Research Update:

Outlook On KBC Bank Ireland Revised To Stable; Ratings Affirmed At 'BBB-/A-3'

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Overview

- We see reduced downside risk to KBC Bank Ireland PLC's (KBCI's) creditworthiness, specifically regarding its capitalization as measured by Standard & Poor's risk-adjusted capital (RAC) framework.
- We are therefore revising our outlook on KBCI to stable from negative, and affirming our 'BBB-/A-3' ratings.
- The outlook revision mainly reflects our view that KBCI's regulatory Tier 1 capital will remain robust, and capitalization as measured by our RAC framework will remain above the 5.0% threshold.

Rating Action

On July 16, 2013, Standard & Poor's Ratings Services revised its outlook on KBC Bank Ireland PLC to stable from negative. At the same time, we affirmed our 'BBB-/A-3' long- and short-term counterparty credit ratings on KBCI.

Rationale

While it continues to compare poorly with many Western European peer banking systems, we see the economic and industry risk trends in the Irish banking system as stable. We see Ireland's political and macroeconomic stability as improved and we believe that, for Irish banks, the worst of the losses may now have passed. Nevertheless, the Irish banking sector still faces significant challenges around how it manages its considerable stock of nonperforming loans (NPLs), deleverages non-core assets, optimizes business and operating models for a low growth environment, and returns to profitability.

Consistent with our view of the Irish banking system, we have not changed our assessment of KBCI's 'bb-' stand-alone credit profile (SACP). We see reduced downside risk to the bank's creditworthiness, specifically around capitalization as measured by our risk-adjusted capital (RAC) framework. Two factors underpin our assessment: the gradually reducing risk of further large losses at KBCI, and KBC Group's continued support of KBCI in terms of capital and funding.

On May 16, 2013, KBC Group reported that KBCI made a post-tax loss of €77 million in the first quarter of 2013, after registering a €99 million impairment charge. While this indicates that the bank still has some way to go before it returns to profitability--something we do not expect before end-2014--the first-quarter result reflects an ongoing, slow, and sometimes uneven trend of gradually paring back losses, even while preprovision earnings appear to be under some pressure.

As in previous quarters, the losses led parent KBC Bank NV (KBC; A-/Positive/A-2) to make a capital injection, totalling €125 million, to ensure stability in KBCI's regulatory capitalization. KBCI's Tier 1 ratio at March 2013 was a reported 12.3% and, via similar injections, has stayed consistently above 11% in the past six quarters. This gives us some confidence that the ratio will remain at this level through end-2014. KBCI has not yet reported statutory results for end-2012 but we estimate a pro forma RAC ratio of about 5.1%-5.3% at this date, taking into account post-year-end capital actions to optimize the mix of capital.

The long-term counterparty credit rating on KBCI remains three notches higher than the 'bb-' SACP, reflecting our view that KBCI is "strategically important" to its parent, KBC, under our group rating methodology. While KBC remains highly supportive of its Irish subsidiary, we note it has publicly stated that KBCI is not a core part of its future growth strategy. KBCI would not ordinarily meet our criteria for being assessed as a "strategically important" subsidiary; in particular our criteria that the subsidiary is unlikely to be sold and is important to the group's long-term strategy, or is reasonably successful at what it does. We view the latter as a difficult criteria to meet in the context of the uncertain Irish operating environment, as reflected in our Banking Industry Country Risk Score (BICRA) score of '7' for Ireland (where '1' indicates the lowest risk, and '10' the highest). That said, we view any potential sale as highly unlikely over the two-year outlook horizon and we understand that KBC will continue to support KBCI's capital and funding needs. We consider KBCI to be of "low" systemic importance and we factor no government support into our ratings on the bank.

Outlook

The stable outlook mainly reflects our view that KBCI's regulatory Tier 1 capital ratio will remain robust, and that its RAC ratio will remain above the 5.0% threshold. It also reflects KBC's track record as a highly supportive parent when it comes to funding and capital, and our opinion that this is unlikely to change.

We would likely lower the ratings if KBCI's SACP were to deteriorate. This could happen if its RAC ratio were to fall below the 5.0% threshold or if KBCI's asset quality, provisioning coverage, or impairment charge trends become demonstrably weaker than peers'.

We note that KBCI's management is refocusing the bank toward retail banking and developing a base of customer deposit funding. We view this as a logical strategy, but given the adverse macroeconomic environment we believe it may undermine the bank's efficiency in the short-term (and therefore its loss-absorption capacity from earnings) as investment seems unlikely to lead to any rise in earnings in the coming year. We consider the success of this attempt to reposition the KBCI franchise as unproven, for now.

We may also take a negative rating action if we observe that the links between KBCI and KBC are weakening, even allowing for our expectation of continued support. This could lead us to revise our group status assessment for KBCI to "moderately strategic". Assuming no change in the SACP, the group status revision would lead us to lower the counterparty credit ratings by two notches. This is because a "moderately strategic" group status only allows for one notch of group support, compared with the current three notches.

We are unlikely to raise the ratings on KBCI in the short term, because:

- The BICRA economic and industry risk scores for Ireland are both stable, which means we are unlikely to revise upward our assessment of the bank's SACP; and
- We expect KBCI's performance to lag many other parts of the group and we do not anticipate the bank becoming significantly more important to the group's strategy.

Ratings Score Snapshot

Issuer Credit Rating	BBB-/Stable/A-3
SACP	bb-
Anchor	bb
Business Position	Moderate (-1)
Capital and Earnings	Moderate (0)*
Risk Position	Adequate (0)
Funding and Liquidity	Average and Adequate (0)
Support	+3
GRE Support	0
Group Support	+3
Sovereign Support	0
Additional Factors	0

*When a bank's anchor SACP, derived from the BICRA methodology, is in the 'bb' category and its common equity regulatory Tier 1 ratio is greater than the local regulatory requirements, a "moderate" assessment of capital and earnings results in no adjustment for the SACP (see paragraph 88 of our bank criteria).

Related Criteria And Research

- Group Rating Methodology, May 7, 2013
- Banks: Rating Methodology And Assumptions, Nov. 9, 2011
- Banking Industry Country Risk Assessment Methodology And Assumptions, Nov. 9, 2011
- Banks: Bank Capital Methodology And Assumptions, Dec. 6, 2010
- Various Rating Actions Taken On Irish Banks Following Sovereign Review, July 16, 2013

- Banking Industry Country Risk Assessment: Ireland, July 16, 2013
- Outlook On Ireland Revised To Positive On Improved Prospects For Debt Reduction; Ratings Affirmed At 'BBB+/A-2', July 12, 2013

Ratings List

Ratings Affirmed; CreditWatch/Outlook Action

	To	From
KBC Bank Ireland PLC		
Counterparty Credit Rating	BBB-/Stable/A-3	BBB-/Negative/A-3
Senior Unsecured	BBB-	

Additional Contact:
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Complete ratings information is available to subscribers of RatingsDirect at www.globalcreditportal.com and at spcapitaliq.com. All ratings affected by this rating action can be found on Standard & Poor's public Web site at www.standardandpoors.com. Use the Ratings search box located in the left column. Alternatively, call one of the following Standard & Poor's 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.