

Rating Action: Moody's affirms KBC Group and KBC Bank's ratings and changes outlook to positive

28 Jun 2022

Paris, June 28, 2022 -- Moody's Investors Service ("Moody's") today affirmed the A1 long-term deposit ratings of KBC Bank N.V. (KBC Bank) and the Baa1 long-term senior unsecured debt and issuer ratings of KBC Group N.V. (KBC). The rating agency also affirmed the A2 backed senior unsecured debt ratings of KBC IFIMA S.A. (IFIMA), as well as KBC Bank's Baseline Credit Assessment (BCA) and Adjusted BCA of baa1. KBC Bank's short-term deposit ratings were also affirmed at Prime-1 and KBC Group's short-term Deposit Note/CD programme was affirmed at Prime-2. Finally, the rating agency also affirmed KBC Bank's long-term and short-term Counterparty Risk Rating (CRR) of Aa3 and Prime-1, as well as its Counterparty Risk (CR) Assessment of Aa3(cr) and Prime-1(cr). The outlook on KBC Bank's long-term deposit ratings, and KBC Group's long-term issuer and senior unsecured debt ratings was changed to positive from stable.

A list of all affected ratings is provided at the end of this press release.

RATINGS RATIONALE

The affirmation of KBC Bank's BCA of baa1 reflects KBC Group's high solvency, including strong earnings power, supported by its solid presence in Belgium and CEE countries, and diversified businesses, spanning banking activities, insurance and asset management, which have been providing strong growth in fees. Moody's considers KBC's profitability to be superior to that of most European peers, as evidenced by its net income to tangible assets ratio of 0.9% in 2021 (Moody's calculation).

KBC has thus far delivered on its strategic plan's objectives, aiming to gain market shares in its core markets and developing its highly integrated bancassurance model in Belgium and Czech Republic. KBC's ambition to achieve sizable presence in Slovakia, Hungary and Bulgaria through organic growth and acquisitions is also on track.

Over the outlook period, Moody's expects the bank to report higher revenues. Such a growth, stemming from mortgages and commercial loans as well as rate hikes in its core markets, will likely offset inflationary pressures on costs and slow recovery on Belgian mortgage lending margins.

The baa1 BCA is also supported by KBC's sound asset quality, with a low nonperforming loan (NPL) ratio of 2.5% at year-end 2021, and conservative provisioning policy. The group's sale of all of KBC Bank Ireland PLC's remaining non-performing mortgage loan portfolio, which was completed in February 2022, has significantly de-risked KBC's balance sheet given the high- proportion of legacy impaired loans in the Irish loan book, lowering the NPL ratio in line with peers. Moody's also considers that pockets of risk in the domestic portfolio have receded, as the bank tightened its credit standard on mortgage origination in Belgium in line with stricter rules introduced by the National Bank of Belgium on indebtedness and leverage since 2019.

Moody's still expects a moderate increase in problem loans in coming quarters due to the combined effects of the termination of Covid-related support measures in Belgium, and the second-order impact from the military conflict in Ukraine on European economies. This could have a bearing on clients highly exposed to energy prices and supply bottlenecks in the CEE markets, while KBC's subsidiaries are exposed to high industry concentration in volatile sectors, including commercial real estate and construction.

While KBC's direct credit exposure to Russia, Ukraine and Belarus is very small (€55 million), it estimated its indirect exposure (i.e. clients most impacted by newly emerging risks) at circa €8 billion, i.e 2.2% of its total loan book. KBC thus increased its Stage 2 Expected Credit Loss (ECL) allowance by €223 million in Q1 2022, due to the uncertainties surrounding geopolitical and emerging risks, partly offset by a €205 million reduction in Covid-related forward-looking provisions booked in 2020. Overall, Moody's expects cost of risk to remain at low levels of around 25 basis points in 2022.

KBC's long-term deposit rating of A1 and IFIMA's backed senior unsecured debt rating of A2 benefit from a very low and low loss-given-failure, respectively, leading to a two-notch and one-notch uplift, respectively, from the bank's Adjusted BCA. Both ratings also reflect the moderate likelihood of support from the Belgian

government, owing to KBC's systemic nature in Belgium, which leads to an additional notch of uplift from the bank's Adjusted BCA. KBC Group's senior unsecured debt rating of Baa1 benefits from a moderate loss-given-failure and a low probability of government support, leading to no uplift from the Bank's Adjusted BCA.

OUTLOOK

The change of outlook to positive of KBC Bank, IFIMA and KBC Group's long-term deposit, issuer and senior unsecured debt ratings, where applicable, reflects Moody's expectation that KBC's strong earnings generated in recent years will continue to be supported by strong revenue growth, thanks to (i) continued volume growth, and (ii) gradual positive effects from rising interest rates on assets and liabilities, despite headwinds from the macro-economic environment. This, combined with Moody's expectation of a moderate cost of risk, should more than offset inflationary pressures on costs. As a result, Moody's expects KBC to increase its capital buffer above its minimum Common Equity Tier 1 (CET1) target of 15% (CET1 ratio stood at 15.3% as of March 2022), through strong annual profit generation, stable earnings distribution of 50%, and moderate risk-weighted assets (RWA) growth. This capital buffer provides strong risk absorption capacity to the bank, and the room to make some bolt-on acquisitions, although they have been of modest size in recent years.

Besides, Moody's considers that continued issuance of senior unsecured and subordinated debt by KBC Group in order to comply with minimum requirement for own funds and eligible liabilities (MREL) targets will add subordination benefitting KBC Bank's and IFIMA's senior creditors, which could lead to reduced expected loss for such creditors over the outlook horizon, provided that balance sheet growth remains moderate.

FACTORS THAT COULD LEAD TO AN UPGRADE OR DOWNGRADE OF THE RATINGS

An upgrade of KBC Bank's BCA could result from sustained earnings generation capacity, above peers, whilst maintaining low asset risk, and higher capital levels, despite headwinds from the macro-economic environment. An upgrade of KBC Bank's BCA would result in an upgrade of the long-term ratings of KBC Bank, IFIMA and KBC Group.

An upgrade of KBC Bank's and IFIMA's senior unsecured ratings could also result from continued issuance of senior unsecured and subordinated debt by KBC Group in order to comply with MREL targets.

Although unlikely given the positive outlook, a downgrade of KBC Bank's BCA could be driven by a sustained reduction in profitability, should fees or net interest income both materially decline; regulatory capital ratios at the bank and group levels reducing below targets, because of, for example, more aggressive earnings distribution, lending growth or acquisitions; and a deterioration in asset quality.

A downgrade of KBC Bank's BCA would typically result in a downgrade of the long-term ratings of KBC Bank, IFIMA and KBC Group.

These ratings could also be downgraded if there is a significant and sustained decrease in the debt loss-absorption capacity, resulting in a higher loss given failure for one or more instrument classes.

LIST OF AFFECTED RATINGS

Issuer: KBC Group N.V.

..Affirmations:

....Short-term Deposit Note/CD Program, affirmed P-2

....Long-term Issuer Rating, affirmed Baa1, outlook changed to Positive from Stable

....Short-term Issuer Rating, affirmed P-2

....Senior Unsecured Regular Bond/Debenture, affirmed Baa1, outlook changed to Positive from Stable

....Senior Unsecured Medium-Term Note Program, affirmed (P)Baa1

....Subordinate Regular Bond/Debenture, affirmed Baa2

....Subordinate Medium-Term Note Program, affirmed (P)Baa2

....Preferred Stock Non-cumulative, affirmed Ba1(hyb)

...Other Short Term, affirmed (P)P-2

..Outlook Action:

...Outlook changed to Positive from Stable

Issuer: KBC Bank N.V.

..Affirmations:

...Long-term Counterparty Risk Ratings, affirmed Aa3

...Short-term Counterparty Risk Ratings, affirmed P-1

...Long-term Bank Deposits, affirmed A1, outlook changed to Positive from Stable

...Short-term Bank Deposits, affirmed P-1

...Long-term Counterparty Risk Assessment, affirmed Aa3(cr)

...Short-term Counterparty Risk Assessment, affirmed P-1(cr)

...Baseline Credit Assessment, affirmed baa1

...Adjusted Baseline Credit Assessment, affirmed baa1

..Outlook Action:

...Outlook changed to Positive from Stable

Issuer: KBC IFIMA S.A.

..Affirmations:

...Backed Senior Unsecured Regular Bond/Debenture, affirmed A2, outlook changed to Positive from Stable

...Backed Senior Unsecured Medium-Term Note Program, affirmed (P)A2

...Backed Subordinate Regular Bond/Debenture, affirmed Baa2

...Backed Subordinate Medium-Term Note Program, affirmed (P)Baa2

...Backed Other Short Term, affirmed (P)P-1

..Outlook Action:

...Outlook changed to Positive from Stable

PRINCIPAL METHODOLOGY

The principal methodology used in these ratings was Banks Methodology published in July 2021 and available at <https://ratings.moodys.com/api/rmc-documents/71997>. Alternatively, please see the Rating Methodologies page on <https://ratings.moodys.com> for a copy of this methodology.

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