EUROPEAN
PRIVATE BANKERS

PILLAR III DISCLOSURE
2012

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GLOSSARY

AFS: Available For Sale

ALCO: Asset-Liability Committee

ALM: Assets and Liabilities Management

BIL: *Banque Internationale à Luxembourg*

CIU: Collective Investment Undertaking

CORM: Central Operational Risk Management

CQS: Credit Quality Step

CRM: Credit Risk Mitigation

CSA: Credit Support Annex

CSSF: *Commission de Surveillance du Secteur Financier*

EBA: European Banking Authority

ECAI: External Credit Assessment Institution

ECap: Economic Capital Model

EXCO: the Executive Committee

FX: Foreign Exchange

GIS: Global Institutional Services

GMRA: Global Master Repurchase Agreement

GMSLA: Global Master Securities Lending Agreement

GTRM: Group Trading Risk Meeting

ICAAP: Internal Capital Adequacy Assessment Process

ISDA: International Swaps and Derivatives Association

LORM: Local Operational Risk Management

M-t-M: Mark-to-Market

OFRs: Own Funds Requirements

OTC: Over-the-Counter

STA: Standardised Approach

VaR: Value at Risk

NOTE TO THE READERS

KBL European Private Bankers S.A., hereafter referred to as the 'Bank', the 'Group' or 'KBL *epb*', is a banking group headquartered in Luxembourg which provides private banking services through its network of European private banks.

As a Luxembourg-based banking group, KBL *epb* is subject to the prudential supervision of the *Commission de Surveillance du Secteur Financier* (CSSF). This report meets the consolidated disclosure requirements enclosed in Part XIX of the CSSF circular 06/273, the so-called "Pillar III disclosure". This particular CSSF circular sets the requirements related to the own fund adequacy in the financial sector by transposing into Luxembourg law directives 2006/48/EC and 2006/49/EC of the European Parliament and of the Council derived from the recommendations of the Basel Committee (Basel II).

The quantitative tables in the following pages may sometimes show small differences due to the use of concealed decimals. These differences, however, do not in any way affect the true and fair view of this document. Similarly, the value zero '0.0' in the following tables indicates the presence of a number after the decimal, while ' - ' represents the value nil.

Through this report, references will be made to the annual consolidated accounts (English version) which are publicly available on the Bank's internet website at http://www.kbl.lu.

1 INTRODUCTION

The year 2012 saw the conclusion of the deal between Precision Capital SA and KBC Group NV (the former shareholder) for the purchase of a 99.9% interest in KBL *epb*. The new shareholder Precision Capital SA is a holding company based in Luxembourg, making KBL *epb* the head of a private banking group. It is thus the first year that the information of Part XIX of the CSSF circular 06/273 is disclosed at KBL *epb*'s level, explaining the absence of comparative year in the current report. Consequently, this risk report includes all the relevant information for the fiscal year 2012 only, regarding the activities of KBL *epb* within its prudential consolidation perimeter.

The aim of this Pillar III report is twofold. First, the report brings a precise idea of the way the risks faced by the Bank are processed through each of its entity. Second, the report draws a fair picture of the risks to which the Bank is exposed by providing various datasets related to those risks.

In order to achieve this twofold goal, the report is organised as follows:

- Section 2 presents the structure of the Bank and more precisely the entities constituting the Bank that are included or excluded from accounting and prudential scopes of consolidation;
- Section 3 describes the structure and the roles played by the departments involved in the risk management of the Bank at various levels of control;
- Section 4 summarises KBL *epb's* Basel II Pillar I prudential figures;
- Section 5 focuses on the governance and the data related to credit risk;
- Section 6 focuses on the governance and the data related to market risk;
- Section 7 focuses on the governance and the data related to operational risk;
- Section 8, 9 and 10 respectively focus on equity holdings, ALM risk and securitisation;
- finally, Section 11 presents the remuneration policy of the Bank.

2 STRUCTURE OF KBL *EPB*

Since July 2012, the opportunity has been given to KBL *epb* to be part of Precision Capital, a Luxembourg holding that represents the interests of Qatari investors. In the wake of the acquisition of KBL *epb,* Precision Capital also acquired a Luxembourg-based retail bank: *Banque Internationale à Luxembourg (*BIL*).* These transactions resulted in bringing KBL *epb* and BIL closer as sister companies encompassed in Precision Capital. Although the two banks might benefit from opportunistic cost synergies, they remain independent regarding their activities, decisions and risk exposures.

KBL *epb* provides private banking services to its customers throughout Europe thanks to a dense network of local private banking subsidiaries. The Bank's total portfolio is composed of equity participations in 17 entities.

List of Subsidiaries*

Denomination	Interest	Statutory Prudential Supervision	Prudential Scope of Consolidation	Description
Fully consolidated Subsidiaries				
Brown, Shipley & Co. Limited	*100%*	*Yes*	Yes	*Private banking, United-Kingdom*
Fidef Ingénierie Patrimoniale S.A.	*100%*	*No*	*Yes*	*Financial sector, Luxembourg*
Financière et Immobilière S.A.	*100%*	*No*	*Yes*	*Financial sector, Luxembourg*
KB Lux Immo S.A.	*100%*	*No*	*Yes*	*Real Estate, Luxembourg*
KBL Monaco Private Bankers	*100%*	*Yes*	*Yes*	*Private Banking, Monaco*
KBL Beteiligungs A.G.	*100%*	*Yes*	*Yes*	*Financial holding, Germany*
KBL Richelieu Banque Privée S.A.	*100%*	*Yes*	*Yes*	*Private banking, France*
KBL Informatique G.I.E.	*100%*	*No*	*Yes*	*Other (non financial), Luxembourg*
KBL (Switzerland) Ltd	*99.99%*	*Yes*	*Yes*	*Private banking, Switzerland*
Kredietrust Luxembourg S.A.	*100%*	*No*	*Yes*	*Financial services, Luxembourg*
Puilaetco Dewaay Private Bankers S.A.	*100%*	*Yes*	*Yes*	*Private banking, Belgium*
Theodoor Gilissen Bankiers N.V.	*100%*	*Yes*	*Yes*	*Private banking, the Netherlands*
Vitis Life S.A.	*100%*	*Yes*	*Yes*	*Life insurance, Luxembourg*
Equity Method Consolidation				
EFA Partners S.A.	*52.70%*	*No*	*Yes*	*Holding, Luxembourg*
European Fund Administration S.A.	*51.13%*	*No*	*Yes*	*Fund administration, Luxembourg*
Non-consolidated Subsidiaries (materiality threshold not reached)				
Forest Value Investment Management S.A.	*26.13%*	*No*	*Yes*	*SICAV-SIF, Luxembourg*
Horacio sàrl	*100%*	*No*	*Yes*	*Real estate, Luxembourg*

* More information on KBL *epb*'s subsidiaries can be found at page 83 of the annual report 2012.

The accounting scope of consolidation includes all entities at the exception of Forest Value Investment Management S.A., which is deducted from own funds, and Horacio sàrl. All these entities are also part of the prudential scope of consolidation, including as from 2012 the life insurance provider Vitis Life SA, whose assets are included in the prudential scope of consolidation as requested by the Bank and accepted by the CSSF.

3 RISK MANAGEMENT AT KBL *EPB*

At KBL *epb, r*isk management is seen as a transversal process which involves all the Bank's entities at different levels and is organised according to 5 levels of control (or 'lines of defence').

Five Lines of Defence

The three first levels of control correspond to the subset of internal controls.

The first level of risk management is directly carried out by the departments generating the risks: front office, back office or support. They are responsible for the management of these risks on a daily basis. They carry out the first level of control whose results are escalated to the management and to the departments responsible for the second level of control.

The second level of risk management comprises several departments that intervene in their specific areas of expertise. First, the Risk Control Function (described more precisely at page 7) operates in the management of financial risks - mainly credit risk, market/trading risk, Assets and Liabilities Management (ALM) risk and liquidity risk, either for own accounts or for clients accounts - and most of the non financial risks, of which operational risks, business risks and strategic risks. Then, the Compliance department is responsible for second-level management of compliance risks. Finally, other second-level control departments comprise Finance, Human Resources, Legal, Tax and Corporate Centre that are operating in their respective areas of specialisation.

The goals of the departments in charge of the 2nd level of controls are to:

- ensure an exhaustive coverage of the 1st level of control;
- ensure that they provide a comprehensive view of the underlying risks;
- verify the adequacy and efficiency of the corrective measures that would have been implemented.

In order to achieve these tasks, the 2nd level control entities:

- independently reprocess the controls performed at the 1st level and compare the results;
- daily perform the analysis of exception reports (outstanding vs. limit);
- challenge the justification provided by the risk owner;
- require additional information on any specific exception/warning;
- require corrective measures based on its findings and conclusions;
- escalate to management body any issue that could not be settled between the two first levels of control.

The Internal Audit is the third level of risk management that performs a regular and independent review of all entities and activities of the Group, the second level of control departments included.

External audit is the fourth level of risk management and the Regulatory Authorities the fifth and final level. They are part of the 'external controls'.

All the five lines of defence interact with each other as well as with the Board, the Audit Compliance and Risk committee, the sub-Risk Committees and the Executive Committee (EXCO).

The Risk Control Function

As part of the 2nd level of control, the mission of the Risk Control Function, according to the European Banking Authority (EBA), is to ensure that each key risk the Bank faces is identified and properly managed by the relevant departments and that a comprehensive view on all relevant risks is reported to the Bank's supervisory and management functions represented respectively by the Board of Directors and the EXCO. Therefore, the tasks of the Risk Control Function consists in identifying, measuring, monitoring, addressing and reporting the risks that fall within its scope of competence.

In addition, the Risk Control Function provides relevant independent information, analyses and provides expert judgement on risk exposures, and emits advices on proposals and risk decisions made by the management as regards to their compliance with the Group's risk appetite. The aim is to assist the management, the EXCO and the Board in order to take informed decision regarding their risks.

A key aspect of the Risk Control Function is to react quickly and efficiently in periods of crisis/stress. Any material risk development (such as a large operational incident, a major fraud, etc.) detected or reported is indeed immediately assessed and escalated to the EXCO. The local Risk Control Functions escalate in the same manner material risk developments to the Group Risk Control Function.

Two principles govern the mission of the Risk Control Function; these principles are the proportionality and the subsidiarity. The proportionality principle states that the depth of analysis and the frequency of reports are proportional to the risks at stake after all mitigating measures have been set up. The subsidiarity principle implies that control and advisory are performed at the level that ensures the best efficiency (at Group or local level for example).

In order to ensure its independence, the Risk Control Function is organisationally separate from the monitored and controlled activities and does not perform any task that fall under its own monitoring and control role.

KBL *epb*'s Risk Control Function is organised around five departments:

- The Integrated Risk department. This is the subsidiaries' single point of contact with the Group Risk Control, it is responsible for coordinating general risk issues within the Group and for overseeing specific local files. The department is in charge of preparing subsidiaries' Risk Committee meetings. Work relating to pillar II of Basle II (Internal Capital Adequacy Assessment Process – ICAAP – report for the Group) is also carried out within this department.

- The Operational Risk Control and Process Management department, which is responsible for overseeing operational risk issues and updating procedures. This department also manages the insurance programme for the Group. The Process management is intended to establish a consistent and exhaustive set of interdisciplinary procedures.

- The Market Risk Control department is tasked with the modeling of market risk as well as the control of more specific ALM and liquidity risks. Controls to identify potential risks in clients' portfolios are also developed in this entity. Finally, the - department takes responsibility for the regulatory watch over and the reporting related to the risks covered by the Risk Control Function.

- The Credit Risk Control department is in charge of credit risk control for KBL *epb* including borrower risk, issuer risk, counterparty risk, recovery risk, migration risk, country risk, credit risk concentration. This department also plays a role in drawing up and ensuring the respect of the criteria for accepting securities as collateral, as well as in monitoring credit risk for custodian banking activities.

- The Middle Office and Collateral Management department is responsible for regular level two controls of market operations (trading risk), and for the management of the Bank's collateral which is mainly related to repurchase agreements, securities lending and derivative transactions.

In order to perform its mission at the level of the Group, the Risk Control Function also relies on local Risk Functions. Although the latter hierarchically report to local management, there is a functional link between the local Risk Control departments and the Risk Control Function:

- recruitment and annual appraisal of the Head of local Risk Control departments is a joint decision by the Risk Control Function and the relevant local hierarchical reporting line;
- local Risk Control departments benefit from a full support from the Risk Control Function in terms of methodological help, alerts and guidance;
- as a single point of contact within each subsidiary/branch, the local Risk Control department reports immediately to the Risk Control Function any significant risk, exposure or issue.

Board Risk Committee

In all major entities of the Group, the Board, while keeping the entire responsibility for the set up and oversight of risk management, has delegated the follow-up and performance of the risk framework to sub-Committees, such as the Board Risk Committee at KBL *epb*'s level, which is dedicated to financial, operational, client and reputation risks.

This committee submits the level of risk appetite to be approved by the Board - expression of the amount and type of risk that the Bank is able and willing to accept in the pursuit of its business objectives - that applies to all entities of the Group. Then, this Committee delegates to the EXCO the responsibility of implementation of the

appropriate risk management framework to ensure that the risk profile of the Group remains within the defined risk appetite.

Finally, the Risk Control Function performs a reporting to the Board Risk Committee on a regular basis, by providing backward and forward looking empirical measures regarding all the key risks.

Sub Risk Committees

Sub Risk Committees have been created in order to handle specific types of risks.

The Asset-Liability Committee (ALCO) deals with financial risks such as credit risk, ALM risk, liquidity risk and trading risk, as well as with capital management and balance sheet management. The Chief Financial Officer, the Chief Risk Officer, the Head of Group ALM, the Head of market activities, the Chief Investment Officer ('CIO') and the remaining members of the EXCO are members of this Committee.

The Credit Approval Committee deals with new credit proposals (accompanied by a mandatory opinion from the Credit Risk Control). Should the case arise, this committee also deals with first discussion about credit risk issues, which are if necessary further escalated to the ALCO/EXCO.

The *Comité d'Autorisation et de Supervision des nouveaux produits* (CAS) ensures that our clients fully understand the mechanics of sophisticated products (e.g. structured products) and that, in each entity of the Group, these products are in line with customers' needs and risk profile. Permanent members of the CAS belong to Risk Control, Financial Markets, Compliance, Legal, KBL Private Banking/KTL Asset Management, and Marketing departments. The Committee is held every month and upon request.

4 CAPITAL ADEQUACY AND SOLVENCY

Own Funds Instruments

Ordinary shares – The share capital of KBL European Private Bankers SA consists of ordinary shares with a nominal par value of EUR 9.30 per share. All ordinary shares carry voting rights and each share represents one vote. No participation certificates or non voting rights shares have been issued.

Treasury Shares – At the end of 2012, KBL *epb* held 844 ordinary shares in portfolio. The voting-rights attached to these shares have been suspended.

Preference shares – These shares are included in the 'parent shareholder’s equity' section. These instruments meet the IAS 32 definition of equity instruments.

Non-voting core capital securities – In February 2001, KBL European Private Bankers issued a subordinated bond due on 23rd February 2016, listed on the Luxembourg Stock Exchange. These non-voting core-capital securities have an equal ranking (*pari passu*) with ordinary shares upon liquidation. The Bank used the proceeds of this issuance to support general corporate purposes. Furthermore, the Bank occasionally issues debt certificates.

Own Funds Figures

Eligible own funds (in EUR million)	31st December 2011	31st December 2012
Tier 1 capital	**676.7**	**527.1**
Capital, share premium, reserves and retained earnings	982.0	1,034.7
Minority interests	0.3	0.3
Year result (transferred to reserves following the General Meeting's approval of accounts)		-251.1
Treasury shares	-0.1	-0.1
Intangible assets & goodwill	-305.5	-231.4
Deferred tax assets		-25.2
Tier 2 capital	**267,1**	**254.4**
Upper T2: preference shares	30.0	30.0
Upper T2: positive AFS reserve	24.4	58.0
Lower T2: subordinated liabilities	212.7	166.4
Deduction	**-47.3**	**-1.0**
Participation in Forest Value Management Investment (participation in Vitis Life SA before 31st December 2012)	-47.3	-0.6
Securitised assets deducted from own funds	-	-0.4
Total eligible own funds	896.5	780.5

Internal Own Funds Adequacy Evaluation

In order to assess its internal capital adequacy, the Bank has adopted an internal Economic Capital model (i.e. ECap) encompassing the main risks to which the Group is (or might be) exposed: i.e. credit risk, ALM risk, operational risk, market risk and business risk. ECap is calibrated to reflect the worst unexpected loss in the fair value of the Group on a one-year time horizon within a confidence interval of 99.9%.

Capital Requirements

In parallel with the internal own funds adequacy, KBL *epb* shall comply with the supervisory capital requirements as set out under the CSSF circular 06/273, these requirements are related to Credit Risk, Market Risk and Operational Risk. Hereunder are presented the capital requirements related to each type of risk.

Own funds requirements at 8% of risk weighted assets (in EUR million)	31st December 2011	31st December 2012
Credit Risk	**241.5**	**258.8**
Central governments/central banks	1.6	2.8
Regional governments/local authorities	-	0.1
Public sector entities	0.0	0.0
International organisations (multilateral development Banks included)	0.0	0.6
Institutions	29.7	32.1
Corporate	103.7	128.6
Retail	19.9	18.7
Secured by mortgage (residential and commercial)	18.5	21.9
Covered bonds	-	0.5
Securitisation	22.8	3.9
Collective investment undertakings (CIU)	15.9	19.5
Others	27.1	28.2
Past due	2.2	1.9
Settlement Risk	**0.2**	**0.0**
Position Risk	**9.3**	**8.2**
Interest rate risk	8.9	7.9
Equity risk	0.5	0.3
Foreign exchange Risk	**1.4**	**0.8**
Operational Risk	**68.7**	**65.5**
Total own funds requirements	321.1	333.4
Total eligible own funds ratio	22.34%	18.73%

5 CREDIT RISK

Credit Risk Management

Proprietary credit risks within the Group mainly originate from:

- private banking activities in the form of Lombard and mortgage loans;
- uncommitted lines covering the trading activity and counterparty exposures with banks, e.g. foreign exchange transactions, money markets, swaps, reverse repurchase agreements, securities lending, derivatives;
- bond positions in ALM portfolios in the form of liquid floating/fixed rate notes and synthetic asset swaps;
- granting of uncommitted lines to clients of the 'Global Institutional Services' division or 'GIS' in Luxembourg (mainly Collective Investment Undertakings) to cover temporary overdrafts.

Credit risk also arises from other activities, such as the Institutional Management and Global Custody divisions. For more clarity, the following table maps the major types of credit risk by activities within KBL *epb*:

	Borrower risk	Issuer risk	Counterparty risk	Recovery risk	Migration risk	Country risk	Concentration rsik
Private Banking Loans	O			O	O	O	O
Market Prof. Activities			O	O	O	O	O
ALM Portfolios		O		O	O	O	O
GIS Clients	O			O			O
Global Custody			O		O	O	O

The objectives of the credit risk management process can be described as follows:

- identify credit risk in due time, enabling to act adequately upon risks;
- translate the KBL Group Risk Appetite Statements into a set of workable measures, ensuring that credit risk stays within the limits set;
- monitor the quality of the credit risk within the Group;
- deliver input for strategic decisions regarding credit risk through useful and timely information to senior management.

Governance of the credit risk management process

The first line of defence is composed by the business entities. Therefore, several entities play a role in the first line of defence in the Credit Risk Management framework, such as the Wealth Management ('commercial network'), the credit department, the ALM function, the Financial Markets department and the GIS- Network Management.

Each entity/business unit relies on specific procedures, processes and applications in order to assess the risks prior and after accepting individual credit risk exposures.

The second line of defence is composed by the Risk Control Function whose tasks include:

- the monitoring of credit risks from a portfolio level to the whole Group level;
- the development of credit risk measurements;
- the development of credit risk frameworks;
- credit risk issues advisory and reporting to EXCOs and relevant risk committees;
- business decision related to the credit risk.

Facts of 2012

As a consequence of the divestment of KBC Group from the capital of KBL *epb*, the Bank gained new responsibilities in terms of risk management and governance. As a consequence, new systems and policies have been developed through the year 2012. The first new risk system implemented aims at managing interbank limits. This new system centralised in Luxembourg and fully integrated in the Large Exposures regulation defines interbank limits proportionally to the Bank's capital and risk appetite.

Similarly to interbank limits, as from the exit of KBC Group, the Credit Risk Control department has developed a new framework defining and monitoring country limits. The methodology has also been adapted in such a way as to cover all types of country risks and particularly the contagion which has shown severe impacts in Europe since 2010.

At the beginning of 2012, the EXCO set out a new version of the guidelines related to the collateral accepted in secured professional transactions (reverse repurchase agreements and securities lending transactions). The new rules define operational limits for counterparty concentration, allowed financial collaterals and correlation limits between exposures and collaterals.

Additionally, the Bank developed a 'credit risk warning' system that detects significant variations in risk parameters (linked to counterparties, countries, etc.) at the level of both the Bank and clients' assets. The system is empowered by several sources of information which can be split in two categories:

- quantitative resources brought by ratings, stock prices, CDS or Asset swap prices, etc.;
- qualitative resources brought by the by press, internet and front business lines.

Additionally, this credit risk warning system has been furnished with a risk scale feature which measures and monitors precisely the risk incurred by the Group and its clients regarding the creditworthiness of counterparties.

Counterparty Credit Risk

The credit risk incurred in professional market activities is managed through the interbank limit system that aims at managing KBL epb*'s* main dealing room credit risk exposures.

The following exposures are part of this sub-section:

- treasury exposures (money market loans, commercial papers, certificates of deposit, treasury portfolios, interest rate swaps, floating rate notes, cross currency interest rate swap, repurchase agreements, securities lending transactions, etc.)
- foreign exchange (FX) exposures (spot transactions, outright, FX swaps, etc.)
- main exposures on structured products (equity swaps, OTC options, etc.)

Additionally, the interbank limit system covers long and medium term exposures on banking counterparties under the form of credit lines granted and securities (bonds and shares) held. The management of the credit risk related to banking counterparties is carried out on a consolidated basis, including all the Group's entities exposures and their related counterparties/groups of counterparties.

The interbank limit system defines ceilings which represent the maximum exposures the Bank deems acceptable to undertake upon banking counterparties and groups of banking counterparties given their size and credit quality. The system ensures compliance with the large exposures limit.

Schematically, the interbank limit system is as follows:

Actual Exposures < *Operational Lines* < *Theoretical Limits* < *Large Exposure Limit*

Large exposure limit: the largest theoretical limits have always to be lower than the Regulatory Large Exposure limit (25% of KBL *epb*'s own funds). The calculation of the Bank's own funds, for the purpose of the interbank limit system, incorporates a buffer of +/- 10%.

Theoretical limits are the maximum amount of risk KBL *epb* is willing to take on an institutional counterparty. Such limits are based on the size, the quality and the systemic importance of the counterparty as well as on the Bank's own funds.

Operational lines are determined after an in-depth analysis by the Group Credit Risk Control. Such lines have to be lower than the theoretical limits (besides exceptions validated by the EXCO).

Exposures have to be lower than operational lines. Exposures are charged against two distinct lines according to their maturity:

- the weighted outstanding exposure, which is the current exposure to every counterparty, weighted by type of product; representing either market or credit risk;
- the settlement exposure, corresponding to exposures to counterparties on the due date of the transaction (delivery/payment); representing pure credit risk.

In order to mitigate counterparty credit risk, the Bank enters into Credit Support Annex (CSA) contracts with several counterparties. In such a case, the risk exposure is derived

from the net amount of contracts alive with a counterparty taking margin calls into account.

Additionally to individual limits represented by operational lines that are defined at counterparties' level, the aggregated exposure amount of counterparties by incorporation country shall stay below predefined levels.

Finally, the management and supervision of collateral received for secured transactions, in addition to contract management, is handled by Collateral Management, which is part of the Risk Control Function. The respect of the eligibility of the collateral, as the concentration and correlation limits, is monitored on a daily basis by the Group Credit Risk Control department.

Counterparty Credit Risk arising from OTC derivative transactions
As required by the CSSF circular 06/273, the counterparty credit risk data related to Over-the-Counter (OTC) derivative transactions are presented hereunder.

31st December 2012 (In EUR Million)	Gross M-t-M Value	Netting	Netted M-t-M Value	Collateral	Net Exposure	Add-on	Net Exposure Value
Credit derivatives and OTC derivative transactions	245.5	179.5	66.0	-	66.0	182.4	248.3

The 1st column of data refers to the positive mark-to-market (M-t-M) value of OTC derivative contracts without taking account of netting agreements. In a second step, the netted global M-t-M exposure value is computed by including the netting effect of contracts carrying a negative M-t-M value for counterparties who have concluded a CSA netting agreement with KBL *epb.* The Bank reduced its gross exposure by almost EUR 179.5 million at the end of 2012 thanks to these netting agreements.

At last, the net exposure value that is taken into account for computing the regulatory risk weighted assets related to these OTC contracts is derived from the sum of the net exposure and the regulatory add-on. This add-on is itself derived from the multiplication of a coefficient that depends on each contract's characteristics (i.e. the underlying and the residual maturity) by the nominal value of the contract.

Credit Risk Exposures

This subsection presents the methodology and the data related to the Group's value of exposures arising from credit risk under the standardised approach for credit risk weighting.

Standardised Approach (STA)
KBL *epb* applies the Standardised Approach for weighting exposures to credit risk. This method uses a combination of exposure segregation by type of debtor/transaction (i.e.

exposure classes) and a differentiation by creditworthiness in order to weight the exposure value that is used to compute the required corresponding own funds.

As stated under the current regulation, the Group breaks down its credit risk banking book into fourteen exposure classes:

- central governments and central banks;
- local authorities and regional governments;
- public sector entities;
- multilateral development banks;
- institutions;
- corporates;
- retail clients;
- exposures secured by mortgage on immovable properties (residential or commercial);
- exposures in past due;
- covered bonds;
- securitisation;
- collective investment undertaking (CIU);
- other exposures.

The prudential risk weight that is assigned to each exposure in each class depends on the credit assessment, published by an External Credit Assessment Institution (ECAI), related to the issuer/issue KBL *epb* has an exposure to. The ECAI providing the credit assessments are the three market leaders: Moody's, Standard & Poor's and Fitch Ratings. These assessments are used following the principle of the 'worst of the two best', which corresponds to picking the higher risk weight from those induced by the two most favourable credit assessments available.

Following the circular 06/273 of the CSSF, this treatment is used for determining the risk weights applicable to exposures belonging to the following credit risk classes: central governments and central banks, local authorities and regional governments, public sector entities, international organisations and multilateral developments banks, corporates, covered bonds, and securitisations. When by nature or by the rules, no external credit assessment can be used for credit risk weighting, the regulatory rules determine the risk weight to apply, e.g. the risk weight of exposures to institutions is currently derived from the debtor's country of incorporation.

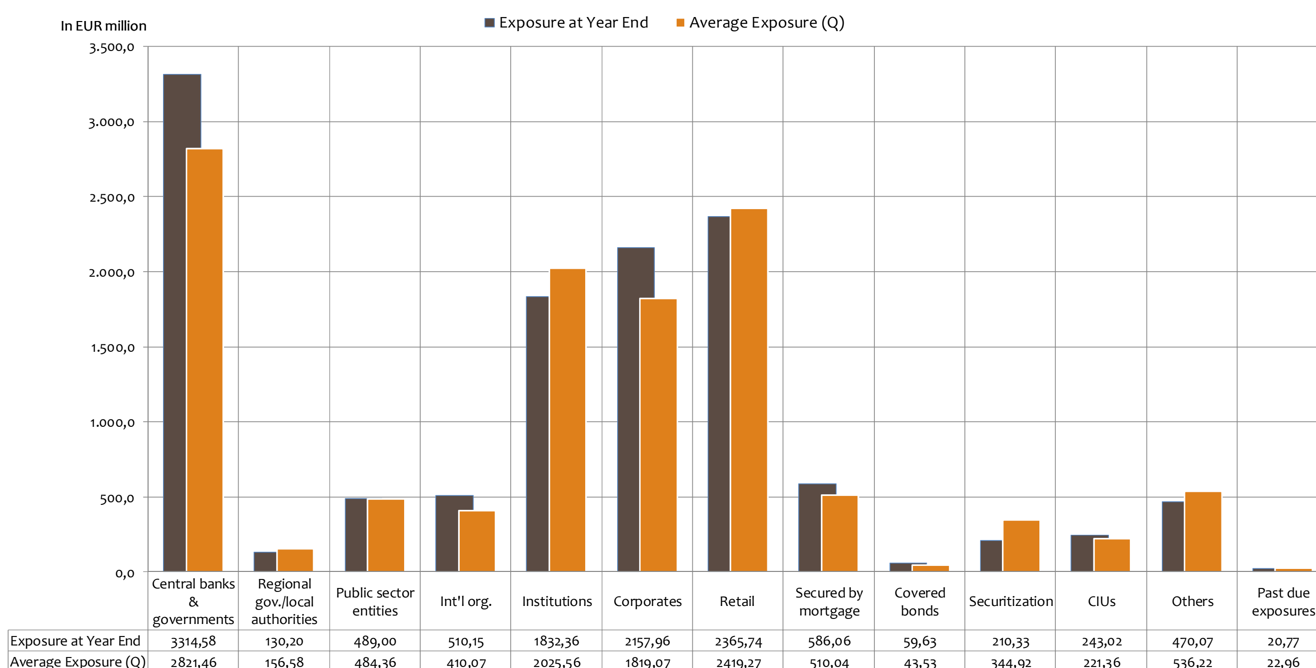
Credit Risk Exposures Data

Unless otherwise specified, the figures reported in the tables presented hereafter correspond to:

- the accounting value net of specific impairment for on-balance sheet items;
- the mark-to-market value for credit derivatives and OTC derivative contracts plus the add-on value;
- the pre-conversion-factor value of off-balance sheet items, corresponding to the full commitment the bank has agreed to undertake.

Quarterly Average and End-of-the-Year Exposure Values by STA Class – 2012

The most significant credit risk classes at 31st December 2012 were central governments and central banks (27%), retail clients (19%)*, corporates (17%), and institutions (15%), which accounted for nearly 80% of the bank's total exposure.



	Central banks & governments	Regional gov./local authorities	Public sector entities	Int'l org.	Institutions	Corporates	Retail	Secured by mortgage	Covered bonds	Securitization	CIUs	Others	Past due exposures
Exposure at Year End	3314,58	130,20	489,00	510,15	1832,36	2157,96	2365,74	586,06	59,63	210,33	243,02	470,07	20,77
Average Exposure (Q)	2821,46	156,58	484,36	410,07	2025,56	1819,07	2419,27	510,04	43,53	344,92	221,36	536,22	22,96

* It should be noted that the amount of exposure in the retail class of credit risk is inflated by EUR 1,930.17 million that corresponds to off-balance sheet revocable retail credit lines not giving rise to any capital requirement (conversion factor of 0% applied to low risk off-balance sheet items).

Geographical Breakdown of Credit Risk Exposures by STA Class – 2012

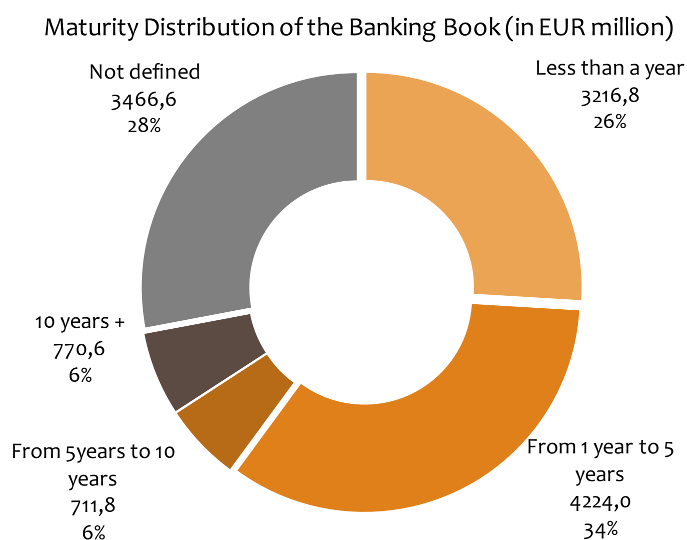
The business activities of KBL *epb* are concentrated in Europe, thereby, most of the Bank's counterparties are themselves established in Europe, and hence the credit risk exposures arising from KBL *epb*'s banking activities are naturally concentrated in Europe (more than 95% in terms of gross exposures).

Exposure class (STA) In EUR million	Western Europe	Central & Eastern Europe	North Amercia	Asia	Middle-East	Rest of the World	*Total*
Central governments/ central banks	3,190.1	90.3	-	-	21.3	13.0	*3,314.6*
Regional governments/ local authorities	122.3	-	7.9	-	-	-	*130.2*
Public sector entities	488.9	-	-	-	-	0.1	*489.0*
International organizations (incl. Multilateral development banks)	510.2	-	-	-	-	-	*510.2*
Institutions	1,718.1	8.7	44.3	22.0	15.7	23.5	*1,832.4*
Corporate	1,910.9	4.8	158.8	2.7	10.2	70.6	*2,158.0*
Retail	2,321.4	-	2.7	0.8	0.7	40.1	*2,365.7*
Secured by mortgage	582.6	-	-	0.2	-	3.2	*586.1*
Covered bonds	59.6	-	-	-	-	-	*59.6*
Securitisation	203.2	-	2.5	-	-	4.7	*210.3*
CIU	235.7	-	-	-	-	7.3	*243.0*
Others	470.0	-	0.1	-	-	0.0	*470.1*
Past due	20.8	-	-	-	-	-	*20.8*
Total	*11,833.7*	*103.7*	*216.2*	*25.8*	*47.8*	*162.5*	***12,389.9***

Residual Maturity Distribution of Credit Risk Exposures by STA Class – 2012

At the end of 2012, the maturity profile of KBL *epb*'s banking book was in majority (60%) composed of items maturing prior to the next 5 years, of which 43% with a residual maturity shorter than a year:

Exposure class (STA) In EUR million	Residual Maturity					Total
	Less than a year	From 1 year to 5 years	From 5years to 10 years	10 years +	Not defined	
Central governments/ central banks	459.8	1,678.4	355.6	190.7	630.2	*3,314.6*
Regional governments/ local authorities	13.5	72.4	33.9	10.5	-	*130.2*
Public sector entities	450.1	26.1	4.6	-	8.3	*489.0*
International organizations (incl. Multilateral development banks)	90.3	249.0	167.6	3.2	-	*510.2*
Institutions	1,004.6	661.1	13.9	0.0	152.8	*1,832.4*
Corporate	76.0	1,014.7	69.9	42.5	270.8	*2,158.0*
Retail	258.9	89.8	34.7	17.3	1,965.0	*2,365.7*
Secured by mortgage	85.7	167.0	29.2	298.1	6.1	*586.1*
Covered bonds	4.5	55.1	-	-	-	*59.6*
Securitisation	-	8.8	2.5	199.0	-	*210.3*
CIU	0.1	-	-	-	243.0	*243.0*
Others	88.8	200.1	-	-	181.1	*470.1*
Past due	0.6	1.5	-	9.4	9.3	*20.8*
Total	*3,216.8*	*4,224.0*	*711.8*	*770.6*	*3,466.6*	***12,389.9***



Sector Distribution of Credit Risk Exposures by STA Class – 2012

In 2012, exposures were mainly concentrated in three sectors, authorities, the financial sector and private persons (85% of the total exposure).

Economic Sector **In EUR million**	*Central gov. & central banks*	*Regional gov. & local authorities*	*Public sector entities*	*Int'l org,(incl. Mult.dev. Banks)*	*Institutions*	*Corporate*	*Retail*	*Secured by mortgage*	*Covered bonds*	*Securit-isation*	*CIU*	*Others*	*Past Due*	*Total*
Agriculture, farming & fishing	-	-	-	-	-	35.2	-	-	-	-	-	-	-	35.2
Authorities	3,314.6	130.2	460.6	501.5	-	1.8	-	-	-	-	-	-	-	4,408.6
Automotive	-	-	-	-	-	11.1	-	-	-	-	-	-	-	11.1
Beverages	-	-	-	-	-	2.7	-	3.4	-	-	-	1.0	-	7.0
Building & construction	-	-	-	-	-	2.0	-	-	-	-	-	29.9	-	32.0
Chemicals	-	-	-	-	-	16.1	-	-	-	-	-	1.8	-	17.9
Commercial real estate	-	-	-	-	-	28.1	0.0	17.0	-	-	-	-	2.7	47.8
Consumer products	-	-	-	-	-	166.2	-	-	-	-	-	1.0	9.3	176.5
Distribution	-	-	-	-	-	147.9	-	-	-	-	-	-	2.6	150.5
Electricity	-	-	0.1	-	-	275.6	-	-	-	-	-	-	-	275.7
Finance & insurance	-	-	25.4	8.7	1,780.2	545.3	3.4	98.1	59.6	210.3	243.0	88.8	0.6	3,063.6
Food producers	-	-	-	-	-	6.6	-	-	-	-	-	-	-	6.6
Horeca	-	-	-	-	-	1.6	-	-	-	-	-	-	-	1.6
IT	-	-	-	-	-	23.0	-	-	-	-	-	-	-	23.0
Machinery & heavy equipment	-	-	-	-	-	1.0	-	-	-	-	-	2.4	0.7	4.0
Media	-	-	-	-	-	6.0	-	-	-	-	-	0.0	-	6.1
Metals	-	-	-	-	-	9.6	-	-	-	-	-	0.2	-	9.8
Oil, gas & other fuels	-	-	-	-	-	20.3	-	-	-	-	-	0.9	-	21.2
Paper & pulp	-	-	-	-	-	-	0.9	-	-	-	-	0.1	-	1.0
Private persons	-	-	-	-	-	201.0	2,358.5	463.8	-	-	-	11.5	2.0	3,036.7
Services	-	-	2.9	-	-	127.1	0.0	2.8	-	-	-	0.3	2.9	136.1
Shipping	-	-	-	-	-	12.0	-	-	-	-	-	2.3	-	14.3
Telecom	-	-	-	-	-	108.4	-	-	-	-	-	1.3	-	109.7
Textile & apparel	-	-	-	-	-	3.8	-	-	-	-	-	-	-	3.8
Tobacco	-	-	-	-	-	2.3	-	-	-	-	-	-	-	2.3
Traders	-	-	-	-	-	1.6	-	-	-	-	-	-	-	1.6
Other	-	-	-	-	52.1	327.4	2.9	1.0	-	-	-	328.5	-	711.9
Water	-	-	-	-	-	74.2	-	-	-	-	-	-	-	74.2
Total	3,314.6	130.2	489.0	510.2	1,832.4	2,158.0	2,365.7	586.1	59.6	210.3	243.0	470.1	20.8	**12,389.9**

Past Due Exposures

Within the Group, past due exposures are split in two categories:

- non-performing loans or past due which are files with delinquencies over 90 days;
- other exposures for which a loss is considered as likely and for which an impairment is booked.

In all entities of KBL Group, the need for impairment is justified on a case by case analysis, ratified in management discussion (local Credit Committees) and through the consolidation process.

Impairment levels always take into account the expected recovery amount, including collateral (reference to market valuation, discounted cash flow approach or percentage of residual exposure). The Credit Risk Control department proposes impairment adjustments to the Credit Committee after discussion with the Accounting Department. At the end of the first three quarters, the Credit Committee decides the adjustments to perform. In the last quarter impairments and provisions are decided by the Executive Committee relying on the opinion of the Credit Committee.

Various elements can justify the classification under the past due category and the booking of specific impairments. Most of the hints leading to recognition of impairments are derived from the permanent monitoring of the portfolio at the two first levels of risk management defence. Potential triggers for classification under the "problem loans" category may also arise from formal reviews of credit files, request for waiver or modifications of covenants, renegotiation of terms and conditions, late payments of interest and/or principal (delinquencies), decrease of the value of the pledged portfolio (for Lombard loans), 'downgrades' or 'credit watches' of external credit ratings, the price evolution of quoted assets, external information (press articles, published financial results), etc.

Geographic Distribution of Past Due Exposures – 2012

Similarly to the distribution of exposures, past due exposures are mainly concentrated in Western Europe. Other past due exposures located in Oceania and Latin America are fully impaired leading to a null exposure value.

Geographical area In EUR thousand	**Exposure amount net of impairment**	**Impairment amount**
Western Europe	20,766.7	31,461.1
Rest of Europe	-	-
North Amercia	-	-
Asia	-	-
Middle-East	-	-
Rest of the World	-	7,584.0
Total	***20,766.7***	***39,045.1***

Sector Distribution of Past Due Exposures – 2012

In 2012, despite the high sector concentration of credit risk exposures, impairments were recognised across various sectors.

Economic Sector In EUR thousand	*Past due exposures (net of impairment)*	*Impairment amount*	*Yearly P&L impairment addition*	*Yearly P&L impairment reversal*
Commercial real estate	*2,698.6*	*4,908.8*	*-*	*-*
Consumer products	*9,347.6*	*8,506.9*	*8,506.9*	*-*
Distribution	*1,751.7*	*5,481.7*	*2,106.1*	*-*
Electricity	*-*	*22.2*	*22.2*	*-*
Finance & insurance	*556.8*	*8,352.5*	*8,352.5*	*-*
Machinery & heavy equipment	*613.6*	*39.0*	*-*	*-*
Private persons	*3,084.4*	*3,183.2*	*2,392.1*	*7.4*
Services	*2,714.1*	*7,582.8*	*515.0*	*20.9*
Shipping	*-*	*307.2*	*307.2*	*-*
Telecom	*-*	*9.3*	*9.3*	*-*
Other	*-*	*651.4*	*651.4*	*-*
Total	**20,766.7**	**39,045.1**	**22,862.8**	**28.4**

Additionally, in 2012, the impairment amount unrelated to the credit risk class of past due exposures amounted to EUR 35.77 million (average impairment rate of 84%) , 67% of which was related to equity and collective investment undertaking positions.

Credit Risk Mitigation Techniques

The Collateral Management aims to mitigate the default risk which entails the following risk:

- Counterparty risk (pre-settlement / settlement risk)
- Debtor risk (borrower / issuer)
- Guarantor risk

Netting agreements

All OTC transactions with market counterparties must be covered by an appropriate Master Agreement:

- securities lending operations by a Global Master Securities Lending (GMSLA) Agreement (or equivalent);
- (Reverse)Repurchase operations by a Global Master Repurchase Agreement (GMRA);
- other OTC Derivatives by an ISDA Master Agreement (ISDA), completed with a Credit Support Annex (CSA) which enables the exchange of collateral.

Legally, these framework agreements allow, in case of default of the counterparty involved in the agreement (or 'event of default' or 'termination event' depending on the agreement's terminology), to consider all the operations with the counterparty, to close

them all and to apply one netted "close-out" amount due to the Bank by the counterparty or due by the Bank to the counterparty. Hence, in assessing the credit risk, they allow the calculation of an aggregated exposure amount (sum of exposures on each operation) per counterparty (group of counterparties).

Those operations are in general subject to daily exposure calculations (aggregated exposure amount per counterparty involved in an agreement) followed by potential margin-calls and exchange of collateral mitigating the credit risk.

Collateral with Private Customers (Lombard loans)

The type of securities accepted as collateral and a grid of pledge value rates, by type of securities (cash, bonds, shares, funds, structured products, etc.), are computed by the Risk Control Function and validated by the EXCO: the 'General Loan Policy to Customers'.

The aim of this grid is to rely on predefined pledge value rates for the largest part of the securities proposed by customers as collateral (most liquid and less volatile securities). Securities not specifically addressed by the grid may also be accepted and valued as collateral. In these cases, the Credit Committee, when analysing the credit request, and after proposal from the credits department and the opinion of the Risk Control, will determine the applicable level of pledge value.

A pledge value is associated to each security in the portfolio accepted as collateral in Lombard loans, representing a percentage of the market value of this security. As a matter of principle, the pledge value of the portfolio (sum of all securities' pledge values) has to cover the amount of the loan (unsecured part to limit as far as possible). In other words, the Loan-to-Value ratio (based on the pledge value) has always to remain below 100%, meaning a Loan to Market Value largely lower.

This method ensures that the Bank's exposures are secured in the event of adverse market movements. In such a case, it also gives the opportunity to emit margin calls without loosing the advantage of the credit protection.

The Standard Pledge value of the collateral portfolio is calculated by using the applicable pledge value rates, security by security. Additional haircuts may then be applied to the Standard Pledge Value, in order to reach the Adjusted Pledge Value.
The additional haircuts may be justified by:

- concentration (too important weight of a specific type of asset in the portfolio);
- illiquidity (unreasonable time frame to liquidate the position in the market);
- currency mismatch (between the currency of the loan and the currency of the pledged securities).

Collateral with Professional Counterparties

Criteria for securities used as collateral in securities lending and (reverse) repurchase transactions are validated by the EXCO upon request from the Financial Markets department and opinion from the Risk Control Function.

The criteria used refer to the type of securities/issuers (e.g. sovereign, bank & corporate bonds; commercial papers and certificates of deposit, asset backed securities, etc.), eligible countries, currencies and maximum residual maturities. Specific rules also apply to the concentration risk by counterparty and by security accepted as collateral, as well as correlation risk limits between debtors and the financial collaterals given as protection.

The respect of these rules is monitored on a daily basis by the Credit Risk Control department. It is the responsibility of the Risk Control Function to update the list of eligible collaterals based on risk evolution and market practices.

Throughout the Group, the collateral management is performed by the Collateral Management Department which is part of the Risk Control Function (or through third collateral management services: Clearstream).

The Collateral management department consists of several sections, of which the most important are:

> **Margin call**: staff members are responsible for the daily monitoring of the margins (the amount of additional collateral that should be posted or received) and for contacting external counterparties from which collateral should be received. This entity is responsible for correct and complete upload of outstanding exposure to the collateral management application.
>
> **Collateral Quality Control**: staff members constitute the first line of defence regarding collateral adequacy in ISDA-CSA, GMSLA and GMRA margin call process. On a day-to-day basis, the Collateral Management department monitors ex ante the quality of the collateral to be received, referring to the criteria agreed in the executed agreements and to the criteria approved by the EXCO.

The Dealing Room, in particular the 'Repo' Entity, is the first line of defence regarding the quality of the securities bought and sold back in a reverse repurchase transaction (GMRA contract).

Credit Risk Mitigation Data
Hereunder are presented the figures related to the credit risk mitigation at KBL *epb*. These figures correspond to two different regulatory approaches of credit risk mitigation, the substitution method and the financial comprehensive method.

The first technique applied at KBL *epb* is the substitution method for guaranteed exposures, which occurs when exposures towards counterparties receive the guarantee from a third party. Under this technique, the risk weight actually applied to the exposure is the one assigned to the guarantor as if it was the original bearer of the debt.

The second technique used at KBL *epb* to mitigate credit risk is the financial collateral comprehensive method. Under this method, the exposure value towards counterparties is diminished by the prudentially corrected amount of the financial collateral (e.g. securities) given under each transaction. In order to compute the resulting value of exposure under each transaction, the value of both the exposure and the collateral are assigned a prudential haircut which raises the exposure value and diminishes the collateral one depending on the nature of the transaction and the securities involved.

Exposures Covered by Guarantees and Financial Collaterals by STA class – 2012

The total amount of guaranteed and collateralised exposures respectively accounted for EUR 39.1 million and EUR 683.2 million in 2012. It is however important to note that the figures presented in the two following tables do not include the effect of financial collaterals considered under netting agreements (e.g. in the case of reverse repurchase agreements).

Exposure class (STA) In EUR thousand	Exposures covered by guarantees	Exposures covered by collateral
Central governments/Central banks	-	-
Regional governments/local authorities	-	-
Public sector entities	-	438,407.3
International organizations *(incl. Multilateral development banks)*	-	-
Institutions	2,944.0	4.2
Corporate	35,942.9	47,972.7
Retail	184.2	172,795.2
Secured by mortgage	-	20,461.6
Covered bonds	-	-
Securitisation	-	-
CIU	-	-
Others	-	3,525.8
Past due	-	-
Total	**39,071.1**	**683,166.8**

Exposure Amounts and Financial Collateral Impact by STA Class and Credit Rating – 2012

At the end of 2012, the first two Credit Quality Steps (rating ranging from AAA to A-) represented more than 49% of all exposures. Simultaneously, more than 99% of the use of financial collaterals (unrelated to netting agreements) was linked to exposures to non rated counterparties.

Exposure class (STA) In EUR million	Rating (Standard & Poor's classification)	AAA to AA-	A+ to A-	BBB+ to BBB-	BB+ to BB-	B+ to B-	Lower than B-	Non Rated	Total
	CQS	1	2	3	4	5	6		
Central governments & central banks	Before CRM	2,977.4	128.3	141.1	58.0	0.7	-	9.2	3,314.6
	After CRM	2,977.4	128.3	141.1	58.0	0.7	-	9.2	3,314.6
Regional governments & local authorities	Before CRM	126.4	3.8	-	-	-	-	-	130.2
	After CRM	126.4	3.8	-	-	-	-	-	130.2
Public sector entities	Before CRM	30.5	-	-	-	-	-	458.5	489.0
	After CRM	30.5	-	-	-	-	-	20.0	50.6
International organizations	Before CRM	502.1	2.1	6.0	-	-	-	-	510.2
	After CRM	502.1	2.1	6.0	-	-	-	-	510.2
Institutions	Before CRM	452.6	1,075.0	143.8	15.9	1.0	3.0	141.0	1,832.4
	After CRM	452.6	1,075.0	143.8	15.9	1.0	3.0	141.0	1,832.4
Corporate	Before CRM	54.7	524.8	486.7	31.8	8.1	-	1,051.9	2,158.0
	After CRM	54.7	524.8	483.2	31.8	8.1	-	1,007.4	2,110.0
Retail	Before CRM	-	-	-	-	-	-	2,365.7	2,365.7
	After CRM	-	-	-	-	-	-	2,192.9	2,192.9
Secured by mortgage	Before CRM	-	-	-	-	-	-	586.1	586.1
	After CRM	-	-	-	-	-	-	565.6	565.6
Covered bonds	Before CRM	7.7	3.0	-	-	-	-	48.9	59.6
	After CRM	7.7	3.0	-	-	-	-	48.9	59.6
Securitisation	Before CRM	199.0	9.2	1.4	0.4	0.4	-	-	210.3
	After CRM	199.0	9.2	1.4	0.4	0.4	-	-	210.3
CIU	Before CRM	-	-	-	-	-	-	243.0	243.0
	After CRM	-	-	-	-	-	-	243.0	243.0
Others	Before CRM	0.0	6.6	4.9	0.3	0.0	-	458.2	470.1
	After CRM	0.0	6.6	4.9	0.3	0.0	-	454.7	466.5
Past due	Before CRM	-	-	-	9.3	-	-	11.4	20.8
	After CRM	-	-	-	9.3	-	-	11.4	20.8
Total	Before CRM	4,350.5	1,752.8	783.8	115.7	10.2	3.0	5,373.8	**12,389.9**
	After CRM	4,350.5	1,752.8	780.3	115.7	10.2	3.0	4,694.2	**11,706.7**

6 MARKET RISK

First Line of Defence: the Dealing Room

The Dealing Room is the first line of control related to trading activities of the Group and is devoted to a permanent monitoring of trading positions, to proposals of strategies, etc., with the aim of optimizing the risk/return ratio of the Bank.

Trading limits are prudently monitored. Each limit breach leads to an investigation carried out by the related risk owner in order to determine the precise circumstances of the limit breach and the necessary corresponding prevention measures.

Limit breaches, as well as 'Early Warnings', are also reported immediately to the Risk Control Function and to the relevant corporate governance committee members (Board of Directors, Board Risk Committee, EXCO or CAS) depending on their severity.

Second Line of Defence: the Risk Control/Middle Office

This second level control is performed by the Risk Controllers (Middle Office as part of the the Risk Control Function).

Among other tasks dedicated to the second level of control, the Middle Office executes independent critical financial controls on Front Office (FO) activities as set down by policy-setting entities such as Risk Control entities, Accounting, Regulator, Internal and External Auditors as well as those imposed by relevant corporate governance committees (Board of Directors, Board Risk Committee, EXCO, CAS).

Middle Office is independent of business and support units they monitor and control. Middle Office reports on a regular basis the Group's outstanding positions to the Dealing Room (daily), to the EXCO (weekly), to the ALCO (monthly) and to the Board Risk Committee (quarterly).

Group Trading Meeting

The Group Trading Risk Meeting (GTRM) ensures a close monitoring of all trading activities within authorised limits. This meeting is held on a weekly basis and includes the following participants:

- The General Manager of Global Financial Markets;
- The General Manager of Group Risk Control;
- The Head of Money Market desk;
- The Head of Bond desk;
- The Head of Equity & Structured Products desk;
- The Head of Third Party Funds desk;
- The Head of Credit Risk Control;
- The Head of Middle Office & Collateral Management (acting as secretary).

During the meeting, the evolution of the various outstanding amounts compared to their respective limits, the results and the highlights of each activity are analysed by the GTRM members. Although members attending the meeting do not constitute a decision authority, their advices are important in the EXCO decision process.

The Control of Hedges and Other Risk Mitigation Techniques

The main mission of the Dealing Room is to support the development of both Wealth management and the Global Investors Services (GIS).

Besides, positions taken for trading purposes rely on a conservative philosophy and are carried out on an accessory basis. They are subject to strict rules in terms of limits and of previously approved products.

The EXCO has approved a set of primary limits in terms of nominal amount and basis point value (BPV) as well as a set of secondary limits expressed in terms of concentration limits, credit risk limits, stop losses which refine and complement the primary limits. A set of delegation authorities has also been approved in terms of percentage of the limit.

Dealing Room activities are concentrated in Luxembourg, no trading activities are allowed in the subsidiaries.

The ownership of the definitions and methodologies used for the group wide measurement of trading market risk lies with the Group Risk Function. New methodologies or changes in existing methodologies and/or amount are decided at the level of the Group EXCO.

The Middle Office identifies limit breaches, computes and reports the Profit & Loss, informs the top management and ensures that all products are correctly reflected in the Front Office and in the accounting of the Bank.

Risk Weighted Assets and Own Funds Requirements for Market Risk – 2012

Market Risk (in EUR million)	Risk Weighted Assets	Own funds requirements (8%)
Settlement Risk	-	-
Position Risk	**102.5**	**8.2**
Interest rate risk	98.8	7.9
Equity risk	3.7	0.3
Foreign exchange Risk	**10.0**	**0.8**
Total own funds requirements for market risk	112.5	9.0

7 OPERATIONAL RISK

Capital Requirement for Operational Risk

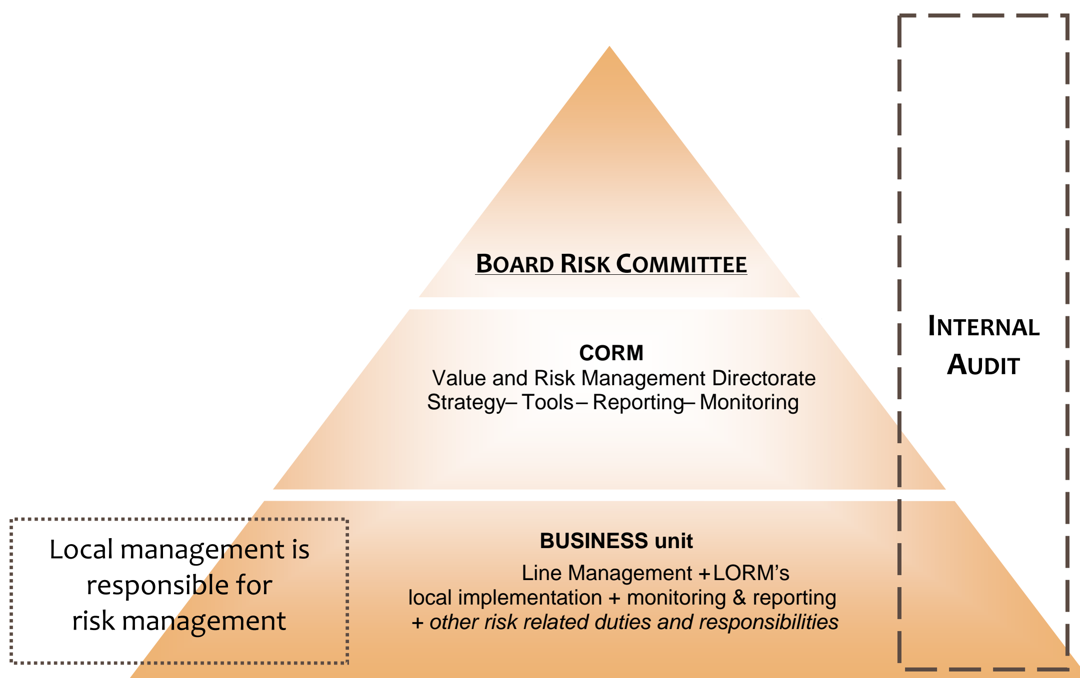
The capital requirement for operational risk is calculated under the regulatory standardised approach as the 3 year average of a percentage of the gross income that depends on the bussiness lines that have generated this gross income.

Governance of Operational Risk Management

The line management of each of the Group's entity is expected to observe and implement the operational risk management framework and all decisions related thereto to the extent that such decisions are consistent with their own local obligations. Key principles have been defined and are applicable within the Group.

The key principle is that Operational Risk Management remains the responsibility of the business unit, even in the absence of an approved group-wide methodology or other instructions. Line management is supported in its task to manage operational risk by Local Operational Risk Managers (LORMs) and Central Operational Risk Management (CORM).

The structure can be summarized as follows:



Central Operational Risk Management (CORM)

In each of the Group's entity, a CORM is appointed to undertake the implementation of the operational risk methodology subject to the approval of the local Risk Committee. The CORM has to enhance line management awareness about operational risks, to rapidly achieve appropriate risk response for key risks and meet the Basel II requirements.

At the level of Luxembourg, the CORM activity is performed by the Group Operational Risk Control with regards to:

- implementing the decisions of the Board Risk Committee in Luxembourg and roll out these decisions in the whole Group;
- providing training and coaching to the Local Operational Risk Managers;
- monitoring progress of implementation and the proper functioning of the operational risk framework;
- monitoring the quality control.

Local Operational Risk Management (LORM)

Local Operational Risk Managers (LORMs) are appointed in the various entities of the Group (Head Office, subsidiaries and branches). They are responsible, either full-time or along with other duties, for co-ordinating all efforts in the field of operational risk management within their entity and report to the Central Operational Risk Management.

Entities in Charge of Operational Risk

First Level Controls

Business managers are the 'risk owners' in charge/accountable for the operational risk management of their own activities. This involves the day-to-day risk management at the operational level, in accordance with the operational risk framework of the Bank and its risk appetite.

Second Level Controls

This second level of control is generally performed by the Risk Controller, but it could also be performed by another independent unit of the first line management such as Compliance, ITS Governance, Risk and Security, Legal, etc.

Operational risk mitigation techniques

At KBL *epb, o*perational risk mitigation techniques consist in:

- Internal loss events database

  Any loss event discovered or identified (with actual or potential profit and loss impact) is declared and registered in a database “Loss Event Reporter” (LER). It is then analysed in order to challenge the first line management on the actual reasons of the loss event occurrence and the adequate response to implement in order to mitigate this kind of risk.

- Risk Self Assessments (RSA)

The purpose of the RSA is to detect the major plausible operational risks that could threaten the achievement of an entity's objectives, and the activities and processes affected by the different risks identified. First line management and Local Operational Risks Managers are in charge of creating and maintaining their own risk self assessment matrix. This process aims at reducing the operational losses and at raising the awareness of line management about operational risks.

- Case studies
  In order to test the resilience/vulnerability of the bank's entities, the Group Operational Risk Control regularly proposes to simulate some major operational events, derived from the real life (experiment within other financial institutions or some group entities), and analyse the expected reaction of the Bank.

- Common Operational Risk Rules System
  The Common Operational Risk Rules System (CORRS) consists in gathering all relevant operational risk principles/rules and centralizing them in a common repository. The CORRS is clearly the corner stone of the operational risk management within the Group and focuses on its core business.

- Business process analysis
  A systematic analysis of the work process in its entirety, by identifying weaknesses and risk factors, aims at eliminating the major causes of operational risk events.

Risk Weighted Assets and Own Funds Requirements for Operational Risk – 2012

Operational Risk (in EUR million)	Risk Weighted Assets	Own funds requirements (8%)
Operational Risk	**818.8**	**65.5**
Total own funds requirements for operational risk	818.8	65.5

8 EQUITY HOLDINGS

In order to diversify its global risk position, the portfolio of KBL *epb* includes various direct equity positions. As at 31st December 2012, the total fair value of equity holdings amounted to EUR 68.8 million distributed across several sectors (see chart below), almost all holdings are quoted on public exchanges (more than 99%). The realized and unrealized profits attributable to equity positions are respectively kEUR 512.0 and kEUR -630.0 for the year 2012.

As at 31st December 2012 (in EUR thousand)	Book value (fair value)
Basic Materials	5,701.4
Communications	3,541.4
Consumer (cyclical)	9,785.1
Consumer (non-cyclical)	13,341.4
Diversified	1,205.4
Energy	3,701.2
Financial	9,483.7
Industrial	15,659.1
Technology	3,338.5
Utilities	3,047.9
Total	***68,805.1***

9 ALM RISK AT KBL *EPB*

At KBL epb, ALM risks are defined as the market risks that are induced by all the non-trading activities, either on or off balance sheet**.**

Those market risks are segregated according to the following internal conventions:

- **Interest rate risk** is the risk of unfavourable changes in the level or volatility of interest rates resulting in a negative impact on the economic value or P&L of the Bank. At KBL *epb*, the interest rate risk only relates to the risk-free rates, credit spread risk being assessed separately.
- **Currency price risk (or Foreign Exchange Risk – FX Risk)** is the risk of unfavourable change in the level of volatility of the currency exchange rates compared to the reference currency, resulting in a negative impact on the economic value or profit of the Bank. At KBL *epb*, this includes commodity prices (precious metal).
- **Equity price risk** is the risk of unfavourable changes in the level or volatility of the equity market prices resulting in a negative impact on the economic value or profit of the Bank, directly through impairments or AFS reserve, indirectly through the impact on the (Private Banking) business of the Bank. At KBL *epb*, this includes funds prices as well.
- **Real estate risk** is the risk of unfavourable movement of the value of the Bank's own real estate property resulting in a negative impact on the economic value or profit of the Bank.
- **Credit spread risk** is the risk of unfavourable changes in the level or volatility of the interest rates, compared to the related risk-free rates, resulting in a negative impact on the economic value or profit of the Bank. This risk represents the impact of changes in debt quality of bank's debtors on the related interest rates exposures.

ALM Governance

Based on the Global Risk Appetite Statement issued by the Board, the Group ALCO monitors and decides the ALM strategy of the group in terms of risk, balance sheet gap, solvency and liquidity upon recommendation from the ALM department.

The Group ALM is in charge of

- presenting/recommending ALM strategies and actions to the ALCO in terms of risk, balance sheet gap, solvency and liquidity;
- the day-to-day implementation of the Group ALCO decisions (with the support of affiliates ALM departments);
- the control of the correct implementation of the Group ALCO's decisions;
- the necessary alert to the ALCO and ALCO members if urgent action is required outside of monthly ALCO meetings.

KBL *epb* Global Financial Markets/Treasury department (GFM) is in charge of

- the Trading Books of KBL *epb* Luxembourg;
- the operational liquidity management;
- advising on all ALM subjects including (but not limited to) the execution on all transactions decided by the ALCO or Group ALM.

Asset Management departments of the Group are in charge of

- providing advice or managing part of the banking books along precise guidelines and SLA defined by the ALCO;
- advising on all ALM subjects including (but not limited to) the global market trends and their possible impacts on the Group.

KBL *epb* Group Risk Control is in charge of

- transforming the overall principles included in the Risk Appetite statement into detailed risk limits (to be approved by the ALCO);
- monitoring the correct use of the available limits and reports on a monthly basis to the ALCO;
- defining and implementing the models of risk measurement and the stress tests;
- gathering all needed information regarding risk exposures in group members from their risk counterparts and report accordingly to the ALCO;
- ensuring conformity with the regulatory constraints;
- advising on all ALM subjects including (but not limited to) the implementation of the risk policy;
- Risk Control hierarchically reports to the Chief Risk Officer who is an EXCO member.

Underlying Objectives of the ALM at KBL

ALM aims firstly at providing a positive and stable contribution to the P&L account by optimizing the management of the balance sheet, within the limits of risks as they have been decided by the relevant governing bodies.

Stable contribution to the P&L means that the ALM decisions are made with the objective to avoid as much as possible that ALM investments cause any significant unwanted volatility in the P&L of the Bank, by adopting adequate strategies – including hedging, portfolio profiling techniques and stop-loss strategies.

The overall policy is to match assets and funding maturities where possible and to hold sizeable liquid assets. Consequently, ECB eligible bond assets are to be vastly predominant.

A strategic objective of the Bank is to diversify its asset composition by deploying a portion of its resources into various markets, sectors and instruments with distinctive risk return characteristics, which are not usually available in loans and advances and short-term money markets. In the fixed income instruments, issuers with various types

and levels of risks will be used within the overall limits as decided by the ALCO. Equity investments can be decided by the ALCO when it is considered that they can bring an added value.

Measures and Methodologies

Interest Rate Risk

To assess the impact of the interest rate risk on the economic capital of the Bank, the net present value of assets and liabilities is computed before and after a 'shock':

- consecutive to a parallel rise of the interest rates (normalised sensitivity indicator called basis point value) or,
- defined through a parametric Value at Risk methodology.

Furthermore, the impact of interest rate risk on the Net Interest Margin is estimated on a one-year period, before and after an interest rate movement (market).

For a detailed view on the impacts of yield curve movements on the Bank's balance sheet and interest margin, please refer to pages 77 and 78 of the 2012 annual report.

Currency Price Risk (Foreign Exchange Risk or FX Risk)

The structural FX risk is calculated on a consolidated basis by mean of a parametric VaR relying on a 20 years history.

Equity Risk

The structural equity risk measurement used at KBL *epb* is based on a parametric VaR calculation method applied to standard geographical indices obtained after regression of all related equities on these indices.

Real Estate Risk

The real estate risk measurement (e.g. the risk of having our own properties and investment properties loosing value due to unfavourable movement of the house price indices) is based on a parametric VaR calculation method applied to the standard real estate indexes.

Global ALM Risk

As VaR is a common indicator to assess equity, FX, real estate and interest rate risks, ALM Risk is globally assessed by mean of Value-at-Risk model, especially for the calculation of the Economic Capital (in the context of the Internal Capital Adequacy Assessment Process), after application of an inter-risks diversification matrix.

10 SECURITISATION

KBL *epb*'s securitisation activities are not extensively developed; the Bank does not take part in any sponsoring or origination activities. At the end of 2012, the total value of gross exposures to securitised assets - all of them treated under the Available-For-Sales category of assets - accounted for 1.7% of the total gross exposure.

Exposures to securitised assets as at 31st December 2012 (in EUR million)

Risk Weight	20%	50%	100%	350%	1250%	Total
Securitisation	196.5	8.3	1.4	0.4	0.4*	206.8
Risk Weight	40%	100%	225%	650%	1250%	Total
Re-Securitisation	2.5	0.9	-	-	-	3.4

*This exposure is deducted from own funds.

11 REMUNERATION POLICY

Context and Principles

Compensation schemes are designed to take account of competences required, evaluations, skills and performance. These schemes aim at aligning the long-term shareholder's interests and the long-term group-wide profitability while taking account of the Bank's Solvency and Core Tier one ratios. Moreover, the compatibility between the relevant stakeholders' interests, the Bank's Corporate Social Responsibility Policy and compensations should be satisfied.

The Board of Directors and the Executive Committee
The remuneration policy related to the Board and to the EXCO members is based on the prevailing legislation, the Corporate Governance Code and market data. This policy is monitored and regularly reviewed by the Remuneration Committee with the assistance of specialist members of the staff in order to ensure its continuous compliance with the law, the aforementioned code, and the prevailing market practices and trends. The Chairman of the Remuneration Committee informs the Board of the committee's activities and submits any changes to be made to the remuneration policy and its practical implementation. The Board may also make its own proposal to the Remuneration Committee in order to examine potential changes to the remuneration policy and advise it accordingly.

Material Risk Takers
The allocation mechanism and the acquisition rule of the variable remuneration of the so-called material risk takers (risk taking employees, control functions and members of executive bodies) are determined in accordance with the CSSF Circular 06/273 (modified by CSSF Circular 10/496) or the prevailing local regulation. The variable part of the compensation of these employees, which is at least composed by 50% of shares or equivalent instruments, is partly deferred over a minimum of 3 years; the subsequent vesting of remuneration is thereafter subject to performance conditions.

The Remuneration Committee

The mission of the Remuneration Committee is to define, implement and maintain a remuneration policy in accordance with the guidelines outlined in the circular CSSF 06/273. This Committee has decision-making authority regarding the remuneration of the members of the Executive Committee, particularly with regard to the structure of the remuneration and the individual remuneration.

The Remuneration Committee is authorised to undertake any activity within its terms of reference, and provide any additional advice or support within the Group that is required in the scope of its duties. The Remuneration Committee shall carry out the duties for the parent company, major subsidiary undertakings and the Group as a whole, as appropriate.

Composition of the Remuneration Committee as at 31st December 2012:

Name	Responsibility
George NASRA	Chairman
Jan Maarten de JONG	Member
Edmond MULLER	Member
Jan HUYGHEBAERT	Member

The Group's Head of Human Resources department participates as a subject matter expert to the meetings of the Remuneration Committee.

Role and responsibilities

The role and responsibilities of the Remuneration Committee are defined by the regulations approved by the Board. The tasks of the Remuneration Committee are the following ones:

- propose a group-wide remuneration policy to the Board that is aligned with the Bank's long-term business strategy, its business objectives, its risk appetite and values, whilst recognising the interests of relevant stakeholders;
- propose the remuneration principles to the Board, including the terms and other commitments to be made on the retirement, resignation or dismissal, of the members of the Board, with the aim of ensuring fairness and avoiding reward for failure;
- advise the Board on the policy governing the remuneration, particularly the determination criteria, structure and total amounts of remuneration, related to the members of the EXCO, General Managers, local EXCO members, senior staff heading the 5 Group control functions, front office staff active within Financial Markets, Credits and Wealth Management, and, any other staff member having a material impact on the Bank's risk profile whose total variable compensation package may exceed EUR 100.000 (in gross terms);
- approve individual compensation packages related to the members of the EXCO, General Managers, local EXCO members, senior staff heading the 5 Group control functions, front office staff active within Financial Markets, Credits and Wealth Management, and, any other staff member having a material impact on the Bank's risk profile and whose total variable compensation package may exceed EUR 100.000 (in gross terms);
- approve bonus pools;
- advise the Board on retention/incentive bonuses in exceptional circumstances;
- advise the Board on any material exemptions or changes to the principles of the Group's remuneration policy;
- monitor the application of the authority delegated to the EXCO and Local Remuneration Committees to ensure that policies and principles are being consistently and effectively applied;

- liaise as required with the Audit, Compliance and Risk Committees and the Group Risk function in relation to risk-adjusted performance measures;
- approve the contents of the annual Remuneration Policy Statement for the Pillar 3 external disclosure.

In the course of 2012, the Remuneration Committee met four times and the attendance rate of members stood at 100%. The Chairman of the Remuneration Committee reported to the Board on the work of the Committee after each meeting and presented his proposals on matters subject to a decision of the Council.

The main topics handled by the Remuneration Committee during the year 2012 were:

- the fixed remuneration paid to the members of the EXCO;
- the application of changes and exceptions to the remuneration policy;
- the implementation of EBA Guidelines on remuneration policies and practices;
- the evaluation of the activities of the EXCO throughout 2012;
- the remuneration of the Chairman of the Board;
- the remuneration package of members of the EXCO;
- the accelerated vesting of deferred compensation upon retirement;
- the set up of rules related to phantom stock remuneration;
- the practical application of the staff retention plan;
- the implementation of a quantitative risk alignment framework for "identified staff";
- contact with the CSSF regarding the Remuneration Policy.

Identification of the Material Risk Takers

In accordance with the CSSF Circular 06/273, the population of Material Risk Takers, has been determined based on a Bank's Risk Management self-assessment.

The following staff members are considered to be Material Risk Takers; therefore, their remunerations are subject to a supplementary set of rules:

- Group level members of the board and of the EXCO ;
- business entities level members of the boards and of the EXCOs;
- General Managers;
- heads of control functions (i.e. Risk Management, Audit, Finance, Human Resources, Compliance);
- front office staff active within Financial Markets, Credits and Wealth Management of which the variable remuneration could induce risks based on the Bank's self-assessment;
- any other staff member whose total variable compensation package may exceed EUR 100.000 in gross terms and which may have a material impact on the Bank's risk profile.

A thorough risk analysis by the Risk Management and Compliance departments of the Bank (given the principle of proportionality defined in CSSF Circular 11/505) led to the following figures:

Material Risk Taker category	Number of employees
Group EXCO members and General Management	15
Total number of identified Material Risk Takers	87

Compensation of the Board Members

The compensation of the Board is ruled by a system of fixed remuneration and attendance fees ('jetons de presence'). The fixed part of the remuneration directly impacts the net profit of the year, whereas attendance fees are charged as expenses.

KBL epb does not grant loans or guarantees to Board members.

Compensation of the Members of the Executive Committee

The Board determines the remuneration of the members of the EXCO on the basis of advice obtained from the Remuneration Committee.

In accordance with the Group's remuneration policy, the total individual remuneration paid to the members of the EXCO comprises both a fixed and a variable component.

Fixed compensation
Decisions related to the fixed compensation of the members of the EXCO are taken by the Board based on a proposal made by the Remuneration Committee. This proposal is itself based on analyses related to market practices and compensations observed for similar functions in the same type of companies.

Variable compensation
The principles determining the annual variable compensation of the members of the EXCO are based on the achievement of objectives that are set by the Board at the beginning of the year and which are based on the advice of the Remuneration Committee. Those pre-agreed objectives are balanced between economic and financial objectives (Financial Key Performance Indicators) on the one hand and non-economic objectives (Non-Financial Key Performance Indicators) on the other hand.

Those elements are based on the combination of:

- adjusted net profit-based measures (assessed at Group and entity levels) including Operating Result;
- risk measures: Solvency ratio, Core Tier One ratio;
- the Assets Under Management (AUM) fluctuations;
- individual performance-based measures such as: the compliance with applicable rules and risk standards, managerial behaviours/skills, ethical behaviour, management of incidents, internal audit results follow-up, planning and organisation.

A proportion of 40% of the annual variable compensation is deferred over a period of 3 years, is not acquired faster than proportionally and is subject to risk adjustments. A portion of 50% of the annual variable compensation is awarded in Phantom Shares whose vesting is delayed gradually over three years and subject to the achievement of a performance objective.

Control Functions Compensation

In order to prevent conflicts of interests, the variable compensation devoted to control functions is not based on the specific financial results of the underlying businesses being controlled.

When profit-based variable compensation is being considered for control functions, the level of such compensation is based on the results of the Group, or on the results of an entity, which is at least one organisational level higher than the level of the control function entity.

The remuneration of the senior staff responsible for managing the control functions is not solely left to direct superiors; instead, it is directly overseen by the Remuneration Committee.

Compensation of Other Material Risk Takers

The total compensation follows the same principles as the one followed for the EXCO members' compensation; however, economic, financial and non-economic objectives only reflect their scope of responsibilities.

Remuneration, Performance and Risk Appetite

The variable compensation, linked to economic and financial objectives, is determined by a quantitative risk adaptation mechanism such that selected parameters must be met before any variable compensation linked to results may be granted.

The total amount available for granting variable compensations is determined on the basis of a ‘bonus pool’, which is capped to a reasonable portion (i.e. it should not prevent the Bank to strengthen its capital base) of the entity’s reported profit of the ongoing period.

The bonus pool calculation depends on the Operating Result, the Adjusted Net Profit of the current year and the Solvency and Core Tier One ratios over the last business/risk cycle (i.e. 3 years). The bonus pool amount allocated to the Material Risk Takers is expressed as a percentage of the Operating Result.

Over a year, if the performance assessed at the level of the Group or at the entity level or both, is more than 30% lower than the budgeted performance, then the EXCO may decide that the bonuses will be adjusted to zero for either the Group as a whole, or for a specific entity.

The variable compensation related to non-economic objectives is based on the evaluation of a number of agreed criteria. For 2012, these criteria were: compliance with applicable rules and risk standards, managerial behaviours/skills, ethical behaviour, management of incidents, internal audit results follow-up, planning & organisation, communication & transparency, quality of reporting and proactivity & initiative.

In the case of mediocre individual performance based on non-financial criteria (less than 50% of the maximum score), the EXCO may decide that bonuses (at all levels) will be adjusted to zero.

Level of Remuneration

On an individual basis, an absolute cap is set across the Group on the total yearly-allocated variable compensation level. This absolute cap is defined as 750.000 EUR in gross terms per individual.

For the members of the EXCO and the General Management of the Bank, the variable compensation is capped at a certain level of the fixed remuneration, depending on the nature of the function:

Function	Maximum variable-to-fixed remuneration ratio*
Control function	50%
Commercial function	300%
Other	200%

*Or the maximum ratio allowed under the prevailing local regulation.

Risk-Adjusted Remuneration, Malus and Clawback Provisions

The profit-based variable compensation paid out to Material Risk Takers is subject to ex-ante and to ex-post risk adjustment measures.

Ex-ante risk adjustments measures are based on two main criteria:

- Quantitative: Solvency and Core Tier One ratios over the last business/risk cycle (i.e. 3 years).
- Qualitative: compliance and internal control risk assessment.

Ex-post risk adjustments can be operated either by reducing deferred (but not yet vested) amounts of compensation (malus) or by re-claiming ownership of upfront amounts or deferred amounts already vested (clawback).

A malus will be applied:

- in case of evidence of misbehaviour or serious error by the staff member (e.g. breach of code of conduct and other internal rules, especially concerning risks);
- if KBL *epb* or an underlying entity suffers from a significant downturn in its financial performance;
- if KBL *epb* or an underlying entity suffers from a significant failure of risk management;
- in case of significant changes in the Bank's economic or regulatory capital base.

For each individual, a clawback will be applied in case of:

- established and proven fraud;
- (the use of) misleading information;
- negative financial performance;
- remuneration received while breaching the CSSF Circular 06/273, the Markets in Financial Instruments Directive (MiFID) or the European Banking Authority Guidelines.

Remuneration figures – 2012

Over the year 2012, a total of EUR 0.38 million were spent in relation with 7 employees as a result of recruitment of personnel, on the other hand, EUR 2.52 million were spent in relation with termination of employment, this amount is related to 6 persons and the highest amount paid to an individual reached EUR 1.55 million.

In 2012, the remuneration related to front (34 individuals) and back (53 individuals) offices were respectively of EUR 12.03 million and EUR 9.84 million. More specifically the remuneration structure of identified Material Risk takers was as follows in 2012:

Members of the Group EXCO and General Management (in EUR million)

Total remuneration

Fixed remuneration: - base salary - other (pension, allowances, car leasing, etc.)	5.29 4.13 1.16
Variable remuneration:	-

Other Material Risk Takers (in EUR million)

Total remuneration

Fixed remuneration:	15.12
- base salary	12.78
- other (pension, allowances, car leasing, etc.)	2.34
Variable remuneration	1.46

Variable remuneration

Cash	0.98
Equity-related instruments	0.48
Other	

Variable remuneration

Non-deferred	1.08
Deferred	0.38

Schedule of phantom shares vesting awarded in 2012

	Vesting in 2013	Vesting in 2014	Vesting in 2015
Deferred amounts	0.06	0.06	0.06

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