

RATING ACTION COMMENTARY

Fitch Affirms KBC Group NV at 'A'; Outlook Stable

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Fitch Ratings - Paris - 26 Jul 2022: Fitch Ratings has affirmed KBC Group NV's (KBC) Long-Term Issuer Default Rating (IDR) at 'A' and KBC Bank NV's (KBC Bank) at 'A+'. The Outlooks are Stable. Fitch has also affirmed KBC's and KBC Bank's Viability Ratings (VRs) at 'a'. A full list of rating actions is detailed below.

Fitch has withdrawn KBC's and KBC Bank's Support Ratings of '5' and Support Rating Floors of 'No Floor' as they are no longer relevant to the agency's coverage following the publication of its updated Bank Rating Criteria in November 2021. In line with the updated criteria, we have assigned KBC and KBC Bank Government Support Ratings (GSR) of 'no support' (ns).

KEY RATING DRIVERS

Fitch assesses KBC on a consolidated basis as the insurance and banking operations are managed in a highly integrated manner. KBC is the group's holding company, and its VR is equalised with that of KBC Bank, which represents around 90% of group assets.

The group is regulated on a consolidated basis, holding company double leverage is generally maintained at below 120%, and we view fungibility of capital between the holding company and the bank as high. Liquidity and capital are managed centrally at the group level.

Diversified Business Model: KBC's ratings are underpinned by its leading franchises in commercial banking and insurance in Belgium and the Czech Republic, strong and diversified earnings generation, solid capitalisation, and sound funding and liquidity. The

ratings incorporate Fitch's view that the group operates in slightly weaker operating environments than domestic peers. This is due to operations in less developed and more volatile countries in central and eastern Europe (CEE), although it has a conservative risk appetite.

Adequate Asset Quality: Asset quality is a rating weakness relative to other financial metrics, for which we score higher. KBC's asset-quality metrics have structurally improved with the sale of its EUR1.1 billion Irish non-performing loans (NPL) legacy book in August 2021. Its Stage 3 loans ratio declined by about 83bp over the year to 2.5% at end-2021, and is now more in line with peers'.

We expect the group's asset quality to be moderately affected by a weaker economic outlook. Although direct exposure to Russia and Ukraine is negligible, the group's exposure to SME and corporate, particularly in CEE countries, poses moderate downside risks to the group's asset quality. Nevertheless, we expect the Stage 3 loans ratio to remain below 3% by end-2023.

Robust Earnings Generation: KBC's profitability is strong and compares favourably with that of peers. The group's earnings generation has been resilient even in more challenging environments owing to its sound business and geographic diversification, integrated bancassurance business model, and sound pricing power in home markets. KBC has maintained costs under tight control.

In 2022, we expect lower net income after its strong 2021 performance, driven by higher operating costs and normalising loan impairment charges (LICs). We expect the group's four-year average operating profit/risk weighted assets (RWAs) to remain in line with its 2012-2021 long-term average of just under 3%.

Strong Capital Buffers: Capitalisation is strong, reflecting robust internal capital generation, and compares well with similarly rated peers'. KBC's medium-term target of a common equity Tier 1 (CET1) ratio of at least 15% provides comfortable buffers above minimum capital requirements. We expect KBC to operate with a CET1 buffer above management's stated target in the near term, despite higher capital return and growth.

Sound Funding and Liquidity: The bank has a stable and diversified retail funding base, and nearly all of its subsidiaries are self-funded. The group's funding profile is underpinned by its strong retail and SME deposit franchise with customer deposits being the main source of funding. Wholesale funding maturities are reasonably balanced, and an ample liquidity buffer adequately mitigates refinancing risk.

RATING SENSITIVITIES

Factors that could, individually or collectively, lead to negative rating action/downgrade:

KBC's and KBC Bank's ratings are sensitive to a substantial and durable deterioration in asset quality and operating profitability, most likely due to severe damage to the SME and corporate loan portfolios, with operating profit/RWAs decreasing significantly below 3%. Ratings are also likely to be downgraded if, at the same time, the group's CET1 ratio falls below its internal target of 15% without prospects of a swift recovery.

A change in KBC's risk appetite could be negative for the ratings, for example, if contribution of more volatile CEE countries to KBC's earnings grows rapidly as this could imply an increase in exposure to weaker operating environments.

KBC's ratings could also be downgraded in case holding-company double leverage remains above 120% without a clear path to reduction, although this is not Fitch's expectation.

Factors that could, individually or collectively, lead to positive rating action/upgrade:

Upside for KBC's and KBC Bank's VR is limited. An upgrade would be contingent on a stronger business profile, with no increase in their risk profile, and a structural improvement in asset-quality metrics, while maintaining strong profitability and capitalisation.

OTHER DEBT AND ISSUER RATINGS: KEY RATING DRIVERS

KBC BANK'S IDRS, SENIOR DEBT AND DERIVATIVE COUNTERPARTY RATING (DCR)

KBC Bank's Long-Term IDR and senior debt ratings are one notch above the bank's VR because of the presence of resolution debt buffers raised by KBC to protect KBC Bank's senior external creditors. We therefore consider that in a failure, the risk of default on senior obligations is lower than the risk of the bank failing.

The group has adopted a single-point-of-entry resolution strategy, with KBC the resolution entity. All MREL instruments, including senior debt, are issued by KBC and down-streamed to KBC Bank and rank junior to third-party senior creditors.

KBC Bank's Short-Term IDR of 'F1' is the baseline option mapping to an 'A+' Long-Term IDR. This reflects Fitch's funding and liquidity assessment of 'a+' for the group.

KBC Bank's DCR is aligned with its Long-Term IDR, because under Belgian legislation derivative counterparties have no preferential status over other senior obligations in a

resolution.

SUBORDINATED DEBT AND OTHER HYBRID SECURITIES

The Tier 2 subordinated debt issued by KBC is rated two notches below its VR, reflecting Fitch's baseline notching for incremental loss severity.

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

KBC IFIMA's SENIOR DEBT

KBC IFIMAS.A.'s senior debt is aligned with KBC Bank's IDRs as it is guaranteed by KBC Bank and we believe that KBC Bank will ensure these obligations are met.

Subordinated debt issued by KBC IFIMA and guaranteed by KBC Bank on a subordinated basis is rated two notches below KBC Bank's VR to reflect below-average recovery expectations.

OTHER DEBT AND ISSUER RATINGS: RATING SENSITIVITIES

KBC BANK'S IDRS, SENIOR DEBT AND DERIVATIVE COUNTERPARTY RATING (DCR)

KBC's and KBC Bank's short-term senior unsecured debt ratings would be upgraded if their Long-Term IDRs are upgraded to 'AA-' or if their funding and liquidity score is revised up to 'aa-' or above.

KBC Bank's Long-Term IDR and debt ratings could be downgraded to the same level as KBC's if Fitch considers that resolution buffers down-streamed into the bank no longer provide creditors with some protection in the event of the bank's failure.

SUBORDINATED DEBT AND OTHER HYBRID SECURITIES

The ratings of the subordinated Tier 2 and additional Tier 1 securities issued by KBC are sensitive to changes to KBC's VR. In addition, the rating of the additional Tier 1 securities is sensitive to changes in Fitch's assessment of the probability of the notes' non-performance risk relative to the risk captured by KBC's VRs.

KBC IFIMA's SENIOR DEBT

The senior debt ratings issued by KBC IFIMA are sensitive to a change in KBC Bank's IDRs. The subordinated Tier 2 notes issued by KBC IFIMA are sensitive to changes to the VR of KBC Bank, which guarantees the notes.

KBC's and KBC Bank's GSRs reflect Fitch's view that sovereign support for KBC and KBC Bank is possible but cannot be relied on given the implementation of the Bank Resolution and Recovery Directive in Belgium.

VR ADJUSTMENTS

The 'a+' operating environment score is below the 'aa-' implied score due to the following adjustment: international operations (negative).

BEST/WORST CASE RATING SCENARIO

International scale credit ratings of Financial Institutions and Covered Bond issuers have a best-case rating upgrade scenario (defined as the 99th percentile of rating transitions, measured in a positive direction) of three notches over a three-year rating horizon; and a worst-case rating downgrade scenario (defined as the 99th percentile of rating transitions, measured in a negative direction) of four notches over three years.

The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Best- and worst-case scenario credit ratings are based on historical performance. For more information about the methodology used to determine sector-specific best- and worst-case scenario credit ratings, visit

<https://www.fitchratings.com/site/re/10111579>

REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

The principal sources of information used in the analysis are described in the Applicable Criteria.

ESG CONSIDERATIONS

Unless otherwise disclosed in this section, the highest level of ESG credit relevance is a score of '3'. This means ESG issues are credit-neutral or have only a minimal credit impact on KBC and KBC Bank, either due to their nature or the way in which they are being managed by KBC and KBC Bank. For more information on ESG Relevance Scores, see www.fitchratings.com/esg

RATING ACTIONS

ENTITY / DEBT ◆

RATING ◆

PRIOR ◆

KBC Group NV	LT IDR	A Rating Outlook Stable		A Rating Outlook Stable
		Affirmed		
	ST IDR	F1	Affirmed	F1
	Viability	a	Affirmed	a
	Support	WD	Withdrawn	5
	Support Floor	WD	Withdrawn	NF
	Government Support	ns	New Rating	
subordinated	LT	BBB+	Affirmed	BBB+
senior unsecured	LT	A	Affirmed	A
subordinated	LT	BBB-	Affirmed	BBB-
senior unsecured	ST	F1	Affirmed	F1

[VIEW ADDITIONAL RATING DETAILS](#)

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APPLICABLE CRITERIA

[Bank Rating Criteria \(pub. 12 Nov 2021\) \(including rating assumption sensitivity\)](#)

ADDITIONAL DISCLOSURES

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ENDORSEMENT STATUS

KBC Group NV

EU Issued, UK Endorsed

KBC IFIMA S.A.

EU Issued, UK Endorsed

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