



Rating Action: **Moody's upgrades KBC Bank's deposit ratings to Aa3; outlook stable**

07 Jun 2023

Senior unsecured ratings of KBC affirmed at Baa1; outlook remains positive

Paris, June 07, 2023 – Moody's Investors Service (Moody's) today upgraded the long-term deposit ratings of KBC Bank N.V. (KBC Bank) to Aa3 from A1 and the backed senior unsecured debt ratings of KBC IFIMA S.A. (IFIMA) to A1 from A2. The rating agency concurrently affirmed the long-term senior unsecured debt and issuer ratings of KBC Group N.V. (KBC) at Baa1, as well as KBC Bank's Baseline Credit Assessment (BCA) and Adjusted BCA at baa1. KBC Bank's short-term deposit ratings were affirmed at Prime-1, and KBC's short-term Deposit Note/CD programme rating was affirmed at Prime-2. Finally, the rating agency also affirmed KBC Bank's long-term and short-term Counterparty Risk Rating (CRR) of Aa3 and Prime-1, as well as its Counterparty Risk (CR) Assessment of Aa3(cr) and Prime-1(cr). The outlook on KBC Bank's long-term deposit ratings was changed to stable from positive, and the outlook on KBC's long-term issuer and senior unsecured debt ratings and IFIMA's backed senior unsecured debt ratings remains positive.

A list of all affected ratings is provided at the end of this press release.

RATINGS RATIONALE

AFFIRMATION OF THE BCA

The affirmation of KBC Bank's BCA at baa1 reflects KBC's sound solvency, including strong earnings power, supported by its solid presence in Belgium and CEE countries, and diversified businesses, spanning banking activities, insurance, and asset management. KBC has thus far delivered on the objectives of its strategic plan, aiming to gain market shares in its core markets and developing its highly integrated bancassurance model in Belgium and Czech Republic. KBC's ambition to achieve sizable presence in Slovakia, Hungary and Bulgaria through organic growth and acquisitions is also on track. KBC's recurring profitability is strong, as evidenced by its net income to tangible assets ratio of 0.7% in 2022 (Moody's calculation), and Moody's expects that KBC's strong earnings generation will be supported in 2023 by the positive effects of rising interest rates on its net interest income.

The baa1 BCA is also supported by KBC's sound asset quality, with a low nonperforming loan (NPL) ratio of 2.2% at end-March 2023 (Moody's calculation), and conservative provisioning policy. The group's sale of all of KBC Bank Ireland PLC's remaining non-performing mortgage loan portfolio, which was completed in February 2022, has significantly de-risked KBC's balance sheet. Moody's still expects a moderate increase in problem loans in the coming quarters, as higher energy costs and price inflation weaken borrowers' repayment capacity. Moody's views a significant portion of KBC's loan book to be highly exposed to newly emerging risks (such as energy prices, supply bottlenecks, high inflation and rising interest rates), as reflected in a material proportion of loans classified as Stage 2 (Stage 2 loans amounted to 19% of total outstanding loans at end March 2023, up from 13.6% at year-end 2021 but down from 19.9% at year-end 2022, compared to the EU average of 9.4% at end 2022). In Belgium, Moody's expects the impact of rising interest rates on borrowers' repayment capacity to be less abrupt than in its other markets, given that the majority of KBC's domestic mortgages carry fixed interest rates, and because there are limits on the maximum interest rate hikes that Belgian banks are allowed to pass on to mortgage borrowers with variable-rate loans.

The baa1 BCA of KBC Bank also reflects KBC's strong capital level (the group's ratio of Common Equity Tier 1

(CET1) stood at 16.1% as of March 2023). The ratio will nonetheless decrease following the planned announcement of the distribution of surplus capital later in the year, but will remain above KBC's minimum CET1 target of 15%, because of strong annual profit generation, stable earnings distribution of 50%, and moderate risk-weighted assets (RWA) growth. This capital buffer provides strong risk absorption capacity to the bank, and the room to make some bolt-on acquisitions, although they have been of modest size in recent years.

The baa1 BCA of KBC Bank also reflects KBC's solid funding profile. Customer deposits are the bank's main funding source, accounting for around 63% of its balance sheet as of the end of March 2023. As a result of its structural liquidity excess, which is reflected in its loan-to-deposit ratio of 82% as of March 2023, KBC holds a comfortable buffer of high-quality liquid assets, amounting to €91 billion as of March 2023, out of which €45 billion consists of LCR eligible bonds. Given the sharp rise in market interest rates in 2022, the market value of KBC's bond portfolio, which is recognized at amortised cost, was significantly below its accounting value at end March 2023, translating into an unrealized loss of €3.7 billion, i.e. 3.4% of risk-weighted assets and 21% of its CET1 capital. While the valuation gap is more material than that of European peers, some of which have in contrast recognized a large portion of such losses in their regulatory capital ratios, Moody's considers that such losses are very unlikely to be crystallized for liquidity purposes. KBC's deposit franchise is strong, with 83% of total customer deposits consisting of more stable retail and SME clients, and Moody's views KBC's Liquidity Coverage Ratio (LCR) of 152% as ample, with liquidity reserves that include €46 billion of cash at central banks and its large portfolio of securities it can use as collateral to access further liquidity without crystallizing unrealized losses.

UPGRADE OF KBC BANK'S LONG-TERM DEPOSIT RATING AND IFIMA'S BACKED SENIOR UNSECURED RATING

The upgrade of KBC Bank's long-term deposit rating to Aa3 and IFIMA's backed senior unsecured debt rating to A1 reflect the continued issuance of senior unsecured and subordinated debt by KBC in order to comply with minimum requirement for own funds and eligible liabilities (MREL) targets, adding subordination benefitting KBC Bank's and IFIMA's senior creditors. KBC Bank's long-term deposit rating and IFIMA's backed senior unsecured debt rating now benefit from an extremely low and very low loss-given-failure, respectively, leading to a three-notch and two-notch uplift from the bank's Adjusted BCA. Both ratings also reflect the moderate likelihood of support from the Belgian government, owing to KBC's systemic nature in Belgium, which leads to an additional notch of uplift from the bank's Adjusted BCA.

AFFIRMATION OF KBC'S SENIOR UNSECURED DEBT RATING

KBC's senior unsecured debt rating of Baa1 benefits from a moderate loss-given-failure and a low probability of government support, leading to no uplift from KBC Bank's Adjusted BCA.

OUTLOOK

The positive outlook on KBC's long-term issuer and senior unsecured debt ratings and IFIMA's backed senior unsecured debt rating reflects Moody's view that higher interest rates will keep on improving KBC's net interest income, although some of the benefit will be offset by slower loan growth and pressures on mortgages in Belgium. While the economic slowdown will lead to some deterioration in loan performance, the banks' high capital base and ample provisioning provide a shield against loan losses and asset quality deterioration, which should limit the risks of a material increase in risk costs over the outlook horizon.

The outlook on KBC Bank's long-term deposit ratings has been changed to stable, because any further positive pressure on KBC Bank's BCA would be offset by the removal of the government support uplift, given that the long-term deposit rating it is now at par with the sovereign rating of the Government of Belgium (Aa3, Belgium).

FACTORS THAT COULD LEAD TO AN UPGRADE OR DOWNGRADE OF THE RATINGS

An upgrade of KBC Bank's BCA could result from sustained profitability gains, whilst containing the rise in asset risks, and increasing capital levels. All things equal, an upgrade of KBC Bank's BCA would result in an upgrade of the long-term ratings of IFIMA and KBC.

Conversely, an upgrade of KBC Bank's BCA would not lead to an upgrade of the bank's long-term deposit ratings, which are at par with the Aa3 sovereign rating of Belgium.

Although unlikely at present, a downgrade of KBC Bank's BCA could result from a sustained reduction in profitability, should fees and net interest income both materially decline; a decline in regulatory capital ratios at the bank and group levels below current targets; and a deterioration in asset quality and non-performing loans in particular.

A downgrade of KBC Bank's BCA would typically result in a downgrade of the long-term ratings of KBC Bank, IFIMA and KBC.

The long-term ratings of KBC Bank, IFIMA and KBC could also be downgraded if there is a significant and sustained decrease in the debt loss-absorption capacity, resulting in a higher expected loss at failure for one or more instrument classes.

LIST OF AFFECTED RATINGS

Issuer: KBC Group N.V.

..Outlook Actions:

....Outlook, Remains Positive

..Affirmations:

....ST Deposit Note/CD Program (Local Currency) , Affirmed P-2

....LT Issuer Rating (Foreign Currency) , Affirmed Baa1 POS

....ST Issuer Rating (Foreign Currency) , Affirmed P-2

....Senior Unsecured Regular Bond/Debenture (Foreign Currency) , Affirmed Baa1 POS

....Senior Unsecured Regular Bond/Debenture (Local Currency) , Affirmed Baa1 POS

....Senior Unsecured Medium-Term Note Program (Foreign Currency) , Affirmed (P)Baa1

....Senior Unsecured Medium-Term Note Program (Local Currency) , Affirmed (P)Baa1

....Subordinate Regular Bond/Debenture (Local Currency) , Affirmed Baa2

....Subordinate Medium-Term Note Program (Foreign Currency) , Affirmed (P)Baa2

....Subordinate Medium-Term Note Program (Local Currency) , Affirmed (P)Baa2

....Pref. Stock Non-cumulative (Local Currency) , Affirmed Ba1 (hyb)

....Other Short Term (Foreign Currency) , Affirmed (P)P-2

....Other Short Term (Local Currency) , Affirmed (P)P-2

Issuer: KBC Bank N.V.

..Upgrades:

....LT Bank Deposits (Foreign Currency) , Upgraded to Aa3 STA from A1 POS

....LT Bank Deposits (Local Currency) , Upgraded to Aa3 STA from A1 POS

..Outlook Actions:

....Outlook, Changed To Stable From Positive

..Affirmations:

....LT Counterparty Risk Rating (Foreign Currency) , Affirmed Aa3

....LT Counterparty Risk Rating (Local Currency) , Affirmed Aa3

....ST Counterparty Risk Rating (Foreign Currency) , Affirmed P-1

....ST Counterparty Risk Rating (Local Currency) , Affirmed P-1

....ST Bank Deposits (Foreign Currency) , Affirmed P-1

....ST Bank Deposits (Local Currency) , Affirmed P-1

....LT Counterparty Risk Assessment , Affirmed Aa3(cr)

....ST Counterparty Risk Assessment , Affirmed P-1(cr)

....Baseline Credit Assessment , Affirmed baa1

....Adjusted Baseline Credit Assessment , Affirmed baa1

Issuer: KBC IFIMA S.A.

..Upgrades:

....Backed Senior Unsecured Regular Bond/Debenture (Foreign Currency) , Upgraded to A1 POS from A2 POS

....Backed Senior Unsecured Regular Bond/Debenture (Local Currency) , Upgraded to A1 POS from A2 POS

....Backed Senior Unsecured Medium-Term Note Program (Local Currency) , Upgraded to (P)A1 from (P)A2

..Outlook Actions:

....Outlook, Remains Positive

..Affirmations:

....Backed Subordinate Regular Bond/Debenture (Foreign Currency) , Affirmed Baa2

....Backed Subordinate Medium-Term Note Program (Local Currency) , Affirmed (P)Baa2

....Backed Other Short Term (Local Currency) , Affirmed (P)P-1

PRINCIPAL METHODOLOGY

The principal methodology used in these ratings was Banks Methodology published in July 2021 and available at <https://ratings.moodys.com/rmc-documents/71997>. Alternatively, please see the Rating Methodologies page on <https://ratings.moodys.com> for a copy of this methodology.

REGULATORY DISCLOSURES

For further specification of Moody's key rating assumptions and sensitivity analysis, see the sections Methodology Assumptions and Sensitivity to Assumptions in the disclosure form. Moody's Rating Symbols and Definitions can be found on <https://ratings.moodys.com/rating-definitions>.

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