STANDARD & POOR'S RATINGS SERVICES
McGRAW HILL FINANCIAL

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KBC Bank Ireland PLC

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KBC Bank Ireland PLC

SACP	bb		+	Support	+3	+	Additional Factors	-1

Anchor	bb+	
Business Position	Moderate	-1
Capital and Earnings	Moderate	0
Risk Position	Adequate	0
Funding	Average	0
Liquidity	Adequate	

GRE Support	0
Group Support	+3
Sovereign Support	0

Issuer Credit Rating
BBB-/Stable/A-3

Major Rating Factors

Strengths:	Weaknesses:
• 100% ownership by KBC Bank N.V. • Funding stability and liquidity underpinned by access to parental funding. • Relatively efficient operating model.	• Modest market position and geographic diversification. • Unlikely to move into recurring profitability until 2016. • Moderate capitalization, under our risk-adjusted capital methodology.

Outlook: Stable

Standard & Poor's Ratings Services' stable outlook on KBC Bank Ireland PLC (KBCI) reflects our view that the improving macroeconomic environment and reducing impairments will support KBCI's capital position, which we forecast to remain sustainably above 5% as measured by our projected risk-adjusted capital (RAC) ratio.

However, while we view KBCI's strategy as logical, we consider management's attempt to reposition the KBCI franchise as a work in progress. We could therefore lower the ratings if we consider that management is unlikely to develop KBCI into a retail-focused bank that can generate solid and sustainable earnings, or if we believe that the bank is lagging peers in terms of working through its large stock of nonperforming assets (NPAs). We could then revise our business position to "weak" from "moderate" or our risk position to "moderate" from "adequate".

We could take a similar action if we observe that the links between KBCI and KBC are weakening, which could lead us to revise our group status assessment and the uplift for potential group support that we factor into our ratings on KBCI.

We could raise the ratings by removing the negative transitional notch if we see strong indications that (a) the bank has returned to sustained profitability, (b) the strategic repositioning is working successfully, and (c) KBCI maintains a RAC ratio comfortably in excess of 5.0%.

Rationale

The starting point for our ratings on KBCI is based on our view of the banking system in Ireland. We then review the bank's stand-alone credit factors. We consider KBCI's business position to be less competitive than that of peers because it lacks the franchise and diversity of larger banks in Ireland. We view the bank's regulatory capital position as solid, but capitalization is relatively low when we calculate it using our risk-adjusted capital (RAC) framework. However, we consider KBCI's capital levels to be stabilizing and expect that the bank will likely maintain a RAC ratio above 5.0% through end-2015, with the parent supporting its capitalization where needed. Our assessment of KBCI's risk position reflects its geographical concentration and loss experience, which we consider to be broadly on par with peers. It also reflects our view that embedded losses have now been largely recognized. When we assess KBCI's funding and liquidity we view favorably the support provided to KBCI by its parent KBC, which has enabled KBCI to deal with any refinancing risk despite the growing but still-modest nature of its deposit-taking franchise.

Anchor:'bb+'

We continue to view economic risks in Ireland as high, albeit improving. We are now seeing clearer evidence that the Irish economy is recovering from its deep contraction and that property prices are trending upward. Furthermore, the private sector has gone through a substantial deleveraging. We expect domestic system-wide credit losses to remain low on the back of provision releases and declining inflows into new arrears. However, the stock of NPAs is high relative to higher-ranked banking systems and we expect its workout to take a while. This factor continues to weigh on our view of economic risk. Ireland's banking industry risk has reduced but remains high relative to many peers. Pre-provision profitability for Irish banks has improved on the back of expanding net interest margins and we view the post-crisis structure of the industry as stable, with relatively few domestically-focused players. That said, Ireland's weak regulatory track record, government ownership of much of the banking sector, and relatively shallow domestic debt capital markets continue to be constraining factors.

Table 1

KBC Bank Ireland PLC Key Figures					
	--Year-ended Dec. 31--				
(Mil. €)	**2014**	**2013**	**2012**	**2011**	**2010**
Adjusted assets	13,681.0	14,628.3	17,163.9	18,589.1	18,146.4
Customer loans (gross)	14,647.8	15,234.1	16,045.6	16,928.7	17,503.0
Adjusted common equity	502.6	528.9	456.2	842.3	835.6
Operating revenues	242.7	260.9	273.0	284.3	371.2
Noninterest expenses	136.0	102.0	73.6	66.9	49.4
Core earnings	(90.5)	(863.7)	(304.4)	(269.3)	(177.1)

Business position: Profitability would validate the repositioned business model

We view KBCI's business position as "moderate" compared to larger and more diverse peers such as Bank of Ireland (BOI) and Allied Irish Banks (AIB). At end-2014, KBCI reported total assets of €13.7 billion, placing it outside the top-five largest banks in Ireland. By the end of first-quarter 2015, it had market shares of about 10% in mortgage lending and 6% in retail deposits, including current accounts.

Originally a commercial bank, KBCI diversified into residential mortgage lending in the early 2000s, which gave it a more diverse spread of revenues than is typical for relatively small lenders. Revenues comprise recurring interest and commission income from retail, corporate, and consumer finance lending as well as from asset management, which it introduced in fourth-quarter 2014. We consider that the absence of a branch network and the substantial use of parent funding significantly aid efficiency, but contribute to the KBC brand being less deeply ingrained in the Irish market than leading bank brands.

KBCI has deleveraged significantly since 2007, shrinking total assets to €13.7 billion by end-2014, from €24.1 billion in 2007, as it is winding down its corporate portfolio. It has reduced its corporate exposure by about €2.6 billion since 2008. As the bank has reduced its corporate lending, preprovision earnings have also declined. Nonetheless, the business has been relatively stable in our view, aided by financial support from its parent, KBC.

KBCI's repositioning of its franchise and operational capabilities for broad-based growth in retail banking has led to heavy investments in technology to facilitate deposit gathering, the operation of current accounts, internet and mobile banking, brand awareness, and distribution (including the opening of physical "hubs" in city centers). We view this strategy as logical and showing the group's commitment to the Irish business, but still a work in progress.

We note that the bank performed well in 2014, recording a 12% market share of new mortgages and 7.4% of new current accounts. We expect KBCI to continue building on progress made to date in its repositioning initiative, in a banking system that remains competitive but which has consolidated substantially since 2008. However, it is requiring significant upfront investment and we believe that prospects for volume and revenue growth remain somewhat constrained by the low interest rate environment combined with asset margin pressure, as well as still-low customer activity. We therefore expect that this phase of development could weaken the bank's efficiency in the coming year.

Table 2

KBC Bank Ireland PLC Business Position					
	--Year-ended Dec. 31--				
(%)	2014	2013	2012	2011	2010
Total revenues from business line (currency in millions)	242.7	260.9	273.0	284.3	371.2
Commercial banking/total revenues from business line	4.3	14.4	20.0	23.6	22.6
Retail banking/total revenues from business line	88.6	78.6	73.0	72.1	70.2
Commercial & retail banking/total revenues from business line	92.9	92.9	92.9	95.7	92.8
Trading and sales income/total revenues from business line	5.0	5.0	5.0	4.0	7.1
Other revenues/total revenues from business line	2.1	2.1	2.1	0.3	0.1
Investment banking/total revenues from business line	5.0	5.0	5.0	4.0	7.1
Return on equity	(14.6)	(154.3)	(46.7)	(34.1)	(19.7)

Capital and earnings: Profitability in sight but to lag most domestic peers

We view KBCI's capital and earnings as "moderate", reflecting a RAC ratio of 5.6% at year-end 2014. We project that the RAC ratio will operate in the 6.0%-6.8% range through end-2016. Its Tier 1 ratio at end-2014 was a reported 12.7%, and we expect it to remain in the 12%-13% range. Similarly to domestic peers who are exposed to residential mortgages and commercial real estate (CRE), KBCI has been loss-making since 2010 due to high loan impairment charges. KBC remains supportive of KBCI and has partly offset the accounting losses and stabilized the regulatory capital ratio, offering some degree of stability to capitalization.

KBCI made a post-tax loss of €91 million in full-year 2014, after registering a €198 million loan impairment charge. This is a significant reduction from the €864 million post-tax loss that KBCI reported for 2013, which included an unusually high €775 million impairment charge in the fourth quarter linked to a rebasing of provisions. In our view, the full-year 2014 results indicate that KBCI continues to make gradual progress in paring back losses, although this process could remain somewhat uneven from quarter to quarter. Nevertheless, whereas a few Irish peers have now moved back into profit, we expect that KBCI will not move into meaningful recurring profitability until 2016. We assume that the impairment charges will be around €150 million in 2015 and €100 million in 2016, but we recognize that they could be lower in the event of changes in provisioning policies or writebacks. We also factor in an improving but still-squeezed interest margin (albeit we might see some margin improvements stemming from lower funding costs), relatively low but growing retail customer activity, and ongoing high investment. Together these factors will likely continue to weigh on pre-provision earnings.

KBCI's RAC ratio improved to 5.6% at end-2014, from 4.9% at end-2013. The rise is partly explained by its deleveraging of corporate risk-weighted assets and by a €130 million capital injection from its parent, but also stems from lower Standard & Poor's average risk-weights given our improved assessment of economic risks in Ireland. The RAC ratio includes the €280 million hybrid capital instruments that KBCI issued to KBC in 2012. We assign "intermediate" equity content to the notes and they now constitute one-quarter of KBCI's total adjusted capital (TAC). The large gap between the RAC ratio and the Tier 1 ratio primarily reflects (a) a material difference in the risk-weights that we apply to credit exposures; (b) a lower tolerance for the proportion of hybrid capital instruments we include in the capital base; and (c) our exclusion from TAC of deferred tax assets for tax-loss carryforwards. We base our projection of a RAC ratio through end-2016 in the 6.0%-6.8% range on three main variables:

- The earnings expectation outlined above;
- Continued deleveraging, notably including the steady divestment of corporate loans at close to book value; and
- Our expectation that KBC will remain supportive, injecting or optimizing KBCI's capital base where needed.

Table 3

KBC Bank Ireland PLC Capital And Earnings					
	--Year-ended Dec. 31--				
(%)	2014	2013	2012	2011	2010
Tier 1 capital ratio	12.7	12.2	11.1	11.0	10.3
S&P RAC ratio before diversification	5.6	N.M.	3.9	5.1	8.0
S&P RAC ratio after diversification	4.6	N.M.	3.3	4.3	6.9
Adjusted common equity/total adjusted capital	75.2	75.2	75.2	100.0	100.0
Net interest income/operating revenues	105.8	108.0	104.2	106.9	104.7
Fee income/operating revenues	(1.1)	(1.6)	(0.7)	0.3	1.1
Market-sensitive income/operating revenues	(4.8)	(6.4)	(3.5)	(7.5)	(7.1)
Noninterest expenses/operating revenues	56.0	39.1	27.0	23.5	13.3
Preprovision operating income/average assets	0.8	1.0	1.1	1.2	1.7
Core earnings/average managed assets	(0.6)	(5.4)	(1.7)	(1.5)	(0.9)

N.A.--Not available. N/A--Not applicable. N.M.--Not meaningful.

Risk position: Embedded losses recognized, but the workout of NPAs will take time

We view KBCI's risk position as "adequate" when compared with peers in systems with similar economic risk. We consider that the low complexity of the bank's business model aids management control and that the uplift in provisioning in 2010 and in late 2013 has improved coverage of weaker performing loans.

At end-2014, KBCI's €14.6 billion gross loan book was biased toward residential mortgages, with corporate lending (most of it real-estate-related) accounting for about 19% of balances. The spread of retail and commercial credit exposures notionally offers some diversification, but given the pressures—albeit reducing--on Irish household and corporate borrowers and the small size of the Irish market, this spread of exposures does not enhance KBCI's credit standing. We expect the bank will continue to gradually deleverage in the coming two years given its focus on winding down the corporate book, but we believe that this will be increasingly counterbalanced by new lending in mortgages and, to a lesser extent, consumer finance.

We consider KBCI's stock of NPAs to be large at about 52% of customer loans at year-end 2014. The increase in provisioning from previous years stems from a reassessment of KBCI's provisioning adequacy in the fourth-quarter of 2013, prompted by the European Banking Authority paper on forbearance and nonperforming loans (NPLs), as well as the asset quality review (AQR) in late 2014. We note that the charge was linked to the recategorization of almost all restructured mortgages as impaired. Despite this outsized charge, we consider KBCI's provisioning of troubled assets to be in line with Irish peers. In our view, Irish real estate collateral values are now showing relatively broad-based stability and we also consider that the bank has now recognized embedded losses. Data for full-year 2014 suggests that underlying asset quality has largely stabilized, with the stock of commercial NPLs starting to reduce while mortgage NPLs are only rising very modestly. In our view, this is principally due to a lag before a customer can be moved to a better probability of default (PD) assessment; slow court processes and a relative lack of foreclosures; and very limited capitalization of arrears.

The impairment charge in 2014 significantly reduced, helped by a collective loan impairment reversal of €20 million. As with peers, we expect the bank will make further progress in the coming year in its efforts to agree arrangements with mortgage borrowers and we should have better clarity on whether it has genuinely succeeded in putting their debt servicing on a sustainable footing.

We consider that the RAC ratio slightly overstates KBCI's exposure to unexpected loss. This is because our RAC methodology is conservative despite treating exposures to riskier buy-to-let mortgages (about one-quarter of the gross mortgage book) as standard mortgages. A bank such as KBCI, which uses an internal rating-based approach (IRB) for regulatory capital purposes, has provided significantly against NPL exposures, which our approach does not fully recognize.

Table 4

KBC Bank Ireland PLC Risk Position					
	--Year-ended Dec. 31--				
(%)	**2014**	**2013**	**2012**	**2011**	**2010**
Growth in customer loans	(3.8)	(5.1)	(5.2)	(3.3)	(3.9)
Total diversification adjustment / S&P RWA before diversification	21.4	N.M.	20.4	19.3	16.5
Total managed assets/adjusted common equity (x)	27.3	27.7	37.6	22.1	21.7
New loan loss provisions/average customer loans	1.4	6.8	3.3	3.1	2.9
Net charge-offs/average customer loans	0.0	0.3	0.3	0.0	0.0
Gross nonperforming assets/customer loans + other real estate owned	51.5	47.9	27.7	21.5	14.2
Loan loss reserves/gross nonperforming assets	38.6	37.3	38.7	34.1	30.2

N.A.--Not available. N/A--Not applicable. N.M.--Not meaningful.

Funding and liquidity: Continued strong focus on deposit gathering

In our opinion, KBCI's funding is "average" and its liquidity position is "adequate". We believe support from KBC will continue to allow KBCI to deal with any refinancing risk despite the growing, but still-modest, nature of its own deposit-taking franchise.

KBCI's funding position remains underpinned by KBC. Parent funding--sourced directly from Head Office and via customer deposits placed with KBC's Dublin branch and on-lent to KBCI--has long accounted for the majority of the bank's funding base. Because we classify this group funding as wholesale and it is largely short term, the Standard & Poor's stable funding ratio of 46% at end-2014 (up from 37% at end-2013) remains relatively weak. Its 0.19x liquidity ratio, as measured by our broad-liquid-assets to short-term wholesale-funding ratio, is similarly negatively affected. However, our overall assessment includes a qualitative overlay reflecting the demonstrated stability of parent funding.

Over the past three years, group-sourced funding has been generally reducing in absolute terms due to extensive deleveraging and because KBCI is seeing steady growth in retail and corporate deposits. Between end-December 2013 and end-December 2014 the retail deposit base grew by €0.54 billion, to €3.4 billion. Corporate and institutional deposits grew by about €0.2 billion to €0.81 billion over the same period.

We consider the development of a stronger, retail-focused deposit franchise to be generally supportive of the ratings.

However, we give most analytical weight to franchise-based insured deposits that are granular and balanced between current and savings accounts, as these tend to be stickier. While we expect the customer deposit base to continue to grow, we see deposit quality as a longer term development.

We consider the bank's pool of eurozone government securities and its ability to generate collateral from its mortgage book to be supportive of its liquidity because these can provide access to secured funding, such as covered bonds, or contingent external sources like monetary authorities. We understand that the group also remains willing to provide liquidity to the bank if needed.

Table 5

KBC Bank Ireland PLC Funding And Liquidity					
	--Year-ended Dec. 31--				
(%)	**2014**	**2013**	**2012**	**2011**	**2010**
Core deposits/funding base	33.9	25.9	17.2	9.8	14.5
Customer loans (net)/customer deposits	278.3	357.4	522.6	921.8	677.9
Long term funding ratio	41.8	32.6	24.0	44.1	23.4
Stable funding ratio	46.4	36.9	27.9	48.8	26.8
Short-term wholesale funding/funding base	62.2	71.9	80.2	58.5	80.1
Broad liquid assets/short-term wholesale funding (x)	0.2	0.2	0.2	0.2	0.2
Net broad liquid assets/short-term customer deposits	(313.1)	(264.2)	(454.0)	(1,660.6)	(1,957.8)
Short-term wholesale funding/total wholesale funding	91.0	94.3	94.1	64.8	93.7
Narrow liquid assets/3-month wholesale funding (x)	0.2	0.2	0.2	0.2	0.2

External support: Ratings benefit from continued strong KBC support

The potential long-term counterparty credit rating is three notches higher than the 'bb' SACP, reflecting our view that KBCI is "strategically important" to parent KBC under our group rating methodology. While KBC remains highly supportive of its Irish subsidiary, including the current phase of investment, we note it has publicly stated that KBCI is not a central part of its future growth strategy. KBCI would not ordinarily meet our criteria for being a strategically important subsidiary because we do not currently consider it to be important to the group's long-term strategy, and because its financial performance remains depressed by impairments and moderate pre-provision earnings. However, we consider that any potential sale is highly unlikely within the two-year outlook horizon as we understand that KBC will continue to support KBCI's capital and funding needs and as prospective earnings generation have improved, supported by a more favorable economic backdrop.

We consider KBCI to be of "low" systemic importance in Ireland and we factor no Irish government support into our ratings on the bank.

Additional rating factors: Slow return to profitability compared to larger peers and large stock of NPAs results in a downward adjustment by one notch

The rating is one notch lower than that implied by the three notches of uplift for group support. The one-notch downward revision reflects the group's still-short track record of improvements in financial performance. Results for full-year 2014 showed an improvement over 2013 in terms of lower loan loss provisions, and we expect this positive trend to continue for the next two years. However, the stock of NPAs still remains large and although we expect preprovision earnings to improve, they remain weaker than those of its peers. We consider KBCI likely to narrow that gap within the next two years. Therefore, we would likely remove the one-notch downward revision if the bank returned to sustained profitability within our expected time horizon, while continuing to make progress in working through its NPAs.

Related Criteria And Research

Related Criteria

- Group Rating Methodology, Nov. 19, 2013
- Banks: Rating Methodology And Assumptions, Nov. 9, 2011
- Banking Industry Country Risk Assessment Methodology And Assumptions, Nov. 9, 2011
- Bank Capital Methodology And Assumptions, Dec. 6, 2010
- Revised Market Risk Charges For Banks In Our Risk-Adjusted Capital Framework, June 22, 2012
- Bank Hybrid Capital And Nondeferrable Subordinated Debt Methodology And Assumptions, Jan. 29, 2015
- Bank Rating Methodology And Assumptions: Additional Loss-Absorbing Capacity, April 27, 2015
- Quantitative Metrics For Rating Banks Globally: Methodology And Assumptions, Jul. 17, 2013
- Use Of CreditWatch And Outlooks, Sep. 14, 2009
- Banks: Methodology For Mapping Short- And Long-Term Issuer Credit Ratings For Banks, May 04, 2010

Related Research

- Irish Bank Ratings Affirmed On Reducing Economic Risks, Dec. 9, 2014
- KBC Bank Ireland 'BBB-/A-3' Ratings Affirmed On Stable Irish Banking Industry Risk; Outlook Negative, June 10, 2014
- Banking Industry Country Risk Assessment: Ireland, June 10, 2014
- Most Irish Bank Ratings Affirmed On Stable Industry Risks, June 10, 2014
- Ireland Upgraded To 'A-' On Improved Domestic Prospects, June 6, 2014
- Belgium-Based KBC Group Outlook Revised To Negative On Potential Government Support Reduction; Ratings Affirmed, April 30, 2014
- KBC Bank Ireland Outlook Revised To Negative On Expected Fourth-Quarter Impairment Charge; 'BBB-/A-3' Ratings Affirmed, Nov. 28, 2013

Anchor Matrix

Industry Risk	Economic Risk									
	1	2	3	4	5	**6**	7	8	9	10
1	a	a	a-	bbb+	bbb+	bbb	-	-	-	-
2	a	a-	a-	bbb+	bbb	bbb	bbb-	-	-	-
3	a-	a-	bbb+	bbb+	bbb	bbb-	bbb-	bb+	-	-
4	bbb+	bbb+	bbb+	bbb	bbb	bbb-	bb+	bb	bb	-
5	bbb+	bbb	bbb	bbb	bbb-	bbb-	bb+	bb	bb-	b+
6	bbb	bbb	bbb-	bbb-	bbb-	**bb+**	bb	bb	bb-	b+
7	-	bbb-	bbb-	bb+	bb+	bb	bb	bb-	b+	b+
8	-	-	bb+	bb	bb	bb	bb-	bb-	b+	b
9	-	-	-	bb	bb-	bb-	b+	b+	b+	b
10	-	-	-	-	b+	b+	b+	b	b	b-

Ratings Detail (As Of July 29, 2015)

KBC Bank Ireland PLC	
Counterparty Credit Rating	BBB-/Stable/A-3
Senior Unsecured	BBB-
Counterparty Credit Ratings History	
20-Jul-2015	BBB-/Stable/A-3
28-Nov-2013	BBB-/Negative/A-3
16-Jul-2013	BBB-/Stable/A-3
08-Dec-2011	BBB-/Negative/A-3
11-Jul-2011	BBB+/Negative/A-2
02-Feb-2011	BBB+/Watch Neg/A-2
26-Nov-2010	A-/Watch Neg/A-2
25-Aug-2010	A-/Stable/A-2
Sovereign Rating	
Ireland (Republic of)	A+/Stable/A-1
Related Entities	
Ceskoslovenska Obchodni Banka A.S.	
Issuer Credit Rating	A/Negative/A-1
CSOB Pojistovna a. s.	
Financial Strength Rating	
Local Currency	A-/Stable/--
Issuer Credit Rating	
Local Currency	A-/Stable/--
KBC Bank N.V.	
Issuer Credit Rating	A/Negative/A-1
Certificate Of Deposit	A/A-1/A-1
Commercial Paper	A-1
Junior Subordinated	BB+

Ratings Detail (As Of July 29, 2015) (cont.)	
Junior Subordinated	BBB-
Senior Unsecured	A
Short-Term Debt	A-1
Subordinated	BBB
KBC Group N.V.	
Issuer Credit Rating	A-/Negative/A-2
Junior Subordinated	BB
KBC Group Re S.A.	
Financial Strength Rating	
Local Currency	A-/Negative/--
Issuer Credit Rating	
Local Currency	A-/Negative/--
KBC Insurance N.V.	
Financial Strength Rating	
Local Currency	A/Negative/--
Issuer Credit Rating	
Local Currency	A/Negative/--

*Unless otherwise noted, all ratings in this report are global scale ratings. Standard & Poor's credit ratings on the global scale are comparable across countries. Standard & Poor's credit ratings on a national scale are relative to obligors or obligations within that specific country. Issue and debt ratings could include debt guaranteed by another entity, and rated debt that an entity guarantees.

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