

Insurance Markets

Research Update:

KBC Bank 'A/A-1' Ratings Affirmed On Government Support And ALAC Review; Outlook Remains Negative

Primary Credit Analysts:

Nicolas Hardy, Paris (33) 1-4420-7318; nicolas.hardy@standardandpoors.com

Marc-Philippe Juilliard, Paris +(33) 1-4075-2510; m-philippe.juilliard@standardandpoors.com

Secondary Contacts:

Philippe Raposo, Paris (33) 1-4420-7377; philippe.raposo@standardandpoors.com

Charlotte Chausserie-Lapree, Paris (33) 1-4420-7205; charlotte.chausserie@standardandpoors.com

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Overview

- We believe the prospect of extraordinary government support for Belgian banks is now uncertain in view of the country's well-advanced and effective resolution regime.
- We are therefore removing the one notch of uplift for government support that we had previously incorporated in the long-term counterparty credit ratings on KBC Group's main core operating subsidiaries, KBC Bank and KBC Insurance.
- However, we now include one notch in the long-term ratings on KBC Bank because we consider that the bank has already built some additional loss-absorbing capacity (ALAC) and will continue to do so.
- We are therefore affirming our long- and short-term counterparty credit ratings on KBC Bank at 'A/A-1'.
- We are lowering our ratings on KBC Insurance to 'A-' because we do not believe ALAC support will be available for insurance subsidiaries, but affirming KBC Group Re at 'A-' because we now regard it as a core group entity.
- The outlook on KBC Bank, KBC Group, and the core subsidiary Ceskoslovenska Obchodni Banka A.S. remains negative, reflecting uncertainties on the preferred resolution strategy in Belgium and our view of the negative trend for economic risk in the country.
- The outlook on core insurance entities KBC Insurance and KBC Group Re is stable as we don't foresee downside pressure on their group membership or the unsupported group credit profile in the next two years.

Rating Action

As previously announced on Dec. 2, 2015, Standard & Poor's Ratings Services has affirmed its long- and short-term counterparty credit ratings on Belgium-based KBC Bank N.V. at 'A/A-1' and on its nonoperating holding company (NOHC) KBC Group N.V. at 'A-/A-2'. We also affirmed our 'A/A-1' ratings on core subsidiary Czech Republic-based Ceskoslovenska Obchodni Banka A.S. The outlook on these entities remains negative.

We affirmed our 'BBB-/A-3' ratings on KBC Bank Ireland PLC. The outlook is stable.

We lowered our counterparty credit and insurer financial strength ratings on KBC Insurance N.V. to 'A-' from 'A' and affirmed our 'A-' counterparty credit

and insurer financial strength ratings on insurance subsidiary KBC Group Re S.A. The outlook on both entities is now stable.

We also affirmed our counterparty credit and insurer financial strength ratings on CSOB Pojistovna at 'A-'. The outlook is stable.

Rationale

We believe that the prospect of extraordinary government support for the Belgian banking sector is now uncertain following the expected full implementation of the EU Bank Recovery and Resolution Directive, including bail-in powers, from Jan. 1, 2016. We do not completely exclude the possibility of such support, and we consider that systemically important Belgian institutions such as KBC Bank face several more years of structural and balance sheet reforms to address their "resolvability" (mitigating the systemic impact if they fail). Nevertheless, we believe the Belgian government's ability and willingness to provide support is lower and less predictable under the enhanced resolution framework. We have therefore reclassified the tendency of the Belgian government to support private sector commercial banks as "uncertain" under our criteria, and removed the one notch that we previously included for government support in the long-term counterparty credit rating on the group's core operating entity, KBC Bank.

We have added one notch of uplift within KBC's stand-alone credit profile (SACP), and so within the long-term rating on KBC Bank, because we consider that KBC is likely to increase and maintain ALAC close to our 4.5% threshold. We view the Belgian resolution regime as "effective" under our ALAC criteria because, among other factors, 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.

We use a 4.5% threshold for KBC Group, as opposed to the usual 5.0%, because we qualitatively adjust for the portion of KBC Group's insurance operations that we expect would be outside the scope of required bail-in capitalization.

We include in our ALAC assessment the subordinated instruments issued by the bank or similar ones issued by KBC Group and already down-streamed to the bank, because we believe they have capacity to absorb losses without triggering a default on KBC Bank's senior obligations and they meet our other criteria for inclusion. We are still uncertain whether the resolution entity would be the bank or the NOHC. Once we have clarity on this, we may include senior debt issued at the NOHC, if KBC were to follow that route and we have certainty, based on the final legal documentation of any new instrument, that such instruments could protect senior bondholders at KBC Bank. As of today, there is no such debt outstanding at the NOHC level, but we believe there is a reasonable chance that it will contribute to ALAC in the foreseeable future. On this basis, we calculate that ALAC was 2.4% of Standard & Poor's risk-weighted assets at year-end 2014. We expect this ALAC ratio to be about

4.5% in 2018, but it could be lower if our calculation of risk-weighted assets is inflated by deterioration in our assessment of economic risk in Belgium (currently at '2' with a negative trend).

The projected ALAC ratio reflects our expectations that:

- Excess Standard & Poor's total adjusted capital (TAC) will increase over the period, with a projected risk-adjusted capital (RAC) ratio already in the 8.75%-9.25% range, which is above the 7% threshold to qualify for an adequate capital and earnings position under our criteria. This excess TAC will contribute to the buildup of the ALAC buffer, in accordance with our criteria.
- KBC will gradually replace maturing Tier 2 capital instruments with ALAC-eligible instruments.

Our calculation of the projected RAC ratio standing within the 8.75%-9.25% range at end-2017 is based on the following assumptions:

- On average, 2.5% growth of Standard & Poor's risk-weighted assets for credit risk over 2016-2017.
- The full repayment of state aid, including penalties, before the end of 2017. We understand that a significant amount could be repaid earlier.
- Annual net income of €2 billion on average and a dividend payout ratio of 50%.

We expect that future regulatory requirements will lead KBC to increase its existing buffer of loss-absorbing capacity. At the same time, KBC stated in its third-quarter 2015 presentation to investors that "the excess capital can be returned to the shareholders if no value-added business investments are found." We also understand that a 50% payout ratio from 2016 represents a minimum. Our RAC ratio, and therefore excess TAC, is sensitive to more aggressive capital management.

As a result of the above, we have maintained the GCP at 'a', which now includes ALAC support instead of government support.

We revised the group status of insurance subsidiary KBC Group Re S.A. to core, on the back of KBC Group Re's increasing role as the group's central vehicle for third party reinsurance purchases and its high integration within the group. Indeed, KBC Group Re has discontinued writing third-party business and is now fully focused on accepting, directly and indirectly, premiums from KBC group entities only.

We have subsequently affirmed our ratings on core banking and insurance subsidiaries Ceskoslovenska Obchodni Banka and KBC Group Re, on the highly strategically important insurance subsidiary CSOB Pojistovna, and on the strategically important subsidiary KBC Bank Ireland PLC.

We lowered our counterparty credit and insurer financial strength ratings on KBC Insurance N.V. to 'A-' from 'A' because we now notch down from the 'a-'SACP, as we removed government support and we do not believe ALAC support will be available for insurance subsidiaries.

The ratings on hybrid capital instruments issued by the group entities are unaffected.

Outlook

The outlook remains negative on both KBC Bank and KBC Group. It reflects the remaining uncertainties on what resolution strategy will prevail in Belgium, especially for banks with a holding company, such as KBC. The resolution strategy imposed by the regulator will influence the issuing strategy, especially at the holding company level. The negative outlook also acknowledges our assessment of a negative trend for economic risk in Belgium. If we were to lower our economic risk assessment, this would negatively influence ALAC ratios via higher risk weights.

We could remove the notch of ALAC and lower the ratings if the following two risk factors materialized:

- Standard & Poor's risk-weighted assets grew faster than we expect without a commensurate growth of capital. This situation could arise if we believed that economic risk, as measured under our banking industry country risk assessment, was heightening in Belgium. It could also stem from a more rapid growth of risk assets than we expect in countries that display higher economic risk than Belgium.
- The amount of debt qualifying as ALAC remained insufficient.

We would revise the outlook to stable if we considered that either of the two abovementioned risk factors was becoming increasingly remote.

We expect to have more clarity on the resolution strategy in the first half of 2016. If, based on our understanding of this strategy, we include senior debt issued at the NOHC KBC Group in ALAC, we would likely affirm the rating on KBC Bank with a stable outlook, everything else being equal. However, we would likely lower the rating on KBC Group to 'BBB+', one notch below the SACP, reflecting the fact that the holding company is likely to be the resolution entity. This is consistent with our approach for Swiss and U.K. banks.

The outlook on the core banking subsidiary Ceskoslovenska Obchodni Banka is negative because it mirrors the outlook on the parent. Any rating action on the parent would translate into a similar rating action on this core subsidiary.

The outlook on core insurance entities KBC Insurance and KBC Group Re is stable because we do not expect downward pressure on their group membership or on the SACP in the next two years. The outlook on CSOB Pojistovna is stable, based on the company's stand-alone credit profile, which was not reviewed as part of our review of government support.

Ratings Score Snapshot

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

Related Criteria And Research

Related Criteria

- Bank Rating Methodology And Assumptions: Additional Loss-Absorbing Capacity, April 27, 2015
- Rating Government-Related Entities: Methodology And Assumptions, March 25, 2015
- Bank Hybrid Capital And Nondeferrable Subordinated Debt Methodology And Assumptions, Jan. 29, 2015
- Principles For Rating Debt Issues Based On Imputed Promises, Dec. 19, 2014
- Standard & Poor's National And Regional Scale Mapping Tables, Sept. 30, 2014
- National And Regional Scale Credit Ratings, Sept. 22, 2014
- Group Rating Methodology, Nov. 19, 2013
- Ratings Above The Sovereign-Corporate And Government Ratings: Methodology And Assumptions, Nov. 19, 2013
- Use Of 'C' And 'D' Issue Credit Ratings For Hybrid Capital And Payment-In-Kind Instruments, Oct. 24, 2013
- Assessing Bank Branch Creditworthiness, Oct. 14, 2013
- Quantitative Metrics For Rating Banks Globally: Methodology And Assumptions, July 17, 2013
- Criteria For Assigning 'CCC+', 'CCC', 'CCC-', And 'CC' Ratings, Oct. 1, 2012

- Revised Market Risk Charges For Banks In Our Risk-Adjusted Capital Framework, June 22, 2012
- Banks: Rating Methodology And Assumptions, Nov. 9, 2011
- Banking Industry Country Risk Assessment Methodology And Assumptions, Nov. 9, 2011
- Bank Capital Methodology And Assumptions, Dec. 6, 2010
- Methodology For Mapping Short- And Long-Term Issuer Credit Ratings For Banks, May 4, 2010
- Use Of CreditWatch And Outlooks, Sept. 14, 2009
- Commercial Paper I: Banks, March 23, 2004

Related Research

- Most European Bank Ratings Affirmed Following Government Support And ALAC Review, Dec. 2, 2015
- Credit FAQ: How Standard & Poor's Applied Its Government Support And ALAC Criteria To European Banks In December 2015, Dec. 2, 2015
- Standard & Poor's To Conclude Its Review Of Systemic Support For Remaining EU Banks By Early December 2015, Oct. 1, 2015
- Government And ALAC Support Ratings Uplift For Systemically Important European Banking Groups, Oct. 1, 2015
- How The Regulatory Reform Process Could Reshape Banks' Business Models And Affect Issuer Ratings, Aug. 18, 2014
- Standard & Poor's Takes Various Rating Actions On European Banks Following Government Support Review, April 29, 2014

Ratings List

Ratings Affirmed

KBC Bank N.V.

Ceskoslovenska Obchodni Banka A.S.

Counterparty Credit Rating	A/Negative/A-1
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KBC Group N.V.

Counterparty Credit Rating	A-/Negative/A-2
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CSOB Pojistovna a. s.

Counterparty Credit Rating	A-/Stable/--
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Financial Strength Rating	A-/Stable/--
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KBC Bank Ireland PLC

Counterparty Credit Rating	BBB-/Stable/A-3
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Ratings Affirmed; Outlook Action

	To	From
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KBC Group Re S.A.

Counterparty Credit Rating	A-/Stable/--	A-/Negative/--
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Financial Strength Rating	A-/Stable/--	A-/Negative/--
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Downgraded

	To	From
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KBC Insurance N.V.

Counterparty Credit Rating	A-/Stable/--	A/Negative/--
Financial Strength Rating	A-/Stable/--	A/Negative/--

N.B. This list does not include all ratings affected.

Additional Contact:

Financial Institutions Ratings Europe; FIG_Europe@standardandpoors.com

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