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Research Update:

Belgian KBC Bank And Czech Subsidiary CSOB Outlook Revised To Stable On Stronger Balance Sheet; 'A/A-1' Ratings Affirmed

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Overview

- Bancassurance group KBC is building a sizable stock of senior debt at its holding company, which could protect the operating company's senior creditors in resolution.
- We expect KBC Bank will continue to display strong and resilient earnings, grow, and perform well in the core markets where it operates.
- We are revising our outlook on KBC Bank and core subsidiary CSOB to stable from negative and affirming our 'A/A-1' ratings on the banks.
- The stable outlook on KBC Bank reflects our expectation that the group will continue to strengthen its core capital metrics and grow its buffer of bail-in-able instruments over the next two years.

Rating Action

On Oct. 24, 2016, S&P Global Ratings revised to stable from negative its outlook on Belgium-based KBC Bank N.V.

At the same time, we affirmed our long- and short-term counterparty credit ratings on KBC Bank N.V. at 'A/A-1' and on its nonoperating holding company (NOHC) KBC Group N.V. at 'BBB+/A-2'.

Additionally, we affirmed the issue ratings on subordinated and hybrid capital instruments issued by these entities.

Our ratings on the following entities forming the KBC bancassurance group are unchanged, and the outlooks are all stable:

- 'A/A-1' ratings on core subsidiary Czech Republic-based Ceskoslovenska Obchodni Banka A.S. (CSOB).
- 'BBB-/A-3' ratings on strategically-important subsidiary KBC Bank Ireland PLC.
- 'A-' ratings on KBC Insurance N.V. and KBC Group Re S.A.
- 'A-' ratings on Czech-based insurer CSOB Pojistovna.

Rationale

The outlook revision reflects the continued strengthening of KBC group's balance sheet and its solid, resilient, earnings profile despite the low-interest-rate environment. We believe the group is gradually building-up a buffer of bail-in-able instruments, which in our view is likely to increase in

the next two to three years and substantially exceed our threshold of 4.5% of S&P Global Ratings risk-weighted assets (RWAs). In particular, the holding company KBC Group N.V. this year started to issue a sizable stock of senior debt (€1.5 billion in total so far), which in our view will contribute to further protect KBC Bank's senior creditors in a resolution scenario. We expect that the holding company will continue this type of issuance and we therefore think that the risk of KBC's additional loss-absorbing capacity (ALAC) buffer falling short of our projections has declined.

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

We expect the ALAC buffer to represent about 5.25%-5.5% of S&P Global Ratings' RWA by end-2018. We include in our ALAC assessment the subordinated instruments and senior debt issued by KBC Group N.V. because we believe they all have capacity to absorb losses without triggering a default on the operating company KBC Bank's senior obligations and they meet our other criteria for inclusion.

Regulatory authorities in Belgium have not formally confirmed the choice of the NOHC as the resolution entity for the group, but we believe that this is a likely scenario, or possibility among other choices, and view positively the €1.5 billion of debt already issued by KBC Group N.V. in 2016.

We expect KBC's ALAC ratio to stand well above 4.5% in 2018.

The projected ALAC ratio reflects our expectations that:

- Excess total adjusted capital (TAC), as per our calculation, will increase over the period, with a projected risk-adjusted capital (RAC) ratio already in the 8.75%-9.25% range by end-2018, 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 build-up of the ALAC buffer.
- KBC will replace maturing Tier 2 capital instruments with ALAC-eligible instruments and KBC Group N.V. will continue to issue senior debt in each of the coming two years, at least equivalent every year to the amount already issued in 2016.

We have maintained the unsupported group credit profile (GCP) at 'a-', reflecting our expectation that KBC will continue to display resilient earnings (as it leverages its bancassurance operating model), grow and perform well in the core markets where it operates, in particular in its second home market, the Czech Republic.

We project that its RAC ratio will stand in the 8.75%-9.25% range by end-2018. Under this scenario, we make the following assumptions:

- On average a 3.5% annual increase in S&P Global Ratings' RWA over 2016-2018, as the group continues to grow its balance sheet in European

countries where it already operates, excluding Ireland.

- Annual profits standing slightly above €2 billion on average, thanks to a resilient, although slightly declining, net interest margin, strong contribution of insurance and asset under management activities, stable operating expenses with a cost-to-income ratio hovering around 55%, and a low consolidated cost of risk at or marginally below 30 basis points (bps).
- A dividend payout ratio of at least 50%, based on public disclosures.
- No change in the group's perimeter in our base-case scenario. The group has made efforts over past years to reduce the number of countries in which it operates and to exit risky and non-client-driven businesses.

If we were to change our views on economic risk in Belgium (currently at '2' with a negative trend), our projected RAC ratio would be lower but still within the 7%-10% range for an adequate capital assessment. The amount of excess core capital above the 7% threshold, contributing to the build-up of the ALAC buffer, would also remain material. The ALAC buffer would still be sufficient to meet our requirement.

Consequently, we have maintained the supported GCP at 'a'. As we do not believe ALAC support will be available for insurance subsidiaries, we continue to notch down for them from the unchanged 'a-' unsupported GCP.

We have subsequently affirmed our ratings on the core banking subsidiary CSOB. Our ratings on the insurance subsidiaries KBC Insurance N.V., and KBC Group Re, on the highly strategically important insurance subsidiary, CSOB Pojistovna, and on the strategically important bank subsidiary KBC Bank Ireland are unchanged.

Outlook

The stable outlooks on KBC Bank and KBC Group N.V. reflect our view that the group will continue in the next two years to strengthen its core capital metrics and grow its buffer of bail-in-able instruments, both of which are strengthening its loss-absorbing capacities. We expect KBC to display resilient earnings, as it leverages on its bancassurance operating model to offset pressure from the low-interest-rate environment, to grow and perform well in the core markets where it operates.

We could lower the ratings if KBC departed from the prudent capital management it exhibited over past years and opted for a more aggressive growth pattern, organically or via acquisitions, or a more shareholder-friendly dividend payout strategy.

We believe that a rating upgrade is remote in the next two years. It would require a considerable improvement of the group's capital metrics or stronger diversity of its business model. We do not foresee either of these scenarios over 2016-2018.

The outlook on the core banking subsidiary CSOB is stable, mirroring the outlook on the parent. Any rating action on the parent would translate into a similar rating action on this core subsidiary. The ratings equalization reflects our view that a unique resolution strategy, at group level, is probable, even if we expect the Czech regulator to clarify further in 2017 how it approaches the case of locally systemic financial institutions, which are part of a wider pan-eurozone banking group regulated by the European Central Bank.

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 downward pressure on their core group membership, or on the unsupported GCP in the next two years. Similarly, the outlook on CSOB Pojistovna is stable, based on the company's highly strategic importance to the group.

Ratings Score Snapshot

KBC Bank N.V.

	To	From
Issuer Credit Rating	A/Stable/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	+1
GRE Support	0	0
Group Support	0	0
Sovereign Support	0	0
Additional Factors	0	0

Related Criteria And Research

Related Criteria

- Bank Rating Methodology And Assumptions: Additional Loss-Absorbing Capacity, April 27, 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
- Group Rating Methodology, Nov. 19, 2013

- Assessing Bank Branch Creditworthiness, Oct. 14, 2013
- Quantitative Metrics For Rating Banks Globally: Methodology And Assumptions, July 17, 2013
- Guarantee Criteria--Structured Finance, May 7, 2013
- Revised Market Risk Charges For Banks In Our Risk-Adjusted Capital Framework, June 22, 2012
- Banking Industry Country Risk Assessment Methodology And Assumptions, Nov. 9, 2011
- Banks: Rating 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

- Banking Industry Country Risk Assessment: Belgium, Aug. 17, 2016
- Ratings Component Scores For The Top 50 European Banks--September 2016, Sept. 28, 2016
- KBC Group N.V. Rating Lowered To 'BBB+' On Expectation Of Loss-Absorbing Role In Resolution; Outlook Stable - January 18, 2016

Ratings List

Ratings Affirmed; CreditWatch/Outlook Action

	To	From
KBC Bank N.V.		
Ceskoslovenska Obchodni Banka A.S.		
Counterparty Credit Rating	A/Stable/A-1	A/Negative/A-1

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

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