



Tagging Info

Fitch Downgrades Belfius on Support Revision; Affirms KBC

Policy Ratings Endorsement
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Fitch Ratings-Paris/London-19 May 2015: Fitch Ratings has affirmed KBC Bank's and KBC Groep NV's (KBC Groep) Long-Term Issuer Default Ratings (IDRs) and senior debt ratings at 'A-' with Stable Outlook.

At the same time, the agency has downgraded Belfius Bank SA/NV's (Belfius) Long-term IDR and senior debt ratings to 'BBB+' from 'A-' and its Short-term IDR and senior debt ratings to 'F2' from 'F1'. The Outlook on Belfius is Positive.

Fitch has also affirmed KBC Bank's Viability Rating (VR) at 'a-' and has published a VR for KBC Groep at 'a-'. Belfius' VR has been affirmed at 'bbb+'.

KBC Verzekeringen's and KBC Group Re's Insurer Financial Strength (IFS) ratings have also been affirmed at 'A-' with Stable Outlooks.

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

The rating actions are in conjunction with Fitch's review of sovereign support for banks globally, which the agency announced in March 2014. In line with its expectations announced in March last year and communicated regularly since then, Fitch believes legislative, regulatory and policy initiatives have substantially reduced the likelihood of sovereign support for US, Swiss and European Union commercial banks.

As a result, Fitch believes that, in line with our Support Rating (SR) definition of '5', extraordinary external support while possible can no longer be relied upon for KBC Bank, KBC Groep and Belfius. We have, therefore, downgraded their SRs to '5' from '1' and revised their Support Rating Floors (SRFs) to 'No Floor' from 'A-'.

As a result of the revision to the SRFs, the Long-term IDR of Belfius is now driven by its standalone creditworthiness, as expressed in the VR. KBC Bank's and KBC Groep's IDRs remain driven by their respective VRs.

The ratings actions are also part of a periodic portfolio review of seven Benelux banking groups rated by Fitch.

KEY RATING DRIVERS - IDRs, VRs AND SENIOR DEBT - KBC BANK AND KBC GROEP

Asset quality remains KBC Bank's main rating weakness. The ratings are, however, underpinned by the bank's strong retail and corporate franchise in its two key markets, Belgium and the Czech Republic, its fairly conservative risk appetite, improving earnings generation, sound capital ratios and robust liquidity.

The asset quality trend reported in the last year to end-March 2015 was positive, with a slight decline in the level of impaired loans, but KBC Bank's impaired loans-to-gross loans ratio remains high and compares poorly with similarly rated peers. Around half of impaired loans relate to the bank's Irish loan book, for which loan impairment charges (LICs) are expected to fall. Nevertheless, the bank's fairly high level of unreserved impaired loans represents a vulnerability for KBC Bank's credit risk profile.

KBC Bank's risk appetite is supported by the dominance of the stable and fairly low-risk Belgian operations, while exposure to some central and eastern European countries gives rise to potential earnings and risk volatility. Earnings generation has improved to levels comparable with similarly rated peers. However, the bank could benefit from a longer track record of resilient and stable profitability.

The VR and IDRs of KBC Groep are equalised with those of KBC Bank, reflecting the dominance of the bank in

the group (around 90% of KBC Groep's assets), our expectation that double leverage will reduce and the use of the holding company for capital raising-purposes, including recent Tier 2 and additional Tier 1 transactions. Liquidity is managed at bank level.

KEY RATING SENSITIVITIES - IDRs, VRs AND SENIOR DEBT - KBC BANK AND KBC GROEP

Fitch does not expect to upgrade KBC Bank's ratings in the near term in light of the bank's asset quality weaknesses. In the medium-term, a significant reduction in impaired assets would be beneficial to the ratings. An unexpected rise in loan impairment charges, weaker capitalisation or a deterioration of recurring profitability could result in a downgrade.

The Short-term ratings are sensitive to the bank maintaining strong liquidity. The ratings of KBC Groep are likely to move in tandem with those of KBC Bank. If and when state hybrid instruments are repaid, double leverage beyond 120% could result in a downgrade of KBC Groep's ratings.

KEY RATING DRIVERS - IDRs, VR AND SENIOR DEBT - BELFIUS

Belfius's ratings reflect the improvement in the bank's capital ratios and liquidity to satisfactory levels, a sound franchise in retail and public sector banking, providing it with a healthy loan book, and lower profitability than domestic peers. The latter is partly explained by its low-risk low-return business model.

Legacy issues have been reduced in recent years, in particular its exposure to Belfius's former parent Dexia. However, some concentration risk and a large derivative book remain. Fitch expects Belfius's risk appetite to benefit from continued de-risking of legacy exposures as well as improved risk policies and underwriting standards on new lending. These expectations underpin the Positive Outlook on the bank's Long-term IDR.

We expect Belfius's underlying profitability to improve but losses from further de-risking could continue to represent a drag on overall profitability. The bank has consolidated its retail banking franchise, which combined with its insurance product offering should support profit generation. In corporate banking Belfius remains a challenger.

Improved earnings are also strengthening internal capital generation, especially since Belfius has not paid a dividend since it came under state ownership. While Fitch assumes the bank will resume dividend payments in the medium-term, capitalisation should improve further through retained earnings and further deleveraging.

KEY RATING SENSITIVITIES - IDRs, VR AND SENIOR DEBT - BELFIUS

An upgrade of Belfius' ratings is contingent on continued successful de-risking of legacy exposures, accompanied by solid balance sheet metrics and conservative underwriting standards. The ratings and Outlook are sensitive to a setback in the de-risking process. In addition, a deterioration of capitalisation or profitability, or a material disruption to the bank's access to market funding, would all be negative for the ratings.

KEY RATING DRIVERS AND SENSITIVITIES - SUPPORT RATING AND SUPPORT RATING FLOOR

The SRs and SRFs reflect Fitch's view that senior creditors can no longer rely on receiving full extraordinary support from the Belgian sovereign in the event that KBC Bank or Belfius becomes non-viable.

In Fitch's view, the EU's Bank Recovery and Resolution Directive (BRRD) and the Single Resolution Mechanism (SRM) are now sufficiently progressed to provide a framework for resolving banks that is likely to require senior creditors participating in losses, if necessary, instead of or ahead of a bank receiving sovereign support. In the EU, BRRD has been effective in member states since 1 January 2015, including minimum loss absorption requirements before resolution financing or alternative financing (eg, government stabilisation funds) can be used. Full application of BRRD, including the bail-in tool, is required from 1 January 2016.

Any upgrade to the SR and upward revision to the SRF 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.

KEY RATING DRIVERS AND SENSITIVITIES - SUBORDINATED DEBT AND OTHER HYBRID SECURITIES

Belfius's lower Tier 2 securities (XS0286515621, issued by Belfius Financing Company and guaranteed by Belfius) are notched down once from the bank's VR, in line with Fitch's rating criteria for such securities, to reflect the above-average loss severity of this type of debt. Their ratings are sensitive to any changes in Belfius's VR.

Subordinated debt and hybrid securities issued by KBC Bank are notched down from KBC Bank's VR. Therefore, their respective ratings are sensitive to any changes in KBC Bank's VR.

Hybrid securities issued by KBC Bank are rated four notches lower than KBC Bank's 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). The ratings of the perpetual hybrid instrument and the subordinated debt are primarily sensitive to any changes in KBC Bank's VR.

Subordinated debt issued by KBC Groep is rated one notch lower than KBC Groep's VR to reflect relative loss

severity. The CRD IV-compliant undated deeply subordinated additional Tier 1 debt securities issued by KBC Groep are rated five notches below KBC Groep's VR. The notching reflects the notes' higher expected loss severity relative to senior unsecured creditors (two notches) and higher non-performance risk (three notches).

The rating of the subordinated and additional Tier 1 debt securities is broadly sensitive to the same factors as those that would affect KBC Groep's VR. In addition, the notes' rating is sensitive to a build-up of additional double leverage at KBC Groep. The additional Tier 1 debt notes' rating is also sensitive to changes to Fitch's assessment of the probability of the notes' non-performance risk relative to the risk captured in KBC Groep's VR.

RATING DRIVERS AND SENSITIVITIES - BELFIUS BANK SUBSIDIARY

Belfius Financing Company is a wholly-owned financing subsidiary of Belfius and all its issues are guaranteed by its parent. The debt ratings are aligned with Belfius's ratings and are sensitive to the same factors that might drive a change in the bank's senior and subordinated debt ratings.

KEY RATING DRIVERS AND SENSITIVITIES - KBC VERZEKERINGEN

The main rating driver for KBC Verzekeringen is its core strategic importance within KBC Group. In addition, the ratings are supported by the company's solid regulatory solvency ratio, which reached 334% at end-March 2015, by its strong business position, especially in Belgium, and by its sound profitability. The equalisation of KBC Verzekeringen's IFS rating and IDR reflects continuing government support for the group by means of hybrid capital. The group's 'A-' IDR therefore acts as a cap on KBC Insurance's IFS rating.

Any changes to KBC Group's ratings could affect KBC Verzekeringen's ratings. In addition, if KBC Verzekeringen becomes less strategically important to KBC Group, prompted by a significant and sustainable deterioration in its profitability, a negative new business margin, or a regulatory solvency ratio of below 150%, this would likely result in a downgrade. Conversely, the IFS rating could be upgraded by one notch if the group repays the Flemish Region hybrid capital while maintaining KBC Verzekeringen's strong financial profile.

KEY RATING DRIVERS AND SENSITIVITIES - KBC SUBSIDIARIES AND AFFILIATED COMPANIES

KBC IFIMA N.V, KBC Financial Products International, Ltd, KBC North America Finance Corp and KBC Bank Ireland plc are wholly owned subsidiaries of KBC Bank. Their debt ratings are aligned with those of KBC Bank, based on an extremely high probability of support if required and are sensitive to the same factors that might drive a change in KBC Bank's IDRs.

Fitch has also affirmed KBC Group Re's IFS rating, the group's wholly owned core captive reinsurance subsidiary based in Luxembourg, at 'A-'. The affirmation reflects KBC Group Re's core strategic status to KBC Verzekeringen. Fitch also views positively its solid standalone financial profile, its cautious management and the termination of the remaining CDOs. Any changes to its parent's rating are likely to have a corresponding impact on KBC Group Re's ratings.

The rating actions are as follows:

Belfius Bank:

- Long-term IDR downgraded to 'BBB+' from 'A-'; Outlook Positive
- Short-term IDR downgraded to 'F2' from 'F1'
- Viability Rating affirmed at 'bbb+'
- Senior debt downgraded to 'BBB+/F2' from 'A-/F1'
- Support Rating downgraded to '5' from '1'
- Support Rating Floor revised to 'No Floor' from 'A-'

Belfius Financing Company:

- Senior debt downgraded to 'BBB+' from 'A-'
- Commercial paper downgraded to 'F2' from 'F1'
- Subordinated (lower Tier 2) debt XS0286515621 affirmed at 'BBB'

KBC Bank

- Long-term IDR affirmed at 'A-', Outlook Stable
- Short-term IDR affirmed at 'F1'
- Viability Rating affirmed at 'a-'
- Support Rating downgraded to '5' from '1'
- Support Rating Floor revised to 'No Floor' from 'A-'
- Senior debt affirmed at 'A-/F1'
- Commercial paper affirmed at 'F1'
- Perpetual subordinated debt securities affirmed at 'BB+'

KBC IFIMA N.V.

- Senior debt affirmed at 'A-'
- Short term debt affirmed at 'F1'
- Subordinated debt affirmed at 'BBB+'
- Market linked securities affirmed at 'A-emr'

KBC Financial Products International, Ltd.

- Senior debt affirmed at 'A-'
- Commercial paper affirmed at 'F1'

KBC North America Finance Corp.

- Commercial paper affirmed at 'F1'

KBC Bank Ireland plc

- Commercial paper affirmed at 'F1'

KBC Groep

- Long-term IDR affirmed at 'A-', Outlook Stable
- Short-term IDR affirmed at 'F1'
- Viability Rating published at 'a-'
- Support Rating downgraded to '5' from '1'
- Support Rating Floor revised to 'No Floor' from 'A-'
- Senior debt affirmed at 'A-/F1'
- Subordinated debt affirmed at 'BBB+'
- Undated deeply subordinated securities (BE0002463389) affirmed at 'BB'

KBC Verzekeringen N.V.

- IFS rating affirmed at 'A-', Outlook Stable
- Long-term IDR affirmed at 'A-', Outlook Stable

KBC Group Re

- IFS rating affirmed at 'A-', Outlook Stable

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Additional information is available on www.fitchratings.com

Applicable criteria, 'Global Bank Rating Criteria', dated 20 March 2015, and 'Insurance Rating Methodology', dated 4 September 2014 is available at www.fitchratings.com.

Applicable Criteria and Related Research:

Global Bank Rating Criteria

Additional Disclosure

Solicitation Status

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