Pillar III Report 2013

EUROPEAN
PRIVATE BANKERS

KBL EUROPEAN PRIVATE BANKERS

1 Contents

Glossary 4
Note to Readers 5
1 | Introduction 6
2 | Structure of KBL *epb* 7
List of Subsidiaries & Associates 8
Corporate Governance & Decision Structure 8
Governance Culture 9
Board & Executive Committee: Structure and Key Governance Principles 9
Responsibility Scope, Reporting Lines and Decision Delegation per Key Domain 11
3 | Risk Management at KBL *epb* 11
Five Lines of Defence 11
The Risk Control Function 12
Board Risk Committee 14
Sub Risk Committees 14
4 | Own Funds, Capital Adequacy & Group Solvency 16
Own Funds Instruments 16
Own Funds Figures 17
Internal Own Funds Adequacy Evaluation 17
Capital Requirements 18
5 | Credit Risk 19
Credit Risk Management 19
Governance of the Credit Risk Management Process 20
Counterparty Credit Risk 20
Management of Wrong-Way Risk 21
Counterparty Credit Risk Arising from Credit Derivatives and OTC Derivative Transactions 22
Credit Risk Exposures 23
Standardised Approach (STA) 23
Credit Risk Exposures Data 24
Defaulted Exposures 28
Credit Risk Mitigation Techniques 30
Netting Agreements 30

Collateral with Private Customers (Lombard Loans) 30
Collateral with Professional Counterparties 31
Credit Risk Mitigation Data 32
6 | Market Risk 35
First Line of Defence: the Dealing Room 35
Second Line of Defence: the Risk Control/Middle Office 35
Group Trading Risk Meeting 36
The Control of Hedges and Other Risk Mitigation Techniques 36
7 | Operational Risk 37
Capital Requirements for Operational Risk 37
Governance of Operational Risk Management 37
Central Operational Risk Management (CORM) 38
Local Operational Risk Management (LORM) 38
Entities in Charge of Operational Risk 39
First Level Controls 39
Second Level Controls 39
Operational Risk Mitigation Techniques 39
8 | Equity Holdings 41
9 | ALM Risk 41
Interest Rate Risk 41
Credit Spread Risk 42
Foreign Exchange Risk 42
Equity Price Risk 42
Liquidity Risk 43
Real Estate Risk 43
ALM Governance 43
Underlying Objectives of the ALM at KBL *epb* 44
Measures and Methodologies 45
Interest Rate Risk 45
Foreign Exchange Risk 45
Equity Risk 45
Real Estate Risk 45
Global ALM Risk 45
10 | Securitisation 46
11 | Remuneration Policy 47
Context and Principles 47

- The Board of Directors and the Executive Committee 47
- Material Risk Takers 47
The Board Remuneration & Nomination Committee 48
- Role and responsibilities 48
Identification of the Material Risk Takers 50
The Remuneration Process 51
Compensation of the Board Members 51
Compensation of the Members of the Executive Committee 51
- Fixed compensation 52
- Variable compensation 52
Control Functions Compensation 53
Compensation of Other Material Risk Takers 53
Remuneration, Performance and Risk Appetite 53
Level of Remuneration 54
Risk-Adjusted Remuneration, Malus and Clawback Provisions 55
Remuneration figures – 2013 56

2 Glossary

AFS	Available-For-Sale
ALCO	Asset-Liability Committee
ALM	Asset and Liability Management
CIU	Collective Investment Undertaking
CEO	Chief Executive Officer
CFRCO	Chief Finance, Risk and Compliance Officer
CIO	Chief Investment Officer
COO	Chief Operating Officer
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	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
MRT	Material Risk Taker
OFRs	Own Funds Requirements
OTC	Over-the-Counter
P&L	Profit & Loss
STA	Standardised Approach
RWA	Risk Weighted Assets
VaR	Value at Risk

3 Note to 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" as applicable in the year 2013. This particular CSSF circular set the requirements related to the own funds adequacy in the financial sector by transposition into Luxembourg law of 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 are made to the annual consolidated accounts which are publicly available in the OAM section of Luxembourg Stock Exchange's website (www.bourse.lu).

1 Introduction

The year 2013 can be seen as the launch of a transformation phase for the Bank leading to a reassessment of its strategic position in a recovering economic environment while coping with an evolving regulatory landscape that is currently reshaping the private banking industry.

The regulatory pressure indeed surged in response to the latest financial crisis with the introduction of new regulatory frameworks such as the Capital Requirements Directive Package IV, the European Market Infrastructure Regulation or the transposition in Luxembourg law of the Directive 2011/16/EU on administrative cooperation in the field of taxation.

As a response to these evolutions, the Bank undertook a deep transformation phase which consists of a review of its strategic model and management structure with the ambition to emerge as a leading European private banking group in the near future.

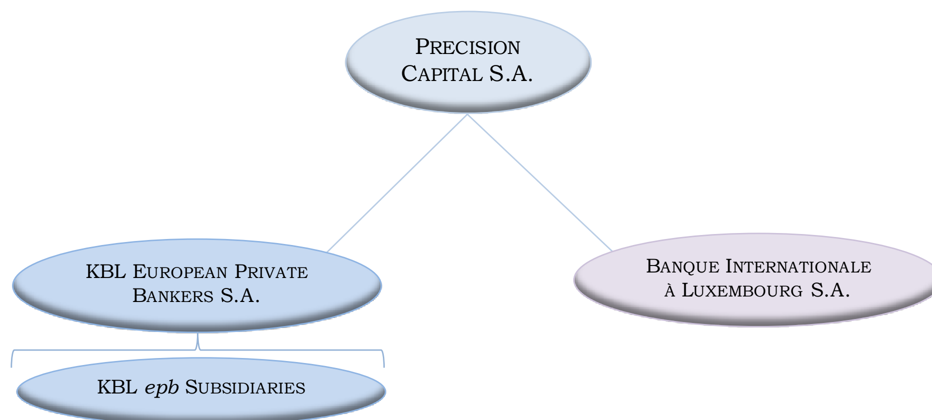
In this context, the goal of the Pillar III Report 2013 is twofold. First, the report brings a precise idea of the way the risks faced by the Bank are processed through each of its entity. Second, the report draws a fair picture of the risks to which the Bank is exposed by providing various datasets 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 entities of the Bank in the 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 data related to credit risk;
- Section 6 focuses on the governance and data related to market risk;
- Section 7 focuses on the governance and data related to operational risk;
- Section 8, 9 and 10 respectively focus on equity holdings, ALM risk and securitisation;
- Section 11 presents the remuneration policy of the Bank.

2 Structure of KBL *epb*

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 15 entities. The Bank is itself part of Precision Capital S.A., a Luxembourg-based financial holding which also encompasses *Banque Internationale à Luxembourg S.A.*.



List of Subsidiaries & Associates

Denomination	Capital Held	Statutory Prudential Supervision	Prudential Scope of Consolidation	Description
Fully Consolidated Subsidiaries				
Brown, Shipley & Co. Limited	100%	Yes	Yes	Private banking, United-Kingdom
KBL Immo S.A.	100%	No	Yes	Real estate, Luxembourg
KBL Monaco Private Bankers	100%	Yes	Yes	Private banking, Monaco
KBL Beteiligungs A.G.	100%	No	Yes	Holding, Germany
Merck, Finck & Co.	100%	Yes	Yes	Private banking, 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%	Yes	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	Insurance, Luxembourg
Associates				
EFA Partners S.A.	52.70%	No	Yes	Holding, Luxembourg
European Fund Administration S.A.	48.58%	Yes	Yes	Fund administration, Luxembourg
Non-Consolidated Subsidiaries				
Forest Value Investment Management S.A.	25.60%	No	Yes	SICAV-SIF, Luxembourg
Horacio sàrl	100%	No	Yes	Real estate, Luxembourg

The accounting scope of consolidation includes all entities at the exception of Forest Value Investment Management S.A. and Horacio sàrl which fall below the consolidation materiality threshold. The prudential scope of consolidation is identical to the accounting scope of consolidation.

In 2013, the entity *Fidef Ingénierie Patrimoniale S.A.* in which the Bank had a 100% interest was excluded from the scope of consolidation due to its liquidation.

Corporate Governance & Decision Structure

To sustain the ambitions of the Group in terms of commercial positioning and financial targets while leveraging the benefits of being a group, a strong and integrated governance framework has been approved by the Group Board of the Bank and rolled out throughout the Group taking into account the proportionality principle as well as local laws and regulations.

This group governance framework is articulated around the main following principles :

- Governance culture: principles all employees should thrive for.
- Board & Executive Committee: structure and governance principles.
- Reinforcement of the steering of the Group notably by:
  - a clear allocation of responsibilities within the Bank;

- the definition of decision delegation right per key domain;
- the strengthening of functional reporting lines between the group and subsidiary functions.

Governance Culture

Throughout the Group, management and employees should in all their decisions and respective activities thrive to:

- Serve clients' specific needs with the highest quality in advisory and wealth management while taking account of client and local business specificities.
- Continuously build up and protect the Group's reputation acting in line with all relevant rules and regulations.
- Generate sustainable profits.
- Leverage the benefits of being a Group.
- Manage the Group on a day-to-day basis in the most professional and efficient way, actively focusing senior management attention where it matters the most.
- Be a trusted employer of choice to attract, develop and retain the best talent.

Board & Executive Committee: Structure and Key Governance Principles

Group Board

The Group Board upon delegation from the shareholder sets the overall Group strategy and ensures that effective control mechanisms are put in place. This board shall be composed of a minimum of 8 directors, including at least one shareholder representative, six independent directors, the group CEO plus such number of staff representatives directors as may be required by relevant legal provisions.

The Group Board is supported by five sub-committees : Risk, Strategy, Audit, Compliance and Legal, Remuneration and Nomination, each of them being composed of a sub-set of the Group Board Directors. Each committee is chaired by a non-executive Director, and assisted by the occasional/permanent presence of managers and external advisors when relevant.

Responsibility for the evaluation and compensation of Directors of the Group Board lies with the Remuneration and Nomination Committee. Decision regarding nomination or mandate termination of a director lies with the Shareholder Assembly.

Subsidiary Board

A subsidiary Board validates the strategy, enforces its implementation and ensures that internal control mechanisms are in place at local level. This type of board has in target state at least two members of the Group Executive Committee and two independent directors. Such an independent director shall not have a simultaneous mandate at the

Group Board unless an individual exception is granted by the Board Remuneration and Nomination Committee of the Group Board.

A subsidiary Board is supported by three committees: first Audit, second Remuneration and Nomination, and third, Compliance, Legal and Risk. These committees are chaired by a non-executive director and are composed of a sub-set of members of the Subsidiary Board which are assisted by the occasional/permanent presence of Group and subsidiary managers.

The composition of the aforementioned Subsidiary Board (and Board Committees) is further adjusted to strictly comply with local laws and regulations.

Group Executive Committee and Subsidiary Management Team

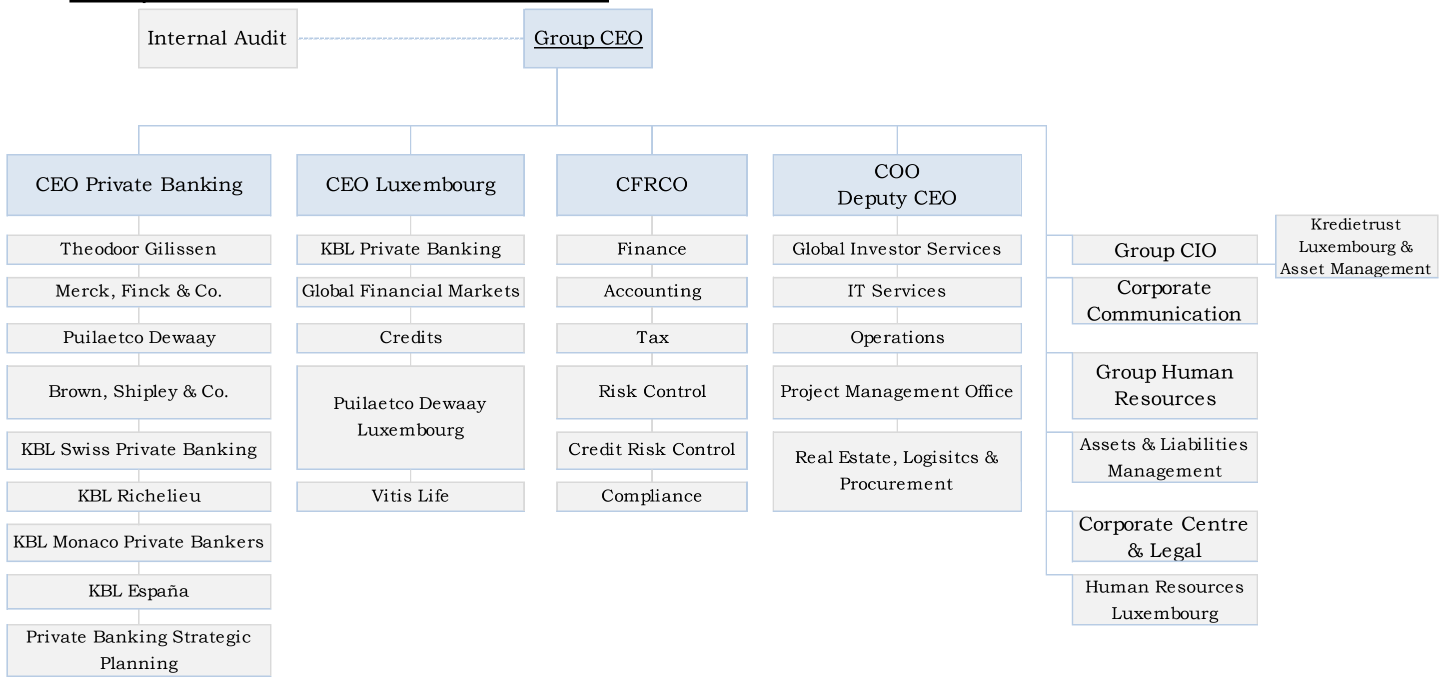
The Group Executive Committee (Group EXCO) operates under delegated authority of the Group Board to implement the Group strategy and objectives set by the Group Board. It is composed, in target state, of five to six members, each with a focused individual mandate translating into clear (P&L) accountability and separation between business and support/control roles.

The Group EXCO is supported by a set of sub-committees including notably: Group Credit Committee, Group ALCO, Acceptance Committee, Luxembourg Coordination Committee, Staff Pension Committee, Luxembourg Audit and Compliance Committees of the Group EXCO.

Responsibility for Group EXCO members evaluation, compensation, nomination or dismissal lies within the Board Remuneration and Nomination Committee of the Group Board.

At subsidiary level, the management team shall at least be composed of a CEO and a CFRO. A local CIO (managing investments) and COO (managing IT and Operations) shall also be appointed but do not necessarily need to be members of the subsidiary management team. The subsidiary management team where relevant is supported by a set of sub-committees.

Group Executive Committee Structure



Responsibility Scope, Reporting Lines and Decision Delegation per Key Domain

- Financial performance accountability and ownership: any component of the Group financial performance is assigned to a clear owner in a cascaded way (Group EXCO members, subsidiaries/Business Units or departments). These owners are accountable for reaching objectives set in the strategic and budget plans within the guidelines set by the Group.
- Reporting lines between Group and subsidiary functions are set up to ensure smooth coordination between entities.
- The Group function head has an end-to-end responsibility for the adequate performance of its function.
- Each subsidiary CEO or business unit leader is the primary responsible for the financial performance of its entity.
- Escalation procedure are put in place such that any fundamental disagreement between a subsidiary function Head and the Group function Head is escalated to the subsidiary CEO by the Group function Head, then to the CEO Private Banking or CEO Luxembourg – and in last resort to the Group EXCO - to reach an agreement through a peer-to-peer discussion.

Finally, the Group governance framework provides detailed information about the scope of responsibility per key area within the Bank, the decision delegation as well as the role of key decision bodies.

3 Risk Management at KBL *epb*

At KBL *epb,* risk management is seen as a transversal process which involves all the Bank's entities at different levels and which 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 risks: front office, back office or support. They are responsible for the management of their 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 12) 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 objectives, 2nd level control entities perform the following tasks:

- independently reprocess controls performed at the 1st level and compare results;
- 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 their 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 Regulatory Authorities are the fifth and final level. They are part of the pool of 'external controls'.

Each of the five lines of defence interact with each other as well as with the Group Board, the Audit, Compliance and Legal, and Risk committees, 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 consist 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 and analyses, provides expert judgement on risk exposures, issues 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 falls under its own monitoring and control role.

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

- 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. Finally, the department takes responsibility for the regulatory watch over and the reporting related to the risks covered by the whole 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 level two controls of market operations. The department is also in charge of the management of the Bank's collateral, mainly related to repurchase agreements, securities lending and derivative transactions.

- The Group Risk Advisory department 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. Amongst other things, the department is in charge of preparing subsidiaries' Board Risk Committee meeting.

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;
- they report 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 (i.e. expression of the amount and type of risk that the Bank is able and willing to accept in the pursuit of its business objectives) to be approved by the Board and applied 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.

In this context, the Risk Appetite of the Board has been reshaped in 2013 in a formalised 'Risk Appetite statement', based on which a new recurrent risk reporting has been set up for both ALCO and BRC Committees.

This reporting provides 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), initially dedicated to financial risks (a.o. credit, ALM, liquidity and trading risks) has been extended in 2013 to the risks covered by the Risk Appetite statement (a.o. operational, reputation, regulatory, client risks). The Chief Finance, Risk and Compliance Officer, the Head of Risk Control, the Deputy Chief Finance Officer, the Head of Group ALM, the Head of Global Financial Markets activities, the Chief Investment Officer ('CIO') and the remaining members of the EXCO are members of this Committee.

The Group Credit Committee (GCC) 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 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 Own Funds, Capital Adequacy & Group Solvency

Own Funds Instruments

Ordinary shares – The share capital of the Bank consists of 20.14 million of ordinary shares with a nominal par value of EUR 9.30 per share. All ordinary shares carry voting rights each share representing one vote. No participation certificate or non-voting right share has been issued.

Treasury Shares – As at the end of 2013, the Bank held 844 ordinary shares in portfolio. The voting-rights attached to these shares have been suspended.

Preference shares – As at the end of 2013, 4,041 preference shares were outstanding, these shares are entitled to receive an initial dividend of EUR 0.25 per share. If there are no profits, this dividend entitlement is carried forward to subsequent periods. Any profits remaining once this first dividend has been paid are shared out between all shareholders.

Non-voting capital securities – In February 2001 the Bank issued a subordinated bond, due 23 February 2016, listed on Luxembourg Stock Exchange. These non-voting securities rank *pari passu*, without any preference among themselves, with all other present and future unsecured and subordinated obligations of the Bank. Therefore, upon liquidation a bondholder will be subordinated in right of payment to the claims of depositors and all other unsubordinated creditors of the Bank. These subordinated bonds have been syndicated and subscribed pursuant to an underwriting agreement entered into with the Manager appointed for the issue. The Bank used the proceeds of this issuance for general corporate purpose

Own Funds Figures

Prudential Own Funds (EUR million)	31st December 2012	31st December 2013
Tier 1 Capital	527.1	522.6
Capital, share premium, reserves and retained earnings	1034.7	788.9
Minority interests	0.3	0.3
Year result incorporated in prudential own funds	-251.1	-
Treasury shares	-0.1	-0.1
Intangible assets & goodwill	-231.4	-231.7
Application of IAS 19R	-	-18.4
Deferred tax assets	-25.2	-16.4
Tier 2 Capital	254.4	179.9
Upper Tier 2: preference shares	30.0	0.1
Upper Tier 2: positive AFS reserve	58.0	60.3
Lower Tier 2: subordinated liabilities	166.4	119.5
Deduction	-1.0	-0.6
Participation in Forest Value Investment Management Investment	-0.6	-0.6
Securitised assets deducted from own funds	-0.4	-
Total Prudential Own Funds	780.5	701.9

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, in 2013, KBL *epb* complied with supervisory capital requirements set out in 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 - 8% of risk weighted assets (EUR million)		31st December 2012	31st December 2013
Credit Risk		258.8	239.4
Central governments/central banks		2.8	2.8
Regional governments/local authorities		0.1	0.0
Public sector entities		0.0	0.1
International organisations (multilateral development banks included)		0.6	0.0
Institutions		32.1	21.2
Corporate		128.6	112.3
Retail		18.7	15.3
Secured by mortgage (residential and commercial)		21.9	25.9
Covered bonds		0.5	0.6
Securitisation		3.9	2.3
Collective investment undertakings (CIUs)		19.5	21.2
Other		28.2	35.7
Past Due		1.9	2.2
Settlement Risk		0.0	0.0
Position Risk		8.2	5.3
Interest rate risk		7.9	5.1
Equity risk		0.3	0.3
Foreign Exchange Risk		0.8	0.8
Operational Risk		65.5	63.3
Total Own Funds Requirements		333.4	308.8
Own Funds Ratios	Tier 1	12.64%	13.53%
	Total	18.73%	18.18%

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 Risk
Private Banking Loans	■			■	■	■	■
Market Professional Activities			■	■	■	■	■
ALM Portfolios		■		■	■	■	■
GIS Clients	■			■			■
Global Custody			■		■	■	■

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 function, the ALM function, the Global Financial Markets function 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.

Counterparty Credit Risk

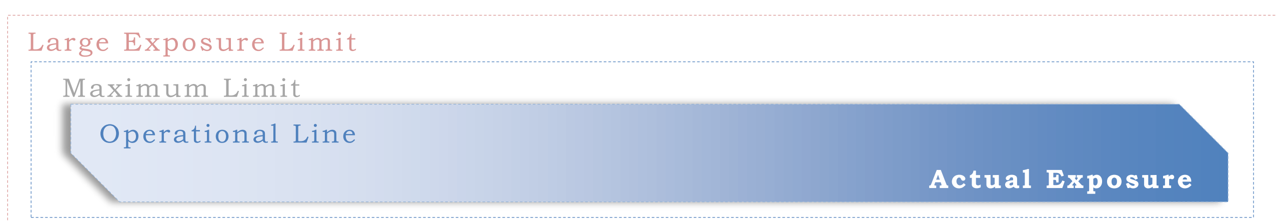
The credit risk incurred in professional market activities is managed through the interbank limit system that aims at managing KBL *epb*'s main dealing room credit risk exposures.

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 may be presented as follows:



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%.

Maximum limits are the maximum amount of risk KBL *epb* is willing to take on an institutional counterparty. Such limits are based on the size and the quality 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 maximum 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.

Management of Wrong-Way Risk

KBL *epb* adopts a conservative policy towards the wrong-way risk, i.e. the risk that occurs when the exposure to a counterparty is adversely correlated with the credit quality of that counterparty.

Regarding the **specific wrong-way risk**, the Bank never concludes contracts with underlying instruments linked to the counterparty (i.e. derivative contracts based on the counterparty's own securities, reverse repo transactions with counterparty's securities used as collateral, etc.).

Regarding the **systemic wrong-way risk**, the risk of exposures' increase due to market factors is mitigated by the use of cash margin call in euro for derivatives (all covered by CSA contracts) on the one hand and on the other hand by the use of correlation limits between counterparty and collateral per country for secured cash or securities lending and borrowing transactions.

Counterparty Credit Risk Arising from Credit Derivatives and OTC Derivative Transactions

As required by the CSSF circular 06/273, as amended, counterparty credit risk data as of 31 December 2013 related to Over-the-Counter (OTC) derivative transactions are presented in the following table.

31st December 2013 (EUR million)	Gross M-t-M	Netting Benefit	Add-on	Collateral	Net Exposure
Credit Derivatives and OTC Derivative Transactions	219.4	209.3	291.7	49.0	252.8

The 1st column of data, Gross M-t-M refers to the positive mark-to-market value of credit derivatives and OTC derivative transactions 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 an ISDA netting agreement with the Bank. Such agreements helped to reduce the counterparty credit risk exposure value of these transactions by more than EUR 209 million as at the end of 2013.

The regulatory counterparty credit risk exposure value is then calculated by adding an add-on to the M-t-M exposure. This add-on corresponds to a percentage of the nominal value of each transaction which depends on both the residual maturity and the underlying asset.

At last, the net exposure value - which is the basis for RWA calculation - is derived by subtracting margin calls and other collaterals received from counterparties involved in these derivative transactions.

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 regulation applicable in 2013, the bank allocates its banking book credit risk and counterparty credit risk into fourteen exposure classes:

Central Governments and Central Banks
Local Authorities and Regional Governments
Public Sector Entities
International Organisations and Multilateral Development Banks
Institutions
Corporates
Retail Clients
Exposures Secured by Commercial/Residential Properties
Exposures in Past Due
Covered Bonds
Securitisation
Collective Investment Undertakings (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* is exposed to. ECAIs providing the Bank's credit assessments are the three leading rating agencies: 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.

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 weighting credit risk, the regulatory rules determine the risk weight to apply, e.g. under rules applicable in Luxembourg, the risk weight of an exposure to an institution is derived from the rating of the country of incorporation of the obligor.

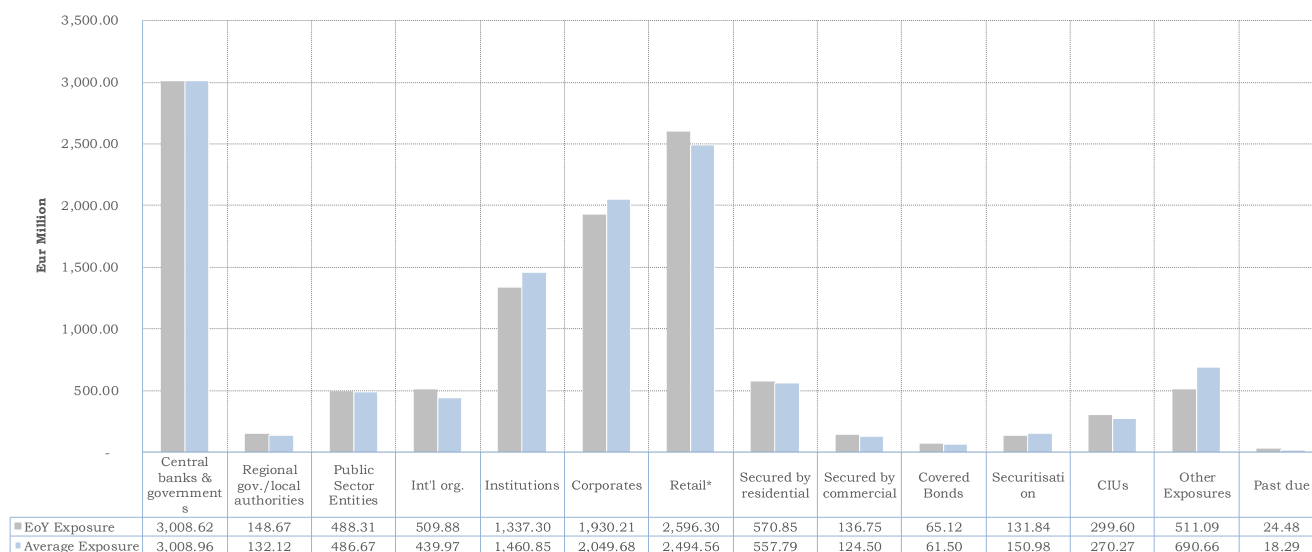
Credit Risk Exposures Data

Unless otherwise specified, the figures reported in the tables presented hereafter take account of relevant netting agreements and 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 corresponding regulatory add-on;
- the pre-conversion-factor value of off-balance sheet items, corresponding to the full commitment the bank has agreed to undertake.

Yearly Average Exposure and End-of-Year Exposure by STA class - 2013

As at 31st December 2013, the total credit risk exposure reached EUR 11.76 billion slightly below (-1.6%) the yearly average. The main credit risk classes were Central Banks & Central Governments (26%), Retail (22%) and Corporates (16%) without significant variations across classes during the year.



	Central banks & governments	Regional gov./local authorities	Public Sector Entities	Int'l org.	Institutions	Corporates	Retail*	Secured by residential	Secured by commercial	Covered Bonds	Securitisation	CIUs	Other Exposures	Past due
EoY Exposure	3,008.62	148.67	488.31	509.88	1,337.30	1,930.21	2,596.30	570.85	136.75	65.12	131.84	299.60	511.09	24.48
Average Exposure	3,008.96	132.12	486.67	439.97	1,460.85	2,049.68	2,494.56	557.79	124.50	61.50	150.98	270.27	690.66	18.29

* It should be noted that the amount of exposure in the retail class of credit risk is inflated by EUR 2.06 billion 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 - 2013

Activities of the Bank are naturally concentrated in Europe, which accounts for 95% for the total credit risk exposure with a particular concentration in the Eurozone (80% of the total exposure) while the remainder of the European exposure is mainly composed of United-Kingdom exposures.

Exposure Class (EUR Million)	Eurozone	Rest of Europe	North Amercia	Asia	Middle-East	Rest of the World
Central governments / Central banks	2,380.0	574.0	-	-	38.4	16.1
Regional governments / local authorities	92.1	31.6	25.0	-	-	-
Public sector entities	462.9	25.3	-	-	-	0.1
International organisations (incl. mult. dev. banks)	477.2	20.7	-	12.0	-	-
Institutions	793.7	389.6	56.9	78.3	3.2	15.6
Corporate	1,474.6	224.9	128.7	2.6	3.3	96.1
Retail	2,517.4	51.1	0.9	1.3	0.5	25.1
Secured by mortgage	518.8	185.0	1.0	0.2	-	2.5
Covered bonds	39.9	25.2	-	-	-	-
Securitisation	126.2	0.8	1.7	-	-	3.2
Collective investment undertakings	229.0	-	20.6	45.7	-	4.3
Others	391.9	104.2	15.0	-	-	0.0
Past Due	11.6	12.9	-	-	-	0.0
Total	9,515.3	1,645.4	249.7	140.1	45.5	163.1

Residual Maturity Distribution of Credit Risk Exposures by STA Class - 2013

As at the end of 2013, the maturity profile of the Bank's total credit risk exposure was relatively short-term with 26% of exposures maturing prior to a year and 54% maturing prior to 5 years.

Exposure Class (EUR Million)	Residual Maturity				
	Less than a year	From 1 to 5 years	From 5 to 10 years	More than 10 years	Undefined
Central governments / Central banks	*694.8*	*850.2*	*284.7*	*15.0*	*1,163.9*
Regional governments / local authorities	*24.8*	*68.4*	*51.6*	*3.8*	-
Public sector entities	*454.7*	*25.9*	*6.8*	-	*0.8*
International organisations (incl. mult. dev. banks)	*58.4*	*287.1*	*161.3*	*3.1*	-
Institutions	*622.4*	*408.1*	*7.1*	*0.0*	*299.7*
Corporate	*630.5*	*1,005.2*	*113.0*	*27.6*	*153.9*
Retail	*255.0*	*227.3*	*12.8*	*11.2*	*2,090.0*
Secured by mortgage	*91.0*	*238.1*	*27.9*	*347.0*	*3.6*
Covered bonds	*32.5*	*25.7*	*6.9*	-	-
Securitization	-	*1.7*	-	*130.2*	-
Collective investment undertakings	*88.5*	*0.1*	-	-	*211.1*
Others	*66.5*	*180.9*	*0.0*	-	*263.6*
Past Due	*13.5*	*1.8*	*0.0*	*0.1*	*9.1*
Total	3,032.6	3,320.7	672.1	538.1	4,195.6
	26%	*28%*	*6%*	*5%*	*36%*

Sector Distribution of Credit Risk Exposures by STA Class – 2013

In 2013, credit risk exposures were mainly concentrated among three sectors: authorities, the financial sector and private persons (84% of the total exposure).

STA Credit Risk Exposure Classes

Sector Distribution (EUR Million) – Sector Breakdown

Sector	Central governments / Central banks	Regional governments / local authorities	Public sector entities	International organisations (incl. mult. dev. banks)	Institutions	Corporate	Retail	Secured by mortgage	Covered bonds	Securitization	Collective investment undertakings	Others	Past Due	Total	
Agriculture, farming & fishing	-	-	-	-	-	21.1	12.2	-	-	-	-	0.4	-	33.7	0.3%
Authorities	3,008.6	148.7	458.0	453.7	-	20.7	-	-	-	-	-	-	0.0	4,089.7	34.8%
Automotive	-	-	-	-	-	16.4	0.6	-	-	-	-	4.6	0.1	21.7	0.2%
Aviation	-	-	-	-	-	5.5	-	-	-	-	-	0.1	0.0	5.6	0.0%
Beverages	-	-	-	-	-	36.7	-	3.0	-	-	-	1.8	-	41.4	0.4%
Building & construction	-	-	-	-	-	32.0	1.0	2.8	-	-	-	32.0	0.0	67.9	0.6%
Chemicals	-	-	-	-	-	44.3	0.5	-	-	-	-	12.2	-	57.0	0.5%
Commercial real estate	-	-	-	-	-	63.1	10.9	164.2	-	-	-	0.2	15.4	253.8	2.2%
Consumer products	-	-	-	-	-	30.2	-	-	-	-	-	15.8	-	46.0	0.4%
Distribution	-	-	-	-	-	0.9	0.1	-	-	-	-	0.9	-	1.9	0.0%
Electricity	-	-	0.1	-	-	155.2	0.4	-	-	-	-	7.3	-	163.0	1.4%
Electrotechnics	-	-	-	-	-	-	-	-	-	-	-	-	-	-	0.0%
Finance & insurance	-	-	25.3	56.2	1,337.3	627.7	-	105.1	65.1	131.8	299.6	45.5	0.6	2,694.2	22.9%
Food producers	-	-	-	-	-	25.4	0.1	-	-	-	-	4.2	-	29.6	0.3%
Horeca	-	-	-	-	-	4.5	0.7	-	-	-	-	5.0	-	10.2	0.1%
IT	-	-	-	-	-	21.6	1.1	-	-	-	-	5.1	-	27.8	0.2%
Machinery & heavy equipment	-	-	-	-	-	40.6	3.0	-	-	-	-	13.7	0.7	58.0	0.5%
Media	-	-	-	-	-	10.2	0.3	-	-	-	-	2.4	0.0	12.8	0.1%
Metals	-	-	-	-	-	19.6	0.2	-	-	-	-	1.3	-	21.1	0.2%
Oil, gas & other fuels	-	-	-	-	-	75.0	-	-	-	-	-	8.1	-	83.1	0.7%
Paper & pulp	-	-	-	-	-	16.7	-	-	-	-	-	2.4	-	19.1	0.2%
Private persons	-	-	-	-	-	132.6	2,513.2	418.4	-	-	-	19.2	2.4	3,085.8	26.2%
Services	-	-	0.8	-	-	112.6	37.5	1.2	-	-	-	6.3	2.9	161.2	1.4%
Shipping	-	-	-	-	-	2.3	-	-	-	-	-	-	0.0	2.3	0.0%
Telecom	-	-	-	-	-	91.2	-	-	-	-	-	4.2	0.0	95.4	0.8%
Textile & apparel	-	-	-	-	-	6.0	0.1	-	-	-	-	2.9	0.0	9.0	0.1%
Timber & wooden furniture	-	-	-	-	-	-	0.3	-	-	-	-	-	-	0.3	0.0%
Tobacco	-	-	-	-	-	4.5	-	-	-	-	-	0.8	-	5.3	0.0%
Traders	-	-	-	-	-	67.4	4.4	-	-	-	-	5.0	2.5	79.3	0.7%
Other	-	-	4.1	-	-	238.5	9.9	12.9	-	-	0.0	309.7	-	575.0	4.9%
Water	-	-	-	-	-	7.8	-	-	-	-	-	0.0	-	7.8	0.1%

Defaulted Exposures

In line with the applicable regulation, defaulted exposures are recognised across the Group in the following cases:

- the exposure is more than 90 days past due;
- the obligor is considered “unlikely to pay” its obligation(s) towards the Bank without taking actions such as the realisation of its collateral.

Moreover, as soon as an exposure is considered as impaired under IAS 39, it shall also be considered as defaulted. In all entities of the 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 default exposure 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 this 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 – 2013

Similarly to the distribution of exposures, credit risk items belonging to the past due exposure class (i.e. more than 90 day past due) were mainly concentrated in Europe. These exposures accounted for 0.2% of the total credit risk exposure after impairment.

Geographic Distribution of Past Due Exposures

(EUR Million)	Gross Exposure	Impairment	Net Exposure
Eurozone	34.5	22.9	11.6
Rest of Europe	14.6	1.6	12.9
North Amercia	-	-	-
Asia	-	-	-
Middle-East	-	-	-
Rest of the World	0.0	0.0	0.0
Total	49.1	24.6	24.5

Sector Distribution of Past Due Exposures – 2013

In 2013, a total EUR 49.1 million gross of impairment exposure was recognised as past due. The top two sectors, commercial real estate and services, accounted for more than 60% of the amount with EUR 31.2 million past due exposures.

Sector Breakdown of Past Due Exposures

Sector Breakdown (EUR Million)	Gross Exposures	Impairment Amount	Yearly Impairment Addition	Yearly Impairment Reversal
Authorities	0.0	0.0	-	0.0
Automotive	1.01	0.92	-	-
Aviation	1.58	1.58	-	0.07
Building & construction	0.10	0.10	0.00	-
Commercial real estate	20.28	4.91	-	-
Electricity	0.02	0.02	-	-
Finance & insurance	1.74	1.16	0.01	0.00
Machinery & heavy equipment	0.72	0.04	-	-
Media	0.00	0.00	-	0.00
Private persons	5.63	3.22	0.16	0.08
Services	10.86	7.98	0.00	0.02
Shipping	0.31	0.31	0.00	-
Telecom	0.01	0.01	-	0.00
Textile & apparel	1.48	1.48	0.00	1.00
Traders	5.29	2.82	-	0.00
Other	0.04	0.04	-	0.00
Total	49.1	24.6	0.2	1.2

Besides past due exposures, further impairments for a total amount of EUR 33.0 million were recognized in the following credit risk classes: Others, Corporate, Secured by Mortgage and Retail. More than half of this amount (51%) is related to an impairment on an equity investment, the rest of this amount is related to defaulted exposures that are not recognised as past due exposures.

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-Pledge-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 losing 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) received 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 – 2013

The total amount of guaranteed and collateralised exposures respectively accounted for EUR 56.9 million and EUR 538.9 million in 2013. It should however be noted that these figures do not include the effect of financial collaterals considered under netting agreements, such as securities received in reverse repurchase agreements or cash margins received in derivatives transactions.

Exposure Class (EUR Million)	Exposure covered by guarantees	Exposure covered by financial collaterals
Central governments/Central banks	25.9	-
Regional governments / Local authorities	-	-
Public sector entities	-	1.6
International organisations (incl. mult. dev. banks)	-	-
Institutions	-	-
Corporate	31.0	180.1
Retail	-	309.6
Secured by mortgage	-	33.6
Covered bonds	-	-
Securitization	-	-
Collective investment undertakings	-	-
Others	-	13.6
Past Due	-	0.3
Total	56.9	538.9

KBL EUROPEAN PRIVATE BANKERS

Exposure Amounts and Financial Collateral Impact by STA Class and Credit Quality Step – 2013

At the end of 2013, the first two Credit Quality Steps as prescribed by the standardised approach represented more than 50% of all credit risk exposures. Simultaneously, almost all eligible financial collaterals used for credit risk mitigation purposes (unrelated to netting agreements) was linked to exposures to non-rated counterparties for a total amount of EUR 537.0 million.

Exposure Class (EUR Million)	Credit Quality Step (Standardised Approach)						
	1	2	3	4	5	6	Non-rated
	Rating Equivalent (S&P's)						
	AAA to AA-	A+ to A-	BBB+ to BBB-	BB+ to BB-	B+ to B-	lower than B-	NR
	Gross of collateral						
	Net of collateral						
Central governments/Central banks	2,672.4	69.1	259.2	7.9	0.0	-	-
	2,672.4	*69.1*	*259.2*	*7.9*	*0.0*	-	-
Regional governments / Local authorities	148.7	-	-	-	-	-	-
	148.7	-	-	-	-	-	-
Public sector entities	488.2	-	-	-	-	-	0.1
	486.6	-	-	-	-	-	*0.1*
International organisations (incl. mult. dev. banks)	509.9	-	-	-	-	-	-
	509.9	-	-	-	-	-	-
Institutions	1,105.8	78.1	137.6	4.1	3.2	0.0	8.5
	1,105.8	*78.1*	*137.6*	*4.1*	*3.2*	*0.0*	*8.5*
Corporate	95.9	487.6	367.2	21.5	-	4.1	952.6
	95.9	*487.6*	*367.2*	*21.5*	-	*3.8*	*772.8*
Retail	-	-	-	-	-	-	2,596.3
	-	-	-	-	-	-	*2,286.7*
Secured by mortgage	-	-	-	-	-	-	708.9
	-	-	-	-	-	-	675.3
Covered bonds	65.1	-	-	-	-	-	-
	65.1	-	-	-	-	-	-
Securitization	128.8	2.1	1.0	-	-	-	-
	128.8	*2.1*	*1.0*	-	-	-	-
Collective investment undertakings	45.7	-	-	-	-	2.9	251.0
	45.7	-	-	-	-	*2.9*	*251.0*
Others	0.0	-	-	-	-	-	511.1
	0.0	-	-	-	-	-	*497.5*
Past Due	-	-	-	-	-	0.0	24.5
	-	-	-	-	-	*0.0*	*24.1*
Total Gross Exposures	5,260.4	636.9	765.0	33.5	3.2	7.0	5,053.1
Total Net Exposures	*5,258.8*	*636.9*	*765.0*	*33.5*	*3.2*	*6.7*	*4,516.1*

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 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 Risk 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 – 2013

Market Risk (EUR Million)	RWA	Own Funds Requirements
Settlement Risk	0.0	0.0
Position Risk	66.5	5.3
Interest Rate Risk	63.2	5.1
Equity Risk	3.3	0.3
Foreign Exchange Risk	9.6	0.8
Total Requirements for Market Risk	76.1	6.1

7 Operational Risk

Capital Requirements 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 business 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:

- Operational Incident database
  Any operational incident/event discovered or identified (with actual or potential profit and loss impact) is declared and registered in a database "Operational Incident Database". 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 Control Self Assessments (RCSA)
  The purpose of the RCSA 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. The RCSA methodology mainly consists in:
  - identification and assessment of the controls;
  - assessment of the residual risk vs. inherent risk;
  - consideration of new scales for risk assessment and risk taxonomy based on regulatory requirements.

  First line management and Local Operational Risks Managers are in charge of creating and maintaining their own risk control self assessment matrix. This process aims at reducing the operational losses and at raising the awareness of line management about operational risks.

- Scenario analysis
  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 – 2013

Operational Risk (EUR Million)	RWA	Own Funds Requirements
Operational Risk	791.6	63.3
Total Requirements for Operational Risk	791.6	63.3

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 2013, the total fair value of listed equity holdings amounted to EUR 132.6 million distributed across several sectors (see chart below).

Equity Sector (EUR Million)	Fair Value
Basic Materials	10.70
Communications	8.11
Consumer cyclical	20.70
Consumer non-cyclical	21.67
Diversified	0.86
Energy	11.30
Financial	22.62
Industrial	25.72
Technology	6.75
Utilities	4.22
Total	132.65

In addition, at the same reference date, the bank held EUR 20.8 million of listed but illiquid or non-listed stocks. Non-consolidated subsidiaries accounted for 14% of this amount.

The realized and unrealized profits attributable to equity positions were respectively EUR 3.7 million and EUR 35.8 million for the year 2013.

9 ALM Risk

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 adverse movement of interest rates resulting in a deterioration of the economic value or profit of the Bank. At KBL *epb*, the interest rate risk focuses on risk-free rates, Credit Spread risk being assessed separately.

  This risk is mainly induced by the investment bond portfolio and the loan book.

The majority of Loans & Receivables to customers is granted on a floating basis, which considerably reduces the Interest Rate Risk. We also consider that the Credit Spread Risk is minimal on loans given high collateral standards in place.

Regarding the investment bond portfolio, as at the end of 2013, 25% is hedged either with floating-rate notes or swaps, reaching a total value of EUR 3.5 Billion (including swap values) with an overall duration of 1.7 years. These bonds are the reinvestment of the Bank's free capital and available stable deposits from customers of the various group entities. Around 65% of the straight (non swapped) bonds are maturing over the next three years. Cyclical strategies implemented (called Ladder approach) also aim at smoothing the impact of interest rate movements. A parallel shift of the curve by 1% is estimated to have a negative impact on the value of the bond portfolio of 59.0 million. Although credit risk is outside of the scope of this ALM section, it is worth noting that the Weighted Average Rating Factor of the investment bond portfolio is single A flat.

- ***Credit Spread Risk*** is the risk that the premium paid by issuers over and above the risk free rate would increase due to a deterioration (of the perception) of the quality of those issuers, such deterioration resulting in a deterioration of the economic value or P&L of the Bank.

- ***Foreign Exchange Risk*** is the risk of unfavourable change of currency exchange rates (including commodity & precious metals) compared to the reference currency, resulting in a negative impact on the economic value or profit of the Bank. The ALM policy, in line with the Risk Appetite statement, is to have no active Foreign Exchange Risk. All assets are funded in matched currencies.

- ***Equity Price Risk*** is the risk of adverse movement of equity (including investment funds) market prices resulting in a negative impact on the economic value or profit of the Bank.

  The equity exposure is an opportunistic exposure decided by the ALCO based on an analysis (both on technical and on fundamental parameters) that equity are expected to bring added value in terms of profits and diversification (contra-cyclical feature of equity vs. interest rate). As opposed to the bond investment portfolio which will always be present, the equity portfolio may be fully divested if the analysis concludes that risks outweigh possible advantages. Exposures are allowed on the main markets (US, Europe and less developed markets) with a sizable European bias. A strict investment policy including constraints in terms of diversification, liquidity and stop-loss is implemented.

- ***Liquidity Risk*** is the risk that the bank would not have enough resources to fund its assets. In general, this risk is split between the short-term (or operational) risk managed by the Treasury department on a day-to-day basis and the medium or long-term risk managed by the ALM department.

  Eligibility targets for the investment bond portfolio are as follows: European Central Bank collateral eligibility 80% and Basel III liquidity eligibility 60% after haircut. As at 31st December 2013, the proportions were respectively 87% and 63%. ALM portfolios strategies are built in order to ensure regular liquidity inflows. The equity portfolio is not considered as it may be divested.

- ***Real Estate Risk*** is the risk of unfavourable movement of the value of the Bank's own real estate properties resulting in a negative impact on the economic value or profit of the Bank.

  As per estimates updated regularly, the marketable value of the real estate properties owned by the Bank is well above their book value, this is expected to remain unchanged as these key assets are located in prime locations.

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 gaps, solvency and liquidity upon recommendation from the ALM department. Group ALCO meetings are held monthly.

The ALM department is in charge of

- presenting/recommending ALM strategies and actions to the ALCO in terms of risk, balance sheet gaps, solvency and liquidity;
- the day-to-day implementation of the Group ALCO decisions including the management of investments in the ALM books throughout the Group, *via* functional responsibility *vis-à-vis* local ALM departments on the balance sheet management activities of the subsidiaries and taking part in local ALCO/ALM meetings;
- the reporting to the ALCO of actions which have been undertaken (e.g. investments and divestments in portfolios);
- the necessary alert to the ALCO and ALCO members if urgent action is required outside of monthly ALCO meetings;
- rolling out an adequate Fund Transfer Pricing policy;

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

- the operational liquidity management;
- advising on all ALM subjects including (but not limited to) the execution of 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);
- the control of the correct implementation of the Group ALCO's decisions by the ALM department;
- monitoring the correct use of available limits and reporting on a monthly basis to the ALCO;
- defining and implementing the models of risk measurement and 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 CFRCO who is an EXCO member.

Underlying Objectives of the ALM at KBL *epb*

The ALM department aims first at providing a positive and stable contribution to the profit of the Bank by optimizing the management of its 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 and Basel III eligible 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). The net impact on the Bank's interest rate margin of a positive 1% parallel shift of the interest rate risk curve was estimated at EUR -12.9 million as at the end of 2013. More information on the Banks' profit sensitivity to interest rate may be found at pages 79 and 80 of the consolidated accounts.

Foreign Exchange 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 dropping in value due to unfavourable movement of the house price indices) is based on a parametric VaR calculation method applied to the standard real estate indices.

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 role of the Bank in securitisation activities is limited to the detention of an ABS portfolio, in run off-mode since 2008 with an exception brought to the attention of competent authorities. As a consequence, the Bank does not take part in any securitisation process, i.e. it does not assume the role of originator, servicer, manager or distributor.

The monitoring of the credit risk related to the ABS exposures is performed through the follow up of their rating at a minimum weekly frequency, and any ABS with a rating below A- is integrated in a watch list presented to the monthly ALCO Committee.

In addition, any negative credit watch or any exceeded expected maturity of ABS leads to a strengthened internal monitoring. Market risks are monitored through Value at Risk and sensitivity (basis point value) indicators.

All securitisation investments are treated under the IFRS Available-For-Sale category and belong to the banking book and as such give rise to own funds requirements relying on credit rating as prescribed under the regulatory standardised approach. As at the end of 2013, risk weights related to these securitisation exposures were as follows.

Securitized Assets Exposure (EUR Million)	AAA to AA-	A+ to A-	BBB+ to BBB-	BB+ to BB-	Lower than BB-
Risk weight	*20%*	*50%*	*100%*	*350%*	*1250%*
Securitisation	127.1	1.2	1.0	-	-
Risk weight	*40%*	*100%*	*225%*	*650%*	*1250%*
Re-Securitisation	1.7	0.9	-	-	-

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 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 & nomination 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 & Nomination 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 & Nomination 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 Board Remuneration & Nomination Committee

The mission of the Board Remuneration & Nomination 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 Board Remuneration & Nomination 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 & Nomination 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 & Nomination Committee as at 31st December 2013:

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

The Group's CEO, Group's Head of Human Resources department and the General Secretary of KBL are invited as permanent guests to the meetings of the Board of Remuneration and Nomination Committee.

Role and responsibilities

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

Remuneration Responsibilities:

- 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, 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, 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).
- Ensure that all provisions regarding disclosure of remuneration are fulfilled.
- 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 on remuneration issues delegated to the Group EXCO and Local Remuneration Committees to ensure that policies and principles are being consistently and effectively applied, seeking support and input from Group HR and Group Risk as appropriate, and appropriate sign-off from the business units.
- Review major changes in Labour Law when deemed necessary.
- Liaise as required with the other Board Specialised Committees and with the Group Risk function in relation to risk-adjusted performance measures.
- Approve the contents of the annual Remuneration Policy Statement for Pillar III external disclosure.

Nomination Responsibilities:
- Review and recommend to the Board of Directors any change in the principles stated in the Governance Memo relating to the composition of the Board of Directors, the Board of Directors Specialised Committees, the Group EXCO and other relevant bodies.
- Draw up and review, as necessary, subject to approval by the Board of Directors, the evaluation process of the Board of Directors Members.
- Draw up and review as necessary the training program for newly appointed Members of the Board of Directors and the training sessions for current Members;
- Draw up and review as necessary, subject to approval by the Board of Directors, the succession plan for Members of the Board of Directors (except for staff representatives) and the Group EXCO.
- Define and review as necessary, subject to approval by the Board of Directors, the criteria which shall be used in selecting new Board of Directors Members.
- Define the specific profile to be met by candidate to be (i) a member of the Board of Directors, (ii) Chairman of each Board Specialised Committee and (iii) a member of the EXCO, included the CEO.
-

Other Responsibilities:

- Review the Terms of References as necessary and recommend to the Board of Directors for approval any amendments as appropriate.
- Recommend any amendments to the Bank BRNC's membership to the Board of Directors for approval.
- Perform annual self assessment on the effectiveness and efficiency of the Bank's BRNC.

In the course of 2013, the Board of Remuneration & Nomination Committee met six times and the attendance rate of members stood at 94%. The Chairman of the Remuneration and Nomination 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 & Nomination Committee during the year 2013 were:

- the fixed remuneration and bonuses 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 and Key Performance Indicators of the EXCO and MRTs throughout 2013;
- the remuneration of the Chairman of the Board;
- the remuneration package of members of the EXCO;
- the Material Risk Takers recruitment and exit packages;
- the set up of rules related to phantom stock remuneration;
- the practical application of the MRTs, key performers and private bankers bonuses plan;
- the implementation of a quantitative risk alignment framework for "identified staff";
- the implementation of Staff Pension Committee "Terms of References"
- 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 Group EXCO;

- Group function heads of control functions (i.e. Risk Management, Audit, Finance, Human Resources, Compliance);
- business units heads members of the Board, the Local EXCOs and general management based in Luxembourg (General Managers);
- business units function heads (local heads of control functions and possibly other function heads);
- 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 Control 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	27
Total number of identified Material Risk Takers	98

The Remuneration Process

An overall remuneration governance process is in place to cover all remuneration practices within the Group. The approach, principles and objectives of compensation schemes are disclosed to the relevant stakeholders, regulators and to the public, if requested and based upon the governance rules and codes in force.

Compensation of the Board Members

The compensation of the Board is ruled by a system of fixed remuneration and attendance fees ('jetons de présence'). The fixed part of the remuneration as well as attendance fees are both charged as expenses.

Finally, the Bank is allowed to 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 Board of Remuneration & Nomination 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 Board of Remuneration & Nomination 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 Board of Remuneration & Nomination 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 financial, people, quality/risk and Customer criteria's :

- 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 & Nomination 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 including modifier. For 2013, 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	100%
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 – 2013

Over the year 2013 at the headquarter, a total of EUR 0.17 million were spent in relation with 7 employees as a result of recruitment of personnel, on the other hand, no amount was spent in the framework of employment termination of members of the direction and material risk takers.

In 2013, the remuneration related to front (38 individuals) and back (60 individuals) offices were respectively of EUR 13.06 million and EUR 10.35 million. More specifically the remuneration structure of identified Material Risk takers was as follows in 2013:

Members of the Group EXCO and General Management (in EUR million)	
Fixed remuneration	**7.41**
Base salary	6.14
Other (pension, allowances, car leasing, etc.)	1.27
Variable remuneration:	**0.21**

Other Material Risk Takers (in EUR million)	
Fixed remuneration	**14.57**
Base salary	12.43
Other (pension, allowances, car leasing, etc.)	2.14
Variable remuneration:	**1.22**
Cash	**0.63**
Equity-related instruments	**0.59**
Other	-
Non-deferred	**0.75**
Deferred	**0.47**
Schedule of phantom shares vesting awarded in 2013	
Vesting in 2014	0.08
Vesting in 2015	0.08
Vestin in 2016	0.08