Press release

Outside trading hours - Regulated information*

Brussels, 16 November 2015 (07.00 a.m. CET)

# KBC 3Q2015: Strong quarterly profit of 600 million euros

# Excellent 1.8 billion euros of profit for the first nine months of 2015

**During the summer months, our clients continued to put their trust in us: lending and deposit volumes went up in virtually all of the countries where we operate. A low cost of credit also ensured that profit thrived. In a backdrop of economic recovery, but also of low interest rates and volatile financial markets, KBC ended the third quarter of 2015 with a strong net profit of 600 million euros, somewhat below the 666 million euros recorded in the previous quarter and the 608 million euros recorded in the year-earlier quarter. The total result for the first nine months of 2015 stands at 1 776 million euros. The business model performed very well, as illustrated by the fact that all countries were profitable in the third quarter.**

## Financial highlights for the third quarter of 2015, compared with the second quarter of 2015:

- Both the banking and insurance franchises in our core markets and core activities turned in a good performance.
- We again granted more loans in Belgium (+2%), the Czech Republic (+2%), Slovakia (+5%) and Bulgaria (+3%), while clients further increased their deposits in most of our countries: the Czech Republic (+2%), Hungary (+1%), Slovakia (+3%), Bulgaria (+4%) and Ireland (+4%)
- Lower prepayment fees and the low interest rate environment caused our net interest income to contract by 3%, and the net interest margin narrowed from 2.06% to 1.99%
- Sales of non-life insurance products across all our markets were up year-on-year, and the non-life combined ratio stood at an excellent 89% year-to-date. Sales of life products decreased.
- Clients further increased their assets managed by KBC. Total assets under management of our group ended somewhat down at 200 billion euros, despite these positive net entries, mainly as a result of the weak market performance. Our net fee and commission income dropped substantially due to lower sales and

the weak market performance from very strong levels in the second quarter and is estimated to end in the range of 360 to 370 million euros for the fourth quarter

- The result from financial instruments at fair value was modest given the stable valuation of the derivatives we use for asset/liability management purposes and weak level of dealing room income, among other factors.
- Excluding special bank taxes, costs were down 2%. The cost/income ratio stood at a good 54% year-to-date.
- The cost of credit amounted to a low 0.23% of our loan portfolio year-to-date.
- Our liquidity position remains solid, and our capital base – with a common equity ratio of 17.4% (fully loaded, Danish compromise) – remains well above the regulator's target.

## Johan Thijs, our group CEO added:

*'The confidence and trust we receive from both existing and new clients show that our approach is paying off. We posted an excellent result of 600 million euros in the third quarter through our strong banking and insurance franchise, and achieved it in challenging economic times. Clients' trust in us is reflected in the growth of our deposit base, our loan book and the net increase in sales of our investment products as well as through our insurance products. I am also very pleased to see that a profit was recorded this quarter in all our countries. However, the continuing low level of interest rates remains a challenge for the entire financial sector. And the volatility in the financial markets puts a challenge on the fee business. Nevertheless, we continue to invest in the future and are pro-actively rolling out our digitalisation plans further in order to serve clients even better.*

*On the regulatory front, the National Bank of Belgium announced its new capital buffers for Belgian systemically important banks, including ours. The regulator's decision clarifies for the group and our stakeholders the capital requirements KBC must meet. We feel comfortable with the size of the additional buffer that the National Bank is asking and that we had already factored in to our capital management models. As our capital position is currently very robust we can easily absorb this extra buffer and still stick to our strategic ambitions and planned dividend pay-out ratio of at least 50%. That is a comforting signal to all stakeholders who put their trust in us.'*

| Overview<br>KBC Group (consolidated) | 3Q2014 | 2Q2015 | 3Q2015 | 9M2014 | 9M2015 |
|---|---|---|---|---|---|
| Net result, IFRS (in millions of EUR) | 608 | 666 | 600 | 1 289 | 1 776 |
| Basic earnings per share, IFRS (in EUR)* | 1.32 | 1.56 | 1.41 | 2.32 | 4.16 |
| Breakdown of the net result, IFRS, by business unit (in millions of EUR) | | | | | |
| Belgium | 399 | 528 | 358 | 1 102 | 1 216 |
| Czech Republic | 130 | 127 | 153 | 408 | 423 |
| International Markets | 28 | 68 | 92 | -175 | 184 |
| Group Centre | 51 | -57 | -2 | -46 | -47 |
| Parent shareholders' equity per share (in EUR, end of period) | 30.7 | 32.5 | 33.6 | 30.7 | 33.6 |

* Note: if a coupon is paid on the core-capital securities sold to the Flemish Regional Government and a coupon is paid on the additional tier-1 instruments included in equity, it will be deducted from the numerator (*pro rata*). If a penalty has to be paid on the core-capital securities, it will likewise be deducted.

## Business highlights in the quarter under review

- Our core strategy remains focused on providing bank-insurance products and services to retail, SME and mid-cap clients in Belgium, the Czech Republic, Slovakia, Hungary and Bulgaria.
- We continued to work on achieving our strategic objectives within our strict risk and capital framework and under the supervision of the regulatory authorities. In this context, the National Bank of Belgium announced its new capital buffers for Belgian systemically important banks, including ours. These new buffers will be introduced in phases starting from 2016 and are on top of the minimum capital requirements (Joint Capital Decision) that the ECB imposes every year. The additional buffer for KBC will be 0.5% CET1 (phased in, calculated under the Danish compromise) in 2016, and will gradually increase over a three-year period, reaching 1.5% in 2018. As mentioned, this comes on top of the new ECB minimum capital requirement for 2016 which will be announced before the end of this year. In 2015, this minimum requirement was 10.5% CET1 (fully loaded, calculated under the Danish compromise).
- When KBC agreed its strategic refocus with the European Commission in 2009, it undertook to run down or divest the activities of its subsidiary KBC Financial Holding Inc. (US) in order to reduce KBC's risk profile. As a final step, KBC is now going to liquidate KBC Financial Holding Inc. This will result in the tax deductibility of losses already booked in previous years (specifically 2008 and 2009), for which a deferred tax asset will be booked. On balance, the post-tax impact on the result is around 763 million euros, likely to be booked in the fourth quarter. Initially, recognition of the deferred tax asset will have only a limited positive impact of 0.16 percentage points (fully loaded CET1 ratio calculated under the Danish compromise method) on KBC's regulatory capital.
- In line with our strategic objectives, ČSOB Leasing increased its share of the Slovak market and expanded its client base during the second quarter. ČSOB Leasing and Volksbank Leasing International reached agreement for ČSOB Leasing to acquire all the shares of Volksbank Leasing Slovakia and its insurance brokerage subsidiary. The results have been included for the first time in this quarter. The company is a universal leasing company ranked seventh on the Slovak leasing market with a market share of approximately 6% and a balance sheet total of approximately 170 million euros. KBC is the clear leader on the Slovak leasing market through the activities pursued by ČSOB Leasing.
- On the macroeconomic front, the world economy in the third quarter was characterised by a dichotomy between emerging markets and advanced economies. While advanced economies such as the euro area and the US were still growing solidly driven mainly by domestic demand, many emerging markets suffered from low commodity prices and capital outflows in anticipation of the Fed possibly hiking rates for a first time. At the beginning of the fourth quarter, the ECB made it clear that all its policy tools would be available at its December meeting to push up the sustained low rate of inflation in the euro area. This announcement served to lower German bond yields further and weakened the euro again. Owing to the fact that the latest Fed policy statement again raised the probability of a first rate hike in December, the euro weakened

further against the US dollar, which helped the ECB get nearer to its inflation target of close to, but below, 2%. For the same reason, global bond yields edged up again.

- On the corporate sustainability and responsibility front, we again took a number of initiatives. In Belgium, KBC participated in the 'Week of mobility' and stimulated carpooling and teleworking in order to reduce our ecological footprint. ČSOB in the Czech Republic also became a partner of 'Better Place', a web and mobile application. It invites citizens and organisations to help improve their neighbourhood and the environment they live in. Our efforts were further recognised by the following awards: in Hungary, K&H won the CSR Best Practice Award 2015 for its new 'Program for the Underprivileged'. KBC Bank Ireland was certified with the Business Working Responsibly Mark by Business in the Community Ireland. DZI in Bulgaria received the 'Insurer for the society' award, highlighting and reaffirming the good examples of corporate sustainability and responsibility it practises in the insurance business.

## Overview of our results and balance sheet

We provide a full overview of our IFRS consolidated income statement and balance sheet in the 'Consolidated financial statements' section of the quarterly report. Condensed statements of comprehensive income, changes in shareholders' equity, as well as several notes to the accounts, are also available in the same section.

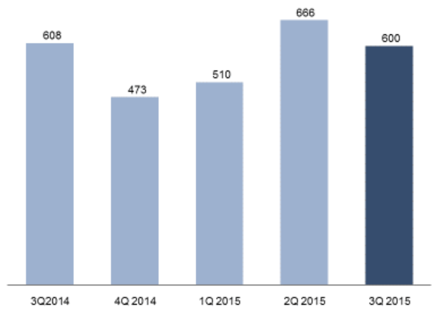
| Consolidated income statement, IFRS<br>KBC Group (in millions of EUR) | 3Q 2014 | 4Q 2014 | 1Q 2015 | 2Q 2015 | 3Q 2015 | 9M 2014 | 9M 2015 |
|---|---|---|---|---|---|---|---|
| Net interest income | 1 120 | 1 123 | 1 091 | 1 092 | 1 062 | 3 185 | 3 245 |
| Interest income | 2 010 | 1 982 | 1 850 | 1 804 | 1 770 | 5 911 | 5 425 |
| Interest expense | -890 | -860 | -759 | -712 | -708 | -2 726 | -2 179 |
| Non-life insurance (before reinsurance) | 139 | 123 | 167 | 155 | 142 | 389 | 464 |
| *Earned premiums* | *321* | *322* | *320* | *326* | *335* | *944* | *981* |
| *Technical charges* | *-183* | *-200* | *-153* | *-172* | *-193* | *-555* | *-517* |
| Life insurance (before reinsurance) | -57 | -45 | -48 | -51 | -51 | -171 | -150 |
| *Earned premiums* | *299* | *343* | *302* | *265* | *289* | *904* | *856* |
| *Technical charges* | *-355* | *-388* | *-350* | *-316* | *-340* | *-1075* | *-1 006* |
| Ceded reinsurance result | 4 | 10 | -11 | -7 | 0 | 6 | -18 |
| Dividend income | 9 | 9 | 12 | 39 | 13 | 47 | 64 |
| Net result from financial instruments at fair value through P&L | 34 | 109 | 57 | 179 | 47 | 118 | 282 |
| Net realised result from available-for-sale assets | 28 | 22 | 80 | 36 | 44 | 128 | 160 |
| Net fee and commission income | 402 | 410 | 459 | 465 | 383 | 1 163 | 1 307 |
| Fee and commission income | 579 | 577 | 632 | 634 | 547 | 1 668 | 1 814 |
| Fee and commission expense | -177 | -167 | -174 | -169 | -164 | -505 | -507 |
| Other net income | 73 | 68 | 49 | 105 | 96 | 26 | 250 |
| Total income | 1 752 | 1 827 | 1 855 | 2 013 | 1 736 | 4 892 | 5 604 |
| Operating expenses | -897 | -964 | -1 125 | -941 | -862 | -2 854 | -2 928 |
| Impairment | -58 | -193 | -77 | -149 | -49 | -313 | -275 |
| on loans and receivables | -190 | -158 | -73 | -138 | -34 | -429 | -245 |
| on available-for-sale assets | -6 | -14 | -3 | -7 | -15 | -14 | -24 |
| on goodwill | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| other | 139 | -21 | -1 | -5 | 0 | 130 | -6 |
| Share in results of associated companies and joint ventures | 6 | 6 | 6 | 8 | 6 | 19 | 20 |
| Result before tax | 803 | 675 | 659 | 930 | 831 | 1 745 | 2 421 |
| Income tax expense | -194 | -202 | -149 | -264 | -231 | -455 | -644 |
| Net post-tax result from discontinued operations | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| Result after tax | 608 | 473 | 510 | 666 | 600 | 1 289 | 1 776 |
| attributable to minority interests | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| **attributable to equity holders of the parent** | **608** | **473** | **510** | **666** | **600** | **1 289** | **1 776** |
| *of which legacy activities and own credit risk* | *114* | *-20* | *-* | *-* | *-* | *153* | *-* |
| Basic earnings per share (EUR) | 1.32 | 1.00 | 1.19 | 1.56 | 1.41 | 2.32 | 4.16 |

| | | | | | | | |
|---|---|---|---|---|---|---|---|
| Diluted earnings per share (EUR) | 1.32 | 1.00 | 1.19 | 1.56 | 1.41 | 2.32 | 4.16 |

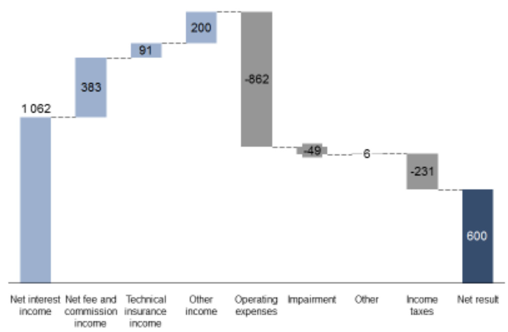
IFRIC 21 (Levies) was approved by the European Union in June 2014 and became effective on 1 January 2015. The main consequence of IFRIC 21 in 2015 is that certain levies have to be recognised in advance, which adversely impacted the results for the first quarter of 2015. As IFRIC 21 needs to be applied retroactively, KBC restated the comparable quarterly figures for 2014. This relates solely to movements between quarters and does not affect the full-year figures.

| Highlights of consolidated balance sheet KBC Group (in millions of EUR) | 30-09-2014 | 31-12-2014 | 31-03-2015 | 30-06-2015 | 30-09-2015 |
|---|---|---|---|---|---|
| Total assets | 251 612 | 245 174 | 258 396 | 256 654 | 257 632 |
| Loans and advances to customers | 125 898 | 124 551 | 124 632 | 126 093 | 126 971 |
| Securities (equity and debt instruments) | 69 530 | 70 359 | 71 948 | 70 755 | 71 115 |
| Deposits from customers and debt certificates | 166 843 | 161 783 | 167 922 | 170 159 | 171 412 |
| Technical provisions, before reinsurance | 19 065 | 18 934 | 19 181 | 19 198 | 19 365 |
| Liabilities under investment contracts, insurance | 12 540 | 12 553 | 13 263 | 12 937 | 12 422 |
| Parent shareholders' equity | 12 840 | 13 125 | 13 928 | 13 576 | 14 022 |
| Non-voting core-capital securities | 2 000 | 2 000 | 2 000 | 2 000 | 2 000 |

**Net result (in millions of euro)**




**Breakdown of net result for 3Q2015 (in millions of euro)**




Up to 2014, we provided not only figures according to IFRS, but also so-called 'adjusted figures'. In these figures, we extracted the impact of legacy activities (remaining divestments and CDOs) as well as the impact of the valuation of own credit risk, and rearranged trading income under 'Net result from financial instruments at fair value'. As these legacy activities have become immaterial (divestments have been finalised and there is no longer any exposure to CDOs) – and in order to simplify reporting – we have now stopped providing adjusted results.

Note: the year-on-year performance was partly affected by the deconsolidation of KBC Bank Deutschland and by a number of other minor changes. These items will be disregarded to enable a meaningful comparison to be made ('on a comparable basis').

The first-time inclusion of the acquisition of Volksbank Leasing in the results is covered in the International Markets Business .

## Analysis of the quarter (3Q2015)

**The net result for the quarter under review amounted to 600 million euros, compared to 666 million euros quarter-on-quarter and 608 million euros year-on-year.**

### Total income down by 14% quarter-on-quarter, with moderately lower net interest income, a substantial drop in net fee and commission income and weaker net result from financial instruments at fair value. Total income flat year-on-year.

- Net interest income stood at 1 062 million euros in the third quarter of 2015. In the current environment of low yields, our net interest income contracted by 3% quarter-on-quarter and by 4% year-on-year, on a comparable basis. The quarter-on-quarter decline was driven by the decrease in prepayment fees following the drop in home loan refinancing in Belgium, the negative hedging effect related to the large amount of home loan refinancing in previous quarters in that country and decreasing reinvestment yields in general, which could not be offset by the positive impact of falling customer funding costs, volume increases, and rate cuts on saving accounts in the Czech Republic. Compared to a year ago, the 4% drop in net interest income was largely driven by a negative hedging result relating to mortgage loans in Belgium, despite sound commercial margins, volume increases and lower funding costs. As a result, the net interest margin came to 1.99% for the quarter under review, 7 basis points lower than the level of the previous quarter, and 14 basis points lower than the level of the year-earlier quarter. Interest income continued to be supported by volume growth: loans went up both quarter-on-quarter (by 1%) and year-on-year (by 3%) and deposit volumes stayed flat quarter-on-quarter (increase in current and savings accounts as opposed to a deliberate decrease in time deposits) and went up by 7% year-on-year.
- Technical income from our non-life and life insurance activities went up year-on-year, but fell quarter-on-quarter. Gross earned premiums less gross technical charges and the ceded reinsurance result contributed 91 million euros to total income, 6% less than in the previous quarter due essentially to higher non-life claims mainly in Belgium. However, it was up 6% year-on-year, boosted by higher non-life premiums, though somewhat mitigated by increased non-life claims.
- Earned premiums from our non-life insurance activities increased by 3% quarter-on-quarter and by 4% year-on-year. Claims during the third quarter were up 12% on the previous quarter and up 5% on their level in the third quarter of 2014. The combined ratio came to an excellent 89% year-to-date.
- Sales of life insurance products (including unit-linked products not included in premium income) were down 7% quarter-on-quarter and 24% year-on-year.
- It should be noted that, during the third quarter, investment income derived from insurance activities was down 11% on its level of the previous quarter, and down 12% on the year-earlier quarter. The quarter-on-quarter change was driven chiefly by the lower level of dividend income following a seasonally high second quarter. The year-on-year change was accounted for primarily by lower net interest income caused by decreasing yields on the bond position.
- The investment climate for clients was volatile in the quarter under review, and this was reflected in lower sales of our mutual funds compared to the excellent previous quarter. Despite new entries, a negative price performance reduced total assets under management by 2% (to 200 billion euros) in the quarter under review. Compared to a year ago, however, they have increased by as much as 11%. The sales-related drop

in entry fees on these investment products, as well as the lower level of management fees for mutual funds, were the main reasons for the significant decrease in our net fee and commission income, which came to 383 million euros, down 4% year-on-year and 18% quarter-on-quarter, on a comparable basis.

- All other income items combined amounted to 200 million euros. They comprised the net result from financial instruments at fair value (47 million euros in the quarter under review, including 2 million euros arising from valuation changes in respect of ALM derivative instruments (compared to 90 million euros in 2Q2015), realised gains on the sale of available-for-sale assets (44 million euros for the quarter under review), dividend income (13 million euros) and other net income (96 million euros, benefiting from a number of positive one-off items in the quarter under review).

## Continued solid cost management: excluding special bank taxes, operating expenses down quarter-on-quarter and more or less flat year-on-year, thanks to reduced legacy costs

- Strict cost control is high on our list of priorities. Our operating expenses amounted to 862 million euros for the third quarter of 2015, significantly down (-8%) on their level of the previous quarter, when a significant part of the special bank taxes had been posted for the full year. Disregarding all of these bank taxes (21 million euros in the current quarter, compared to 264 million in 1Q2015, 83 million euros in 2Q2015, and 48 million euros in 3Q2014), our operating expenses fell by 2% quarter-on-quarter and remained more or less unchanged year-on-year, with higher pension expenses (lower interest rates) and expenses related to investments in further digitalisation being mitigated by lower legacy costs.

  The increase in income enabled the cost/income ratio of our banking activities to improve to 54% year-to-date (from 58% for 2014 as a whole). Adjusted for specific items (mainly the special bank tax, but also excluding some other non-operational items such as tax adjustments and divestments), the cost/income ratio stood at 54% year-to-date as well, similar to 54% for 2014 as a whole, despite investments in further digitalisation.

## Loan impairment charges: considerable drop on levels in the previous and year-earlier quarters

- Loan losses (34 million) were substantially lower than the level recorded in the year-earlier and previous quarters. The quarter-on-quarter decrease came about mainly because of Belgium (a decrease of 54 million euros, lower impairment in general for both loan files and IBNR), the Czech Republic, Hungary and Ireland (a decline of 11, 10 and 7 million euros, respectively) and the Group Centre (a drop of 22 million euros, related primarily to the legacy portfolio of the former Antwerp Diamond Bank). Loan loss impairment in the first nine months of 2015 accounted for some 0.23% the total loan portfolio.

## Results per business unit

- Our quarterly profit of 600 million euros breaks down into 358 million euros for the Belgium Business Unit, 153 million euros for the Czech Republic Business Unit, 92 million euros for the International Markets Business Unit and -2 million euros for the Group Centre. A full results table and a short analysis per business unit is provided in the 'Results per business unit' section of the quarterly report, while more information for each business unit is also given in the analyst presentation (both available at www.kbc.com).

### Strong fundamentals: equity, solvency and liquidity

- At the end of September 2015, our total equity stood at 17.4 billion euros, up 0.9 billion euros on its level at the start of the year. The change in total equity during the first nine months of the year resulted from the inclusion of the 9M2015 profit (+1.8 billion euros), the payment of dividends for 2014 and the related coupon on the remaining state aid (an aggregate -1.0 billion euros) and a number of smaller items (an aggregate +0.1 billion euros).
- Our solvency ratios comfortably surpassed the regulator's double solvency test (a minimum 10.5%). At 30 September 2015, the group's common equity ratio (Basel III, fully loaded, under the Danish compromise, including the remaining aid from the Flemish Regional Government) stood at a strong 17.4%. Under the Financial Conglomerates Directive (FICOD), the group's common equity ratio stood at 17.2% (fully loaded, including the remaining aid from the Flemish Regional Government). The leverage ratio for the group (Basel III, fully loaded) stood at 6.9%. The solvency ratio for KBC Insurance was an excellent 276% at 30 September 2015.
- The group's liquidity position remained at an excellent level, as reflected in an LCR ratio of 118% and an NSFR ratio of 123% at the end of the third quarter of 2015.

## Analysis of the year-to-date period (9M2015)

**Our aggregate result for the first nine months of the year now stands at 1 776 million euros, compared to 1 289 million euros a year earlier.**

Compared to the first nine months of 2014, the result for the first nine months of 2015 was characterised by:

- Higher net interest income (+3% on a comparable basis, up to 3 245 million euros), thanks to substantially lower (subordinated) funding costs, as well as wider margins on loans and lower rates on deposits, all of which was mitigated somewhat by losses on prepaid mortgages in Belgium. Volumes increased for deposits (+7%) and lending (+3%).
- A higher contribution by technical insurance results (gross earned premiums less gross technical charges and the ceded reinsurance result: +32% to 296 million euros). In non-life insurance, the year-to-date combined ratio stood at an excellent 89%.
- A strong increase in asset management activity leading to higher net fee and commission income (+13% on a comparable basis, up to 1 307 million euros). At the end of September 2015, assets under management stood at 200 billion euros, a year-on-year increase of 11%, 7% due to net entries and 4% to the price performance.
- An increase in other income items. The net result from financial instruments at fair value amounted to 282 million euros in the first nine months of 2015 (more than double the figure of 9M2014, thanks mainly to the valuation of ALM derivatives), net realised gains from available-for-sale assets stood at 160 million euros (+25%), dividend income stood at 64 million euros (+35%) and other net income came to 250 million euros (up 224 million euros on the first three quarters of 2014, which had been affected by 231 million euros of provisioning for the new Hungarian act on retail loans).

- Higher operating expenses (+4% on a comparable basis, up to 2 928 million euros), owing essentially to higher special bank taxes. Excluding these taxes, operating expenses were only slightly up (+1% on a comparable basis), primarily because of higher pension expenses, staff expenses and expenses related to investments in further digitalisation, but partly offset by lower expenses at the former Antwerp Diamond Bank. As a result, the year-to-date cost/income ratio stood at 54%.
- Lower loan losses (-41% on a comparable basis, to 245 million euros). The improvement was most pronounced in Ireland (125 million euros less). As a result, the annualised credit cost ratio for the whole group stood at a satisfying 0.23%.
- It is worth noting that a reversal of the impairment recorded on the participation in Antwerp Diamond Bank in 2012 and 2013 lead to a one-off total post-tax positive impact of 132 million euros in the first nine months 2014.

| Selected ratios for the KBC group (consolidated) | FY2014 | 9M2015 |
|---|---|---|
| Profitability and efficiency | | |
| Return on equity* | 14% | 20% |
| Cost/income ratio, banking | 58% | 54% |
| Combined ratio, non-life insurance | 94% | 89% |
| Solvency | | |
| Common equity ratio according to Basel III (fully loaded, incl. remaining state aid) | 14.3% | 17.4% |
| Common equity ratio according to FICOD method (incl. remaining state aid) | 14.6% | 17.2% |
| Leverage ratio according to Basel III (fully loaded, incl. remaining state aid) | 6.4% | 6.9% |
| Credit risk | | |
| Credit cost ratio | 0.42% | 0.23% |
| Impaired loans ratio | 9.9% | 9.0% |
| for loans more than 90 days overdue | 5.5% | 5.2% |
| Liquidity | | |
| Net stable funding ratio (NSFR) | 123% | 123% |
| Liquidity coverage ratio (LCR) | 120% | 118% |

* If a coupon is paid on the core-capital securities sold to the Flemish Regional Government and/or on the additional tier-1 instruments included in equity, it will be deducted from the numerator (*pro rata*). If a penalty has to be paid on the core-capital securities, it will likewise be deducted.

## Statement of risk

- As we are mainly active in banking, insurance and asset management, we are exposed to a number of typical risks for these financial sectors such as – but not limited to – credit default risk, counterparty credit risk, concentration risk, movements in interest rates, currency risk, liquidity and funding risk, insurance underwriting risk, changes in regulations, operational risk, customer litigation, competition from other and new players, as well as the economy in general. Although KBC closely monitors and manages each of these risks within a strict risk framework containing governance and limits, they may all have a negative impact on asset values or could generate additional charges beyond anticipated levels.
- At present, we consider a number of items to constitute the main challenges for the financial sector in general and, as a consequence, are also relevant to KBC. Increasing capital requirements are a dominant theme for the sector and regulatory initiatives are expected on such topics as risk models, floors on risk weighted assets, systemic and other capital buffers and minimum requirement of eligible liabilities and own funds (MREL). Besides these factors, the low interest rate environment remains a continuing challenge. If low rates were to be sustained, this would put material pressure on the long-term profitability of banks and especially insurers. Finally, operational risk and particularly cyber risk have become one of the main threats during the past few years, not just for the financial sector, but overall.
- Risk management data are provided in our annual reports, extended quarterly reports and dedicated risk reports, all of which are available at www.kbc.com.
- As regards macroeconomic trends, the recovery in the advanced economies is expected to continue in the fourth quarter and lead to accelerating levels of growth in 2016 compared to 2015. The further recovery in the euro area will take place in a favourable inflation environment. Inflation will rise only modestly as a result of low and only marginally rising oil prices, a gradual further fall of European unemployment and the deprecation of the euro since 2014 being passed on through higher import prices. However, since headline inflation is still far below the ECB's target, the ECB made it clear in early October that all policy tools would be available at the December meeting to ease its policy stance further and so push up the inflation rate in the euro area.
- The much stronger-than-expected US labour market report for October would appear to fulfil the conditions referred to by the Fed for a rate hike in December. If this start to a Fed rate tightening cycle does not cause too much volatility and economic stress particularly in the emerging markets, we expect 2016 to be a year of higher growth for the euro area and the US, with higher but still modest inflation and moderately higher German bond yields. This will increase the bond yield spread between the US and Germany. As a result of expected monetary policy divergence, the euro will weaken further against the US dollar.

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