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Risk Report
KBC Group

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Introduction: financial highlights in 2023, Risk Statement & Disclosure Policy

KBC is a leading European financial group with a focus on providing bank-insurance products and services to retail clients, small and medium-sized enterprises and mid-cap clients in our core countries: Belgium, the Czech Republic, Slovakia, Hungary and Bulgaria. Elsewhere around the world, the group has established a presence in selected countries and regions.

Financial highlights in 2023

Key figures	31-12-2023	31-12-2022
Net result (in millions of EUR)	3 402	2 818
CET1 ratio (fully loaded)	15.2%	15.3%
LCR	159%	152%
MREL/RWA	30.7%	27.5%

Table 1 - Key figures

Net profit was up by 21% compared to full year 2022 (and by 8% excluding the profit on the sale of substantially all of the assets and liabilities of KBC Bank Ireland to Bank of Ireland Group), as:

- Revenues rose by 12% year-on-year, mainly thanks to higher net interest income, higher net fee and commission income, higher insurance revenues (both life and non-life), a higher net result from FIFV, and sharply higher net other income, partly offset by more negative insurance finance income and expense (IFIE)
- Operating expenses excluding bank tax rose by 7% year-on-year to 4.4 billion euros, fully in line with guidance
 - Total bank and insurance tax (including the European Single Resolution Fund (ESRF) contribution) increased from 646 million euros in 2022 to 687 million euros in 2023
- Net impairment charges amounted to 215 million euros (compared to 282 million euros in 2022). This was attributable to:
 - A 139-million-euro net loan loss impairment charge on the lending book
 - A 155-million-euro reversal of the geopolitical and emerging risk buffer
 - 231-million-euro impairment on 'other' and 'goodwill', including 109-million-euro goodwill impairment in the Czech Republic and 77-million-euro impairment on intangible assets (mainly software)

Capital and liquidity remained strong:

- Our solvency position remained strong with a fully loaded common equity tier-1 ratio of 15.2%.
- A total gross dividend of 4.15 euros per share will be proposed to the General Meeting of Shareholders for the accounting year 2023 (of which an interim dividend of 1 euro per share was already paid in November 2023)
- In line with our announced capital deployment plan for the full year 2023, the distribution of the surplus capital above the fully loaded common equity tier-1 ratio of 15% will be decided at the discretion of the Board of Directors of KBC Group in the first half of 2024.
- The fully loaded Basel III leverage ratio amounted to 5.7%.
- The Solvency II ratio at insurance group level was consistently strong at 206%.

- A continued robust liquidity position at year-end, with a Net Stable Funding Ratio (NSFR) at 136% and a Liquidity Coverage Ratio (LCR) at 159% (i.e. 12-month average LCR). Both ratios are well above the minimum regulatory requirements.

Risk statement

KBC Group is a Financial Conglomerate (FICO), combining bank, insurance and asset management activities, which offers clear benefits, both for its clients (e.g., one-stop-shop experience) and for KBC (e.g., income and risk diversification and cost efficiencies).

As a financial institution, KBC is exposed to risks that are typical for the financial sector, including financial risks (e.g., credit risk, market risk (trading and non-trading), insurance risks, liquidity risk), non-financial risks (e.g., operational risks – including information technology and security risks, compliance risks, reputational risks) and Environmental, Social and Governance (ESG) risks. These different risks can occur simultaneously and might trigger or reinforce each other.

As KBC is a Financial Conglomerate (FICO), special attention is paid to risks resulting from flows and interactions between KBC entities active in different financial sectors (banking, insurance and asset management). All FICO-related risks (e.g., concentration and contagion risks) are well identified and under control thanks to additional mitigation processes. At the same time, our FICO business model brings strengths and opportunities. For example, being a FICO implies offsetting interest rate sensitivities of bank and insurance, possibilities for optimising liquidity, income diversification, etc.

Strong and future-proof risk management that deals effectively with the changing risk landscape is part of KBC's core strengths. Risk management in KBC is organised based on the 3 Lines of Defence (3LOD) concept (with the first line being risk-aware business people, the second line being independent regulatory imposed control functions, i.e. the risk, compliance and actuarial function, and the third line being internal audit). The second line of defence is functioning independently, adequately and effectively, and in line with KBC's updated corporate strategy. In this way, it contributes to KBC's resilience, agility and sustainability and, more broadly, to the achievement of KBC's strategic objectives.

For this purpose, clear corporate and risk governance is in place, as well as a sound risk and control environment with regularly updated risk frameworks and policies – to reflect changes in the internal and external context, including new regulatory requirements – a clearly defined risk appetite for each risk type, a mature product approval process and a deeply embedded risk culture throughout the three lines of defence.

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 2023 Annual Report of KBC Group NV and – more extensively – in this publication.

The most important regulations governing risk and capital management are the capital requirements resulting from the Capital Requirements Regulation and Capital Requirements Directive (CRR/CRD) applying to banking entities, and the Solvency II capital framework applying to insurance entities. KBC follows the Basel III capital requirements in accordance with the current Capital Requirements Regulation, CRR2. The Basel III post-crisis reforms (commonly referred to as Basel IV) will apply when these are transposed into CRR3 and enter into force.

With regard to Environmental, Social and Governance (ESG), disclosure obligations already apply (e.g., EU Taxonomy disclosure regulations, EBA Pillar 3 requirements, the Sustainable Finance Disclosure Regulation) but will be significantly

extended in the coming years. In particular, the upcoming disclosures according to the Corporate Sustainability Reporting Directive are currently being prepared by KBC. In addition, KBC will keep updating the Pillar 3 disclosures to be in line with the latest guidelines and regulations applicable to external regulatory reporting.

The 2023 Risk Report is based on Basel III's third pillar and in accordance with the resulting disclosure requirements of the CRR/CRD of the European Union. **The CRR2-related disclosure templates can be found in a separate Excel file on the kbc.com website, published alongside this Risk Report.** With the introduction of these disclosure templates, the regulatory authorities aim to reinforce market discipline by increasing the consistency and comparability of institutions' public disclosures on the one hand and to achieve data transparency and reconciliation between external reporting, such as the Pillar 3 disclosures, and supervisory reporting based on FINREP and COREP data on the other hand.

Requirements relating to activities that are not applicable/do not exist for KBC are, therefore, not included. Although the disclosures mostly refer to the Basel III first-pillar risk metrics and focus on banking entities, KBC – as a bank-insurance company – has extended the scope to include the insurance activities as well in order to provide an overall view of the KBC group's risk exposure and risk management activities.

Information is disclosed at the highest consolidated level, i.e. KBC Group. Hence, unless explicitly otherwise mentioned, all references to KBC in this report refer to KBC Group Consolidated. Additional information, specifically on the material entities, is confined to the capital information in the 'Capital adequacy' section. For more detailed information, please refer to the local capital disclosures of the entity concerned (for instance, those provided on their websites). KBC ensures that a representative picture is given in its disclosures at all times. The scope of the reported information – which can differ according to the matter being dealt with – is clearly indicated.

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 underwent a final screening by authorised risk management representatives to ensure quality. In addition, the 2023 Risk Report was distributed to the Group Executive Committee (GExCo), the Risk & Compliance Committee (RCC) and the Board of Directors (BoD) to ensure the appropriate approval of the management body as requested under Basel III.

Information disclosed under IFRS, which has been audited, is presented in KBC's annual report. Broadly speaking, the information in the annual report corresponds with the information in this risk report, but a one-on-one comparison cannot always be made due to the different risk concepts used under IFRS and Basel III. In order not to compromise on the readability of this document, relevant parts of the annual report have been reproduced here. On 1 January 2023, IFRS 17 replaced IFRS 4 (Insurance Contracts): the new accounting rules for the recognition, measurement and presentation of insurance contracts (IFRS 17) are mandatory for the reporting period beginning on 1 January 2023. Where applicable and relevant, the 2022 end-of-year figures have been restated as a consequence of the implementation of IFRS 17.

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 2025. However, according to regulatory requirements, a defined number of tables will be made public on a quarterly or semi-annual basis during 2024.

Cross-references

For a number of topics, we refer to other reports in order to avoid too much overlap or duplication of information. This allows us to improve the readability of the report and to add value to it. The table below shows the topics where reference is made to other reports.

Topics	Reports
Information regarding governance arrangements	See the 'Corporate governance statement' section of the 2023 Annual Report of KBC Group NV
Information on the remuneration policy of financial institutions and corporate governance arrangements	KBC Group Compensation Report See the 'Corporate governance statement' section of the 2023 Annual Report of KBC Group NV
Country-by-country information	See the 'Our business units' section and the 'Our business model' strategy section of the 2023 Annual Report of KBC Group NV
New products	See 'In what environment do we operate?' in the 'Our business model' section and the 'Our business units' section of the 2023 Annual Report of KBC Group NV
Credit risk related to KBC Insurance	See the 'How do we manage our risks' section of the 2023 Annual Report of KBC Group NV
Information regarding corporate sustainability, climate change and the information security strategy	See the 'Sustainability Report' on the kbc.com website, the 'Our role in society' and 'Focus on climate and the environment' sections of the 2023 Annual Report of KBC Group NV and the 'Information security strategy of KBC Group', which can also be found on the kbc.com website



Risk Management & Governance

KBC and the financial sector as a whole operate in a rapidly changing environment characterised by volatility, uncertainty, complexity and ambiguity:

- The financial industry is undergoing a major transition, with digital transformation bringing new opportunities (e.g., the opportunity to embed artificial intelligence (AI), big data analysis and automation technologies in our operations to make our interactions with our clients instant, straight-through and friction-free) and challenges (including in the areas of cyber risk, ethical AI and new digital competitors).
- At the same time the financial sector plays a crucial role in the transition to a greener and more sustainable economy: financial institutions not only need to reflect on their own activities, taking into account all new regulations, but also have a crucial role in helping their clients to make the transition towards a more sustainable world.
- On top of this, the industry continues to face major macroeconomic, financial and geopolitical challenges and instability, whereas regulatory and supervisory pressure and uncertainty are rising to unprecedented levels.

KBC responds to these key challenges with its data-driven digital strategy, aiming to create ecosystems that help our clients to save time and money by combining financial and non-financial services, and with its ambition to contribute to a more sustainable world.

The risk, compliance and actuarial functions have the clear ambition to support KBC in achieving these strategic objectives, to contribute to its resilience and agility, to provide management and the Board of Directors with insights supporting risk-conscious decision-making and to inform them about the risks KBC is facing. The strategy of the risk, compliance and actuarial functions therefore finds its origin in the overall KBC Corporate Strategy & Pearl Culture and its translation into the KBC Risk Appetite, which sets the bar for risk management throughout KBC.

To remain in sync with the changing business environment and the KBC Corporate Strategy, the risk, compliance and actuarial functions regularly assess and update their strategy, considering all relevant elements (e.g., top risks), including the 'external supervisory view' and upcoming regulatory changes. In this way, we continuously adapt and further strengthen KBC's Risk Management Framework and its underlying risk management processes.

The strategy of the risk, compliance and actuarial functions is based on three key pillars:

- Support the business: we support, advise and challenge the business in its everyday activities ('business as usual'), in its transformation, aiming to help it keep KBC's control environment up to standards and respect KBC's risk appetite at all times.
- Transform ourselves: in sync with the KBC strategy and business we are becoming more digital, data-driven and STP (straight-through-processing), we are optimising our operational efficiency and we smart copy solutions. By being more efficient and effective in our business-as-usual processes, we create room to develop approaches for new risks. Moreover, we 'think Ecosphere': we continuously extend and improve our risk and compliance framework for an increasingly digital, interconnected and sustainable future.
- People: we attract and nurture talent, building an engaged workforce of the future as an enabler of transformation and the execution of our business as usual. We ensure that our people have a clear view of KBC's strategic direction, how KBC's transformation impacts their job and how they contribute to KBC's strategy.

Risk Management

Risk governance

Our risk governance model includes the following main elements:

- The Board of Directors, supported by the Risk & Compliance Committee, decides on the risk appetite – defining the group’s overall risk playing field and the risk strategy – and supervises KBC’s risk exposure in relation to this risk appetite. It is also accountable for having robust governance arrangements in place to ensure that all material risks of the KBC group are managed appropriately and for promoting a sound, consistent group-wide risk culture.
- The number of external mandates held by the members of the BoD can be found on our kbc.com website under the topic ‘Leadership’ as part of the Corporate Governance section. How the members are recruited, also taking into account the diversity in the composition of the Board, can be found in the ‘Corporate governance statement’ of the KBC Group NV 2023 Annual Report and under the topic ‘Our corporate governance charter’ as part of the Corporate Governance section on our kbc.com website.
- The Executive Committee (ExCo) is the senior management level committee responsible for integrated risk management in alignment with Board of Directors decisions related to risk appetite, strategy, and performance goals.
- The ExCo is supported by the CRO Services Management Committee (CRO Services MC), activity-based risk committees (right-hand side of the figure) and business committees (left-hand side of the figure).

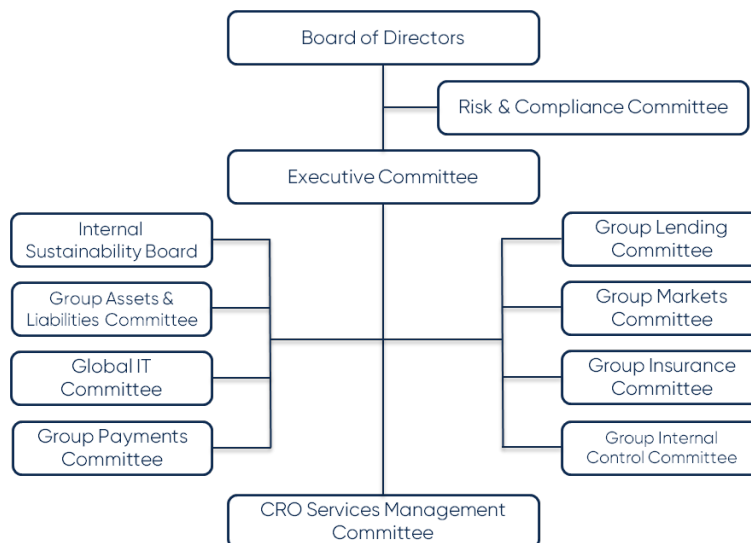


Figure 1 - Schematic overview of the risk governance model

We manage our risks using the ‘Three Lines of Defence’ model:

- Risk-aware business people act as the first line of defence for conducting sound risk management. This means that they are fully responsible for all the risks related to the full lifecycle of their activities, both in a stable, ‘business-as-usual’ context and during changes (project-driven or other), and for ensuring that effective controls are in place. For this purpose, they focus on ensuring that the right controls are performed in the right way, that self-assessments of the business side are of a sufficiently high standard, that there is adequate awareness of risk and that sufficient priority/capacity is allocated to risk themes.

- Independent regulatory control functions, both at group and local level, act as (part of) the second line of defence:
 - The risk function develops, imposes and monitors consistent implementation of the Risk Management Framework, describing the processes, methods and approaches used to identify, measure and report on risks and to define the risk appetite. To strengthen the voice of the risk function and to ensure that the decision-making bodies of the business entities are appropriately challenged on matters of risk management and receive expert advice, KBC has deployed independent Chief Risk Officers (CROs) throughout the group. Close collaboration with the business is assured since they are present in management committees and take part in the local decision-making process, while their independence is achieved through a functional reporting line to the Group CRO. If necessary, they can exercise a right of veto.
 - The compliance function's prime objective is to prevent KBC from running a compliance risk (i.e. incurring loss or damage – regardless of its nature – due to non-compliance with applicable laws, regulations or internal rules) that falls either within the scope of the compliance function or within the areas assigned to it by the ExCo (as described in the Integrity Charter). The compliance function is characterised by its specific status (as provided for by law and regulations and described in the Compliance Charter), its place in the organisation chart (hierarchically under the CRO) and the associated reporting lines (reporting to the RCC and even to the BoD in certain cases).
 - The actuarial function ensures additional quality control by providing expert technical actuarial advice to the supervisory body, the RCC and the executive body of KBC Group NV, of KBC Insurance NV and of all reinsurance and insurance entities within the group. Such advice covers the calculation of the technical provisions for insurance liabilities, the reinsurance policy and underwriting risk. As described in the 'Actuarial Function Charter', in order to safeguard independence, the actuarial function holder reports functionally to the Group CRO.
- Internal audit acts as the third line of defence. It is responsible for giving reasonable assurance to the Board of Directors that the overall internal control environment is effective, and that effective policies and processes are in place and applied consistently throughout the group.

Relevant risk management bodies:

- Risk & Compliance Committee
 - Advises the Board of Directors on the group risk appetite, the monitoring of risk exposure compared to the group risk appetite and the supervision of the implementation, efficiency and effectiveness of the KBC Risk Management Framework;
 - Reviews whether the prices of liabilities and assets and of categories of off-balance-sheet products offered to clients take fully into account the institution's business model and risk appetite;
 - Examines, without prejudice to the tasks of the Remuneration Committee, whether incentives provided by the remuneration system take into consideration risk, capital, liquidity and the likelihood and timing of earnings;
 - Issues periodic opinions on the quality, capacity and skills of the risk function.
- Executive Committee:
 - Makes proposals to the Board of Directors about risk appetite – including the overall playing field and risk strategy – and the KBC Risk Management Framework;
 - Makes proposals to the Risk & Compliance Committee about the assessment of the quality, capacity and skills of the risk function;

- Decides on further cascading of the group's risk appetite through the organisation by defining the playing field in terms of allocated capital and local targets and limits, and by approving limit changes and overruns within their delegation;
 - Monitors the group's major risk exposure to ensure conformity with the risk appetite;
 - Decides on the risk-type-specific risk management frameworks and monitors their implementation throughout the group;
 - Acts as the leading risk committee, covering material issues that are channelled via its supporting committees;
 - Forms, extended with relevant parties, the Group Crisis Committee in group-wide crisis situations.
- Risk committees:
 - The CRO Services Management Committee supports the 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 CRO Services Management Committee convened on seven occasions during 2023;
 - The activity-based Group Risk Committees (for lending (GLC – convened on twelve occasions), markets (GMC – convened on twelve occasions) and insurance (GIC – convened on five occasions)) support the Executive Committee in integrated risk monitoring for these activities at group level;
 - The Group Internal Control Committee (GICC) supports the Executive Committee in monitoring and strengthening the quality and effectiveness of KBC's internal control system. The GICC convened on four occasions during 2023.
 - Business committees:
 - The Group ALCO handles matters related to ALM and liquidity risk;
 - The Global IT Committee handles matters related to information technology and information security risk;
 - The Group Payments Committee handles matters related to operational risk in the payments domain;
 - The Internal Sustainability Board handles matters related to environmental, social and governance (ESG) risks.

To inform the Executive Committee and the Board of Directors adequately with regard to risk topics, the risk function distributes among other things:

- A yearly report on the Internal Capital Adequacy Assessment Process (ICAAP), the Internal Liquidity Assessment Process (ILAAP) and the Own Risk & Solvency Assessment (ORSA), presenting a view on the capital and liquidity adequacy of KBC for the group as a whole and for its entities. These reports are complemented by a FICO report, which zooms in on additional risks that could be triggered by KBC being a Financial Conglomerate and on their mitigation;
- A yearly Internal Control Statement (ICS) evaluating how well KBC is in control of the risks inherent to its operations;
- The Integrated Risk Report (IRR), which is provided eight times per year and which includes the main risk signals, being risk developments that have or could have a negative influence on the company. The Integrated Risk Report provides a holistic view over all risk types, including the follow-up on the risk measures and indicators in comparison to the risk appetite as approved by the Board of Directors. Twice a year, the Integrated Risk Report is supplemented with a climate risk dashboard;

- A yearly update of the recovery plan, which ensures that KBC is ready to take the necessary mitigating actions to return to 'business as usual' in case an extreme crisis undermines its financial stability, as well as quarterly resolvability progress reports (in the IRR) and reporting on other resolution-related topics;
- Dedicated memos on a wide variety of topics which bring relevant topics to the attention of the Executive Committee and Board of Directors (e.g., deep dives, risk-type-specific reports like the information security risk report and the overview of the New and Active Products Process).

Banks are required to maintain an internal governance and control framework that ensures a well-functioning internal risk management. Each year, the Risk & Compliance Committee formally assesses whether the risk, compliance and actuarial functions are functioning independently, effectively and efficiently and have sufficient capacity to do so. For this purpose, KBC conducts a yearly assessment of these functions, including a group-wide risk-based capacity assessment for second line of defence resources. The exercise covers the quantity, quality and capacity of staff and resources, and the progress of the functions in the different strategic focus areas. Results are presented and discussed at the Risk & Compliance Committee. An assessment of the audit function is also conducted on a yearly basis.

The 2023 iteration of the exercise confirmed again that, overall, the risk function has sufficient capacity and the right skills to perform sound risk management. Increasing regulatory/supervisory requirements and expectations, first-line initiatives, the race for talent and scarcity on the labour market for specific profiles, partially mitigated by a multi-location strategy, require ongoing attention if we are to keep our resources aligned with these challenges. The risk-based capacity assessment also indicates that a sufficient mix of experience and maturity is present in the risk function. Finally, KBC ensures that sufficient expertise is built up or available in newer or rapidly evolving areas in which KBC operates, such as ESG, cybersecurity, artificial intelligence, cloud computing and model risk. A comprehensive employee skill management programme is in place and a significant focus on training and skills development ensures continuous development of expertise.

Risk culture



Christine Van Rijssseghem, KBC Group CRO

Culture encompasses the collective mindset and the shared set of values that shape the everyday behaviour of employees. For many years, KBC has had a strong corporate culture called 'PEARL+¹', which guides the actions of our KBC colleagues and the way risks are managed throughout the entire organisation.

The behaviour of staff members is the tangible manifestation of this 'invisible' corporate culture. It is directly observable in a way that culture is not. Therefore, KBC's Risk Management has the following vision: we want to put risk in the hearts and minds of all staff to help KBC create sustainable growth and earn its clients' trust.

In order to maintain and grow trust, it is important that we behave responsibly in everything we do, across all layers of the organisation. This means that the mindset of all KBC staff should extend beyond regulations and compliance.

¹ PEARL: *performance, empowerment, accountability, responsiveness, local embeddedness*

KBC's risk culture is therefore not only visible in its governance and policies, but also in the risk-conscious attitude and behaviour of its management and staff throughout the group.

The 'tone from the top' plays a crucial role in establishing a culture of prudent risk-taking within an organisation. KBC's Board members thoroughly discuss the Risk Appetite Statement, reflecting the amount of risk they are willing to accept in pursuing KBC's strategic objectives. It is a reflection of our risk culture which all KBC colleagues need to adhere to in their decision making. KBC strengthens its risk culture by communicating the risk appetite throughout the organisation in a way that is understandable for all stakeholders, to ensure that the risk mindset becomes part of our staff's DNA.

KBC also adheres to a constructive challenge culture in which members of the management bodies engage in critical discussions, ask relevant questions and challenge assumptions in line with KBC's Pearl+ values and norms. These constructive challenges are also reflected in the meeting minutes of, for example, the Board of Directors, the Risk & Compliance Committee and the Audit Committee.

Not only at the senior management level, but throughout the entire organisation, KBC promotes a 'dare to speak up' culture in which all colleagues are encouraged to speak up about and discuss any risk or dilemma they encounter. To monitor how KBC staff perceive working within KBC, regular engagement surveys – called 'Shape Your Future' in Belgium – are sent out to all staff. 'Dare to speak up' behaviour is also promoted this way. The results of these surveys are always discussed within the different KBC teams and at management level. In case the right risk culture calls for additional attention, follow-up actions need to be defined by the respective team leaders, which are regularly monitored during the year.

Dilemmas and risks evolve along with the constantly evolving world. Therefore, risks are regularly screened and new risks are proactively scanned and analysed. Operational risks such as cyber-related risks or third-party risks, i.e. risks caused by working with external parties such as IT providers, but also ESG (especially climate-related) and compliance-related risks (e.g., in the areas of GDPR, and embargo and conduct risk) are currently considered top risks. KBC aims to limit the impact of these and other risks, not only on the organisation, but also on its clients. Therefore, strict policies and guidelines are in place which are regularly updated to be aligned with new market developments and new regulations. Adherence to these policies is monitored and corrective actions are taken in case of issues. The risk appetite is clearly expressed and updated at least annually by the Board of Directors and translated into strict limits which are monitored and reported on. KBC also regularly organises awareness campaigns towards its staff and clients for example on responsible behaviour when dealing with suspicious counterparties to avoid cyber incidents, or on responsible climate-related behaviour.

To be prepared for unforeseen events, KBC also organises and participates in stress tests simulating scenarios such as a cyberattack or a climate-related event to test KBC's resilience. KBC also regularly organises ethical hacking tests in which we simulate real hacking of our systems to enable us to constantly improve in areas where we are potentially vulnerable.

In addition to climate risk, other ESG risks such as social risks also receive a lot of attention within our organisation. KBC's policies also need to be adhered to when managing the diversity and inclusion of our staff, in the context of responsible remuneration or in areas which touch upon human rights. These policies reflect KBC's corporate values and approved risk appetite while adhering to current regulations.

Finally, KBC's remuneration policies also contribute to establishing a sound risk culture in view of the clear governance and many risk adjustment mechanisms that are included. Good examples are that unethical or non-compliant behaviour cannot be compensated by good financial performance or that variable remuneration should be based on risk and liquidity adjusted profit, not on gross revenues. This means that the remuneration policies also reflect the positive risk culture throughout the entire KBC Group.

Components of a sound risk management

Risk management refers to the coordinated set of activities to proactively identify and manage the risks that KBC faces. It helps KBC to achieve its objectives and to realise its strategy.

The KBC Enterprise Risk Management Framework (ERMF), approved by the Board of Directors, defines the risk governance, including the Three Lines of Defence, and sets clear rules and procedures on how risk management should be performed throughout the group. It refers to a set of minimum standards and risk methods, processes and tools that must be translated into all risk-type-specific Risk Management Frameworks (RMFs) and that all entities must adhere to. The ERMF and risk-type-specific RMFs not only detail how KBC manages risks in business as usual, but also in change (small and big transformations) and crisis situations (going from rather mild stress situations and threats to business continuity up to the most stressful situations, like recovery and resolution). They also aim to keep KBC compliant with regulatory requirements.

In order to continuously safeguard their relevance, the ERMF and risk-type-specific RMFs are annually reviewed, while the quality of their implementation is formally assessed once per year.

The risk management process consists of risk identification, risk measurement, setting and cascading risk appetite, risk analysis, reporting and follow-up.

Risk identification

Risk identification is the process of systematically and proactively discovering, assessing and describing risks, both within and outside KBC, that could negatively impact the group's strategic objectives today and in the future. Not only the sources of risk are analysed, but also their potential consequences and materiality.

For the purpose of risk identification, KBC has set up robust and solid processes at both the strategic and operational level to uncover all material risks to which KBC is exposed. These processes include:

- The Risk Scan, which is a strategic group-wide exercise aimed at identifying and assessing the top risks for KBC, i.e. the financial and non-financial risks that are highly significant for our business model. The identified top risks are inputs for the yearly financial planning process and for several risk management exercises, including for defining the priorities of the risk function, risk appetite setting and stress testing.
- The New and Active Products Process (NAPP), which is a group-wide, formalised process to identify and mitigate product-related risks, both for KBC and for its clients. Within the group, no products, processes or services can be created, purchased, changed or sold without approval in line with NAPP governance. The risk department also conducts periodic assessments of the impact of the expanded and/or updated product and service offering on the group's risk profile.
- Risk signals, which are continuously collected at all levels of the organisation (group and local). The internal and external environments are constantly scanned, using all possible sources of information, to detect events or changes that can potentially impact the group, either directly or indirectly. Risk signal reporting provides management with a summary of the identified risks, their potential impact and possible remedial actions.

Risk measurement

KBC defines risk measurement as 'the action to come to a quantitative expression of a risk, or a combination of risks, on a portfolio of instruments/exposures'. Once risks have been identified, certain attributes of the risk can be assessed, such as impact, probability of occurrence, size of exposure, etc. This is done with the help of risk measures, which allow us to assess the materiality of risks, to monitor them over time (with a frequency that is appropriate for the risk type) and to assess the impact of risk management actions.

Risk measures are designed to measure a specific risk or multiple risks at the same time and can be either internally developed or imposed by the regulator (including the calculation method used). An overview of the extensive set of risk measures in use in the KBC group (both regulatory and internally defined) is provided in the ERMF and risk-type-specific frameworks.

Standards

Risk measurement is an important step in the risk management process as it aims to quantify the various risks that KBC is exposed to. However, 'measuring risk' can be challenging, as it typically requires taking in a lot of data, developing (complex) mathematical models and bringing them all together in time-critical calculation and reporting processes. Unsurprisingly, this in itself can lead to measurement risk.

Given this crucial importance of reliable measurements in decision-making, strict guidelines apply for the design, development and use of risk measurements. The requirements that relate to these processes are documented in the KBC Risk Measurement Standards (RMS).

They aim to install a robust challenger process, creating awareness regarding measurement risk and mitigating this risk where possible, without putting undue burden on the company. Hence, implementing the risk measurement standards ensures that:

- the output of a risk measurement process is of good quality and fit for use;
- the measurement process itself is stable/robust, efficient and cost-efficient.

In order to arrive at sound measurements that facilitate decision processes, the following principles are important:

- Transparency: provide stakeholders with a clear view of all aspects relevant to measuring risk, including any shortcomings and errors;
- Four-eyes principle: have a second pair of eyes to ensure stakeholders can have sufficient confidence in the adequacy of the measurement (i.e. does it adequately reflect the underlying risk) so that the measurement outcome can be used with full confidence for reporting/steering;
- Materiality: measures can exclude information or contain imperfections if this does not affect the decision-making process, meaning that management would not come to a different conclusion if the information was included or the imperfection was remedied.

High-quality measurements are only possible if they are based on data of good quality and reliable processes to collect the data and perform the calculations. The business requirements with regard to the organisation, processes and policies necessary for achieving and maintaining data quality in a structured and efficient way are described in a specific KBC Data Management Framework, owned by KBC's Group Reporting Services department. As part of the overall KBC Risk Management Framework, a dedicated Operational Risk Standard on Data Management was adopted in 2023 which defines, among other things, the minimum requirements for the governance of data management risk, including the roles and responsibilities of the first and second lines of defence (risk functions).

KBC Model Risk Management Standards

KBC's data-driven strategy is underpinned by an expanding set of advanced mathematical, statistical and numerical models to support decision making, measure and manage risk, manage businesses and streamline processes. In this context, AI-based models are becoming an increasingly common feature across the different business domains (banking, insurance, asset management). They include specific guidance on how to build data models and use AI models. As the use of models increases, so does the importance of recognising, understanding and mitigating risks related to the design, implementation or use of models, in order to protect both KBC and its clients.

KBC's model risk management standards establish a framework for identifying, understanding and efficiently managing model risk, similarly to any other risk type.

Setting and cascading risk appetite

Taking and transforming risks is an integral part – and hence an inevitable consequence of – the business of a financial institution. Therefore, KBC does not aim to eliminate all the risks involved (risk avoidance) but instead seeks to identify, control and manage them in order to make optimal use of its available capital (i.e. risk-taking as a means of creating value).

KBC's tolerance for risk is captured via its 'risk appetite'. This risk appetite expresses – both qualitatively and quantitatively – how much and which types of risk we want to take and within which boundaries they should be managed. The ability to accept risk is limited by financial constraints (available capital and liquidity buffers, borrowing capacity, etc.), non-financial constraints (strategic ability, skills, legal constraints, etc.) and regulatory restrictions (e.g., regulatory floors on capital and liquidity ratios). The willingness to accept risk depends on the interests of the various stakeholders. A key component in defining risk appetite is therefore an understanding of the expectations of the organisation's key stakeholders.

Risk appetite is made explicit via the 'risk appetite statement' (RAS), which is decided at both group and local level. The RAS reflects the view of the Board of Directors and top management on the acceptable level and composition of risks, ensuring coherence with the desired return and allowing the group to implement its corporate strategy within a clear risk playing field. The high-level risk appetite objectives, which are annually reviewed and reconfirmed by the Board, are further detailed for each separate risk type via qualitative and quantitative statements and via a risk appetite label, which can be Low, Medium or High. The long-term risk appetite is monitored based on a set of risk measures for which risk thresholds are defined. Lastly, risk appetite is translated into risk-type-specific group limits/targets, which are further cascaded down to the entities.

The risk appetite process is firmly embedded in the financial and strategic planning process (APC - Alignment of Planning Cycles) as it directs the focus and way of working of business and control functions and helps to set priorities accordingly. The Board of Directors annually approves the preliminary risk appetite as input for the APC. When the financial planning is approved by the Board, the final risk appetite is also determined, which is to be respected throughout the planning horizon. For this purpose, the risk appetite is translated into concrete limits and targets ensuring that the risk profile remains within the risk appetite when the financial plan is executed. Adherence to the limits is strictly monitored. In case of limit breaches, decisions need to be taken by the appropriate committees in the organisation to bring the risk profile back within the approved risk appetite.

In the graph below, the actual and expected risk-taking in line with the APC forecast ('risk profile') is compared to the approved risk appetite. The overarching risk profile is expected to improve within the 'medium risk' zone, driven by lower risk profiles for capital, sustainable performance, operational risk and compliance risk, which compensate an expected increase in the credit, market trading, technical insurance and liquidity risk profiles.

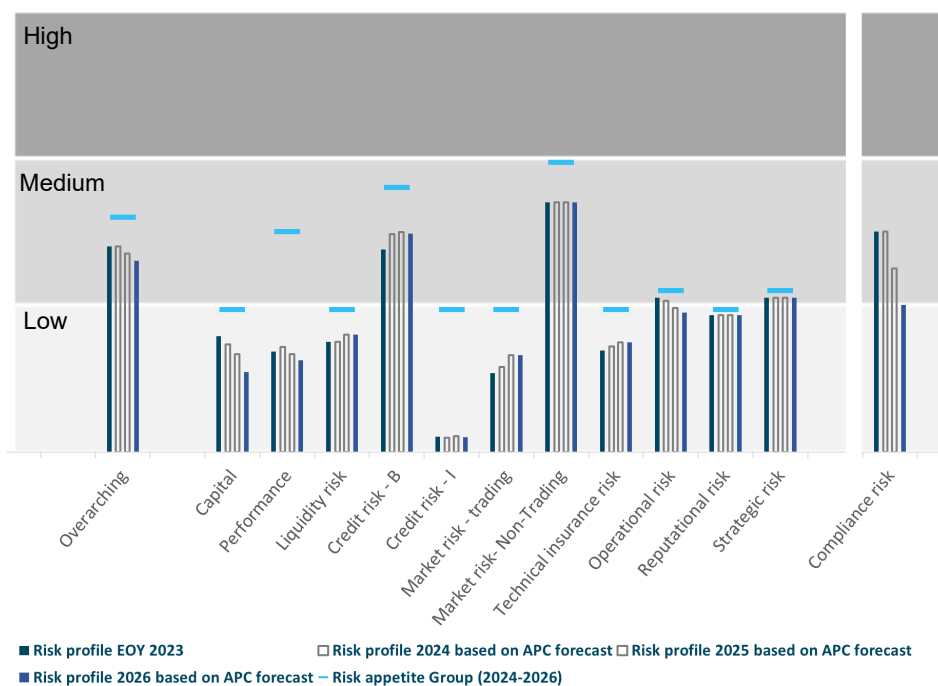


Figure 2 - Schematic overview of risk appetite statement

Risk analysis, reporting and follow-up

Risk analysis and reporting aim to give management an increased level of transparency by providing a comprehensive, forward-looking and ex-post view of the development of the risk profile versus the risk appetite and of the context in which KBC operates.

This is done via reports that are tailored to the needs of the recipients and recognise the different information needs of the Board, senior management and other levels in the organisation, helping them to understand the potential issues and to take the relevant actions. In addition to internal reporting, external reports are also prepared for the different stakeholders of KBC Group, in particular clients, shareholders, debt holders, supervisory authorities, regulators and rating agencies.

The Executive Committee, the Risk & Compliance Committee and the Board of Directors receive periodic and ad hoc updates on KBC's risk landscape through comprehensive internal risk reporting. This includes the 'Integrated Risk Report', which is submitted to these committees eight times per year. This holistic risk report consists of risk signals considered material for the group, allowing us to take timely action if and as needed, and of an overview, for all risk types, of the development of various risk measures versus the risk appetite via the 'health check' dashboard.

The main external reports to the supervisory authority include the ICAAP (Internal Capital Adequacy Assessment Process), ILAAP (Internal Liquidity Adequacy Assessment Process), and ORSA (Own Risk and Solvency Assessment) reports. These provide a holistic and substantiated underpinning of the opinion of the Board and the ExCo on the adequacy of KBC's capital and liquidity. A FICO (Financial Conglomerate) report is also prepared annually. It provides an overview of KBC as a financial conglomerate, with a focus on the financial, commercial and operational interlinkages between its bank, insurance and asset management operations, on the risks that are particularly relevant in this context, and on how these are managed and mitigated. The KBC Group Recovery Plan is also submitted to the supervisory authority, whereas KBC has many deliverables as well towards the resolution authorities in order to support them in preparing a resolution plan for KBC.

Stress testing

Sound risk management does not only apply to business as usual, but also to change and crisis situations (going from rather mild stress situations up to the most stressful, like resolution). In this perspective, stress testing is an important tool to support our risk management and decision-making processes by simulating the potential negative impact of specific events and/or movements in risk factors on KBC's (financial) condition, so that we can better prepare for these situations or adjust our risk exposure proactively.

For this purpose, KBC has developed a comprehensive set of stress tests, ranging from plausible to exceptional and even extreme events or scenarios, both at the level of individual risk types and across risk types (integrated stress tests). The latter look at the interaction and combined impact of stress across multiple risk types, including interaction and feedback loops between stresses on financial indicators.

The outcome of these stress tests is used in important risk management processes and reporting, including ICAAP, ILAAP and ORSA, and recovery and resolution planning. As part of the annual ICAAP, ILAAP and ORSA processes, KBC simulates a once-in-20-years stress event to check and demonstrate that it is able to meet the regulatory capital and liquidity requirements and internal risk appetite targets even under such stressed conditions. Stress tests designed in the context of Recovery Planning are even more severe and bring KBC to the brink of default. In such scenarios, KBC needs to demonstrate its recovery capacity (in terms of both depth and speed of capital-increasing and risk-reducing actions). Finally, stress testing in the context of resolution prepares KBC for situations when the group is no longer viable and authorities need to step in to either save (via bail-in mechanisms) or liquidate the group.

On top of stress testing performed on KBC's own initiative (at group and/or local level), the regulator and supervisory authority can also impose stress tests (e.g., biannual EBA Stress Test, annual EIOPA stress tests, ECB climate stress test, ECB cyber stress test).



ESG in our risk management

ESG risks are the risks of (current or prospective) Environmental, Social or (corporate) Governance (ESG) factors impacting KBC, directly or via its counterparties/exposures. Environmental risk is the risk arising from climate change (climate risk) or from other environmental degradation (such as biodiversity loss, water stress, pollution and waste).

- Environmental risk is the risk arising from climate change (climate risk) or from other environmental degradation, such as biodiversity loss, scarcity of fresh water, (air, water and soil) pollution, and inadequate waste management.
- Social risk is the risk arising from changing expectations concerning relationships with employees, suppliers, clients and communities, such as labour and workforce considerations (labour standards, working conditions, diversity and inclusion, health and safety), human rights and poverty, community impact, client relationships (client protection, including cyber risks, product responsibility, responsible marketing), etc.
- Governance risk is the risk arising from changing expectations concerning corporate governance (corporate policies and codes of conduct, such as responsibilities of senior staff members, remuneration, internal controls, shareholder rights), anti-corruption and anti-bribery, and transparency (e.g., in tax planning, external disclosures, etc.).

In our risk taxonomy, Environmental, Social and Governance risks are identified as key risks related to KBC's business environment which manifest themselves through (all) other traditional risk areas, such as credit risk, technical insurance risk, market risk, operational and reputational risk. As such, ESG is not considered in isolation, but firmly embedded in all aspects and areas of KBC's Risk Management Framework and underlying processes.

This section gives a comprehensive overview of our main ESG risk management processes from a cross-risk-type perspective. For a more detailed overview of our ESG risk management processes of relevance to specific risk types, please refer to the risk-type-specific disclosures in the remainder of this section, which includes a dedicated ESG risk sub-section.

ESG as a cornerstone of KBC's strategy



KBC aims to support the transition to a more sustainable and climate-resilient society now and in the future, working together with its clients and other stakeholders. For this reason, sustainability is an integral part of our overall corporate strategy and embedded in our day-to-day business activities and the products and services we offer.

We aim to maximise our positive impact on society and avoid or limit the negative impact of our products and services. In order to guarantee KBC's long-term sustainability and financial resilience, we pursue strict ESG risk management. Processes and initiatives have been implemented for all three pillars (Environmental, Social and Governance). This section focuses on our ESG risk management processes. Our sustainability

strategy and related opportunities are more thoroughly discussed in the 2023 Sustainability Report, which also includes an overview of the commitments we have made and the international frameworks we adhere to.

In society, too, sustainability and climate change are getting more and more attention as the consequences of climate change are becoming increasingly visible (as evidenced by the 2021 floods in Wallonia and the extreme drought in Europe in the summer of 2023). These climate change impacts are changing the expectations, mindset, consumption and investment patterns of our stakeholders. At the UN Climate Change Conference in Dubai (COP28), countries reaffirmed the Paris Agreement goal of limiting the increase in the global average temperature to well below 2°C (while striving for a target of 1.5°C) above pre-industrial levels and stressed again that global ambition must increase substantially to keep the 1.5°C objective within reach. In February 2024, the European Commission recommended reducing the EU's net greenhouse gas emissions by 90% by 2040 relative to 1990. In the World Economic Forum's 2024 Global Risk Report, the occurrence of extreme weather events is listed as the biggest global risk for the next ten years. Other environmental risks, such as critical change to Earth systems, biodiversity loss, ecosystem collapse and natural resource shortages complete the top 4.

By means of our dedicated Sustainable Finance Programme – which is embedded in our sustainability strategy – we focus on limiting our adverse impact and increasing our positive impact by:

- incorporating environment-related opportunities into our core products, such as bonds, loans, investments and insurance contracts, as much as possible;
- reducing the risks of and exposure to sectors and product lines that have the largest environmental impact; and
- engaging, working with and supporting our clients in their transition towards climate resilience and increasingly including other environmental topics (such as deforestation or plastic pollution, which are gaining attention) in these discussions.

Although the focus of our Sustainable Finance Programme was initially on climate change, we are continuously expanding our scope to include other environmental objectives.

See also 'ESG is embedded in the risk appetite process' in this section for more details on how our sustainability policies determine our risk playing field by formulating clear restrictions and zero tolerances for potentially harmful activities.

Since 2018, climate risk has been reconfirmed as a top risk for KBC in the annual Risk Scan exercise. In 2023, 'other environmental risks' were added to account for the increasing importance of the impacts of environmental degradation.

- If not addressed, climate change is expected to have devastating effects (extreme storms, floods, natural resource shortages, food and water crises, pandemics, mass migration, economic crisis, etc.) with extremely high costs for society, including for financial institutions and their customers;
- The path towards a greener economy on the other hand remains highly dependent on technological breakthroughs, upcoming (EU) policies, regulations and actions by governments (e.g., stricter energy efficiency and nature restoration rules, incentives from the EU Green Deal). These can impact the stability and value of our loan and investment portfolios.

We refer to Annex III for more information.

When managing climate and other environmental risks, we differentiate between:

- Transition risks: risks arising from disruptions and shifts associated with the transition to a low-carbon, climate-resilient or environmentally sustainable economy which include policy changes (e.g., imposition of carbon-pricing mechanisms, energy efficiency requirements or encouragement of sustainable use of environmental resources), technological changes/progress (e.g., old technology replaced by cleaner technology) or behavioural changes (e.g., where consumers or investors shift towards more sustainable products and services or difficulties to attract and retain customers, employees, investors or business partners for companies with a reputation of harming the environment).
- Physical risks: risks related to potential financial implications from physical phenomena associated with both climate and environmental trends such as (chronic) changing weather patterns, rising sea levels, increasing temperatures, biodiversity loss, resource scarcity, reduced water availability, changes in water and soil productivity, etc. and extreme weather events (acute), including storms, floods, fires, heat waves or droughts that may disrupt operations or value chains or damage property.

KBC approaches climate risk from a double materiality perspective, concentrating on both:

- Financial materiality (outside-in view), looking at the impact of climate change on our business. Transition risks, for example, can lead to sudden repricing of assets, market volatility, credit losses and climate-related litigation resulting from financing obsolete (brown) technology or infrastructure, impacting lending and investment portfolios, whereas physical risk can increase the level of claims under the insurance policies we provide as well as the value of our assets or collateral; and
- Environmental and social materiality (inside-out view), looking at our business' impact on the environment. In that regard, KBC has stated publicly that it wants to play a leading role and be a significant lever in the process of transitioning to a more sustainable society and a low-carbon economy, including by committing to aligning its portfolios and business strategy with the Paris Agreement to keep global warming below 2°C while striving for a target of 1.5°C. More information about our decarbonisation targets can be found in the KBC Sustainability Report.

A comprehensive overview of the actions we take as part of our commitment to the environment and the climate is available in the 'Sustainable Finance' section of the 2023 Sustainability Report, which also includes our TCFD (Task Force on Climate-related Financial Disclosures) report. In the next section, we focus on the 'Risk Management' pillar of the TCFD framework.

This section gives a comprehensive overview of our main ESG risk management processes from a cross-risk-type perspective. For a more detailed overview of our ESG risk management processes of relevance to specific risk types, please refer to the risk-type-specific disclosures in the remainder of this section, which includes a dedicated ESG risk sub-section.

Regulation and supervision

The growing attention for the management of ESG risks is also reflected in several legislative initiatives. For banks under ECB remit (such as KBC), for instance, supervisory requirements are formulated in the ECB guide on climate-related and environmental risks.

The newly proposed EU Banking Package CRD6 and CRR3 sets out new regulatory requirements on how banks manage their ESG risks. In this respect, the EBA has also published:

- a report on the role of environmental and social risks in the prudential framework, proposing targeted enhancements to the current Pillar 1 framework,
- draft guidelines on the management of ESG risks, setting requirements for the internal processes and ESG risks management arrangements that institutions should have in place.

KBC has also implemented current ESG-related disclosure requirements (e.g., EU Taxonomy, EBA Pillar 3, Sustainable Finance Disclosure Regulation (SFDR)) and is preparing for upcoming regulation (such as the Corporate Sustainability Reporting Directive (CSRD) and the EIOPA insurance Climate Quantitative Reporting Templates). See also 'Risk analysis, monitoring, reporting and follow-up'.

When integrating ESG risks in all existing risk management processes, KBC aims for full compliance with (upcoming) regulatory requirements.

Integration of ESG in existing risk management governance

The management of ESG risks is fully embedded in our existing Risk Management Governance, as described in the 'Risk governance' section.

With regard to the first, second and third lines of defence, a hybrid organisational structure and governance, with strong central management and clear local accountability in each of our core countries, are in place to ensure that sustainability topics receive the necessary attention and resources in our business operations and strategies.

- The risk function is actively represented on KBC's sustainability committees:
 - The Group CRO is a member of the Executive Committee, the committee having the highest level of direct responsibility for sustainability and climate change.
 - Senior management of the risk function is represented on the Internal Sustainability Board (ISB), the main platform for driving sustainability at group level, and its supporting sustainability committees (the Sustainable Finance Steering Committee, the Sustainable Finance Data & Metrics Steering Committee and the CSRD Steering Committee). Additionally, Risk is part of the core team of the Sustainable Finance Programme, which focuses on integrating environmental matters throughout the group.
 - As strong embeddedness in the local organisation is a key requirement, similar governance is in place in each of KBC's core countries, with local general sustainability managers having been appointed and local risk functions taking active part in locally established sustainability committees.
- Within our Audit Framework, ESG risks are covered in multiple audit tracks.
- Sustainability has been integrated into the remuneration systems for our employees and especially our senior management.
- We continue to take several initiatives to further increase ESG risk awareness, for example by following up on new and changing regulations through a Sustainable Finance Legal Working Group and by organising internal communication and training for (risk) staff and management.

Integration into risk management frameworks and processes

ESG risks are identified in our risk taxonomy as key risks related to KBC's business environment. ESG risks are considered important risk drivers of the external environment and manifest themselves through all other traditional risk areas, such as credit risk, technical insurance risk, market risk, operational risk and reputational risk.

When assessing the potential impacts of ESG risks, we consider three angles, ranging from direct to indirect impacts:

- direct impacts through our own operations, e.g., our own environmental footprint, workforce considerations, diversity and inclusion, corporate governance and codes of conduct;
- impacts through our outsourced activities and suppliers (related to the ESG profile of these third parties); and
- indirect impacts through our core activities (lending, insurance and investment) and clients/exposures.

As such, ESG is not considered in isolation, but firmly embedded in all aspects and areas of KBC's risk management (covering the three above-mentioned angles), for example in the New and Active Products Process (NAPP), in outsourcing processes and in lending, insurance and investment processes. More details are included in this section and in subsequent (risk-type-specific) sections.

Managing indirect ESG impacts

As a financial institution, we are vulnerable to ESG risks mostly indirectly, i.e. with impacts materialising through our core activities (lending, insurance and investment). Although risk assessment methodologies for managing these indirect impacts are more advanced for climate risk compared to some other ESG risk areas, KBC is making continuous efforts to further improve the integration of climate and other ESG risks in the KBC Risk Management Framework and in its risk management processes, for all of KBC's core activities.

When developing our ESG risk management approach, we are taking steps to deal with the specific challenges that are inherent to the assessment of ESG risks:

- There is currently still a lack of data and standardised methods to properly assess and measure ESG risks with the same level of accuracy and quality as is usual for the more traditional risk types. In order to enable a more data-driven approach towards managing ESG risk, we continue to increase our efforts to identify ESG-related data needs, define ESG metrics, adjust data architecture and ensure the implementation in our reporting processes. Since 2022, climate-related data is managed via KBC's dedicated Data & Metrics project (with a separate Steering Committee, involving all core countries and group functions). Core projects managed by the Data & Metrics project relate to the implementation of the EBA binding standards on Pillar 3 disclosures on ESG risks (see Annex III), the EU Taxonomy Regulation and Corporate Sustainability Reporting Directive, as well as to the collection of the necessary data required for setting emission reduction targets for the most climate-relevant sectors (see 'Policies, restrictions and targets' in this section). Significant efforts have already been made to structurally gather key sustainability data such as clients' GHG emission and location data and energy performance data for collateral, and to develop proxies in case of unavailability. The availability and accuracy of those data points will remain an important challenge in the coming years, for instance due to the unavailability of up-to-date EPC labels which are harmonised across different countries and due to the shortage of reliable sustainability data for companies that are exempt from the upcoming ESG disclosure regulation.
- Furthermore, we continuously investigate external developments and potential new methodologies, tools and services, in order to continue to build up relevant knowledge and expertise and gradually gain more insight that

enables us to take additional steps to advance our risk management processes and practices (e.g., adapting credit/insurance/investment policies, adjustment of credit assessment processes, etc.).

- Given that the materialisation of environmental risks builds up over an extended period (with transition risks dominating in the short and medium terms and potential severe physical hazards occurring more frequently in the longer term), we have adjusted our risk processes to make sure that, in addition to the more traditional short-term impacts, medium and long-term considerations are also integrated into risk identification, risk appetite, stress testing and risk reporting.
- Depending on the measures adopted to contain the ongoing deterioration of environmental conditions and its impacts (e.g., economic policies and related regulatory interventions set by governments, technological progress or changing consumer behaviour), different economic and social implications are conceivable. In order to deal with this uncertainty in our climate risk assessments, we consider a range of climate scenarios (making specific assumptions on technological and policy changes and translating these into impacts on, for example, energy production, greenhouse gas (GHG) emissions, oil consumption, etc.).

Managing direct ESG impacts

As responsible behaviour is one of the cornerstones of KBC's sustainability strategy (see KBC's Sustainability Framework at www.kbc.com), many ESG aspects related to our own operations (e.g., our own direct footprint, compliance risks, cyber risks) are already properly managed, monitored and reported to the Group Executive Committee and the Board of Directors.

Social and governance aspects of our own operations are handled within several KBC departments, such as Group Corporate Sustainability, HR (e.g., employee growth and development, diversity and inclusion), Facilities (workplace safety), Compliance (compliance risks), Risk (cyber and other operational risks), Marketing & Communication (responsible marketing), Complaints Handling, etc.

In the 'Our people' and 'Our responsibility' sections of the 2023 Sustainability Report, more information can be found on KBC's initiatives regarding employee growth and development, a safe and healthy working environment, social dialogue, and diversity and inclusion. In this regard, KBC has signed the Principles for Responsible Banking (PRB), the Principles for Responsible Investment (PRI), the Principles for Sustainable Insurance (PSI) and the UN Global Compact. The latter supports companies in doing business responsibly by aligning their strategies and operations with the Ten Principles on human rights, labour standards, the environment and anti-corruption.

In the sections below, KBC's approach towards the integration of climate and other ESG risks into its risk management frameworks and processes is further elaborated. In separate sub-sections, we will zoom in on the general processes in place to perform ESG risk identification, risk measurement, risk appetite and risk reporting.

For a more detailed overview of our ESG risk management processes of relevance for specific risk types, please refer to the risk-type-specific disclosures in the remainder of this section, which includes a dedicated ESG risk sub-section.

We are taking a step-by-step approach where follow-up actions are defined based on the insights gained from our previous actions/analyses and depending on, for example, the availability of data and methodologies and further regulatory developments.

Strong focus on risk identification and materiality assessment

We use a variety of approaches and processes to identify ESG risks, in the short term (0-to-3-year horizon), as well as the medium term (3-to-10-year horizon) and the long term (beyond 10-year horizon). By doing so, we also incorporate a forward-looking perspective. This group-wide process involves all necessary stakeholders, including entities from the business side, corporate sustainability and asset management. To ensure proactive risk identification, we have taken several initiatives:

- ESG risk signals are regularly reported to the Group Executive Committee, the Risk & Compliance Committee and the Board of Directors via the Integrated Risk Report.
- As of 2021, we annually update the Climate Risk Impact Map, our main risk identification process for assessing the materiality of climate risk drivers impacting KBC's businesses and portfolios, for different time horizons and different climate scenarios. In 2023, we have performed several additional identification exercises to increase our understanding of other environmental risks (biodiversity loss, pollution and water stress), leveraging the methodology used for the Climate Risk Impact Map (hence also considering different physical and transition risk drivers and time horizons). These pilot exercises have enabled the extension of the Climate Risk Impact Map to a more general Environmental Risk Impact Map. The conclusions of these analyses feed into our main risk management processes, such as risk appetite, stress testing, reporting and our ICAAP/ILAAP/ORSA process. See below for more information.

Additional ESG risk identification tools have been developed within the scope of several risk-type-specific ESG risk management practices (e.g., ESG assessments in loan origination, integration of ESG into the New and Active Products Process and outsourcing, etc.). More information about these can be found in the dedicated risk-type-specific sections in the remainder of this report.

Extending the Climate Risk Impact Map with other environmental risks

In 2021, KBC initiated the development of a Climate Risk Impact Map. This annual risk identification process aims to identify the most material climate risk drivers for KBC's businesses and portfolios. It reflects the impact of transition risk (policy and regulation, technology and consumer preferences) and physical risk (split according to different climate perils) drivers on the traditional risk types:

- by distinguishing between different drivers of transition and physical risk,
- by considering three distinct industry-standard climate scenarios made available by the Network for Greening of the Financial System (NGFS), i.e. the Net Zero 2050, Delayed transition and Current Policies scenario,
- for three different time horizons: short (0-3 years), medium (3-10 years) and long term (>10 years), as the impacts of climate risk will materialise over different time horizons.

More information on the assessed transition and physical risk drivers, how these can impact our counterparties ('transmission channels') and the climate scenarios considered is available in Annex III.

In the Climate Risk Impact Map, impacts are assessed in an expert-based way, supported by already available quantitative insights. With every (yearly) review of the Impact Map, additional insights, data and quantification are added to the basis for the assessments to allow KBC to evaluate climate risk in a progressively data-driven way.

In addition to a Climate Risk Impact Map at KBC Group level, separate maps have been constructed for Bank, Insurance and Asset Management. Additionally, separate maps have been prepared for our core countries, given that the materiality of climate-related risks can differ across different jurisdictions (transition risks) and locations (physical risks).

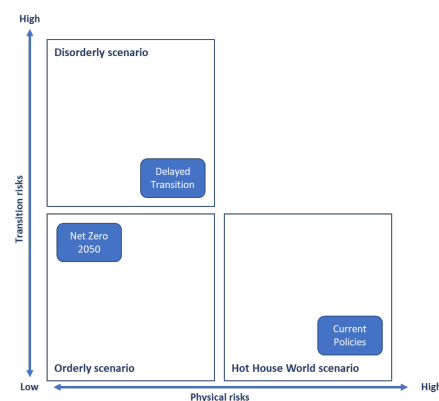


Figure 3 - Scenarios by the Network for Greening the Financial System (NGFS)

In general, considering the risk drivers and transmission channels listed above, the Climate Risk Impact Map results in the following conclusions:

- Transition risks are mainly expected to materialise in the 'Net Zero 2050' scenario on a short and medium time horizon, relatively subdued in case of the 'Orderly transition' and in a more extreme way in the 'Delayed transition' scenario on a longer time horizon (as the scenario assumes an abrupt transition to take place around 2030);
- Physical risks are gradually building up over time in all three scenarios, but to different degrees: whereas they remain relatively under control in the 'Net Zero 2050' scenario and are more pronounced in the 'Delayed transition' scenario, physical risks are assumed to lead to extreme weather conditions with devastating impacts in a 'Current policies' scenario.

Although some impacts could already become visible in the short term (e.g. related to emission-related regulation affecting companies' income and expenses (in climate-vulnerable sectors), or potential physical risk impacts) there are no indications that these impacts will already become material for any of the risk types.

Looking ahead to the medium and long terms, we expect upward pressure from climate change on technical insurance risk, credit risk, legal risk and reputational risk (under the conservative assumption that KBC's portfolio remains unchanged and no additional mitigating actions are taken). These impacts stem both from transition risk and physical risk drivers. More specific considerations per risk type are included in the ESG parts of the risk-type-specific sections.

The conclusions from the Climate Risk Impact Map have been incorporated into our risk management processes. In particular, the Impact Map's insights enable us to incorporate the most material climate risk drivers into our stress testing exercises, and to consider different time horizons and climate scenarios when doing so (see also 'Strengthening ESG risk measurement and stress testing'). The Impact Map's conclusions also allow us to address the most material climate risks within the risk appetite, for example by adjusting policies and setting climate targets and key risk indicators (see also 'ESG is embedded in the risk appetite process' in this section), and to follow up on the associated metrics and targets within our reporting processes. As such, the Climate Risk Impact Map is crucial input to ICAAP/ILAAP/ORSA and the assessment of the impact of climate change on strategic and business model risk.

A qualitative overview of the most material climate-risk-related vulnerabilities and their potential impacts on the traditional risk types is provided in the dedicated ESG sections in the remainder of this report. A distinction is made between transition risk (🏢) and physical risk (🌡️) impacts. Additionally, a distinction between short-term (ST), medium-term (MT) and long-term (LT) expected impacts is reflected in the accompanying tables for the three scenarios being considered. The intensity of the blue shading reflects the severity of the potential impact under the conservative assumption that KBC's portfolio remains unchanged and no additional mitigating actions are taken (static balance sheet assumption).

Extending our approach to other environmental risks

In 2023, we have performed several additional identification exercises to increase our understanding of three other environmental risks (biodiversity loss, pollution and water stress), leveraging the methodology used for the Climate Risk Impact Map (hence also considering different physical and transition risk drivers and time horizons). These environmental risk pilot exercises enable the extension of the Climate Risk Impact Map to a more general Environmental Risk Impact Map.

The main conclusions per risk type of these assessments are included in the ESG parts of the risk-type-specific sections throughout this document. Below, a general overview of potential impacts (applicable across KBC Group) is provided.

Biodiversity loss	<p>Biodiversity loss refers to the reduction of any aspect of biological diversity (i.e. diversity at the genetic, species and ecosystem levels) in a particular area through death (including extinction), destruction or manual removal. This may lead to a decline in the provision of services with a negative impact on the economy.</p> <ul style="list-style-type: none"> • Because of biodiversity loss, companies' costs might increase due to increasing transition risks (investments required to mitigate biodiversity loss) or because physical assets (such as crops) are damaged due to the disruptions that biodiversity loss causes to the environment. Ultimately, companies risk ending up with stranded assets and/or encountering increasing litigation costs. • If the above negative financial consequences are factored into prices, prices that households have to pay might also increase. <p>»» Examples of sectors that greatly impact and/or are highly dependent on ecosystem services are agriculture, food and beverage producers, health and pharmaceuticals and the chemical industry.</p>
Water stress	<p>Water stress occurs when there is not enough available, qualitative (to the extent that it is unfit for use) and accessible water to meet the demands of people and the environment.</p> <ul style="list-style-type: none"> • Companies that use water in their manufacturing process, use water in their products or are dependent on water via their supply chain risk having to deal with increasing costs if water stress risk were to materialise. In extreme cases, reallocation of their activities might even be necessary, further increasing the costs. • For households, which are dependent on fresh water and water utilities, costs might consequently also increase in situations of water stress. Also, if the quality of fresh water is not good enough, increasing health care issues might arise. <p>»» Examples of sectors that greatly impact and/or are highly dependent on water are agriculture, food and beverage producers, the chemical industry and the energy sector. Dwindling water supply can also cause supply chain disruptions as well as water and food insecurity, potentially impacting the economy as a whole.</p>
Pollution	<p>Pollution relates to the direct or indirect introduction, as a result of human activity, of harmful substances, vibrations, heat or noise into air, water or land that may be harmful to human health or the quality of the environment, result in damage to material property, or impair or interfere with amenities and other legitimate uses of the environment.</p> <ul style="list-style-type: none"> • Companies can be directly affected if transition risk drivers force them to invest and change the way they operate and/or if their employees are increasingly ill because of pollution. However, companies can also be indirectly impacted if their supply chain is affected by these risks. Both might result in increasing costs and litigation risk.

- If the above negative financial consequences are factored into prices, prices that households have to pay might also increase. Additionally, health expenditures and mortality rates might go up if households are increasingly exposed to any kind of pollution.



For example, the agricultural sector is more vulnerable to the impact of pollution-reducing measures due to its use of fertilisers. The chemical industry is also under pressure to adapt production processes to reduce pollution (as the European Environment Agency estimated in 2016 that 62% of chemicals (by volume) consumed in Europe were hazardous to the environment and human health).

Table 2 - Other environmental risks (E-risks) and their impacts

Strengthening ESG risk measurement and stress testing

We make use of a series of tools and methodologies to strengthen our ability to identify, measure and analyse climate-related risks by leveraging industry practices (such as the Partnership for Carbon Accounting Financials (PCAF) and the Paris Agreement Capital Transition Assessment (PACTA)) but also by using internally developed tools.

We cover multiple time horizons and use a combination of methodologies, including:

- exposure-based methodologies (e.g., implementation of the ESG assessment for our loan book),
- portfolio alignment-based methodologies (e.g., in the context of our climate targets, PACTA, TRUCOST), and
- scenario-based methodologies (e.g., scenario analyses and stress testing).

The results of these exercises provide further insights into the impact of climate and ESG change on our business model, as well as the impact of our lending, investment and insurance activities on the environment (double materiality). Integrating these methodologies enables us to gradually improve credit underwriting and investment policies, and support us in engaging with our clients.

Below, an overview is provided of integrated/group-wide scenario analyses and stress tests in which ESG is gradually being embedded. For risk-type-specific stress tests (for example, for credit or market risk) and their outcomes, we refer to the risk-type-specific sections in the remainder of this report.

Stress testing and sensitivity analyses

Climate risk and other ESG risks have a prominent role in the scenarios of KBC's stress tests and sensitivity analyses. Non-environmental drivers, such as failure of data protection or operational risk losses from possible cyber hacks, are also included in several stress-testing exercises such as reverse stress testing and the ICAAP/ORSA stress test.

Climate transition and physical risks as well as social risk drivers have already been integrated into several internal stress-testing exercises (see below).

- In reverse stress testing, as part of our capital adequacy assessment, two (severe) climate risk scenarios have been included to KBC's stress-testing mix and split into two sub-scenarios.
 - One scenario relates to highly elevated transition risk (fitting a very severe 'Disorderly transition' scenario with disruptive policy actions. Credit risk and market risk (trading and non-trading activities) have been included in the stress-test calculations by considering corporate and SME PD downgrades across entire climate-vulnerable sectors and spillovers to equity markets. The scenario also assumes a transition-risk-related reputational loss event which causes a loss of interest income and fee and commission income.

- The second scenario focuses on severe physical climate risk impacts. Credit risk and technical insurance risk impacts have been included in the stress-test calculations by considering corporate and SME PD downgrades in entire climate-vulnerable sectors, spillovers to equity markets, and increasing life and non-life insurance claims. The scenario also assumes an operational loss caused by a major flood event.
- The reverse stress test scenarios also included a simulation of a cyberattack leading to a data breach (social risk) and an ensuing fine and reputational loss for KBC.
- A social risk scenario is also included in reverse stress testing. The scenario assumes that the materialisation of social risk leads to a decrease in the creditworthiness of counterparties in social-risk-sensitive sectors (such as chemicals and health care) and downgrades of countries with low external social-risk ratings.

It can be concluded from the reverse stress tests that even very adverse assumptions regarding the severity of transition and physical risks do not jeopardise KBC's solid capital position. KBC's reverse stress-testing approach assumes instantaneous impacts, even if scenario impacts are in reality expected to take place in the near or distant future.

- In the ICAAP/ORSA/ILAAP stress test (3-year scenario), climate risk was added to the main scenario, which was based on a severe stagflation scenario triggered by geopolitical tension, as an additional sensitivity. This additional component of the scenario assumes that the impact of climate change is felt earlier and more intensely than expected. This leads to an increase in the frequency and severity of windstorms and floods in Western and Central Europe, impacting KBC's property insurance and agriculture and construction portfolios. European governments decide on additional actions, such as accelerated and stricter regulation of EPC requirements and renovations, leading to a downward correction in housing markets. The ICAAP/ORSA/ILAAP stress test also included a cyber risk event in the form of a large-scale DDoS attack, which is a smokescreen for an attempt to obtain sensitive data.
- In the assessment of the financial stability of our business model, mild, medium and severe climate risk stresses were considered on short-, medium- and longer-term time horizons. The scenario follows the narrative that the transition towards a green economy is driving up company costs, is weakening creditworthiness of clients in certain sectors and is increasing insurance claims due to changing weather patterns. Moreover, green competition is putting pressure on volumes. Stress was applied on OPEX, net interest income, expected credit losses and RWA stemming from climate stress on corporate sectors, insurance claims stemming from natural catastrophe events and reinsurance premiums. It was concluded that although profitability can be impacted under the more severe climate-related stresses, these would not bring KBC's profitability below the long-term cost of equity.

Depending on the assumptions applied regarding the severity and nature of climate scenarios, the range of climate-related impacts can vary between different risk quantification exercises. For example, in case of gradual and non-disruptive transition risk stress, profitability can be marginally impacted (an impact of several basis points on return on capital). When making very adverse assumptions, such as entire portfolio segments and economic sectors receiving multiple instantaneous rating downgrades in reverse stress testing, impacts can reach magnitudes of several hundreds of millions of euros of P&L impact.

The results of the scenario analyses and stress tests performed support the conclusion from the Climate Risk Impact Map that no material impact is expected within the short term (i.e. the time horizon of our internal capital model). Under Solvency II, the risks associated with natural catastrophe events (physical risks) are adequately capitalised. In our internal capital, we therefore do not hold additional capital to cover the short-term climate change effects. Nevertheless, we are already acting and reacting today by adjusting our processes, policies, and portfolios in order to be prepared for possible (disrupting) medium- or long-term climate change impacts on capital and as such avoid severe future impacts caused by transition or physical risks.

Climate stress-testing exercises and the use of climate scenarios are continuously enhanced following new insights from, for instance, our internal climate risk map (see 'Risk identification') or other methodological tracks which help us to better translate the impact of climate pathways to financial parameters. In tandem, KBC continues to make significant efforts to enhance data availability which will further enable accurate quantification of the climate and other ESG risks we are exposed to.

Looking ahead, in 2024 KBC will perform an additional dedicated climate risk stress test, covering both transition risks and climate-related physical risk events.

ESG is firmly embedded in the risk appetite process

Risk Appetite Statement

Given the increased importance KBC assigns to ESG risks, ESG has been included in KBC's Risk Appetite Statement at the highest level via a specific ESG risk appetite objective, covering both perspectives of 'double materiality':

KBC Group is committed to embedding ESG considerations into its decision making, risk management processes and client and third-party interactions, with the aim of contributing positively to society and safeguarding KBC's long-term sustainability.

Other objectives also address other ESG themes. These include:

- championing a strong corporate culture which encourages responsible behaviour and is supported by a promotion and remuneration policy with a sustainable and long-term view;
- aiming to attract, develop and retain high-quality and committed staff;
- promoting strong Corporate Governance and Risk & Compliance Management, taking into account the internal and external context as key drivers to enhance the organisation's resilience and to create value.

To be less vulnerable to changes in the external environment – including environmental change – we pursue diversity and flexibility in our business mix, client segments, distribution channels and geographies, where we refrain from focusing on short-term gains at the expense of long-term stability. We manage volatility of net results by defining a solid risk management framework and risk appetite to ensure financial and operational resilience in the short, medium and long term.

The high-level risk appetite objectives are further translated for different risk types. More information about them can be found in the section that discusses these risk types in detail.

When integrating climate-related and other ESG risks into our risk appetite process, we not only focus on short-term impacts, but also take extended time horizons into consideration. Potential short-, medium- and long-term impacts, as identified in the Climate Risk Impact Map (see 'Risk identification, Climate Risk Impact Map' in this section) provide input for our risk appetite discussions so that (early) warning signals can be given in case of expected material impacts (for all time horizons) with the aim of steering the strategic debate and initiating risk-mitigation actions in a timely manner (e.g., making policy adjustments or setting additional targets and limits).

Policies, restrictions and targets

In our policies for sustainable and responsible lending, insurance, advisory services and investments ([link](#)) we identify controversial activities with respect to the environment (including climate and biodiversity), human rights, business ethics and sensitive/controversial societal issues (e.g., tobacco and other intoxicating crops, gambling, fur, mining operations, land acquisition and the involuntary resettlement of indigenous people, and prostitution). These specify the economic activities we are not willing to finance (such as activities related to thermal coal) or only under strict conditions (such as biomass technologies, production of palm oil, etc.). More information can be found in the 'Sustainable policies' section of the 2023 Sustainability Report and in the KBC Group Sustainability Policy Framework (www.kbc.com).

The KBC Group Sustainability Policy Framework reflects international best practices, entailing that, for example:

- KBC will not provide financing or advisory services to projects where the client is unwilling or unable to comply with the Equator Principles;
- KBC is a signatory of the UN Global Compact Principles, which it implements in its policies to make sure they are applied in all its operations. The UN Global Compact asks companies to embrace, support and, within their sphere of influence, enact a set of core values in the areas of human rights, labour standards, the environment and combating corruption.

Our sustainability policies clearly define the ESG risk playing field for credit, insurance, advisory services and investments (asset management and proprietary investments) as well as supporting activities such as procurement and are regularly updated to reflect both society's changing expectations and KBC's evolving ambition level.

More specifically, in our policies we have a number of zero tolerances for, or bans on, lending, insurance and advisory services for certain activities:

- In our [energy policy](#),
 - direct financing of coal-related activities is excluded (note that the remaining direct coal credit exposure was zero in the course of 2023);
 - the exploration and development of unconventional oil and gas (Arctic and Antarctic on- and off-shore, deep water drilling, tar sands, shale) and the exploration of any new oil and gas fields is excluded.
- Under our energy policy, exclusions and restrictions are in place for clients with coal-based energy generation capacity, including, amongst others, a complete ban on financing new clients with coal-based electricity or heat generating activities. In 2022 and 2023, we adjusted the policy to make sure we support as widely as possible the energy transition of existing as well as new clients (irrespective of their existing activities). The exceptional, well-defined purpose-driven financing of renewable energy projects is subject to strict conditions, such as the strict ring-fencing of this type of financing from the company's other activities, to ensure we do not support coal-fired electricity or heat generation activities in any form or shape, whether directly or indirectly.
- Our comprehensive [policy on biodiversity](#) excludes or restricts activities impacting forests, protected areas and endangered species, fisheries, mining, intensive cattle farming, and certain high-impact commodities such as palm oil, soy, sugarcane, coffee and cocoa.
- Companies involved in controversial weapon systems (e.g., nuclear weapons, cluster bombs and biological or chemical weapons) and UN Global Compact Worst Offenders enter the '[KBC Blacklist](#)' and are excluded from all our activities, including the actively managed non-RI funds of KBC Asset Management. A group-wide zero-tolerance policy is in place for 'new business with a company on the KBC Blacklist'.
- We have developed a specific due-diligence process for lending, insurance activities and advisory services. This incorporates procedures to deal with any infringements that are detected.

Additionally, several corporate governance policies and policies on responsible behaviour and business ethics are in place to manage ESG-related compliance risks (see our [sustainability policies](#)).

In addition to the bans and zero tolerances within our policies (see above), we have also set targets:

- to reduce our financed emissions by establishing emission reduction targets for the most material carbon-intensive industrial sectors and product lines in our lending business, in line with the Paris Agreement (see the 2023 Sustainability Report);
- to increase the RI funds' share in annual fund production to 65% by 2030;
- to increase the RI funds' share in total assets under distribution to 55% by 2030;
- to reduce the carbon-intensity of corporate investees in Responsible funds by 50% versus 2019 by 2030;
- to reduce the carbon-intensity of the equity and corporate bond portfolio of KBC Insurance by 40% versus 2019 by 2030;
- to reduce the absolute emissions from direct coal-related lending to zero (*however, KBC already reached this target in the course of 2023*);
- to increase the share of renewable energy loans in the total energy credit portfolio to 75% by 2030;
- to increase the share of green electricity of our own electricity consumption to 100% by 2030 (*however, KBC already reached this target by the end of 2021*);
- to reduce the GHG emissions from our own operations by 80% compared to 2015 by 2030.

Within our annual business planning cycle, we focus on the development of new products that provide sustainable solutions, giving priority to energy, real estate, mobility and agriculture. In particular, the business plans at country level include planned growth of the 'green' portfolio.

Introducing climate-related Key Risk Indicators

In addition to the above-mentioned bans, zero tolerances and targets, in 2023, we have introduced a set of climate-related Key Risk Indicators (KRIs) into our risk appetite process. These were defined for the most material transition and physical risks as identified in the Climate Risk Impact Map; they were established for several risk types and cover a large part of KBC's activities and portfolios. Going forward, we aim to further enhance the set of climate-related KRIs, leveraging improved data and insights.

Risk analysis, monitoring, reporting and follow-up

As described throughout this section, KBC has made significant progress in the integration of ESG risks into its risk management processes, such as risk identification, risk measurement and stress testing, and risk appetite. This translates into extensive and increasing coverage of ESG risks in both internal and external reporting.

Internal monitoring and reporting

The Board of Directors, the Risk & Compliance Committee and the Executive Committee are the prime recipients of the various outputs of the main risk management processes. As ESG risks are being integrated into all processes, they are addressed in several internal reports:

- As ESG risks are already firmly integrated into the Internal Capital & Liquidity Adequacy Assessment Processes (and the Own Risk & Solvency Assessment), these risks are extensively addressed in the corresponding ICAAP/ILAAP (or the ORSA, respectively) reporting and also in management reporting on the related processes (e.g., the Risk Scan, the Risk Appetite Statement, reverse stress testing, financial planning);
- ESG-related risk signals are integrated into Integrated Risk Reporting;
- In 2023, a first Climate Risk Dashboard has been included in the Integrated Risk Report (with a half-yearly frequency), which is submitted to the Executive Committee and the Board of Directors. The dashboard includes an analysis and monitoring of climate-related transition and physical risk metrics for KBC's most relevant portfolios and business lines. As the availability of data and measurement methodologies is gradually improving (see the 'Integration into risk management frameworks and processes' section), monitoring of ESG-related risk will also be further enhanced;
- Indicators for climate-related risks and opportunities are integrated into the KBC Sustainability Dashboard (presented to the Board of Directors twice a year), which allows us to monitor progress in the implementation of our sustainability strategy and to make adjustments when necessary.

External reporting

Several externally published reports describe KBC's approach to sustainability, all with different focus points.

- The Sustainability Report, published on an annual basis, is a comprehensive report on KBC's sustainability performance. The report details how we address corporate sustainability and how we implement our sustainability strategy and Sustainable Finance Programme. It also describes the policies and guidelines we observe, the targets (including decarbonisation targets) we have set and our main achievements.
- KBC's Annual Report includes a summary of KBC's approach towards sustainability, as well as additional reporting on EU Taxonomy eligibility and alignment. Further detail can be found in the 2023 Annual Report, in 'Focus on the climate and the environment' in the 'Report of the Board of Directors' section.
- The Pillar 3 Risk Report (the document at hand) specifically focuses on how we integrate ESG risks into our risk management processes and frameworks. The EBA templates on Pillar 3 disclosures on ESG risk are included as of the 2022 report. In the first iterations of this regulatory reporting exercise, required data inputs are based on information that is collected on a best-effort basis and hence is also reliant on proxy estimations. Consequently, the quantitative templates must be interpreted with care and regarded as work in progress, as, going forward, more and better data sources will become available (e.g., as a result of the further implementation of the Corporate Sustainability Reporting Directive (CSRD) and the European Sustainability Reporting Standards (ESRS)). This should allow a better assessment of KBC's exposure to transition and physical risk based on the reported templates. A one-on-one comparison between this and other externally published group reports is not always possible to the full extent. In addition to the templates themselves, more details on the methodologies and type of estimates used are available in Annex III.
- The Sustainable Finance Disclosure Regulation (SFDR), for which KBC Asset Management is implementing the various disclosure requirements (at entity, service and product level).
- Additionally, KBC's responses to the Carbon Disclosure Project (CDP) Questionnaire are available on the CDP website. CDP is a not-for-profit charity that is considered the 'gold standard' for environmental reporting. In 2023, CDP confirmed KBC's position as a sustainability leader in terms of its climate performance (with an A rating and inclusion on CDP's A List).

- KBC is currently preparing for the upcoming implementation of the Corporate Sustainability Reporting Directive (CSRD), which covers ESG impacts, risks and opportunities related to companies' activities (own activities and value chain), how to assess them and, ultimately, how to report on them (to be included in the KBC Annual Report of 2024).
- KBC also participated in the EBA's one-off Fit-for-55 exercise, which is aimed at assessing the resilience of the financial sector in line with the Fit-for-55 package, and to gain insights into the capacity of the financial system to support the transition to a lower-carbon economy under conditions of stress. For this exercise, the EBA requested climate-related data (using predefined templates) from all participating banks, including KBC Group. The data requested related to credit risk (including real estate risk), market risk, interest income and fee and commission income.



Capital Adequacy

Capital Management is a key management process relating to all decisions on the level and composition of our capital. It aims to achieve the best possible balance between regulatory requirements, rating agencies' views, market expectations and management ambitions.

Solvency at KBC group level

Solvency reporting

We report the solvency of the group, the bank and the insurance company based on IFRS data and according to the rules imposed by the regulator. For the KBC group, this implies that we calculate our solvency ratios based on the Capital Requirements Regulation/Capital Requirement Directive (CRR/CRD).

CRR/CRD implements the Basel rules in Europe and is updated from time to time. When new requirements are implemented, a transitional period may be allowed during which these rules are gradually phased in. KBC currently makes use of transitional measures for Tier-2 instruments issued under third-country law that do not apply a contractual bail-in recognition clause, and of the IFRS 9 transitional measures (applied from the second quarter of 2020). The latter make it possible to add back a portion of the increased impairment charges to common equity capital (CET1) when provisions unexpectedly rise due to a worsening macroeconomic outlook during the transition period until 31 December 2024.

Based on the banking regulation package (CRR/CRD), profit can be included in CET1 capital only after the profit appropriation decision has been made by the final decision-making body (for KBC Group this is the General Meeting). The ECB can allow the inclusion of interim or annual profit in CET1 capital before the decision by the General Meeting. In that case, the foreseeable dividend must be deducted from the profit that is included in CET1. Considering that our dividend policy of 'at least 50% of the consolidated profit of the accounting year' does not include a maximum, the ECB requires the use of a 100% pay-out to determine the foreseeable dividend as long as there is no final dividend decision. Consequently, KBC Group no longer requests ECB approval to include interim or annual profit in CET1 capital before the decision by the General Meeting. As such, the annual profit for 2023 and the final dividend for 2023 will be recognised in the transitional CET1 of the first quarter of 2024, which will be reported after the General Meeting. As of 31 December 2021, the fully loaded figures immediately reflect the interim or annual profit, taking into account our dividend policy and/or any dividend proposal and/or decision by the Board of Directors.

The general rule under CRR/CRD for insurance participations is that an insurance participation is deducted from common equity at group level, unless the competent authority grants permission to apply a risk weighting instead (Danish compromise). As of the fourth quarter of 2020, the revised CRR/CRD requires the use of the equity method, unless the competent authority allows institutions to apply a different method. KBC Group has received the ECB's approval to continue using the historical carrying value (a historical carrying value of 2 469 million euros) for risk weighting, after having deconsolidated KBC Insurance from the group figures. The balance sheet reconciliation is included in Annex I.

The minimum solvency ratios required under CRR/CRD are 4.5% for the common equity tier-1 (CET1) ratio, 6% for the tier-1 capital ratio and 8% for the total capital ratio (i.e. pillar 1 minimum ratios). In addition, CRR/CRD requires a capital conservation buffer of 2.5%.

As a result of its supervisory review and evaluation process (SREP), the competent supervisory authority (in KBC's case, the ECB) can require that higher minimum ratios be maintained (= pillar 2 requirements) because, for instance, not all risks are properly reflected in the regulatory pillar 1 calculations. Following the SREP cycle of 2023, the ECB formally notified KBC that the pillar 2 requirement (P2R) would remain unchanged at 1.86% (of which 1.05% in CET1 taking into account CRD Article 104a). KBC may consider further optimising its capital structure by filling up the AT1 and T2 buckets within the P2R. The pillar 2 guidance (P2G) increased to 1.25% CET1 as of 1 January 2024.

The overall capital requirement for KBC is not only determined by the ECB, but also by the decisions of the local competent authorities in its core markets. The most recently announced countercyclical buffer rates by the countries where KBC's relevant credit exposures are located correspond to a countercyclical buffer at KBC group level of 1.24%, up from 0.75% in 2022. Authorities in Belgium, Slovakia, Bulgaria and Hungary have decided to increase the countercyclical capital buffers.

For Belgian systemic financial institutions, the National Bank of Belgium (NBB) had already announced its systemic capital buffers at an earlier date. For the KBC group, this means that an additional capital buffer of 1.5% of CET1 is required.

On 1 May 2022, the NBB introduced a sectoral systemic risk buffer. It replaces the former risk-weighted assets (RWA) add-on for exposures secured by residential real estate in Belgium and is to be held by all banks that apply the Internal Ratings-Based approach (IRB). The amount of the CET1 capital buffer corresponds to 6% as from April 2024 (9% until then) of the RWA for exposures secured by residential real estate in Belgium, which corresponds to 0.14% of total RWA for KBC Group Consolidated.

Altogether, this brings the fully loaded CET1 requirement (under the Danish compromise) to 10.92%, with an additional pillar 2 guidance (P2G) of 1.25%.

The data above reflect the situation as known on 31 December 2023, without taking into account changes – if any – communicated after that date.

KBC aims to be one of the better capitalised financial institutions in Europe. As a consequence, the dividend policy of KBC Group is tailored to that aim. Each year, the Board of Directors will decide at its discretion on the total dividend based on an assessment of risks, forward-looking profitability and strategic opportunities.

The dividend policy prescribes

- a pay-out ratio (i.e. dividend + AT1 coupon) of at least 50% of the consolidated profit for the accounting year;
- an interim dividend of 1 euro per share in November of each accounting year as an advance on the total dividend.

On top of the pay-out ratio of at least 50% of consolidated profit, each year (when announcing the full-year results) the Board of Directors will make a decision at its discretion on the distribution of the capital above a 15.0% fully loaded CET1 ratio, the so-called 'surplus capital'. This surplus capital can be distributed in the form of a cash dividend, a share buyback or a combination of both.

After having received ECB approval, the Board of Directors decided to distribute 1.3 billion euros in the form of a share buyback, which started on 11 August 2023 and will end by August 2024. As such, an amount of 1.3 billion euros is deducted from the fully loaded and transitional common equity ratio as of the third quarter of 2023. An amount of 497 million euros was purchased at the end of 2023 (which has been deducted from IFRS parent shareholders' equity); the remaining 803 million euros to be purchased is deducted separately from the fully loaded and transitional common equity ratio.

The Board of Directors will propose to the General Meeting of Shareholders of 2 May 2024 a final gross dividend of 4.15 euros per share related to the accounting year 2023, consisting of:

- an interim dividend of 1.00 euro per share (412 million euros in total), as decided by KBC Group's Board of Directors on 9 August 2023 and paid on 5 November 2023);

- an ordinary dividend of 3.15 euros per share, to be paid on 15 May 2024 (1 287 million euros in total based on the number of shares as at 31 December 2023; the effective amount that will be paid depends on the number of shares at ex-coupon date, excluding the shares that are bought back until that date).

Solvency figures under CRR/CRD

A summary calculation of the KBC group's solvency ratios under the Danish compromise method is given in the table below, including a breakdown of the deductions and filters applicable to KBC.

In order to meet the requirements for disclosure of the specific items on own funds described in points (d) and (e) of Article 437 (1) of Regulation (EU) No 575/2013, institutions shall complete and publish the general own funds disclosure template as defined in Article 4 of Commission Implementing Regulation (EU) No 1423/2013.

These regulatory required templates can be found in a separate Excel file on the kbc.com website, published alongside this Risk Report.

Solvency at group level (consolidated; under CRR/CRD, Danish compromise method)

In millions of EUR	31-12-2023	31-12-2023	31-12-2022	31-12-2022
	Fully loaded	Transitional	Fully loaded	Transitional
Total regulatory capital, after profit appropriation¹	21 260	19 768	20 100	18 742
Tier-1 capital	18 986	17 389	18 318	16 974
Common equity²	17 236	15 639	16 818	15 474
Parent shareholders' equity (after deconsolidating KBC Insurance)	21 181	18 209	19 623	16 982
Intangible fixed assets, incl. deferred tax impact (-)	-712	-712	-609	-609
Goodwill on consolidation, incl. deferred tax impact (-)	-1 070	-1 070	-1178	-1178
Minority interests	0	0	0	0
Hedging reserve, cashflow hedges (-)	579	579	936	936
Valuation differences in financial liabilities at fair value – own credit risk (-)	-29	-29	-40	-40
Value adjustment due to requirements for prudent valuation (-) ³	-24	-24	-31	-31
Dividend payout (-)	-1 287	0	-1 252	0
Share buyback	- 803	- 803	0	0
Coupon on AT1 instruments (-)	-26	-26	-12	-12
Deduction with regard to financing provided to shareholders (-)	-56	-56	-57	-57
Deduction with regard to irrevocable payment commitments (-)	-90	-90	-90	-90
Deduction with regard to NPL backstops (-) ⁴	-204	-204	-158	-158
Other direct, indirect and synthetic holdings by an institution of own CET1 instruments (negative amount)	0	0	0	0
Deduction re pension plan assets (-)	-121	-121	-143	-143
IRB provision shortfall (-)	-4	0	0	0
Deferred tax assets on losses carried forward (-)	-98	-98	-172	-172
Transitional adjustments to CET1	0	84	0	46
Limit on deferred tax assets from timing differences relying on future profitability and significant participations in financial entities (-)	0	0	0	0
Additional going concern capital	1 750	1 750	1 500	1 500
Grandfathered innovative hybrid tier-1 instruments	0	0	0	0
Grandfathered non-innovative hybrid tier-1 instruments	0	0	0	0
CRR-compliant AT1 instruments	1 750	1 750	1 500	1 500
Minority interests to be included in additional going concern capital	0	0	0	0
Tier-2 capital	2 273	2 379	1 782	1 767
IRB provision excess (+)	277	265	284	136
Transitional adjustments to Tier-2 capital	0	-60	0	-46
Subordinated liabilities issued by KBC Group	1 997	2 174	1 498	1 677
Subordinated liabilities issued by subsidiaries of KBC Group				
Subordinated loans to non-consolidated financial sector entities (-)	0	0	0	0
Minority interests to be included in tier-2 capital	0	0	0	0
Total weighted risk volume	113 038	113 029	109 981	109 966
Banking	103 201	103 192	100 300	100 285
Credit risk	88 042	88 042	85 003	84 988

IRB Advanced approach	59 196	59 196	65 411	65 411
IRB Foundation approach	-0	-0	2 913	2 913
Standardised approach	25 381	25 381	11 124	11 134
Counterparty credit risk	3 166	3 166	2 720	2 720
Other assets	299	299	2 834	2 809
Market risk ⁶	2 116	2 116	3 132	3 132
Operational risk	13 034	13 034	12 166	12 166
Insurance	9 133	9 133	9 133	9 133
Holding-company activities	710	710	562	562
Elimination of intercompany transactions	-6	-6	-14	-14
Solvency ratios				
Common equity ratio (or CET1 ratio)	15.2%	13.8%	15.3%	14.1%
Tier-1 ratio	16.8%	15.4%	16.7%	15.4%
Total capital ratio	18.8%	17.5%	18.3%	17.0%

¹ The difference between the fully loaded and the transitional figure as at 31-12-2023 is explained by the net result for 2023 (3 383 million euros under the Danish Compromise method), the proposed final dividend (-1 698 million euros), the impact of the IFRS 9 transitional measures and IRB excess/shortfall (-15 million euros) and the grandfathered tier-2 subordinated debt instruments (-177 million euros).

² Audited figures (excluding 'IRB provision shortfall', 'Value adjustment due to requirements for prudent valuation' and 'Deduction regarding NPL backstops').

³ CRR ensures that prudent valuation is reflected in the calculation of available capital. This means that the fair value of all assets measured at fair value and impacting the available capital (by means of fair value changes in P&L or equity) needs to be brought back to its prudent value. The difference between the fair value and the prudent value (also called the 'additional value adjustment' or AVA) must be deducted from the CET1 ratio.

⁴ NPL backstops refer to the minimum coverage requirements on non-performing loans for loans originated after 26 April 2019 (CRR requires a deduction from CET1) and the ECB minimum coverage expectations on non-performing loans for exposures defaulted after 1 April 2018 but originated before 26 April 2019 (KBC has decided to voluntarily deduct from CET1 any shortfalls relative to supervisory expectations).

⁵ KBC issued a 750-million-euro AT1 on 5 September 2023 and linked this as a replacement instrument for the 500-million-euro AT1 callable in March 2024. The 500-million-euro AT1 callable in March 2024 is therefore derecognised from own funds and consequently also from MREL.

⁶ The HVAR and SVAR multiplier used for the calculation of market risk is equal to 3.0.

Table 3 - Solvency at group level (Danish compromise)

The fully loaded CET1 ratio dropped slightly from 15.3% at year-end 2022 to 15.2% at year-end 2023, which is explained by the 2023 profit (impact of +3.1 percentage points), the proposed 4.15-euros-per-share dividend for 2023 (impact of -1.5 percentage points), the deduction of the 1.3-billion-euro share buyback (impact of -1.2 percentage points) and the increase in RWA (impact of -0.4 percentage points). KBC Group included a model-related risk-weighted assets add-on of 8.2 billion euros (following an ECB supervisory decision regarding model reviews for predominantly KBC's Belgian corporate and SME credit portfolio), partly mitigated by a -3.2-billion-euro RWA release in the fourth quarter of 2023, which was partly related to the transfer of certain exposures from IRB models to the Standardized Approach in the context of model simplification.

Note that in 2025 the first-time application impact of Basel 4 (based on current EU consensus, a static balance sheet and all other parameters ceteris paribus) is now estimated to have no significant impact on RWA. The fully loaded impact including output floor is estimated at approximately 8.0 billion euros in RWA.

Solvency at group level (consolidated; CRR/CRD, deduction method)

In millions of EUR	31-12-2023	31-12-2023	31-12-2022	31-12-2022
	Fully loaded	Transitional	Fully loaded	Transitional
Common equity	16 521	14 755	16 056	14 574
Total weighted risk volume	108 287	107 858	105 114	104 752
Common equity ratio	15.3%	13.7%	15.3%	13.9%

Table 4 - Solvency at group level (deduction method) Maximum Distributable Amount

Amounts for distribution (dividend payments, payments related to additional tier-1 instruments or variable remuneration) are limited when the combined buffer requirements described above are breached. This limitation is referred to as Maximum Distributable Amount (MDA) thresholds. The table below provides an overview of KBC's buffers compared to these thresholds, both on a transitional basis (i.e. transitional figures relative to the regulatory targets that apply on the reporting date) and on a fully loaded basis (i.e. fully loaded figures relative to the regulatory targets that will apply going forward).

In line with the revised CRR/CRD, the ECB allows banks to satisfy the P2R with additional tier-1 instruments (up to 1.5/8) and tier-2 instruments (up to 2/8) based on the same relative weights as allowed for meeting the 8% Pillar 1 Requirement.

Buffer vs Overall Capital Requirement (consolidated; under CRR/CRD, Danish compromise method)

	31-12-2023 Fully loaded	31-12-2023 Actual	31-12-2022 Fully loaded	31-12-2022 Actual
CET1 Pillar 1 minimum	4.50%	4.50%	4.50%	4.50%
Pillar 2 requirement to be satisfied with CET1	1.05%	1.05%	1.05%	1.05%
Capital conservation buffer	2.50%	2.50%	2.50%	2.50%
Buffer for systemically important institutions (O-SII)	1.50%	1.50%	1.50%	1.50%
Systemic risk buffer	0.14%	0.21%	0.19%	0.19%
Entity-specific countercyclical buffer	1.24%	0.69%	0.75%	0.40%
Overall Capital Requirement (OCR) - with P2R split CRD Art. 104a(4)	10.92%	10.45%	10.49%	10.14%
CET1 used to satisfy shortfall in AT1 bucket (B)	0.30%	0.30%	0.48%	0.48%
CET1 used to satisfy shortfall in T2 bucket (C) ²	0.45%	0.36%	0.84%	0.86%
CET1 requirement for MDA (A+B+C)	11.68%	11.11%	11.82%	11.48%
CET1 capital (in millions of EUR)	17 225	15 639	16 818	15 474
CET1 buffer (= buffer compared to MDA) (in millions of EUR)	4 025	3 082	3 820	2 846

¹ Situation as known at 31 December 2023 (not taking into account changes communicated after that date).

² The fully loaded tier-2 capital excludes the tier-2 instruments grandfathered under CRR2; these instruments are included in the actual (transitional) tier-2 capital for the period of grandfathering, in line with CRR2 and the COREP 3.0 reporting framework.

Table 5 - Buffer compared to the Overall Capital Requirement

CRR quick fix

In the context of the coronavirus pandemic, the EU amended the CRR, applicable as from 27 June 2020 (so-called 'CRR quick fix'). The table below provides an overview of the main temporary measures, whether KBC applies the measure and their impact as at 31 December 2023.

CRR quick fix (Regulation EU 2020/873 of 24 June 2020) <i>In millions of EUR</i>	Reference to CRR	Applied by KBC (Y/N)	Impact on CET1 capital	Impact on RWA	Impact on CET1 ratio
Filter for FVOCI gains/losses on government exposures	Art. 468	No	-	-	-
IFRS 9 transitional measure (details in annex II)	Art. 473a	Yes	84	-9	0.08%
Sovereigns under Standardised Approach	Art. 500a	No	-	-	-
Outliers in Market risk VaR models	Art. 500c	No	-	-	-

Table 6 - Overview of CRR quick fix

The detailed disclosure regarding the impact of Article 473a in line with EBA guidelines (EBA/GL/2020/12 of 11 August 2020) is included in Annex II.

Solvency figures under the FICOD

As a financial conglomerate, KBC also has to disclose its solvency position as calculated in accordance with the Financial Conglomerate Directive (FICOD; 2002/87/EC). In line with this directive, available capital is calculated on the basis of the consolidated position of the group and the eligible items recognised as such under the prevailing sectoral rules, which are CRD for the banking business and Solvency II for the insurance business. The resulting available capital is to be compared with a capital requirement expressed as a risk-weighted asset amount. For this latter figure, the capital requirements for the insurance business (based on Solvency II) are multiplied by 12.5 to obtain a risk-weighted asset equivalent (instead of the 370% risk weighting applied to the equity value in the insurance company under the Danish compromise). KBC is required to satisfy the pillar 1 requirements. No pillar 2 requirements and no management target have been defined at the level of the FICOD ratio.

Solvency at group level (consolidated; FICOD method)

<i>In millions of EUR</i>	31-12-2023	31-12-2023	31-12-2022	31-12-2022
	Fully loaded	Transitional	Fully loaded	Transitional
Common equity	18 625	17 532	17 873	17 405
Total weighted risk volume	128 965	128 956	123 755	123 740
Common equity ratio	14.4%	13.2%	14.4%	14.1%

Table 7 - Solvency at group level (consolidated; FICOD method)

Leverage ratio

CRR/CRD requires credit institutions to calculate, report and monitor their leverage ratios. The leverage ratio is a supplementary non-risk-based measure to contain the build-up of leverage (i.e. create a backstop on the degree to which a banking firm can leverage its capital base). It is calculated as a percentage of tier-1 capital relative to the total on- and off-balance-sheet exposure (non-risk-weighted). Existing and expected changes in regulation relating to the leverage ratio will be monitored and potential impacts will be assessed.

The leverage ratio is determined and monitored within the quarterly closing process and included in the periodic management reports of the Finance and Risk departments. This monitoring covers both the position of KBC itself (taking our risk appetite into account) as well as benchmarking in terms of relevant peers. All of the above processes are part of KBC's ICAAP (described later in this section).

At the end of December 2023, the fully loaded leverage ratio increased compared to December 2022, mainly thanks to lower total assets driven by lower reverse repo and cash balances with central banks and higher Tier 1 capital (mainly driven by the inclusion of 2023 profits, but partly offset by the share buyback).

The leverage ratio is a supplementary non-risk-based measure to create a 'backstop' in addition to the risk-based ratios. The latter form a constraint for KBC, i.e. a breach of own funds requirements would occur well before the 3% regulatory leverage ratio requirement is reached (as from 1 January 2024, a P2R of 0.1% on the leverage ratio is applicable, increasing the minimum regulatory requirement to 3.1%). Therefore, management focus is primarily on the risk-based ratios. Nevertheless, management has also defined a management target for the leverage ratio of at least 4.5%, which is well above the regulatory requirement of 3.1%. Furthermore, the absolute size of the balance sheet is also monitored from other perspectives (e.g., in the context of MREL requirements).

Leverage ratio at group level (consolidated; under CRR/CRD, Danish compromise method)

<i>In millions of EUR</i>	31-12-2023	31-12-2023	31-12-2022	31-12-2022
	Fully loaded	Transitional	Fully loaded	Transitional
Tier-1 capital	18 986	17 389	18 318	16 974
Total exposure	333 791	333 894	346 481	346 538
Total assets	346 921	346 921	355 872	355 872
Deconsolidation of KBC Insurance	-30 980	-30 980	-30 267	-30 267
Transitional adjustment	-	103	-	57
Adjustment for derivatives	-1 341	-1 341	-3 032	-3 032
Adjustment for regulatory corrections in determining tier-1 capital	-2 286	-2 286	-2 347	-2 347
Adjustment for securities financing transaction exposures	1 357	1 357	813	813
Central Bank exposures	-	-	-	-
Off-balance-sheet exposures	20 119	20 119	25 442	25 442
Leverage ratio	5.7%	5.2%	5.3%	4.9%

Table 8 - Leverage ratio at group level

The regulatory required templates with regard to the leverage ratio can be found in a separate Excel file on the kbc.com website, published alongside this Risk Report.

Minimum requirement for own funds and eligible liabilities (MREL)

Besides the ECB and NBB, which supervise KBC on a going concern basis, KBC is also subject to requirements set by the Single Resolution Board (SRB). The SRB is developing resolution plans for the major banks in the euro area, based on information received from the banks concerned. Such a plan describes how the resolution authorities will approach the resolution of a bank that is failing (or likely to fail) in a way that protects its critical functions, government funds and financial stability. It takes account of the specific features of the bank and is tailor-made. A key feature of the resolution plan is deciding at which level the competent resolution authorities will intervene. A choice has to be made between a single resolution authority that resolves the group as a whole (Single Point of Entry or 'SPE') or different authorities that separately resolve those parts of the group that fall within their jurisdiction (Multiple Point of Entry or 'MPE').

The resolution plan for KBC is based on a Single Point of Entry (SPE) approach at KBC group level, with 'bail-in' as the primary resolution tool. Bail-in implies a recapitalisation and stabilisation of the bank by writing down certain unsecured liabilities or converting them into shares. The SPE approach at group level reflects KBC's business model, which relies heavily on integration, both commercially (e.g., banking and insurance) and operationally (e.g., risk, finance, treasury, ICT, etc.). Debt instruments that are positioned for bail-in are issued by KBC Group NV. This approach keeps the group intact in resolution and safeguards the bank-insurance model in going concern.

It is crucial that there are adequate liabilities eligible for bail-in. This is measured by the minimum requirement for own funds and eligible liabilities (MREL). The SRB defines the minimum MREL level for KBC.

In April 2023, the SRB informally communicated to KBC updated MREL targets for 1 January 2024, expressed as a percentage of Risk-Weighted Assets (RWA) and Leverage Ratio Exposure Amount (LRE):

- 22.92% of RWA as from 1 January 2024 with an intermediate target of 21.63% as from 2022. The Combined Buffer Requirement (CBR) needs to be held on top of this and amounts to 4.90% as at 31 December 2023 and 5.38% as from the fourth quarter of 2024 (Conservation Buffer (2.5%) + O-SII Buffer (1.5%) + systemic risk buffer (0.21% for December 2023 and 0.14% for December 2024) + Countercyclical Buffer (0.69% for December 2023 and 1.24% as from the fourth quarter of 2024). This brings the MREL+CBR to 26.53% for December 2023 and 28.30% for December 2024.
- 7.38% of LRE as from 1 January 2022.

At the end of December 2023, the MREL ratio stood at 30.7% as a percentage of RWA (as opposed to 27.5% as at 31 December 2022) and at 10.4% as a percentage of LRE (as opposed to 8.7% as at 31 December 2022).

The increase in the MREL ratio as a percentage of RWA is mainly driven by the continued issuance of MREL-eligible debt in 2023. The increase of the MREL ratio as a percentage of LRE is mainly explained by the decrease of the leverage ratio exposure.

The binding subordinated MREL targets are:

- 18.97% of RWA as from 1 January 2024 with an intermediate target of 13.50% as from 1 January 2022. The Combined Buffer Requirement needs to be held on top of this and amounts to 4.90% as at 31 December 2023 and 5.38% as from the fourth quarter of 2024 (Conservation Buffer (2.5%) + O-SII Buffer (1.5%) + systemic risk buffer (0.21% for December 2023 and 0.14% for December 2024) + Countercyclical Buffer (0.69% for December 2023 and 1.24% as from the fourth quarter of 2024). This brings the subordinated MREL+CBR to 18.40% for December 2023 and 24.35% for December 2024.
- 7.38% of LRE as from 1 January 2024 with an intermediate target of 6.19% as from 1 January 2022.

To ensure that KBC's HoldCo senior debt is eligible for the subordinated MREL target (i.e. to make sure that no excluded liabilities ranking pari passu with or junior to HoldCo senior debt are present in KBC Group NV), KBC Group NV was converted into a Clean HoldCo for the purpose of resolution in June 2022. Consequently, KBC's entire MREL stack is considered subordinated.

MREL

In millions of EUR

	31-12-2023	31-12-2022
Own funds and eligible liabilities (transitional)	34 672	30 269
CET1 capital (consolidated, CRR/CRD, Danish compromise method)	15 639	15 474
AT1 instruments (consolidated, CRR/CRD)	1 750	1 500
T2 instruments (consolidated, CRR/CRD)	2 674	1 767
Subordinated liabilities (issued by KBC Group NV but not included in AT1 & T2)	8	6
Senior debt (issued by KBC Group, nominal amount, remaining maturity > 1 year)	14 897	11 522
Risk-Weighted Assets (RWA)	113 029	109 966
MREL as % of RWA	30.7%	27.5%
Leverage Ratio Exposure Amount (LRE)	333 894	346 538
MREL as % of LRE	10.4%	8.7%

Table 9 - MREL hybrid view

Solvency of KBC Bank and KBC Insurance separately

In the table below, we have provided solvency information separately for KBC Bank and KBC Insurance. As is the case for KBC Group, the solvency of KBC Bank is calculated based on CRR/CRD. The solvency of KBC Insurance is calculated on the basis of Solvency II.

Solvency, KBC Bank (CRR/CRD)

In millions of EUR

	31-12-2023 Fully loaded	31-12-2023 Transitional	31-12-2022 Fully loaded	31-12-2022 Transitional
Total regulatory capital, after profit appropriation	19 375	17 952	17 164	17 516
Tier-1 capital	16 924	15 573	15 202	15 749
<i>Of which common equity</i>	<i>15 174</i>	<i>13 823</i>	<i>13 702</i>	<i>14 249</i>
Tier-2 capital	2 451	2 379	1 962	1 768
Total weighted risks	103 201	103 192	100 300	100 285
Common equity ratio	14.7%	13.4%	13.7%	14.2%
Tier-1 ratio	16.4%	15.1%	15.2%	15.7%
Total capital ratio	18.8%	17.4%	17.1%	17.5%

Table 10 - Solvency KBC Bank

Solvency, KBC Insurance (incl. volatility adjustment) (Solvency II)

In millions of EUR

	31-12-2023	31-12-2022
Own funds	4 130	3 721
Tier-1	3 629	3 220
IFRS parent shareholders' equity	3 302	2 157
Dividend payout	-233	-309
Deduction of intangible assets and goodwill (after tax)	-198	-194
Valuation differences (after tax)	597	1 410
Volatility adjustment	137	150
Other	25	6
Tier-2	501	501
Subordinated liabilities	501	501
Solvency capital requirement (SCR)	2 005	1 833
Solvency II ratio	206%	203%
Solvency surplus above SCR	2 125	1 888

Table 11 - Solvency KBC Insurance

ICAAP and ORSA

The ultimate accountability for proper and sound capital management and planning at KBC lies with the BoD and Group Executive Committee. KBC's ICAAP (Internal Capital Adequacy Assessment Process, covering the group perspective) and ORSA (Own Risk and Solvency Assessment, covering the insurance activities) are governed by the ICAAP and ORSA policies, owned by the BoD. These policies document KBC's ICAAP and ORSA architecture (e.g., objectives, underlying processes and responsibilities) supporting the management and assessment of KBC's capital adequacy. They are set up in line with applicable regulation and guidelines, including the ECB's guidelines on ICAAP and the Solvency II regulation, and are continuously further improved, for example to embed newer risks such as ESG.

The reference points are KBC's Corporate Strategy and risk appetite, which are the anchors for iterative, continuous ICAAP and ORSA processes based on, for instance, risk appetite setting, forward-looking assessments, monitoring and response. The starting point is the continuous identification of all the material risks (e.g., ESG risks) KBC is or may be exposed to, such that they can be managed appropriately and taken into account in ICAAP/ORSA and capital planning.

For this purpose, we have economic internal capital models in place to complement the existing regulatory capital models (Pillar 1). These allow us to assess our capital adequacy from a Pillar 2 perspective as well and to transfer relevant insights from one perspective to the other, for example to assess to what extent vulnerabilities under stress identified in the internal capital models (e.g., the negative impact of interest rate and spread increases on the economic value of our balance sheet) could show up in the regulatory view and whether these should be proactively mitigated).

In 2023, a new Economic Balance Sheet (EBS) ratio (full fair value approach) was developed, which complements the existing Internal Capital Model ratio (no full fair value approach for balance sheet items at amortised cost). The outcome of these models is reported to the Executive Committee and the Board of Directors on a quarterly basis via the Integrated Risk Report, with more detailed reporting in the annual ICAAP report. These models are subject to an extensive use test. They are, for example, used to measure risk-adjusted performance, to underpin and set risk limits and to assess capital adequacy. They are complemented by a framework for assessing earnings that aims to reveal vulnerabilities in terms of the longer-term sustainability of our business model, and by a balanced mix of stress tests (see below).

The breakdown of KBC's Pillar 2 capital models per risk type is provided in the following tables:

Internal capital distribution based on the Internal Capital Model, KBC Group	2023	2022
Credit risk and counterparty risk	58%	58%
Market risk (banking book)	10%	8%
Market risk (trading book)	1%	2%
Operational risk	9%	8%
Risk related to the insurance entity	17%	16%
Pension risk	5%	7%
Total	100%	100%

Table 12 - Economic internal capital based on the Internal Capital Model, KBC Group

Economic internal capital based on the Economic Balance Sheet ratio, KBC Group	2023	2022
Credit risk and counterparty risk	48%	50%
Market risk (banking book)	23%	21%
Market risk (trading book)	1%	2%
Operational risk	8%	7%
Risk related to the insurance entity	15%	14%
Pension risk	5%	6%
Total	100%	100%

Table 13 - Economic internal capital based on the Economic Balance Sheet ratio, KBC Group

A key process in which our ICAAP and ORSA are deeply embedded is the Alignment of Planning Cycles (APC). This yearly process aims to create an integrated three-year plan in which the strategy, finance, treasury and risk perspectives are collectively taken into account. In the APC, the capital adequacy of KBC Group and its entities, according to both the regulatory and the internal view (economic internal capital models), is projected in forward-looking base case and adverse scenarios. The risk appetite of the group is also set and cascaded in the APC by setting risk limits at group and entity level.

Once a year, the ICAAP and ORSA processes generate comprehensive reports, which are presented to both top management and the supervisory bodies before being submitted to the ECB and NBB. These reports allow the Board to make a statement on the ability of the group and its entities to maintain adequate capitalisation going forward in view of the corporate strategy and business model, the effectiveness of KBC's risk and control environment, its governance and risk culture, and the current and expected development of KBC's risk profile under various scenarios. In case of relevant material developments, the ICAAP and ORSA are updated in order to check KBC's continued capital adequacy.

Stress testing

Stress testing is an important risk management tool that adds value both to strategic processes and to day-to-day risk management. As such, stress testing is an integral part of our risk management framework, and an important building block of our ICAAP and ORSA.

We define stress testing as a management decision-supporting process that encompasses various techniques which are used to evaluate the potential negative impact on KBC's (financial) condition, caused by specific event(s) and/or movement(s) in risk factors ranging from plausible to extreme, exceptional or implausible. As such, it assists in identifying sources of vulnerability and hence in assessing whether our capital is adequate to cover the risks we face.

For this purpose, KBC has developed a balanced stress-testing mix, for each risk type separately and also at an overarching, integrated level, covering all material existing and new risks. These stress-testing mixes are regularly reviewed and approved by the relevant committee to ensure that they remain relevant given the changing environment and risks that could affect KBC.

The stress-testing mix includes sensitivities to critical assumptions used in the APC base case plan. In addition, APC is complemented by a dedicated integrated stress test that is run in parallel. These sensitivities and stress tests are designed to provide assurance that:

- the decisions regarding the financial plan and regarding risk appetite and limit setting are not only founded on a base case, but that they also take account of the impact of more severe macroeconomic, financial market or other assumptions (e.g., adverse changes in regulation);
- the levels of capital and liquidity at group level remain acceptable under severe conditions.

The resulting capital ratios are compared to internal and regulatory capital targets.

Even more severe scenarios and sensitivities are calculated in the context of the recovery plan. These scenarios focus on events that lead to a breach of the regulatory capital requirements. As such, the recovery plan provides another insight into key vulnerabilities of the group and the mitigating actions that management could implement should the defined stress materialise.

Numerous other stress tests are run within KBC that provide valuable information for assessing the capital adequacy of the group. They include reverse stress tests, regulatory stress tests, ad hoc integrated and risk-type or portfolio-specific stress tests at group and local level. Relevant stress test impacts are valuable inputs for defining sensitivities in APC planning.

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), 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. Credit risk thus encompasses default risk and country risk, but also includes migration risk, which is the risk resulting from adverse changes in credit ratings.

Strategy

The strategic objective of granting credit through loans and other credit products on a relationship-driven basis to private individuals, businesses and public authorities is to sustainably and profitably support economic activity in the countries and markets in which we operate. Our credit products are varied in type and structure as they are tailored to suit the needs of our clients, the prevailing legal context, the risk profile of the transaction and the sustainability objectives that we have committed to. Our credit activity is subject to a general risk appetite statement decided upon by the Board of Directors and managed taking into account continuous input in terms of economic outlook and market information.

Managing credit risk

In general, KBC manages the risks associated with credit-granting activities through a robust risk management framework, the implementation of various risk-mitigating measures, the adequate and transparent classification of credit risks and the recording of impairment charges as required. The credit risk playing field is made tangible through Credit Risk Standards and group-wide policies that impose restrictions and provide recommendations with regard to credit risk. Moreover, KBC aims to limit the adverse impact of its activities on the environment and society and to encourage a positive impact based on a responsible lending culture.

In line with the Credit Risk Management Framework, credit risk is managed 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 are set to determine the maximum credit exposure allowed and the level at which acceptance decisions are made. 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 and taking risk-mitigating measures.

The appropriate risk management committees are periodically informed of relevant credit risk signals or observations. Credit risk signals that are considered material are reported to the Executive Committee. In addition, thematic and sectoral deep dives are performed to gain further insights into credit risk and to follow up on policies, procedures and monitoring instruments. The information gathered is used, among other things, to formulate policy actions and recommendations.

The Three Lines of Defence Model ensures the resilience of KBC's risk and control environment and safeguards the sustainability of our business model going forward. In this model, Business acts as the first line of defence, Risk as one of

the second lines and Internal Audit as the third line. They all work together in order to prevent major impact losses for the KBC group.

In the area of credit risk, the Executive Committee is supported by the Group Lending Committee (GLC), which manages KBC's credit risk and the resulting capital requirement in the area of lending. The governance, rules and procedures on how credit risk management should be performed throughout the group are outlined in the Credit Risk Management Framework (CRMF). Its implementation is monitored by Group Credit Risk and its Credit Risk Competence Centre. GCRD works in close cooperation with the local CROs and local risk departments, which are responsible for the local implementation of the CRMF. Business entities are consulted for those areas of the CRMF that impact business processes and/or governance.

How our business model translates into the credit risk profile is explained in the strategy section of the 2023 Annual Report of KBC Group NV.

The building blocks for managing credit risk

Risk identification

A vital part of the credit risk identification process is capturing credit risk signals, at both transactional and portfolio level. Both the internal and external environments are scanned for events or developments that have already occurred or could occur and that directly or indirectly have or could have a significant impact on credit quality. Risk signals provide an overview of the identified risk and outline the possible impact for KBC and, if possible, propose remedial actions.

The appropriate risk management committees are periodically informed of relevant signals or observations. Risk signals that are considered material are reported to the Executive Committee. In addition, thematic and sectoral deep dives are performed to gain further insights into credit risk.

New and upcoming prudential (capital) credit risk regulation and product- or client-specific regulation and legislation is followed up at group or local level to ensure that these are promptly implemented in KBC's policies and instructions.

A specific risk identification process is the leading indicator process designed to identify emerging credit risks that could lead to impairment. The main objective is to have a reliable estimate of impairment for the current quarter at an early stage, thus avoiding surprises. It is part of the quarterly reporting round on loan and bond impairment.

Risk measurement

Credit risk measurement involves a quantitative expression of a credit risk on a portfolio of instruments/exposures by applying a model or methodology. A minimum group-wide set of credit risk measurements is defined and can be complemented with local measurements.

Central to this is the risk class, with a ranking being made based on the Probability of Default (PD) and the Loss Given Default (LGD). 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. A number of uniform models throughout the group (models for governments, banks, large companies, etc.) are in place, while others have been designed for specific geographic markets (SMEs, private individuals, etc.) or types of transaction. We use the output generated by these models to split the non-defaulted loan portfolio into internal rating classes ranging from 1 (lowest risk) to 9 (highest risk) for the PD. We assign PD 10 to PD 12 to a defaulted obligor. The same internal rating scale is used throughout the group.

Impairment losses are recorded according to IFRS 9 requirements (calculated on a lifetime expected credit loss (ECL) basis for defaulted borrowers and on a 12-month or lifetime ECL basis for non-defaulted borrowers, depending on whether there has been a significant increase in credit risk and a corresponding shift from 'Stage 1' to 'Stage 2'). Specific collective IFRS 9 models are used for this purpose, except for material defaulted borrowers, which are assessed individually to estimate ECL.

Setting and cascading risk appetite

The KBC Risk Appetite Statement defines the amount of credit risk KBC is able and willing to accept in pursuit of its strategic objectives. Credit risk appetite is made tangible by assigning credit risk limits and early warning levels to a limited set of credit risk (signal) indicators, which are valid for one year. The group risk appetite, including the strategic objectives with regard to credit risk tolerance, is determined by the Board of Directors by means of an annual review. KBC's medium risk appetite for credit risk is illustrated by the fact that internal processes to set risk limits are aimed at reaching this risk level. The GLC decides upon and periodically reviews a framework of limits, early warning levels and policies on credit risk activities that is consistent with the group's risk appetite. This framework is submitted to the Board of Directors for approval.

Primary credit risk limits are decided by the Board of Directors or the Executive Committee. These entail limits on Expected Loss (EL), Stressed Credit Loss (SCL) and Credit Risk-Weighted Assets (RWA) and, for new home loan production, Loan-to-Value (LTV) and Debt-Service-To-Income (DSTI). These limits are supplemented by a portfolio limit system (PLS) framework to constrain concentration risk on counterparty groups or authorities and other credit risk limits set at group or local level that include sector and activity limits and limits on risks.

The risk playing field is also determined by group-wide risk boundaries defined in Credit Risk Standards, which aim to align risk management of specific credit-risk-related topics throughout the group by defining restrictions and/or recommendations.

Risk analysis, monitoring, reporting and follow-up

The loan portfolio is analysed on a continuous basis. In addition to portfolio analyses performed by Business, the local and group credit risk departments analyse the credit risk profile of the loan portfolio in order to obtain an independent view of the evolution of credit risk. The results of the analyses are reported to the appropriate risk committees. It is the responsibility of both line management and the risk committees to respond, i.e. to keep or bring risks in line with the risk appetite. Corrective action can be taken to avoid (further) credit risk, reduce the risk (mitigation), transfer the risk or accept the risk.

Stress testing

Stress testing is a core component of sound credit risk management and is performed at local and group level.

Impact of external developments on credit risk

While the impacts of the coronavirus pandemic and (supply chain) dislocation during the ensuing economic recovery have subsided and Covid restrictions have been phased out, the continuing Russia-Ukraine conflict and the associated disruption of worldwide energy markets, rapidly rising inflationary pressures and increasing interest rates presented new challenges for credit risk management.

For private individuals, soaring energy bills and inflationary pressures on prices for daily goods and services were bound to affect the credit repayment capacity of weaker borrowers. Thanks to adequate alleviation, this has not resulted in payment problems with home loans and consumer finance facilities. For businesses, the strong increase in energy costs has – in ‘energy-intensive’ sectors – negatively impacted profit margins and cash buffers. Gradually, evidence emerged that these input cost increases could be recuperated through higher sales prices. Furthermore, private individuals have somewhat adjusted their consumption pattern away from discretionary spending, which has the potential to imperil some sectors due to reduced demand. Also, higher refinancing risks of maturing debt in a high interest-rate environment have the potential to trigger more defaults of businesses. Consequently, a number of vulnerable industries may find themselves in a continuing challenging environment.

Credit risk management actions have been taken to anticipate, measure, mitigate and manage the above emerging risks. Accordingly, credit portfolios are monitored closely, origination processes have been adjusted (e.g., to reflect increased household budgets for the underwriting of home loans), specific credit policies have been tightened (e.g., conditions to enter into lending to certain activities of the Commercial Real Estate sector) and watchlists have been continued. For Commercial Real Estate (CRE) financing, for example, the evolution of any refinancing risk is a standard and crucial element in the credit acceptance process. For loans financing completed properties with high balloon or even bullet repayment at loan maturity, the refinancing risk is evaluated in-depth considering the quality of the building, the diversification and strength of the tenants, the general strength of the real estate market (demand/supply balance, vacancy rates), the Loan-to-Value ratio at maturity, and the residual repayment period based on the estimated rental income and more conservatively projected interest rates. In addition to such an analysis at individual file level, the credit portfolio is monitored closely and the CRE credit underwriting policy has been tightened to address the increased refinancing risk.

Despite the challenging context, traditional credit risk metrics (such as forbearances, arrears and PD deterioration, new defaults) have not pointed to a substantial deterioration in credit quality for the KBC portfolios in 2023, as further reflected in a comfortable credit cost ratio.

Finally, since the Russian invasion of Ukraine, a level of impairment management overlays has been maintained for the geopolitical and emerging risks, and a selection of vulnerable portfolios and sub-portfolios have been earmarked for increased risk potential. For related figures, including the methodology and evolution of these impairment overlays, we refer to Note 3.9 of the ‘Consolidated financial statements’ section of the 2023 Annual Report. Looking ahead, the development of the Israeli-Palestine conflict and other incidents (for example in the Red Sea) may heighten geopolitical and emerging risks, as a possible escalation into a broader (regional) conflict may have larger and prolonged consequences.

Managing credit risk 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 an 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. A number of uniform models throughout the group (models for governments, banks, specialised lending, etc.) are in place, 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. In the 'Internal modelling' section of this report, more details are provided on the method used to determine the PD and LGD in order to obtain a good understanding of the creditworthiness of a counterparty or transaction. In this way, creditworthiness, as established in the PD and LGD risk parameters, forms an essential part of the credit acceptance process for both the IRB portfolio and the Standardised portfolio.

We use the output generated by these models to split the non-defaulted 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 an irreversible court order is passed instructing the repossession of the security. 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. 'Defaulted' status is fully aligned with the 'non-performing' and 'impaired' statuses. Obligors in PD classes 10, 11 and 12 are therefore referred to as 'defaulted' and 'impaired'. Likewise, 'performing' status is fully aligned with the 'non-defaulted' and 'non-impaired' statuses.

For credits linked to defaulted borrowers in PD classes 10, 11 and 12, 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 portfolio basis for smaller credit facilities. In addition, for non-defaulted credit in PD classes 1 to 9, we also record impairment losses on a 'portfolio basis'.

Since 2018, the portfolio-based impairment losses are recorded according to IFRS 9 requirements and specific IFRS 9 models are used for this purpose. For defaulted borrowers on smaller credit facilities, they are calculated on a lifetime expected credit loss (ECL) basis. For non-defaulted borrowers, the calculation is done on a 12-month or lifetime ECL basis (depending on whether there has been a credit risk deterioration and a corresponding shift from 'Stage 1' to 'Stage 2').

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

Managing credit risk 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, as well as on the full scope of credit risk.

Whereas some limits are in notional terms, we also use measures 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. Irrespective of whether it concerns portfolios under IRBA or Standardised portfolios, IRBA risk parameters are defined for the entire portfolio and used for our internal risk monitoring.

Basel III implementation at KBC Group

With regard to the implementation of Basel III, in the past few years KBC considered IRB roll-out for all important entities (defined as any subsidiary that accounts for more than 1% of the risk-weighted assets for credit risk at KBC Group NV). As a result of the model simplification² agreement with the ECB, KBC Group's entire sovereign portfolio, the entities K&H and ČSOB Slovak Republic as well as a number of models for smaller portfolios in Belgium and the Czech Republic will report under the Standardised approach as of 31 December 2023. Going forward, the criteria used to assess IRB roll-out as opposed to the use of the Standardised approach will be aligned with this agreement. Compliance with these criteria will continue to be checked at least annually. However, the rule that non-material entities use the Standardised approach remains unchanged.

Currently, all material entities, apart from UBB, K&H and ČSOB Slovak Republic, have adopted the IRB Advanced approach. The Basel III Standardised approach is being adhered to until further notice by other non-material entities of the KBC group, in accordance with permanent partial use as per Article 150 (d) of Regulation (EU) No 575/2013 (CRR).

Roll-out of Basel III pillar 1 approach at end of year shown	2023	2021-2022	2019-2020
IRB Advanced Approach*	KBC Bank CBC Banque ČSOB Czech Republic KBC Lease Belgium KBC Commercial Finance KBC Immolease	KBC Bank CBC Banque ČSOB Czech Republic KBC Lease Belgium KBC Commercial Finance KBC Immolease K&H Bank KBC Bank Ireland	KBC Bank CBC Banque ČSOB Czech Republic KBC Credit Investments KBC Lease Belgium KBC Commercial Finance KBC Immolease K&H Bank KBC Bank Ireland
IRB Foundation approach*		ČSOB Slovak Republic	ČSOB Slovak Republic
Standardised approach	UBB K&H Bank ČSOB Slovak Republic KBC Autolease Non-material entities	UBB KBC Bank Bulgaria (as of 2022) KBC Autolease Non-material entities	UBB OTP Banka Slovensko KBC Autolease Non-material entities

* Note that entities that apply the IRB approach can also report a specific part of their portfolio using the Standardised approach

Table 14 - Roll-out of Basel III pillar 1 approach

² We have received the ECB's approval regarding a model simplification agreement under which a significant portion of the IRB portfolio will be subject to the Standardised approach as of 31 December 2023.



Overview of RWAs

The table below provides an overview of how Basel III RWA for the KBC group changed over 2023. This table shows the overall RWA figures, including non-material entities, non-transactional RWA (like operational risk and market risk) and the RWA for KBC Insurance according to the Danish compromise approach. It is the only table in this section of the report that contains information other than on credit risk. The minimum capital corresponds with 8% of RWA.

Exposure at Default (EAD) is used as a basis for determining 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.

The Internal Ratings-Based Advanced (IRBA) approach is primarily used by KBC to calculate its risk-weighted assets. Based on a full application of all the CRR/CRD IV rules, it is used for approximately 70% of the weighted credit risks. The remaining weighted credit risks (about 30%) are calculated according to the Standardised approach.

The MOC (Margin of Conservatism) approach is used to express all types of uncertainty in PD, LGD and EAD estimates. Through the MOC approach, these uncertainties are incorporated into the model itself. Only in specific cases we charge additional RWA in the form of an additional add-on under MOC (e.g., late model review).

EU OV1 - Overview of total risk exposure amounts	a	b	c
	Total risk exposure amounts (TREA)		Total own funds requirements
	31/12/2023	31/12/2022	31/12/2023
<i>In millions of EUR</i>			
1 Credit risk (excluding CCR)	94 697	91 890	7 576
2 Of which the standardised approach	25 381	11 134	2 031
3 Of which the Foundation IRB (F-IRB) approach	0	2 913	0
4 Of which slotting approach			
EU 4a Of which equities under the simple risk-weighted approach	668	796	53
5 Of which the Advanced IRB (A-IRB) approach	59 196	65 483	4 736
6 Counterparty credit risk - CCR	3 166	2 720	253
7 Of which the standardised approach	1 030	821	82
8 Of which internal model method (IMM)	828	849	66
EU 8a Of which exposures to a CCP	59	37	5
EU 8b Of which credit valuation adjustment - CVA	921	757	74
9 Of which other CCR	328	256	26
15 Settlement risk	0	0	0
16 Securitisation exposures in the non-trading book (after the cap)	18	26	1
17 Of which SEC-IRBA approach			
18 Of which SEC-ERBA (including IAA)			
19 Of which SEC-SA approach	18	26	1
EU 19a Of which 1250%			
20 Position, foreign exchange and commodities risks (Market risk)	2 068	3 146	165
21 Of which the standardised approach	271	365	22
22 Of which IMA	1 797	2 781	144
EU 22a Large exposures			
23 Operational risk	13 079	12 184	1 046
EU 23a Of which basic indicator approach			
EU 23b Of which standardised approach	13 079	12 184	1 046
EU 23c Of which advanced measurement approach			
24 Amounts below the thresholds for deduction (subject to 250% risk weight)	1 074	1 410	86
25 Other non-credit-obligation assets excl. DTA (For information, included in row 5)	9 868	6 450	789
26 Participation in KBC Insurance weighed at 370%, according to the Danish compromise (For information, included in row 1 only)	9 133	9 133	731
28 Additional risk exposure amount due to Article 3 CRR (For information, included in row 1 only)	319	2 430	26
29 Total	113 029	109 966	9 042

Table 15 - EU OV1_Overview of RWAs

In 2023, RWA at KBC group level increased by +3.1 billion euros (or +2.8%). The largest change can be attributed to credit risk (other than counterparty credit risk) with an increase of +2 807 million euros. Counterparty credit risk showed an increase of +446 million euros in RWA. Market risk shows a decrease of -1 078 million euros. Lastly, we have a +895-million-euro RWA increase for operational risk.

The breakdown by the most material entities shows that the consolidated credit risk RWA change is primarily driven by the sale of the remaining retail lending portfolio of KBC Ireland in the first quarter (-3 950 million euros) and the increase at the Belgium Business Unit (+6.8 billion euros). RWA at ČSOB Czech Republic remained status quo (-131 million euros), whereas RWA increased significantly at UBB Bulgaria (+928 million euros). The decrease at K&H (-1 292 million euros) and Group Centre (-621 million euros) as well as the increase at ČSOB Slovak Republic (+1 508 million euros) are mainly linked to the ECB model simplification decision implemented in the fourth quarter.

The overall change in RWA in 2023 can be explained mainly by underlying volume and asset quality portfolio changes, internal model changes, regulatory changes, the sale of the remaining retail portfolio of KBC Ireland and changes for market and operational risk. Note that the change in RWA is broken down by these different drivers on a best-effort basis. Simultaneous driver changes tend to amplify or compensate each other's effect on RWA. The most material drivers are set out below.

(1) The volume impact on the credit risk RWA amounted to roughly +4.9 billion euros, excluding the foreign-exchange impact and the sale of the KBC Ireland portfolio. The increase, due to volume, was material in most segments and entities of the group, despite the sometimes difficult economic conditions. There was an overall volume decline (around -250 million euros), but not in Group Treasury. The largest RWA increase as a result of volume comes from the corporate and specialised lending segments, across the various entities.

(2) The impact of changes in the drivers for asset quality (PD and LGD) was substantial over the past year, with an RWA decline of -2.5 billion euros in the IRB portfolio. The main changes were the following:

- Overall asset quality improvement of the credit portfolio reflected by lower PDs, resulting in a substantial RWA decrease (around -500 million euros);
- Lower RWA for defaults (around -800 million euros), mainly in the KBC Bank corporate segment;
- Collateral registration for exposures in the specialised lending portfolio at ČSOB Czech Republic is always lagging behind the registration of the underlying credits; consequently, for this type of transaction the LGD improves in the next quarter. This effect represents an LGD RWA decrease of about -700 million euros;
- Improved collateral eligibility in the specialised lending portfolio of K&H resulted in a substantial LGD RWA decrease (around -500 million euros).

(3) Changes in credit risk RWA are also determined by changes in transactional models. The overall net impact in 2023 was +8.7 billion euros, mainly resulting from the increase linked to an ECB model add-on that was imposed predominantly for KBC's Belgian corporate and SME credit portfolio.

(4) New regulatory requirements or changes in methodology had a major impact on credit risk RWA in 2023. The overall impact is a decrease of -3.3 billion euros. The most important items are set out below:

- In consultation with the ECB, a model simplification path has been agreed for KBC Group and implemented in the year-end reporting. The ECB decision includes the following items:
 - the IRB part of the group-wide Sovereign exposure will fall under the Standardised approach;
 - in addition, the exposure of some smaller models will also shift to the Standardised approach;
 - for the entities K&H and ČSOB Slovak Republic, the RWA calculation of the loan portfolio will fall entirely under the Standardised approach.

The RWA effect of all these changes amounts to -3.8 billion euros.

- The expiry of the temporary preferential treatment of EU government bonds in the Standardised portfolio impacted RWA in two ways (+454 million euros):
 - the impact of the partial expiry in the first quarter of 2023 on the corresponding UBB exposure (+135 million euros);
 - an add-on taken in the fourth quarter to cover for the RWA impact of this regulatory change on the exposure involved, throughout the KBC group, in the first quarter of 2024 (+319 million euros).

(5) Foreign exchange movements resulted in a limited RWA decrease (-166 million euros), the most material underlying changes being the appreciation of HUF (+166 million euros) and depreciation of CZK (-242 million euros). In addition, there was a total RWA decrease for other currencies, mainly USD, of around -90 million euros.

(6) Other events with impact on credit risk RWA had a total impact of -3.8 billion euros. The main drivers were:

- the sale of the remaining retail lending portfolio of KBC Ireland in the first quarter (-3 950 million euros);
- lower RWA for deferred tax assets (-259 million euros);
- an RWA increase for counterparty risk and CVA (+446 million euros);

(7) A change in market risk RWA of -1 078 million euros.

(8) A change in operational risk RWA of +895 million euros.

Exposure to credit risk

The tables in the credit risk section provide an overview – as described in the EBA guidelines – of the overall credit risk based on the figures for the end of December 2023. The scope is aligned with that of the KBC Group COREP reporting, meaning that all KBC group entities are included. It should be noted, however, that KBC Insurance is reported in the COREP on the basis of the Danish Compromise method and as a result no transactional data of this entity is included in the tables. The product scope is limited to the lending portfolio excluding all derivatives (such as interest rate swaps) and repos; these are dealt with in the 'Counterparty credit risk' section.

Unless otherwise stated, all exposure under the Standardised and IRB Foundation approaches is attributed to the region, sector and exposure class of the guarantor. This implies that if substitution is applied to a certain exposure of 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 substitution is applied, this exposure will be incorporated under 'Institutions' in the breakdowns provided. This substitution logic does not apply to the IRB Advanced approach, since under that approach the effect of a guarantee received is included in the LGD measurement.

Disclosure of credit risk quality

A client/facility is considered to be in default if – and only if – one or more of the following conditions are fulfilled:

1. The client/facility is 'unlikely to pay';
2. The client/facility is '>90 DPD default';
3. The client/facility is 'irrecoverable'.

KBC's definition of default builds on the definition set out in the Basel II Capital Requirements Regulation (CRR), which has been further elaborated in the EBA guidelines on the application of the definition of default. Based on the EBA paper on Forbearance and Non-performing exposures, KBC's definition of default is also fully aligned with the EBA's definition of non-performing (PD 10-11-12), i.e. they should be regarded as synonymous. The same holds true for the definition of 'impaired financial instrument' according to International Financial Reporting Standards (IFRS).

The regulatory required credit risk quality-related templates, together with their analysis, can be found in a separate Excel file on the kbc.com website, published alongside this Risk Report.

Forborne exposure

In order to avoid a situation where an obligor facing financial difficulties ends up defaulting, loans can be renegotiated and forbearance measures granted in accordance with internal policy guidelines.

Forbearance measures consist of concessions towards a borrower that may involve:

- lowering or postponing interest or fee payments;
- extending the term of the loan to ease the repayment schedule;
- capitalising arrears;
- declaring a moratorium (temporary principal and/or interest payment holidays);
- providing debt forgiveness.

After a forbearance measure has been decided upon, a forbearance tag is attached to the file in the credit systems for identification, monitoring and reporting purposes.

A client with a forbore loan will in principle be assigned a PD class that is higher than the one it had before the forbearance measure was granted, given the higher risk of the client. In accordance with IFRS 9 requirements, a facility tagged as 'forborne' will always be allocated to 'Stage 2' (please note that this only applies to non-defaulted clients, since defaulted clients are always classified in 'Stage 3').

If a client/facility has been assigned 'defaulted' status (before or at the time forbearance measures are granted), the client/forborne facility (depending on whether defaulted status is assigned at client or facility level) must remain defaulted for at least one year. Only upon strict conditions can the client/facility be reclassified as 'non-defaulted'.

A forbore facility with a 'non-defaulted' status will be tagged as 'forborne' for at least two years after the forbearance measure has been granted, or after the client/facility becomes non-defaulted, and can only be removed when strict extra criteria have been met (non-defaulted, regular payments, etc.).

As forbearance measures constitute an objective indicator (i.e. impairment trigger) that requires assessing whether impairment is needed, all forbearance measures are subject to an impairment test.

The regulatory required forbore exposure-related templates, together with their analysis, can be found in a separate Excel file on the kbc.com website, published alongside this Risk Report.

Credit Risk Mitigation (CRM)

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).

Collateral in the lending portfolio

Collateral is held to mitigate the risks (both identified and inherent) in individual loans. The KBC Credit Risk Standards on Collateral Management describe the standards and controls on how collateral should be treated in the credit process from the initial credit application to the decision to take collateral, establishing collateral, monitoring, etc. until the release of collateral. They contain the whole scope of requirements for quality assessment and valuation of collateral as well as

minimum requirements for collateral monitoring. The standards and controls are based on the requirements stipulated by CRD IV1, the ECB Guidance to banks on non-performing loans and the EBA guidelines on loan origination and monitoring.

Collateral applying to lending exposure subject to the Standardised approach has a direct effect by lowering the EAD, which in turn has a direct effect on RWA and on required capital. The CRD eligibility criteria for the Standardised approach are always the reference for collateral application. However, the effective scope of collateral KBC obtains from its clients to cover exposure falling under the Standardised approach is much broader than the figure taken into account for risk weight 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.

Under the IRB Foundation approach, only collateral meeting the eligibility criteria and minimum requirements (as imposed by the CRR) to qualify for credit risk mitigation has been included in the figures. Note, however, that following the implementation of the model simplification agreed with the ECB, there is only limited IRBF exposure left at KBC Group level.

For the lending exposure subject to the IRB Advanced approach, the collateral applying to these exposures affects RWA because collateral is included in LGD modelling.

Unfunded credit protection

Unfunded credit protection is provided entirely through guarantees.

The impact of guarantees under the Standardised and IRB Foundation approaches is at the level of exposure receiving a better rating through a lower risk weight (STA) or PD substitution (FIRB), resulting in lower capital requirements.

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.

The main types of guarantors are government entities and large financial institutions, such as banks, investment banks and insurance companies.

The regulatory required CRM-related templates, together with their analysis, can be found in a separate Excel file on the kbc.com website, published alongside this Risk Report.

Disclosure of the use of the Standardised approach

Credit exposure and CRM – Standardised approach

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 also uses external ratings from S&P's, Fitch and Moody's to define the risk bucket of exposures. The EBA standard table is used for mapping these external ratings.

If two external ratings are available, the lower of the two is used. If there are three external ratings with different risk weights attached to them, the risk weight corresponding with the second-best rating is applied. If no rating is available, the risk weight provided by the Standardised approach is used.

The tables below show the exposure calculated using the Standardised approach for the end of 2023, broken down by exposure class, excluding the SFT. The exposure classes are those defined for the purpose of regulatory reporting according to the Standardised approach, viz.:

- Central governments or central banks: claims on central authorities and governments and other assets weighted at 0% (such as Cash and Cash at central banks);
- Regional government or local authorities: 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 mortgages on immovable property: 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);
- Exposures in default: 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;
- Exposures associated with particularly 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;
- Institutions and corporates with a short-term credit assessment: 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';
- CIU: claims on Collective Investment Undertakings;
- Equity: Shares and Mutual Funds. Previously the equities were reported under the exposure class of the issuing entity of the equity instrument. Now all equity exposure is grouped under this single exposure class;
- Other: all other claims (e.g., other assets).

Credit risk exposure and CRM effects – Standardised approach

	a	b	c	d	e	f
EU CR4 - Standardised approach – Credit risk exposure and CRM effects						
Exposure classes	Exposures before CCF and before CRM		Exposures post CCF and post CRM		RWAs and RWAs density	
	On-balance-sheet exposures	Off-balance-sheet exposures	On-balance-sheet exposures	Off-balance-sheet exposures	RWAs	RWAs density (%)
<i>At 31 December 2023 (in millions of EUR)</i>						
1 Central governments or central banks	58 641	226	59 754	97	429	0.72%
2 Regional government or local authorities	1 914	103	1 895	45	99	5.08%
3 Public sector entities	2 296	215	2 495	224	21	0.77%
4 Multilateral development banks	421	24	773	3		0.00%
5 International organisations	1 719	155	1 719	78		0.00%
6 Institutions	1 977	513	1 565	15	386	24.41%
7 Corporates	12 113	6 202	11 584	2 155	12 100	88.07%
8 Retail	6 771	1 779	6 013	744	4 472	66.19%
9 Secured by mortgages on immovable property	12 138	390	12 138	176	4 470	36.30%
10 Exposures in default	405	61	334	11	391	113.44%
11 Exposures associated with particularly high risk	32	18	32	9	62	150.00%
12 Covered bonds	33		33		3	10.00%
13 Institutions and corporates with a short-term credit assessment						
14 Collective investment undertakings	114		114		22	18.85%
15 Equity	51		51		64	126.67%
16 Other items	3 783	140	3 783	70	2 864	74.34%
17 Total	102 405	9 671	102 282	3 548	25 381	23.98%

Table 16 - EU CR4_Standardised approach – Credit risk exposure and CRM effects

Compared to 2022, the table clearly shows the impact of the shift of exposure from IRB to Standardised as a result of the model simplification agreement. The exposure, both on- and off-balance-sheet, before CCF and CRM increased from 24 billion euros in 2022 to 112 billion euros in 2023. However, the conclusion remains that the use of CRM for the Standardised exposure is very limited. The most important substitution shift remains the one at K&H from 'Retail' to 'Central governments'. Comparing 2022 and 2023, the RWA density figures have remained stable, except for the asset classes 'Regional government or local authorities' and 'Public sector entities'. The exposure for these asset classes was very low and increased substantially after the model simplification change with mainly 0% weighted exposure (see the next table, EU CR5).

Risk weight by exposure class – Standardised approach

The table below shows the exposure (post CCF and CRM) at year-end 2023, calculated using the Standardised approach and broken down by exposure class and risk weight.

	a	c	d	e	f	g	i	j	k	l	o	p	q
EU CR5 - Standardised approach													
Exposure classes													
At 31 December 2023 (in millions of EUR)	0%	4%	10%	20%	35%	50%	75%	100%	150%	250%	Others	Total	Of which unrated
1 Central governments or central banks	56 344	781	2 185	358		145		38	0*		0	59 851	90
2 Regional government or local authorities	1 447	0	0	493		0		0			0	1 940	346
3 Public sector entities	2 633	0	4	73		7		3			0	2 719	1136914
4 Multilateral development banks	775	0	0			0		0			0	775	
5 International organisations	1 719	0	0			0		0			0	1 719	
6 Institutions		0	0	1 361		210		10			0	1 580	193
7 Corporates		0	0	228		424		13 078	9		0	13 739	12 988
8 Retail exposures		0	0			0	6 757	0			0	6 757	6 757
9 Exposures secured by mortgages on immovable property		0	0		10 368	1 945	0	0	0		0	12 314	12 314
10 Exposures in default		0	0			0		252	93		0	345	345
11 Exposures associated with particularly high risk		0	0			0		0	41		0	41	41
12 Covered bonds		0	33			0		0			0	33	0
13 Exposures to institutions and corporates with a short-term credit assessment		0	0			0		0			0		
14 Units or shares in collective investment undertakings	0	0	0			0		0	0		114	114	1
15 Equity exposures		0	0			0		42		9	0	51	51
16 Other items	624	0	0	127		0		1 987	0	107	1 008	3 853	2 221
17 Total	63 542	781	2 222	2 641	10 368	2 731	6 757	15 408	143	116	1 122	105 830	35 346

*11/04/2024 – Adjusted due to formatting.

Table 17 – EU CR5_Standardised approach

The share of unrated exposure decreased significantly. This is because the increase in exposure in the asset class 'Central governments or central banks' is by far the most significant and this asset class typically has a very low share of unrated exposure.

Disclosure of the use of the IRB approach to credit risk

Credit exposure and CRM – IRB approach

The tables below show total exposure calculated using the IRB approach, broken down by exposure class. The exposure classes are those defined for the purpose of regulatory reporting according to the IRB approach³:

- Central governments and central banks: 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;

³ 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 exposure class.

- 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: this exposure class includes all exposure not belonging to one of the other exposure classes, i.e. mainly exposure to corporate, SME or non-bank financial counterparties;
- Specialised lending: exposure to entities created specifically to finance projects or commercial real estate;
- SMEs (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 exposure class includes exposure to private individuals or SMEs, managed in the retail network, for which the total exposure to the counterparty does not exceed 1 million euros. This exposure class is further broken down, depending on whether or not the exposure is secured by (residential or commercial) real estate (including mortgages), and depending on whether the exposure is to private individuals or SMEs;
- Qualifying revolving retail: this includes revolving retail exposure, such as exposure to credit cards and overdrafts;
- Other non-credit obligation assets: besides 'other assets', this category includes the residual value of leasing transactions and deferred tax assets (DTA);
- Equity: this category includes shares and mutual funds.



EAD covered by the IRB methods by exposure class

This table shows the importance of each IRB method by asset class, taking the EAD after CCF of the IRB loan portfolio as a reference.

EAD covered by the A-IRB model

31/12/2023 (in millions of EUR)

	EAD	EAD %
Central governments and central banks		
Institutions	12 528	7.25%
Corporates – SMEs	21 227	12.28%
Corporates – Specialised lending	10 999	6.36%
Corporates – Other	37 718	21.81%
Retail – Secured by real estate SMEs	10 853	6.28%
Retail – Secured by real estate non-SMEs	63 985	37.01%
Retail – Qualifying revolving	940	0.54%
Retail – Other SMEs	7 009	4.05%
Retail – Other non-SMEs	7 459	4.31%
Equity IRB	185	0.11%
Total	172 902	99.80%

Table 18 - EAD covered by the IRB model (AIRB)

The shifts resulting from the model simplification have changed the distribution percentage per asset class. This is mainly due to the transfer of the entire Central Government and Central Bank exposure to the Standardised approach.

EAD covered by the F-IRB model

31/12/2023 (in millions of EUR)

	EAD	EAD %
Central governments and central banks		
Institutions		
Corporates – SMEs	87	25.28%
Corporates – Specialised lending		
Corporates – Other	256	74.72%
Total	342	0.20%

Table 19 - EAD covered by the IRB model (FIRB)

Since ČSOB Slovak Republic was the only KBC Group IRBF entity and it now reports under the Standardised approach, IRBF exposure has become immaterial.

The regulatory required credit risk IRB templates, together with their analysis, can be found in a separate Excel file on the kbc.com website, published alongside this Risk Report.

Disclosure of exposures to securitisation positions

KBC has a very limited investment portfolio of securitisation positions of 120 million euros, consisting primarily of European residential mortgage-backed securities (RMBS). In recent years no new investments were made, resulting in a gradual decrease of the portfolio due to redemptions.

The investment portfolio of securitisation positions consists entirely of senior positions. Since no new investments were made in recent years, the portfolio is primarily composed of non-STS positions.

KBC applies the SEC-SA approach for calculating the risk-weighted exposures on its investment portfolio of securitisation positions. If conditions for the SEC-SA are not met, the SEC-ERBA approach is used in accordance with the hierarchy of approaches as foreseen in the regulation and applying external ratings from Moody's and S&P.

The RMBS portfolio is measured at amortised cost as these investments are held within a business model whose objective is to hold assets in order to collect the contractual cashflows on specified dates that are solely payments of principal and interest. In line with KBC's accounting policies, an Expected Credit Loss (ECL) model is used to measure impairments on financial assets at amortised cost. The RMBS portfolio carries 12-month expected credit losses.

The regulatory required securitisation templates, together with their analysis, can be found in a separate Excel file on the kbc.com website, published alongside this Risk Report.

Internal modelling

The credit risk models developed by KBC over the years to support decisions in the credit process include Probability of Default (PD), Loss Given Default (LGD) and Exposure At Default (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;
- generating input for other credit risk models (e.g., behavioural scores as pooling criteria for the retail portfolio).

The internal rating process depends on the exposure class:

	Type of model	Batch or manual process	Frequency	Overruling possible
(i) central governments and central banks	Statistical expert-based models	Manual process	Annual, or when specific information affecting the credit rating becomes available	Yes
(ii) institutions	Statistical default/non-default models based on objective and subjective input	Manual process	Annual, or when specific information affecting the credit rating becomes available	Yes
(iii) corporate, including SMEs, specialised lending and purchased corporate receivables	Statistical default/non-default models based on objective and subjective input	Batch (for corporates and SMEs) and manual process (for corporates, specialised lending and purchased corporate receivables)	Batch: monthly	Yes
	Statistical expert-based models		Manual: annual, or when specific information affecting the credit rating becomes available	
	Generic flexible rating tool			
(iv) retail	Statistical default/non-default models based on objective inputs	Batch process	Monthly	No

Table 20 - Internal Rating Process

The 'equities' exposure class is not included in this table since to calculate the RWA we do not use a PD for this. We use the 'simple risk-weighted approach', which means that, depending on the type of equity, a percentage is simply applied to the exposure (190%, 290% or 370%).

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 European regulations. 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 to strike a good balance 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 qualitative input, using machine learning techniques. At KBC, this method is 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 quantitative models, but also use qualitative input entered by a credit adviser (for instance, management quality). At KBC, this method is used to rank large corporate clients, 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 'Asset-based real estate lending' 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, known as the KBC Master Scale.

Once all the steps have been taken and the model has been 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 could 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, expert opinion, etc.).

For IRB portfolios, internal ratings are used for RWA calculations and to support the internal (credit) processes. For these portfolios, in principle, external ratings are only used as benchmark/challenge in model reviews. There are two exceptions to this; in very specific cases external ratings can be used to rate sovereigns and insurance companies. For sovereigns, the lowest external rating of Fitch, Moody's or S&P is used if the direct exposure is below 1 million euros and the total country exposure is lower than 50 million euros. For insurers, the external financial strength rating of S&P can be used if there is only reinsurance risk on the counterparty. If this rating for insurers is not available, the financial strength rating of Moody's, Fitch or A.M. Best is assigned.

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).

For IRB portfolios, a downturn LGD is used; the loss that is expected to occur in an economic downturn.

KBC uses historical information that is available on losses of defaulted counterparties to model LGD, including cure rates (the likelihood that a defaulted obligor returns to performing state) and recovery rates (the recoveries from collateral or other sources).

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 the majority of cases, parameters predicted by models do not perfectly match those that are ultimately observed. This has a number of reasons, the most significant of which are:

- Intrinsic randomness - For practical purposes, some aspects of the future are intrinsically unpredictable. Conceptually, a model can only ever predict non-random aspects of future developments;
- Unstable context - Models operate on the presumption that the future will be structurally identical, or at least very similar to the past and present. In practice this may not always be the case;
- Data quantity - Our knowledge of the past is limited, so models are based on incomplete information;
- Data quality - Model data may be incomplete, unreliable, biased or otherwise deficient;
- Methodology - The method used to derive a model may be unable to capture the true relationships between predictors and the estimated parameter.

Once identified, one can classify the adverse effects of such model deficiencies into two categories, i.e. model predictions can be inaccurate (or biased) and imprecise. Bias refers to a structural deviation of model-predicted parameters from their actual values such as systematic over- or underestimations. Imprecision results in a spread of model parameter predictions around the actual values.

To ensure that risk parameters are not underestimated in the majority of cases, a Margin of Conservatism (or MoC) Framework accounts for uncertainty in PD, LGD and EAD estimates by means of conservative corrections to parameter estimates.

In exceptional cases, the appropriate degree of conservatism may not be achieved by including an MoC in the transactional ratings. In that case, an RWA correction can be imposed.

Role of validation

The term 'four-eyes principle' refers to a precautionary measure that requires at least two people to review a particular activity. Application of this principle is essential in risk measurement, as it allows us to reduce measurement risk. It takes two forms, namely 'verification' and 'validation'.

Verification is a process during which a second pair of eyes assesses whether a measurement-related activity has been performed in accordance with prescribed policies/guidelines/procedures and/or best practices.

Consequently, as a rule, a person cannot verify their own work. Verification can be linked to data gathering, data processing, as well as the implementation of a model, but not to modelling itself.

Validation is a specific – more stringent – form of verification, aimed at challenging an internally designed model, and can only be performed by members of an independent validation unit. Validation is key to the challenging process, as it provides an independent view of the internal model.

The internal models measuring required capital (Pillar 1 and 2) and models which serve as input for these models (e.g., behavioural score models) are subject to formal model validation.

Checks and decisions on rating models

Decisions on the appropriateness of models and changes to the models are made by the CRO of the entity where the model is used or the Group CRO (for models that are used group-wide).

Annual validation

Every IRB model is validated on a yearly basis in accordance with the following principles:

- The annual validation is performed by the independent validation unit;
- An annual validation cannot include model changes;
- Fixed tests are defined with fixed thresholds;
- The scope of the annual validation is the implemented model;
- The resulting outcome of the annual validation is either 'redesign needed' or 'no redesign needed', the latter possibly supplemented with a decision to recalibrate the model.

The annual validation of IRB models is performed by the independent validation unit and results in advice to the CRO on the appropriate actions to be taken.

Redesign/recalibration

A model is redesigned/recalibrated by a modelling team; the proposed redesign/recalibration is validated by the independent validation unit.

The CRO decides based on a proposal by the model owner, supplemented by independent advice from the independent validation unit.

Key models used for the most important portfolios

(in millions of EUR)	Key IRB models					
	Corporates	Financial Institutions	Central governments	Asset-backed real estate	Private persons	Non-regulated retail
Central governments and central banks*			•			
Institutions		•				
Corporates	•			•		
Corporates-SME	•			•		
Retail-SME						•
Retail-non-SME					•	

(*) Portfolio moved to Standardised approach on 31-12-23, hence the model is no longer used for IRB purposes.

Table 21 - Asset classes key IRB models

ESG in credit risk management

The management of ESG risks is integrally embedded in the Credit Risk Management Framework.


ESG risk identification







To ensure proactive risk identification, we have taken several initiatives relating to Environmental, Social and Governance risk management:


- The **Climate Risk Impact Map** is leveraged for credit risk management purposes. It identifies the climate risk drivers that are the most relevant to KBC's credit portfolios, both for transition and physical risks. In order to capture growing insights and portfolio evolutions, the Climate Risk Impact Map is reviewed on a yearly basis. The main conclusions are:

Credit risk	ST	MT	LT
Net Zero			
Delayed transition			
Current policies			

Figure 4 - Climate Risk Impact Map: outcome for credit risk

 Depending on the pace and strictness of upcoming low-carbon regulations and the degree of adaptability of counterparties, a significant impact within KBC's credit portfolio could be expected. The credit quality of KBC's counterparties may be impacted due to increased costs of adaptation or even the inability to make the transition. Additionally, certain companies in vulnerable sectors could feel additional stress stemming from a loss of clients, further impacting credit risk. The emission-intensive sectors in KBC's portfolio are considered to be the most vulnerable to transition risk.

Legend	
	No/limited impact
	Mild impact
	Material impact
	Critical impact
	Transition risks
	Physical risks

 The most relevant physical risk driver for KBC's credit risk portfolios is water-related physical risk, more specifically flood risk. A possible impact is an increase in clients' probability of default, due to damage to their physical assets or disruption of their businesses. In addition, the value of affected collateral could decline. Credit portfolios are still assumed to be exposed to temperature and wind-related physical risks, albeit to a lesser extent.

In 2023, this impact map has been supplemented for **other environmental risks** by piloting the assessment of credit risks stemming from biodiversity loss, pollution and water stress. Emerging regulations to prevent biodiversity loss, to safeguard freshwater resources and to prevent pollution may impact our credit risk. Also, counterparties that are heavily dependent on natural resources may be impacted by biodiversity loss, pollution or water stress due to supply chain and operational disruptions. Ultimately, in case these issues become structural, this might impact their performance and therefore impact credit risk.

- For the above-mentioned emission-intensive sectors, deep dives (so-called '**White Paper**' analyses) were performed to investigate, amongst others, in more depth the transition risk related to climate change. Eight industrial sectors and three product lines were selected. The relevant sectors were energy, real estate, agriculture, food and beverages, building and construction, chemicals, transport and metals. The product lines were mortgages, car loans and car leasing. These portfolios are considered material for KBC both from a carbon-emission perspective and from an exposure perspective (covering a material part of KBC's loan book). For a subset of these portfolios, KBC has set climate targets and reports on the progress made.

Generally, in the White Papers we assess different environmental challenges for the sectors and product lines with the largest impact, taking into account the specific context of our home countries. More details on the overall White Paper approach can be found in our Sustainability Report.

- In line with our Climate Risk Impact Map, physical hazards were also thoroughly addressed. Specifically with respect to flood risk, which is considered the most relevant physical risk driver from a credit risk point of view, various loan portfolios throughout KBC Group were analysed. The assessment distinguished between fluvial, pluvial and coastal flood risks. For further information on this exercise as well as on KBC's physical risk assessments in general, reference is made to Annex III of the Risk Report. Note that the actual sector impacts are provided in ESG Template 5, which can be found in a separate Excel file on the kbc.com website, published alongside this Risk Report.
- A key tool for detecting the related risks in the corporate and SME loan portfolios is the **Environmental and Social Heatmap**. It provides a qualitative score for environmental as well as social risks at sector level. For material credit files in sectors with a high risk score (according to the above-mentioned Heatmap), a dedicated **ESG assessment** is performed at counterparty level. Such an assessment can take place both in the loan origination process and in the review process.
- At counterparty level, **Internal Carbon Pricing (ICP)** is also leveraged to assess the financial impact of carbon taxation on greenhouse gas-intensive businesses. More specifically, estimated greenhouse gas emissions and KBC's ICP are used to test the sensitivity of a counterparty's earnings.
- To understand how business clients deal with ESG challenges and to support them in this transition, **client dialogues** can be an essential part of such a counterparty assessment. We also use this dialogue to collect our clients' environmentally relevant data.

ESG risk measurement and stress testing

The **Paris Agreement Capital Transition Assessment (PACTA)** methodology helps us to assess the transition risk in our loan portfolio. This analysis determines whether the companies in our loan portfolio are following a transition path in line with targets set by various climate transition scenarios. The results of this year's exercise confirm again that, within its industrial loan portfolio, KBC only has limited exposure to companies that contribute the most to global greenhouse gas emissions. This finding confirms the general risk appetite of KBC, as our loan books do not include large single-name exposures to activities which contribute the most to global greenhouse gas emissions. For further information on PACTA, we refer to the Appendices of the Sustainability Report.

Continuous efforts are made to improve the overall quality and availability of ESG-related data. In order to measure the transition risk related to financing counterparties with high greenhouse gas emissions, KBC takes a progressive approach in collecting actual emission data from its counterparties. To calculate and measure all financed emissions in our corporate loan portfolio, the **Partnership for Carbon Accounting Financials (PCAF)** methodology is used. Financed greenhouse gas emissions are reported in Template 1 of the ESG-related disclosures. For further information on PCAF, we refer to the Appendices of the Sustainability Report.

We keep developing and improving our **modelling exercises** that deal with climate risks, and continue to evaluate how transition and physical risks affect our credit portfolios. In terms of transition risks, earlier analysis estimated the potential changes in Expected Loss (EL) of highly climate-relevant portfolios under six different climate scenarios. With respect to physical risks, portfolio data and scientific research are used to determine how our portfolio responds to chronic as well as physical risks associated with climate change. Further explanations and outcomes of these assessments can be found in Annex XIII and Template 5 of the ESG-related disclosures on physical risks. Additionally, a pilot analysis was performed in 2023 to explore the potential impacts of physical risks, and more specifically flood risk, on Loss Given Default.

In general, the insights gained from the above-mentioned methodological tracks are valuable for identifying hot spots in KBC's loan portfolio, as input for target setting and monitoring, for initiating policy adjustments and for climate risk stress testing. More information on stress-testing exercises and their results can be found in the overarching ESG section 'Risk

measurement, scenario analysis and stress testing'. These are also part of our continuous efforts to further integrate climate risk into our credit assessment processes.

As the availability of data and measurement methodologies will further improve, quantification of ESG-related risks will gradually be extended. Management has the ability to overrule the expected credit losses and to capture events that are not part of the financial assessment, such as the growing insights into ESG and climate-related risks.

Setting and cascading risk appetite regarding ESG

Firstly, counterparties that are excluded from lending are identified in the KBC Group Blacklist, the KBC Human Rights Offenders List and the KBC Controversial Regimes List. For further information we refer to the [sustainability policies](#) as published on KBC's website.

The credit risk playing field is made tangible through Credit Risk Standards and group-wide policies that impose restrictions and provide recommendations with regard to credit risk (see also 'Policies, restrictions and targets'). KBC aims to limit the adverse impact of its activities on the environment and society and to encourage a positive impact based on a responsible lending culture. These principles are laid out in the **Credit Risk Standards on Sustainable and Responsible Lending**, which include restricted activities regarding biodiversity/ecosystem services and other environmental domains, and social domains, such as gambling, weapons, etc. As explained in 'Risk identification', our clients' ESG profile is assessed and taken into consideration in loan origination and review processes. The Credit Risk Standards on **Loan Pricing** and **Collateral Management reflect environmental risks in pricing and collateral valuations**. Note that Credit Risk Standards and policies are also regularly reviewed for the rapidly evolving ESG landscape.

ESG risk analysis, monitoring and follow-up

Our standard credit risk monitoring instruments are iteratively enriched with ESG metrics, such as energy efficiency for real estate. In addition, dedicated ESG monitoring instruments have been set up. Based on the E&S Heatmap, the **E&S Portfolio Report** of the industrial loan portfolio is drawn up on a semi-annual basis. In this process, KBC monitors its exposure towards subsectors prone to environmental and social risks.

KBC has also introduced **Climate-related Key Risk Indicators (KRI)** in the Risk Appetite Process for credit risk. These cover both transition and physical risk, are monitored on a semi-annual basis by the Group Lending Committee and are also leveraged in the group-wide **Climate Risk Dashboard** (see above).

Counterparty Credit Risk

Counterparty credit risk (CCR) is the risk related to the non-payment or non-performance of a counterparty in a professional transaction (excluding money market placements, which can be considered as borrower risk), due to that party's insolvency or lack of willingness to pay or perform.

Professional transactions are transactions concluded with the intermediation of professional dealers or traders, and include OTC derivatives (e.g., foreign exchange swaps, interest rate/equity swaps, future rate agreements, etc.), Security Financing Transactions ((reverse) repos) and exchange-traded derivatives.

Strategy

Our strategic objectives in undertaking trading and sales activities are to offer sound and appropriate financial products and solutions to our clients in order to help them manage their risks and access capital. The credit risks resulting from these activities are called counterparty credit risks (CCR) and originate from trading and sales activities involving derivatives and Security Financing Transactions. Lying at the intersection of credit risk and market risk, CCR draws from the relevant topics of both risk types. The Credit Risk Management Framework for professional transactions (CRMF_PT) covers pre-settlement risk, settlement risk, country risk and wrong way risk, and additionally lays down standards related to collateral management, counterparty limit setting, stress testing and CCR risk measurements. The counterparty credit risks are reported to group senior management through the Group Markets Committee (GMC).

Counterparty credit risk management is organised in a decentral way although close cooperation exists between the central centre of competence and the local risk teams involved in the follow-up of CCR.

- The Competence Centre for Counterparty Credit Risk is responsible for developing the CCR frameworks and risk standards, enhancing the CCR process, models and methodology. The team monitors the relevant portfolio evolutions, and prepares risk reports, which are submitted to the Group Markets Committee (GMC). The GMC meets every month and is chaired by the Group CRO.
- The local risk teams implement the group frameworks and standards, follow up on counterparty credit risks and report to local committees.

Managing counterparty credit risk

In the area of counterparty credit risk, the Executive Committee is supported by the Group Markets Committee (GMC), which advises on risk monitoring and capital usage with respect to trading activities. The governance, rules and procedures on how counterparty risk management should be performed throughout the group are outlined in the CRMF_PT. Its implementation is monitored by Group Risk and its Counterparty Credit Risk Competence Centre, ensuring that an effective CCR management process is in place throughout the KBC group.

The building blocks for managing counterparty credit risk

Risk identification

Risk identification is the process of systematically and proactively discovering, recognising, assessing and describing risks, both within and outside KBC. Specifically for counterparty credit risk, the risk identification process supports on:

- a counterparty risk limit framework (see 'Limit monitoring');
- real-time (pre-deal) risk follow-up at counterparty level;
- a large variety of controls (including risk factor coverage, wrong way risk analysis, etc.);
- a comprehensive stress test framework.

Risk measurement

The exposure calculations of counterparty credit risk make use of one of the following methodologies:

- For derivatives:
 - Internal Model Method (IMM)
 - Standardised CCR (SA-CCR)
- For Security Financing Transactions, we use the Financial Collateral Comprehensive method.

All these methodologies start from the same premise: the exposure of trades is measured over the lifetime of the trade, taking into account the replacement cost (which can change on a day-to-day basis due to changes in market rates), portfolio effects and credit risk mitigation.

Below we briefly zoom in on each of the methodologies, their link to capital calculations and limit monitoring.

The Internal Model Method

KBC Group uses the Internal Model Method (IMM) to measure the exposure of the interest rate and foreign exchange derivatives of KBC Bank NV and CBC Banque NV. The IMM uses a Monte Carlo-based approach to simulate the expected market values over the lifetime of the trades. These expected market value profiles serve as input for the Credit Risk Mitigation model, where netting and collateral may be applied. The resulting exposure profiles are then used in the appropriate risk process:

- Effective Expected Positive Exposure (EEPE) feeds into the capital calculation. EEPE is the weighted average over time of the effective expected exposures where the weights are the proportion that an individual expected exposure represents of an entire time interval. The average is taken over one year or, if all trades within the netting set mature within one year, it is taken over the period of the longest maturity in the netting set.
- Potential Future Exposure (PFE) results from a time profile of simulated positive exposures. For limit monitoring we use the 97.5th percentile of the resulting distribution of exposures. Unlike the EEPE value, which is limited to a maturity of one year, the PFE is calculated for the entire lifetime of the trade.

The Standardised Counterparty Credit Risk (SA-CCR)

The SA-CCR calculation is used for the remaining part of the derivative portfolio. The SA-CCR methodology uses concepts similar to the Internal Model Method. The SA-CCR approach can be broken down into three building blocks:

- The regulatory imposed alpha factor (1.4).
- The replacement cost, which is based on the net market value of the counterparty's derivative portfolio (or the trade market value for single trades), exchanged collateral (posted or received variation margin) and an estimate of the maximum open risk for collateralised netting sets (provided by the Net Independent Collateral Amount (NICA), Minimum Transfer Amount (MTA) and Threshold Amount).
- In the SA-CCR methodology, the Potential Future Exposure is driven by two elements:
 - An add-on, which is a measure for the riskiness of a derivative transaction in a netting set.
 - A PFE multiplier, a value between 5% (risk-reducing) and 100% (no impact) that recognises the risk-reducing impact on the add-on of a current negative exposure or of excess collateralisation (i.e. collateral greater than the net market value).

The SA-CCR calculation provides an exposure at default which is used in limit monitoring and in the capital calculation process.

The Financial Collateral Comprehensive Method (FCCM)

The FCCM method is used to compute the exposure amount of Security Financing Transactions (SFTs) for both regulatory reporting (i.e. regulatory capital calculations) and limit monitoring purposes. SFT trades can be split into two sub-groups, i.e. reverse repo and repo trades.

- **Reverse repo transactions:** these transactions are considered deposits made by KBC, with KBC lending cash against securities until the cash is repaid.
- **Repo transactions:** these transactions are considered funding, as KBC receives cash in exchange for securities provided as collateral until the cash is repaid.

To conclude such transactions, a General Master Repurchase Agreement (GMRA) needs to be signed 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.

A Security Financing Transaction can be broken down into a cash leg and a security leg. The exposure for these trades can be calculated as the difference between the cash leg and the volatility-adjusted market value of the security leg.

Credit risk mitigation techniques

In each of the methods described above, we apply credit risk mitigation techniques, which are provided by a netting agreement governing close-out netting, the exchange of collateral and clearing through Qualified Central Clearing parties.

Close-out netting

Close-out netting is one of the main risk mitigation techniques. The aim of close-out netting is to allow, in the event of default, a timely termination and settlement of the net value of all trades with the defaulted counterparty. Close-out netting consists of two components:

- Close-out, which is the right to terminate transactions with the defaulted counterparty and therefore to cease any contractual payment;
- Netting, which is the right to offset amounts due to termination of individual contracts to determine a net position.

Close-out netting will reduce counterparty risk as it will reduce pre-settlement risk. This is governed by a legal agreement, the most common of which is the ISDA Master Agreement. Netting will only be applied if its legal effectiveness and enforceability is assured.

Collateral

Besides close-out netting, collateral is used as a separate credit risk mitigation technique. For derivatives, the exchange of collateral is governed by the Credit Support Annex (CSA), an addendum to the ISDA Master Agreement. The CSA stipulates the mechanics of the collateralisation process and, as such, determines the risk characteristics of the exposure. It stipulates, for example, whether the contract is unilateral or bilateral, the timing of collateral transfers, etc.

Before collateral is taken into account as a valid risk mitigant, it has to fulfil a number of requirements. It must be eligible for risk mitigation in the regulatory capital calculations. Legal comfort must have been obtained regarding the ownership of the collateral in all relevant jurisdictions.

Despite having a range of eligibility criteria for collateral, the exchanged collateral is limited to either bonds (government bonds or corporate bonds) or cash. In order for collateral to be effective in times of need, KBC monitors:

- concentration of the received collateral;
- liquidity of the received bonds, and
- the impact (on collateralisation) of a possible rating downgrade of one of the contractual parties (KBC or the counterparty).

We identify two forms of collateral being exchanged:

- Variation margin
 - Variation margin is the collateral exchanged between counterparties, which covers changes in the market value of the portfolio of trades. Variation margin payments are usually made daily and are typically in cash.
- (Bilateral) initial margin
 - Initial margin (IM) refers to the collateral exchanged between counterparties to OTC derivative contracts to cover current and potential future exposure in the time interval between the last exchange of variation margin before the default of a counterparty and the liquidation of positions or hedging of market risk following the default.

Both the variation margin and the (bilateral) initial margin are governed by Commission Delegated Regulations (EU) 2012/648 and (EU) 2016/2251. The general principles described above are an integral part of the collateral standards.

The regulatory required CCR5 template can be found in a separate Excel file on the kbc.com website, published alongside this Risk Report. In this table, we provide an overview of the composition of the collateral for CCR exposures. We distinguish between collateral used in derivative transactions and collateral used in SFTs:

- Collateral used in derivative transactions: in this section we report both the initial margin (IM) and the variation margin (VM).

- Collateral used in SFTs:
 - Here we report both the security leg of the SFT and the collateral exchanged in the General Master Repurchase Agreement (GMRA).
 - The security leg of reverse repos is added to the SFT collateral received column. Almost all of the securities underlying these transactions are government securities, with the underlying issuers of the remaining securities being mainly banks and corporate entities.
 - The security leg of repo trades is added to the SFT collateral posted column.

Central clearing

Central clearing is used to reduce counterparty credit exposures; an overview of the exposure cleared at a central clearing counterparty is provided in table CCR8. This regulatory required template can be found in a separate Excel file on the kbc.com website, published alongside this Risk Report. KBC only clears exposures with Qualified Central Clearing Parties (QCCP).

Setting and cascading risk appetite

The risk appetite does not explicitly distinguish counterparty risk from credit risk. Therefore, we refer to the section 'Credit Risk'.

Risk analysis, monitoring and follow-up

An important task of the risk function (Risk Markets and/or Local Risk) is to perform qualitative and quantitative analysis and to formulate CCR advice regarding proposals submitted by Business to the GMC, the GLC and the CRO Service Management Committee. This role of the risk function can be split into a proactive and a reactive part.

- In its proactive role, the risk function analyses the results of risk calculations and monitors market developments, industry trends, changes in regulations and new modelling insights. The risk function provides advice to the Group Markets Committee (GMC) with respect to changing and/or improving methodologies and CCR risk processes.
- In its reactive role, it monitors and reports on CCR, informs senior management of developments in CCR, challenges business decisions which might impact CCR positions, and provides risk advice on business proposals (e.g., advice for the New and Active Products Process (NAPP) committee).

Scope

The scope of counterparty credit risk is limited to credit risks related to professional transactions. These professional transactions are transactions concluded with the intermediation of professional dealers or traders of the Markets directorate, namely:

- derivatives,
- Security Financing Transactions (SFTs),

This for all entities referred to in the scope description of the credit risk disclosures.

Wrong way risk

Wrong way risk (WWR) occurs when the exposure to a counterparty is adversely correlated with the credit quality of that counterparty. In other words, WWR arises when default risk and exposure increase simultaneously. Two types of wrong way risk can be identified:

- specific wrong way risk (SWWR)
- general wrong way risk.

Specific wrong way risk

SWWR arises when a transaction is structured in such a way that the exposure to the counterparty is positively correlated with the probability of default of that counterparty. Two typical examples of SWWR are:

- The counterparty and the issuer of the reference asset of a transaction are the same entity or are affiliates.
- The collateral supporting a transaction is issued by the counterparty or its affiliates.

KBC strives to avoid SWWR at the origination of the transactions:

- New products are analysed to detect any occurrence of SWWR. If identified, this may result in mitigating actions.
- We avoid accepting collateral where the issuer of the collateral has a legal and/or economic connection to the counterparty of the trade.

The derivative portfolio is monitored for the presence of SWWR. Detected SWWR trades are presented to the Group Markets Committee (GMC) for information purposes.

General wrong way risk

General wrong way risk occurs when the probability of default of the counterparty is positively correlated with the exposure due to developments in general market risk factors (e.g., interest rates, inflation or exchange rates). GWWR is monitored by using a set of stress test scenarios aimed at trades where a positive relationship exists between the counterparty's creditworthiness and the exposure. The GWWR report is presented to the Group Markets Committee for information purposes.

Limit monitoring

Counterparties willing to trade OTC derivatives or enter into Security Financing Transactions (SFTs) with the bank require a professional limit, which is subject to approval by the appropriate credit committee. This limit allows traders at the bank to monitor – in real time – the outstanding exposure per counterparty calculated using the models described above (IMM, SA-CCR, FCCM). Possible breaches of the professional limit are handled in the credit process.

Impact of a rating downgrade on collateral

The impact of a rating downgrade of KBC Bank NV on the collateral posted to counterparties is assessed on a regular basis as part of the ongoing CCR stress test framework. The table below provides an overview of the impact of a downgrade by 1 notch, 2 notches and 3 notches, respectively.

Impact of own Rating Downgrade on required collateral

At 31 December 2023 (in millions of EUR)

Rating Downgrade	Downgrade	Impact on collateral
A-	1-notch downgrade	12
BBB+	downgrade of 2 notches	150
BBB	downgrade of 3 notches	325

Table 22 - Impact of a rating downgrade of KBC Bank NV on required collateral 31-12-23

Regulatory treatment

Default risk RWA

As mentioned above, KBC Group NV uses an approved internal model method (IMM) for exposures originating in KBC Bank NV and CBC Banque NV, both at consolidated and solo level. The internal model method covers the portfolio of foreign exchange (FX) derivatives and interest rate (IR) derivatives. All other portfolios are calculated using the Standardised Counterparty Credit Risk (or SA-CCR) for CCR capital calculations or the Financial Collateral Comprehensive Method (FCCM) for SFT exposures. Table CCR1 provides a breakdown of the exposure calculations per approach.

The CCR7 table provides an overview of the IMM RWA flows over the last quarter. There was a significant increase in the IMM RWA (total impact of 116 million euros), mainly driven by an increase of the exposure (136 million euros RWA). This regulatory required template can be found in a separate Excel file on the kbc.com website, published alongside this Risk Report.

Default risk RWA by regulatory risk-weighting approach

KBC uses three regulatory risk-weighting approaches: the Standardised approach, the IRB Foundation approach and the IRB Advanced approach. A breakdown of the CCR exposure by each of the credit risk approaches and asset classes is provided in the following tables:

- EU CCR3 – Standardised Approach-CCR exposures by regulatory exposure class and risk weight. The RWA related to the position can be calculated by multiplying the exposure amount by the respective risk weight in the header of the table.
- EU CCR4a – IRB F approach – CCR exposures by exposure class and PD scale
- EU CCR4b – IRB A approach – CCR exposures by exposure class and PD scale

These regulatory required templates can be found in a separate Excel file on the kbc.com website, published alongside this Risk Report.

Credit value adjustment

Credit Valuation Adjustment (CVA) is a regulatory capital charge to cover the volatility of expected losses due to counterparty credit risk exposure related to over-the-counter (OTC) derivatives. The CVA capital charge is calculated according to the regulatory Standardised formula.

Over 2023, the CVA RWA increased by 21%, mainly due to an increase in the number of trades subject to the CVA risk charge.

ESG in Counterparty Credit Risk management

ESG in KBC Group is documented in the 'Climate-related and other ESG risk' section. The following specific actions are set up in the counterparty credit risk domain.

- In 2021, KBC initiated the development of a **Climate Risk Impact Map**, as described in the 'ESG in our risk management' section. This annual process aims to identify the most material climate risk drivers for KBC's businesses and portfolios, including the counterparty credit risk portfolio. It reflects the distinct impact of transition risk (policy and regulation, technology and consumer preferences) and physical risk drivers (split according to different climate perils) on the traditional risk types, thereby considering three different climate scenarios for three different time horizons. The CCR portfolio, too, can be impacted by transition risks, which can influence the equity derivatives and commodity derivatives. However, the CCR portfolio is relatively short-term compared to the horizon of the transition scenarios, which limits the risk.
- **Climate risk stress tests** have been developed for the CCR portfolio. These stress tests focus on the short-term transition risks (2023, 2024 and 2025) and follow the 'Disorderly' scenario as required by the ECB stress test of 2022. In this test we mainly stress the exposure of equity derivatives and commodity derivatives and assess its impact on the CCR RWA.

Market Risk Management (trading)

Market risk relates to changes in the level or in the volatility of prices in financial markets. Market risk in trading activities is the potential negative deviation from the expected value of a financial instrument (or portfolio of such instruments) in the trading book due to changing interest rates, exchange rates, equity or commodity prices, etc.

Strategy

Our strategic objectives in undertaking trading activities are to offer sound and appropriate financial products and solutions to our clients in order to help them manage their risks and access capital, and to engage in certified market making activities. In addition to the small (long or short) positions that occur during our certified market making activities, our focus on client-driven, client-facilitation-related business leaves us with some residual market risks, which are necessary to enable us to fulfil our intermediary role towards clients. The reason is that we have to rely on standard market products for our portfolio hedging, with the result that a certain amount of residual risk remains on the books since standard market products tend to have standard sizes and expiry dates and an exact hedge of bespoke client trades is not always possible.

Our focus is on trading in interest rate instruments, while our activity on the foreign exchange (FX) and equity markets has traditionally been limited.

Managing market risk in trading activities

The objective of our market risk management, overseen by the CRO Markets & Treasury, is to measure, report and advise on the market risk of the aggregate trading position at group level, to ensure that activities are consistent with the group's risk appetite.

In the area of market risk in the trading activities, the Executive Committee is supported by the Group Markets Committee (GMC), which advises on risk monitoring and capital usage with respect to trading activities. The governance, rules and procedures on how trading risk management should be performed throughout the group are outlined in the Trading Market Risk Management Framework. Its implementation is monitored by Group Risk and its Market Risk Trading Competence Centre.

The group's trading activity is managed centrally both from a business and a risk management perspective. This means that, wherever possible and practical, the residual trading positions (and hence the market risk) of almost all of our trading entities are systematically transferred to KBC Bank NV. The centralisation of trading risk management implies close co-operation among all the risk management units at both group and local level. This close co-operation allows consistent reporting to group senior management through the Group Markets Committee (GMC), which is chaired by the Group CRO, with the Group CFO as Deputy Chair, and includes senior representatives from Risk and Business. The GMC thus has an integrated overview of the risk and capital consumption of the trading activity, including, apart from market risk, non-financial and counterparty risks of the dealing rooms. It keeps track of structural trends, monitors risk limits and may decide to impose corrective actions.

The building blocks for managing market risk in trading activities

Risk identification

The risk function analyses the results of value and risk calculations, market developments, ESG risk assessments, industry trends, new modelling insights, changes in regulations, etc. and provides advice to the Group Markets Committee (GMC) with a view to changing or refining measurement methods, limits, hedging methods or positions. Furthermore, before a new or changed dealing room product or activity can be introduced, as part of the NAPP process, the risk function screens whether the risk aspects (including ESG risks) are correctly and sufficiently covered and provides risk advice that includes powers of veto.

Risk measurement

Ownership of the definitions used for the group-wide measurement of trading market risk lies with the risk function. We measure risk via a number of parameters including nominal positions, concentrations, Basis Point Value (BPV) and other sensitivities (the so-called 'greeks') and scenario analysis. However, the primary tool we use for measuring and monitoring market risk exposures in the trading book is the Historical Value-at-Risk (HVaR) method, which gives 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.

Setting and cascading 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. KBC's low risk appetite for market risk in trading activities is illustrated by the fact that market risk RWA for trading activities is around 2 to 3% of KBC's total RWA. It is set in line with the overall requirements as defined in our overarching risk management framework and is overseen by the GMC via a risk limit framework consisting of a hierarchy of limits and early warning indicators, submitted to the Board of Directors for approval. The limits are defined down to trading desk level and, in addition to HVaR, include a series of concentration limits, basis-point-value limits and (stress) scenario limits. The hierarchy of the risk limit framework can be split into the main primary limits and a series of secondary limits. Any breaches of the two primary Group limits (i.e. the KBC Group HVaR limit and the Group RWA limit) could imply a breach of the group risk appetite and hence can only be approved by the Board of Directors. Primary limit overruns at entity level must be approved by the Group Executive Committee. However, it is important to point out that, other than KBC Bank NV, all entity limits are small. This is because KBC Bank NV holds about 98% of the trading-book-related regulatory capital of KBC Group NV due to the previously mentioned systematic transferring of residual positions of entities, and therefore risk, to KBC Bank NV. All secondary limit overruns must be approved by the GMC. However, depending on the type of limit and its purpose, the GMC can delegate smaller secondary limit breaches and/or breaches for a limited period of time (referred to as 'level 1 overrun delegation') to a lower management level. It should be noted that in addition to, for example, the Global Head of Trading, the accountable CRO also has to approve these level 1 overruns. The Market Risk Trading Competence Centre keeps a log of all limit overruns, with full details regarding the overruns (type of limit, duration of the overrun, amount of the overrun, delegation level, explanation of the overrun, etc.). Overruns outside level 1 delegation are presented at the following GMC meeting with a request for ratification. If the GMC refuses to ratify the overrun, the overrun in question must be reduced as fast as market conditions allow.

Risk analysis, reporting and follow-up

In addition to the more proactive elements described under 'Risk identification', this involves compiling the necessary external and internal reports, issuing advice on business proposals, and monitoring and advising on the risks attached to the positions. Whereas, as mentioned previously, 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 risks associated with a particular issuer or country are also subject to concentration limits. For the non-linear positions, although we monitor the 'greeks' via 'soft' limits, our formal limit framework is based on scenario and stress scenario grids involving multiple shifts of underlying risk factors. The reason why our formal limits are based on the worst-case scenario of such grids is that it is more intuitive for senior management as it reflects the actual P&L impact, using full revaluation, of such shifts. Some composite and/or illiquid instruments, which cannot be modelled in an HVaR context, are subject to nominal and/or scenario limits. Thus, overall, we monitor and follow up the risks of the positions by means of:

- a risk limit framework consisting of a hierarchy of limits and early warning indicators;
- day-to-day and month-to-day stop loss limits at both desk and trader level;
- a large variety of controls (including parameter reviews, daily reconciliation processes, and analyses of the material impact of proxies);
- internal assessments;
- a comprehensive stress test framework.

The GMC, which meets every month, receives an extensive Core Report as well as periodic and ad hoc memos and reports. The GMC also receives a dashboard halfway between the monthly meetings whose frequency is increased (up to daily, if needed) depending on market circumstances. The Executive Committee ratifies the minutes of the GMC meetings and also receives market-risk-related information and risk signals in its Integrated Risk Report eight times per year. The GMC holds a meeting every month for which it receives an extensive Core Report as well as regular and ad hoc memos and reports. A more concise 'GMC Dashboard' is circulated to the GMC members between meetings so that the GMC members have up-to-date information available on the trading activities of the KBC group. The frequency of this dashboard can be increased depending on the trading environment (e.g., stress in the markets). The Group Executive Committee ratifies the minutes of the GMC meetings and also receives market-risk-related information and risk signals in its monthly Integrated Risk Report.

Stress testing

In addition to the risk limit framework, we conduct extensive stress tests on our positions on a weekly basis. Whereas the HVaR model captures potential losses under normal market conditions, stress tests show the impact of exceptional circumstances and events with a low degree of probability. The historical and hypothetical stress-test scenarios incorporate both market risk and the liquidity aspects of disruptions in the market. The stress tests are discussed at GMC meetings to enable the members to gain an insight into potential weaknesses in the positions held by the group. More information on the stress tests performed can be found below.

Scope

Trading activities are carried out by our dealing rooms in Belgium, the Czech Republic, Hungary, Bulgaria and Slovakia, as well as via a minor presence in the UK and Asia. As mentioned in the 'Managing market risk in trading activities' section, wherever possible and practical, the residual trading positions of almost all of our trading entities are systematically transferred to KBC Bank NV.

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 driven by counterparty or operational aspects, nor does it capture the effects of further trading or hedging.

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, sovereign credit spreads, exchange rates, exchange rate volatility, equity, equity volatility, equity dividends and inflation rates. Specific (issuer) risk is calculated using the Standardised Approach. To compute shifts in the risk factors, the Historical Value-at-Risk 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.

KBC's HVaR methodology for regulatory capital calculations 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, with an equal weighting for each scenario). The 500-day historical data set is a daily moving window (with a two-day lag which serves as a data-cleaning buffer), i.e. movements in the markets each day that they are open are added to the data set and the oldest scenarios removed. The outcome for a 10-day holding period is calculated in three steps. The historical daily movements in the risk factors used in the VaR calculations are scaled so that they are relevant for the current day's levels, the movement generated for the given risk factor is then scaled up by the square root of 10 to obtain a movement for a 10-day holding period, these shifts in the risk factors are then applied to the position on a given date for the scope that the HVaR is being calculated for (using full revaluation) and the corresponding P&Ls computed to produce the outcome for that scenario.

The Management HVaR calculation matches the regulatory methodology except that a one-day holding period is used as it is more intuitive for senior management and is more in line with P&L reporting, day-to-day management, stop losses and back-testing. An HVaR is calculated on a daily basis, with limits in place, at consolidated group level and desk level as well as for KBC Securities and UBB, our Bulgarian entity (the materiality of these two entities does not justify the systematic transfer of positions to KBC Bank NV as described in the 'Governance' section).

As with any model, there are a certain number of uncertainties/deficiencies. However, the model is subject to regular review and improvements. During 2023, there were some minor changes to the HVaR model but the total impact on the HVaR result was not significant.

The table below shows the Management HVaR (99% confidence interval, one-day holding period, historical simulation) for the linear and non-linear exposure at all the dealing rooms of the KBC group that can be modelled by HVaR.

Market risk (management HVaR)		
<i>In millions of EUR</i>	2023	2022
Average for 1Q	7	8
Average for 2Q	6	9
Average for 3Q	6	10
Average for 4Q	7	9
As at 31 December	8	7
Maximum in year	10	12
Minimum in year	4	6

Table 23 - Market risk (management HVaR)

A breakdown of the risk factors (averaged over the full year) in KBC's HVaR model is shown in the table below. Please note that the equity risk stems from the equity desk, as well as from KBC Securities.

Breakdown by risk factor of trading HVaR for the KBC group (Management HVaR)		
<i>In millions of EUR</i>	Average for 2023	Average for 2022
Interest rate risk	6.3	8.6
FX risk	0.9	1.3
FX options risk	0.2	0.3
Equity risk	2.1	0.8
Diversification effect	-3.0	-2.1
Total HVaR	6.5	8.9

Table 24 - Breakdown by risk factor of trading HVaR for the KBC group (Management HVaR)

We have provided an overview of the derivative products under Note 4.8 in the 'Consolidated financial statements' section of the 2023 Annual Report of KBC Group NV.



Regulatory capital

A summary of the capital requirements for trading risk at year-ends 2022 and 2023 is shown in the table below. It shows the regulatory capital requirements by risk type, as assessed by the internal model. Business lines not included in the internal model calculations are measured according to the Standardised Approach and likewise shown by risk type. The regulatory required templates can be found in a separate Excel file on the kbc.com website, published alongside this Risk Report.

Trading regulatory capital requirements by risk type							
In millions of EUR		Interest rate risk	Equity risk	FX risk	Commodity risk	Total	Resulting RWAs
31/12/2023							
Market risks assessed by Approved Internal Model	HVaR	43	13	5		61	759
	SVaR	57	16	10		83	1 038
Market risks assessed by the Standardised Approach		5	2	15*	0	22	271
Total		105	31	29	0	165	2 068
31/12/2022							
Market risks assessed by Approved Internal Model	HVaR	67	14	12		93	1 163
	SVaR	79	31	19		129	1 618
Market risks assessed by the Standardised Approach		4	2	23*	0	29	365
Total		150	47	54	0	252	3 146

* In accordance with COREP requirements, this figure includes capital requirements for FX risk in the banking book, which makes up the majority of this figure, although this does not stem from trading activities

Table 25 - Trading regulatory capital requirements by risk type

Approved Internal Model (AIM)

As can be seen in the above table, about 87% of KBC Group's capital requirements related to market risk are determined using KBC Bank NV's Approved Internal Model (AIM). This figure increases to 95% if capital requirements for foreign exchange risk in the banking book are removed (which is thus the percentage of capital requirements covered in the 'Back-testing' section, see below). Both the HVaR and SVaR component decreased by about 35% between 2022 and 2023. Two thirds of this decrease can be explained by the regulatory multiplier of the average HVaR and SVaR used for Approved Internal Model market risk RWA calculations dropping from 3.5 to 3.0 (please see the 'Back-testing' section elsewhere in this report for more details), with the remaining decrease being driven by a combination of smaller interest rate positions and more diversification between the risk factors.

The KBC Bank NV AIM is 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). The methodology is identical to that used for HVaR calculations, though the 500 scenarios 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 the positions in scope of the KBC Bank NV AIM (the 'stressed' period), and 250 antithetic ('mirror') scenarios, obtained by reversing these 250 regular scenarios. In addition to regulations, which require a calibration of the stressed period used for SVaR at least once a year, we also check on a monthly basis that the period

selected is indeed the most severe for the positions held. During 2023, the SVaR period was from June 2008 to June 2009, i.e. the period of the Lehman Brothers crisis.

Standardised Regulatory Capital Requirements

The Standardised Approach is used to calculate the regulatory capital requirements for the very small positions that remain at the local KBC entities (for practical, legal or regulatory reasons) and for the business lines not included in the HVaR calculations. It is also used to calculate the regulatory capital requirements for the FX risk in the banking book, although it should be noted that these positions are not part of the dealing room business.

The Standardized Approach sets out general and specific risk weightings per type of market risk (interest rate risk, equity risk, FX risk and commodity risk). The 22 million euros in capital requirements shown in the table in the 'Regulatory capital' section would drop to 8 million euros when the capital requirements for the FX risk in the banking book are removed. Similarly, the corresponding figure for 2022 would have been 7 million euros, thus virtually unchanged between the two reporting dates.

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, thus acting as a tool that helps to evaluate risk appetite.

For the Financial Markets activities, both historical and hypothetical stress tests are performed on a weekly basis, whereby risk factors relating to interest rates, FX and equity prices and their volatilities are shifted. These scenarios model inter alia parallel interest rate shifts, steepening/flattening of interest rate curves, changes in basis swap spreads and changes in interest rate volatility, as well as shifts in FX and equity prices and their volatilities.

The historical stress tests that are carried out use a number of historical scenarios, as shown in the following table. In the 2023 review of trading market risk stress testing, the GMC decided that, in addition to adding some new scenarios, the older scenarios (10 in total, going back to the 1980s, 1990s and early 2000s) would be discontinued as there is less data for these scenarios, similar scenarios have occurred during the more recent period and market risk factors have evolved since then.

Events	Events Period (start to end)
Early credit crunch	09-07-2007 – 20-08-2007
Credit crisis peak	14-01-2008 – 18-03-2008
Lehman Brothers crisis	05-09-2008 – 24-11-2008
Early peripheral sovereign crisis	31-03-2010 – 31-05-2010
Greek crisis, further austerity package	13-06-2011 – 22-07-2011
August 2011 stock markets fall	26-07-2011 – 06-09-2011
Belgian sovereign crisis	13-09-2011 – 05-12-2011
Syriza sweeps to power	29-12-2014 – 26-01-2015
Switzerland abandons euro cap	13-01-2015 – 21-01-2015
Renewed Greek default fears	29-05-2015 – 03-08-2015
Brexit	20-06-2016 – 30-06-2016
De-pegging pressure on Czech koruna	20-12-2016 – 31-01-2017
De-pegging of Czech koruna	15-03-2017 – 11-04-2017
Early COVID-19	04-03-2020 – 24-03-2020
Russian invasion of Ukraine	07-02-2022 – 18-03-2022
Re-emergence of embedded inflation	02-05-2022 – 16-06-2022
UK mini-budget crisis	12-09-2022 – 21-10-2022
2023 banking turmoil	02-03-2023 – 20-03-2023

Table 26 - Historical stress tests

Concerning the hypothetical stress tests, the validity of the calibrated shifts is checked by comparing them with the most relevant regulatory stress tests. However, unlike the case with regulatory stress tests – which typically only use market shifts in one direction – KBC also calculates the result for a given shift in the opposite direction and takes the worst-case result as this better reflects the dynamic nature of trading book positions (i.e. residual positions can be ‘long’ or ‘short’, and thus can benefit from, as well as be vulnerable to, a stressed market environment – typically around a third of the scenarios shown in the above historical stress test table result in a positive P&L for KBC’s dealing rooms).

The worst-case scenarios for both the hypothetical and historical stress tests, together with the respective losses, are then reported at the GMC meetings. These results are accompanied by an analysis of these worst-case scenarios, providing the GMC with an insight into potential vulnerabilities in the portfolio. In addition, a more in-depth report on stress test results is submitted to the GMC on a semi-annual basis. This report also includes a review of the stress tests (as regards mix and checking that they remain up to date and relevant). In all the stress tests conducted during the year, the worst-case scenario results were comfortably covered by the market-risk regulatory capital requirements.

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 profit or loss figures. The concept behind back-testing the HVaR model is the expectation that the calculated HVaR will be larger than all but a certain fraction of the trading outcomes, where this fraction is determined by the confidence level assumed by the HVaR measure. In line with regulations, back-testing at KBC uses the 99% confidence level and one-day HVaR holding period. In other words, one would expect a loss in excess of the HVaR for one in every one hundred trading days. A loss in excess of the HVaR is referred to in the Capital Requirements Regulation (CRR) as an overshooting.

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 overshootings on a more granular level increases as there is less diversification. However, allowing for this, the number of overshootings for all levels underpinned the quality of the HVaR model.

The CRR stipulates that all banks with approved internal models (AIMs) must apply two back-tests, designated by their regulators, to their consolidated positions. The two required CRR back-tests designated by the ECB are:

- 'Hypothetical back-testing': this compares the HVaR to the daily economic P&L of the Middle Office, while keeping the portfolio unchanged and removing the effect of fees, commission and net interest – sometimes referred to as the 'hands-off P&L');
- 'Actual back-testing': the same as 'hypothetical back-testing', but allowing for trades applicable on a given position date (excluding commission and fees).

If there are more than four overshootings over a rolling window of 250 business days, this results in an increase in the regulatory multiplier of average HVaR and SVaR used for AIM capital requirement calculations. Overshootings are reported to the relevant risk committees and the applicable regulators on both an ad hoc and quarterly basis.

For more information regarding the evolution of the back tests and the overshootings during 2022 and 2023, we refer to the regulatory required templates, which can be found in a separate Excel file on the kbc.com website, published alongside this Risk Report.

The KBC Bank Approved Internal Model (AIM) had four overshootings during 2023, which was less than the six overshootings recorded in 2022. The first overshooting in January 2023 was caused by a significant sudden drop in most interest rates, triggered by the publication of disappointing US economic data. The second and third overshootings were driven by the banking turmoil in March 2023 (i.e. the collapse of Silicon Valley Bank and Credit Suisse). The last overshooting occurred at the end of 2023 and was caused by negative valuation adjustments recorded on a quarterly basis in the economic P&L used for back-testing.

Due to the above-mentioned overshootings, in compliance with CRR regulations, the multiple of the average HVaR and SvaR used for Approved Internal Model (AIM) market risk RWA calculations was 3.5 and 3.0 for 2022 and 2023, respectively.

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 systems 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 independent 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 monthly 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 and liquidity risk.

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. It is important to point out that, from a practical point of view, the vast majority of the open positions held in the trading books of KBC Group are valued using either quoted prices or prices that can be directly derived from exclusively observable input parameters.

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 cashflow 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 is summarised in Note 1.0 of the 2023 Annual Report of 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 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 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 and input parameters) or deviations from group policies for financial instruments measured at fair value. The GVC consists of members of Group Finance, Market Risk Management, and Middle Office units.

ESG in market risk (trading) management

As it is a subject that is so important in these times, it is important to point out that environmental risk is indeed embedded in the activities and planning of the dealing room business of KBC and that the trading activities are also subject to the general KBC Group sustainability policies.

As mentioned in the introduction to this section, the market risks of clients (i.e. interest rates, FX and equity) are hedged using standard products with the same market risk drivers, i.e. the bulk of the positions held by the dealing room simply have (offsetting) exposure to these market risks. Therefore, the environmental risks in the dealing room business arise primarily from equities and bonds but, in a trading book environment, such positions are only held for a short time by definition, i.e. no structural (or directional) positions are held as may be the case for other business lines. Both the ECB's and our own ESG risk assessments (e.g., the Climate Risk Impact Map, the main results of which are presented in the table below, and the pilot study on other environmental risks) have confirmed that trading market risk regarding ESG aspects is limited. The Group Markets Committee (GMC) is kept closely informed of the immateriality via a quarterly update (including ESG dashboards and the results of a climate risk stress test representing a 'Disorderly transition' scenario), with a full review being submitted on an annual basis.

Market risk - Trading	ST	MT	LT
Net Zero			
Delayed transition			
Current policies			

Figure 5 - Climate Risk Impact Map: outcome for market risk (trading)

Climate Risk Impact
Mild impact
Material impact
Critical impact

Market Risk Management (non-trading)

Market risk relates to changes in the level or in the volatility of prices in financial markets. The process of managing our structural exposure to market risks in the non-trading activities covers interest rate risk, gap risk, basis risk, option risk (such as prepayment risk), currency risk, equity price risk, real estate price risk, credit spread risk and inflation risk. 'Structural exposure' encompasses all exposure inherent in our commercial activity or in our investments (banking and insurance). Trading activities are therefore not included. This process is also known as Asset/Liability Management (ALM).

Strategy

The treasury departments centralise the support provided to all KBC businesses involving financial flows, partly by securing the necessary funding or managing the acquired funds. Aside from the liquidity aspects, which are discussed in the next section, the Group and Local Treasury functions measure and manage the market risks arising from the group activities and investments, with the double objective of ensuring the sustainability of the Group and entity balance sheets and generating net interest income. They take into account all risk aspects, such as prepayment risks and other option risks in the banking book and manage a balanced investment portfolio. The management of the positions implies, among other things, that the treasury function uses derivatives to hedge against interest rate and foreign exchange risks on the balance sheet. Hedge accounting techniques are applied to avoid profit and loss volatility that would result from the different accounting treatment of balance sheet investment items and derivatives.

Managing market risk in non-trading activities

In the area of market risk in the non-trading activities, the Executive Committee is supported by the Group Asset and Liability Committee (ALCO), which is to provide assistance in the area of (integrated) balance sheet management at group level. The governance, rules and procedures and how asset and liability risk management is performed throughout the group are outlined in the Non-Trading Market Risk Framework. Its implementation is monitored by Group Risk and its Market Non-Trading Risk Competence Centre. Within the risk function, the ALM & Liquidity Risk Council, chaired by the CRO Markets & Treasury, aims to establish, facilitate, promote and support the solid and efficient integration of all tasks assigned to the local and group risk departments covering ALM and liquidity risks.

The Group and Local Treasury functions act as the first line of defence and measure and manage market risk on a playing field defined by the risk appetite and the limits.

The risk function is the second line of defence. Given the specifics of the Treasury domain and in support of the Group CRO, a CRO Markets & Treasury was appointed who is accountable for the Treasury activities. The group-wide Extended Competence Centre for ALM & Liquidity Risk is in turn responsible for installing the principles for ALM risk management, which are laid down in a group-wide Non-Trading Market Risk Management Framework that defines the risk playing field.

The third line of defence is provided by internal audit, which ensures an independent review and challenge of the Group's first- and second-line ALM (risk) management processes.

The building blocks for managing market risk in non-trading activities

A number of group-wide building blocks are defined to ensure proper risk management:

Risk identification

To identify market risks in the non-trading portfolios a number of tools are used, including the New and Active Products Process (NAPP), the Environmental Risk Impact Map, the risk scan, and early warning processes triggered by recurrent monitoring. Risk signals are an important tool as well. For this purpose, both the internal and external environments are scanned for events and developments that could have an impact on our non-trading books. Relevant risk signals are reported to management, including a proposal for remedial actions where possible. New and upcoming regulations are followed up at group or local level to ensure that these are implemented in KBC's policies and instructions.

Risk measurements

A common rulebook, which supplements the framework for technical aspects, and a shared group measurement tool ensure that these risks are measured consistently throughout the group through, among others:

- Basis-Point-Value (BPV) for interest rate risk;
- gap analysis for interest rate risk, related to repricing mismatches between assets and liabilities and inflation risk;
- economic sensitivities for currency risk, equity price risk and real estate price risk.

Measures are complemented by stress tests, covering back-testing of prepayments, net interest income results under various scenarios, or the impact on regulatory capital stemming from interest, spread or equity risk residing within the banking books.

Setting and cascading risk appetite

The group risk appetite, including the strategic objectives with regard to non-trading market risk tolerance, is determined by the Board of Directors by means of an annual review. KBC aims at a low risk appetite for non-trading market risk, as illustrated by the percentage of -3.91% resulting from the outlier EBA stress test for the Economic Value of Equity. This is much lower than -15%, a level at which the regulator may consider increasing its supervision. However, the behavioural nature of cashflows such as current and savings accounts and prepayments on mortgages inevitably induces some model risk, causing the risk appetite level to be set at 'medium'.

Limits cover all material market risks faced by the ALM function: limits covering interest rate risk, equity risk, real estate risk and foreign exchange risk for the consolidated entities are approved by the Board of Directors and limits for each local entity are approved by the Executive Committee.

Risk analysis, reporting and follow-up

Besides regulatory reporting, structural reporting to the ALCO is performed. The reporting process includes a sign-off process to ensure data accuracy.

Scope

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.

Interest rate risk, credit spread risk and equity risk account for the lion's share of the total risk and will thus be discussed in more detail. However, real estate risk, inflation risk and foreign exchange risk are also briefly addressed below.

Impact of external developments on market risk in the non-trading activities

After the significant rate hikes in 2022, 2023 was characterised by a normalisation of interest rates after years of low rates. Banks in general experienced a sizeable shift from current and savings accounts to fixed-rate instruments. The issue of the one-year State Note in Belgium illustrated the overall trend of shifting from non-maturity deposits towards term deposits or fixed-rate instruments. However, KBC always applies a prudent investment approach for current and savings accounts and holds significant buffers in short-term investments to be able to absorb material outflows. As such, given these prudent buffers, the large success of the Belgian State Note did not trigger any specific action for the existing investments from a market risk point of view.

Sub-risk types

Interest rate risk

We define interest rate risk in the banking books as the risk arising from adverse movements or volatility in interest rates. The main technique used to measure interest rate risks is the 10 BPV method, which 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 swap curve (negative figures indicate a decrease in the value of the portfolio). It is managed on a daily basis by the treasury function and assessed on a monthly basis by the second line of defence, with the possibility to perform an ad hoc analysis between two reporting dates. We also use other techniques such as gap analysis, the duration approach or stress testing. Scenario analysis is performed for net interest income. We apply an expected shortfall (Monte Carlo-based) approach to assess the resilience of the capital position to interest rate movements. These measures are performed at least on a quarterly basis.

Interest rate risk and gap risk for the banking activities

Impact of a parallel 10-basis-point increase in the swap² curve for the KBC group

In millions of EUR	Impact on value ¹	
	2023	2022
Banking	-45	-36
Insurance	11	4
Total	-33	-32

1. Full market value, regardless of accounting classification or impairment rules.

2. Based on a risk-free curve (swap curve).

Table 27 - Impact of a parallel 10-basis-point increase in the swap curve for the KBC group Impact on value

The ALM interest rate positions of the banking entities are managed via a system of market-oriented internal pricing for products with a fixed maturity date, and via a replicating portfolio technique for products without a fixed maturity date. The bank also adjusts its interest rate profile through interest rate derivatives to stay within the limits set by the risk appetite. Current and savings accounts are segmented based on several characteristics and a maturity profile is assigned to the different segments, ranging from Overnight to 15 years' maturity for the long end of the most stable profiles. The average tenor of the portfolio ranges between 3 years and 4 years.

Swap BPV (10 basis points) of the ALM book, banking activities*

In millions of EUR	2023	2022
Average for 1Q	-45	-75
Average for 2Q	-46	-66
Average for 3Q	-55	-70
Average for 4Q	-45	-36
As at 31 December	-45	-36
Maximum in year	-55	-75
Minimum in year	-45	-36

* Unaudited figures, except for those 'As at 31 December'

Table 28 - Swap BPV (10 basis points) of the ALM book, banking activities

For the scope of the banking activities, two other methodologies to measure interest rate sensitivity, which is comparable across institutions, are the outlier stress test (SOT) on Economic Value of Equity (EVE) and the outlier stress test (SOT) on Net Interest Income (NII), both calculated according to the guidelines of the European Banking Authority.

For the SOT on EVE, six different scenarios are applied to the banking books (material currencies) every quarter. These scenarios comprise material parallel shifts up and down, steepening or flattening of the swap curves or shifts in the short-term rates only. For those scenarios, we combine the shift in the yield curves with changes in maturities depending on clients' behaviour (e.g., interest-rate-driven prepayment behaviour) and use a run-off balance sheet where maturing items are not replaced. The worst-case scenario impact (the most negative impact on the economic value of equity) is set off against tier-1 capital. For the banking book at KBC group level, the SOT EVE came to -3.91% of tier-1 capital at year-end 2023. This is well below the -15% threshold, which is monitored by the European Central Bank and indicates that the overall interest rate sensitivity of KBC's balance sheet is limited.

As from 2023, the SOT EVE is complemented by the SOT NII, which measures the impact of two scenarios (parallel up and down) on NII, assuming a constant balance sheet. The impact of the worst-case scenario on NII is also set off against tier-1 capital. According to this measure too, the interest rate sensitivity of KBC is limited: it came to -1.27% at year-end 2023, compared to the 5% outlier threshold used by the supervisory authority.

We also manage the interest rate sensitivity of assets and liabilities across the different maturities, through sensitivity gap analysis in the banking book. 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

<i>In millions of EUR</i>	0–1 year*	1–5 years	5–10 years	> 10 years	Non-interest bearing	Total
31/12/2023	6 793	2 343	5 644	2 179	-16 958	0
31/12/2022	-705	7 249	6 332	820	-13 696	0

* The methodology has been adapted to include Cash at central banks and Non-maturity deposits kept in O/N in the first time bucket. The 2022 figures have been restated accordingly.

Table 29 - Interest sensitivity gap of the ALM book (including derivatives), banking activities

The interest sensitivity gap shows our overall 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 (upward-sloping) yield curve. The economic value of the KBC group is sensitive primarily to movements at the mid- to 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 clients 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.

We also adopt an interest rate gap view for 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

<i>In millions of EUR</i>	0–1 year	1–2 years	2–3 years	3–4 years	4–5 years	>5 years	Total
31/12/2023							
Fixed-income assets backing liabilities, guaranteed component	1 787	741	932	787	1 044	8 225	13 516
Equity							937
Property							108
Other (no maturity)							299
Liabilities, guaranteed component	1 595	1 201	807	882	834	9 474	14 793
Difference in time-sensitive expected cashflows	192	-460	125	-95	210	-1250	-1278
Mean duration of assets							6.72 years
Mean duration of liabilities							7.92 years
31/12/2022							
Fixed-income assets backing liabilities, guaranteed component	1 233	1 489	855	1 048	844	8 738	14 208
Equity							929
Property							112
Other (no maturity)							95
Liabilities, guaranteed component	1 367	1 201	807	882	834	9 474	14 566
Difference in time-sensitive expected cashflows	-134	288	48	166	11	-737	-358
Mean duration of assets							6.66 years
Mean duration of liabilities							8.76 years

Table 30 - Expected cashflows (not discounted), life insurance activities

As mentioned above, 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	31/12/2023	31/12/2022
5.00% and higher	3%	3%
More than 4.25% up to and including 4.99%	6%	7%
More than 3.50% up to and including 4.25%	4%	4%
More than 3.00% up to and including 3.50%	9%	9%
More than 2.50% up to and including 3.00%	3%	3%
2.50% and lower	73%	72%
0.00%	2%	2%
Total	100%	100%

Table 31 - Breakdown of the reserves for non-unit-linked life insurance by guaranteed interest rate, insurance activities

Interest rate risk for the KBC group

Given that KBC has interest rate exposure in different home markets and currencies, we also manage our interest rate sensitivity at currency level. The following tables show the impact on the KBC group of a 10-basis-point parallel upward shift of swap curves, broken down by currency.

Interest Rate Risk – swap BPV in thousands of EUR	31/12/2023	Overall	EUR	CZK	HUF	BGN	USD	GBP	CHF	Other
Banking activities		-44 585	-27 324	-15 253	-3 130	3 031	-804	-1 135	0	29
Insurance activities		11 476	12 882	- 590	-376	-440	0	0	0	0
Total*		-33 109	-14 442	-15 842	-3 507	2 591	-804	-1 135	0	29

* KBC Asset Management is only included in the total exposure, not in the banking activities.

Table 32 - Interest Rate Risk – swap BPV in thousands of EUR 31-12-23

Interest Rate Risk – swap BPV in thousands of EUR	31/12/2022	Overall	EUR	CZK	HUF	BGN	USD	GBP	CHF	Other
Banking activities		-35 917	-29 230	-9 846	- 750	5 832	-986	-987	10	40
Insurance activities		4 187	6 467	-1 540	-270	-470	0	0	0	0
Total*		-31 730	-22 763	-11 386	-1 020	5 362	-986	-987	10	40

* KBC Asset Management is only included in the total exposure, not in the banking activities.

Table 33 - Interest Rate Risk – swap BPV in thousands of EUR 31-12-22

Credit spread risk

We purchase bonds with a view to acquiring interest income. Their selection is largely conservative and based on criteria such as credit risk rating, risk/return measures and liquidity characteristics.

We manage the credit spread risk for, *inter alia*, 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. This economic sensitivity is illustrated in the table below.

Exposure to sovereign bonds at year-end 2023, carrying value¹

Total (by portfolio)

<i>In millions of EUR</i>	At amortised cost	At fair value through other comprehensive income (FVOCI)	Held for trading	Total	For comparison purposes: total at year-end 2022	Economic impact of +100 basis points ³
KBC core countries						
Czech Republic	12 079	1 278	2 254	15 611	13 556	-721
Belgium	7 052	4 126	267	11 445	10 664	-659
Slovakia	3 524	617	66	4 207	3 618	-223
Hungary	2 405	472	189	3 066	2 624	-114
Bulgaria	2 282	350	16	2 649	2 335	-101
Other countries						
France	3 710	1 703	38	5 451	5 520	-219
Spain	1 846	853	0	2 699	2 556	-103
US	2 447	13	0	2 460	1 573	-91
Ireland	1 029	167	0	1 196	1 224	-47
Italy	256	1 436	0	1 692	1 180	-42
Rest ²	6 706	2 192	135	9 033	8 791	-482
Total carrying value	43 337	13 206	2 966	59 509	53 642	
Total nominal value	43 718	13 641	2 948	60 306	55 537	

¹ The table excludes 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 1 billion euros at year-end 2022.

³ Theoretical economic impact in fair value terms of a parallel 100-basis-point upward shift in the spread over the entire maturity structure. Only a portion of this impact is reflected in profit or loss and/or equity. Figures relate to non-trading positions in sovereign bonds for the banking and insurance businesses (impact on trading book exposure was quite limited and amounted to 14 million euros, including supranational bonds at year-end 2022).

Table 34 - Exposure to sovereign bonds at year-end 2023, carrying value

At year-end 2023, the carrying value of the total government bond portfolio measured at fair value through other comprehensive income (FVOCI) incorporated a revaluation reserve of -0.6 billion euros, before tax (-191 million euros for France, -188 million euros for Belgium, -38 million euros for the Czech Republic, -36 million euros for Slovakia and -125 million euros for the other countries combined).

At year-end 2023, Belgian and Czech sovereign bonds accounted for 43% of our total government bond portfolio, reflecting the importance to KBC of Belgium and the Czech Republic, the group's primary core markets.

Apart from interest rate risk, the main risk to our holdings of Belgian and Czech sovereign bonds is a widening of the credit spread. To assess the potential impact of a 100-basis-point upward shift in the spread (by year-end 2022), we apply two approaches:

- The theoretical full economic impact approach, which assumes a potential sale of the entire portfolio at market prices. The impact of a 100-basis-point shift would then result in a change in value of -1 380 million euros (see previous table);
- The IFRS approach is limited to Bank Group activities, as the Insurance business is captured by the value of its participation under the Danish Compromise. The impact on IFRS profit or loss is limited since the majority of the portfolio of Belgian and Czech sovereign bonds is classified as 'At amortised cost', implying that sales prior to maturity are unlikely (74%: impact only upon realisation). The remaining part is classified as 'FVOCI' (26%: no impact on profit or loss); the impact of a 100-basis-point increase on IFRS unrealised gains is -59 million euros (before tax) for FVOCI assets.

In addition to the sovereign portfolio, the KBC group holds a non-sovereign bond portfolio (banks, corporations, supranational bodies). The sensitivity of the economic value of this banking book portfolio to a 100-basis-point change in the credit spread is shown in the following table.

Exposure to non-sovereign bonds at year-end, by rating: economic impact of +100 basis points

<i>In millions of EUR</i>	31/12/2023	31/12/2022
Bonds rated AAA	-87	-108
Bonds rated AA+, AA, AA-	-108	-115
Bonds rated A+, A, A-	-121	-109
Bonds rated BBB+, BBB, BBB-	-30	-34
Non-investment grade and non-rated bonds	-13	-21
Total carrying value (excluding trading portfolio)*	11 736	11 462

* Total carrying value restated for 2022 due to the transition to IFRS 17

Table 35 - Exposure to non-sovereign bonds at year-end, by rating: economic impact of +100 basis points

Equity risk

KBC holds equity portfolios, for several purposes. The largest part of the equity portfolio is held as an economic hedge for long-term insurance liabilities, in the Life and non-Life businesses, that can hardly be matched by bond investments. A limited tactical portfolio (87 million euros) aims to contribute to the financial objectives through dividend pay-outs and capital gains. Non-listed equities in the Insurance business (0.18 billion euros) as well as equity in the balance sheet of the Bank are of a strategic nature and are linked to the realisation of KBC Group's business model. There is no material private equity exposure.

While the valuation of listed equity is based on market observation, non-listed equities are valued through different techniques. For those non-listed participations, File managers will select the more suited methodology. Recent acquisitions are valued at cost. Loss-making participations, among which young companies in development phase, are valued based on their net equity. Otherwise, the following methods are considered:

- Discounted cashflow method, when future cashflows are available;
- The valuation used in a recent capital transaction related to the equity, if applicable;
- Peer analysis through Balance Sheet multiples provided by Asset Management, when equity prices of listed companies with a similar profile are available;
- Third-party pricing.

At least once a year, valuations for non-listed equities are challenged by the Finance department.

More information on non-trading equity exposure is provided in the table below.

Equity portfolio of the KBC group (breakdown by sector, in %)

	Banking activities ²		Insurance activities ²		Group ²	
	31/12/2023	31/12/2022	31/12/2023	31/12/2022	31/12/2023	31/12/2022
Manufacturing	0%	0%	42%	35%	36%	30%
Financial and insurance activities	43%	43%	22%	24%	25%	26%
Information and communication	10%	7%	13%	11%	12%	11%
Scientific and technical activities	17%	20%	2%	3%	4%	5%
Other and not specified	11%	6%	3%	5%	4%	5%
General services	6%	6%	2%	2%	2%	2%
Real estate activities	14%	17%	0%	0%	2%	3%
Building & construction	0%	0%	2%	2%	1%	1%
Human capital	0%	0%	2%	2%	1%	2%
Transportation and storage	0%	0%	1%	2%	1%	1%
Wholesale and retail trade	0%	0%	12%	15%	10%	13%
Total		100%		100%		100%
In billions of EUR	0.23	0.22	1.39	1.33	1.63	1.55
of which unlisted	0.22	0.21	0.18	0.14	0.40	0.35

¹ The main reason for the difference between the 1.55 billion euros in this table and the 2 billion euros for 'Equity instruments' in Note 4.1 of the 'Consolidated financial statements' section in the 2020 KBC Group Annual Report is that shares in the trading book (0.43 billion euros) are excluded above, but included in the table in Note 4.1.

Table 36 - Equity portfolio of the KBC group (breakdown by sector, in %)

Impact of a 25% drop in equity prices

<i>In millions of EUR</i>	2023	2022
Banking activities	-59	-55
Insurance activities	-348	-333
Total	-407	-387

Table 37 - Impact of a 25% drop in equity prices

Non-trading equity exposure

<i>In millions of EUR</i>	Net realised gains (in income statement) ¹		Net unrealised gains on year-end exposure (in equity) ¹	
	31/12/2023	31/12/2022	31/12/2023	31/12/2022
Banking activities	-	-	19	12
Insurance activities	2	-1	212	80
Total	2	-1	231	91

¹ The 2022 figures for Insurance activities and Group have been restated following the transition to IFRS 17.

Table 38 - Non-trading equity exposure

Real estate risk

The groups' real estate businesses hold a limited real estate investment portfolio. 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 25% drop in real estate prices

<i>In millions of EUR</i>	2023	2022
Bank portfolios	-94	-94
Insurance portfolios	-107	-78
Total	-201	-172

Table 39 - Impact of a 25% drop in real estate prices

Inflation risk

Inflation can indirectly impact a financial company in many ways, for instance via changes in interest rates or operational costs. Therefore, inflation in general is not easily quantifiable as a market risk concept. However, certain financial products or instruments have a direct link with inflation and their value is directly impacted by a change in market expectations. KBC Bank uses indexed bonds as an opportunity to diversify its asset portfolio. At KBC Insurance, it relates specifically to workmen's compensation insurance, where particularly in the case of permanent or long-term disabilities an annuity benefit is paid to the insured person (with the annuity being linked to inflation by law). KBC Insurance partly mitigates the risks by investing in inflation-linked bonds so that any increase in liabilities arising from mounting inflation is offset by an increase in the value of the bonds. However, these liabilities are long-dated and significantly exceed the investment horizon of such index-linked bonds. Therefore, KBC Insurance complements its inflation hedging programme by investing in real estate and shares, as these assets are traditionally correlated with inflation and do not have a maturity date.

The banking business holds a 600-million-euro portfolio of indexed bonds. Aside from this, we are not exposed to inflation risk in a measurable way. For the insurance activities, the undiscounted value of the inflation-sensitive cashflows was estimated at -515 million euros, against which a 452-million-euro portfolio of indexed bonds at market value and 28.7 million euros in direct and indirect real estate were held.

The banking business holds a 600-million-euro portfolio of indexed bonds. Aside from this, we are not exposed to inflation risk in a measurable way. For the insurance activities, the undiscounted value of the inflation-sensitive cashflows was estimated at -515 million euros, against which a 452-million-euro portfolio of indexed bonds at market value and 28.7 million euros in direct and indirect real estate were held.

The banking business holds a portfolio of inflation linked bonds with a sensitivity to inflation (BPI) of 7.5 million euros (for a 0.10% move in inflation expectations) at the end of 2023. For the insurance activities the BPI of liabilities was calculated at 4.8 million euros against which inflation-linked bonds are held with a 4.4-million-euro BPI, supplemented with a 26-million-euro real estate portfolio. The sensitivity of liabilities to inflation is only known with a quarter's delay. Therefore, the insurance figures in this section are based on the third quarter of 2023.

Foreign exchange risk

We pursue a prudent policy as regards our structural currency exposure. Material foreign exchange exposures in the ALM books of banking entities with a trading book are transferred via internal deals to the trading book, where they are managed within the allocated trading limits. The foreign exchange exposure of banking entities without a trading book and of insurance and other entities has to be hedged, if material. However, non-euro-denominated equity holdings in the investment portfolio are not required to be hedged, as foreign exchange volatility is considered part of the investment return.

KBC focuses on stabilising the common equity ratio against foreign exchange fluctuations, which has improved KBC's capacity to cushion external shocks and is beneficial to all stakeholders. This implies a reduction in the hedging of participations. To ensure consistency between banking and insurance entities, strategic insurance participations are no longer hedged either, as they do not affect the common equity ratio of KBC Group under the Danish compromise.

Impact of a 10% decrease in currency value*	Impact on value		Impact on value	
	Banking		Insurance	
	31/12/2023	31/12/2022	31/12/2023	31/12/2022
<i>In millions of EUR</i>				
CZK	-209	-231	-31	-31
HUF	-85	-100	-9	-7
BGN	-93	-96	-22	-17
USD	6	-1	-52	-47

* Exposure for currencies where the impact exceeds 10 million euros in Banking or Insurance

Table 40 - Impact of a 10% decrease in currency value

Hedge accounting

Assets and liabilities management uses derivatives to mitigate interest rate and foreign exchange risks. The aim of hedge accounting is to reduce the volatility in P&L resulting from the use of these derivatives.

KBC decided not to apply hedge accounting to credit and equity risks. When the necessary criteria are met, it is applied to remove the accounting mismatch between the hedging instrument and the hedged item. For more information about hedge accounting, please see 'Notes on the accounting policies' in the 'Consolidated financial statements' section of the 2023 Annual Report of KBC Group NV.

Risk categories applying to hedge accounting

Interest rates

Hedging derivatives are used to mitigate an interest rate risk that arises from a difference in the interest rate profile of assets and their funding liabilities. The hedge accounting status of a hedge can be associated with either the asset or the liability item.

Interest rate derivatives can be designated as:

- Hedges of the fair value of recognised assets or liabilities. Changes in the fair value of derivatives that are designated and qualify as fair value hedges are recorded in profit or loss, together with any changes in the fair value of the hedged asset or liability that are attributable to the hedged risk. The gain or loss relating to the ineffective portion is also recognised in profit or loss.
- Hedges of the cashflow of recognised assets and liabilities which are either certain or highly probable forecasted transactions. The effective portion of changes in the fair value of derivatives that are designated and qualify as cashflow hedges is recognised in the cashflow hedge reserve within equity. The gain or loss relating to the ineffective portion is recognised directly in profit or loss.

KBC uses macro hedge accounting strategies for homogeneous portfolios of smaller items, where the frequency of occurrence or the relatively small size of the average operation renders the one-to-one relationship sub-optimal. This is the case for inter alia mortgages, loans to SMEs or customer deposits. Macro hedge strategies may be dynamic and undergo frequent changes based on balancing the portfolio ('open portfolio hedge'), among other things.

The micro hedge designation is used when large individual assets or liabilities are hedged. Typical assets are large corporate loans and bond acquisitions for which the credit spread profile is relevant. Liabilities can include KBC's own issues or specific long-term facilities offered by a central bank. Micro hedges are either fair-value or cashflow based.

Foreign exchange

KBC has strategic investments denominated in non-euro currencies. The net asset value of significant participations is partly funded in the local currency by deposits and foreign exchange derivatives, to ensure stability of the CET1 ratio. By using hedges of net investments in foreign operations, the foreign exchange component is reported in equity until realisation (unwinding of funding due to liquidation, dividend payments or other decreases in net asset value).

KBC also has a limited portfolio of foreign-currency-denominated bonds that are funded through euro proceeds. These bonds are hedged by cross-currency interest rate swaps to create a synthetic EUR fixed-rate interest income. Cashflow hedge accounting (microhedge) is performed to mitigate foreign exchange volatility.

Hedge effectiveness

Hedge effectiveness is determined at the inception of the hedge relationship, as well as through periodic prospective and retrospective effectiveness assessments, to ensure that a relevant relationship between the hedged item and the hedging instrument exists and remains valid.

Effectiveness testing

For interest rates, several prospective and retrospective tests are performed to ensure the relationship between the hedged item and the hedging instrument qualifies for the hedge accounting strategy.

Prospective tests are mostly based either on a sensitivity analysis (verifying if the basis point value of the hedged portfolio relative to the hedging instrument stays within the 80-125% interval) or volume tests (if the principal amount of hedge-eligible items exceeds the notional volume of hedging instruments expected to be repriced or repaid in each specified time bucket).

For macro cashflow hedges, extensive forward-looking analyses assess the sufficient likelihood that the future volume of hedged items will largely cover the volume of hedging instruments. A hedge ratio – measuring the proportion of a portfolio that is hedged by derivatives – is calculated for each hedging strategy.

The retrospective effectiveness test of the hedge relationship is periodically carried out by comparing the change in fair value of the portfolio of hedging instruments relative to the change in fair value of the hedged eligible items imputable to the hedged risk over a given period (the ratio of fair value changes remains within the 80-125% interval).

For foreign exchange hedging, effectiveness is ensured by adjusting the sum of the nominal amount of the funding deals and foreign exchange derivatives to the targeted hedge amount of the strategic participations. For foreign-currency-denominated bonds swapped into euro, the start date, maturity date and coupon dates are also matched.

Sources of hedge ineffectiveness

Ineffectiveness for interest rate swaps may occur due to:

- differences in relevant terms between the hedged item and the hedging instrument (it can include discrepancies in interest curves and in periodicity);
- a reduction in volume of the hedged item that would fall under the volume of hedging instruments for any time bucket;
- the credit value adjustment on the interest rate swap not being matched by the loan. However, hedging swaps are fully collateralised or traded through clearing houses and the credit value adjustment is limited.

Regarding the hedge of the net investment in foreign currency, the interest rate component from the hedging instruments can be a source of inefficiency. The counterparty risk on the hedging instrument, even if collateralised, can also be a source of inefficiency.

Discontinuation of hedge accounting

Hedge accounting strategies failing the effectiveness tests are discontinued. A de-designated hedging instrument can be re-designated in a new hedge relationship. Effective hedge accounting strategies may also be discontinued for technical or strategic reasons. Any impact on profit and loss arising from hedge ineffectiveness and discontinuation is reported to the ALCO.

Capital sensitivity to market movements

Available capital can be impacted by changes in the value of balance sheet items (e.g., sovereign and corporate bonds and equity) booked at fair value through other comprehensive income or fair value through profit or loss. This impact can be negative when the market is stressed, which can be triggered by a number of market parameters, including swap rates or bond spreads that increase or equity prices that fall. At KBC, we use this capital sensitivity as a common denominator to measure the vulnerability of the banking book to different market risk shocks.

CET1 ratio sensitivity to main market drivers (under Danish compromise), KBC group (as % of CET1) IFRS impact caused by	31/12/2023	31/12/2022
+100-basis-point parallel shift in interest rates	-0.1%	-0.1%
+100-basis-point parallel shift in spread	-0.2%	-0.1%
-25% in equity prices	-0.1%	-0.1%

Table 41 - CET1 ratio sensitivity to main market drivers (under Danish compromise), KBC group (as % of CET1) IFRS impact

The table shows that the sensitivity of capital to market movements is limited. This is because the majority of KBC's bond portfolio is deemed to be held to maturity and is therefore booked at amortised cost. Those positions do not impact capital unless they are liquidated before maturity. Note that KBC holds material amounts of liquid assets (see the liquidity section) to absorb unexpected funding outflows. If these are not sufficient, KBC can still enter into repo agreements to access liquidity rather than having to realise losses on the bonds.

Regulatory capital

Regulatory capital for non-trading market activities totalled 14 million euros. It is used to cover foreign exchange exposures only, as KBC does not have any commodity exposures. In line with regulations, other types of non-trading market risk are covered through pillar II assessments.

ESG in market risk (non-trading) management

Within the ALM scope, ESG risk, specifically environmental risk, is considered for the portfolios of sovereign and corporate bonds, equity investment, and direct real estate. For all products, environmental transition risk is assessed on the basis of either sector (for corporate bonds and direct equity), country (for sovereign bonds), or physical risk (for direct real estate). The results of this assessment flow into the Climate Risk Impact Map for non-trading market risk.

For sovereign bonds, classification is made based on an internal sustainability barometer of countries, which are classified as having low, medium, or high risk in respect of environmental commitments. Corporate bonds and direct equity positions are classified by sector as having low, medium, or high climate transition risk. The analysis for the sensitivity of corporate bonds and equity positions to sustainability risks follows a scenario inspired by the 'Disorderly transition' scenario, developed by the 'Network for Greening the Financial System' (NGFS), which was used in the ECB Climate Stress Test exercise carried out in 2022. For corporate bonds, sensitivity is measured by a credit spread shock based on the aforementioned 2022 ECB climate stress test spread shocks. Equity value is shocked per sector based on ECB climate equity shocks. For relevant positions in KBC Insurance NV, the carbon footprint of

Market risk – Non-trading	ST	MT	LT
Net Zero			
Delayed transition			
Current policies			

Figure 6 - Climate Risk Impact Map: outcome for market risk (non-trading)

Legend	
	No/limited impact
	Mild impact
	Material impact
	Critical impact

aggregated investment products is assessed using TRUCOST data. Since 2023, we also have a carbon intensity target for investments in corporates of KBC Insurance NV.

Direct real estate represents a smaller and stable exposure. Monitoring takes place at the time of acquisition and at least once a year for the total portfolio. Energy efficiency regulation of commercial and residential property could reduce the value of direct property and real estate funds. The value of real estate portfolios (direct and indirect) might decline due to properties being located in high-risk areas. Direct real estate is measured on a position-by-position basis with an emphasis on physical risk, specifically flood risk and energy consumption (using the EPC score as a proxy). Insights are gathered and reported in alignment with other risk types in the Climate Risk Impact Map (see 'Components of sound risk management').

All treasury investment decisions are made in line with the single binding framework, which defines the screening criteria for responsible investments. The framework and screening criteria apply to all investments in fixed-income products and equities in banking and insurance entities. Our investment activities (asset management and proprietary investments) are also subject to internal screening. Responsible Investment (RI) funds, moreover, have to meet additional criteria. The criteria are monitored by the RI Advisory Board, which is fully independent of KBC.

KBC has its Group Investment Policy in place to manage the ESG risks in its investment portfolios. Companies that are in any way involved in the extraction of thermal coal and/or that are power-generation companies with a coal-based electricity production capacity are excluded from all investment funds (both RI and conventional funds, with the exception of index-linked and structured funds) as well as from KBC's proprietary investments. Additionally, government bonds of countries that are considered to have the most controversial regimes are excluded from the Group Investment Policy.

The bond and equity portfolios are monitored via climate risk KRIs to ensure positions do not become more susceptible to transition risk. For corporate bonds and equity positions, the majority of the exposure is, and is expected to remain, in sectors with low transition risk. The same approach is taken with sovereign bonds.

Liquidity Risk Management

Liquidity risk is the risk that an organisation will be unable to meet its liabilities and obligations as they come due, without incurring higher-than-expected costs.

Strategy

KBC is an integrated bank-insurance group, catering mainly for retail, private banking, SME and mid-cap clients. Our core markets are Belgium, the Czech Republic, Slovakia, Hungary and Bulgaria, and we have a limited presence in other countries.

This business model is also reflected in KBC's funding mix. A large part of customer funding is held on current and savings accounts (65% of the total funding mix) and consists of stable and granular retail, SME and mid-cap deposits from clients in our core markets. A significant share of those deposits (around 50%) are covered by the Deposit Guarantee Scheme (DGS), further protecting the stability of these funds.

In addition to customer funding, the funding mix is completed and diversified by additional funding sources such as debt markets and unsecured and secured wholesale markets.

Apart from a stable and diversified funding mix and good access to market funding, the business model of KBC as an international bank-insurer offers additional benefits which can be leveraged in its funding and liquidity management.

Managing liquidity risk

To efficiently and effectively manage the funding flows in the group and to benefit from KBC Group's and KBC Bank's favourable credit ratings, KBC's liquidity and funding are managed centrally at group level.

In the area of liquidity risk, the Executive Committee is supported by the Group Asset and Liability Committee (ALCO), which is chaired by the Group CFO, with the Group CRO as Deputy Chair, and includes senior representatives from Risk and Business, which is to provide assistance in the area of (integrated) balance sheet management at group level, including liquidity and funding. The governance, rules and procedures on how asset and liability risk management is performed throughout the group are outlined in the Liquidity Risk Management Framework. Its implementation is monitored by Group Risk and its group-wide Extended Competence Centre for ALM & Liquidity Risk, acting as the second line of defence. Within the risk function, the ALM & Liquidity Risk Council, chaired by the CRO Markets & Treasury, aims to establish, facilitate, promote and support the solid and efficient integration of all tasks assigned to the local and group risk departments.

The Group and Local Treasury functions act as the first line of defence and are responsible for KBC's overall liquidity and funding management. 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. The Group Treasury function also actively monitors its collateral on a group-wide basis.

The risk function is the second line of defence. Given the specifics of the Treasury domain and in support of the Group CRO, a CRO Markets & Treasury was appointed who is accountable for the Treasury activities. The group-wide Extended Competence Centre for ALM & Liquidity Risk is in turn responsible for installing the principles for liquidity risk management, which are laid down in a group-wide Liquidity Risk Management Framework that defines the risk playing field.

The third line of defence is provided by internal audit, assuring an independent review and challenge of the Group's first- and second-line liquidity (risk) management processes.

The building blocks for managing liquidity risk

Risk identification

The NAPP process, the Climate Risk Impact Map, the risk scan, stress testing and materiality assessments are important tools used for risk identification. An annual assessment of key risk drivers impacting liquidity is performed as well. When relevant, risk signals are presented in Treasury Risk Reports (ALCO) and Integrated Risk Reports (ExCo, BoD, RCC).

Risk measurement

Identified liquidity risks are measured by means of both regulatory metrics such as the Liquidity Coverage Ratio (LCR, which stood at 159%) and the Net Stable Funding Ratio (NSFR, which stood at 136%), and internal metrics on, for example, the funding mix and concentration and the composition of the liquid asset buffer. In the maturity analysis table below, KBC's structural liquidity risk is illustrated by grouping the assets and liabilities according to the remaining term to maturity (using the contractual maturity date). The difference between the cash inflows and outflows is referred to as the 'net funding gap'. The regulatory required templates can be found in a separate Excel file on the kbc.com website, published alongside this Risk report.

Setting and cascading risk appetite

The Board of Directors sets the overall risk appetite objective for liquidity in close cooperation with the Executive Committee and sets the limits for these measures. The group risk appetite, including the strategic objectives with regard to liquidity risk tolerance, is determined by the Board of Directors by means of an annual review. KBC's low risk appetite for liquidity risk is illustrated by the fact that KBC is well above the thresholds for regulatory and internal liquidity measures. The ALCO decides upon and periodically reviews a framework of limits, early warning levels and policies on liquidity risk activities that is consistent with the group's risk appetite. This framework is submitted to the Board of Directors for approval.

Risk analysis, reporting and follow-up

To mitigate day-to-day liquidity risk, group-wide trends in funding liquidity and funding needs are monitored continuously by the Group Treasury function in the first line and the Group Risk function in the second line. A Liquidity Contingency Plan drafted by the Group Treasury function is in place to address possible liquidity crisis situations and is tested at least annually.

Stress testing

Liquidity stress tests assess KBC's liquidity contingency risk by measuring how the liquidity buffer of the group's bank and insurance entities changes under extreme stressed scenarios. This buffer is based on assumptions regarding liquidity outflows and liquidity inflows resulting from actions to increase liquidity. The liquidity buffer has to be sufficient to cover liquidity needs 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. This information is fed into the Liquidity Contingency Plan. To assess whether our liquidity situation will remain adequate in forward-looking scenarios, both likely (e.g., base-case) and adverse stress scenario analysis is performed. The internal stress tests constitute a balanced mix with a wide range of scenarios, which are reviewed at least annually and regularly adapted to the changing environment. In 2023 the scenarios were further expanded with a forward-looking environmental stress test and a digitalisation and social media stress test.

Moreover, KBC has an Internal Liquidity Adequacy Assessment Process (ILAAP) in place to ensure it has robust strategies, policies, processes and systems for identifying, measuring, managing and monitoring liquidity risk and funding positions over all appropriate time horizons, in order to maintain adequate levels of liquidity buffers.

Scope

The Liquidity Risk Management Framework is applicable to all material entities of the KBC group that carry out banking activities, i.e. KBC Bank NV, CBC Banque SA, KBC Autolease NV, KBC Lease (Luxembourg) SA, KBC Immolease NV, KBC Lease Belgium NV, KBC Investments Limited, ČSOB Bank Group Czech Republic, ČSOB Bank Group Slovak Republic, KBC Bank Ireland, UBB, KBC Commercial Finance NV, KBC IFIMA SA and K&H Bank.

For (re)insurance undertakings, the Liquidity Risk Management Framework details liquidity requirements which are in line with the Solvency II requirements concerning risk management and the Own Risk and Solvency Assessment (ORSA).

Liquidity Adequacy Assessment Process (ILAAP)

Ultimate accountability for proper and sound liquidity management and planning at KBC lies with the BoD and Group Executive Committee. KBC's ILAAP (Internal Liquidity Adequacy Assessment Process) is governed by the ILAAP policy, owned by the BoD. This policy documents KBC's ILAAP architecture (e.g., objectives, underlying processes and responsibilities) supporting the management and assessment of KBC's liquidity adequacy. The ILAAP policy is set up in line with applicable regulation and guidelines, including the ECB's guidelines on ILAAP, and is continuously further improved, for example to embed newer risks such as ESG.

Points of reference for KBC's ILAAP process are the corporate strategy and risk appetite, which are the anchors of an iterative, continuous ILAAP based on, for instance, risk appetite setting, forward-looking assessments and monitoring. The starting point is the continuous identification of all the material risks (e.g., the risk of outflows of non-maturity deposits) KBC is or may be exposed to, such that they can be managed appropriately and taken into account in the ILAAP and liquidity planning.

As the regulatory (Pillar 1) measures on liquidity, such as LCR and NSFR, on their own do not provide a holistic perspective on the strengths and potential weaknesses of KBC's liquidity position, they are complemented with internal measures

(Pillar 2 view) that, for instance, give an indication of the size and strength of KBC's liquid assets that can be drawn upon in case of deposit outflows.

A key process in which our ILAAP is deeply embedded is the Alignment of Planning Cycles (APC). This yearly process aims to create an integrated three-year plan in which the strategy, finance, treasury and risk perspectives are collectively taken into account. In the APC, the liquidity adequacy of KBC Group and its entities, according to both the regulatory and the internal view, is projected in forward-looking base-case and adverse scenarios. The risk appetite of the group is also set and cascaded in the APC by setting risk limits at group and entity level.

Once a year, the ILAAP process generates a comprehensive report, which is presented to both top management and the supervisory bodies before being submitted to the ECB. This report allows the Board to make a statement on the ability of the group and its entities to maintain adequate liquidity going forward in view of the corporate strategy and business model, the effectiveness of KBC's risk and control environment, its governance and risk culture, and the current and expected development of KBC's risk profile under various scenarios. In case of relevant material developments, the ILAAP is updated in order to check KBC's continued liquidity adequacy.

Impact of external developments on liquidity risk

The significant increase in short-term interest rates following the monetary policy tightening implemented by the ECB as of 2022 impacted the composition of the deposit base at KBC Group. However, no significant deposit outflows were observed until the beginning of September. In September, a tax-beneficial Belgian State Note with a one-year maturity was issued. Although the issuance of the Belgian State Note can be considered as a stress event, KBC effectively managed to absorb the liquidity impact while maintaining its robust liquidity profile (the issuance led to a deposit outflow of 5.7 billion euros at the level of KBC Bank NV and CBC Banque SA).

Structural liquidity risk

In the table below, we have illustrated the structural liquidity risk by grouping the assets and liabilities according to the remaining term to maturity (using the contractual maturity date). The difference between the cash inflows and outflows is referred to as the 'net funding gap'.

Note that this structural liquidity gap only provides a very partial view on the strength of KBC's liquidity buffers: it does not consider the concept of a Liquid Asset Buffer, i.e. the fact that KBC can monetise its liquid bonds at all times via repo or pledging. In the table, cash-generating capacity from bonds is only visible at final maturity of the bond. As a result, the net funding gaps shown in the first buckets in the table do not reflect this cash-generating capacity. The Liquid Asset Buffer amounts to 97 billion euros at year-end 2023, of which 72 billion euros in unencumbered central bank eligible assets and the remainder in cash and withdrawable central bank receivables. KBC will use these liquid assets to address any net outflows. It also ignores any mitigating actions that KBC can take in times of stress in order to improve its liquidity position.

Liquidity risk (excluding intercompany deals)*

<i>In billions of EUR</i>	<= 1 month	1-3 months	3-12 months	1-5 years	>5 years	On demand	Not defined	Total
31/12/2023								
Total inflows	4	12	27	100	115	7	47	312
Total outflows	49	30	20	26	6	152	29	312
Professional funding	10	3	1	0	0	4	0	18
Customer funding	24	14	14	13	5	148	0	218
Debt certificates	11	13	5	13	1	0	0	43
Other	4	0	0	0	0	0	29	33
Liquidity gap (excl. undrawn commitments)	-45	-18	7	74	108	-145	18	0
Undrawn commitments	-	-	-	-	-	-	-48	-48
Financial guarantees	-	-	-	-	-	-	-11	-11
Net funding gap (incl. undrawn commitments)	-45	-18	7	74	108	-145	-41	-59
31/12/2022								
Total inflows	6	12	20	82	115	53	34	322
Total outflows	38	20	29	24	5	178	29	322
Professional funding	6	0	20	5	0	4	0	36
Customer funding	19	9	8	12	3	174	0	226
Debt certificates	8	11	1	7	1	0	0	28
Other	4	0	0	0	0	0	29	33
Liquidity gap (excl. undrawn commitments)	-32	-8	-9	58	111	-125	5	0
Undrawn commitments	-	-	-	-	-	-	-47	-47
Financial guarantees	-	-	-	-	-	-	-11	-11
Net funding gap (incl. undrawn commitments)	-32	-8	-9	58	111	-125	-53	-58

* Cashflows include 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. '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 4.1 of the 'Consolidated financial statements' section of the 2021 Annual Report of KBC Group NV). 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.

Table 42 - Liquidity risk (excluding intercompany deals)

Liquid asset buffer

At year-end 2023, besides the cash at central bank the KBC group had 72 billion euros' worth of unencumbered central bank eligible assets, 58 billion euros of which in the form of liquid government bonds (80%). The remaining available liquid assets were covered bonds (11%). Most of the liquid assets are expressed in our home market currencies. The funding from non-wholesale markets was accounted for by stable funding from core customer segments in our core markets.

Funding information

We have a strong retail/mid-cap deposit base in our core markets, resulting in a stable funding mix. A significant portion of the funding is attracted from core customer segments and markets. The KBC group's funding mix⁴ can be broken down as follows:

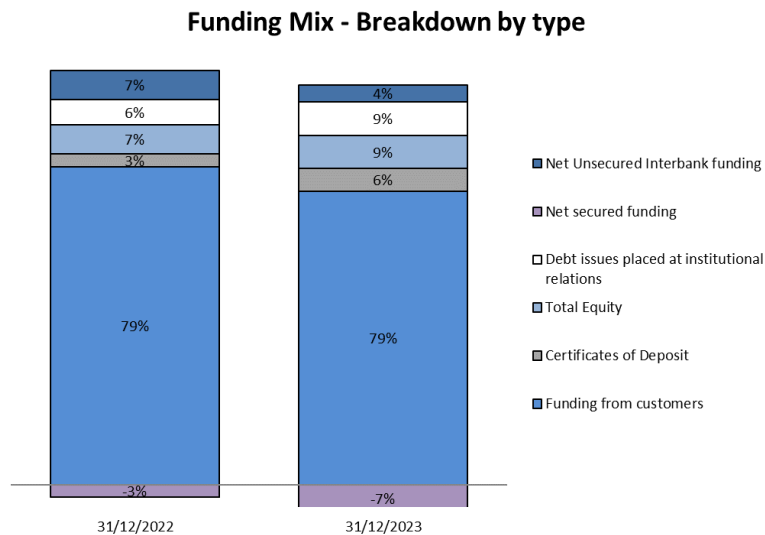


Figure 7 - Funding mix (breakdown by type)

- Funding from customers (roughly 218 billion euros, 79% of the total figure), consisting of demand deposits, time deposits, savings deposits, other deposits, savings certificates and debt issues placed in the network. Some 86% of the funding from customers relates to private individuals and SMEs. A significant share of those deposits (around 50%) are covered by the Deposit Guarantee Scheme (DGS), further protecting the stability of these funds.
- Debt issues placed with institutional investors (25 billion euros, 9% of the total figure), mainly comprising covered bonds issues), tier-2 issues and KBC Group NV senior debt.
- Net unsecured interbank funding (12 billion euros, 4% of the total figure).
- Net secured funding (-20 billion euros in repo funding, -7% of the total figure) and certificates of deposit (17 billion euros, 6% of the total figure). Net secured funding was negative at year-end 2023 due to the fact that KBC is a net provider of secured funding, i.e. it carried out more reverse repo transactions than repo transactions.
- Total equity (24 billion euros, 9% of the total figure, including additional tier-1 (AT1) issues for 2.25 billion euros).

Please note that in November 2012, KBC announced its 10-billion-euro Belgian residential mortgage covered bonds programme; in 2020 this programme was extended to 17.5 billion euros. This programme gives KBC access to the covered bond market, allowing it to diversify its funding structure and reduce the cost of long-term funding.

⁴ Please note that the funding mix graph in the quarterly General Investor Presentation excludes reverse repo transactions and wholesale lending.

Derivatives exposures and potential collateral calls

In LCR calculations, the expected net cashflows resulting from derivative transactions are fully taken into account if the cashflow occurs within the LCR horizon (e.g., net interest payment in plain vanilla IRS, notional and interest payments in CCIRS, etc.).

Contingent flows linked to derivatives that are factored into the calculation of LCR are:

- Rating downgrades on margin calls;
- Additional collateral needs resulting from the impact of an adverse market scenario.

Currency mismatch in LCR

Although the FX position is closed by policy, there might still be a maturity mismatch in the balance sheet per currency (e.g., short-term US dollar funding with longer-term euro assets). Therefore, the volume of currency maturity mismatches in the balance sheet is also monitored.

The monitoring involves the use of liquidity ratios to address both short-term liquidity (via LCR) and structural liquidity (via NSFR), as well as the drivers behind their development (balance sheet). The main goal is to regularly monitor the underlying currency mismatch positions in order to gain an insight into the sensitivity of the cost of FX funding to market shocks.

Asset encumbrance

KBC is a retail-oriented bank that finances 79% of its assets by means of customer funding. A certain reliance on long-term wholesale funding is tolerated and even desired for bail-in purposes, funding diversification and cost optimisation reasons. By the end of 2012, KBC received approval to set up a covered bond programme, which has further diversified the investor base and offers the bank access to funding markets that remain open in times of market stress.


Besides covered bonds, KBC has also rendered part of its mortgage book liquid via the creation of Residential Mortgage-Backed Securities (RMBS) notes that are fully retained. Their prime purpose is therefore not to attract funding, but to enhance liquidity.


KBC has imposed an internal limit on the share of secured funding in the total funding mix of KBC Bank (consolidated). In this regard, secured funding includes net repo exposure (both long term and short term), covered bonds and securitised exposure amounts issued by KBC and effectively sold on the market.

The regulatory required templates related to asset encumbrance can be found in a separate Excel file on the kbc.com website, published alongside this Risk Report.

ESG in liquidity risk management







The Climate Risk Map and pilots on other environmental risks show that physical and transition risks will have a limited impact with mitigating actions in place or ongoing.

 KBC's liquidity buffers could be impacted by increasing credit spreads (see credit and market risk) which could lower the market value of high-quality liquid assets (HQLA) such as bonds. Withdrawals (or non-renewal) of funding triggered by clients needing cash to adjust business plans in the light of the green transition or expectations regarding a bank's commitment towards climate action that are deemed insufficient can also lower our liquidity buffers. The expected cash inflows can also decline when credit defaults increase (see credit risk).

 Impacts on liquidity positions could stem from both increasing bond/credit spreads due to physical risk (see credit and market risk) lowering HQLA and expected inflows, and from clients withdrawing cash to finance damage repairs resulting from physical events.

Liquidity risk	ST	MT	LT
Net Zero			
Delayed transition			
Current policies			

Figure 8 - Climate Risk Impact Map: outcome for liquidity risk

Legend	
	No/limited impact
	Mild impact
	Material impact
	Critical impact
	Transition risks
	Physical risks

We will continue to assess our current ESG stress-testing package of both backward reverse stress testing and forward-looking stress testing against the evolving benchmark of market best practices and include new liquidity scenarios to measure their impact.



Insurance Risk Management

Technical insurance risk is the risk of loss due to (re)insurance liabilities or of adverse developments in the value of (re)insurance liabilities related to non-life, life and health (re)insurance contracts, stemming from uncertainty about the frequency and severity of losses.

More detailed information can be found in our 2023 Solvency & Financial Condition Report, which is available on the [kbc.com](https://www.kbc.com) website. We refer to the KBC Annual Report for disclosures relating to IFRS 17 (see the 'Insurance risk management' section).

Strategy

The technical insurance risk playing field is defined through the standards and policies of the Insurance Risk Management Framework. To support stability in earnings and capital, appropriate risk mitigation is implemented by means of reinsurance programmes protecting against the impact of large claims or accumulation of losses and by means of a diversified exposure across all core markets.

Managing technical insurance risk

In the area of technical insurance risk, the Executive Committee is supported by the Group Insurance Committee (GIC), which monitors risks and capital regarding the (re)insurance activities. The governance, rules and procedures on how technical insurance risk management should be performed throughout the group are outlined in the Technical Insurance Risk Management Framework. Its implementation is monitored by Group Risk and its Insurance Risk Competence Centre. The Competence Centre is responsible for providing support for local implementation and for the functional direction of the insurance risk management processes of the insurance subsidiaries. The actuarial function helps to ensure continuous compliance with the requirements regarding the calculation of technical provisions and the risks arising from this calculation, and assesses the reinsurance policy and underwriting risk (see below for the specific tasks of the actuarial function).

Risk identification

Risk identification is the process of systematically and proactively discovering, recognising, assessing and describing risks, both within and outside KBC, that could negatively impact the KBC group's strategic objectives today and in the future. A strong risk identification process covers different time horizons (from shorter-term risks to medium-/longer-term risks, such as climate risks, which are expected to materialise over an extended time horizon, including beyond the APC horizon). The time horizon defines the type of actions that are needed, ranging from immediate remedial actions to creating risk awareness and further analysing potential impacts, up to initiating structural change to prepare for the risk. The latter is typically done for new or emerging risks, such as climate change. A timely, forward-looking and adequate identification

and first-time assessment of risks increases the opportunities for a sound follow-up and response and hence is key to safeguarding KBC's long-term sustainability.

The 'New and Active Products Process' (NAPP) has been set up to identify and mitigate all risks related to new and existing products and services which may negatively impact the client and/or KBC.

Deep dives (in-depth studies, case studies, detailed risk assessments) are performed to gain additional insights into the risk profile or into potential (future) vulnerabilities for KBC due to a specific issue that has been identified.

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, each subdivided into catastrophe and non-catastrophe risks.

- **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 sub-types included under 'Life' and 'Non-life' also appear in the 'Health' category.

The various sub-types 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., windstorms, 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 that 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.

Risk measurement

Risk measures, applied consistently throughout the group, are classified into regulatory measures, internal measures and complementary measures:

- Regulatory measures, such as SCR (Solvency Capital Requirement), MCR, (Minimum Capital Requirement), Technical Provisions, Best Estimates and Risk Margin.
 - The SCR is a regulatory Pillar 1 capital measurement for (re)insurance entities. The SCR is the capital required to ensure that the (re)insurance company will be able to meet its obligations over the next 12 months with a probability of at least 99.5%. The KBC Solvency capital ratio stood at 206% at year-end 2023, as opposed to 203% at year-end 2022.
 - The diagram below shows the solvency capital requirement (SCR) broken down by risk module, illustrating the impact of the technical insurance risk modules (Life, Non-life and Health underwriting). It should be noted that the total SCR for the underwriting risk accounts for more than 50% of undiversified basic Solvency II Pillar 1 capital.

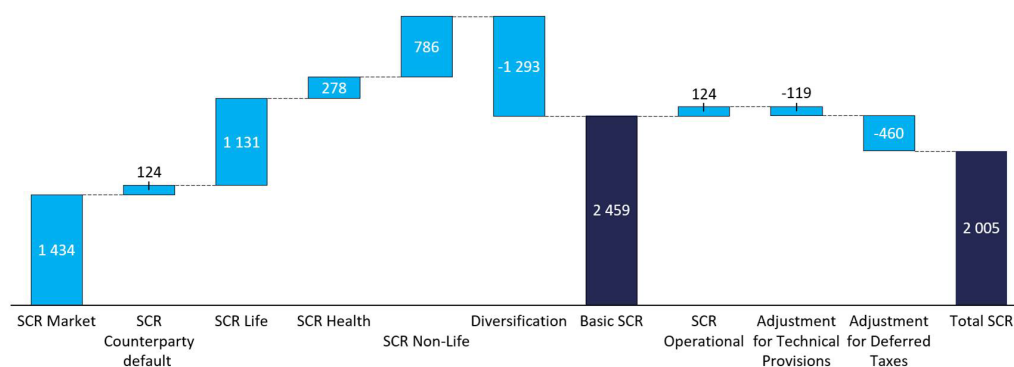


Figure 9 - Solvency II capital requirements 31-12-23

- More detailed information on the Solvency II results and the ratios is provided in our Solvency & Financial Condition Report, which is available at www.kbc.com, and in the 'How do we manage our capital?' section of the 2023 Annual Report of KBC Group NV.
- Internal measures: they add a probability of occurrence to the impact on the P&L (which is an amount). In this respect, we classify:
 - Expected loss: the loss due to technical insurance risk that is estimated on average. This coincides with the Best Estimate (see Solvency II Technical Provisions - Guidelines).
 - Stressed loss: the loss due to technical insurance risk that KBC incurs in negative but not extremely negative circumstances. The probability of the loss is rather high (e.g., once in 5 years, 10 years, 20 years).
 - Unexpected loss: a measure that expresses the loss due to technical insurance risk that KBC may face in extreme circumstances. The probability of the loss is rather low (e.g., once in 200 years).

Complementary measures: consists of a set of measures which are not considered (technical insurance) risk measures, but which provide additional insights into the insurance liabilities from a risk perspective, such as value of new business, value of business in force, economic return and economic combined ratios, through-the-cycle combined ratio, etc.

- Stress testing: internally and externally driven (regulatory) stress tests and sensitivity analyses are performed and the outcome of these tests is reported in the annual Own Risk and Solvency Assessment (ORSA) report and other reports.

Setting and cascading risk appetite

The group risk appetite, including the strategic objectives with regard to the insurance risk tolerance, is determined by the Board of Directors by means of an annual review. KBC's low risk appetite for insurance risk is illustrated by the fact that insurance business is mainly found in the segments of retail and small enterprises (i.e. retail, self-employed and SME clients) with whom KBC wants to build a sustainable relationship in alignment with the strategy of KBC Group as an integrated bank-insurance group. A high degree of diversification is reached through the wide range of insurance product types that are offered to these clients as well as the diversified exposure across all core markets. Where larger risks are taken in the portfolio or where risks could accumulate on a larger scale, risk mitigation is achieved by purchasing appropriate reinsurance programmes. Reinsurance programmes can be divided into three main groups, i.e. property insurance, liability insurance and personal insurance. Most of the reinsurance contracts are concluded on a non-proportional basis, which provides specific cover against the impact of large loss events.

The insurance risk limits are determined and set by the Board of Directors and further cascaded to the local entities (GExCo). The GIC (Group Insurance Committee) advises the BoD on the group risk appetite and the supervision of the risk exposure compared to the group risk appetite.

If the risk profile is not in line with the risk appetite, the reason has to be identified and analysed (e.g., which lines of business are contributing to the deviating risk profile) and the outcome and corrective action must be discussed at the GIC. Breaches at group level are subject to the approval of the Board of Directors and local breaches are subject to the approval of the GExCo.

Risk analysis, reporting and follow-up

Regular reporting and follow-up of the risk measurements is presented in the Insurance Integrated Risk Report, which is submitted to the Group Insurance Committee on a quarterly basis. In addition, relevant risk signals are reported on a regular basis as part of the regular Group Integrated Risk Report.

Scope

The Insurance Risk Competence Centre 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: KBC Insurance NV (Belgium), KBC Group Re (Luxembourg), K&H Insurance Zrt. (Hungary), ČSOB Pojišť'ovna (Czech Republic), ČSOB Poist'ovňa (Slovak Republic) and DZI Insurance (Bulgaria).

Actuarial function

The Solvency II regulatory framework requires an actuarial function to be installed as one of the independent control functions (in addition to the risk management, compliance and internal audit functions) at the level of each insurance entity and at insurance group level. An actuarial function holder is appointed to take charge of the actuarial function's activities. Basically, the task of such a function is to ensure that the company's Board of Directors or Supervisory Board is fully informed of technical actuarial topics in an independent manner.

The main tasks of the actuarial function are to:

- ensure the appropriateness of the methodologies and underlying models used, as well as the assumptions made, in the calculation of technical provisions;
- assess the sufficiency and quality of the data used in the calculation of technical provisions;
- compare best estimates against experience;
- inform the administrative, management or supervisory body of the reliability and adequacy of the calculation of technical provisions;
- express an opinion on the overall underwriting policy;
- express an opinion on the adequacy of reinsurance arrangements; and
- contribute to the effective implementation of the risk management system, in particular with respect to the risk modelling underlying the calculation of the capital requirements.

More detailed information on the actuarial function can be found in our Solvency & Financial Condition Report, which is available at www.kbc.com.



ESG in technical insurance risk management

Risk identification

Strategic sectoral projects (so-called ‘White Papers’) are set up, where relevant also covering an assessment of the impact of climate change on specific KBC insurance portfolios (such as insurance for real estate, mobility and agriculture). These White Papers mention mitigating actions, for example for agriculture in Belgium, which include implementing premium increases and policy adjustments for the multi-peril insurance.

Client dialogue is an essential part of KBC’s approach to better understanding how business clients already deal or plan to deal with sustainability challenges and to supporting them in this transition. We also use this dialogue to collect our clients’ environmentally relevant data and steer business clients towards additional disclosures that might become necessary (e.g., related to the Corporate Sustainability Reporting Directive (CSRD) or the EU Taxonomy).

The Climate Risk Impact Map and three pilots on other environmental risks (biodiversity, water stress and pollution) are used to identify the climate and environmental risk drivers most relevant to KBC’s insurance portfolios. In addition, deep dives are performed to gain further insight into technical insurance risk and the impact of climate change.

Technical insurance risk	ST	MT	LT
Net Zero			
Delayed transition			
Current policies			

Figure 10 - Climate Risk Impact Map: outcome for technical insurance risk



Transition risk drivers could have a potential impact on

technical insurance risk via several transmission channels. Legal limits in the cover for flood risks in Belgium increased in 2023. Additionally, in case clients are confronted with increased climate litigation, insurers could face additional costs if these companies have taken out general third-party liability insurance. This risk can be mitigated by, for example, contractual limits and clauses related to environmental damage. Lastly, higher claims on new insurance products covering green technologies can result in higher losses because of underpricing due to a lack of data. Electric vehicles are top of mind here and KBC is monitoring the amount of claims in order to make timely adjustments in the product offering.

Legend	
	No/limited impact
	Mild impact
	Material impact
	Critical impact
	Transition risks
	Physical risks



Flood risk and windstorms pose major threats to property insurance activities, and to a lesser extent to Life insurance and multi-peril climate insurance. Annual flood losses are expected to increase between 50% and 80% by 2050 if no mitigating actions are taken by society. Temperature-related climate risk drivers mainly materialise in the form of increased mortality rates and hence Life insurance claims. This risk will manifest itself in case of increased heat waves and a higher number of diseases and possible epidemics. An increase in droughts could impact insurance products for the agricultural sector and the (waterway) transportation sector.

Risk measurement and stress testing in ESG

For our Non-life property insurance portfolio, we assess more extreme weather conditions (such as changes in flood, windstorm, hail and precipitation patterns) using a number of internal and external measures and stress tests in order to analyse their potential impact. External broker and vendor models are also used within KBC to model extreme events of this kind. KBC insists on an active dialogue regarding the inclusion of climate change in the scenario analysis performed by these providers. Physical risks in other regions around the world are also closely monitored, as they can affect the

global reinsurance market on which KBC relies. See also the ‘Strengthening ESG risk measurement and stress testing’ section.

Risk appetite statement

From an insurance perspective, KBC Group aims to limit the adverse impact of its activities on the environment and society and to encourage a positive impact, based on a responsible insurance culture and according to the principles described in the KBC Group Sustainability Framework. In line with its updated climate-related ambitions, KBC Insurance will further elaborate its policies and client engagement in the area of sustainability. To support stability in earnings and capital for our insurance business, appropriate risk mitigation is implemented by means of reinsurance programmes protecting against the impact of large claims or accumulation of losses due to climate change effects and by means of a diversified exposure across all core markets.

In our insurance business, ‘green’ products, such as insurance for electrical vehicles, are being developed and flood risk considerations are incorporated into insurance underwriting and pricing for KBC Insurance’s property portfolio.

Risk analysis, reporting and follow-up

Risks are reported internally, for example via the climate risk dashboard available to the Group Insurance Committee, and through the external reports required by law, such as the EU Taxonomy.



Non-Financial Risks

Operational risk

Operational risk is the risk of inadequate or failed internal processes, people and systems or from sudden man-made or natural external events.

This definition is in line with the definition in the Basel II Capital Accord and the Capital Requirements Directive. Information on legal disputes is provided in Note 5.7 of the 'Consolidated financial statements' section of the 2023 Annual Report of KBC Group NV.

Strategy

In order to achieve its strategic goals of client centricity and sustainable growth, KBC is committed to pursuing operational excellence, to striving for simplicity (e.g., reducing process complexity) and to leveraging straight-through processing. KBC does this within a strong risk and control environment with effective controls and risks that are proactively managed. Moreover, we aim to be a resilient organisation, which is reflected in a deeply embedded culture of learning from mistakes to limit near misses, losses and incidents towards our clients. We encourage a risk culture where risk self-assessments and implementation of remediating actions are an integral part of business activities.

Managing operational risk

In managing operational risk, the Executive Committee is supported by the Group Internal Control Committee (GICC). The GICC, chaired by the Group CRO, steers the strengthening of the quality and effectiveness of KBC's internal control system. The following key stakeholders are standing members of the GICC: Group Risk including the Competence Centres for Operational Risk, Group Compliance including the Anti-Fraud Unit, Group Legal and Corporate Audit. KBC's core markets are structurally represented on the GICC by the Chief Risk Officers (CROs). Depending on the topic, other second line of defence expert functions (e.g., Model Risk, Finance) complete the committee. The GICC meets on a quarterly basis.

The business committee Global IT Committee (GITCO), chaired by the Group Chief Innovation Officer (CIO) and with the Group Risk function structurally represented, serves as the governance structure to ensure alignment on Information Security and IT strategy across the group. The GITCO meets on a monthly basis.

The governance, rules and procedures on the performance of operational risk management throughout the KBC group are outlined in the Operational Risk Management Framework. The framework is aligned with the Basel requirement for Operational Resilience and the EU Digital Operational Resilience Act (DORA) – Regulation (EU) 2022/2554. The implementation of the framework is coordinated and monitored by the Operational Risk Competence Centres of Group Risk, which consist of risk experts at both group and local level. They:

- cooperate with other expert functions covering the nine operational risk sub-types: Information Technology, Information Security, Business Continuity, Process, Outsourcing and Third-Party, Model, Legal, Fraud and Personal and Physical Security risk;
- define the Operational Risk Management Framework and the minimum standards for operational risk management processes for the group;
- provide oversight and advice on the strength of the control environment for keeping the operational risk profile in line with the risk appetite and inform senior management and oversight committees of the operational risk profile. Structural reporting to the GICC – on a quarterly basis – and to the GITCO – on a monthly basis – is in place.

The building blocks for managing operational risk

Risk identification

KBC identifies its operational risks by carrying out various activities, like following up on legislation, using the output of the New and Active Products Process (NAPP), performing risk scans, analysing key risk indicators and performing independent control monitoring activities and root cause analysis of operational incidents, near misses and losses.

A structured repository of operational risks and related mitigating controls is in place, with a review process ensuring that the repository remains in line with new or emerging operational risk sub-types.

Risk self-assessments on the operational business lines are performed by the first line of defence with the aim of identifying additional local risks and possible operational control gaps. Dynamic trigger-based risk assessments are executed based on the continuous screening of both internal and external risk events.

On top of that, regular proactive scanning of the environment is performed in order to identify external or internal (cyber) trends which could negatively impact our company in a direct or indirect way. These are also known as risk signals and are reported via the Integrated Risk Report.

Risk measurement

Unified group metrics and scales are in place to determine individual (inherent and residual) operational risk levels in the business lines and to underpin the risk profile of an entity in a comprehensive and integrated way across operational risk sub-types and across KBC group and its entities.

In addition, a group-wide uniform scale is used to express the internal control state of business lines and KBC entities. Monthly data-driven monitoring of the control environment is in place whereby Internal Control Statement (ICS) scores are calculated and shared with the entities, based on indicators derived from the group-wide tool, such as:

- The control maturity reflecting the effectiveness of the controls;
- The number of outstanding action plans and audit recommendations;
- Operational losses (including legal claims).

Setting and cascading risk appetite

The group risk appetite, including the strategic objectives with regard to operational risk, is determined by the Board of Directors by means of an annual review. To accommodate the implementation of the changes and given KBC's fast-changing internal environment, the risk appetite for operational risk is set at the 'lower end of medium', but with clear

constraints. Overall, KBC strives for a 'low' operational risk profile for its business-as-usual operations. Moreover, KBC aims for an overall control environment with 'limited improvements needed'. Losses need to remain under control (below a loss tolerance level set from a 'low-risk' perspective) and disruptions affecting clients must be kept under control. However, a temporarily higher risk profile is accepted if this clearly relates to or is triggered by a large change project (such as a transformation programme, M&A projects, replacement of the core banking system, etc.) and if, for instance, it would be too costly or even impossible to manage the risks down again immediately. The 'lower end of medium' risk profile is only accepted under the condition that the 'large change projects' and the related risks are properly managed.

The current operational risk profile in relation to the operational risk appetite is discussed every quarter as part of the Operational & Compliance Risk Core Report submitted to the GICC. For all operational risk sub-types, Early Warning Indicators are set which are monitored and reported to the Group ExCo in case of any issues.

Risk analysis, reporting and follow-up

Operational risk analysis and reporting aim to give management a transparent and comprehensive, forward-looking and ex-post view on the development of the risk profile and the context in which KBC operates.

The Operational & Compliance Risk Core Report is discussed by the GICC on a quarterly basis and key messages are reported to the Executive Committee. The Operational & Compliance Risk Core Report provides an overview of the overall operational risk profile of the consolidated KBC group (and entities) and the different sub-types of operational risk. It contains relevant risk signals, early warnings, trends in losses and near misses and individual material events including lessons learned from root cause analysis. Data quality in group tools is monitored via dashboards.

The maturity of the internal control environment is reported to KBC's senior management on a monthly basis via ICS scores and once a year via the annual Internal Control Statement. The Internal Control Statement is elaborated in a separate section below.

Stress testing

The Competence Centres for Operational Risk deliver scenarios with a potential negative impact on KBC's (financial) position in order to prepare the KBC entities for (extreme) crisis situations. These scenarios describe specific operational risk events ranging from plausible to exceptional or even extreme and/or movements in operational risk loss impacts according to the baseline and the adverse scenario. Stress testing, for example, enables KBC entities to deal with local cyber crises and handle major incidents. To ensure that Information Security and Information Technology risks are effectively mitigated, a number of challenges are performed throughout the group on a regular basis, such as ethical hacking exercises, technical Cyber Resilience & Readiness Testing, detailed investigations, employee phishing tests, crisis simulations and other incident drills.

Scope

All KBC entities are in scope of the Operational Risk Management Framework as operational risk lies at the core of any company's day-to-day business operations, meaning it is directly linked to the building blocks of a company (people, processes and systems). In addition, it covers risks emerging from actions that specifically target the operations of the organisation (e.g., intentional fire, external fraud or theft, cyber hacking), as well as sudden damaging and/or destructive external events that affect the company in its day-to-day operations and that are non-financial in nature (e.g., a fat finger error, a climate risk event such as flooding, a pandemic or a war).

Focus on top risk areas

The broad spectrum of operational risks is categorised into a number of sub-risk types, in accordance with Basel requirements and industry practice. Specific attention was paid to the top sub-risk types set out below.

Information risk management

Within operational risk management, information risk management encompasses the risks of information security, information technology and business continuity management, the latter including crisis management. Information security risk is one of the most material risks that financial institutions face today, as it is driven by increasingly important external factors (such as geopolitical tensions, cybercrime, technological growth and innovation, e.g., Artificial Intelligence) and internal factors (such as further digitalisation, experiments with emerging technology, and so on).

KBC's Competence Centre for Information Risk Management (Group IRM) is part of Group Risk and comprises both the traditional assurance activities (setting standards, testing controls, group-wide reporting) and KBC's internationally recognised and certified Group Cyber Emergency & Response Team (CERT). Each country has a local second-line team (local 2LoD IRM) which focuses on Information Risk and has similar responsibilities as Group IRM in its core activities. These local teams are functionally steered by the risk function at group level.

Outsourcing risk management

Outsourcing risk management is a specific aspect of Third-Party risk management. Regulatory requirements regarding follow-up, measurement and reporting of outsourcing risk have increased over the years. As contracting external service providers is an essential part of operational processes and intra-group outsourcing is an important aspect of the KBC strategy, the need to focus on outsourcing risk remains a key element of the group-wide risk management at KBC.

To ensure robust management of its outsourcing processes and risks, KBC has put in place a group-wide outsourcing framework, which comprises a group-wide Outsourcing Policy and group-wide Outsourcing Risk Standards. Both policy and standards are supported by first and second lines of defence guidance to ensure a standardised approach, in compliance with the EBA and EIOPA Guidelines on Outsourcing, throughout the whole KBC group.

Key control objectives are in place to adequately mitigate risks arising from either external or internal outsourcing during the full lifecycle of a service provider: from selection and pre-contractual stages to renewal, termination and exit strategies. Qualitative risk governance of KBC outsourced activities is ensured by regular risk assessments (including a set of mandatory sub-risks: Process, IT, Information Security, ESG, Model, Fraud, Legal, Concentration, Offshoring and Step-in), their frequency being defined by the criticality of the outsourced activity.

Model risk management

KBC's data-driven strategy is underpinned by an expanding set of advanced mathematical, statistical and numerical models to support decision-making, measure and manage risk, manage businesses and streamline processes. AI-based models are also becoming an increasingly common feature across the different business domains (banking, insurance, asset management). As the use of models increases, so does the importance of recognising, understanding and mitigating risks related to the design, implementation or use of models, in order to protect both KBC and its clients.

KBC's model risk management standards establish a framework for identifying, understanding and efficiently managing model risk, similar to any other risk type.

Business continuity management including crisis management

To ensure availability of critical services, KBC has a business continuity management (BCM) process in place. This ensures regular business impact analysis is performed and recovery time objectives are defined and implemented.

The BCM process is a mature process within the group, with a focus on both prevention and response. Crisis prevention focuses on reducing the probability of a crisis, while crisis response focuses on the effective and efficient handling of a crisis should one occur. To enable this, practical scenarios called runbooks are available on how to handle an ongoing crisis.

Root causes of Operational Losses

The Loss Data Collection Process is one of the cornerstones of operational risk management and covers all operational risk event types in line with Basel classification.

The reporting process ensures that responsible parties are notified, perform proper root cause analysis and take actions to improve the control environment. Individual major loss events are reported to the group CRO and local CRO. Structural loss reporting to senior accountable management and risk committees, including trends analysis and benchmarking with peers, is in place.

The main root causes of operational losses at KBC, according to gross loss impact of events identified over the past three years, are associated with issues with execution, delivery and process management, followed by external fraud and clients, products and business practices (see graph below). Other categories remain limited in gross loss P&L impact as well as in terms of number of events (< 5%).

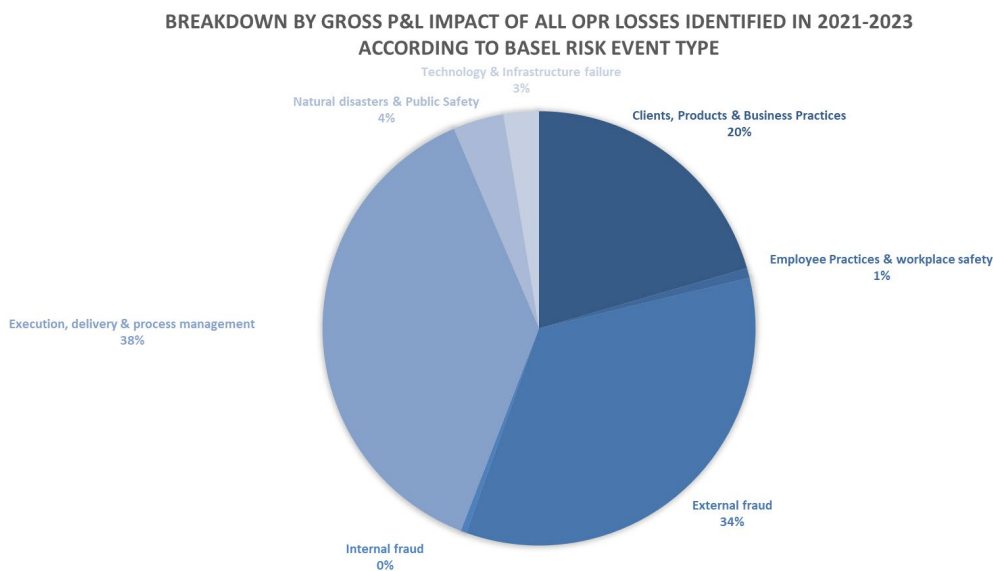


Figure 11 - Breakdown of gross P&L impact of losses according to Basel risk event types over 2021-2023

ESG in operational risk management

As ESG is becoming more important, a strong focus was placed on improving ESG risk management. Within our operational risk management processes, ESG-related controls are in place for managing cyber risk, model risk (e.g., avoiding bias in models, ensuring ethical AI), business continuity (e.g., ensuring continuity of services provided to clients, also in case of disruptions caused by climate or other ESG risk drivers), legal risk (including climate litigation), personal and physical security risk (with respect to personnel and clients) and process risk (ensuring safe, reliable and efficient processes and services for clients).

The identification of environmental risk has gained maturity. The New and Active Products Process (NAPP) has been set up to identify and mitigate all risks related to new and existing products and services which may negatively impact the client and/or KBC. To ensure responsible product development within KBC, no product, process or service can be created, purchased, changed or sold without review in line with NAPP governance.

Particular attention is paid to the adequate 'green' labelling of newly developed products, aligned with regulatory frameworks such as the EU Taxonomy and the ICMA Green Bond framework.

Sustainability and climate-related policies are explicitly taken into account when deciding on new products or services through the NAPP. KBC also screens its outsourced entities and suppliers by using the Sustainability Code of Conduct. The Code is in line with the UN Global Compact Principles and applies to all entities of KBC Group. It sets out rules requiring suppliers to comply with defined labour standards, to respect human rights, to engage with the community and society, etc. Additionally, based on KBC Group's sustainability policies, unsustainable counterparties, with whom no transactions will be concluded, have been included in the KBC Blacklist. As input to any outsourcing decision, a risk assessment is always prepared according to due diligence guidance also covering ESG risks.

The Climate Risk Impact Map was reviewed with a heavier focus on quantifying the underpinning compared to last year's exercise, including the execution of a modelling exercise assessing the impact of physical drivers on the critical buildings. Operational risk resulting from a failure to adapt to policies and regulations grows in relevance as more drastic changes in policies and regulations materialise. Mainly in the medium term of a 'Delayed transition'

Operational risk	ST	MT	LT
Net Zero			
Delayed transition			
Current policies			

Figure 12 - Climate Risk Impact Map: outcome for operational risk

scenario, the probability of errors made in addressing new regulations can increase following the abrupt changes needed to comply with regulations, increasing the probability of climate-related litigation and reputational damage. Severe weather events have the potential to disrupt critical infrastructure and services, mainly in the long term, especially in a 'Current policies' scenario.

Legend	
	No/limited impact
	Mild impact
	Material impact
	Critical impact

Damage to assets and infrastructure owned by third parties and service providers poses relevant operational risks and impacts business continuity. These are, however, considered in our business continuity plans which cover the impact of climate-related and environmental events with a focus depending on the local context. In 2023, additional environmental controls were integrated in the Business Continuity Management (BCM) process.

The pilots on other environmental risk were launched in 2023 and show that, for biodiversity loss and water stress (e.g., pandemics and lack of usable water), physical risks might have a material impact on operational risk in the long term, especially in a 'Current policies' scenario.

Specific KRIs were created for operational risk and included in the assessment of the risk appetite statement. KBC has the ambition to keep its operational risk under control, to be resilient and to be properly prepared for a variety of crises, including those with a climate risk driver, in order to avoid disruption of services and to be maximally protected against cybercrime within an ever-changing threat landscape. Integrity, availability and confidentiality of our company data and the data of our clients is of utmost importance.

Compliance risk

Compliance risk is the risk that a judicial, administrative or regulatory sanction is imposed on an institution and/or its employees because of non-compliance with the laws and regulations pertaining to the compliance domains, resulting in loss of reputation and potential financial loss. This loss of reputation can also be the result of non-compliance with the internal policy in this regard and with the institution's own values and codes of conduct in relation to the integrity of its activities.

As a matter of priority and as a minimum, the scope of activities of the Compliance function is to be concentrated in the following areas of integrity: Anti-Money Laundering and Countering the Financing of Terrorism, Tax Fraud Prevention, Investor Protection, Data Protection, Business Ethics, Fraud Risk Management, Protection of the Policyholder, Non-Discrimination, Consumer Protection, Governance Aspects of CRD IV and V, Solvency II and/or local legislation and Sustainable Finance.

In the area of compliance risk, the Executive Committee is supported by the Group Internal Control Committee (GICC) in the area of strengthening the quality and effectiveness of KBC's internal control system. Compliance risk is covered by the Compliance Charter, the Integrity Policy and the Group Compliance Rules. A coordinated approach is in place to include compliance risk in risk processes where relevant (e.g., risk scan, risk appetite, etc.).

To manage compliance risks, KBC aims to comply with laws and regulations in the compliance domains as determined by KBC's Compliance Charter. The Compliance function's role in managing these risks is twofold: on the one hand, it provides advice from an independent viewpoint on the interpretation of laws and regulations pertaining to the domains it covers. This preventive role is put into practice by Group Compliance Rules that define minimum requirements for the entire group, the provision of procedures and instructions, tailored training courses, daily advice and independent opinions in the New and Active Products Process, information on new regulatory developments to the governance bodies in support of the group strategy and the implementation of legal and regulatory requirements by the various businesses concerned.

On the other hand – as the second line of defence – it carries out risk-based monitoring to ensure the adequacy of the internal control system. More specifically, monitoring allows it to verify whether legal and regulatory requirements pertaining to the different compliance domains covered are correctly implemented in the business. It also aims to ensure the effectiveness and efficiency of the controls performed by the first line of defence. Moreover, quality controls are performed in the main group entities to assure the Board of Directors that the compliance risk is properly assessed by the local Compliance function. Lastly, 'compliance and conduct risk' has been identified as a top risk for some years now, which relates to anti-money laundering, GDPR, sustainable finance and embargoes.

Since 2020, significant efforts have been concentrated on the scalable and future-proof features of the Compliance function. This was achieved by simplifying more processes, fostering group-wide cooperation among the teams and central steering by means of working programmes to ensure excellency in design and efficiency, for example through automation and Artificial Intelligence. Hence, as a first step, a common integrated platform to enhance the management of money laundering – on 'Know Your Transaction' – has been developed and is being rolled out in Belgium and at the Central European entities. Based on modelling and machine learning it allows, among other things, improved detection of unusual behaviours. In the past few years, resources were increased within the Compliance function to enable a strong reinforcement of the Compliance Monitoring Programme and to keep pace with the expanding regulatory requirements and fast strategic and business developments.

The values defended by the group and the key requirements are set out in detail in the Integrity Policy. They are complemented by a content-based strategy and by backward and forward-looking, qualitative and quantitative key risk and performance indicators to better underpin the risk profile of the organisation and to reflect the ultimate aim of conforming to the letter and spirit of the law.

The prevention of money laundering and terrorism financing, including embargoes, has been a top priority for the Compliance function in the past few years and will continue to be prioritised in 2024. It is an area where knowledge of the client (Know Your Customer (KYC)), updating their profiles and monitoring transactions (Know Your Transaction (KYT)) are essential. Efforts are continuously made to adapt the organisation to a constantly changing regulatory environment, particularly with regard to clients who present an increased risk and for whom additional information is required. A Financial Crime Unit was set up to enhance synergies between AML (Anti-Money Laundering), embargoes and Fraud. The Compliance function is also closely following the EU developments at the level of the new AML Authority (AMLA) and regulatory provisions expected in 2024. Special emphasis is placed on a preventive risk management approach (for example, embargo circumvention measures).

The control functions including Compliance ensure that, under the New and Active Products Process, the launch of any new products conforms with the many legal and regulatory provisions in place, such as MiFID II, the Insurance Distribution Directive (IDD) and other local and EU Regulations, as well as being in line with KBC's values.

Conformity with GDPR and data protection obligations is a central hallmark of any sustainable and client-centric organisation. In the context of KBC's data-driven strategy, it is crucial to pay attention to all upcoming regulatory developments in the data protection domain, as there are many. Continued vigilance with regard to the data protection domain is essential to ensure future-proof, reliable and trustworthy bank-insurance activities.

Since 2020, Kate, the personal assistant, has gained maturity and can increasingly facilitate the everyday lives of our clients. The study of the potential use of generative AI models is closely followed to ensure that risks are duly identified.

From the point of view of sustainability, KBC promotes a strong corporate culture that encourages responsible behaviour throughout the entire organisation, including in terms of Environmental, Social and Governance (ESG) responsibility. Several compliance domains are closely linked to these aspects, such as corporate governance, investor/consumer protection, ethics & fraud, anti-money laundering, etc. For example, sustainable investments and ESG characteristics in MiFID and IDD are closely followed from the Compliance perspective. Sustainability and climate-related policies are also taken into account when deciding on new products or services. Particular attention is devoted to the adequate 'green' labelling of newly developed products (within the NAPP process), aligned with regulatory frameworks such as the EU Taxonomy and the International Capital Markets Association (ICMA) Green Bond framework. The effective implementation of sustainability policies is being monitored.

Operational risk and regulatory capital requirements

In line with the current Basel III adequacy rules for banking institutions, KBC uses a standardised approach for the calculation of the regulatory operational risk capital.

KBC's bank activities are classified in line with the Basel business lines: corporate finance, trading & sales, retail banking, commercial banking, payment & settlements, agency services, asset management, and retail brokerage. Within each business line, the gross income (relevant indicator) is used as a broad indicator for the scale of business operations as well as the operational risk exposure. The capital charge for each business line is calculated by multiplying the gross income by the 'beta' factor assigned to that business line. These beta factors serve as a proxy for the industry-wide

relationship between the operational risk loss experience for a given business line and the aggregate level of gross income for that business line. The total capital charge is calculated as the three-year average of the simple summation of the regulatory capital charges across each of the business lines in each year.

Basel Business line	Beta factor
Corporate Finance	18%
Trading & Sales	18%
Retail Banking	12%
Commercial Banking	15%
Payments & Settlements	18%
Agency Services	15%
Asset Management	12%
Retail Brokerage	12%

Table 43 - Beta factors for Basel business lines, used for the Standardised approach for operational risk regulatory capital

Operational risk regulatory capital	2023	2022
<i>In millions of EUR</i>		
Risk-Weighted Assets	13 079	12 184
Capital	1 046	975

Table 44 - Operational risk regulatory capital

When calculating operational risk (including compliance risk) capital, we use the Standardised approach under Basel III. Operational risk capital at KBC group level totalled 1 046 million euros at the end of 2023, compared to 975 million euros at the end of 2022. This increase of 7.3% originates from higher gross income.

In December 2017, the Basel Committee on Banking Supervision published the Basel III post-crisis reforms. The date of 1 January 2022 initially set for the implementation of the revised Basel III was deferred by one year by the Governors and Heads of Supervision to increase the capacity of banks and supervisors to respond to the coronavirus pandemic. On 31 October 2022, the Council of the European Union published its proposal to amend applicable European legislation in line with the Basel III post-crisis reforms, which states that 'this Regulation shall apply from 1 January 2025'.

Internal Control Statement

The regulatory required Internal Control Statement (ICS) reporting is a yearly exercise in which the Group ExCo:

- evaluates how well the KBC group is in control of the risks inherent to its operations, and
- endorses and follows up action plans to strengthen its Internal Control Environment for each identified significant control weakness.

This yearly Group ExCo opinion is approved by the Group Board of Directors.

In support of the ICS reporting, the KBC ICS Policy describes the governance in place, as well as the process including the roles and responsibilities of the main stakeholders involved. The KBC ICS Policy is owned and approved by the Group Board of Directors.

As the Internal Control System is structured by the second and third lines of defence, the KBC ICS Policy is connected with:

- The Operational Risk Management Framework (ORMF), which is part of the Enterprise Risk Management Framework. The ORMF sets the standards for efficient and effective management of operational risks throughout the KBC group.

- The Compliance Charters, Policies and Rules that establish the status of the Compliance function and define the roles and responsibilities of the Compliance function and the business for efficient and effective management of compliance risks throughout the KBC group.
- The Internal Audit Charter and Internal Audit methodology (compliant with IIA standards), which give insight into the role and responsibilities of the Internal Audit function and the Audit methodology used throughout the KBC group.
- The ICS Guidelines of Group Operational Risk and Group Compliance and the 'Audit Opinion on the quality of the Internal Control' standards of Corporate Audit, which give more specific guidance in preparation of the ICS KBC group reporting per control function.

The KBC ICS Policy is applicable to all KBC entities in scope of the ICS as the local ICS ExCo reports underpin the ICS KBC group reporting.

At the end of 2023, the Group ExCo was of the opinion that the overall quality of KBC's Internal Control System is largely up to standards; (continued) improvements are needed in specific areas in view of the overall risk appetite of the KBC group. Appropriate actions have been defined or are ongoing.

Reputational risk

Reputational risk is the risk arising from the loss of confidence by, or negative perception on the part of, stakeholders (such as KBC employees and representatives, clients and non-clients, shareholders, investors, financial analysts, rating agencies, the local community in which it operates, etc.) – be it accurate or not – that can adversely affect a company's ability to maintain existing, or establish new, business and client relationships, and to have continued access to sources of funding.

Reputation is a valuable asset in business and this certainly applies to the financial services industry, which thrives to a large extent on trust. Reputational risk is mostly a secondary risk since it is usually connected to – and materialises together with – another risk. To manage reputational risk, which is often secondary in nature, we remain focused on sustainable and profitable growth, fulfilling our role in society and the local economy to the full to the benefit of all stakeholders. We promote a strong corporate culture that encourages responsible behaviour throughout the entire organisation, including social and environmental responsibilities. In this respect KBC commits to the Paris Agreement climate goals through the Collective Commitment for Climate Action, strives to limit the negative impact of its products and services on society and provides its clients with financial solutions and business opportunities with a positive impact.

The group risk appetite, including the strategic objectives with regard to reputational risk tolerance, is determined by the Board of Directors by means of an annual review. KBC's low risk appetite for reputational risk is illustrated by the fact that we have set a strict risk appetite for all our risks and have policies and processes in place to manage them (e.g., NAPP). We also proactively manage incidents. We put the clients' interests at the heart of what we do and foster trust by treating our clients fairly and honestly, by meeting their expectations as fully as possible and by approaching them proactively in a highly personal manner.

The governance, rules and procedures and how reputational risk management should be performed throughout the group are outlined in the Reputational Risk Management Framework. Its implementation is monitored by Group Risk and its Reputational Risk Competence Centre. Proactive and re-active management of reputational risk is the responsibility of Business, supported by specialist units (including Group Communication, Investor Relations and Group Compliance). In

this respect, we actively monitor a non-exhaustive list of business indicators which provide valuable input from a risk management perspective, including Net Promotor Scores (NPS), the Corporate Reputation Index, statistics on complaints, ESG ratings and the evolution of the stock price index and other financial indicators.

ESG in reputational risk management

The most important impacts of climate and other environmental risks on our reputational risk profile are identified in the Climate Risk Impact Map and in pilot exercises on other environmental risks (see ‘ESG in our risk management’).

The outcome of the Climate Risk Impact Map shows that:



Changing investor, client or community expectations and public scrutiny regarding the financing of sectors or activities which are harmful or perceived to be harmful can lead to reputational damage, for example in the form of litigation cases. The reputation of a financial institution can also be tarnished by being accused of not having sufficiently ambitious commitments or an inadequate approach to combating climate change. Additionally, greenwashing (i.e. offering services or products that are not as environmentally friendly as initially indicated) and the unsuccessful implementation of stricter policies and regulations can damage a financial institution’s reputation.



A higher frequency in losses stemming from physical risk events could lead to increased complaints in insurance claims handling, which gives rise to reputational risk. In the longer term, reputational risk could also increase if insurers increasingly restrict their underwriting or drastically increase insurance premiums in an attempt to keep the risks insurable, whilst keeping their loss ratio under control. Insurance companies have a societal role and can be criticised for not fulfilling this role.

Reputational risk	ST	MT	LT
Net Zero			
Delayed transition			
Current policies			

Figure 13 - Climate Risk Impact Map: outcome for reputational risk

Legend	
	No/limited impact
	Mild impact
	Material impact
	Critical impact
	Transition risks
	Physical risks

The outcome of the pilot exercises on other environmental risks shows that the identified reputational risks are very similar and predominantly stem from changing policies (e.g., PFAS regulation or nitrogen agreements), shifting consumer preferences and physical risks arising from insurance, in which respect KBC will need to take up its societal role in claims processing and pay-out.

To manage reputational risks, KBC promotes a strong corporate culture that encourages responsible behaviour throughout the entire organisation, including in terms of social and environmental responsibility. In order to fulfil our role in society, we aim to support our clients in the transition towards a low-carbon economy throughout our core activities. This is done in various ways:

- Our sustainability policies, restrictions and targets define a clear risk playing field with regard to ESG risks.
- As highlighted in the section on credit risk, a sector-based environmental and social (E&S) sectoral heatmap has been developed and implemented in the loan origination and review processes. As this tool allows us to identify hot spots in the corporate and SME loan books, our reputational risks remain mitigated if exposure to these hot spots is limited or decreasing.
- Collaborating with unsustainable counterparties might result in reputational risk. However, since KBC screens its outsourced entities and suppliers by using the Sustainability Code of Conduct (as stated in the ‘Operational risk’ section), the reputational risks are managed.

We also keep reputational risks under control by close monitoring and peer benchmarking of our ESG ratings, by making adequate assessments and by responding to controversies. Via our Climate Risk Dashboard (as outlined in 'ESG in our risk management') we monitor on a semi-annual basis whether KBC's GHG targets are on track and whether there are changes in KBC's ESG ratings.



Annexes

Annex I

Balance sheet reconciliation

Disclosure according to Article 2 in Commission Implementing Regulation (EU) No 1423/2013

Capital Base	Financial statements	Deconsolidation insurance	Prudential treatment	Own funds 31-12-23 (*)
<i>In millions of EUR</i>				
Total regulatory capital, KBC Group (after profit appropriation)				19 768
Tier-1 capital				17 389
Common equity				15 639
Parent shareholders' equity	18 511	- 301		18 209
Intangible fixed assets (incl. deferred tax impact) (-)	-1 109	63	334	- 712
Goodwill on consolidation (incl. deferred tax impact) (-)	-1 237	168		-1 070
Minority interests	0			0
Hedging reserve (cashflow hedges) (-)	579	0		579
Valuation diff. in fin. liabilities at fair value - own credit risk (-)	- 29			- 29
Value adjustment due to the requirements for prudent valuation (-)	0		- 24	- 24
Dividend payout / share buyback (-)	- 803			- 803
Remuneration of AT1 instruments (-)	0		- 26	- 26
Deduction re financing provided to shareholders (-)	- 56			- 56
Deduction re Irrevocable payment commitments (-)	- 90			- 90
Deduction re NPL backstops (-)	- 204			- 204
Deduction re pension plan assets (-)	- 121	- 1		- 121
IRB provision shortfall (-)	0			0
Deferred tax assets on losses carried forward (-)	- 98			- 98
Transitional adjustments to CET1	0		84	84
Limit on deferred tax assets from timing differences relying on future profitability and significant participations in financial sector entities (-)	0			0
Additional going concern capital	1 750			1 750
CRR compliant AT1 instruments	1 750			1 750
Tier-2 capital	2 379			2 379
IRB provision excess (+)	265			265
Transitional adjustments to CET1	0		- 60	- 60
Subordinated liabilities	2 674	- 500		2 174

(*) An overview of the entities included in the financial statements of KBC Group NV and their method of consolidation is provided at <https://www.kbc.com/en/our-structure>

Table 45 - Balance sheet reconciliation

Annex II

Own funds and capital & leverage ratios with/without transitional arrangements for IFRS 9

Own funds and capital & leverage ratios with/without transitional arrangements for IFRS 9

<i>In millions of EUR</i>		31-12-2023	30-09-2023	30-06-2023	31-03-2023	31-12-2022
Available capital (amounts)						
1	Common Equity Tier 1 (CET1) capital	15 639	15 593	17 058	17 048	15 474
2	Common Equity Tier 1 (CET1) capital as if IFRS 9 has not been applied	15 555	15 533	16 992	16 981	15 428
3	Tier 1 capital	17 389	17 343	18 558	18 548	16 974
4	Tier 1 capital as if IFRS 9 has not been applied	17 305	17 283	16 992	16 981	16 928
5	Total capital	19 768	19 770	21 009	20 988	18 742
6	Total capital as if IFRS 9 has not been applied	19 744	19 784	21 024	21 004	18 741
Risk exposure amount						
7	Total risk-weighted assets	113 029	115 222	108 909	107 649	109 966
8	Total risk-weighted assets as if IFRS 9 has not been applied	113 038	115 255	108 945	107 686	109 981
Capital ratios						
9	CET1 (as a % of risk exposure amount)	13.84%	13.53%	15.66%	15.84%	14.07%
10	CET1 (as a % of risk exposure amount) as if IFRS 9 has not been applied	13.76%	13.48%	15.60%	15.77%	14.03%
11	Tier 1 capital (as a % of risk exposure amount)	15.38%	15.05%	17.04%	17.23%	15.44%
12	Tier 1 capital (as a % of risk exposure amount) as if IFRS 9 has not been applied	15.31%	15.00%	15.60%	15.77%	15.39%
13	Total capital (as a % of risk exposure amount)	17.49%	17.16%	19.29%	19.50%	17.04%
14	Total capital (as a % of risk exposure amount) as if IFRS 9 has not been applied	17.47%	17.17%	19.30%	19.50%	17.04%
Leverage ratio						
15	Leverage ratio total exposure measure	333 894	343 571	358 778	342 707	346 431
	Leverage ratio total exposure measure as if IFRS 9 has not been applied	333 791	343 496	358 696	342 624	346 374
16	Leverage ratio	5.21%	5.05%	5.17%	5.41%	4.90%
17	Leverage ratio as if IFRS 9 has not been applied	5.18%	5.03%	4.74%	4.96%	4.89%

On 22 June 2020, KBC received ECB approval to apply CRR Art. 473a at the level of KBC Group and KBC Bank consolidated as of 30 June 2020.

KBC applies both the static component (CRR Art. 473a paragraph 2) and the dynamic component (CRR Art. 473a paragraph 4).

When recalculating the risk exposure amount, we assign a risk weight of 100 % to exposures under the Standardised approach (CRR Art. 473 paragraph 7a).

The impact of Art. 473a stems mainly from ECL accounted for in 2Q20 and recognised in CET1 under CRR Art. 26(2) in 4Q20.

Table 46 - Own funds and capital & leverage ratios with/without transitional arrangements for IFRS 9

Annex III

This Annex includes additional information on several subjects included in the 'ESG in our risk management' section. In particular, the following topics are further detailed:

III.1 ESG governance, remuneration and training

III.2 The Climate Risk Impact Map

III.3 Physical risk assessments

III.1 ESG governance, remuneration and training

ESG governance

The risk function is actively represented on KBC's sustainability committees:

- The Group CRO is a member of the Executive Committee, the committee having the highest level of direct responsibility for sustainability and climate change.
- The senior general manager of Group Credit Risk represents the risk function on the Internal Sustainability Board (ISB). The ISB, chaired by the CEO, is the primary forum for the discussion of all ESG-related topics and the main platform for driving sustainability at group level (the Group CFO is the Deputy Chair, the Senior General Manager Group Corporate Sustainability is a member, and senior managers from all business units and core countries are represented). It debates and makes strategic and commercial decisions on all sustainability-related matters.
- The senior general managers of Group Risk and Group Credit Risk are members of:
 - the Sustainable Finance Steering Committee, chaired by the Group CFO, which monitors the overall progress and technical implementation of the Sustainable Finance Programme. This programme specifically focuses on KBC's approach to climate action and other environmental themes, such as biodiversity, water and circularity. The risk function is also represented in the core team of the Sustainable Finance Programme;
 - the Data & Metrics Steering Committee (chaired by the Group CFO), which was established in 2021 to address the growing climate-related data needs. All core countries and group functions are represented on this committee;
 - the CSRD Steering Committee, which was established in 2023 to oversee the implementation of the CSRD regulation at group level.
- As strong embeddedness in the local organisation is a key requirement, similar governance is in place in each of KBC's core countries, with local general sustainability managers having been appointed and local risk functions taking active part in locally established sustainability committees.
- More information can be found in the 'Sustainability strategy' section of the 2023 Sustainability Report.

Internal Audit, as the third line of defence, ensures that transversal risks – including ESG risks – are covered in multiple audits (e.g., sustainable lending policy in Credit audits, sustainable investment policy in Asset Management audits). Additionally, audits specifically focusing on ESG risks are also part of the multi-year audit plan.

Remuneration

Sustainability has been integrated into the remuneration of our senior management and employees.

- Elements such as sustainability are becoming increasingly important and today determine at least 30% of the collective, variable, results-related remuneration components awarded to members of the Executive Committee. Progress on these criteria is evaluated every six months using the KBC Sustainability Dashboard. The Board of Directors, specifically the Remuneration Committee, is responsible for the ultimate assessment of the criteria used to evaluate the members of the Executive Committee.
- All KBC senior managers have an explicit sustainability objective to increase sustainability awareness and to encourage management to take concrete action in the domain of sustainability (including climate policy). At least 10% of the variable remuneration received by senior management depends on the achievement of individual targets related to the implementation of the group's sustainability strategy.
- The non-recurrent results-based bonus KBC pays its employees in Belgium has been partially linked to sustainability targets since 2012. In 2023, the targets were linked partly to our direct footprint – Green Mobility (coming to the office using an environmentally friendly means of transport) – but also to employee development (training days, digitality and progress management) and cybersecurity (phishing tests).

Raising awareness and providing training on ESG risk

In 2023, we continued our efforts towards creating risk awareness by:

- following up on new and changing regulations through a Sustainable Finance Legal Working Group;
- active involvement in regular working groups with peers and other financial institutions in order to keep up to date on best practices for integrating climate-related and environmental risks (e.g., collaboration with UNEP FI, Equator Principles);
- organising internal communication and training for all staff and management, as well as developing more specialised training for risk managers. This includes:
 - providing general awareness training for all staff;
 - further roll-out of the internally developed climate game (increasing awareness of climate-related aspects which can change traditional banking and insurance);
 - developing and offering training courses aimed at specific functions (e.g., relationship managers, product managers, (expert) risk managers, etc.);
 - offering a specific (mandatory) training programme for new KBC senior management which focuses on the PEARL+ leadership model with specific attention for trust and psychological safety, and adaptive and inclusive leadership. Additionally, it includes a deep dive into KBC's overall strategy with a focus on such topics as sustainability, responsible behaviour and artificial intelligence. These programmes are offered through 'KBC University'; more information about this is available in the Sustainability Report.


III.2 The Climate Risk Impact Map


In 2021, KBC initiated the development of a Climate Risk Impact Map. This annual risk identification process aims to identify the most material climate risk drivers for KBC's businesses and portfolios. It reflects the impact of transition risk (policy and regulation, technology and consumer preferences) and physical risk (split according to different climate perils) drivers on the traditional risk types:

- by distinguishing between different drivers of transition and physical risk,
- by considering three distinct climate scenarios,
- for three different time horizons.




In addition to a Climate Risk Impact Map at group level, separate maps have been constructed for Bank, Insurance and Asset Management. Additionally, separate maps have been prepared for our core countries, given that the materiality of climate-related risks can differ across different jurisdictions (transition risks) and locations (physical risks).




The transition and (chronic and acute) physical risk drivers considered in the Climate Risk Impact Map are listed in the tables below.

 Transition risk		Risks arising from shifts and disruptions associated with the transition to a low-carbon, climate-resilient or environmentally sustainable economy.
Drivers	Policy and regulation	An increase in carbon and energy prices, carbon taxes, reduction of emission rights, energy efficiency regulation for commercial and residential property.
	Technological development	Substitution of existing products and services with green alternatives based on new technologies, failure of/uncertainty surrounding new technologies.
	Consumer preferences	Changes in customer behaviour and investor expectations, uncertainty in market signals, customer/community perceptions of an organisation's contribution to climate change, green competition.

 Physical risk		Risks related to potential financial implications from physical phenomena associated with both (chronic) climate trends and extreme (acute) weather events.	
		<i>Chronic changes</i>	<i>Acute events</i>
Drivers	Temperature	Increase/decrease in average temperature, increase/decrease in max. and min. temperatures, etc.	Increase in frequency and severity of heat/cold waves, wildfires, etc.
	Wind	Changing wind patterns	Cyclones/windstorms, tornados, etc.
	Water	Sea level rise, structural increase/decrease in average rainfall, changing precipitation patterns, etc.	Increase in frequency and severity of floods (coastal, river, pluvial) and droughts, hailstorms, snow/ice, etc.
	Solid mass	Soil degradation	Landslides, subsidence, erosion, etc.

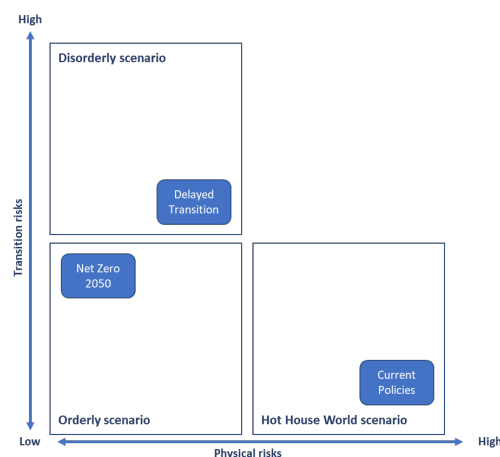
Both transition and physical risks can materialise via several transmission channels, potentially impacting KBC's balance sheet through several risk types (see below). A general overview of these transmission channels is provided in the table below.

	Transition risk 	Physical risk 
 Corporates & SMEs	<p>Depending on each individual company's transition plans, impacts can differ across and within sectors:</p> <ul style="list-style-type: none"> Companies can be directly affected (e.g., loss of clients, increased costs and lower profitability, increased litigation costs, etc.), but also indirectly as their supply chain might be impacted by transition risk. Failure to make a transition or making a transition at too slow a pace can lead to a loss of business. Additional investments might be necessary and costs may increase. 	<p>Companies can be impacted by physical risk through direct damage caused by extreme weather events:</p> <ul style="list-style-type: none"> Critical assets can be damaged/destroyed or infrastructure can become temporarily unavailable. This can translate into additional investments, relocations of production sites and capital depletion. Physical risks can cause supply-side shocks when impacting transportation or primary resources, impacting the prices of affected products.

	<p>Some sectors are more prone to climate-related transition and physical risks than others. Certain activities require significant energy usage or directly emit greenhouse gases (GHG), making them more vulnerable to transition risks. Other activities can be particularly prone to physical risks. For eight carbon-intensive industrial sectors (energy, commercial real estate, food production, building and construction, chemicals, transportation and metals) and three product lines (mortgages, car loans and car leasing), strategic sectoral projects (so-called 'White Papers') have been set up with a focus on our credit, business, advisory services and insurance activities. The White Papers clearly analyse the challenges and technological developments in each of these sectors and business lines, including the relevant European and local regulations and action plans, relevant physical risks and their impact on KBC's portfolios in terms of climate-related risks and opportunities, which reporting metrics can be used to steer these portfolios, etc. They also provide an initial outline of possible risk-mitigating measures, commercial policy adjustments and how we can steer the portfolio in line with the Paris Agreement. The specific context of our local businesses in all our home countries is considered in these assessments. More details can be found in the 2023 Sustainability Report (the 'Our commitment to the environment' section) and in the risk-type-specific sections in the remainder of this report.</p>	
 Households	<ul style="list-style-type: none"> Households can face increased costs regarding utilities and/or food. As energy efficiency considerations are increasingly being factored into house prices, energy-inefficient houses may decrease in value or increase more slowly. 	<ul style="list-style-type: none"> Extreme weather events can damage real estate or other assets (such as vehicles). Even though this damage is mostly covered by insurance, the insurance premiums can also be expected to go up. Costs can increase, e.g., due to increased costs for cooling/heating, increased food costs, etc.
 Sovereigns	<p>The impact on sovereigns follows the impact of the underlying economy. In extreme circumstances, sovereigns which are most vulnerable to transition and physical risks can, for example, run the risk of downgrades.</p>	
 Financial institutions	<p>The extent to which financial institutions will be impacted by transition and physical risks depends on their business (banking/(re)insurance) and portfolio characteristics.</p>	

The timing and severity of transition risks and physical risks (i.e. the 'climate pathway') depend mainly on government and policy action. Given the uncertainty on the climate pathway in respect of future events, climate risk impacts are estimated for three distinct climate scenarios. These are made available by the Network for Greening of the Financial System (NGFS) and encompass a global, harmonised set of transition pathways, physical climate change impacts and economic indicators. Importantly, macroeconomic insights provided by these scenarios facilitate an assessment of the impact of these scenarios on the financial sector as a whole and KBC in particular. Aligning with NGFS scenarios ensures assumptions are aligned with the industry standards and facilitate a comparison between the impact map and other internal and external climate-risk-related exercises. The relevance of these scenarios has already been demonstrated as these were also selected by the ECB for its 2022 climate stress test. Each scenario contains different assumptions regarding the timing and impact of various physical and transition risk drivers:

- **Net Zero 2050 (Orderly scenario):** in this scenario, there is early and decisive action to reduce global emissions in a gradual way, with clearly signposted government policies implemented relatively smoothly. There is a structural reallocation but no other macroeconomic shock. Transition risk is present, but remains rather limited. The actions are sufficient to limit global average temperature increases to below 1.5°C. However, even this moderate increase in global temperatures leads to higher physical risks.
- **Delayed transition (Disorderly scenario):** in this scenario, action to address climate change is delayed by ten years. To compensate for the delayed start, a more far-reaching adjustment is required. Companies and consumers change their behaviour in response to these dramatic shifts, and asset prices see a sharp repricing as a result, leading to a macroeconomic shock. The climate target is still met and global average temperature increases are limited to below 2°C. In this scenario, physical risks increase more than in the Net Zero 2050 scenario and transition risks are severe.
- **Current policies (Hot house world):** this scenario assumes no limit on the global temperature by 2100, assuming no accelerated economic transition and a continuation of current policy trends. Physical climate change has severe consequences in this scenario, with climate impacts ensuing from emissions reflecting the riskier (high) end of current estimates.



As the impacts of climate risk will materialise over different time horizons, impacts are assessed for three different time frames: short (0-3 years), medium (3-10 years) and long term (>10 years).

III.3 Physical risk assessments

The following sections contain a description of the various physical risk assessments performed. In line with our Climate Risk Impact Map, both acute and chronic physical hazards were considered. The assessments were geographically tailored to the territories of the five KBC home countries (Belgium, the Czech Republic, Slovakia, Hungary and Bulgaria).

The actual sectoral impacts (per NACE level and from a bank perspective) are provided in template 5, which can be found in a separate Excel file on the kbc.com website, published alongside this Risk Report.

Flood risk

A harmonised flood risk assessment was performed on various loan portfolios throughout the group. The assessment distinguishes between fluvial, pluvial and coastal flood risks.

Fluvial flood risk

The basis of the fluvial flood risk analysis is the fluvial (riverine) flood map provided by the Joint Research Centre (JRC)⁵ which reflects those areas with a flooding return period of 10 years.

⁵ <https://data.jrc.ec.europa.eu/collection/id-0054>

For the mortgage portfolios, the percentage of high-risk properties is limited across the home countries of KBC Group (up to 2%). For the corporate and SME portfolios, this percentage is slightly higher (up to 3%).

Pluvial flood risk

Pluvial flooding is geographically more widespread. Our risk modelling team designed in-house pluvial flood maps per country based on a surface water run-off algorithm which simulates water flowing to local topographic minima.

The percentage of properties in the mortgage portfolios which are highly likely to be impacted by pluvial flooding is again limited across the KBC Group home countries (up to 2%). Similar to fluvial flood risk, the corporate and SME portfolios are slightly more exposed to pluvial flood risk than the mortgage portfolios.

Coastal flood risk

For KBC Group, coastal flood risk is assumed to be most relevant along the Belgian coastline as a combination of strong windstorms and high tides is a natural condition for this type of hazard (which is less likely to occur along the Bulgarian coastline).

The basis of the analysis is a coastal flood map with a return period of 100 years, provided by the Flemish Environmental Agency (VMM). Only a marginal percentage of our exposure is considered high-risk.

Risk mitigation

Insurance coverage for flooding is relatively high in the KBC Group home countries (especially for the 'collateralised with immovable property' exposure, for which property insurance is a standard requirement) and the (credit) risk is thus partially mitigated. The metrics above consequently focus on the part of the portfolio for which the assets have a potential to be very severely affected by floods. This specifically involves properties located in a flooding area with a flood depth of more than one metre. This threshold ensued from literature and methodologies used by insurance brokers. To reflect increased flood severity implied by adverse climate scenarios, the threshold is lowered to 0.5 metres for longer-term exposure.

Heat stress

Heat waves occur in all of the KBC Group home countries, with varying frequencies, intensities and durations. Table 1 illustrates this by means of the average number of observed and projected (RCP8.5 scenario) heat wave days, obtained from the Copernicus Climate Portal⁶. Clearly the heat stress is higher and tends to increase more prominently in the more southern countries.

	BE	CZ	SK	HU	BG
2020 (observed)	7	7	8	9	8
2040 (projected)	7	10	12	14	16

Table 1 - Average number of heat wave days

The assessed sectors where heat stress may result in unrealised income are the agricultural and energy sectors. As there is a natural overlap with the drought hazard type, within this assessment the sensitivity to heat stress of the agricultural sector is implicitly covered in the drought risk assessment and further described in the corresponding section. Regarding the energy sector, heat stress may for instance result in emergency actions to avoid outages due to very high electricity consumption (cf. 2022 Texas power outages) or reduced electricity production due to reduced cooling capabilities (cf. 2022

⁶ <https://cds.climate.copernicus.eu/cdsapp#!/software/app-health-heat-waves-projections?tab=app>

French nuclear plants). Some activities in this sector may be more exposed than others (e.g., renewable energy production has no or limited cooling needs) but in this initial assessment no distinction is made on the basis of economic activity in the sector.

The sensitivity to heat stress is driven by the country's average number of heat wave days during the warm period of the year (June-July-August-September). More specifically, for short-term and medium-term exposure the sensitivity is driven by the observed number of heat days, while for longer-term exposure the number of heat days projected for 2040 becomes the driver.

Drought

Periods of low water or soil moisture levels occur in all of the KBC group home countries and may impact a variety of sectors in different ways: lower crop yields, water scarcity for water-intensive sectors, riverine-based supply chain issues, etc. Some of the secondary effects may be broad but difficult to quantify and the focus in the current assessment is therefore restricted to the agricultural and water (supply) sectors.

Scientific research⁷ has established a relationship between observed drought levels (quantified via the standardized Precipitation-Evapotranspiration Index or SPEI) and the likelihood that different economic activities will be impacted. Given the limited geographic size of the KBC home countries, no further distinction is made based on areas within a country. The assessment has resulted in the breakdown provided in Table 2.

	BE	CZ	SK	HU	BG
Agriculture	17%	12%	13%	14%	16%
Water (supply)	14%	11%	9%	10%	11%

Table 2 - Sensitivity to drought risk

Wildfires

Statistics of the Global Wildfire Information System (GWIS)⁸ show that wildfire events occur in all of KBC Group's home countries, albeit rarely, and that almost all burned areas observed are cropland. The risk is hence concentrated in NACE sector A, specifically agricultural activities (A1.1 and A1.2).

Table 3 below shows for each KBC Group home country the regional variation of the percentage of cropland which is burned on average per year. The very low values indicate that wildfire risk is negligible in most home countries apart from some regions in Bulgaria. No clear trend could be identified in the historical time series provided by GWIS.

BE	CZ	SK	HU	BG
0.0%	0.0%	0.0% - 0.1%	0.0% - 0.5%	0.0% - 3.7%

Table 3 - Regional variation of average percentage of burned cropland

⁷ Blauhut et al., 2015, Towards pan-European drought risk maps: quantifying the link between drought indices and reported drought impacts, *Environ. Res. Lett.* 10 (2015) 014008

⁸ <https://gwis.jrc.ec.europa.eu/apps/country.profile/>

Windstorms

Windstorm risk is present throughout the European continent, which means that any real estate asset as well as various economic activities will carry a certain risk as physical assets may be damaged and economic activities may be (temporarily) interrupted in case of severe windstorms. However, the impact from the windstorm hazard is typically insured (especially in case of exposure collateralised with immovable property) and the risk from a credit risk perspective is consequently partially mitigated. Our assessment therefore reflects the residual risk of very extreme windstorm events where potential underinsurance may materialise. The Windstorm Information System (WISC) of the Copernicus Climate Portal⁹ allows us to identify those European regions with the greatest historical average annual windstorm damage. As only one thinly populated area in Belgium is in a top 5% impacted region, we conclude that from a credit/collateral perspective the windstorm hazard is not a material risk in the KBC Group home markets.

Landslides

Landslides typically occur on steep hilly terrain where a significant amount of rainwater has accumulated and may destroy infrastructure and/or (temporarily) prevent economic activities (e.g., growing crops). The European Soil Data Centre (ESDAC) provides a European spatial dataset¹⁰ which maps the landslide susceptibility levels on a scale of 1 (very low) to 5 (very high) and which is used to geographically identify the risk. The sensitivity to high landslide risk is limited across the KBC Group home countries (up to about 2% of the portfolio exposure in some countries).

Subsidence

Subsidence is the downward vertical movement of the Earth's surface, which can be caused by both natural processes and human activities. In particular groundwater-related subsidence has become a growing issue, especially in Belgium. The main risk is damage to real estate (and a corresponding loss in property value) and the assessment is hence confined to exposure collateralised by real estate.

The European Soil Data Centre (ESDAC) provides a European spatial dataset¹¹ which maps the natural susceptibility of agricultural soils to compaction if they were to be exposed to compaction, on a scale of 1 (low) to 4 (very high). The areas in the KBC Group home countries with the highest risk are located in Belgium and Hungary.

For Belgium, recent scientific research¹² provides insight into the subsidence actually observed and identifies the West of Belgium and the port of Antwerp as the areas with the highest risk. Other scientific research¹³ assesses the likelihood that subsidence will occur based on various conditions, such as the rate of decline of the groundwater table. Combining this information allows us to conclude that a limited fraction of residential and commercial properties have a very high risk of being damaged due to subsidence.

For Hungary, the identified area is thinly populated and the subsidence risk is considered to be limited.

⁹ <https://wisc.climate.copernicus.eu/wisc/>

¹⁰ <https://esdac.jrc.ec.europa.eu/content/european-landslide-susceptibility-map-elsus-v2>

¹¹ <https://esdac.jrc.ec.europa.eu/content/natural-susceptibility-soil-compaction-europe>

¹² https://orbi.uliege.be/bitstream/2268/263690/1/ShortPaper-IGARS2021_PYDeclercq.pdf

¹³ Li et al. 2021, *Land subsidence due to groundwater pumping: hazard probability assessment through the combination of Bayesian model and fuzzy set theory*, *Nat. Hazards Earth Syst. Sci.*, 21, 823–835

Erosion

Soil erosion by water is a significant threat with a negative impact on ecosystem services, crop production, drinking water and carbon stocks. The European Soil Data Centre (ESDAC) provides a European spatial dataset¹⁴ which maps Soil Loss by Water Erosion. The highest erosion risk in the KBC Group home countries is found in the steep mountainous areas of Slovakia, while the risk is negligible for the other countries. In terms of economic activities, the sector suffering the most severe impact is the agricultural sector.

¹⁴ <https://esdac.jrc.ec.europa.eu/content/soil-erosion-water-rusle2015>

Annex IV

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Glossary

3 LOD (Three Lines of Defence)

The 3 LOD model ensures the resilience of KBC's risk and control environment and safeguards the sustainability of our business model going forward. In this model, Business acts as the first line of defence, Risk as one of the second lines and Internal Audit as the third line. They all work together in order to prevent big impact losses for the KBC group.

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.

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.

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.

CAD ratio

Total eligible capital / Risk-weighted assets (the result must be at least 8% according to the Basel regulations).

CCF (Credit Conversion Factor)

The CCF converts an off-balance-sheet exposure to its on-balance credit exposure equivalent. Off-balance-sheet exposures have a probability of becoming a credit exposure and shifting onto the balance sheet, for example if a guarantee is called or an undrawn credit exposure is drawn. The CCF is an estimate of this probability.

The expected value of the credit exposure is obtained by multiplying the CCF by the value of the off-balance-sheet exposure.

CET1 ratio (common equity ratio)

A risk-weighted measure of the group's solvency based on common equity tier-1 capital (the ratios given here are based on the Danish compromise). Changes to the capital rules are gradually implemented to allow banks to build up the necessary capital buffers. A bank's capital position, taking account of the transition period, is referred to as the 'transitional view'. The capital position based on full application of all the rules – as would be the case after this transition period – is referred to as 'fully loaded'.

Cure rate

Rate of clients who default and revert subsequently to 'non-defaulted' status.

Default

A client/facility is considered to be in default if – and only if – one or more of the following conditions are fulfilled: the client/facility is 'unlikely to pay' and/or the client/facility is '>90 dpd default', and/or the client/facility is 'irrecoverable'.

KBC's definition of default builds on the definition set out in the Basel II Capital Requirements Regulation (CRR). Based on the EBA paper on Forbearance and Non-performing exposures, KBC's definition of default is also fully aligned with the EBA's definition of non-performing (PD 10-11-12), i.e. they should be regarded as synonymous. The same holds true for the definition of 'impaired financial instrument' according to International Financial Reporting Standards (IFRS).

Downturn LGD (Downturn Loss Given Default)

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 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.

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.

FV (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.

Forbearance measures

Forbearance measures consist of concessions (the loan's terms/conditions are renegotiated) towards a borrower facing, or about to face, financial difficulties. Forbearance measures can be taken only if the borrower and the bank both agree to them. Forbearance measures are applied at facility level.

Forborne loans

Forborne loans are exposures to debt contracts for which forbearance measures have been taken and for which the exit criteria are not fulfilled. The forbearance definitions apply to:

- all KBC group entities exposed to credit risk;
- all types of borrowers (individuals, SMEs, corporates, banks, authorities, etc.), including the natural and legal entities in the debtor's group that are included in the accounting scope of consolidation;
- the following types of loans/facilities: all debt instruments (loans and advances and debt securities) and off-balance-sheet exposures, apart from held-for-trading exposures. Off-balance-sheet exposures comprise the following revocable and irrevocable items: loan commitments given, financial guarantees given and other commitments given.

They do not apply to:

- full service car lease and derivatives exposure (i.e. non-money market professional transactions).

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.

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.

IBNR (Incurred but not Reported) impairments

IBNR impairments are impairment losses recognised on unimpaired loans and advances, as well as on unimpaired debt securities in a Loans & Receivables book, Available-for-Sale (AFS) book or Held-to-Maturity (HTM) book.

They are estimated on a portfolio basis using a model-based (statistical) method. Loans and advances, as well as debt securities in a Loans & Receivables book, Available-for-Sale (AFS) book or Held-to-Maturity (HTM) book, are grouped together based on a default expectation rating that takes several indicators of impairment into account. IBNR impairments are an estimate of the specific provisions to be booked for a credit event (also known as the 'impairment trigger') that has already occurred, but is still unknown, and will only emerge at a later date.

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.

Impairment on financial assets

A financial asset or a group of financial assets is impaired and impairment losses are incurred if, and only if, there is objective evidence of impairment as a result of one or more events that occurred after the initial recognition of the asset (a 'loss event') and that loss event (or events) has an impact on the estimated future cashflows of the financial asset or group of financial assets that can be reliably estimated. If any such evidence exists, the entity applies the appropriate impairment methodology to the financial asset concerned.

Losses expected as a result of future events, no matter how likely, are not recognised.

Impaired Loans Ratio

This portfolio risk ratio indicates the proportion of impaired loans in the loan portfolio. The numerator is the impaired part of the loan portfolio and the denominator of the loan portfolio. Both the numerator and denominator are measured by gross carrying amount, while the ratio is expressed as a percentage.

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 method also takes into account the internal estimates of Exposure At Default and Loss Given Default.

ISDA Master Agreements (International Swaps and Derivatives Association 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.

LCR (Liquidity Coverage Ratio)

Stock of high-quality liquid assets divided by total net cash outflows over the next 30 calendar days. A result of 100% (or more) indicates that a bank maintains 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 in the Commission Delegated Regulation (EU) 2015/61 of 10 October 2014. The LCR can also indicate whether a buffer or shortage exists by subtracting the total net cash outflows over the next 30 calendar days from the stock of high-quality liquid assets.

Leverage ratio

The leverage ratio is a new supplementary non-risk-based measure to contain the build-up of leverage (i.e. a backstop as regards the degree to which a bank can leverage its capital base). It is calculated as a percentage of tier-1 capital relative to the total on- and off -balance-sheet exposure (non-risk-weighted).

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.

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).

MtM (Mark-to-Market)

The act of assigning a market value to an asset.

MREL (Minimum Requirement for own funds and Eligible Liabilities)

Indicates the extent to which a bank has sufficient own funds and eligible liabilities available for bail-in. MREL and bail-in are based on the principle that shareholders and debt holders should bear losses first if a bank fails. The ratio is expressed as a percentage of Total Liabilities and Own Funds (TLOF).

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:

- prudential supervision of financial institutions from both the micro-prudential and macro-prudential angle, and the prompt detection of systemic risk;
- supervision of information, the functioning of the financial markets and respect for the appropriate code of conduct, together with consumer protection.

NPL exposure

For Non-Performing Loans (NPL) exposure, KBC uses the Impaired Loans Ratio (please refer to this definition).

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 divided by required stable funding, with available stable funding derived from the different parts of the liabilities side of the balance sheet (required funding = assets side). Regulatory defined weightings to describe stability are assigned to the different parts (both assets and liabilities). A ratio of 100% means that the funding situation is stable.

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.

Past due

A financial contract is past due when a counterparty fails to make payment when contractually due.

In factoring, a purchased receivable is past due when the debtor of the invoice fails to make payment on the due date of an undisputed invoice.

PD (Probability of Default)

The probability that an obligor will default within a one-year horizon.

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.

Risk appetite

Risk appetite, as defined by the Board of Directors, is the amount and type of risk that KBC is able and willing to accept in pursuit of its strategic objectives. While the ability to accept risk is limited by financial (e.g., available capital) and non-financial regulatory and legal constraints, the willingness to accept risk depends on the interests of various stakeholders (shareholders, creditors, employees, management, regulators, clients, etc.). Risk appetite aims to find the right balance of satisfaction for all stakeholders.

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) or TREA (Total Risk Exposure Amount)

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.

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.

SRB (Single Resolution Board)

The Single Resolution Board (SRB), which became operational on 1 January 2015 (fully responsible for resolution on 1 January 2016), is the resolution authority for significant banking groups and for any cross-border banking group established within participating member states. Resolution is the restructuring of a bank by a resolution authority through the use of resolution tools in order to safeguard public interests, including the continuity of the bank's critical functions and financial stability, at minimal costs to taxpayers.

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

$[\text{tier-1 capital}] / [\text{total weighted risks}]$. 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).

TLTRO (Targeted Longer-Term Refinancing Operation)

The targeted longer-term refinancing operations (TLTROs) are Eurosystem operations that provide financing to credit institutions for periods of up to four years. They offer long-term funding at attractive conditions to banks in order to further ease private sector credit conditions and stimulate bank lending to the real economy. The TLTROs are targeted operations, as the amount that banks can borrow is linked to their loans to non-financial corporations and households. Moreover, in TLTRO II the interest rate to be applied is linked to the participating banks' lending patterns.

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.

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.