

Research Update:

KBC Group And Insurance Subsidiaries Outlooks Revised To Negative On COVID-19 Impact; Ratings Affirmed

April 23, 2020

Overview

- Despite European governments' and the European Central Bank's measures to contain the COVID-19 pandemic, global and regional economies face an unprecedented challenge and substantial downside risks.
- We are revising our outlook on nonoperating holding company KBC Group N.V. and its insurance subsidiaries KBC Insurance N.V and KBC Group Re S.A. to negative from stable, because the group's financial profile may suffer during current challenging conditions, despite strong buffers to absorb shocks.
- We are affirming our issuer credit and issue ratings, because of KBC Group's diversified business profile, very robust balance sheet, and strong operating performance significantly mitigates effects from the adverse operating environment.
- The affirmation and stable outlook on bank operating entities KBC Bank and Ceskoslovenska Obdочni Banka reflects the substantial buffers of already existing bail-in-able debt, which we believe further protect the banks' senior creditors even in the case of a moderate deterioration of the financial profile and group stand-alone credit profile.

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Rating Action

On April 23, 2020, S&P Global Ratings revised its outlook to negative on nonoperating holding company (NOHC) KBC Group N.V. (KBC or the group), KBC Insurance N.V., and KBC Group Re. S.A. The outlooks on bank operating companies KBC Bank N.V and Ceskoslovenska Obdочni Banka (CSOB) remain stable.

At the same time, we affirmed our issuer credit and issue ratings on all entities within and related to the KBC Group, and their respective debt instruments (see Ratings Score Snapshot section for more details).

Rationale

The revision of the outlook to negative from stable on KBC reflects economic and market stress triggered by the COVID-19 pandemic. Our base-case expectation is that the group will perform resiliently, due to its ample liquidity, strong capital, and robust operating performance cushioning inevitably rising credit costs, but we see increased downside risks to asset quality and earnings in the coming quarters.

In addition to the human cost, the pandemic has caused large parts of global economic activity to grind to a halt. With isolation strategies still very much in force, we expect a sharp economic contraction in 2020, with a 7.3% forecast GDP decline for the eurozone (see "Europe Braces For A Deeper Recession In 2020," published April 20, 2020, on RatingsDirect). We project a rebound to about 5.6% in 2021, but risks remain elevated, and the effects of COVID-19 will be evident long after the crisis subsides.

We have affirmed the ratings on KBC because we think its credit strengths significantly mitigate the adverse operating environment. They include its diverse business profile across banking, insurance, and asset management in its main markets Belgium and the Czech Republic. In addition, it had robust capital, funding and liquidity metrics at the onset of the pandemic and strong operating performance, including robust pricing power where it operates, good cost control, and a low risk profile. Nevertheless, the group has exposure to some segments that may be particularly affected by the current recession, including small businesses/entrepreneurs in Belgium, and corporates that depend on discretionary spending. Although manageable in the context of a strong pre-provisioning income, we think its earnings will face an increase in International Financial Reporting Standards 9 credit impairments. Its capital generation through retained earnings is bolstered by the sector-wide suspension of ordinary share dividends and buybacks until later in 2020.

The affirmation and the stable outlooks on the core bank operating companies, KBC Bank and CSOB, reflect the additional protection from bail-in-able buffers to the bank's senior creditors specifically. The amount of additional loss-absorbing capital (ALAC) already issued is substantial and stabilizes the credit quality of the operating banks, even if the group stand-alone credit profile (SACP) weakens to 'a-' (currently 'a'). CSOB is a bank and insurance leader in the Czech Republic, KBC's second home market, and is core to the group. Our ratings on CSOB move in tandem with those on KBC Bank. Since ALAC does not benefit insurance entities outside the bank resolution perimeter, the outlooks on KBC Insurance and KBC Group Re are negative, in line with that on the NOHC.

Outlook

KBC Group

The negative outlook reflects increased downside risks to asset quality and earnings from the economic and market effects of the COVID-19 pandemic. Although we note KBC's significant revenue diversity, robust balance sheet, and the unprecedented fiscal and monetary response from Belgian and European authorities, a deep and extended economic downturn could materially increase impairment losses and weaken revenue over our two-year outlook horizon.

Downside scenario: Given the relative headroom we believe KBC has at the current rating level, we could lower the long-term rating on the NOHC to 'BBB+' only if we think the deteriorating operating environment is likely to substantially weaken asset quality and profitability. The likely trigger for us to consider a downgrade would be sufficient pressure on capital for our risk-adjusted capital to potentially fall below 10%, compared with an estimated ratio exceeding 11% at year-end 2019.

Upside scenario: We could revise the outlook to stable if KBC's earnings and balance sheet demonstrate relative resilience, especially compared with similarly rated peers, or if governments and central banks are successful in averting a deep, long-lasting recession.

KBC Bank

The stable outlook reflects the high stock of bail-in-able instruments, which offers sufficient protection to senior creditors, even in the context of a moderately weakening group SACP.

Downside scenario: We would downgrade the bank to 'A', if its stock of bail-in-able instruments is no longer enough to support an 'A+' rating. This could happen because either the group departs from its senior issuances at the NOHC level, or growth in risk-weighted assets is high. The latter could be due to a sharp increase in nonperforming loans in weaker geographies like Central and Eastern Europe or Ireland, weakening our ALAC ratio.

Upside scenario: Any upside is remote at this stage.

Ratings Score Snapshot

Core Bank Operating Entities: KBC Bank And CSOB

	To	From
Issuer Credit Ratings	A+/Stable/A-1	A+/Stable/A-1
SACP	bbb+	bbb+
Anchor	bbb+	bbb+
Business Position	Strong (+1)	Strong (+1)
Capital & Earnings	Strong (+1)	Strong (+1)
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

Nonoperating Holding Company KBC Group N.V.

	To	From
Issuer credit rating	A-/Negative/A-2	A-/Stable/A-2

Insurance Subsidiaries

	To	From
Issuer credit rating	A-/Negative/--	A-/Stable/--

Related Criteria

- General Criteria: Group Rating Methodology, July 1, 2019
- 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: 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

Related Research

- Negative Rating Actions Taken On Multiple Benelux Banks On Deepening COVID-19 Downside Risks, April 23, 2020
- Negative Rating Actions Taken On Various French Banks On Deepening COVID-19 Downside Risks, April 23, 2020
- How COVID-19 Risks Prompted European Bank Rating Actions, April 23, 2020
- Europe's AT1 Market Faces The COVID-19 Test: Bend, Not Break, April 22, 2020
- How COVID-19 Is Affecting Bank Ratings, April 22, 2020
- Europe Braces For A Deeper Recession In 2020, April 20, 2020
- European Banks' First-Quarter Results: Many COVID-19 Questions, Few Conclusive Answers,

April 1, 2020

- COVID-19: The Steepening Cost To The Eurozone And U.K. Economies, March 26, 2020
- COVID-19 Countermeasures May Contain Damage To Europe's Financial Institutions For Now, March 13, 2020
- The Coronavirus Will Shave 50 Basis Points Off Eurozone Growth, March 4, 2020
- KBC Group N.V., Jan. 15, 2020

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. A description of each of S&P Global Ratings' rating categories is contained in "S&P Global Ratings Definitions" at https://www.standardandpoors.com/en_US/web/guest/article/-/view/sourceId/504352 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.

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