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Research Update:

Belgium-Based KBC Group And Core Bank And Insurance Subs Upgraded On Balance Sheet Strengthening; Outlooks Stable

Primary Credit Analyst:
Nicolas Hardy, Paris (33) 1-4420-7318; nicolas.hardy@spglobal.com

Secondary Contacts:
Philippe Raposo, Paris (33) 1-4420-7377; philippe.raposo@spglobal.com
Charlotte Chausserie-Lapree, Paris (33) 1-4420-7205; charlotte.chausserie@spglobal.com
Annette Ess, CFA, Frankfurt (49) 69-33-999-157; annette.ess@spglobal.com

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Overview

- We consider that KBC Group will continue strengthening its balance sheet, thanks to solid financial performance, a low risk profile, clear growth strategy, and a business model all helping to adapt to evolving regulatory requirements.
- We therefore now assess the unsupported group profile at 'a' compared with 'a-' previously, while still adding a notch of uplift for additional loss absorption capacity due to KBC's sizable buffer of bail-inable debt.
- Consequently, we are raising by one notch our ratings on the group's core banking and insurance entities, and on the nonoperating holding company (NOHC), as well as our ratings on long-term senior and subordinated instruments issued by the bank and the NOHC.
- The stable outlooks on all these entities reflect our view that the group will continue to expand and perform well in its core markets, with continuously strong and resilient earnings as it leverages its efficient bancassurance operating model.

Rating Action

On July 30, 2018, S&P Global Ratings raised its long-term issuer credit ratings on the core banking entities of the KBC bancassurance group, namely Belgium-based KBC Bank N.V. and Czech Republic-based Ceskoslovenska Obchodni Banka A.S. (CSOB) to 'A+' from 'A'. We also raised our long-term ratings on the nonoperating holding company (NOHC) KBC Group N.V. to 'A-' from 'BBB+' and the issuer credit and insurer financial strength ratings on KBC Insurance and KBC Group Re to 'A' from 'A-'. The outlooks on all these entities are stable.

We also raised our long- and short-term resolution counterparty ratings on the two main operating banks forming the KBC group, namely KBC Bank and CSOB, to 'AA-/A-1+' from 'A+/A-1'.

Additionally, we raised by one notch our issue ratings on the subordinated and hybrid capital instruments issued by these entities.

Our ratings and outlook on subsidiary KBC Bank Ireland PLC (BBB-/Positive/A-3) are unaffected.

Rationale

The upgrade reflects our view that KBC will continue strengthening its balance sheet, thanks to its solid financial performance and low-risk profile, clear medium term strategy, and a business model well adapted to evolving regulatory requirements.

In our view, the group benefits from a strong and sustainable competitive position, as the bank and insurance company's leading market shares in the Belgian and Czech markets illustrate. We believe KBC's well-integrated bancassurance model makes the group resilient to the effects of upcoming regulatory, digital, and competitive challenges facing the financial industry. KBC's previous financial performance and earnings retention have helped improve its core capital to what we consider strong and now close to the levels exhibited by the best-capitalized large universal banks in Europe, and we expect that this trend will continue.

KBC's overall size appears modest compared with that of many similarly rated large and more diversified international banking groups, but it ranks among the most profitable banking groups in Europe, thanks to its very strong bancassurance franchise in Belgium, diversified revenue sources, supportive efficiency ratios, and robust risk management. Most of its revenues stem from low-risk Belgian and Czech markets. Moreover, pockets of risks that have created issues in the past, such as market activities or in the Irish operations, are now marginal or have been turned around. This reinforces the predictability of revenues and low-risk nature of the business model.

In recent years, the group's strategic focus has been on derisking, and strengthening core, relatively lower-risk commercial banking and insurance activities. According to our metrics, KBC's capitalization is now stronger, and on par with its Dutch and Nordic peers. However, we note that KBC has some appetite for organic and external growth, as illustrated by its acquisition of United Bulgarian Bank in 2017.

We estimate our risk-adjusted capital (RAC) ratio for the group, before diversification, was at 10.8% as of year-end 2017. This is higher than we initially anticipated, due to lower growth of S&P Global Ratings' risk-weighted assets (RWA) metric, as well as the group's solid financial performance and stronger total adjusted capital, the numerator of the RAC ratio. The increase in the ratio also reflects our view of reduced risk for banks operating in Ireland and Czech Republic during 2017. We project the group's RAC ratio will remain in the 10.5%-11.0% range by year-end 2020, based on the following assumptions:

- On average a 4%-5% annual increase in our RWA figure as the group's balance sheet continues to expand in European countries where it already operates, excluding Ireland.
- Annual net profits of €2.5 billion on average, thanks to resilient net interest income, especially in the two largest markets Belgium and Czech

Republic; healthy contribution of insurance activities and assets under management; stable operating expenses; and a low cost of risk overall. The cost of risk has declined in Ireland, in particular, where it used to be very high. Given the group's geographic footprint, including in countries we see as risker than Belgium, we do not exclude a moderate rise of the cost of risk in the medium term.

- A dividend payout ratio in the 50%-60% range.
- No material change in the group's perimeter in our base-case scenario, but we do not exclude opportunistic moves in line with the group's strategy of strengthening its presence in core markets. KBC considers that its common equity tier 1 reference capital position of 16% also includes a 2% flexible buffer for potential acquisitions.

Our assessment of KBC's additional loss absorption capacity (ALAC) leads us to continue to add one notch of uplift to the group credit profile (GCP), reflecting KBC's buildup of senior 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-inable debt. We estimate that the ALAC buffer will increase to over 6.5% of our RWA measure by year-end 2019, based on KBC's internal capital generation and the expected continuing issuance of subordinated and senior unsecured debt instruments by KBC Group N.V. 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.

Given these expectations and assumptions, and our views on KBC's strategic positioning and financial performance, we have revised our assessment of the unsupported GCP to 'a' from 'a-' while maintaining the one notch of ALAC uplift for KBC's core banking entities. Because we do not believe ALAC support will be available to the insurance subsidiaries in a resolution scenario, we continue to equalize our ratings on those entities with the 'a' unsupported GCP.

Our ratings on KBC Bank Ireland (BBB-/Positive/A-3) are unaffected because we derive our ratings from our combined view on this entity's intrinsic credit factors and its strategic importance to the group.

Outlook

Our stable outlooks reflect our expectation that, in the next two years, the group will continue to expand and perform well in its core markets. We expect the overall group to display strong and resilient earnings as it leverages its efficient bancassurance operating model, which should help alleviate pressure from the low-interest-rate environment.

We could lower the ratings if we were to revise our assessment of the unsupported GCP downward, which could happen if the group departed from prudent capital management or exhibited a more aggressive growth pattern, organically or via acquisitions.

We believe strengthening of the unsupported GCP to 'a+' is a remote possibility over the next two years because it would require a more diverse business model or substantially lower risk exposure, which is constrained by growth in countries that carry higher risk than in Belgium.

Our stable outlook on KBC Bank reflects our expectation that, over the next two years, KBC will steadily implement its strategy to maintain a high core regulatory capital ratio at the bank. In addition, we expect KBC will build a large buffer of instruments (mainly issued by the group's NOHC) in excess of 5.25% of our RWA figure that protects KBC Bank's senior creditors.

We would lower our ratings on KBC Bank if we were to revise our assessment of the GCP downward. We would also lower the ratings on the bank if the issuance of bail-in-able debt falls short of 5.25% of our RWA in the next 24 months, either because the group has adopted a more acquisitive or shareholder-friendly strategy, which would inflate RWA, or because capital market conditions complicate the issuance of large amounts of bail-in-able debt.

Ceskoslovenska Obchodni Banka

The stable outlook on CSOB mirrors that on its parent, KBC Bank. Any rating action on KBC Bank in the next two years would translate into a similar rating action on this core subsidiary.

Despite the prevailing regulatory uncertainties in the Czech Republic, we use the supported GCP as the reference point for equalizing the ratings. This is because we anticipate that the group would be subject to a single resolution process, which would seek to ensure that CSOB continued to service its senior obligations on time and in full. If we concluded that the ALAC support incorporated in our ratings on the parent would not extend to the Czech subsidiary, for example because it would potentially be subject to separate a resolution, we would likely equalize our long-term rating on CSOB with the unsupported GCP of 'a'.

Other group entities

The outlooks on other group entities are unchanged. The outlook on core insurance entities KBC Insurance and KBC Group Re is stable because we do not expect their core group status to change over the next two years, since insurance remains an integral part of the group's strategy. We also expect the unsupported GCP to remain unchanged over the next two years.

Ratings Score Snapshot

KBC Bank N.V.

	To	From
Issuer Credit Rating	A+/Stable/A-1	A/Positive/A-1
SACP	a	a-
Anchor	bbb+	bbb+
Business Position	Strong (+1)	Strong (+1)
Capital and Earnings	Strong (+1)	Adequate (0)
Risk Position	Adequate (0)	Adequate (0)
Funding and Liquidity	Average and Adequate (0)	Average and Adequate (0)
Support	+1	+1
ALAC Support	+1	+1
GRE Support	0	0
Group Support	0	0
Sovereign Support	0	0
Additional Factors	0	0

Related Criteria

- 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: Bank Hybrid Capital And Nondeferrable Subordinated Debt Methodology And Assumptions, Jan. 29, 2015
- General Criteria: Principles For Rating Debt Issues Based On Imputed Promises, Dec. 19, 2014
- General Criteria: Group Rating Methodology, Nov. 19, 2013
- Criteria - Financial Institutions - Banks: Quantitative Metrics For Rating Banks Globally: Methodology And Assumptions, July 17, 2013
- Criteria - Financial Institutions - Banks: Banks: Rating Methodology And Assumptions, Nov. 9, 2011

- Criteria - Financial Institutions - Banks: Banking Industry Country Risk Assessment Methodology And Assumptions, Nov. 9, 2011
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009
- Criteria - Financial Institutions - Banks: Commercial Paper I: Banks, March 23, 2004

Ratings List

Upgraded; Outlook Action; Ratings Affirmed

	To	From
KBC Bank N.V.		
Ceskoslovenska Obchodni Banka A.S.		
Issuer Credit Rating	A+/Stable/A-1	A/Positive/A-1

Upgraded; Ratings Affirmed

	To	From
KBC Group N.V.		
Issuer Credit Rating	A-/Stable/A-2	BBB+/Stable/A-2
KBC Bank N.V.		
Certificate Of Deposit	A-1	A-1
Commercial Paper	A-1	A-1
Junior Subordinated	BBB-	BB+
Junior Subordinated	BBB	BBB-

Upgraded

	To	From
KBC Insurance N.V.		
KBC Group Re S.A.		
Issuer Credit Rating		
Local Currency	A/Stable/--	A-/Stable/--
Financial Strength Rating		
Local Currency	A/Stable/--	A-/Stable/--
Ceskoslovenska Obchodni Banka A.S.		
KBC Bank N.V.		
Resolution Counterparty Rating	AA-/--/A-1+	A+/--/A-1
KBC Group N.V.		
Senior Unsecured	A-	BBB+
Subordinated	BBB	BBB-
Junior Subordinated	BB+	BB
KBC Ifima N.V.		
Senior Unsecured	A+	A

Subordinated	BBB+	BBB

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. Complete ratings information is available to subscribers of RatingsDirect at www.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column. Alternatively, call one of the following S&P Global Ratings numbers: Client Support Europe (44) 20-7176-7176; London Press Office (44) 20-7176-3605; Paris (33) 1-4420-6708; Frankfurt (49) 69-33-999-225; Stockholm (46) 8-440-5914; or Moscow 7 (495) 783-4009.