FitchRatings

Fitch Revises KBC Bank's Outlook to Positive; Affirms at 'A'

Fitch Ratings-Paris/London-07 December 2017: Fitch Ratings has revised KBC Bank's Outlook to Positive from Stable, while affirming its Long-Term Issuer Default Rating (IDR) at 'A'. KBC Groep NV's (KBC Group) Long-Term IDR has also been affirmed at 'A', with Stable Outlook.

Both KBC Bank's and KBC Group's Viability Ratings (VRs) have been affirmed at 'a' and senior debt ratings at 'A'.

Fitch has also affirmed KBC Verzekeringen's and KBC Group Re's Insurer Financial Strength (IFS) Ratings at 'A+', and KBC Verzekeringen's Long-Term IDR at 'A'. The Outlooks on the IDR and IFS Ratings are Stable.

A full list of rating actions is at the end of this rating action commentary.

The revision of the Outlook on KBC Bank's Long-Term IDR to Positive reflects Fitch's expectation that the bank's Long-Term IDR might be rated one notch above the bank's VR following the build-up of a significant and sustainable junior debt buffer at the bank that provides additional protection for the bank's senior unsecured creditors. KBC Bank has proposed a single point of entry approach at the level of KBC Group and most debt issued out of the holding company is streamed down to the bank in a subordinated form that ranks junior to senior creditors to meet the upcoming minimum requirement for eligible liabilities and own funds.

The rating actions are part of a periodic review of major Belgian and Luxembourg banking groups rated by Fitch.

KEY RATING DRIVERS
IDRS, VR, DERIVATIVE COUNTERPARTY RATING (DCR) AND SENIOR DEBT

KBC BANK
The ratings reflect the strong retail and commercial franchise of KBC Bank in its two key markets, Belgium and the Czech Republic, gradual improvement in its Irish legacy loan portfolio, limited market risk, strong and diversified earnings generation, solid capitalisation and sound funding and liquidity.

Its stock of impaired loans is steadily decreasing, but will most likely remain high compared with peers in the medium term. The group reported an impaired-to-gross loans ratio of 6.6% at end-September 2017 (end-2016: 7.2%), with about half of impaired loans in Ireland. Our base case is for a material part of restructured (and still classified as impaired) Irish loans to cure in the next two years, aided by a solid economic recovery, and for the high amount of total unreserved impaired loans to decline to a more acceptable level.

Asset quality is supported by the dominance of the bank's fairly low-risk Belgian operations and by stable Czech operations. Exposure to some 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.

Earnings generation has improved and compares well with similarly rated peers. The bank is building a track record of resilient and stable profitability, underpinned by management's focus on the bancassurance business model in its core markets and tight cost control. Capitalisation at KBC Bank is solid with fully loaded CET1 and leverage ratios of 14% and 4.7%, respectively, at end-September 2017.

Liquidity is strong. The bank has a solid retail funding base, and nearly all subsidiaries are self-funded. Customer deposits are its largest source of funding and fund its lending. The bank also has access to the debt capital markets directly and via KBC Group. Its wholesale funding maturities are reasonably even, and the bank's ample liquidity buffer further mitigates refinancing risk.

The DCR is at the same level as the Long-Term IDR and senior debt ratings because under Belgian legislation, derivative counterparties have no preferential status over other senior
obligations in a resolution scenario.

IDRS, VR, DCR AND SENIOR DEBT
KBC GROUP
KBC Group's ratings are equalised with the ratings of KBC Bank, reflecting the dominance of the bank in the group (around 90% of group assets), the regulatory focus on the group as a consolidated entity, low double leverage, the use of the holding company for capital raising and high fungibility of capital between the holding company and the bank. Liquidity is managed at the group level.

IDR AND IFS
KBC VERZEKERINGEN AND KBC GROUP RE
The ratings reflect KBC Verzekeringen's core strategic importance in the integrated bancassurance business model of KBC Group. KBC Verzekeringen relies on its parent for its business position and strategic direction and its capital management is integrated within KBC Group.

At the current level, KBC Verzekeringen's ratings are in line with the company's standalone creditworthiness. The ratings are underpinned by KBC Verzekeringen's sound profitability, leading bancassurer position in Belgium, strong capital adequacy and prudent asset allocation.

KBC Group reported consolidated net profit for insurance activities of EUR224 million in H117 (H116: EUR123 million); non-life underwriting profitability was strong with a combined ratio of 84% (H116: 95%); however, life premium income was lower than in H116. The ratings also reflect KBC Verzekeringen's strong consolidated regulatory Solvency II ratio of 217% at end-1H17.

KBC Group Re's core status within the KBC Group reflects a formal capital support agreement with KBC Verzekeringen and the adoption of its parent's brand name.

SUPPORT RATING AND SUPPORT RATING FLOOR
KBC Bank's and KBC Group'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.

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.

Hybrid securities issued by KBC Bank are rated four notches lower than its VR (two notches for non-performance and two notches for relative loss severity). Subordinated debt issued by KBC IFIMA N.V is rated one notch lower than KBC Bank's VR (for relative loss severity) as the notes are guaranteed by KBC Bank.

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).

SUBSIDIARY AND AFFILIATED COMPANY
The senior debt issued by KBC Bank's fully owned subsidiaries KBC IFIMA S.A. and KBC Bank Ireland plc is guaranteed by KBC Bank, and the subsidiaries' debt ratings are aligned with the bank's IDRs to reflect our view that KBC Bank will ensure these obligations are met.

RATING SENSITIVITIES
IDRS, VR, DCR AND SENIOR DEBT
KBC BANK
Fitch expects the tail risk in KBC Bank's Irish legacy loan portfolio to continue to decrease, while earnings generation and capitalisation will remain strong. Setbacks to these expectations could lead to a VR downgrade. A further upgrade of the VR is unlikely in the foreseeable future.

The Long-Term IDR, senior debt ratings and DCR of KBC Bank could be upgraded to one notch above the bank's VR once the qualifying junior debt buffer is sufficient and sustainable to protect senior obligations from default in case of failure, either under a resolution process or as part of a private sector solution (ie, distressed debt exchange) to avoid a resolution action.

Without such a private sector solution, we would expect a resolution action being taken on KBC 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 common equity Tier 1 (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 qualifying junior debt buffer of approximately 9% would most likely be sufficient to restore the bank's viability without affecting senior creditors.

At end-September 2017, the qualifying junior debt buffer at KBC Bank amounted to 8.5% of weighted risks. We expect KBC group will further strengthen this junior debt buffer and maintain a buffer of approximately 9% on a sustainable basis. This is in line with the group's stated target of meeting the current minimum requirement for own funds and eligible liabilities (MREL).

KBC GROUP
KBC Group's ratings are likely to move in tandem with the VR of KBC Bank. Double leverage beyond 120% (around 100% at end-2016) could result in a downgrade of KBC Group's ratings.

IDR AND IFS
KBC VERZEKERINGEN AND KBC GROUP RE
As a consequence of the strong links of KBC Verzekeringen with KBC Group, changes to the group's ratings are likely to result in similar changes to KBC Verzekeringen and KBC Group Re's ratings.

KBC Group Re relies on KBC Verzekeringen for its role as a captive reinsurer, business position, strategic direction and asset management expertise. Changes to its parent's ratings are likely to have a corresponding impact on KBC Group Re's ratings.

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.

SUBORDINATED DEBT AND OTHER HYBRID SECURITIES
Subordinated debt and hybrid securities issued by KBC Bank, KBC IFIMA N.V 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.

SUBSIDIARY AND AFFILIATED COMPANIES
The senior debt ratings of KBC IFIMA S.A. and KBC Bank Ireland plc are sensitive to the same factors that might drive a change in KBC Bank's IDRs.

The rating actions are as follows:

KBC Bank
- Long-Term IDR affirmed at 'A', Outlook revised to Positive from Stable
- Short-Term IDR affirmed at 'F1'
- Viability Rating affirmed at 'a'
- Support Rating affirmed at '5'
- Support Rating Floor affirmed at 'No Floor'
- Derivative Counterparty Rating: affirmed at 'A(dcr)'
- Senior debt affirmed at 'A'/'F1'
- Commercial paper affirmed at 'F1'
- Perpetual subordinated debt securities (BE0119284710) affirmed at 'BBB-'

KBC IFIMA S.A.
- Senior debt affirmed at 'A'
- Short-term debt affirmed at 'F1'
- Subordinated debt affirmed at 'A-'
- Market-linked securities affirmed at 'Aemr'

KBC Bank Ireland plc
- Commercial paper affirmed at 'F1'

KBC Group
- Long-Term IDR affirmed at 'A', Outlook Stable
- Short-Term IDR affirmed at 'F1'
- Viability Rating affirmed at 'a'
- Support Rating affirmed at '5'
- Support Rating Floor affirmed at 'No Floor' '
- Senior debt affirmed at 'A'/'F1'
- Subordinated debt affirmed at 'A-'
- Undated deeply subordinated securities (BE0002463389) affirmed at 'BB+'

KBC Verzekeringen
- Long-Term IDR affirmed at 'A', Outlook Stable
- Insurer Financial Strength Rating affirmed at 'A+', Outlook Stable

KBC Group Re

- Insurer Financial Strength Rating affirmed at 'A+', Outlook Stable

Contact:
Primary Analysts
Olivia Perney Guillot (KBC Bank, KBC IFIMA S.A, KBC Group, KBC Bank Ireland plc)
Senior Director
+33 1 44 29 91 74
Fitch France S.A.S.
60 rue de Monceau
75008 Paris

Federico Faccio (KBC Verzekeringen and KBC Group Re)
Senior Director
+44 20 3530 1394
30 North Colonnade
E14 5GN London

Secondary Analysts
Bjorn Norrman (KBC Bank, KBC IFIMA S.A, KBC Group, KBC Bank Ireland plc)
Senior Director
+44 20 3530 1330

Nicola Caverzan (KBC Verzekeringen and KBC Group Re)
Associate Director
+44 20 3530 1642

Committee Chairs
Artur Szeski (KBC Bank, KBC IFIMA S.A, KBC Group, KBC Bank Ireland plc)
Senior Director
+48 22 338 6292

Chris Waterman (KBC Verzekeringen and KBC Group Re)
Managing Director
+44 203 530 1168

Media Relations: Francoise Alos, Paris, Tel: +33 1 44 29 91 22, Email: francoise.alos@fitchratings.com; Peter Fitzpatrick, London, Tel: +44 20 3530 1103, Email: peter.fitzpatrick@fitchratings.com.

Additional information is available on www.fitchratings.com

The following issuer(s) did not participate in the rating process, or provide additional information, beyond the issuer's available public disclosure: KBC Group Re S.A., KBC Insurance NV

Applicable Criteria
Global Bank Rating Criteria (pub. 25 Nov 2016) (https://www.fitchratings.com/site/re/891051)
Insurance Rating Criteria (pub. 30 Nov 2017) (https://www.fitchratings.com/site/re/905036)

Additional Disclosures
Dodd-Frank Rating Information Disclosure Form (https://www.fitchratings.com/site/dodd-frank-disclosure/1033611)
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Issuer(s)

KBC Group Re S.A.
KBC Insurance NV

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Solicitation Status

Fitch Ratings was paid to determine each credit rating announced in this Rating Action Commentary (RAC) by the obligatory being rated or the issuer, underwriter, depositor, or sponsor of the security or money market instrument being rated, except for the following:

Unsolicited Issuers:

Entity/Security	ISIN/CUSIP/COUPON RATE	Rating Type	Solicitation Status
KBC Group Re S.A.	-	Long Term Issuer Default Rating	Unsolicited
KBC Group Re S.A.	-	LT Financial Strength Rating	Unsolicited
KBC Insurance NV	-	Long Term Issuer Default Rating	Unsolicited
KBC Insurance NV	-	LT Financial Strength Rating	Unsolicited

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