trees for charcoal which will supply a number of towns with the wood they need for burning. ARGUS is also supporting restoration of the equatorial rain forest in that region which is the habitat of the bonobo, thus directly benefiting them, too.

This campaign is associated with the ARGUS climate fund, which offsets the emissions from KBC's car fleet by investing in climate projects in third world countries.

POWERED BY ARGUS
BOOM
DOET LEVEN

10 HOW IS KBC MANAGED?

KBC is managed by a Board of Directors, which was made up of 25 members on 31 December 2011, four of whom are appointed by the government, and an Executive Committee of seven members, chaired by the CEO.

Possible changes to the composition of the Board of Directors were given careful consideration in 2011. It was decided that the number of members would be gradually reduced to less than eighteen. It was also decided to try to increase representation of women on the Board (in order to satisfy the 30% criterion sooner than prescribed by law) and increase the number of independent directors from our Central and Eastern European home markets.

The first concrete steps in this direction will be taken pursuant to the Annual General Meeting on 3 May 2012. The number of directors will be reduced to 22, and a second female director has been put forward for appointment. She would also become the first Central European member of the Board.

In 2012, the CEO, Jan Vanhevel, who took office in 2009 and has since overseen the successful implementation of the restructuring plan, decided to retire. The Board appointed Johan Thijs to succeed him.

The remuneration policy for the Board of Directors and Executive Committee is based on prevailing legislation, the Corporate Governance Code (the Code) and market data. It is checked at regular intervals for compliance with changes in the legislation, the Code and current market practices and trends. The remuneration KBC pays its management is comparable to that at other European financial institutions. Compared with similar European financial institutions, the amounts paid to the Chairman and members of the KBC Group Executive Committee tend to be at the lower end of the range, and hence some way below the average. The high bonuses paid by many international investment banks are not part of KBC's culture.

Thomas Leysen,
Chairman of the Board of Directors of KBC Group

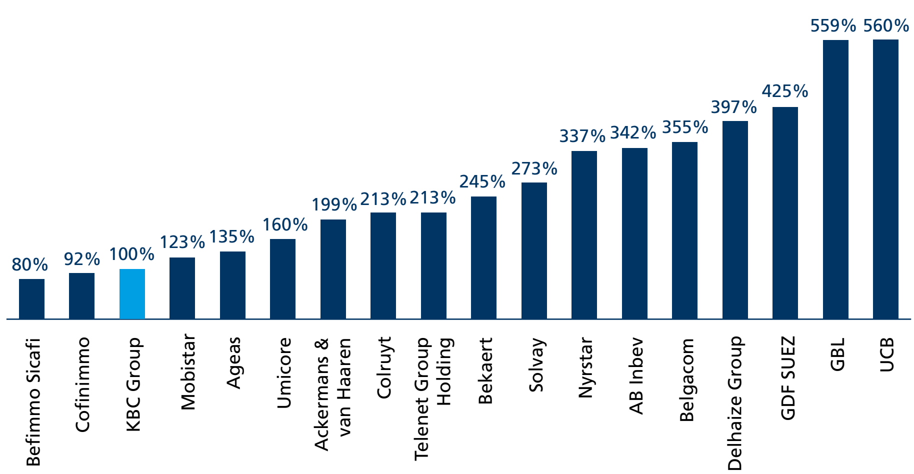
KBC owes an enormous debt of gratitude to Jan Vanhevel. He was prepared to take the helm in exceedingly difficult circumstances in 2009, postponing the retirement he had been planning to take that year. Since then, he has shown unconditional dedication to the group in leading the design and implementation of a far-reaching strategic plan. KBC's survival as an independent bancassurance group is due in no small part to his tireless efforts.

The total pay package of members of the Executive Committee is made up of a fixed component (which is guaranteed) and a variable component (that is linked to KBC's results and to performance objectives, whereby both the achievement of the objectives and the way in which they are achieved play a part). The European CEBS guidelines are used to establish the variable component. KBC ensures, for example, that the variable component is never higher than the fixed component and that payment is spread over a number of years, or that no payment is made if the results are poor or certain objectives not met. The President and members of the KBC Group Executive Committee voluntarily and at their own initiative waived their contractual right to variable bonuses in three of the past four years (2008, 2009 and 2011) due to the weaker results. The CEO's gross fixed salary was 727 605 euros in 2011. Full details of KBC's remuneration policy are provided in the annual report which is available at www.kbc.com.

KBC and the Board of Directors are sensitive to the social debate about top salaries in the financial sector, and more particularly in companies that have received state aid. However, the Board also believes that it is essential to offer appropriate, competitive terms to motivate the team that has taken office since the financial crisis. KBC does not therefore support the option of abolishing variable remuneration entirely.

In 2011, members of the Board of Directors received only attendance fees for meetings, and did not receive any profit-related bonus or stock options. The Chairman of the Board receives a fixed remuneration. Detailed information in this regard is provided in the annual report which is available at www.kbc.com.

Comparison of pay* of CEOs of BEL 20 companies, KBC = 100%



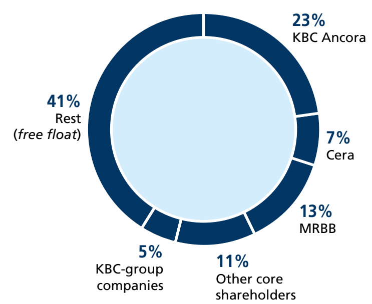
* Fixed, variable and other components (as given in the annual reports of the companies concerned).

11 WHO ARE KBC'S SHAREHOLDERS?

KBC is a listed financial institution with a solid base of stable shareholders and a clear long-term vision.

KBC shares are listed on the Brussels stock exchange with the ticker symbol KBC. However, *more than 50%* of KBC's capital is held by core shareholders. The main shareholders are Cera, KBC Ancora, MRBB and a group of other core shareholders. Cera is a co-operative with more than 400 000 members. Cera is also the majority shareholder of KBC Ancora, a listed company, that is the only holder of an active participating interest in KBC Group. MRBB is the financial holding company of the *Boerenbond* (farmer's union). In addition, several entrepreneurial families have held a stable interest in KBC for decades, and intend to continue to do so in the future. As a result, KBC is firmly anchored in Belgium. This means that, together with its reference shareholders, the group can develop a long-term vision and strategy that does not depend on short-term objectives.

Shareholder structure (31-12-2011)



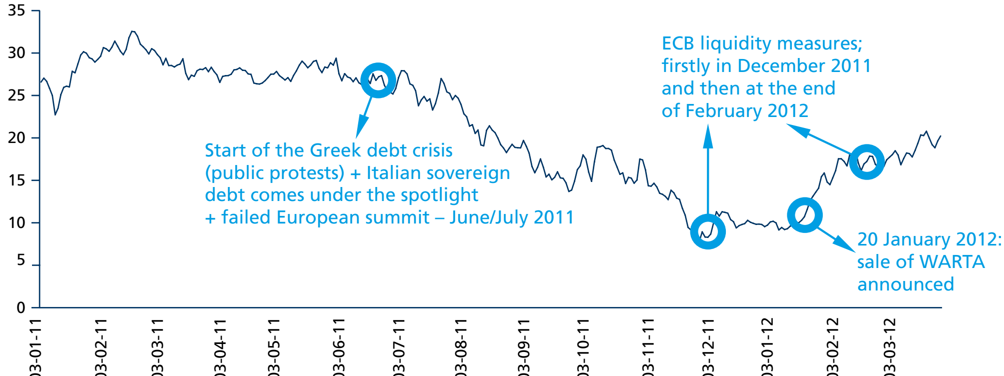
Thomas Leysen,
Chairman of the Board of Directors of KBC Group

The fact that having stable shareholders is a viable and sustainable model has been confirmed many times in the past years of crisis. The core shareholders remained calm at all times during one of the worst-ever financial and economic crises, never losing sight of the long-term vision. The solid base, and the rapid responses worked out with the various governments at crucial moments in the crisis ensured that KBC remains the only large, independent Belgian bancassurer.

In addition, many KBC staff also invested in the company's shares, as a sign of their confidence and belief in the group. Many individuals are also doing that indirectly, for instance if they save through pension funds or other investment funds that invest partly in KBC shares.

The shareholders waived any return on their capital in 2011, except for a *technical* dividend of 1 euro cent per share. That was required, in accordance with the agreement with the European Commission, to make it possible to make an interest payment to the government.

KBC share price



12 WHAT ARE THE MAJOR CHALLENGES FACING KBC?

Johan Thijs, CEO and President of the Executive Committee of KBC Group

After reading this report, you will realise that much has been achieved and much has changed in the last year. Thanks to the unstinting efforts of our staff, we are back on track. We are more focused than ever on pursuing our core banking and insurance business in a number of carefully selected countries and we are making good progress in dealing with the legacies of the past.

However, the work is far from over. We are fully aware of the many challenges that lie ahead. There is still uncertainty about where the global economy is heading and it would be premature to claim that the sovereign debt crisis in the euro area has been solved for good.

In economic terms, we have to continue to implement the strategic plan approved by the European Commission. The principal divestments still to be carried out concern Absolut Bank (Russia), KBC Banka (Serbia), NLB Vita and the minority interest in Nova Ljubljanska banka (Slovenia), Antwerp Diamond Bank (Belgium), KBC Bank Deutschland (Germany) and a number of other activities. Preparatory work for most of these projects has already started.

The implementation of our strategic plan should make it possible for us to repay the government authorities as agreed

KBC employee, Koen, cycles up the Col du Galibier for 'Climbing for Life'.

and on time. At the same time, the plan should enable KBC to remain an independent financial group with a healthy liquidity position and comfortable capital buffer that is large enough to satisfy the more rigorous capital requirements imposed by the regulators on all financial institutions to counter any future shocks.

We will also continue to reduce risks, more particularly our portfolio of structured and repackaged loans (CDOs and ABS). In this way, we aim to limit the volatility of results in the future due, for instance, to rising or falling market values, and more importantly to continue to reduce the risk for the government and taxpayers. In the meantime, these products could still cause the results to be volatile, both on the upside and the downside.

We will continue to monitor the economic situation in Ireland and Hungary closely. In Ireland, through KBC Bank Ireland, we have a loan portfolio of some 16.7 billion euros (chiefly home loans). The domestic economy in Ireland worsened at the end of 2011 and is expected to continue to struggle in 2012. Consumer confidence, business confidence and business expenditure were hit by the weaker global economic situation and the ongoing severe austerity measures in Ireland itself. As a result, house prices have also fallen steeply. Due to the economic situation and high unemployment, many borrowers are finding it difficult to repay their loans. We have already set aside sizeable provisions to cover this in previous quarters, but will also set aside a further 500-600 million euros in 2012.

A new law was adopted in Hungary in 2011 to help households with mortgage loans in foreign currency. The law made it possible for a limited period for households to repay their debts in foreign currency at a fixed, much lower exchange rate. The difference between the fixed exchange rate and the market rate has to be borne by the banks. The Hungarian Bankers Association has taken the matter to the Constitutional Court in Budapest, because they believe the government's decision to be contrary to the Hungarian constitution. Regardless of this, KBC set aside provisions in 2011 for its portfolio of foreign-currency mortgage loans. KBC has also had to contend with heavy taxation of banks and insurance companies in Hungary in the last few years. As a result of these government measures, our Hungarian subsidiary, K&H – like many other Hungarian financial institutions – has made losses. We expect the economic situation in Hungary to remain difficult in 2012 too. However, we believe that K&H can return to profit in 2012.

KBC is determined, together with its over 47 000 employees, to address the challenges responsibly and in the best way possible. That applies to our customers, staff and shareholders, and of course working as closely as possible with government authorities and regulators. In this way we hope to be recognised once again as an essential link in society.

Johan Thijs,
CEO and President of the Executive Committee of KBC Group

In our operations we continue to strive for a continuous improvement in service by optimising the range of products and services we offer. For instance, we wish to adapt to the changing needs of our customers, who increasingly wish to bank where they want and using their preferred channel. In 2011, we launched mobile banking for smartphones and iPads and so on. We also had a first on the Belgian market, with the introduction of the 'scashing' (scan & cash) mobile function. Scashing is a simple way of transferring money via a smartphone using a QR code. In early 2012, the KBC Mobile Banking app won the public vote in Belgium in the 'Financial Services' category of Accenture's Innovation Award. In the years ahead we will continue to devote much attention to technology and make sizeable investments to remain a pioneer in that area.

Editor-in-chief: KBC Group Communication – GCM, Havenlaan 2, 1080 Brussels, Belgium
Sub-editing, translation, concept and design: Communication – CMM, Brusselsesteenweg 100, 3000 Leuven, Belgium
Printer: Van der Poorten, Diestsesteenweg 624, 3010 Leuven, Belgium
Publisher: KBC Group NV, Havenlaan 2, 1080 Brussels, Belgium

This report has been printed on paper that is not harmful to the environment.

KBC