08 Nov 2019 | Affirmation

Fitch Affirms KBC Group at 'A'; Outlook Stable

Fitch Ratings-Paris-08 November 2019:

Fitch Ratings has affirmed KBC Group NV's Long-Term Issuer Default Rating (IDR) at 'A' and KBC Bank's Long-Term IDR at 'A+'. The Outlooks on are Stable. Fitch has affirmed KBC Group's and KBC Bank's Viability Ratings (VRs) at 'a'. A full list of rating actions is at the end of this rating action commentary.

The ratings actions are part of a periodic portfolio review of major banks in Belgium and Luxembourg rated by Fitch.

Key Rating Drivers

Fitch assesses the group on a consolidated basis as it is managed as a group with the insurance and banking operations highly integrated. KBC Group acts as the holding company for the group, and its VR is equalised with the VR of KBC Bank, which represents around 90% of group assets. The group is regulated on a consolidated basis, there is low double leverage at the holding company, and we view fungibility of capital between the holding company and the bank as high. Liquidity and capital are managed centrally at the group level.

KBC Group's and KBC Bank's VRs reflect the group's strong retail and commercial franchises in its two key markets, Belgium and the Czech Republic, and its improved asset quality, although its asset quality remains weaker than most similarly rated peers. They also reflect the group's operations in potentially volatile countries, albeit within a fairly conservative risk appetite, strong and diversified earnings generation, solid capitalisation, and sound funding and liquidity.

The stock of impaired loans has been steadily decreasing. The group's gross impaired loans/gross loans ratio improved to 3.7% at end-June 2019 following the 4Q18 sale and the 2Q19 write-offs of legacy impaired loans in Ireland. Despite the significant progress in recent years, KBC Group's impaired loans ratio is still higher than that of most similarly rated peers, although the gap has narrowed. We expect the ratio to reduce further, albeit at a slower pace, as restructured Irish loans cure. Impaired loans in Ireland accounted for close to a third of KBC Group's total impaired loans at end-June 2019.

Asset quality is supported by the dominance of the bank's fairly low-risk Belgian lending and by stable Czech operations. Exposure to several other countries in central and eastern Europe (CEE) gives rise to potential volatility in earnings and asset quality, but we believe risk controls and credit standards are robust.

The group's capitalisation is sound, with a fully-loaded common equity Tier 1 (CET1) ratio of 15.6% at end-June 2019 and a leverage ratio of 6.1% at the KBC Group level. The group's internal CET1 ratio target of at least 14%, excluding an additional buffer for potential M&A (1.7% as of end-June 2019), provides a solid buffer above regulatory requirements. Capital encumbrance by unreserved impaired loans has declined and is now broadly in line with similarly rated peers at 16% of equity at end-June 2019.

KBC Group's resilient and stable profitability is underpinned by its bancassurance business model in its core markets and tight cost control. The group's profitability metrics compare strongly with peers, although we believe that higher earnings are needed to compensate for the slightly higher risk appetite from operations in less stable CEE countries. The Belgian and Czech operations generate the majority of earnings, contributing over half and around a quarter of profit, respectively. Earnings from international operations benefited in recent years from releases of loan loss allowances in Ireland, which were less pronounced in 1H19.

Funding and liquidity are a rating strength. The bank has a solid retail funding base, and nearly all of its subsidiaries are self-funded. Customer deposits are the main source of funding and are well in excess of customer loans. The group also has access to the debt capital markets through a wide range of products, at both the bank and the holding level. Its wholesale funding maturities are reasonably well spread, and the ample liquidity buffer further mitigates refinancing risk.

KBC Group's Long-Term IDR is in line with its VR. The 'F1' Short-Term IDR is the baseline option mapping to a Long-Term IDR of 'A', which reflects Fitch's assessment of funding and liquidity, which is scored at 'a+'. KBC Group's senior unsecured debt is rated in line with the IDRs as we view the probability of default on senior unsecured obligations as the same as the probability of default of the issuer.

KBC BANK'S IDRS, SENIOR DEBT AND DERIVATIVE COUNTERPARTY RATING

KBC Bank's Long-Term IDR and senior debt ratings are one notch above its VR because Fitch believes that the risk of default on senior obligations, as measured by the Long-Term IDR, is lower than the risk of the bank failing, as measured by its VR. This is due to a significant and sustainable buffer of qualifying junior debt (QJD), which in our view is sufficient to protect the bank's senior obligations from default in case of failure, either under a resolution process or as part of a private-sector solution (i.e. distressed debt exchange) to avoid a resolution action.

Without such a private-sector solution, we would expect a resolution action being taken on KBC Group when it breaches minimum capital requirements. The group is regulated on a consolidated basis but the bank makes up the bulk of the group. We assume the intervention point would be at a CET1 ratio no lower than 6.25% of risk-weighted assets. Fitch believes that KBC Group would need to meet its minimum capital requirements immediately after a resolution action. Given KBC Bank's domestic systemic importance, Fitch believes minimum capital requirements will include most, if not all, of its combined buffer requirements. On a risk-weighted basis, Fitch has estimated that a CET1 capital requirement around 15% is plausible under a bail-in scenario post resolution action, and that a QJD buffer of approximately 9% would most likely be sufficient to restore the bank's viability without affecting senior creditors.

At end-June 2019, the QJD buffer at KBC Bank was 9.4% of group risk-weighted assets (RWAs). We expect a buffer of approximately 9% to be maintained on a sustainable basis. Our expectation is based on the group's need to meet the minimum requirement for own funds and eligible liabilities (MREL), set at 25.9% of group RWAs. The group has adopted a single-point-of-entry resolution strategy, with KBC Group being the resolution entity. All MREL instruments, including senior debt, are issued at group level and downstreamed to KBC Bank as junior-ranked instruments to third-party senior creditors.

KBC Bank's 'F1' Short-Term IDR is the baseline option mapping to a 'A+' Long-Term IDR. KBC Bank's Derivative Counterparty Rating (DCR) is at the same level as its Long-Term IDR, because under Belgian legislation, derivative counterparties have no preferential status over other senior obligations in a resolution scenario.

SUPPORT RATING AND SUPPORT RATING FLOOR

KBC Group's and KBC Bank's Support Ratings of '5' and Support Rating Floors of 'No Floor' reflect Fitch's view that senior creditors can no longer rely on receiving full extraordinary support from the sovereign in the event that KBC Bank becomes non-viable. The EU's Bank Recovery and Resolution Directive and the Single Resolution Mechanism for eurozone banks provide a framework for resolving banks that is likely to require senior creditors participating in losses, instead of or ahead of a bank receiving sovereign support.

SUBSIDIARY AND AFFILIATED COMPANY

The senior debt issued by KBC Bank's fully owned subsidiary KBC IFIMA S.A. is guaranteed by KBC Bank, and its ratings are aligned with KBC Bank's IDRs to reflect our view that KBC Bank will ensure these obligations are met.

SUBORDINATED DEBT AND OTHER HYBRID SECURITIES

Subordinated debt and hybrid securities issued by KBC Bank and KBC Group are notched down from the entities' respective VRs.

Legacy hybrid securities issued by KBC Bank are rated four notches lower than its VR (two notches for non-performance and two for relative loss severity). Subordinated debt issued by KBC IFIMA S.A. is rated one notch lower than KBC Bank's VR to reflect below-average recovery expectations. The notes are guaranteed by KBC Bank on a subordinated basis.

Subordinated debt issued by KBC Group is rated one notch lower than its VR to reflect relative loss severity. The CRD IV-compliant, undated, deeply subordinated, additional Tier 1 debt securities issued by KBC Group are rated five notches below its VR. The notching reflects the notes' higher expected loss severity relative to senior unsecured creditors (two notches) and higher non-performance risk (three notches).

RATING SENSITIVITIES

VRS, KBC GROUP'S IDRS AND SENIOR DEBT

Rating upside for the VRs is currently limited given the weaker loan book quality compared with similarly rated peers. Fitch expects a further reduction in the bank's impaired loan ratio. An upgrade would also be contingent on an improved risk profile, including an improved operating environment in the more volatile countries in which the group operates. The current rating factors in Fitch's expectations that earnings generation and capitalisation will remain strong. KBC Group's ratings are also sensitive to deterioration in the holding company double leverage beyond 120%.

KBC BANK'S IDRS, SENIOR DEBT AND DERIVATIVE COUNTERPARTY RATING

KBC Bank's Long-Term IDR, senior debt ratings and DCR are sensitive to changes in its VR. KBC Bank's ratings are also sensitive to a material reduction in the QJD buffer, in particular should it fall below 9%. The notching is also sensitive to changes in assumptions on the resolution intervention point and post-resolution capital needs, and the development of resolution planning more generally.

SUPPORT RATING AND SUPPORT RATING FLOOR

An upgrade of KBC Bank's or KBC Group's Support Ratings and upward revision of the entities' Support Rating Floors would be contingent on a positive change in the Belgian sovereign's propensity to support its banks. While not impossible, this is highly unlikely, in Fitch's view.

SUBSIDIARY AND AFFILIATED COMPANIES

The senior debt ratings of KBC IFIMA S.A. are sensitive to the same factors that might drive a change in KBC Bank's IDRs.

SUBORDINATED DEBT AND OTHER HYBRID SECURITIES

Subordinated debt and hybrid securities issued by KBC Bank, KBC IFIMA S.A. and KBC Group are primarily sensitive to KBC Bank's and KBC Group's VRs. The ratings of the hybrid securities are also sensitive to changes in Fitch's assessment of the probability of the notes' non-performance risk relative to the risk captured by KBC Bank's and KBC Group's VRs. The ratings of notes issued by KBC Group are sensitive to a build-up of additional double leverage at the holding company.

Public Ratings with Credit Linkage to other ratings

The senior debt ratings issued by KBC IFIMA S.A. are aligned with KBC Bank's IDR. The rating of the subordinated debt issued by KBC IFIMA is one notch lower than KBC Bank's VR to reflect below-average recovery expectations.

ESG Considerations

The highest level of ESG credit relevance is a score of 3 - ESG issues are credit neutral or have only a minimal credit impact on KBC Group, either due to their nature or the way in which they are being managed by KBC Group. For more information on our ESG Relevance Scores, visit www.fitchratings.com/esg.

KBC Group NV; Long Term Issuer Default Rating; Affirmed; A; RO:Sta
; Short Term Issuer Default Rating; Affirmed; F1
; Viability Rating; Affirmed; a
; Support Rating; Affirmed; 5
; Support Rating Floor; Affirmed; NF
----senior unsecured; Long Term Rating; Affirmed; A
----subordinated; Long Term Rating; Affirmed; A-
----subordinated; Long Term Rating; Affirmed; BB+
----senior unsecured; Short Term Rating; Affirmed; F1
KBC IFIMA S.A.
----subordinated; Long Term Rating; Affirmed; A-

----senior unsecured; Long Term Rating; Affirmed; A+
----senior unsecured; Short Term Rating; Affirmed; F1
KBC Bank; Long Term Issuer Default Rating; Affirmed; A+; RO:Sta
; Short Term Issuer Default Rating; Affirmed; F1
; Viability Rating; Affirmed; a
; Support Rating; Affirmed; 5
; Support Rating Floor; Affirmed; NF
; Derivative Counterparty Rating; Affirmed; A+(dcr)
----preferred; Long Term Rating; Affirmed; BBB-
----senior unsecured; Long Term Rating; Affirmed; A+
----senior unsecured; Short Term Rating; Affirmed; F1

Contacts:

Primary Rating Analyst
Olivia Perney,
Managing Director
+33 1 44 29 91 74
Fitch France S.A.S.
60 rue de Monceau
Paris 75008

Secondary Rating Analyst
Andreea Playoust,
Director
+33 1 44 29 91 71

Committee Chairperson
Christian Scarafia,
Senior Director
+44 20 3530 1012

Media Relations: Louisa Williams, London, Tel: +44 20 3530 2452, Email: louisa.williams@thefitchgroup.com

Additional information is available on www.fitchratings.com

Applicable Criteria

Bank Rating Criteria (pub. 12 Oct 2018)

Short-Term Ratings Criteria (pub. 02 May 2019)

Additional Disclosures

Dodd-Frank Rating Information Disclosure Form

Solicitation Status

Endorsement Policy

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