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## **KBC exceeds ECB's asset quality review and stress test thresholds and maintains strong buffer**

*KBC notes the announcements made today by the European Central Bank (ECB) and National Bank of Belgium regarding the results of the comprehensive assessment carried out by the ECB.*

*The impact of the stress test on the Common Equity Tier-1 ratio (CET1 ratio) under the adverse scenario in 2016 caused the CET1 ratio to fall by 2.6 percentage points. The impact of the asset quality review (AQR) was limited, reducing the CET1 ratio by 0.6 percentage points.*

*The combined impact of the repayment of state aid, as agreed with the European Commission, during the 3-year stress test horizon (1.8 billion EUR including penalties and coupon), the AQR and the pure stress test, resulted in a CET1 ratio of 8.3%, which represents a considerable buffer of 2.8 percentage points (2.8 billion EUR) above the ECB-imposed threshold of 5.5%, showing KBC's resilience.*

*Johan Thijs, KBC Group CEO welcomed today's announcements as follows: 'KBC acknowledges the outcome of the ECB's comprehensive assessment, which proves that KBC comfortably meets these stringent solvency requirements and also provides a reassuring signal to all stakeholders placing their trust in our institution. It also demonstrates the capacity to continue repaying the state aid received. KBC will continue to ensure that appropriate capital levels are maintained and that the focus remains on sustainable growth in core markets and activities. The result is also illustrative of KBC's strong fundamentals in the form of a healthy client-driven bank-insurance business model, a robust liquidity position supported by a very solid and loyal customer deposit base in our core markets of Belgium and Central Europe, and a comfortable level of solvency that enables us to continue increasing our lending to clients and to actively support the communities and economies we are active in.'*

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## ***1. What was the objective of the comprehensive assessment?***

*A contribution to restoring trust...*

The comprehensive assessment is an important step towards bringing greater transparency to banks' balance sheets and creating more consistent supervisory practices in Europe, with the ultimate aim of **restoring trust** in financial institutions.

*... ahead of the European Central Bank taking control of supervision*

**130 banks** in the euro area were subject to this exercise, carried out prior to the European Central Bank (ECB) assuming full responsibility for supervision, i.e. on 4 November 2014. The comprehensive assessment was led by the ECB in collaboration with the National Bank of Belgium, and was supported at all levels by independent third parties. A level playing field has been endeavoured to be put in place through, for instance, rigorous quality assurance and the use of stringent methodology.

## ***2. What are the components of the comprehensive assessment?***

*A two-pillar exercise incorporating a strict methodology*

The exercise consisted of a review of the books ending on 31 December 2013 (**an asset quality review or AQR**) and a **stress test** over a 3-year horizon (2014-2016). The stress test started from the AQR-adjusted balance sheet as of year-end 2013 and hence includes conservative adjustments.

- ° The **AQR** was held to enhance the transparency of banks' balance sheets by reviewing the quality of their assets, including the adequacy of asset and collateral valuations and related provisions.

The AQR is a *prudential* exercise: the review 'challenges' the balance sheet of an institution, departing from a conservative point of view. The approach at times is asymmetric, meaning that some 'positives' are not accounted for, whereas 'negatives' are.

The approach does not necessarily correspond with an accounting view. The outcomes of the assessment, therefore, should not and cannot be transposed directly and in full to the published accounts under International Financial Reporting Standards (IFRS) or General Accepted Accounting Principles (GAAP).

- ° The **stress test** was performed in close cooperation with the European Banking Authority (EBA), using common methodology. It examined the resilience of banks' balance sheets and earning power to stress scenarios.

The stress test incorporates the simulated impact of two scenarios over a 3-year period: a *baseline* scenario and an *adverse* scenario. Both scenarios are based on a number of assumptions (e.g., a constant balance sheet) and hence are hypothetical, which is inherent to any stress test.

Moreover, the (measurement of) the impact of these scenarios has been subject to a number of *constraints and simplifications*. As with the AQR, some 'positives' could not be accounted for in the stress test, whereas 'negatives' had to be. Even the outcome of the stress test for the baseline scenario, therefore, is *not* an appropriate prediction of KBC's performance in the years to come.

### 3. What was the scope of the comprehensive assessment for KBC?

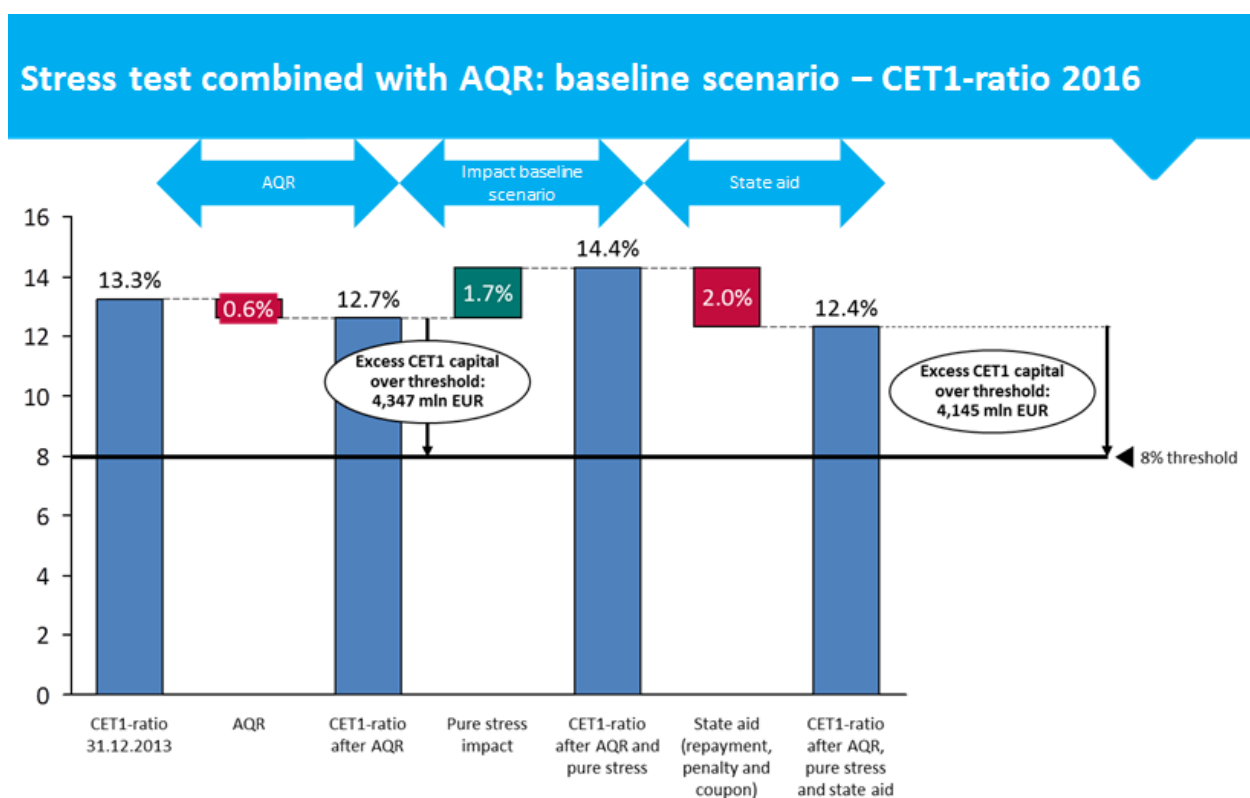
Whereas the comprehensive assessment targets **KBC Group NV**, only the consolidated accounts of *KBC Bank* have been subject to the book review (AQR).

The same holds true for the stress test: the impact of scenarios on the **banking activities** (not the *insurance business*) was calculated. The capital position (CET1 ratio), however, is measured at the level of KBC Group NV<sup>1</sup>.

### 4. How did KBC perform?

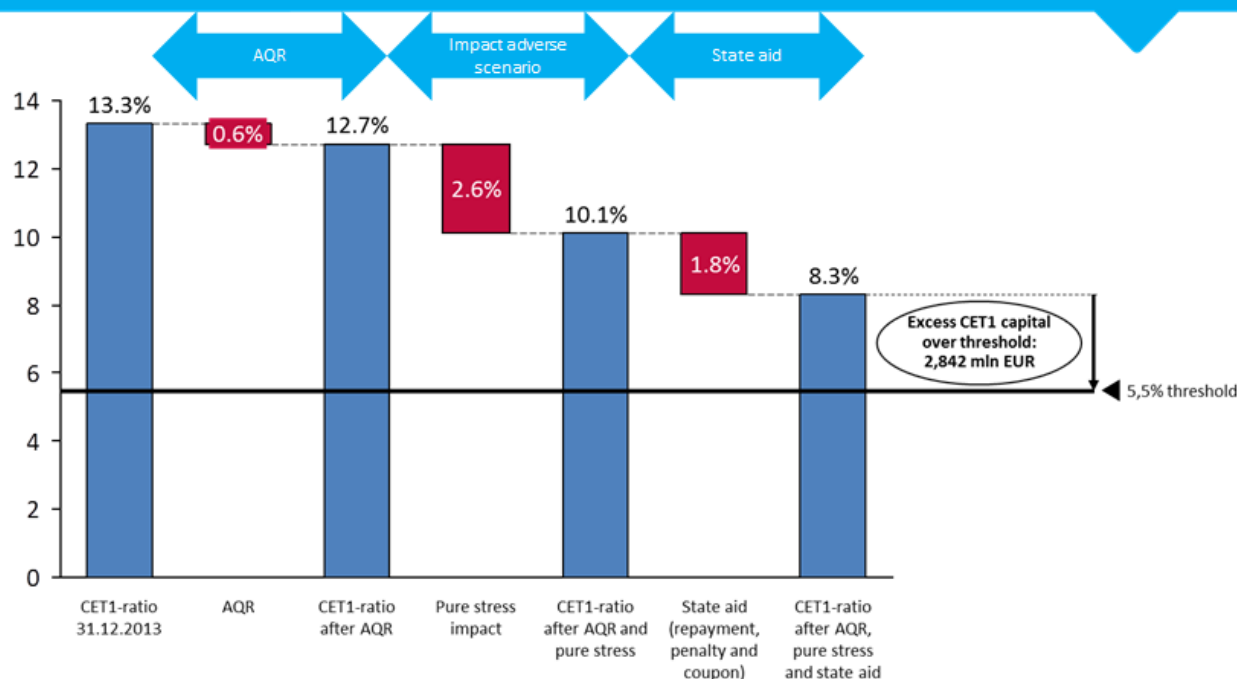
Starting from the solid CET1 ratio of 13.3% at the end of 2013, both the sole impact of the AQR and the combined impact of the AQR and the stress test leave KBC with a **considerable buffer above the ECB-imposed thresholds** (i.e. floors triggering capital measures: a CET 1 ratio of 8% for the AQR, 8% and 5.5% for the stress tests after the AQR):

- 4.3 billion EUR for the AQR alone;
- 4.1 billion EUR for the stress test after AQR adjustment in the baseline scenario;
- 2.8 billion EUR for the stress test after AQR adjustment in the adverse scenario.



<sup>1</sup> As agreed with the ECB, entities already earmarked for divestment at the end of 2013 have been kept out of scope. The impact of this exercise was very limited.

## Stress test combined with AQR: adverse scenario – CET1-ratio 2016



The combined result reflects **three major impacts**, as illustrated in the above graph:

- an adjustment resulting from the prudential **asset quality review (AQR)**,
  - o which translates into a 0.58-percentage-point reduction of the CET1 ratio as of 2013;
- the **pure stress test**,
  - o which *adds* 1.7 percentage points to the CET1 ratio by 2016 under the baseline scenario, yet
  - o which *absorbs* 2.6 percentage points of the CET1 ratio by 2016 under the adverse scenario;
- the amount of **repayment of state aid**, as agreed with the European Commission, during the 3-year horizon of the stress test (1.84 billion EUR<sup>2</sup>), which further reduces the CET1 ratio
  - o by 2.0 percentage points in the baseline scenario
  - o by 1.8 percentage points in the adverse scenario<sup>3</sup>.

The **main driver** of the total gross<sup>4</sup> AQR adjustment of 0.6 billion EUR is the **Irish mortgage** book, which represents 0.3 billion EUR of that gross figure. Therefore, this portfolio accounts for half (51%) of the total AQR adjustment.

Further to the new EBA guidelines in respect of the definition of default and forbearance<sup>5</sup>, the Irish mortgage portfolio had already undergone a major reclassification from the end of 2013 (over 2 billion EUR was reclassified to 'default'), with corresponding additions to provisions (see communication of 14 November 2013 at [www.kbc.com](http://www.kbc.com)). KBC acknowledges that a conservative view in the AQR exercise unavoidably results in a prudential adjustment.

KBC has continued to apply the EBA definitions in 2014. Over 700 million EUR's worth of Irish mortgage loans were migrated to 'default' status in the first half 2014, as individual impairment triggers were met (for example, receipt of multiple forbearance). KBC has seen a continued reduction in arrears in 2014. There has

<sup>2</sup> 1 billion EUR in capital plus the 50% penalty and a 8.5% coupon.

<sup>3</sup> In the baseline scenario, Risk Weighted Assets (RWA), i.e. the denominator of the CET1 ratio, are lower than in the adverse case. This explains why exactly the same amount of repayment causes a higher percentage point reduction of the CET1 ratio in the baseline scenario than in the adverse scenario.

<sup>4</sup> Before offsetting the tax impact.

<sup>5</sup> A forbearance measure is a concession in respect of a loan (e.g., repayment alleviation) granted to a client in financial difficulties.

also been a strong improvement in the underlying fundamentals in Ireland over the year to date, including robust GDP growth and rising house prices.

Given the above, KBC is able to confirm its prior total Irish loan loss provisioning, i.e. at the high end of the 150 to 200 million EUR range and at 50 to 100 million EUR for both 2015 and 2016.

Prudential gross adjustments in respect of the 6 **other loan portfolios** included under the scope of the AQR came to 0.2 billion EUR, most of which was accounted for by large corporate Belgian files including foreign branches (124 million EUR). KBC will use this information to re-assess individual files and possibly adapt its loan provisioning on a case-by-case basis. We expect these individual re-assessments to have a non-material impact on provisions.

Prudential gross adjustments resulting from the other work blocks of the AQR (e.g. the valuation of **derivatives**), were less than 0.1 billion EUR.

There are obviously **many drivers** impacting the outcome of the stress test. The scenarios impact both the earning power (and hence available capital, i.e. the numerator of the CET1 ratio) and the risk weighted assets (the denominator). More insight into the main drivers is given in a number of slides at [www.kbc.com](http://www.kbc.com).

## **5. What is KBC's conclusion after having successfully passed the tests?**

*Johan Thijs, KBC Group CEO concludes: 'Over the last 12 months, we have worked hard and cooperated in a very constructive manner with the ECB. We understand that the ECB had to find an equilibrium and, therefore, could not take into account all the nuances for every specific institution, including KBC. On this basis, KBC acknowledges the outcome of the ECB's comprehensive assessment. Meanwhile, 2014 has been a crucial year for KBC. A year in which KBC has continued to collapse all remaining legacy CDOs, substantially reduced the risk profile of the group, and completed the entire divestment plan agreed with the European Commission back in November 2009. KBC is now ready to face the challenges that lie ahead. Achieving sustainable and profitable growth through bank-insurance and superior client satisfaction is and remains our strategic focus.'*

KBC repeats what it announced at its Investor Day in June 2014:

KBC wants to build on its strengths and be among the best-performing, retail-focused financial institutions in Europe. This aim will be achieved by:

- strengthening in a highly cost-efficient way its bank-insurance business model for retail, SME and mid-cap clients in its core markets;
- focusing on sustainable and profitable growth within the framework of solid risk, capital and liquidity management;
- creating superior client satisfaction via a seamless, multi-channel, client-centric distribution approach.

By achieving this, KBC wants to become the reference in bank-insurance in its core markets.

## **Notes to editors:**

Further details on the results of the AQR and stress test under the baseline and adverse scenarios, as well as information on credit exposures and exposures to central and local governments, are provided in the disclosure tables based on the common format provided by the ECB and EBA. They can also be found on the websites of the ECB and EBA: <http://www.ecb.europa.eu/ssm/assessment> and [www.eba.europa.eu](http://www.eba.europa.eu)

The methodology underlying the comprehensive assessment exercise was outlined by the ECB prior to its announcement to ensure consistency across all the banks in the EU banking system that were involved in the exercise. For more details, see the ECB website: <http://www.ecb.europa.eu>.

**This information is provided for comparison purposes only and should not in any way be directly compared to banks' other published information.**

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\* This news item contains information that is subject to the transparency regulations for listed companies.

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