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# KBC Group N.V.

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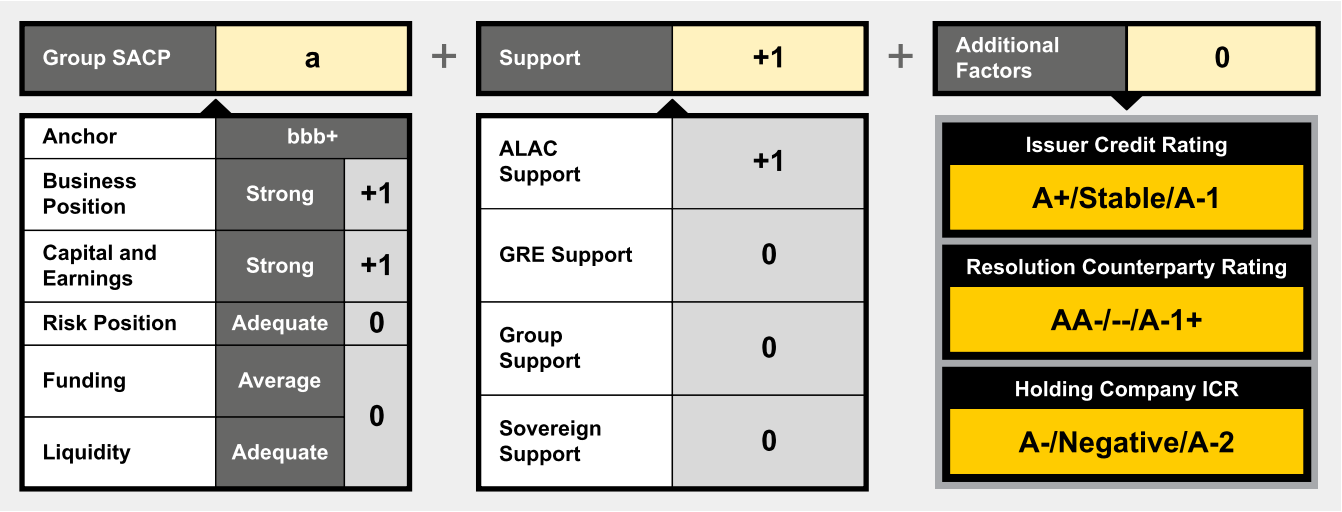
# KBC Group N.V.




SACP--Stand-alone credit profile. The issuer credit rating (ICR) and resolution counterparty rating shown apply to core bank operating subsidiaries. The bank holding company ICR applies to KBC Group N.V., and is one nocht below the group SACP.

## Major Rating Factors

| Issuer Credit Rating |
| --- |
| A-/Negative/A-2 |

| Strengths: | Weaknesses: |
| --- | --- |
| • Clear strategic focus to leverage the bank insurance model in core markets, combined with a leading competitive position in the low-risk Belgian and Czech markets.<br>• Strong earnings capacity compared with European peers, despite low interest rates.<br>• Robust capital ratios, but also an acquisitive strategy and a potential for capital returns in the medium-term. | • Sizable exposure to corporates and small and midsize enterprises (SMEs) where asset quality could be pressured by the COVID-19 pandemic.<br>• Exposure to higher economic risk in Central and Eastern Europe (CEE) and Ireland.<br>• Relatively large share of nonperforming assets in Ireland and to a lesser extent in Bulgaria. |

## Outlook

### KBC Group N.V. (KBC)

The negative outlook reflects increased downside risks to asset quality and earnings from the economic and market effects of the COVID-19 pandemic. Although we note KBC's significant revenue diversity, robust balance sheet, and the unprecedented fiscal and monetary response from Belgian and European authorities, an extended economic downturn could materially increase impairment losses and weaken revenue over our two-year outlook horizon.

#### Downside scenario

Given the relative headroom we believe KBC has at the current rating level, we could lower the long-term rating in the next 12 to 24 months on the nonoperating holding company (NOHC) to 'BBB+' if we think the deteriorated operating environment will last and in turn substantially weaken asset quality and profitability. The likely trigger for us to consider a downgrade would be sufficient pressure on capital for our risk-adjusted capital (RAC) to potentially fall below 10%, compared with an estimated ratio exceeding 11.3% at year-end 2020. The pressure could either come from depressed earnings or a less conservative capital policy.

#### Upside scenario

We could revise the outlook to stable if KBC's earnings and balance sheet demonstrate relative resilience, especially compared with similarly rated peers, or if governments and central banks are successful in averting a deep, long-lasting recession.

### KBC Bank

The stable outlook reflects the high stock of bail-in-able instruments, which offers sufficient protection to senior creditors, even in the context of a moderately weakening group stand-alone credit profile (SACP).

#### Downside scenario

We would downgrade the bank in the next 12 to 24 months to 'A' if its stock of bail-in-able instruments is no longer enough to support an 'A+' rating. This could happen because either the group departs from its senior issuances at the NOHC level, or growth in risk-weighted assets is high. The latter could be due to a sharp increase in nonperforming loans (NPLs) in weaker geographies like CEE or Ireland, weakening our additional loss-absorbing capacity (ALAC) ratio, or to large acquisitions.

#### Upside scenario

Any upside is remote at this stage.

## Rationale

We base our ratings on KBC Bank and its core subsidiaries on our analysis of the consolidated creditworthiness of the larger KBC group--whose NOHC controls 100% of the bank and sister company KBC Insurance N.V.--given the very

high degree of integration between banking and insurance operations. Both KBC Bank and KBC Insurance are core to the larger group.

We believe that the group has a strong and sustainable competitive position, reflecting its leading market shares in the Belgian and Czech bank and insurance markets. Insurance brings diversity to income streams and supports customer loyalty. KBC is one of the most profitable banking groups in Western Europe, and we expect its profitability, although temporarily depressed due to the pandemic, to remain better than peers in 2021 and 2022. Capitalization has been gradually strengthening in the five years to 2020, and while we expect now it will modestly decline in the coming years on the back of renewed dividends and KBC's updated financial policy, it should, in our opinion, remain strong in coming two years.

The strategic focus in recent years has been strengthening commercial banking and insurance activities in core countries, through organic growth and targeted small acquisitions in eastern Europe in particular. However, the group has exposure to some segments that may be particularly negatively affected by the current crisis, including small businesses/entrepreneurs, and corporates that depend on discretionary spending, for which KBC provisioned €783 million in 2020. Although manageable in the context of a strong profitability, earnings are facing an increase in new provisioning for credit losses that did not materialize yet but should kick-in as governments' support fade in 2021. We believe the group's funding and liquidity position to be sound, with a large and stable retail deposit base combined with a sizable liquidity portfolio that amply covers wholesale funding maturities. The group SACP is 'a'.

The group has a clear resolution strategy; the NOHC is the point of entry in resolution. Our assessment of ALAC leads us to add one notch of uplift to the group SACP, reflecting KBC's plan to hold a sizable buffer of senior debt at the holding company level that is structurally subordinated to the bank's senior debt. Consequently, the issuer credit rating (ICR) on KBC Bank is at the level of the Group Credit Profile GCP, at 'A+'; and the ICR on KBC Group N.V. is one notch below the group SACP because of structural subordination, at 'A-'.

### Anchor:'bbb+' based on the weighted average of economic risk related to the countries where the bank operates

KBC's 'bbb+' anchor reflects the blended Banking Industry Country Risk Assessment economic risk scores of the countries where the bank operates and the Belgian industry risk. KBC is present outside Belgium in higher economic risk countries in CEE and in Ireland. The weighted economic risk is therefore slightly weaker than for a bank operating in Belgium only, whose anchor would be 'a-'.

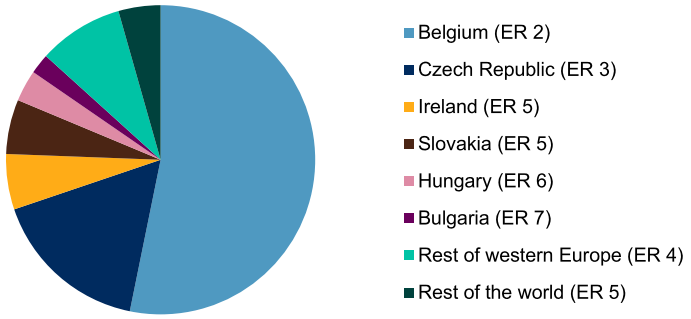
Our '2' economic risk score for Belgium reflects the generally favorable domestic operating conditions for banks. We regard Belgium's economy as wealthy, highly diversified, and export oriented, with a net external asset position. High government debt and relatively high taxes constrain fiscal flexibility, but private-sector debt, especially in the corporate sector, is at the lower end of the peer spectrum. We see the economic risk trend as negative because of increased risks to banks' credit profiles resulting from the impact of the COVID-19 pandemic on the economy. As is the case for most European countries, the pandemic caused a severe recession in Belgium in 2020 and we expect a gradual recovery in 2021. Still, we anticipate the recovery will not entirely offset the damage to most-affected corporate sectors and SMEs. Under our current forecasts, we expect the domestic cost of risk to average 45 basis points (bps) in 2020-2022 compared with 15bps-20bps in 2019, mainly due to SMEs and a few larger corporates. We

are mindful that this base case remains subject to significant uncertainty. The risk of economic imbalances remains low, in our view, but we will continue monitoring the buildup of household debt and rise in real estate prices over the medium term.

Our industry risk score of '3' with a stable trend reflects our view of the ample domestic funding sources for Belgian banks, despite the challenge of generating revenues from reinvesting excess resources without increasing risk. The four largest banks maintain stable and dominant domestic market shares, which underpins industry stability. Regulatory standards are, in our view, in line with those of Belgium's Western European peers.

**Chart 1**

**KBC Group's Loan Portfolio By Market With Economic Risk Scores**




Data at end-September 2020. ER--Economic Risk. ER scores are part of S&P Global Banking Industry Country Risk Assessments. ER scores rank from 1 to 10, 1 being the lowest risk level. Sources: KBC, S&P Global Ratings



**Table 1**

**KBC Group N.V.--Key Figures**

| | --Year ended Dec. 31-- | | | | |
|---|---|---|---|---|---|
| **(Mil. €)** | **2020** | **2019** | **2018** | **2017** | **2016** |
| Adjusted assets | 284,587 | 253,760 | 248,977 | 253,290 | 236,024 |
| Customer loans (gross) | 163,316 | 158,671 | 150,575 | 145,038 | 137,729 |
| Adjusted common equity | 15,143 | 14,610 | 12,800 | 12,457 | 11,210 |
| Operating revenues | 7,185 | 7,636 | 7,528 | 7,712 | 7,143 |
| Noninterest expenses | 4,156 | 4,303 | 4,235 | 4,074 | 3,947 |
| Core earnings | 1,538 | 2,500 | 2,605 | 2,615 | 2,408 |

Source: S&P Global Ratings.

## Business position: Leading bank and insurance franchise in Belgium and the Czech Republic

KBC's focused strategy to be a market leader in countries where it operates, its well-integrated bank insurance model, and its digital focus make the group resilient to upcoming challenges facing the industry. With €321 billion of reported assets at end-2020, KBC is a diversified financial services group. KBC is smaller than many of the large and diversified banking groups operating in Europe, but we believe it displays superior earnings and efficiency metrics.

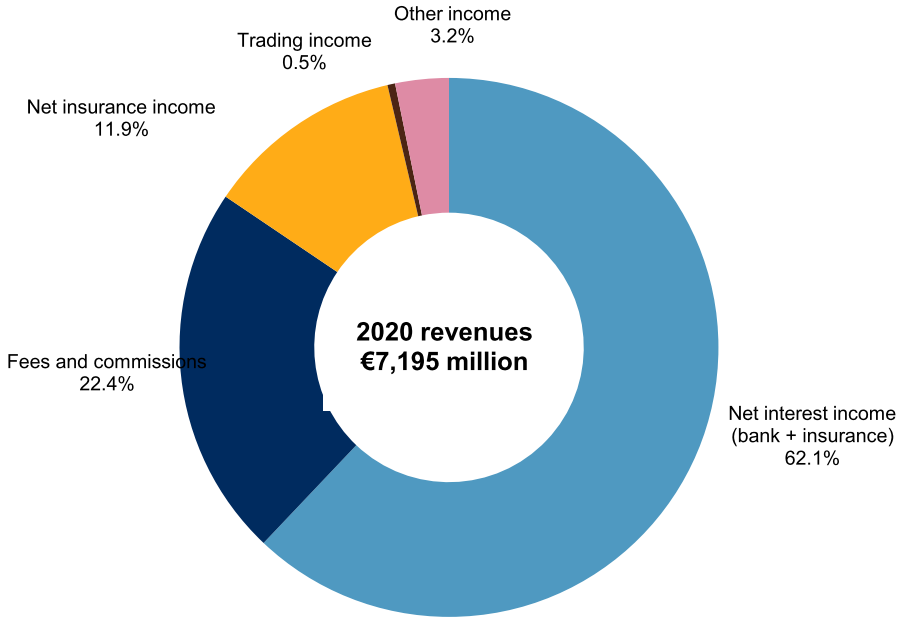
The group's main banking arm, KBC Bank, is a market leader in the wealthy Flemish part of Belgium and has a domestic market share of about 19% in terms of retail credit and deposits. Its Czech bank subsidiary, Ceskoslovenská Obchodní Banka, is a leading domestic player, with a 21% share of the loan and deposit market, which we consider a low risk segment. The group's presence in other target markets, such as Ireland and CEE (Hungary, Slovakia and Bulgaria), is smaller. However, KBC Bank's long-term presence in these markets provides profitable geographic diversity, and has accounted for 16%-21% of group revenue since 2015.

KBC Insurance is highly integrated, with bank channels accounting for the majority of total sales. This enables high levels of efficiency and a dominant share of profitable unit-linked life policies. KBC Insurance enjoys a market share of 13% in life insurance and 9% in property and casualty (P/C) insurance in Belgium, and 8% in both life and P/C insurance in the Czech Republic. The insurance business has historically been a strong contributor to revenue and, above all, it provides diverse earning streams and supports customer loyalty. The recently announced acquisition of NN's Bulgarian pension insurance and life insurance businesses follows the same principle of building a scalable integrated bank-insurance model in core countries.

KBC's fee income, which provides about 20%-25% of operating revenue, also adds to the group's business diversity. The bulk of the fee income is driven by the asset-management business, with reported assets under management of €212 billion at end-2020.

**Chart 2**

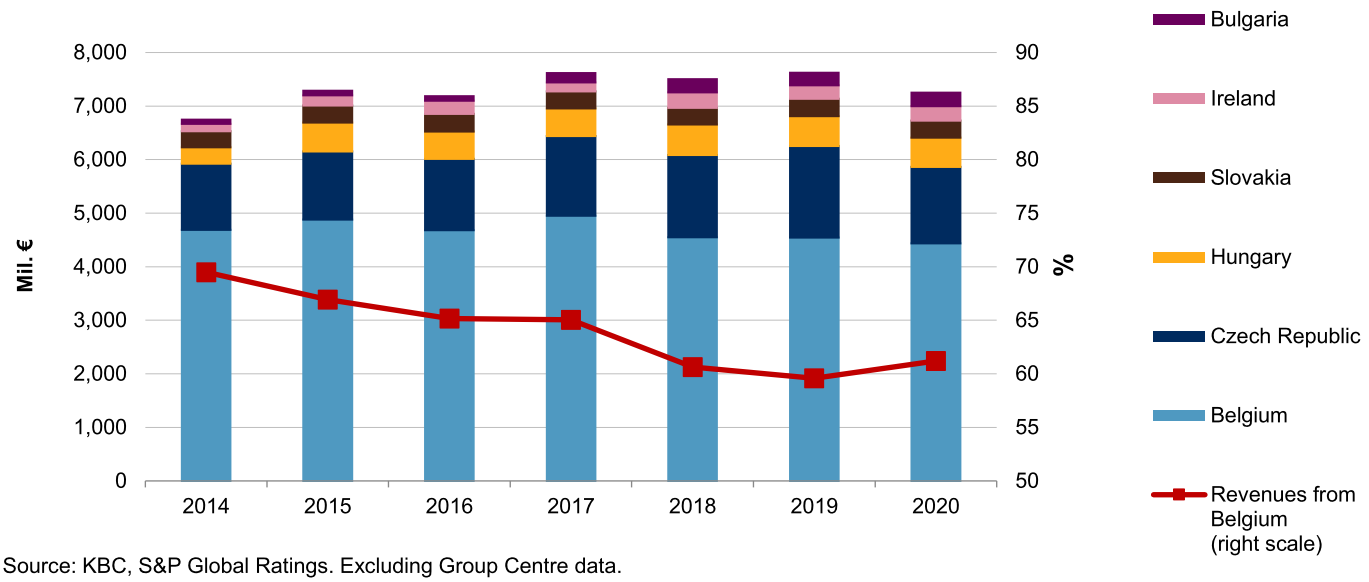
**KBC 2020 Revenues By Business Line (%)**
The group's diversified business model is a strength




Sources: KBC, S&P Global Ratings.

**Chart 3**

**KBC Group's Revenue By Country**
Reliance on Belgian market has declined amid stable revenue



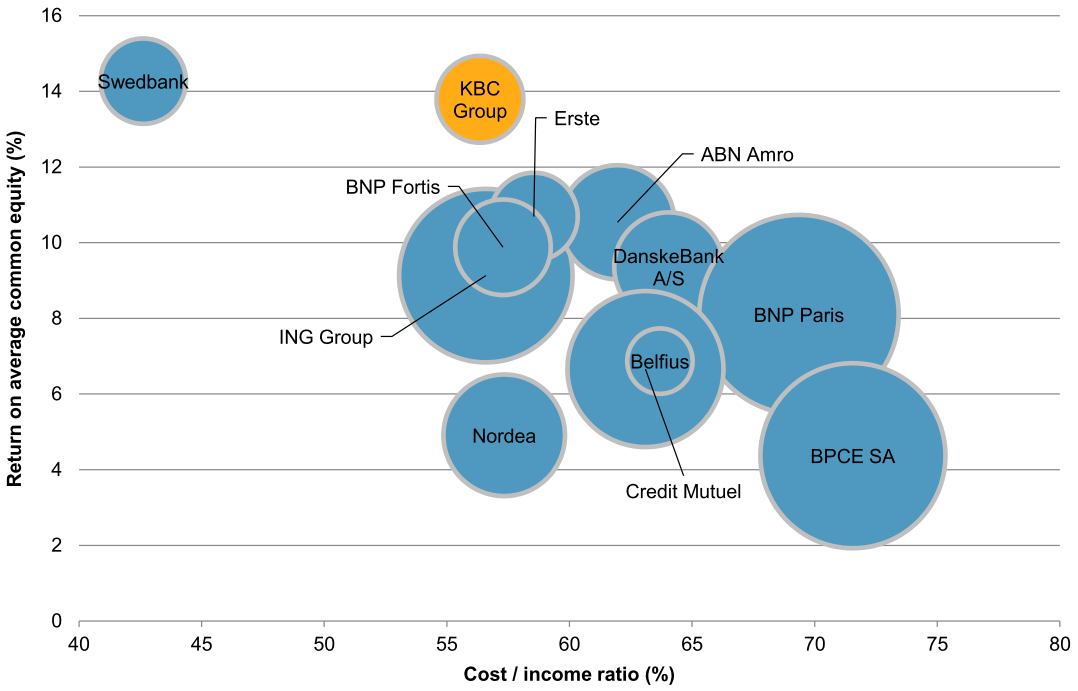

Source: KBC, S&P Global Ratings. Excluding Group Centre data.


KBC Group N.V. is a listed holding company with about 40% of the shareholder base constituting a stable syndicate of core shareholders, which supports the execution of long-term strategic objectives. We view positively management's actions toward, and clear focus on, the optimization of the bank's insurance business model in the core markets in which it operates, as well as its focus on retail and small to midsize corporate activities, with low dependence on financial markets. This business model has allowed the group to post a solid return on equity compared with its western European peers, and we expect this to continue. The group remains acquisitive, even if we expect primarily bolt-on acquisitions, of relatively small size in the group's context, as the ones realized in Slovakia and Bulgaria recently.

Beyond recurrent earnings, the superior efficiency of the group is reflected in a cost-to-income ratio averaging 57% for the past five years. The current headwinds from lower for longer interest rates pressures the revenue line, leading KBC to continue a strict cost control of its operations. We expect KBC's cost-to-income ratio to remain at 55%-57% in 2021–2022, which would still be better than most of its European peers, other than peers in Nordic region.

**Chart 4**

**KBC's Efficiency Ratios Compared With Peers (As Of December 2019)**
The group's efficiency and profitability helped to withstand pandemic pressure




Bubble size represents gross customer loans in EUR. Source: S&P Global Ratings.


Since 2017, KBC clarified its intention to further leverage on its presence in Ireland, where the group operates through KBC Bank Ireland PLC (KBCI), which we view as a strategically important subsidiary of the group. We believe that creating the same successful combination of banking and insurance activities in Ireland will be challenging and gradual, notwithstanding the ongoing workout of NPLs. Further, we view positively the pilot role assigned to KBCI to develop and test the group's digital proposition.

**Table 2**

**KBC Group N.V.--Business Position**

| | --Year ended Dec. 31-- | | | | |
|---|---|---|---|---|---|
| **(%)** | **2020** | **2019** | **2018** | **2017** | **2016** |
| Loan market share in country of domicile | 19.0 | 20.0 | 0.2 | 0.2 | 0.2 |
| Total revenues from business line (currency in millions) | 7,185.0 | 7,636.0 | 7,528.0 | 7,712.0 | 7,238.0 |
| Commercial & retail banking/total revenues from business line | 73.7 | 73.8 | 72.8 | 62.0 | 69.9 |
| Trading and sales income/total revenues from business line | 0.5 | 2.4 | 3.1 | 11.1 | 7.5 |
| Insurance activities/total revenues from business line | 11.9 | 9.5 | 9.3 | 8.3 | 6.1 |
| Asset management/total revenues from business line | 13.9 | 14.2 | 14.7 | 16.0 | 15.3 |
| Other revenues/total revenues from business line | 0.0 | 0.1 | 0.1 | 2.6 | 1.3 |
| Investment banking/total revenues from business line | 0.5 | 2.4 | 3.1 | 11.1 | 7.5 |

**Table 2**

| KBC Group N.V.--Business Position (cont.) | | | | | |
|---|---|---|---|---|---|
| | --Year ended Dec. 31-- | | | | |
| **(%)** | **2020** | **2019** | **2018** | **2017** | **2016** |
| Return on average common equity | 7.4 | 13.8 | 14.8 | 15.4 | 16.0 |

### Capital and earnings: Resilient capitalization despite earnings pressure from COVID-19

We view KBC's capital strength as broadly in line with that of most Dutch and Nordic peers. The group's profitability is among the strongest among Europe's universal banks. We believe that a strong earnings capacity will provide support to the bottom line, which is under pressure from the economic disruption caused by the COVID-19 pandemic, and maintain its strong capitalization over the next two years.

KBC reported a profit before tax of €1.9 billion for 2020, down from €3.1 billion in 2019. The sharp decline was mainly led by loan loss impairments increasing to €1.2 billion, from €217 million for 2019, and a 5.7% year-on-year decrease in operating revenues due to lower interest income and lower fee income due to lower activity. Conversely, insurance revenues improved, in the non-life segment in particular, which highlights the benefits of the bank-insurance model. Cost of risk peaked at €1.2 billion, of which more than half was a management overlay to account for which expected credit loss (ECL) models are missing. So far only 8% of the €783 million provision linked to COVID-19 have been booked for stage 3 loans, leaving more than €700 million for future doubtful loans. We therefore see the provisioning policy as relatively conservative.

KBC reported a high Basel 3 common equity tier 1 (CET1, fully loaded) ratio of 17.6% at end-2020, compared with 17.1% at end-2019. KBC updated its capital policy in February 2021 setting a target of 14.5% CET1, with an additional management buffer of 1%. This compares with a 10.45% overall minimal capital requirement. We understand this current target could be adjusted post implementation of Basel 4 rules if the industry follows the route of lower capital targets. KBC estimates the Basel 4 rules would lower its CET1 ratio by 1.3%.

We estimate KBC's RAC ratio was 11.3%-11.8% as of Dec. 31, 2020; higher than in 2019 mainly because of the dividend restrictions imposed by the European Central Bank (ECB) to all banks in 2020 and up to end-September 2021. We project that the RAC ratio will stay in the 10.25%-10.75% range by end-2022, down from 2020, as it incorporates the group's updated financial policy as of February 2021. We still view the group's financial policy as supportive to strong capitalization, but the RAC ratio will probably decrease in coming years as dividend restrictions are lifted and because KBC could return to shareholders the capital exceeding its target..

To arrive at this projection, we make the following assumptions:

- On average a 5% annual increase in S&P Global Ratings' risk-weighted assets (RWAs) over 2021-2022. This is slightly higher than our assumption of around 3%-4% increase in credit growth as we expect increased stage migration to stage 2 and stage 3 loans in 2021.
- Annual net profits to gradually recover from 2020's low €1.4 billion. Despite interest income pressure from low interest rates we project €1.7 billion-€1.9 billion in 2021 and close to €2 billion in 2022.
- Operating revenues to grow again by 1.5%-2.0% annually after the sharp decline in 2020. Fee, insurance, and other revenues should help the top line in next two years while interest income will continue to fall on the back of the

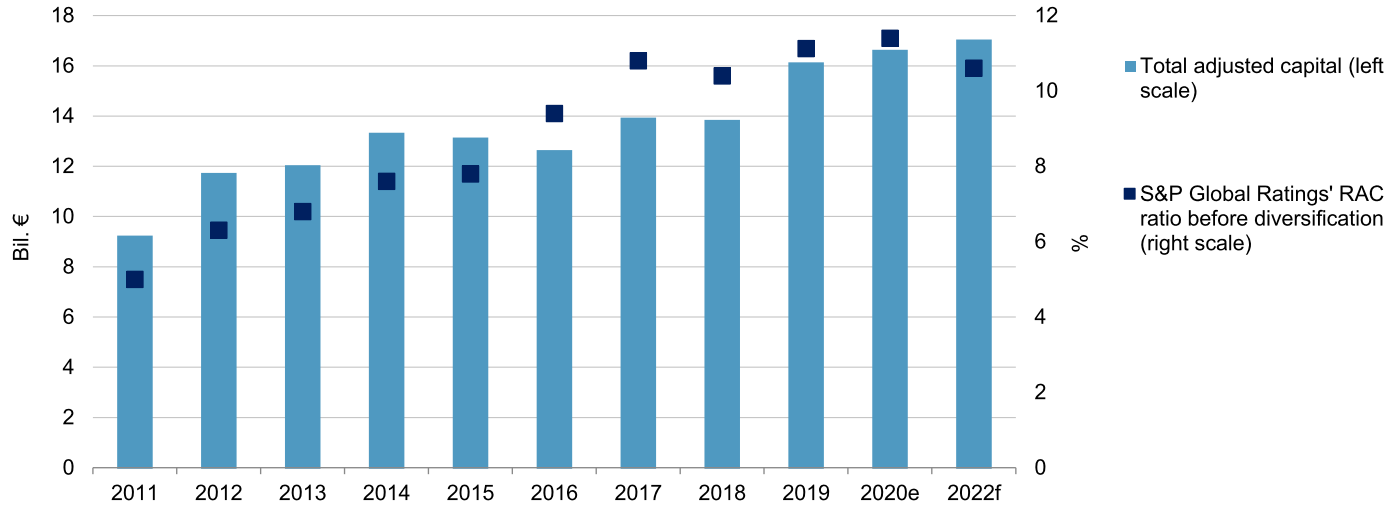
lower for longer interest rate environment. Overall, with operating costs under control, we project cost-to-income in the 56%-58% range in 2021-2022.

- We expect cost of risk to moderate to around 40bps in 2021 and 30bps in 2022. This is still higher than the past ten-year average as we believe additional provisioning may be needed to cover SME and corporate defaults in the coming two years.
- The payment of a 0.44€ dividend per share out of 2020, in line with the ECB restrictions, and a dividend payout ratio of at least 50% of consolidated profit going forward.
- Following KBC's updated capital policy in early 2021, we also now assume (i) a 2€ per share ad-hoc dividend to be paid in fourth-quarter 2021 out of 2020 results and a 1€ interim dividend on 2021 profit, if the economic situation allows and the ECB restrictions are lifted, and (ii) potential distribution of the capital exceeding the fully loaded 15.5% CET1 ratio (14.5% CET1 target + the 1% management buffer) by end-2022, either in the form of extraordinary dividends or share buy-backs.

Our base-case scenario includes no transformative change in the group's structure through acquisitions or sales, but we do include some capital expenditure for opportunistic moves like KBC did with OTP Banka Slovensko in 2020 and NN's Bulgarian insurance business in 2021.

**Chart 5**

**Stabilizing Capitalization**
KBC capital and RAC ratio since 2011




e--Estimate. f--Forecast, 50 basis points average range. RAC--Risk-adjusted capital. From 2016 figures the total-adjusted capital is calculated under our revised RAC Framework Methodology (published July 2017), which fully deducts participations in insurance subsidiaries. Source: S&P Global Ratings.


We calculate the RAC ratio of KBC at the group level because we consider that KBC will remain an integrated bank insurance group, and because it manages capital allocation on a consolidated basis. We believe that KBC Insurance's

capital position is consistent with the overall capital position of banking activities.

**Table 3**

**KBC Group N.V.--Capital And Earnings**

| | --Year ended Dec. 31-- | | | | |
|---|---|---|---|---|---|
| **(%)** | **2020** | **2019** | **2018** | **2017** | **2016** |
| Tier 1 capital ratio | 19.1 | 18.7 | 17.0 | 18.0 | 17.9 |
| S&P Global Ratings' RAC ratio before diversification | N/A | 11.1 | 10.4 | 10.8 | 9.4 |
| S&P Global Ratings' RAC ratio after diversification | N/A | 12.3 | 10.9 | 11.9 | 10.4 |
| Adjusted common equity/total adjusted capital | 91.0 | 90.7 | 92.8 | 89.9 | 88.9 |
| Net interest income/operating revenues | 62.2 | 60.5 | 60.4 | 53.4 | 59.6 |
| Fee income/operating revenues | 22.4 | 22.7 | 22.8 | 22.1 | 20.3 |
| Market-sensitive income/operating revenues | 0.5 | 3.5 | 3.2 | 13.7 | 8.8 |
| Cost to income ratio | 57.8 | 56.4 | 56.3 | 52.8 | 55.3 |
| Preprovision operating income/average assets | 1.0 | 1.2 | 1.1 | 1.3 | 1.2 |
| Core earnings/average managed assets | 0.5 | 0.9 | 0.9 | 0.9 | 0.9 |

N/A--Not applicable.

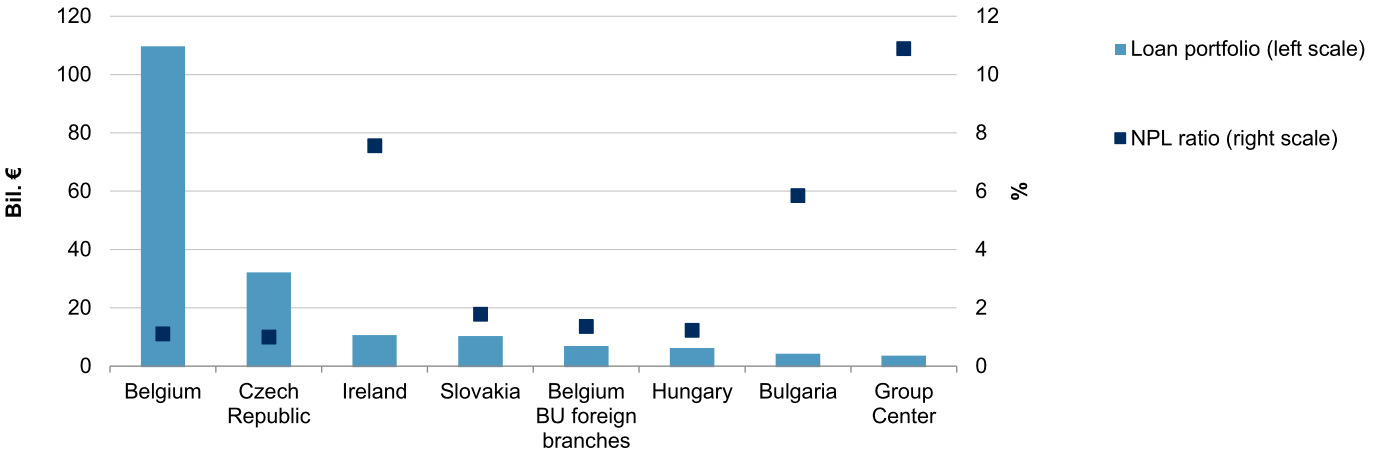
### Risk position: Loan book is well provisioned but under increasing pressure from exposure to segment sensitive to the current recession

KBC Bank's loan portfolio is geographically diverse, and single-name and sector concentrations are low. We understand that KBC aims to expand, but within the boundaries of its existing areas of expertise. In our view, KBC will cautiously manage its expansion strategy after years of significant efforts to reduce risk. Operating conditions have deteriorated since the onset of the COVID-19 pandemic, and while we are seeing only a limited number of SME and corporates defaults at this stage, we expect this number to increase in next two years as governments' support measures fade off.

The majority of the group's risk assets relate to the group's Belgian business unit, with the Czech Republic business also responsible for a large part. We do not expect any rapid transformation of the group's geographical breakdown of activities, but we monitor to what extent over time there is a gradual rebalancing of group activities between Belgium, a low-risk but mature market, and other markets in Eastern Europe with higher growth potential but higher risk profiles. Overall, we believe that KBC's RAC ratio adequately reflects the credit risk of operating in countries with higher economic risk than Belgium, particularly Ireland and CEE countries.

**Chart 6**

**KBC Group's Loan Portfolio Is Geographically Diverse With Credit Risk Mostly Concentrated In Mature Markets**
Asset-quality metrics for KBC Group's main loan portfolios




Source: KBC, S&P Global Ratings. NPL--Nonperforming loans, namely 90 days past due loans. Data as of Dec. 31, 2020.


Typically, low-risk mortgage loans represent the largest component of KBC's loan book (40%), mainly in Belgium (€38 billion), the Czech Republic (€16 billion), and Ireland (€10 billion). KBC reported prudent average indexed loan to value (LTV) on mortgages of 56% in Belgium, 60% in the Czech Republic, and 67% in Ireland. The Irish loan portfolio had gradually recovered since 2015 resulting from active de-risking of non-retail exposures. However, with the Irish economy being severely negatively impacted by the pandemic, the impaired portfolio at KBC Ireland remains high, at 13.9%, and credit cost jumped to 88bps in 2020, well above levels in any other key geographies for the group. Bulgaria is the other weaker spot in terms of asset quality.

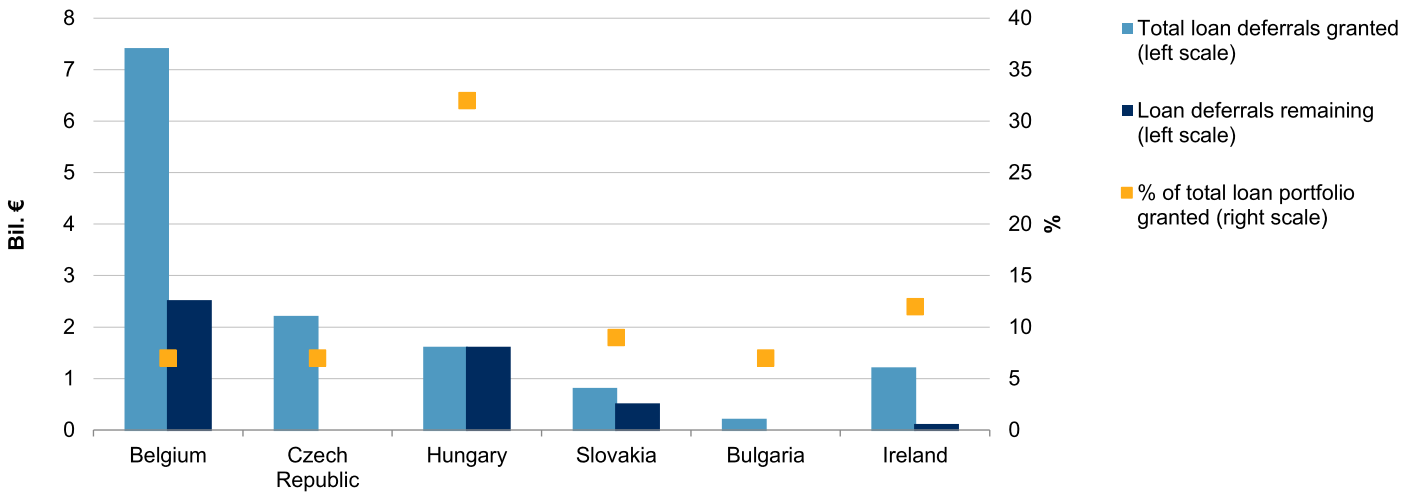
KBC's corporate exposure to sectors highly vulnerable to COVID-19 such as hotels, restaurants, cafés, entertainment, and leisure, or the manufacturing exposure to automotive, shipping or aviation, etc. is around 5%-6% of its loan book. We calculate KBC's NPL ratio (impaired loans above 90 days past due) at 2% at end-2020, stable year-on-year. The NPL trajectory has been broadly stable in recent quarters and is better than most large French and Dutch peers'. However, in our opinion, the group's NPL ratio is likely to peak in the next two years, once the government support measures to businesses and individual gradually comes to an end. We project NPLs will be higher than that for KBC's peers operating solely in Belgium or Nordic countries, reflecting KBC's sizable corporate and SME book and exposure to relatively risker economies. However, we believe this risk is mitigated by KBC's stronger coverage ratio compared with most peers, and by its resilient earnings profile, which provide a comfortable cushion against unexpected losses before impacting capital.

The volumes of loan granted with payment holidays stood at €13.4 billion at end-2020, which corresponds to close to 8% of the portfolio. The group stated that for €8.7 billion of those loans, the moratoria already expired, and payments

have resumed in 96% of the cases. We note, though, that for about half of the SME loans granted under payment holiday, moratoria have either been extended or have not expired yet, and this could result in a rise in nonpayments later in 2021, as this asset class is the most vulnerable.

**Chart 7**

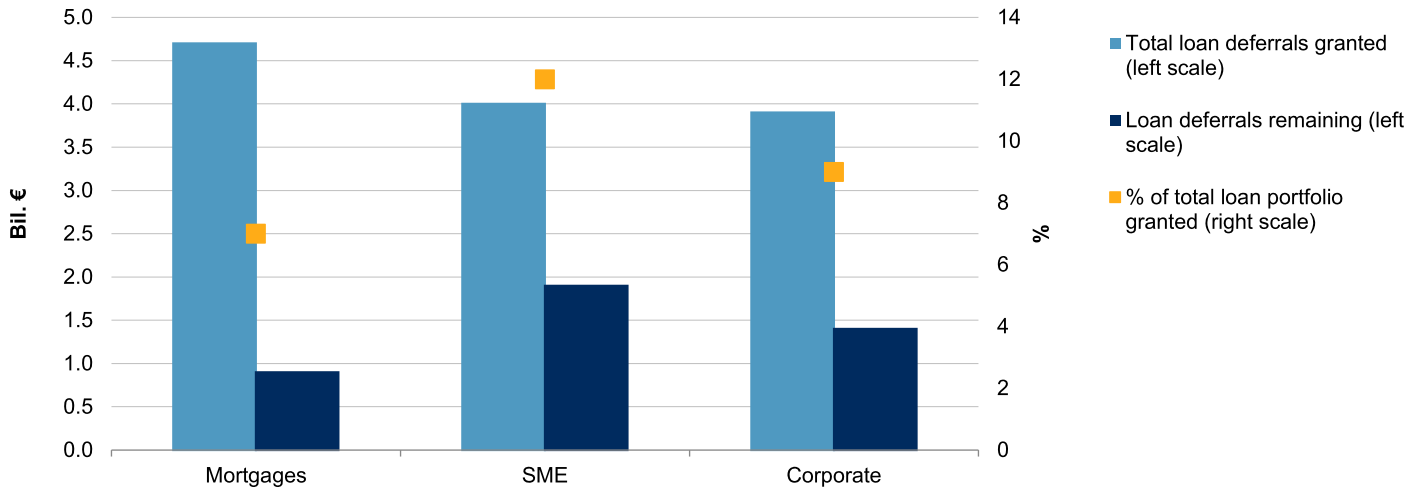
**Payment Holidays Are Ending In KBC's Markets**
Payment holidays by country




Sources: KBC, S&P Global Ratings. Note: In Hungary, loan deferrals are granted on an opt-out basis.

**Chart 8**

**SMEs And Corporates Still Enjoy Payment Holidays**
Payment holidays by segment



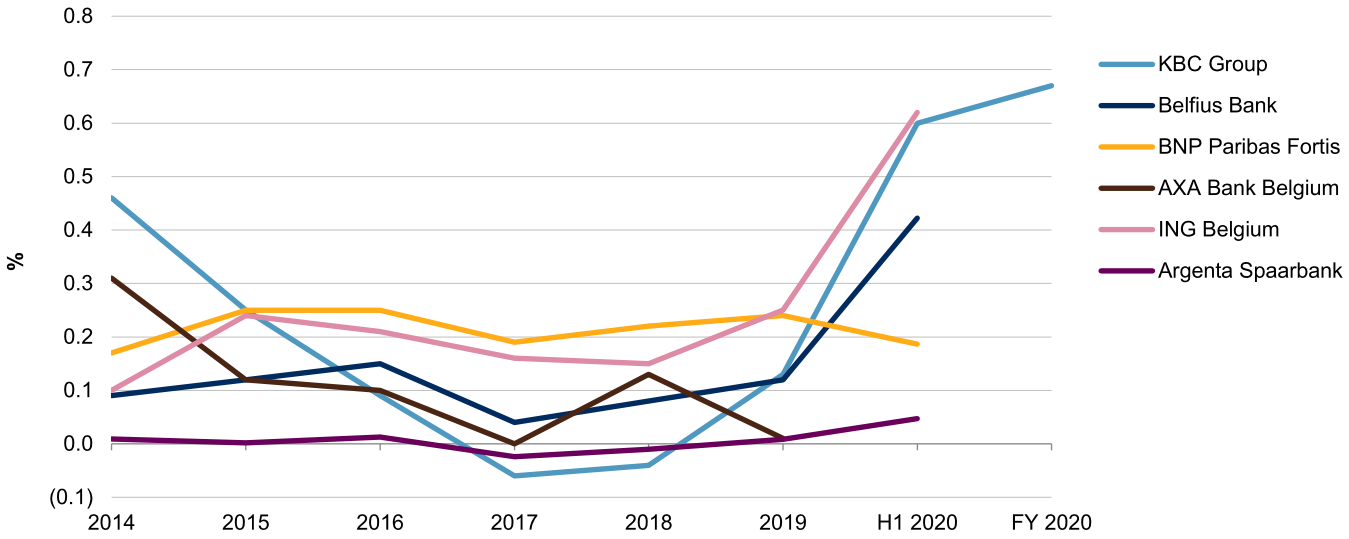

SME--Small and midsize enterprise. Sources: KBC, S&P Global Ratings.


Overall, we expect the group to remain a fundamentally low-risk one, evidenced by an expected 40bps cost of risk in 2021, after 60bps in 2020.

The investment portfolio is mainly composed of sovereign bonds, reflecting a mix of countries where the group operates and other Western European countries.

**Chart 9**

**KBC Group's New Loan Loss Provisions Are In Line With Belgian Peers'**
KBC Group's new loan loss provisions/average loans compared with Belgian peers'




Note: H1 2020 data not annualized, and not published for Axa Bank Belgium. H--Half. FY--Financial year.
Source: S&P Global Ratings.


**Table 4**

**KBC Group N.V.--Risk Position**

| | --Year ended Dec. 31-- | | | | |
|---|---|---|---|---|---|
| **(%)** | **2020** | **2019** | **2018** | **2017** | **2016** |
| Growth in customer loans | 2.9 | 5.4 | 3.8 | 5.3 | 3.2 |
| Total diversification adjustment/S&P Global Ratings' RWA before diversification | N/A | (9.7) | (4.5) | (9.3) | (10.1) |
| Total managed assets/adjusted common equity (x) | 21.2 | 19.9 | 22.2 | 23.5 | 24.5 |
| New loan loss provisions/average customer loans | 0.7 | 0.1 | (0.0) | (0.1) | 0.1 |
| Net charge-offs/average customer loans | N.M. | (0.1) | (0.0) | 0.1 | (0.5) |
| Gross nonperforming assets/customer loans + other real estate owned | 2.0 | 2.1 | 2.7 | 3.6 | 4.1 |
| Loan loss reserves/gross nonperforming assets | 114.8 | 83.9 | 85.9 | 77.1 | 85.3 |

N/A--Not applicable.

## Funding and liquidity: Stable core deposits and adequate liquidity buffers

The bank's large retail branch network provides it with a stable base of core deposits that fully cover the loan portfolio. We calculate that the ratio of total loans to customer deposits remained stable at a low 84% at end-2020. For the same period, we estimate that KBC had a solid stable funding ratio of 140% and a comfortable broad liquid asset coverage ratio of total wholesale funding at 3.7x. These ratios improved over 2020 on the back of strong savings rate following the lockdowns seen across Europe, and they compare favorably to those disclosed by many large European peers. KBC achieves these metrics despite some entities of the group, notably Irish operations, not being self-funded. The

group makes usage of its liquidity excess to these entities.

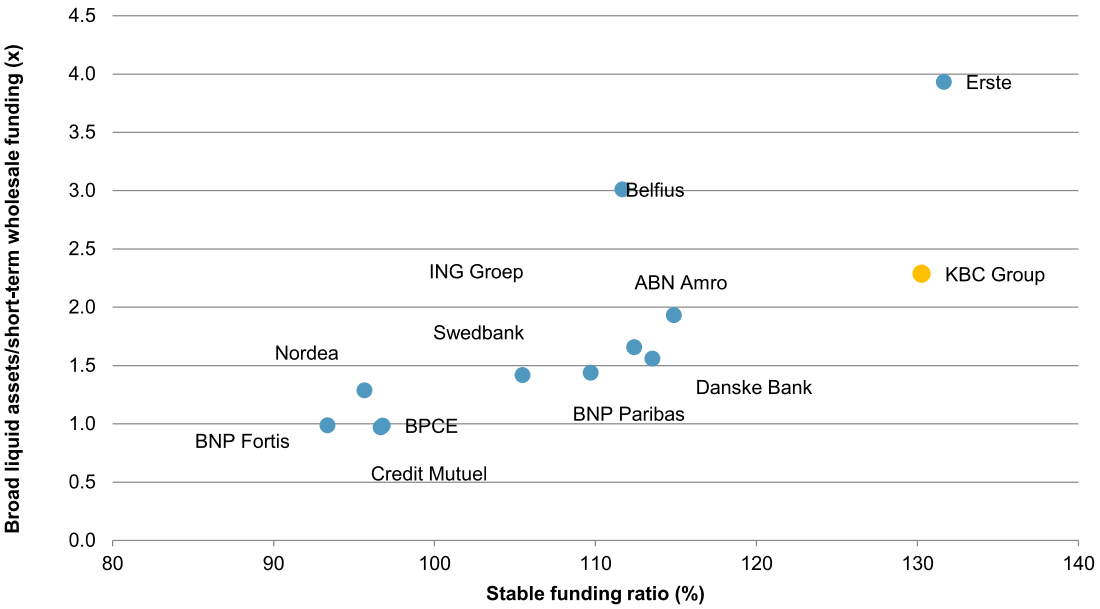
The group also reported metrics well above the regulatory minimum, with an average liquidity coverage ratio of 147% over 2020 reflecting the large stock of high-quality liquid assets, and an estimated net stable funding ratio of 146% at end-2020.

We consider the medium-term wholesale funding that matures in the next three years to be relatively granular and diversified. The €5 billion peak in 2022, of which almost half are in covered bonds, does not present a threat in our view, because KBC is a regular issuer and usually anticipates the refinancing of its instruments, and because the group has a high enough liquidity buffer to delay issuance in the event of an unexpected stress scenario.

We expect KBC to continue to issue senior unsecured debt at the NOHC level, as it aims to build a significant buffer of bail-in-able securities (see chart 6). From this year, KBC will have to refinance its first layer of NOHC senior unsecured debt. In parallel, we expect that KBC will also continue to issue Tier 2 instruments out of the NOHC for the same regulatory reason. We understand that senior unsecured debt may still be issued at the operating company level, for funding purposes only.

**Chart 10**

**KBC Group's Funding And Liquidity Metrics Compare Well With Peers**
Thanks to high deposit bases in Belgium and Czech Republic




Source: S&P Global Ratings. Note: Data at year-end 2020 for KBC Group, ABN Amro, Danske Bank, Swedbank, Nordea, BNP Paribas, BPCE, at Q3 2020 for ING Groep and Erste, at H1 2020 for Belfius and BNP Fortis, at year-end 2019 for Credit Mutuel.

**Table 5**

| KBC Group N.V.--Funding And Liquidity | | | | | |
|---|---|---|---|---|---|
| | --Year ended Dec. 31-- | | | | |
| (%) | 2020 | 2019 | 2018 | 2017 | 2016 |
| Core deposits/funding base | 74.8 | 77.0 | 72.9 | 67.6 | 68.1 |
| Customer loans (net)/customer deposits | 83.6 | 89.4 | 91.1 | 91.4 | 92.7 |
| Long-term funding ratio | 90.0 | 87.1 | 85.1 | 79.4 | 81.2 |
| Stable funding ratio | 140.2 | 123.8 | 123.5 | 126.4 | 125.3 |
| Short-term wholesale funding/funding base | 10.8 | 13.9 | 16.1 | 22.2 | 20.3 |
| Broad liquid assets/short-term wholesale funding (x) | 3.8 | 2.5 | 2.3 | 1.9 | 1.9 |
| Net broad liquid assets/short-term customer deposits | 41.3 | 27.7 | 30.4 | 30.7 | 30.3 |
| Short-term wholesale funding/total wholesale funding | 41.7 | 58.8 | 58.4 | 67.3 | 62.2 |
| Narrow liquid assets/3-month wholesale funding (x) | 5.7 | 3.3 | 3.8 | 3.0 | 3.0 |

## Environmental, Social, And Governance (ESG)

Even if sustainability is central to KBC's strategy, we do not consider that ESG credit factors influence KBC's credit quality more, or less, than main peers'.

Like diversified international peers, KBC is exposed to a wide range of legal and nonfinancial risks due to its operations in multiple business lines and geographies. Corporate governance practices, including control of financial crime and clients' onboarding, are typically of a high standard in a country like Belgium. The bank has substantially strengthened its governance and control framework, and established a clear and articulate risk appetite, which the supervisory board monitors closely. We note KBC has not suffered the similar large conduct or compliance-related issues that most U.K., and some Dutch and Nordic banks have suffered in the past years.

Still, the bank is not immune to risks popping up in foreign operations. In Ireland, the central bank fined KBCI €18.3 million for its role in the "Tracker Mortgage" issue, alongside with other banks in the country. We believe this issue has not shifted customer dynamics in Ireland so far.

As KBC operates in economies with typically weaker social and governance standards than Belgium--notably in some CEE countries--we believe the group has gradually strengthened local management practices to fully align them with group standards. KBC is also a significant player in private banking and asset management, hence the importance of appropriate "Know Your Customer" procedures for the group.

As a diversified bank, KBC is typically exposed to sectors where we see rising energy-transition-related risks (for example, agriculture, fishing, metals, and chemicals). We observe that these exposures represent less than 10% of the bank's loan book, and that KBC communicates on clear environment targets including exiting the financing of coal-related activities and increasing the share of renewables in financed energy projects. KBC aims to have over 65% of its energy credit portfolio comprised of renewable energy by 2030, from 61% achieved at year-end 2020.

## Support: One notch of additional loss-absorbing capacity and an increasing buffer

We believe that the prospect of extraordinary government support for the Belgian banking sector is uncertain under the EU resolution regime. This is because we believe it contains a well-defined bail-in process under which authorities would permit nonviable, systemically important banks to continue critical functions as going concerns following a

bail-in of eligible liabilities. KBC has a single point of entry approach for the bank's resolution strategy.

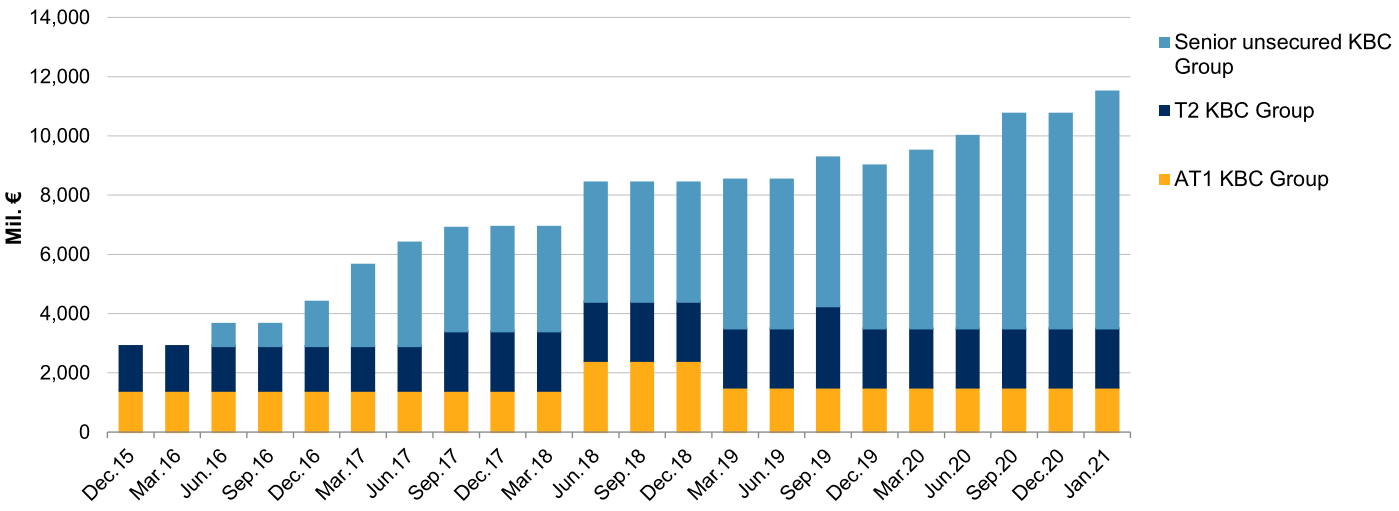
Our assessment of KBC's ALAC leads us to add one notch of uplift to the Group SACP, reflecting KBC's buffer of debt at the holding company that is structurally subordinated to KBC Bank's senior debt. We believe, therefore, that senior creditors of the core banking entities will remain protected by this sizable buffer of bail-in-able debt. We estimate the ALAC buffer is already above the 5.25% threshold we deem appropriate for KBC, at close to 6.7% at end-2020. We project this ratio will remain at about 5.5%-6.5% of our RWA measure by end-2022. Our assumptions include that KBC will replace maturing Tier 2 capital instruments with other ALAC-eligible instruments, and that KBC will continue to issue a sizable amount of senior debt from the NOHC in the coming years.

We use an adjusted 5.25% threshold, as opposed to the usual 5.0%, because we cannot exclude that KBC will have to use part of its ALAC buffer for prepositioning purposes, and we believe the fungibility of such resources would therefore be constrained. This is in line with our approach for KBC's peers, including, for instance, international groups operating in the Czech Republic. We believe that there will be no capital fungibility between bank and insurance operations in case of stress, including a resolution scenario under which we believe that the insurance perimeter would be out of scope.

The minimum requirement for own funds and eligible liabilities target set by the Single Resolution Board for KBC Bank is 9.67% of total liabilities and own funds (TLOF), to be met by end-2021. KBC already meets the requirement at end-2020 with 10.1% of TLOF, including the recognition of 2020 profit.

**Chart 11**

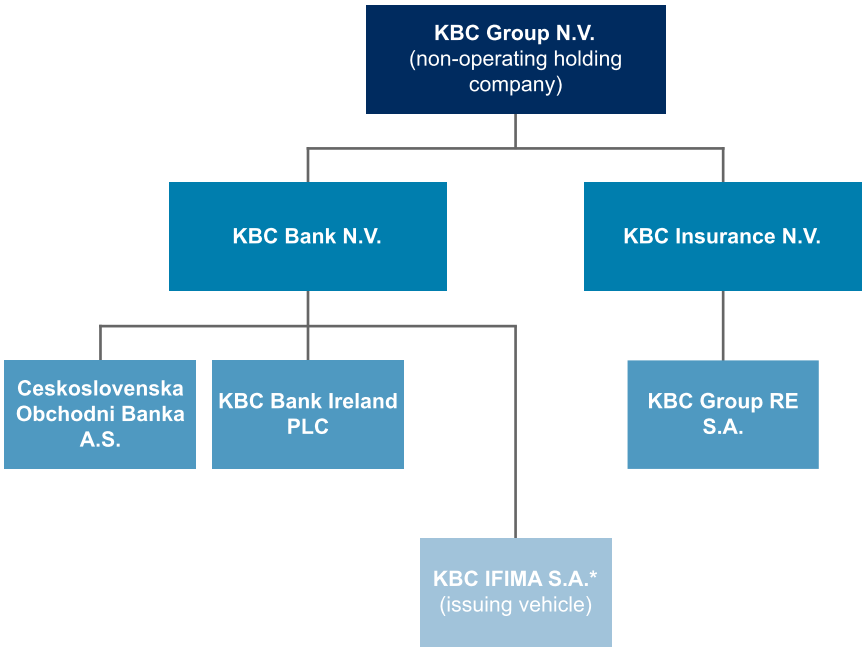
**KBC Group N.V.'s Debt Buffer**




AT1--Additional Tier 1. T2--Tier 2.

## Core and strategically important subsidiaries

**Simplified Structure of KBC Group Showing Entities Rated By S&P Global Ratings**




*KBC IFIMA: not rated; debt issued guaranteed by KBC Bank.


The ratings on KBC Bank and KBC Insurance reflect our view of their core status to the group. KBC Group owns 100% of both KBC Bank and KBC Insurance. We consider KBC Bank and KBC Insurance to be fully integrated with the group. Still, we use the 'a' group SACP to determine the ICR and financial strength rating on KBC Insurance, since we do not believe ALAC support will be available for insurance subsidiaries, which are outside the bank resolution perimeters. We also view the Luxembourg-based reinsurer KBC Group Re S.A. as core to the group, and we equalize our ratings on it with the 'a' group SACP.

The ratings on Ceskoslovenska Obchodni Banka (CSOB) A.S. reflect our view of its core status to the group. We equalize our ratings on it with the GCP, and the ratings on other core operating bank entities of the group, such as KBC Bank. We equalize our ratings on KBC Bank and CSOB, given our view that a single point of entry resolution strategy at the group level is probable, even if the Czech regulator clarifies further how it approaches the case of locally systemic financial institutions that are part of a wider pan-eurozone banking group regulated by the ECB.

The ratings on KBCI reflect our view that this bank is strategically important to the group. We believe that KBCI's integration is likely to increase further, and we do not exclude the possibility that we might consider this subsidiary as highly strategic in the future. This would happen if KBCI business model gets closer to the usual bank insurance group offer as it is the current project, and if its profitability improves closer to KBC's standards.

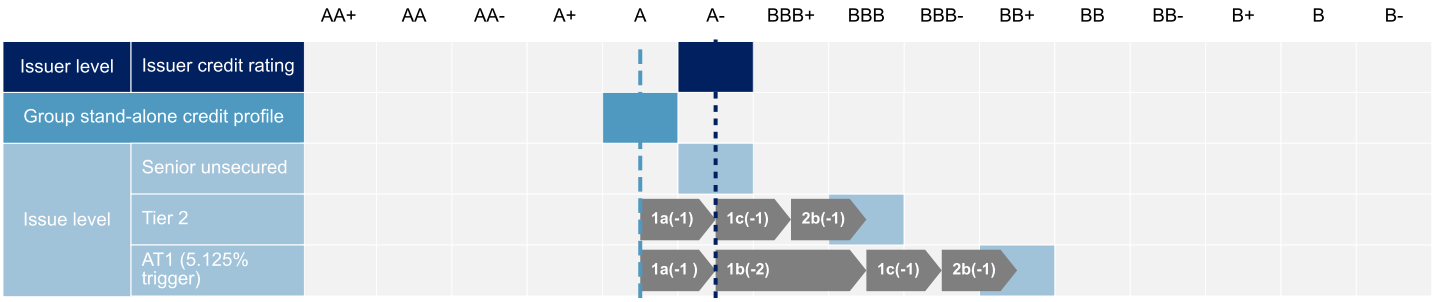
### How we rate the AT1 instruments issued by KBC

Our 'BB+' rating on KBC's AT1 notes is five notches below our 'a' assessment of KBC's group SACP. This five-notch difference represents:

- One notch to reflect subordination risk.
- Two additional notches to take into account the risk of nonpayment at the issuer's full discretion and the hybrid's expected inclusion in the issuer's Tier 1 regulatory capital.
- One notch due to a mandatory contingent capital clause that would lead to equity conversion if KBC's CET1 ratio falls below 5.125%. We do not consider this to be a going-concern trigger.
- One further notch to reflect structural subordination because the notes were issued by KBC Group N.V.

Compliance with the minimum regulatory capital requirements is necessary to avoid the risk of potential restrictions in the payment of coupons on the AT1 notes. We view this risk as limited for KBC since its fully loaded CET1 ratio was 15.4% at end-September 2019, well above the 10.7% minimum set by regulators.

**KBC Group N.V.: NOHC Notching**




**Key to notching**

----- Group stand-alone credit profile
------ Issuer credit rating

| | |
|---|---|
| 1a | Contractual subordination |
| 1b | Discretionary or mandatory nonpayment clause and whether the regulator classifies it as regulatory capital |
| 1c | Mandatory contingent capital clause or equivalent |
| 2b | Other nonpayment or default risk not captured already |

Note: The number-letter labels in the table above are in reference to the notching steps we apply to hybrid capital instruments, as detailed in table 3 of our "Hybrid Capital: Methodology And Assumptions" criteria, published on July 1, 2019.
AT1--Additional Tier 1. NDSD--Non-deferrable subordinated debt. NVCC--nonviability contingent capital.



### Resolution counterparty ratings (RCRs)

An RCR is a forward-looking opinion of the relative default risk of certain senior liabilities that may be protected from default through an effective bail-in resolution process for the issuing financial institution. RCRs apply to issuers in jurisdictions where we assess the resolution regime to be effective and the issuer is likely to be subject to a resolution that entails a bail-in if it reaches nonviability. The long-term RCR for KBC Bank is one notch above the long-term 'A+' ICR, at 'AA-', and short-term rating is 'A-1+'.

## Related Criteria

- General Criteria: Group Rating Methodology, July 1, 2019
- Criteria | Financial Institutions | General: Methodology For Assigning Financial Institution Resolution Counterparty Ratings, April 19, 2018
- Criteria | Financial Institutions | General: Risk-Adjusted Capital Framework Methodology, July 20, 2017
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings, April 7, 2017
- General Criteria: Guarantee Criteria, Oct. 21, 2016
- Criteria | Financial Institutions | Banks: Bank Rating Methodology And Assumptions: Additional Loss-Absorbing Capacity, April 27, 2015
- Criteria | Financial Institutions | Banks: Quantitative Metrics For Rating Banks Globally: Methodology And Assumptions, July 17, 2013
- Criteria | Financial Institutions | Banks: Banking Industry Country Risk Assessment Methodology And Assumptions, Nov. 9, 2011
- Criteria | Financial Institutions | Banks: Banks: Rating Methodology And Assumptions, Nov. 9, 2011
- ARCHIVE | General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

## Related Research

- Tech Disruption In Retail Banking: In Belgium, Smaller Players Could Have A Hard Time Keeping Up With The Big Banks, Oct. 7, 2020
- Capital Resilience Alone Won't Stabilize European Bank Ratings In 2021, Feb. ,3 2021
- Lower And Later: The Shifting Horizon For Bank Credit Losses, Feb. 2, 2021
- Low-For-Even-Longer Interest Rates Maintain Margin Pressure On European Banks, Feb. 2, 2021

| Ratings Detail (As Of March 1, 2021)* | | |
|---|---|---|
| **KBC Group N.V.** | | |
| Issuer Credit Rating | | A-/Negative/A-2 |
| Junior Subordinated | | BB+ |
| Senior Unsecured | | A- |
| Short-Term Debt | | A-2 |
| Subordinated | | BBB |
| **Issuer Credit Ratings History** | | |
| 23-Apr-2020 | *Foreign Currency* | A-/Negative/A-2 |
| 30-Jul-2018 | | A-/Stable/A-2 |
| 18-Jan-2016 | | BBB+/Stable/A-2 |
| 23-Apr-2020 | *Local Currency* | A-/Negative/A-2 |
| 30-Jul-2018 | | A-/Stable/A-2 |

| Ratings Detail (As Of March 1, 2021)*(cont.) | |
|---|---|
| 18-Jan-2016 | BBB+/Stable/A-2 |
| **Sovereign Rating** | |
| Belgium | AA/Stable/A-1+ |
| **Related Entities** | |
| **Ceskoslovenska Obchodni Banka A.S.** | |
| Issuer Credit Rating | A+/Stable/A-1 |
| Resolution Counterparty Rating | AA-/--/A-1+ |
| **KBC Bank Ireland PLC** | |
| Issuer Credit Rating | BBB/Stable/A-2 |
| Resolution Counterparty Rating | BBB+/--/A-2 |
| **KBC Bank N.V.** | |
| Issuer Credit Rating | A+/Stable/A-1 |
| Resolution Counterparty Rating | AA-/--/A-1+ |
| Certificate Of Deposit | A-1 |
| Commercial Paper | |
| *Foreign Currency* | A-1 |
| Junior Subordinated | BBB- |
| **KBC Group Re S.A.** | |
| Financial Strength Rating | |
| *Local Currency* | A/Negative/-- |
| Issuer Credit Rating | |
| *Local Currency* | A/Negative/-- |
| **KBC Insurance N.V.** | |
| Financial Strength Rating | |
| *Local Currency* | A/Negative/-- |
| Issuer Credit Rating | |
| *Local Currency* | A/Negative/-- |

*Unless otherwise noted, all ratings in this report are global scale ratings. S&P Global Ratings' credit ratings on the global scale are comparable across countries. S&P Global Ratings' credit ratings on a national scale are relative to obligors or obligations within that specific country. Issue and debt ratings could include debt guaranteed by another entity, and rated debt that an entity guarantees.

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