KBC Bank

40 YEARS in IRELAND

KBC Bank Ireland

Pillar 3 Disclosures 2012

Contents

1. Background and Introduction

KBC Bank Ireland plc (KBCI) is a wholly owned subsidiary of KBC Bank NV, one of Europe's largest banks. KBCI has been operating in Ireland for 40 years and became a member of the KBC group in 1978.

KBCI prepares consolidated financial statements under International Financial Reporting Standards (IFRS). KBCI is a credit institution authorised by the Central Bank of Ireland (CBI) and is required to file regulatory returns with the CBI for the purpose of assessing, inter alia, its capital adequacy and balance sheet. All subsidiaries are consolidated for both financial statement presentation and regulatory reporting.

KBCI is required to comply with the Capital Requirements Directive (CRD). The CRD was transposed into Irish law in 2006. The CRD is the basis for implementing the Basel II reporting framework.

The CRD has three pillars;

> **Pillar 1** – This pillar specifies the minimum capital requirement a bank must hold for Credit risk, Market risk and Operational risk.
>
> **Pillar 2** – This pillar introduced the ability of banks to estimate their own capital through an Internal Capital Adequacy Assessment Process (ICAAP). The ICAAP is subject to supervisory review from the Central Bank of Ireland, through the Supervisory Review and Evaluation Process (SREP). Pillar 2 also includes liquidity risk, business risk, interest rate risk, pension risk and concentration risk.
>
> **Pillar 3** – The CRD under Pillar 3 requires KBCI to disclose capital and risk management information.

This report is based on the Basel II reporting framework's third pillar and the resulting disclosure requirements for KBCI as at 31 December 2012. Since the end of 2011, the CRD also requires the disclosure of information on the remuneration policy of financial institutions. This information is disclosed in the statutory accounts of KBCI.
Pillar 3 of the framework relates to the disclosure of risk management information to the market, both quantitative and qualitative. This document sets out the information as required by the framework.

This report is compiled for the first time, based on 2012 results due to the size of KBCI relative to KBC group. KBCI is deemed to be a material subsidiary of KBC Bank NV and as such must comply with these disclosure requirements.

This report will be produced on an annual basis to coincide with the annual statutory accounts with information as at 31 December. Comparative data has been included where relevant.

2. Key Highlights 2012

Macro Economic factors

The Irish economy continued to be challenging in 2012. This we had anticipated and signalled, and it has proven to be the case. It too was a year of continued heightened credit costs for KBC Bank Ireland plc (KBCI) as mortgage arrears in its residential loan book continued to increase, albeit at a slower pace than heretofore. This reflects the fact that the majority of our customers continue to repay their mortgages in full and the Bank is seeing signs of success in the implementation of longer term resolution processes for its mortgage arrears customers.

The Central Statistics Office (CSO) House Price Index shows a decline of 4.5% in the year to December 2012. Recent trends point tentatively towards an emerging stabilisation in certain market segments with prices nationwide rising in four of the past six months. The national property price index shows a peak to trough decline in residential property prices of 50% between 2007 and December 2012.

Data for the first three quarters of 2012 show GDP was 0.8% higher than in the corresponding period of 2011.

KBCI 2012 Highlights

Embedding Risk Management - The Risk Management function has continued to develop and expand in 2012. More detail on the structure of the Risk Management function can be found in the risk management governance section of this report.

Lending Portfolio - The overall granted portfolio has reduced by €957m (6%) in 2012. This includes repayments from performing customers in addition to a reduction in the corporate portfolio.

Impaired - Granted Impaired loans (PD 10-12) increased €835m (23%) in 2012. Retail Impaired loans grew €719m (37%) due to loans in arrears >90 days. Defaults in the corporate portfolio increased by €116m (6.9%).

Provisions - The provision charge (Specific and IBNR) for 2012 is €547m. This is further allocated €314m and €233m to the Retail and Corporate portfolios respectively. Total stock of Provisions at 31 December 2012 is €1,720m (€1,906m including reserved interest). This represents an increase on 2011 of 37%.

Forbearance - Forbearance continues to be offered to customers facing difficult circumstances in the current economic climate. KBCI offers forbearance to customers in order to alleviate financial distress and provide support in returning customers to full annuity payments on their debt. KBCI has developed and commenced implementation of longer term resolution options for Retail mortgage customers in chronic arrears as part of the Mortgage Arrears Resolution Strategy (MARS).

Funding - The Bank continued to experience strong growth in its retail funding base with total retail deposits at the end of 2012 of approximately €1.9 billion (2011: €0.9 billion). This was principally generated in personal deposits, with competitive interest rates and the introduction of a range of new products for Irish customers.

2.1 Disclosure Policy

KBCI aims to be as open as possible when communicating to the market about its exposure to risk. Risk management information is therefore included in this separate publication to the annual financial statements.

The most important regulations governing risk and capital management are the Basel II capital requirements applying to banking entities. In the coming year, Basel II capital requirements will be altered or complemented by the Basel III framework. Basel III will gradually come into effect as of 2014.

This risk report is based on Basel II's third pillar and the resulting disclosure requirements. Disclosures required under Pillar 3 are only incorporated if they are deemed relevant and material for KBCI and if their omission or misstatement would change or influence the assessment or decision of a user relying on the information. Information regarded as proprietary or confidential has been excluded from this document given the potential impact on KBCI's competitiveness and counterparty relationships.

A comparison with the previous year is provided unless this is not possible due to differences in scope and/or methodology. This is the first Pillar 3 disclosure document for KBCI.

The information provided in this document is not required to be subject to an external audit. The disclosures have been checked for consistency with other existing risk reports and were subjected to a final screening by authorised risk management representatives to ensure quality.

Information disclosed under IFRS 7, which has been audited, is presented in KBCI's annual report. The information presented in this report coincides with the annual report where possible, but a one to one comparison cannot always be made due to the different risk concepts under IFRS and Basel II. To avoid compromising the readability of this report, relevant parts of the annual report have been reproduced within this report.

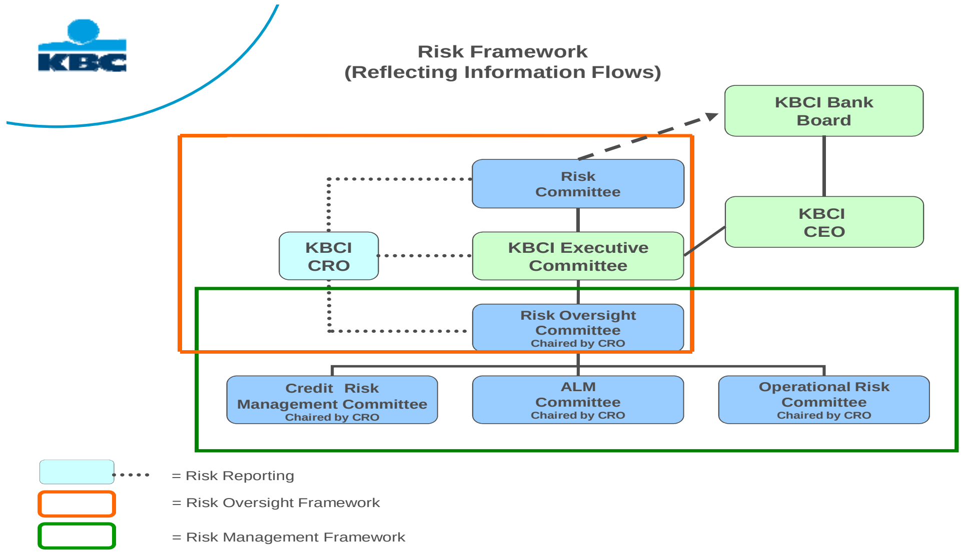
This Pillar 3 disclosure report will be available on the KBCI website www.kbc.ie. These disclosures do not constitute any form of a Financial Statement and should not be relied upon exclusively in making a judgement on KBCI.

3. Risk Management Governance

The KBCI Board is ultimately responsible for the functioning of an effective Risk Management Framework in KBCI.

KBCI has implemented a clearly defined risk governance structure, captured in a Risk Management Framework (RMF), in order to ensure that its risk management is as robust as possible. An element of this structure is the roles and responsibilities that each governance forum has within the context of the Internal Capital Adequacy Assessment Process (ICAAP). The following section sets out these respective roles and responsibilities.

Figure 1



KBCI's management are the first line of defence in the management of the risks faced by KBCI and are responsible for the implementation of the Risk Management Framework. Furthermore, management have the primary responsibility for the operational implementation of risk management and are involved at every stage of the process. Through their day to day involvement, including the monitoring and management of the evolution of KBCI's risk profile for each material risk type in a timely manner, management is best positioned to propose appropriate amendments to key policies, risk limits and risk oversight to ensure that the boundaries of the defined risk appetite and the details of the strategy are respected.

3.1 Board of Directors

The Board of Directors is the ultimate decision maker and arbiter with regard to matters affecting KBCI's strategy, organisation and internal control.

The Board is responsible for the governance and effective working of KBCI's Risk Management Framework and the integration of capital planning and capital management into the Bank's overall risk management culture and framework. The Board is also responsible for ensuring that the capital plan and management policies and procedures are communicated and implemented across KBCI and are supported by sufficient authority and resources.

The Board has established a Risk Committee as a sub-committee to assist it by providing advice in relation to this Risk Management Framework, KBCI's risk appetite and tolerance for future strategy. It is the Board's role to determine risk appetite and set strategy.

3.2 Risk Committee

The Risk Committee oversees the Risk department and the effective working of the Risk Management Framework within KBCI. The Risk Committee is required to review the ICAAP, the ICAAP Policy and risk frameworks at least annually or more frequently should the circumstances warrant it.

3.3 Executive Committee

The KBC Group approach to risk management is to identify three lines of defence against risk impacting the organisation adversely. KBCI have adopted this structure as it reflects best practice in the market and delivers a comprehensive Risk Management Framework with clear roles and responsibilities in terms of the management of risk.

KBCI management are supported in these aspects of their role by the Chief Risk Officer (CRO) and the Risk management department, which act as the second line of defence in risk management, and by Internal Audit, which acts as the third line of defence in risk management.

It is KBC Group practice that the Executive Committee is the common point at which the three lines of defence meet and are managed. This means that the Executive Committee and the Executive Directors maintain a holistic view of the management of KBCI's risks. The Executive Committee advises the Risk Committee on risk matters and can escalate issues to the Risk Committee as appropriate. The Chief Risk Officer, who is a member of the Executive Committee, acts as a liaison bridge between the Risk Committee, the Executive Committee and the Risk Oversight Committee and its sub-committees to ensure that a clear and comprehensive channel of communication is maintained at all times.

3.4 KBCI Management

KBCI’s management are the first line of defence in the management of the risks faced by KBCI and are responsible for the implementation of the Risk Management Framework. This responsibility has been delegated by the Board.

Furthermore, management have the primary responsibility for the operational implementation of risk management and are involved at every stage of the process. Through their day to day involvement, including the monitoring and management of the evolution of KBCI’s risk profile for each material risk type in a timely manner, management is positioned to propose to the Board appropriate amendments to key policies and risk limits to ensure that risk appetite and strategy is maintained.

3.5 The Chief Risk Officer and the Risk Management Department

The CRO, who is a member of the Board and the Risk Committee, is responsible for the proper functioning of the Risk Management Framework and is supported by the Risk Management department. The Risk Management department, with the Risk Oversight Committee and its subcommittees, form the second line of defence in the management of KBCI’s risks.

3.6 Risk Oversight Committee and its Subcommittees

The Risk Oversight Committee assists the Executive Committee, the Risk Committee and the Board in its consideration of the KBCI ICAAP and the Risk Management Framework; an appropriate programme of stress testing activities; the appropriate approach for calculating Pillar I regulatory capital and Pillar II economic capital; updates to KBCI’s risk appetite; the models used by KBCI in the measurement and management of risk; the reporting of the risk profile of KBCI; the use of risk mitigation techniques; the reporting of risk related items by subcommittees; and risk policies and other risk related documents.

The Risk Oversight Committee has a number of subcommittees (specifically the Credit Risk Management, the Operational Risk Management and the ALM Risk Committees) to assist it in the management of specific material risks that KBCI faces, e.g. credit risk is managed by the Credit Risk Committee. Each subcommittee has the authority to decide on all topics within its remit.

The Risk Oversight Committee therefore acts as the primary escalation point for any issues arising from subcommittees. The Risk Oversight Committee has the authority to decide on all topics within its remit and all issues escalated to it by the sub-committees. If the committee feels unable to decide on or respond to a specific matter or the financial impact of an issue or decision is material, the Risk Oversight Committee will escalate the issue to the Executive Committee.

3.7 The Audit Regulatory & Compliance (ARC) Committee

Internal Audit is the third line of defence in the management of KBCI's risks.

The Audit Regulatory & Compliance (ARC) Committee is an independent control function that monitors internal audits of business processes, including risk management, on a periodic basis in accordance with a risk based planning methodology and audit approach. The ARC Committee is a sub-committee of the Board. It reports directly to the Board of Directors and is chaired by an independent non-executive member of the Board.

4. Capital Adequacy

Capital adequacy measures the financial strength of an institution. It relates to the level of capital a financial institution needs to implement its business plans, taking into consideration the risks that threaten the realisation of such plans.

4.1 Risk Appetite

KBCI uses an Internal Capital Adequacy Assessment Process (ICAAP) to ensure it has sufficient capital to cover the current and future risks inherent in its business and future intentions. The objectives of KBCI's ICAAP policy are to adequately identify, measure, aggregate and monitor risks; to use sound risk management systems and continue to develop them further; and to maintain, on an ongoing basis, adequate internal capital to cover the significant risks to which KBCI is exposed, in accordance with KBCI's risk appetite, as determined by the Board.

KBCI's Risk Appetite can be defined as the level of risk KBCI is able and willing to accept in the pursuit of its strategic objectives. This is set and reviewed by the KBCI Board. Typical strategic objectives include not only investor returns, but also stability of earnings, the containment of credit and operational losses, capital adequacy, reputation and regulatory compliance.

It is KBCI's policy to manage the material risks it faces in its business activities. KBCI's management are the first line of defence in the management of the risks faced by KBCI and are responsible for the implementation of the KBCI Risk Management Framework.
To assess the adequacy of capital held by KBCI in relation to the risks identified and managed under the Risk Management Framework, KBCI uses stress testing to assess the impact on its future earnings and capital requirements under different macro-economic and business conditions. Stress testing enables senior management to be prepared for different economic conditions, and circumstances for which KBCI is most vulnerable. KBCI periodically independently assess its stress testing capability to ensure that the stress testing methodology is comparable with peers and aligned to best practice.

4.2 Policy & Processes

KBCI's capital policy is to maintain a capital amount at all times meeting or in excess of its minimum capital requirement. The capital requirement is measured on a regulatory capital basis. KBCI's minimum capital requirement is that it maintains the minimum Tier 1 ratio as required by the Central Bank of Ireland.

Pillar 1 regulatory capital is calculated using appropriate risk models. The scope of pillar 1 regulatory capital covers credit risk, operational risk and market risk[1]. The more material risk for KBCI is Credit Risk. In calculating the capital requirement for Credit Risk, KBCI employ the appropriate models.

RWAs represent the KBCI's assets or off-balance sheet exposures weighted according to risk. RWAs are calculated using the Probability of Default (PD), Exposure at Default (EAD) and Loss Given Default (LGD) for each counterparty adjusted for a maturity factor. RWAs are used in determining the capital requirement of KBCI.

Pillar 2 economic capital takes into account all material risks, as defined in the ICAAP Policy, that KBCI may face. KBCI uses economic capital (Ecap) in determining the adequacy of each material risk's capital requirement. KBCI's calculation of Ecap is performed using appropriate models that form part of the KBC Group Ecap methodology, which is determined by KBCI to be appropriate for use in the Irish market. The Ecap results are reported to the KBCI Risk Oversight Committee, the Risk Committee and the Board on a quarterly basis.

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[1] KBCI does not engage in proprietary trading and as such does not view Market Risk as material.

KBCI is a significant banking subsidiary in KBC Group for Capital adequacy purposes.

Capital Adequacy limits and targets are defined as part of the Risk Appetite. The Risk Appetite is approved by KBCI Board and the capital targets are required to be approved by KBC Group Executive Committee.

4.3 Regulatory Capital

Risk Weighted Assets (RWAs) are calculated using internal models in relation to the IRB processes. The parameters for RWA are outlined in section 4.2 above.

Regulatory capital for KBCI is displayed in the table below. The Tier 1 ratio and CAD ratio are above the minimum set by the Central Bank of Ireland and are in line with the KBCI risk appetite.

Figure 2

Composition of regulatory capital for the year ended 31 December 2012

	2012 ***€m***
Tier 1 capital	
Original Own Funds	**938**
Core Tier 1 capital	558
Non Core Tier 1 capital	380
Regulatory adjustments and deductions	
IRB provision excess (+) / shortfall (-)	(26)
Total Tier 1 capital	912
Total Risk Weighted Assets	8,181
Tier 1 ratio (%)	11.1%
CAD ratio (%)	**11.1%**

Original Own Funds

Original Own Funds is comprised of Core Tier I and Non-Core Tier I capital.

Core Tier I

Core Tier I Capital is comprised of Issued Ordinary Share Capital, Share Premium in respect of the Issued Ordinary Share Capital, a Capital Conversion Reserve Fund and Retained Earnings.

The Capital Conversion Reserve is an undistributable reserve which arose on the conversion of IR£ share capital to € share capital.

Non-Core Tier I

KBCI has entered into bi-lateral loan agreements with KBC Bank NV which qualify as Tier I capital.

- The loan facilities are deeply subordinated and are perpetual. The agreement does not provide KBC Bank NV with a right to call for early repayment;
- The loan cannot be repaid without CBI approval, and cannot be repaid prior to 5 years from drawdown date unless it is replaced by regulatory capital which is of equal or higher quality.
- Interest payments are discretionary (cancellable on a non-cumulative basis) and payable from distributable reserves of KBCI only;
- The loan facilities contain a loss absorbency feature whereby at a specified capital ratio trigger, the principal amount of the loan would be converted to ordinary shares in KBCI at par.

The table below summarises the RWAs for KBCI with the minimum capital requirements as at 31 December 2012.

Figure 3

Credit risk IRB minimum capital requirement for the year ended 31st December 2012

		Note	EAD	Capital Required	RWA Equivalent
Credit Risk	***IRB Advanced***		***€m***	***€m***	***€m***
	Retail		12,551	513	4,890
	IRB Foundation				
	Central governments and Central Banks		744	37	355
	Institutions		2,065	22	214
	Corporates		3,456	209	1,990
	Counterparty	(1)	4,269	9	87
	IRB Other				
	Non-credit obligation assets		102	11	102
	Standardised				
	Retail		30	2	23
			23,217	**803**	**7,661**
Market Risk	Foreign exchange position risk management		**0**	**0**	**0**
Operational Risk	Standardised			**55**	**521**
			23,217	**858**	**8,182**

(1) EAD includes Repo Exposure

Corporate exposures that are covered by guarantees for credit risk mitigation purposes were €210m in 2012.

The table below shows credit risk exposure per PD Band in terms of EAD, RWA and exposure weighted average risk weight as at 31st December 2012. Only lending exposure subject to the IRB approach is captured in this table, (Counterparty credit risk and non credit obligation assets are not included). The table shows exposure before the application of guarantees. This means that there is no shift in asset class due to PD substitution. The RWA for the exposure, however, is presented after all collateral and guarantees have been applied.

Figure 4

PD Band	EAD €m RWA €m Average in %	IRB Foundation Central Governments and Central Banks	Institutions	Corporates	IRB Advanced Retail	Total
PD 1	EAD	308	1,834	28	6	2,175
	RWA	45	166	4	0	215
	Weighted Average Risk Weight	15%	9%	15%	4%	10%
PD 2	EAD	355	24	127	216	722
	RWA	238	7	40	15	300
	Weighted Average Risk Weight	67%	31%	31%	7%	42%
PD 3	EAD	42	0	189	2,047	2,278
	RWA	32	0	124	228	383
	Weighted Average Risk Weight	77%	88%	65%	11%	17%
PD 4	EAD	36		154	3,207	3,397
	RWA	39		87	563	689
	Weighted Average Risk Weight	108%		56%	18%	20%
PD 5	EAD		0	286	1,198	1,484
	RWA		0	251	356	608
	Weighted Average Risk Weight		128%	88%	30%	41%
PD 6	EAD			190	293	483
	RWA			200	149	349
	Weighted Average Risk Weight			105%	51%	72%
PD 7	EAD			293	181	474
	RWA			377	130	507
	Weighted Average Risk Weight			129%	72%	107%
PD 8	EAD			92	289	381
	RWA			137	283	421
	Weighted Average Risk Weight			149%	98%	110%
PD 9	EAD			390	2,451	2,841
	RWA			778	3,166	3,944
	Weighted Average Risk Weight			199%	129%	139%
Total EAD		**741**	**1,858**	**1,749**	**9,888**	**14,237**
Total RWA		**354**	**173**	**1,997**	**4,890**	**7,415**
Total Weighted Average		**48%**	**9%**	**114%**	**49%**	**52%**

Note: There is €34m RWA in the impaired book relating to exposure covered by guarantees

The table below shows financial collateral and other eligible collateral.

Figure 5

Eligible collateral

	Financial Collateral	Real Estate Collateral
IRB Foundation	€ m	€ m
Central governments and Central Banks	-	10
Corporates	44	674
Counterparty	3,922	-
Total	**3,966**	**685**

4.4 Economic Capital

The Economic Capital as at 31 December 2012 for KBCI on a standalone basis is displayed in the table below.

Figure 6

ECAP for the year ended 31 December

	2012 Capital Required
ECAP per Risk Type	
Credit Risk	79%
Operational Risk	5%
ALM Risk	12%
Business Risk	4%
Total ECAP	**100%**

The Economic Capital represents the minimum amount of capital which has to be available in order to protect KBCI against economic insolvency under extreme circumstances.

KBCI’s pillar 2 capital requirement is based on standalone ECAP at a 99.9% confidence interval.

5. Credit Risk Management

5.1 Strategy and Processes

Credit risk is managed at both transactional and portfolio level. Managing credit risk at the transactional level means that there are sound procedures, processes and applications in place to identify and measure the risks before and after accepting individual exposures. Limits and delegations (based on parameters such as internal risk class, type of counterparty) are set to determine the maximum credit exposure allowed and the acceptance levels for decision making.

Managing the level of risk at portfolio level encompasses *inter alia* periodic measuring of, and reporting on, risk embedded in the consolidated loan and investment portfolios, monitoring limits, conducting stress tests under different scenarios, taking risk mitigating measures and optimising the overall credit risk profile. On a monthly basis, portfolio reports are presented to the Credit Risk Management Committee. An analysis of the credit profile of KBCI is presented to the Board as and when it convenes.

5.2 Scope of Credit Risk Disclosures

The scope of the disclosures for credit risk is based on the implementation of Basel II at KBCI as outlined in Section 5.5 below.

5.3 Exposure to Credit Risk

Credit Risk is the most material risk facing KBCI given the profile of its book. The table below shows the distribution of credit risk across the different business units of KBCI based on the approach taken in calculating minimum capital requirements. This information is taken at 31 December 2012.

Figure 7

Credit Risk Exposures €m	
	Outstanding Loan Balance
Standardised	38
IRB Foundation ^	3,479
IRB Advanced	12,445
Total	**15,963**

^ IRB Foundation includes Central Governments, Central Banks, Institutions and Corporates. Outstanding Loan Balances relate to Corporate loans only.

Figure 8

Retail Portfolio - Additional Information	
Retail Book	**€m**
Outstanding Balance	12,445
Undrawn Amount	5
Total	**12,450**
PD Profile	**€m**
PD 1-4	5,421
PD 5-7	1,655
PD 8-9	2,711
PD 10-12	2,663
Total	**12,450**
Weighted Average LGD	**%**
WALGD	**22.1%**

The maturity profile of the credit portfolio as at 31 December 2012 is shown in the table below.

Figure 9

Residual Maturity for KBCI Outstanding Exposures €m				
Maturity Bands	**Corporate/SME**	**Real Estate**	**Retail**	**Total**
< 1 year	441	1,171	35	1,647
>= 1 to <5 years	251	330	153	733
>=5 to <10 years	282	120	790	1,193
>=10 years	719	203	11,467	12,389
Total	**1,694**	**1,824**	**12,445**	**15,963**

5.4 Impaired & Past Due Not Impaired

A financial asset or a group of financial assets is impaired and impairment losses are incurred if, and only if, there is objective evidence of impairment as a result of one or more events that occurred after the initial recognition of the asset (a 'loss event') and that loss event (or events) has an impact on the estimated future cash flows of the financial asset or group of financial assets that can be reliably estimated. Objective evidence that a financial asset or group of assets is impaired includes observable data that comes to the attention of the Bank about the following loss events:

- significant financial difficulty of the issuer or borrower;
- a breach of contract, such as a default or delinquency in interest or principal payments;
- the Bank granting to the borrower, for economic or legal reasons relating to the borrower's financial difficulty, a concession that the lender would not otherwise consider;
- it becoming probable that the borrower will enter bankruptcy or other financial reorganisation;
- the disappearance of an active market for that financial asset because of financial difficulties;
- observable data indicating that there is a measurable decrease in the estimated future cash flows from a group of financial assets since the initial recognition of those assets, although the decrease cannot yet be identified with the individual financial assets in the group, including:
  - Adverse changes in the payment status of borrowers in the group; or
  - National or local economic conditions that correlate with defaults on the assets in the group; or
- the assignment of an exposure to Probability of Default ('PD') band 10-12.

The level of impaired loans increased in KBCI during 2012 by 23% from the 2011 level.

Loans and advances less than 90 days past due are not considered impaired, unless other information is available to indicate the contrary. Loans that are in arrears but not 90 days past due are categorised as “Past Due but Not Impaired”.

The two tables below show the profile of the book in relation to Impaired, past due but not Impaired and neither past due nor Impaired as at 31 December 2012. The first table shows the split based on industry class while the second shows the profile based on geographical breakdown.

Figure 10

Past Due and Impaired Outstanding Exposures by Industry €m				
Industry Class	**Neither Past due Nor Impaired**	**Past Due but Not Impaired**	**Impaired**	**Total**
Corporate	1,725	8	1,784	3,517
Retail	9,042	740	2,663	12,445
Total	**10,767**	**748**	**4,448**	**15,963**

Figure 11

Past Due and Impaired Outstanding Exposures by Geography €m				
Geographic Breakdown	**Neither Past due Nor Impaired**	**Past Due but Not Impaired**	**Impaired**	**Total**
Ireland	10,263	717	4,198	15,178
UK	473	31	205	709
Other	31	0	44	76
Total	**10,767**	**748**	**4,448**	**15,963**

For credit granted to borrowers in PD bands 10, 11 and 12 (Impaired loans), the Bank records specific impairments allowances based on an estimate of the net present value of the recoverable amount. For credit granted to borrowers in PD bands 1 to 9, a collective impairment loss is taken on a ‘portfolio basis’ using a formula that takes account of the expected loss on the portfolio, adjusted by an emergence period to reflect the incurred but not reported impairment loss.

The specific impairments calculated during 2012 are based on the expected loss KBCI would incur in the event that an agreement/facility defaults and becomes irrecoverable. The level of realised losses across the Irish banking sector remains low given the slow judicial process and consumer protection codes of conduct as issued by the Central Bank of Ireland.

The credit impairment losses of KBCI at 31 December 2012 based on industry class and geographical segment are included in the two tables below.

Figure 12

Specific & Portfolio Provisions for Impairment of KBCI Loans €m					
Industry Class	Outstanding Exposure	Performing Outstanding Exposure	Portfolio Provisions	Impaired Outstanding Exposure	Specific Provision Balance
Corporate	3,518	1,733	15	1,784	825
Retail	12,445	9,782	85	2,663	795
Total	**15,963**	**11,515**	**100**	**4,448**	**1,620**

Figure 13

Specific & Portfolio Provisions for Impairment of KBCI Loans €m					
Geographic Breakdown	Outstanding Exposure	Performing Outstanding Exposure	Portfolio Provisions	Impaired Outstanding Exposure	Specific Provision Balance
Ireland	15,178	10,980	93	4,198	1,542
UK	709	504	7	205	62
Other	76	31	0	44	17
Total	**15,963**	**11,515**	**100**	**4,448**	**1,620**

The movement in impairment provisions for 2012 is outlined in the table below.

Figure 14

Provisions Analysis 2012 €m				
Provisions	Opening Balance	2012 Charge	2012 IFRS Unwind/ Write Offs*	Closing Balance
Specific	1,177	511	(68)	1,620
Portfolio	63	36	0	100
Total	**1,240**	**547**	**(68)**	**1,720**

**FX movements included in Unwind/Write Offs*

5.5 Approaches to Credit Risk

The Capital Requirements Directive (“CRD”) provides two approaches for the calculation of minimum regulatory capital requirements for credit risk:

1. The Standardised Approach; and
2. Internal Ratings Based Approach (“IRB Approach”), which can be sub divided into
   a. Foundation Internal Ratings Based Approach (“Foundation IRB Approach”);
   b. Advanced Internal Ratings Based Approach (“Advanced IRB Approach”);

KBCI has been granted permission by the CBI to apply the Advanced IRB approach to its retail mortgage portfolio and the Foundation IRB approach to its Banking and Treasury portfolios. KBCI uses its PDs, LGDs and EADs in the calculation of Pillar I capital requirement for these portfolios.

Under the Standardised Approach, risk weightings for rated counterparties are regulatory-determined standardised risk weightings.

Banks operating under the IRB Approach are allowed to use their own internal estimates of certain risk parameters to calculate regulatory capital requirements for credit risk across different asset classes. These risk parameters are:

- Probability of default (PD),
- Loss given default (LGD)
- Exposure at default (EAD).

For non retail exposures, there are two IRB approaches. Under the Foundation IRB Approach, banks use their own estimate of PD, and regulatory estimates of LGD and EAD. Under the Advanced IRB Approach, banks use their own estimates of all three risk components. For retail exposures, there is no Foundation approach so all three risk measure are internal estimated.

The Pillar I credit risk models are challenged and back-tested on a regular basis to assess their performance on KBCI's portfolios. This challenge is performed by the Credit Risk Management Committee.

KBCI calculates its Pillar II economic capital (Ecap) for Credit risk using the outputs of the KBC Group Credit Portfolio Model (CPM). CPM is developed in accordance with the KBC Group Model Management Framework and is subject to the standard KBC Group modelling and validation processes.

5.6 Credit Risk Mitigation Techniques

KBCI's Credit Assessment is primarily based on an assessment of affordability and repayment capacity.

KBCI views its risk governance structure, including the Board, Risk Committee, Risk Oversight Committee, Credit Risk Management Committee, and the responsibilities for credit risk management from Board level down to line management, as a significant mitigant of credit risk.

In addition to these governance bodies, the KBCI Credit Committee monitors credit risk at a transaction level for new and existing transactions and the KBCI New and Active Products committee monitors the credit risk involved in new products and processes, or in changes to existing products and processes.
A Credit Policy is in place outlining policies in relation to securing collateral, establishing credit reserves and risk exposures.

5.7 Internal Modelling

The credit risk models developed by KBCI include PD, LGD and EAD models, plus application and behavioural scorecards for specific portfolios (retail).

These models are used within the credit process for:
- defining the delegation level for credit approval (e.g., PD models);
- accepting credit transactions (e.g., application scorecards);
- setting limits;
- pricing credit transactions ;
- monitoring the risk of a (client) portfolio;
- calculating the internal economic capital;
- calculating the regulatory capital;

Probability of Default (PD)

Probability of Default (PD) is the likelihood that an obligor will default on its obligations within a one-year time horizon, with default being defined in accordance with Basel II rules. The PD is calculated for each client or for a portfolio. As KBCI operates under IRB approach, KBCI uses its own internal estimates of PD for regulatory capital calculations.

Within KBCI, there are three types of PD models developed:

- Statistical default/non-default models based on objective inputs: Rankings are derived purely mechanically with no subjective input, using regression techniques. At KBCI, this method is only used in the retail segment where objective data is plentiful (e.g., behavioural information).

- Statistical default/non-default models based on objective and subjective input: These are very similar to the purely objective models, but also use subjective input entered by a credit adviser (for instance management quality, market position). At KBCI, this method is used to rank large Western European corporate customers.

- Statistical expert-based models: Rankings are based on quantitative and qualitative input, but due to the small number of observed default events, regression is applied to predict expert assessments of the creditworthiness of the clients, rather than their default/non-default behaviour. At KBC, this method is used to rank borrowers in the SME segment.

The PD score resulting from the rating model is then calibrated towards the Central Tendency (CT). The CT is the expected long term default rate for the given portfolio over a full economic cycle. As such, all of KBCI's PD models are considered to be Through the Cycle (TTC) models.

The output generated by these models is used to split the performing loan portfolio into internal rating classes ranging from 1 (lowest risk) to 9 (highest risk) for the PD according to the KBCI masterscale[2].

Loss Given Default (LGD) Models

Loss Given Default (LGD) is a measure of the loss that a bank would suffer if an obligor defaults. It can be expressed as an amount or as a percentage of the expected amount outstanding at the time of default (EAD).

KBCI estimates LGD by determining the sum of cash flows resulting from the workout and/or collections process, discounted to the time of default and expressed as a percentage of the estimated exposure at default. Each of models developed are methodologically based on historical recovery rates and cure rates (the percentage of defaulted clients returning to performing state) per collateral type or per pool (segmentation-based approach).

As proposed by Basel II, the LGD estimates used for regulatory capital calculations are downturn estimates of LGD.

Exposure At Default (EAD) Models

KBC uses historical information that is available on exposures of defaulted counterparties to model EAD. The EAD model is used to estimate the amount that is expected to be outstanding when a counterparty defaults in the course of the next year.

In most cases, EAD equals the nominal amount of the facility, but for certain facilities (e.g., those with undrawn commitments) it includes an estimate of future drawings prior to default.

[2] The KBCI masterscale is a mapping of PD % to specific bands in order to pool clients based on their risk profile. It consists of 9 bands running from low to high risk where each band is double the risk of the one before it.

All of KBCIs regulatory models are continuously back tested to ensure their performance is satisfactory. Before a model is implemented the following are tested:

- Performance of the calibration
- Rank ordering of defaults/cures
- Migration of defaults/cures
- Stability index
- Ordinal power of LGDs against observed losses

Each model is also independently validated by a separate validation unit where several quantitative and qualitative checks are preformed. Before the approval of a new rating model, the findings of the validation report are presented to the approval committee.

Credit Portfolio Model (CPM)

Economic capital for credit risk is calculated in KBCI using the Credit Portfolio Model (CPM). The CPM models loan portfolio behaviour by simulating common default behaviour between counterparties. CPM takes the idiosyncratic (i.e. individual) behaviour of larger loans and the systematic (i.e. common) behaviour of pools of smaller similar loans into account in simulating multiple default scenarios.

CPM models the systematic behaviour of a counterparty using three risk factors – industry sector, geographical region and size. CPM's sectoral approach uses CREDAC codes associated with each Banking loan. Size is computed based on information gleaned from audited accounts. A significant majority of KBCI's borrowers are based in Ireland and so geography is a less important risk driver for the calculation of KBCI's economic capital on a standalone basis.

CPM uses multiple random simulations of loss events to determine correlated behaviour across segments. In this way the concentration risk originating from a correlated movement of individual sectors is also captured by CPM.

The KBCI specific configuration of CPM includes the following:

- Inter- and intra-sector correlations based on UK and Ireland data, for use with the Banking portfolio.
- A retail index based on unemployment and short term interest rates, for use with the Homeloans portfolio.

CPM assesses concentration risk from the overall perspective of the KBCI portfolio, together with the portfolio structure (i.e. the combination of Retail mortgages, SME, Corporate and CRE lending) and diversification characteristics.

5.8 Counterparty Credit Risk

KBCI defines counterparty credit risk as the credit risk resulting from over the counter transactions, which are in the main interest related transactions (e.g. Interest Rate Swaps), currency related transactions (e.g. FX swaps) or equity related transactions.

Counterparty limits are set for each individual counterparty, taking into account the general rules and procedures set out in a group wide policy. Sub limits can be put in place for each product type. The risk is monitored by a real time limit control system which allows the ALM desk to check limit availability at any time. Limits are monitored and reported by Risk Management on a daily basis.

The counterparty credit risk exposure at default is €185m at 31st December 2012. For further details of counterparty credit risk exposures please see note 16 of the Financial Statements.

6. Liquidity Risk Management

Liquidity risk is the risk that an organisation will be unable to meet its liabilities / obligations as they come due, without incurring unacceptable losses.

6.1 Strategy & Processes

KBCI is committed to adopting prudent liquidity and funding management policies with the objective of maintaining a diversified funding base and ensuring that reliance on short term wholesale sources of funds are within acceptable levels. The management of liquidity and funding risk within KBCI is undertaken within designated limits and other policy guidelines set by the CBI, KBC Group, KBCI Board of Directors and best practice.

Liquidity management for KBCI focuses on the overall balance sheet structure and the control of risk arising from the mismatch of maturities across the balance sheet. KBCI manages its operational liquidity within a delegated 30 day contingency gap limit and makes use of NSFR, LCR and LTD ratio to measure and report on the evolution of its liquidity and funding profile.

It is KBCI policy to ensure that resources are available at all times to meet the bank's obligations arising from withdrawal of customer demand or term deposits, non-renewal of interbank liabilities, the drawdown of customer facilities, asset expansion and other contingent obligations.

6.2 Scope of Liquidity Risk Management

The liquidity Policy covers liquidity risk management and reporting for KBC Bank (Ireland) plc.

6.3 Structural Liquidity Risk

KBCI's structural liquidity risk is measured by grouping the assets and liabilities according to the remaining term to maturity (contractual maturity date). The difference between the cash inflows and outflows is referred to as the 'net liquidity gap'.

KBC's contingency liquidity gap framework is based on operating within a predefined liquidity gap in a 30 day period.

KBCI participated in the ECB's long term refinancing operations (LTRO) of December 2011 and February 2012, borrowing a total of €3.6 billion. This has been redeemed in full in Q1 2013.

7. Securitisations

The objective of the securitisations is to turn illiquid mortgage assets into securitised notes / collateral, against which funding can be raised. The credit institution acts as the loan originator for the mortgage assets. It is then involved in selling the assets to the securitisation vehicle in return for the securitised notes. It continues to act as servicer for the assets and as mortgage manager for the securitisation vehicles. It also acts as transaction swap counterparty for some of the securitisations and subordinated loan provider for all issues. KBCI has ownership of all floating rate notes issued by Phoenix Funding 2 Limited, Phoenix Funding 3 Limited, Phoenix Funding 4 Limited and Phoenix Funding 5 Limited. In 2008, the Bank transferred mortgage loans into Phoenix Funding 2 Limited and Phoenix Funding 3 Limited, in 2009 into Phoenix Funding 4 Limited and in 2012 into Phoenix Funding 5 Limited. The share capital of Phoenix Funding 2 Limited, Phoenix Funding 3 Limited, Phoenix Funding 4 Limited and Phoenix Funding 5 Limited is owned by Capita Trust Nominees No. 1 Limited, a company not related to KBC Bank Ireland plc or any of its subsidiaries.

The financial statements of Phoenix Funding 2 Limited, Phoenix Funding 3 Limited, Phoenix Funding 4 Limited and Phoenix Funding 5 Limited are consolidated into the consolidated financial statements of KBC Bank Ireland plc. Although the companies are not subsidiaries of KBC Bank Ireland plc, the Bank retains substantially all the risks and rewards of the ownership of the assets in Phoenix Funding 2 Limited, Phoenix Funding 3 Limited, Phoenix Funding 4 Limited and Phoenix Funding 5 Limited. The floating rate notes issued by Phoenix Funding 2 Limited, Phoenix Funding 3 Limited, Phoenix Funding 4 Limited and Phoenix Funding 5 Limited are listed on the Irish Stock Exchange.

7.1 Total Outstanding Securitised Exposures

The gross carrying amount of mortgages in the securitised companies recognised in the statement of financial position at 31 December 2012 is:

Figure 15

KBCI Securitisations - €m			
Securitised Book	**Outstanding Exposure 2012****	**Outstanding Exposure 2011****	**Movement since 31.12.2011**
Phoenix 2	6,364	6,561	(196)
Phoenix 3	2,649	2,766	(116)
Phoenix 4	704	733	(28)
Phoenix 5*	874		874
Total	**10,592**	**10,059**	**533**

* Phoenix 5 securitisation initiated in 2012
** Outstanding Exposure excludes all un-secured Top Ups in addition to secured top-ups which do not meet the criteria for inclusion in the respective pools

The notes are eligible as collateral for the ECB and thus provide an added liquidity buffer for KBC Bank. The Basel II securitisation framework does not apply to KBCI as an insufficient amount of the risk incurred has been transferred.

The securitisations are internal and consolidated into the financial statements of KBC Bank Ireland plc ("the bank"). The accounting policies of the securitization companies are in line with the policies adopted by the bank and are set out in the bank's consolidated financial statements.

8. ALM Risk

The process of managing KBCI's structural exposure to market risk is also known as Asset/Liability Management (ALM). ALM risk is defined as the potential negative deviation from the expected net asset value of KBCI's corporate portfolio and sovereign bond portfolio due to changes in the level or in the volatility of market prices.

8.1 Sources of ALM Risk

The primary sources of KBCI ALM risk, i.e. interest rate risk and foreign exchange risk, are:

- The structural interest rate risk position (sovereign bond portfolio); and
- The interest rate risk arising from funding, lending, sales and hedging activities.

The primary source of ALM concentration risk in KBCI's portfolio is the concentration of larger exposures to specific sovereign bonds.

The primary source of ALM counterparty risk is credit exposures to banks and financial institutions with which KBCI transacts hedging derivatives and/or places deposits.

8.2 Measurement Methodology for ALM Risk

KBCI uses two distinct methodologies for the measurement of ALM risk.

KBCI uses the Basis Point Value (BPV) methodology to measure its exposure to interest rate movements. BPV is used to measure interest rate risk associated with loans, funding, swaps, bonds, futures and other interest rate derivatives to capture all interest rate risk arising from KBCI's ALM activities. KBCI uses foreign exchange exposure nominal limits to measure foreign exchange risk.

BPV quantifies the gain or loss on interest rate positions for a 0.1% (10 basis points) parallel shift upwards in the yield curve.

KBCI uses a parametric value at risk (PVaR) methodology to measure and to calculate the economic capital required to mitigate its ALM risk. The PVaR model estimates the value at risk of KBCI's ALM position as the maximum value the portfolio can loose.

- Under instantaneous shocks to key risk drivers such as interest and foreign exchange rates;
- Reflecting market movements over a 1 year period;
- Within a 99% confidence level, meaning that there is a 1% probability that an actual loss will be higher than the predicted loss;
- With respect to the expected value under these shocks;
- For a fixed portfolio composition over a 1 year holding period.

Interest and foreign exchange rates are the key risk to the value of KBCI's ALM portfolio. The PVaR model calculates the value at risk by applying shocks to interest and foreign exchange rates and recalculating the net present value of the ALM portfolio multiple times. The 99% worst loss from these multiple shock scenarios become's KBCI's ALM capital requirement.

The PVaR model uses a term structure for interest and foreign exchange rates, reflecting the fact that interest and foreign exchange rates may change over time. To reduce complexity, shocks are applied to interest rate curves in terms of:

- The level of the rate curve, which leads to a parallel move of the curve up or down.
- The slope or steepness of the rate curve, which leads to a steepening or flattening of the curve.

8.3 Management and Monitoring of ALM Risk

ALM risk is managed by the KBCI ALM Risk Committee, a subcommittee of the Risk Oversight Committee.

The management of KBCI's ALM positions is determined by the ALM Committee in accordance with the KBCI Treasury Policy and KBCI Strategic Interest Rate Risk Policy which clearly sets out the limits and criteria for the banking book and the sovereign bond portfolio respectively.

The banking book position and the sovereign bond portfolio are monitored on an ongoing basis by the ALM department, and by the ALM Committee.

8.4 Mitigation of ALM Risk

Capital is considered a mitigant for ALM interest rate risk as the crystallisation of such risk involves opportunity cost losses which impact on the capital base.

9. Operational Risk Management

Operational Risk is the risk of loss resulting from inadequate or failed internal processes, people, and systems or from external events. Operational risks include the risk of fraud as well as legal, compliance and tax risks. This definition is in line with the Basel Committee on Banking Supervisions consultative document on "Sound Practices for Management and Supervision of Operational Risk".

The impact of incidents on KBCI's and KBC Group's reputation is taken into consideration when establishing vulnerability to operational risk incidents.

KBCI is committed to adopting prudent operational risk management policies with the objective of managing the operational risks faced by KBCI within the KBCI risk appetite.

KBCI uses the Standardised Approach to calculate the regulatory capital for operational risk.
The capital requirement is calculated annually and is the sum of the previous three years' average gross income of each business line adjusted by a beta. The average the gross income is used to prevent major fluctuations in the operational risk capital charge.

The CRD sets out eight business lines allowable under the STA approach, three are applicable to KBCI:

- Commercial Banking
- Retail Banking
- Trading and Sales

9.1 Strategy & Processes

KBC Group has a single, global framework for managing operational risk across the entire group. This framework is embedded in KBCI and consists of a uniform operational risk language in group wide key controls, one methodology and centralised and decentralised reporting.

9.2 Scope of Operational Risk Management

The scope of the Operational Risk Management Committee covers all matters relating to operational risk, with particular focus on operational risks associated with internal processes, people, systems and external events.

The scope of KBCI's operational risk management also includes all subsidiaries and branches of KBCI.

9.3 Operational Risk Governance

The Operational Risk Management Committee (ORMC) assists the ROC in relation to the operational risk matters by reviewing, recommending and/or making decisions as deemed appropriate.

The ORMC convenes on a monthly basis. Only the Risk Oversight Committee can change the functional composition of the ORMC.

KBCI line management remains responsible and accountable for the management of the operational risks incurred by the business areas for which they are responsible.

10. Business and Strategy Risk

Business/strategic risk is defined as the risk of the potential negative deviation from the expected economic value of the organisation due to changes in the volumes and operational margins resulting from changes in the environment of the organisation and maladjusted or inadequately implemented strategies.

10.1 Sources of Business/Strategy Risk

The primary source of business/strategic risk is a change in the KBCI's market environment that results in a negative deviation from KBCI's expected economic value.

The secondary source of business/strategic risk is a maladjusted or inadequately implemented strategy that results in a negative deviation from KBCI's expected economic value.

KBCI also manages the business concentration risk associated with, for example, its distribution channels.

10.2 Measurement Methodology for Business/Strategy Risk

Business/Strategy Risk represents the volatility of revenues and costs due to the impact of changes in the market environment and/or strategic decisions. KBCI does not have a risk model to measure business/strategic risk, but in order to create awareness for this risk it is included in the ICAAP economic capital calculations.

The measurement is based on a high level estimation using a percentage of operating expenses. The calculations are based on a conservative external benchmark approach and validated on an annual basis by KBCI.

10.3 Management and Monitoring of Business/Strategy Risk

The Executive Committee manage KBCI's business/strategy risk by ensuring that the business model continues to be appropriate for the current and foreseeable market circumstances;

- Strategic management:
- Monitoring developments in key markets:
- Revenue and cost management:

The monitoring and control of KBCI's business risk is carried out by the Executive Committee and the Board in reviewing the stability of earnings and in considering the impact on these earnings of changes in the market environment and any strategic decisions taken by the Board.

The Board also reviews and approves annually KBCI's Alignment of Planning Cycles strategic document.

10.4 Mitigation of Business/Strategy Risk

Capital is considered a mitigant for business risk as the crystallisation of such risk involves a reduction in capital generation through lower profits or realisation of losses which impact on the capital base without proportionate decrease in risk assets.

11. Reputational Risk

Reputational risk is defined as the risk arising from the negative perception on the part of stakeholders such as customers, counterparties, shareholders, investors, debt-holders, market analysts, other relevant parties or regulators that can adversely affect a bank's ability to maintain existing, or establish new, business relationships and continued access to sources of funding.

11.1 Sources of Reputational Risk

The primary sources of reputational risk are those activities or actions that can result in a negative perception of KBCI.

KBCI manages the potential impact of reputational risk on its business activities.

11.2 Measurement Methodology for Reputational Risk

The scale of the risk is assessed by the Board on the basis of the profile of KBCI in the Irish market, which reflects the nature and scale of the business activities, the size of the customer base and the market appetite of KBCI, and the conditions of the Irish market which is affected by the actions of all participants, e.g. financial services providers, customers, intermediaries, regulatory authorities, commentators, analysts etc.

11.3 Management and Monitoring of Reputational Risk

The Executive Committee manages reputational risk through controlled business processes, the Risk Management Framework, appropriate policies and procedures, the Staff Code of Conduct, market information, NAPP and operational risk monitoring.

The monitoring and control of KBCI's reputation risk is carried out by the Executive Committee and the Board in considering the reputational impact of the strategy and business activities of KBCI. In addition, KBCI has established a Reputation Council which is a subcommittee of the ORMC and contains representative from relevant areas of the business. This council monitors and advises on potential reputational risk issues. Market or media commentary relating directly or indirectly to KBCI is monitored on an ongoing basis by the Marketing department and reported to senior management, the Executive Committee and the Board Risk Committee.

The reports to the Executive Committee, ARC Committee and Board from the Internal Audit and Compliance functions include areas that are susceptible to reputation risk.

11.4 Mitigation of Reputational Risk

Capital is not considered a mitigant for reputation risk.

KBCI's corporate and social responsibility programme is an example of a pro-active mitigant in relation to reputational risk. KBCI's outreach into the community recognises that its good name and reputation is earned, managed and optimised based on its behaviour towards all stakeholders.

The procedure for dealing with events that could harm KBCI's reputation, such as the dissemination of inaccurate or misleading market commentary or media coverage, which includes the rapid, clear communication to relevant parties, is considered by KBCI to be the most effective mitigation for reputation risk.

12. Pension Risk

KBCI's Pension risk is defined as the risk that a deficit could occur on KBCI's defined benefit pension fund which would impact on KBCI's capital base.

The source of pension risk is KBCI's staff defined benefit pension scheme. From the 31st August 2012, the Scheme closed to future accrual of pensionable service. There is no pension risk attached to the new staff defined contribution pension scheme. Therefore, future pension risk is on a diminishing basis.

12.1 Sources of Pension Risk

The source of pension risk is KBCI's staff defined benefit pension scheme.

12.2 Management and Monitoring of Pension Risk

The Executive Committee manages pension risk in conjunction with the pension trustees by assessing the pension funding against the MFS requirement.

The monitoring and control of KBCI's pension risk is carried out by the Executive Committee and the pension trustees, and reported as required to the Board.

12.3 Mitigation of Pension Risk

Risk is mitigated by holding a diversified range of assets in the pension scheme

Capital is also considered a mitigant for pension risk. Capital would be assigned for any gap in pension funding as identified by the Minimum Funding Standard requirement. As at 31 December 2012 the scheme met its Minimum Funding Standard requirement.

13. Stress Testing

13.1 Stress Testing Pillar III Disclosure

Stress testing is an important risk management tool that is used by KBCI as part of its internal risk management. Stress testing is a means for considering how KBCI's risk profile and capital requirements can be impacted through adverse scenarios. Stress tests inform KBCI on the impact of changing hypothetical internal and external conditions on risk, liquidity and capital needs, any 'buffer' required to regulatory capital and the overall credit-worthiness of the KBCI portfolios.

Stress testing is an important constituent of KBCI's Risk Management Framework and KBCI uses stress testing to assess capital adequacy in relation to its material risks, including credit risk, ALM (interest rate) risk, operational risk, concentration risk and liquidity risk. Within the context of capital adequacy, KBCI carries out stress testing on its Economic Capital (ECAP) requirement.

All material risks, identified in the ICAAP, are subject to stress testing at minimum annually.

13.2 Scenario Stress Tests:

Scenario stress tests combine stresses on different risk types, to examine the evolution over time of aspects of financial measures like P&L, capital required and available liquidity, through a scenario which can be defined under normal (base case) or under stressed conditions, with the aim of triggering management decisions.

KBCI conducts a range of scenario stress testing with appropriate degrees of severity to inform management of possible outcomes. The exact combinations of mild/severe scenarios are determined by the stress testing requirements of the Risk Committee.

Scenario stress tests combine the impact on several material risks with the purpose of identifying KBCI specific vulnerabilities. Inter-risk concentration risk stress testing is included in the scope of scenario stress testing.

13.3 Sensitivity Stress Tests:

Sensitivity stress tests are forward looking stress tests performed on all or a part of KBCI's portfolio, focusing on a single type of risk or a single risk measure and seeking to identify KBCI specific vulnerabilities. Intra-risk concentration risk stress testing is included in the scope of sensitivity stress testing.

A range of sensitivity stress testing may be conducted with different degrees of severity to inform management of possible outcomes. Over time, scenario stress tests consider all material risk types individually and address the main drivers of risk that KBCI is exposed to.

13.4 Reverse Stress Tests

Reverse Stress Testing is a risk management technique to complement the other tools in KBCI's risk management framework. It is used to determine what scenario or scenarios could give rise to a situation that threatens KBCI's solvency or ability to continue in business. Its objective is not to determine a level of capital that would be required as a mitigant of risk; instead the purpose of a reverse stress test is to provide a qualitative description of that event or confluence of events that would transpire and could subsequently lead to KBCI's closure.

A further objective of reverse stress testing is to provide a sounding board for the other elements of KBCI's stress testing program, in particular the firm-wide scenario type stress tests. The top-down nature of reverse stress testing should be able to identify potential business vulnerabilities, which may not be apparent from sensitivity analysis.

Reverse stress testing is a firm-wide test. In common with other types of stress testing, the principle of first round and feedback effects are factored into any macro-economic shocks to KBCI's solvency.

13.5 Risk Specific Stress Tests:

Credit Risk Stress Testing

KBCI performs credit stress testing based on a number of hypothetical economic scenarios.

Credit stress testing is performed at a portfolio or sub-portfolio level and consists of modifications of the baseline credit risk parameters, i.e. PD, LGD and EAD, to simulate credit quality migration based on the changing economic situation and measurement of the consequent impact on the regulatory capital requirements in line with the requirements of Basel II. A credit risk stress scenario may also stress collateral values as changes to collateral values may have a material impact on credit losses. PD and LGD movements may be stressed individually or jointly, depending on the needs of the scenario.

Credit stress testing results are reported to the Risk Oversight Committee and the Board Risk Committee.

ALM (Interest Rate) Risk Stress Testing

KBCI carries out market risk stress tests on interest rates and foreign exchange movements. Scenario analysis is used on a regular basis to analyse possible future events and to capture losses under stress situations as well as normal market conditions. Different scenarios are used to anticipate the impact of different curve movements (FX and Interest rate) and historical events in order to anticipate potential losses arising from these scenarios.

Operational Risk Stress Testing

KBCI performs a number of different stress tests on its operational risk. KBCI uses stress tests based on scenario analysis of hypothetical operational risk events to assess the adequacy of operational risk capital. These tests may be informed by past losses and loss data, but the scenarios are essentially forward looking and may provide narrative on possible new losses that have not occurred in the past.

KBCI views the Business Continuity Test as a critical form of stress test for key operational risks, such as staff, technology and processes.

Liquidity Risk Stress Testing

KBCI carries out Liquidity Risk Stress Testing on a weekly and monthly basis. The liquidity stress testing covers all products in KBCI, in accordance with Regulatory requirements. Scenarios are conducted on point in time data, and stressed severely from there. Time horizons range from one to three months. The results of the stress tests are used to propose risk tolerances for cash-flow mismatches and determine appropriate action for breaches of predetermined tolerances.

Concentration Risk Stress Testing

In identifying suitable concentration risk stress scenarios, KBCI recognises that concentration risk may impact different risk in different ways, e.g.

- Credit risk – large exposure concentrations, counterparty concentration risk, sectoral concentrations, geographical concentrations, collateral type concentrations, correlations between obligors and sectors increase in times of stress.
- Operational risk – the use of loss data in identifying current high frequency medium impact loss events that could increase in frequency and impact in a stressed period
- Liquidity risk – funding concentration on KBC Group, large individual depositors concentration,

KBCI also recognises the inter-risk types of concentration risk, e.g.

- Reputational and funding risk – KBCI relies on its good reputation to attract customer deposits to diversify its funding risk and reduce its funding concentration.
- Operational and liquidity risk – KBCI could have a concentration of operational risk in relation to a single counterparty, which could lead to increased liquidity risk.
- Credit and liquidity risk – further haircuts on KBCI's liquid collateral could result in a reduction in KBCI's available liquidity.

As part of its overall stress testing programme, KBCI will include scenarios that specifically stress concentration risk to understand the impact of risk concentrations specific to KBCI's portfolios and business and funding models.

13.6 ICAAP Stress Testing

On an annual basis KBCI conducts the Alignment of Planning Cycles (APC) strategic forecasting process as part of its Internal Capital Adequacy Assessment Process (ICAAP).

Appendix 1 – Glossary (Key Terms & Abbreviations)

Term	Definition
APC	Annual Planning Cycle
ARC	Audit Regulatory and Compliance
BPV	Basis Point Value
BRC	Board Risk Committee
CAD	Capital Adequacy ratio
CBI	Central Bank of Ireland
CPM	Credit Portfolio Model
CRD	Capital Requirements Directive
CRO	Chief Risk Officer
CSA	Credit Support Annex
CSO	Central Statistics Office
CT	Central Tendency
EAD	Exposure at Default
EC	Executive Committee
ECAP	Economic Capital
Financial Statement	The KBC Ireland plc. and subsidiaries Consolidated Financial Statements for the year ended 31st December 2012.
ICAAP	Internal Capital Adequacy Assessment Process
IRB	Internal Ratings Based Approach
KBCI	KBC Bank Ireland plc
LCR	Liquidity Coverage Ratio
LGD	Loss Given Default
LTD	Loan To Deposits Ratio
MARS	Mortgage Arrears Resolution Strategy
MMF	Model Management Framework
NAPP	New and Active Products Process
NSFR	Net Stable Funding Ratio
ORMC	Operational Risk Management Committee
PD	Probability of Default
PVAR	Parametric Value At Risk
RAF	Risk Appetite Framework
RMF	Risk Management Framework
ROC	Risk Oversight Committee
RWA	Risk Weighted Asset
SREP	Supervisory Review and Evaluation Process
TTC	Through The Cycle