FitchRatings

Fitch Upgrades KBC to 'A'; Outlook Stable

Fitch Ratings-Paris/London-20 March 2017: Fitch Ratings has upgraded KBC Bank's and KBC Groep NV's (KBC Group) Long-Term Issuer Default Ratings (IDRs) and senior debt ratings to 'A' from 'A-', and Viability Ratings (VR) to 'a' from 'a-'. Fitch has also upgraded KBC Verzekeringen's and KBC Group Re's Insurer Financial Strength (IFS) ratings to 'A+' from 'A', and KBC Verzekeringen's Long-Term IDR to 'A' from 'A-'. The Outlooks are Stable. A full list of rating actions is at the end of this commentary.

In addition, Fitch has assigned a 'A(dcr)' Derivative Counterparty Rating (DCR) to KBC Bank as part of its roll-out of DCRs to significant derivative counterparties in western Europe and the US. DCRs are issuer ratings and express Fitch's view of banks' relative vulnerability to default under derivative contracts with third-party, non-government counterparties.

The rating actions are part of a periodic portfolio review of major banks in Belgium and Luxembourg.

KEY RATING DRIVERS
KBC Bank and KBC Group
IDRs, VRs AND SENIOR DEBT
The upgrade reflects continued, gradual improvement in the bank's Irish legacy loan portfolio, which combined with improved profitability and strengthened capitalisation has made KBC Bank more resilient to unexpected shocks.

KBC Bank's ratings are underpinned by its strong retail and corporate franchise in its two key markets, Belgium and the Czech Republic, limited market risk, strong and diversified earnings generation, solid capitalisation and sound funding and liquidity.

The stock of impaired loans is steadily decreasing, but will most likely remain high compared with peers in the medium term. The bank reported an impaired to gross loans ratio of 7.2% at end-2016 (end-2015: 8.6%), with about half of impaired loans in Ireland. Our base case is for a material part of restructured (and still classified as impaired) Irish loans to cure in the next two years, aided by a solid economic recovery, and for the high amount of total unreserved impaired loans to reduce to a more acceptable level.

KBC Bank's asset quality is supported by the dominance of its stable and fairly low-risk Belgian operations and stability in its Czech operations. Exposure to some other central and eastern European countries gives rise to potential earnings and asset quality volatility, but we believe its control framework and credit standards are robust in these countries.

Earnings generation has improved and compares well with similarly rated peers. The bank is building a track record of resilient and stable profitability, underpinned by management's focus on the bancassurance business model in its core markets and tight cost control. The bank has built up solid capitalisation, reporting fully loaded Common Equity Tier 1 and leverage ratios of 14.3% and 5.1%, respectively, at end-2016.

KBC has proposed a single point of entry approach at the level of KBC Group, and we expect a higher share of senior debt to be issued out of the holding company and streamed down to the bank to meet the upcoming minimum requirement for eligible liabilities and own funds.

KBC Group's ratings are equalised with those of KBC Bank, reflecting the dominance of the bank in the group (around 90% of group assets), the regulatory focus on the group as a consolidated entity, low double leverage, the use of the holding company for capital raising and high fungibility of capital between the holding company and the bank. Liquidity is managed at the bank level.

Liquidity is strong. The bank has a solid retail funding base, and nearly all subsidiaries are self-funded. Customer deposits and retail bonds are its largest source of funding and fund its lending. The bank also has access to the debt capital markets directly and via KBC Group. Its wholesale funding maturities are reasonably well spread, and the bank's ample liquidity buffer further mitigates refinancing risk.

SUPPORT RATING AND SUPPORT RATING FLOOR
The Support Rating of '5' and Support Rating Floor of 'No Floor' reflect Fitch's view that senior creditors can no longer rely on receiving full extraordinary support from the sovereign in the event that KBC Bank becomes non-viable. The EU's Bank Recovery and Resolution Directive (BRRD) and the Single Resolution Mechanism (SRM) for eurozone banks provide a framework for resolving banks that is likely to require senior creditors participating in losses, instead of or ahead of a bank receiving sovereign support.

SUBORDINATED DEBT AND OTHER HYBRID SECURITIES
Subordinated debt and hybrid securities issued by KBC Bank and KBC Group are notched down from the entities' VRs.

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) as the notes are guaranteed by KBC Bank.

Subordinated debt issued by KBC Group is rated one notch lower than KBC Group's VR to reflect relative loss severity. The CRD IV-compliant undated deeply subordinated additional Tier 1 debt securities issued by KBC Group are rated five notches below KBC Group'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).

SUBSIDIARIES' SENIOR DEBT
The senior debt issued by KBC Bank's fully owned subsidiaries KBC IFIMA S.A. and KBC Bank Ireland plc is guaranteed by KBC Bank, and the subsidiaries' debt ratings are aligned with the bank's IDRs to reflect our view that KBC Bank will ensure these obligations are met.

DCR
We have assigned KBC Bank a DCR due to its significant derivatives activity. The DCR is at the same level as the Long-Term IDR and senior debt ratings because under Belgian legislation derivative counterparties have no preferential status over other senior obligations in a resolution scenario.

KBC Verzekeringen and KBC Group Re
The upgrade follows the upgrade of KBC Group's IDR.

The ratings reflect KBC Verzekeringen's core strategic importance in the integrated bancassurance business model of the KBC Group. KBC Verzekeringen relies on its parent for its business position and strategic direction and its capital management is integrated within KBC Group.

KBC Verzekeringen's ratings are in line with the company's standalone creditworthiness. The ratings are underpinned by KBC Verzekeringen's sound profitability, leading bancassurer position in Belgium, strong capital adequacy and prudent asset allocation.

KBC Group reported consolidated net profit for insurance activities of EUR314m in FY16 (2015: EUR354m). Non-life underwriting profitability was strong (combined ratio: 93%) and life premium income was higher than in 2015. The ratings also reflect KBC Verzekeringen's strong consolidated regulatory Solvency II ratio (end-2016: 203%).

KBC Group Re's core status within the KBC group reflects the formal capital support agreement with KBC Verzekeringen and the adoption of its parent's brand name.

RATING SENSITIVITIES
KBC Bank and KBC Group
IDRs, VRs AND SENIOR DEBT
The Stable Outlook on the Long-Term IDR reflects our expectation that the tail risk in the bank's Irish legacy loan portfolio will continue to decrease, while earnings generation and capitalisation will remain strong. Setbacks to these expectations could lead to a downgrade. A further upgrade of the VR is unlikely in the foreseeable future.

KBC Group's ratings are likely to move in tandem with those of KBC Bank. Double leverage beyond 120% (currently slightly above 100%) could result in a downgrade of the group's ratings.

SUPPORT RATING AND SUPPORT RATING FLOOR
An upgrade of KBC Bank or KBC Group's Support Ratings and upward revision of the entities' Support Rating Floors 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.

SUBORDINATED DEBT AND OTHER HYBRID SECURITIES
Subordinated debt and hybrid securities issued by KBC Bank, KBC IFIMA N.V and KBC Group are primarily sensitive to KBC Bank and KBC Group's VRs. The ratings of the hybrid securities are also sensitive to changes in Fitch's assessment of the probability of the notes' non-performance risk relative to the risk captured by KBC Bank and KBC Group's VRs. The ratings of notes issued by KBC Group are sensitive to a build-up of additional double leverage at the holding company.

SUBSIDIARIES' SENIOR DEBT
The senior debt ratings of KBC IFIMA S.A. and KBC Bank Ireland plc are sensitive to the same factors that might drive a change in KBC Bank's IDRs.

DCR
The DCR is sensitive to the same factors that might drive a change in KBC Bank's Long-Term IDR. They could be notched up

from the Long-Term IDR if the legal framework changed to give preferential treatment over other senior obligations in a resolution scenario.

KBC Verzekeringen and KBC Group Re
As a consequence of the strong links of KBC Verzekeringen and the KBC Group, any changes to the group's ratings are likely to result in similar changes to KBC Verzekeringen and KBC Group Re's ratings.

KBC Group Re relies on KBC Verzekeringen for its role as a captive reinsurer, business position, strategic direction and asset management expertise. Any changes to its parent's ratings are likely to have a corresponding impact on KBC Group Re's ratings.

The rating actions are as follows:

KBC Bank
- Long-Term IDR upgraded to 'A' from 'A-', Outlook Stable
- Short-Term IDR affirmed at 'F1'
- Viability Rating upgraded to 'a' from 'a-'
- Support Rating affirmed at '5'
- Support Rating Floor affirmed at 'No Floor'
- Derivative counterparty rating: assigned at 'A(dcr)'
- Senior debt upgraded/affirmed 'A'/'F1' from 'A-'/'F1'
- Commercial paper affirmed at 'F1'
- Perpetual subordinated debt securities (BE0119284710) upgraded to 'BBB-' from 'BB+'

KBC IFIMA S.A.
- Senior debt upgraded to 'A' from 'A-'
- Short-Term debt affirmed at 'F1'
- Subordinated debt upgraded to 'A-' from 'BBB+'
- Market linked securities upgraded to 'Aemr' from 'A-emr'

KBC Bank Ireland plc
- Commercial paper affirmed at 'F1'

KBC Group
- Long-Term IDR upgraded to 'A' from 'A-', Outlook Stable
- Short-Term IDR affirmed at 'F1'
- Viability Rating upgraded to 'a' from 'a-'
- Support Rating affirmed at '5'
- Support Rating Floor affirmed at 'No Floor' '
- Senior debt upgraded/affirmed to 'A'/'F1' from 'A-'/'F1'
- Subordinated debt upgraded to 'A-' from 'BBB+'
- Undated deeply subordinated securities (BE0002463389) upgraded to 'BB+' from 'BB'

KBC Verzekeringen
- Long-Term IDR upgraded to 'A' from 'A-', Outlook Stable
- Insurer Financial Strength upgraded to 'A+' from 'A', Outlook Stable

KBC Group Re
- Insurer Financial Strength upgraded to 'A+' from 'A', Outlook Stable

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Applicable Criteria
Global Bank Rating Criteria (pub. 25 Nov 2016) (https://www.fitchratings.com/site/re/891051)
Insurance Rating Methodology (pub. 15 Sep 2016) (https://www.fitchratings.com/site/re/887191)

Additional Disclosures
Dodd-Frank Rating Information Disclosure Form
(https://www.fitchratings.com/creditdesk/press_releases/content/ridf_frame.cfm?pr_id=1020811&cft=eyJ0eXAiOiJKV1QiLCJhbGciOiJIUzI1NiJ9.eyJzZXNzaW9uS2V5IjoiNVJaVzROR05ETlhCWDNNRFowSlNaTkdJT0VCSlMwM1BJNktNMFk5RyIsImV4cCI6MTQ5MDYzMDY2MSwidXNlckIkIjoyNTY1NjMzfQ.DM3rgX78r-FrAxC0J0bgnWTx_Ss6rfOaOUOBoRfOfMw)
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Unsolicited Issuers:

Entity/Security	ISIN/CUSIP/COUPON RATE	Rating Type	Solicitation Status
KBC Group Re	-	Long Term Issuer Default Rating	Unsolicited
KBC Group Re	-	LT Financial Strength Rating	Unsolicited
KBC Verzekeringen N.V. (KBC Insurance)	-	Long Term Issuer Default Rating	Unsolicited
KBC Verzekeringen N.V. (KBC Insurance)	-	LT Financial Strength Rating	Unsolicited

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