STANDARD & POOR'S RATINGS SERVICES
McGRAW HILL FINANCIAL

RatingsDirect®

KBC Bank Ireland PLC

Primary Credit Analyst:
Alexandre Birry, London (44) 20-7176-7108; alexandre.birry@standardandpoors.com

Secondary Contact:
Dhruv Roy, London (44) 20-7176-6709; dhruv.roy@standardandpoors.com

Table Of Contents

KBC Bank Ireland PLC

SACP	bb-	+	Support	+3	+	Additional Factors	0

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-/Negative/A-3

Major Rating Factors

Strengths:

- 100% ownership by KBC Bank N.V.
- Funding stability and liquidity underpinned by access to parental funding.
- Relatively efficient operating model.

Weaknesses:

- Unlikely to move into profit until 2016.
- Modest market position and geographic diversification.
- Moderate capitalization, under our risk-adjusted capital methodology.

Outlook

Standard & Poor's Ratings Services' negative outlook on KBC Bank Ireland PLC (KBCI) principally reflects our view that although its regulatory Tier 1 capital ratio will likely remain robust, our projected 5.0%-5.5% risk-adjusted capital (RAC) ratio remains uncertain. In addition, while we view KBCI's strategy as logical, we consider management's attempt to reposition the KBCI franchise as unproven, for now.

We would expect to lower the ratings if KBCI's stand-alone credit profile (SACP) were to deteriorate. This would most likely happen if we expected that KBCI's RAC ratio would not move sustainably above 5.0%. We would reflect this in a lowering of our capital and earnings assessment to "weak" from "moderate." We may also lower the ratings if we consider that management is unlikely to develop KBCI into a retail-focused bank that is able to generate solid and sustainable earnings, once impairments reduce and the economy improves.

We could lower the ratings if we observe that the links between KBCI and KBC are weakening, even allowing for our expectation that KBC would likely provide support while it remains KBCI's parent. 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 could revise the outlook to stable if we consider it highly likely that KBCI will maintain a RAC ratio comfortably in excess of 5.0% and we saw strong indications that:

- The bank will return to profitability in 2016, as we expect; and
- The strategic repositioning is working successfully.

Rationale

The starting point for our ratings on KBCI is its 'bb' anchor, which is based on our view of the banking system in Ireland. We consider KBCI's business position to be "moderate" (as defined by our criteria) as we consider that it lacks the franchise and diversity of larger Irish peers. We view capital and earnings as "moderate" since we expect that the bank will likely build a RAC ratio above 5.0% through end-2015, with capitalization aided where needed by the parent. Our assessment of KBCI's risk position is "adequate", reflecting geographical concentration and loss experience that appears to be broadly on a par with peers, and our view that embedded losses have now been largely recognised. We view funding as "average" and liquidity as "adequate" due to support from KBC which has enabled KBCI to deal with any refinancing risk despite the growing but still limited nature of its own deposit-taking franchise.

Table 1

KBC Bank Ireland PLC Key Figures

		--Year-ended Dec. 31--			
(Mil. €)	**2013**	**2012**	**2011**	**2010**	**2009**
Adjusted assets	N.A.	17,164	18,589	18,146	19,560
Customer loans (gross)	N.A.	16,046	16,929	17,503	18,215
Adjusted common equity	N.A.	456	842	836	1,105
Operating revenues	N.A.	273	284	371	334
Noninterest expenses	N.A.	73.6	66.9	49.4	57.5
Core earnings	N.A.	-304	-269	-177	92

N.A.--Not available. Note: Most 2013 data is omitted from the data tables in this report as KBCI has not yet published its annual report and accounts for 2013.

Anchor

The 'bb' anchor draws on our BICRA methodology and our view of the economic and industry risk in the Republic of Ireland (A-/Positive/A-2), where KBCI almost exclusively operates. We view Ireland's economic risk as high. Businesses, households, and government finances were all hit hard by the fallout from the collapse in property collateral values and the severe difficulties in the banking system, most especially in the 2008-2011 period. Today we are now seeing clearer evidence that the Irish economy is starting to recover from its deep contraction, and that property prices are on an upward trend. But, we still believe that the Irish banking system continues to suffer as a result of these past events. In particular, the stock of non-performing assets is high relative to higher ranked banking systems and we expect its workout to take a while. Ireland's industry risk is also high, in our view. While some Irish banks have re-established access to wholesale funding markets, on the back of issuance by the Irish sovereign, and funding support from the European Central Bank has reduced, we think that bank funding profiles remain unbalanced. Moreover, income generated by Irish banks is quite modest and we believe that the Irish authorities have been relatively less proactive in forcing their banks to address the deficiencies in their capitalization exposed by fully loaded Basel III metrics.

Business position:Profitability would validate the repositioned business model

We view KBCI's business position as "moderate" in comparison with larger and more diverse peers in Ireland such as Bank of Ireland (BOI) and Allied Irish Banks PLC (AIB).

KBCI has its roots in commercial banking but diversified into residential mortgage lending in the early 2000s, resulting in it having a more diverse spread of revenues than would typically be the case for a relatively small lender. The absence of a branch network and substantial use of parental funding significantly aid efficiency, but in our view contribute to the "KBC" brand being less deeply ingrained in the Irish market than the leading bank brands.

While the bank has deleveraged, aided by financial support from its parent, KBC, the business has been relatively stable in our view. Over the past 24 months, KBCI has moved into its next phase: to position the franchise and operational capabilities for broad-based growth in retail banking, aided by an economic environment in Ireland that is becoming more supportive. This has led KBCI to invest heavily in technology to facilitate deposit gathering, the operation of current accounts, internet and mobile banking, distribution (including a handful of new "hubs" in city centers), and publicity.

We view this strategy as logical and clear evidence of the group's commitment to the Irish business, but still somewhat unproven, for now. We continue to expect that KBCI will make progress in this repositioning initiative, in a banking system that remains competitive but which has consolidated substantially since 2008. However, it is requiring significant upfront investment, and prospects for volume and revenue growth are constrained by the very low interest rate environment, still low customer activity, and high customer inertia. We therefore expect that this phase of development could further weaken the bank's efficiency in the coming year (and therefore its loss-absorption capacity).

Table 2

KBC Bank Ireland PLC Business Position

		--Year-ended Dec. 31--			
(%)	**2013**	**2012**	**2011**	**2010**	**2009**
Total revenues from business line (€ millions)	N.A.	273	284	371	N.A.
Commercial banking/total revenues from business line	N.A.	20.0	23.6	22.6	N.A.
Retail banking/total revenues from business line	N.A.	73.0	72.1	70.2	N.A.
Trading and sales income/total revenues from business line	N.A.	5.0	4.0	7.1	N.A.
Return on equity	N.A.	(46.7)	(34.1)	(19.6)	9.3

N.A.--Not available.

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

We view KBCI's capital and earnings as "moderate". Like domestic peers who are similarly exposed to residential mortgages and commercial real estate (CRE), KBCI has been loss-making since 2010 due to high loan impairment charges. These losses have been offset by regular capital injections from the parent, offering a degree of stability to capitalization. KBCI's Tier 1 ratio at March 2014 was a reported 13.1%, up slightly from 12.2% at end-2013. We expect that it will operate in the 11.5%-13% range for the foreseeable future, and that the RAC ratio will operate in the 5.0-5.5% range.

KBC group reported that KBCI made a post-tax loss of €40 million (on a management view, not statutory basis) in the first quarter of 2014, after registering a €48 million impairment charge. This compares with the €992 million post-tax loss that the group reported for KBCI on the same basis for 2013 as a whole. The 2013 results included an unusually high €773 million impairment charge in the fourth quarter linked to a rebasing of provisions. Setting aside the fourth-quarter charge, in our view the first-quarter result indicates that KBCI continues to make gradual progress in paring back losses, although this process could remain somewhat uneven quarter to quarter.

Nevertheless, whereas a few Irish peers have now moved back into profit, we expect that KBCI will not move into profit until at least late 2015. Within this expectation we assume that the impairment charge will be at the top end of the range indicated by the group; that is, €150-200 million in 2014 and €50-100 million in 2015 and 2016. We also factor in a continued squeezed interest margin, relatively low but growing retail customer activity, and ongoing high investment which together will likely continue to weigh on preprovision earnings.

Table 3

KBC Bank Ireland PLC Capital And Earnings					
		--Year-ended Dec. 31--			
(%)	**2013**	**2012**	**2011**	**2010**	**2009**
Tier 1 capital ratio	12.2	11.1	11.0	10.3	9.3
S&P RAC ratio before diversification	4.9	4.3	5.1	8.0	9.3
S&P RAC ratio after diversification	4.0	3.6	4.3	6.9	7.9
Adjusted common equity/total adjusted capital	N.A.	75.2	100.0	100.0	100.0
Net interest income/operating revenues	N.A.	104.2	106.9	104.7	105.6
Fee income/operating revenues	N.A.	(0.7)	0.3	1.1	2.6
Market-sensitive income/operating revenues	N.A.	(3.5)	(7.5)	(7.1)	(10.8)
Noninterest expenses/operating revenues	N.A.	27.0	23.5	13.3	17.2
Preprovision operating income/average assets	N.A.	1.1	1.2	1.7	1.4
Core earnings/average managed assets	N.A.	(1.7)	(1.5)	(0.9)	0.5

N.A.--Not available.

KBCI's RAC ratio was 4.9% at end-2013, down slightly from the pro forma ratio of 5.2% for June 2013 that included a small change in the capital mix executed in July. KBC was again highly supportive of KBCI in 2013, injecting €869 million of equity in the year to offset the accounting loss and stabilize the regulatory capital ratio.

The RAC ratio includes the "intermediate" equity content hybrid capital instruments that KBCI issued to KBC in 2012, and which 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 material difference in the risk-weights that we apply to credit exposures, as well as a lower tolerance for the proportion of hybrid capital instruments that can be included in the capital base and our exclusion from TAC of deferred tax assets for tax-loss carryforwards.

We project that the RAC ratio will operate in the 5.0%-5.5% range through end-2015. We base this 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.

Risk position: AQR will reveal whether the 2013 provisioning hike is sufficient

Table 4

KBC Bank Ireland PLC Risk Position

	--Year-ended Dec. 31--				
(%)	**2013**	**2012**	**2011**	**2010**	**2009**
Growth in customer loans	N.A.	(5.2)	(3.3)	(3.9)	(3.2)
Total diversification adjustment* / S&P RWA before diversification	21.0	20.4	19.3	16.5	18.3
Total managed assets/adjusted common equity (x)	27.7	37.6	22.1	21.7	17.7
New loan loss provisions/average customer loans	6.8	3.3	3.1	2.9	0.9
Net charge-offs/average customer loans	0.3	0.3	0.0	0.0	0.0
Gross nonperforming assets/customer loans + other real estate owned	48.0	27.7	21.5	23.0	13.7
Loan loss reserves/gross nonperforming assets	37.3	38.7	34.1	18.6	9.4

*For KBCI this is an add on for concentration. N.A.--Not available.

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

At end-March 2014, KBCI's €15.1 billion gross loan book was biased toward residential mortgages, with corporate lending (most of it real estate related) accounting for about 20% of balances. The spread of retail and commercial credit exposures notionally offers some diversification, but given the pressures on Irish household and corporate borrowers alike and the small size of the market we give relatively little analytical credit for this. We expect the bank will continue to gradually deleverage in the coming year, albeit that reducing commercial loans will be increasingly counterbalanced by new lending in mortgages and, to a lesser extent, consumer finance.

KBC's quarterly data for KBCI suggests that underlying asset quality has largely stabilized, with the stock of commercial NPLs having seemingly peaked and mortgage NPLs now only rising very modestly--principally due to the relative lack of foreclosures and very limited capitalization of arrears. In addition, in our view Irish real estate collateral values are now starting to show relatively broad-based stability.

KBC stated that the fourth-quarter reassessment of KBCI's provisioning adequacy was prompted by the European Banking Authority paper on forbearance and nonperforming loans (NPLs), as well as the upcoming asset quality review (AQR) in late 2014. The charge was linked to the recategorization of almost all restructured mortgages as impaired. Still, we consider KBCI's provisioning of troubled assets to be only in line with Irish peers. We expect that the AQR will provide the external validation of provisioning exercise, but we see the prospect of a further outsized impairment charge in 2014 as having reduced significantly. As with peers, we also expect to see increasing evidence through the coming year of whether the bank's efforts to agree arrangements with mortgage borrowers have genuinely succeeded in putting their debt servicing on a sustainable footing.

Overall, we consider that the RAC ratio slightly overstates KBCI's exposure to unexpected loss. This is because while risk exposures to higher risk buy-to-let mortgages (one quarter of the gross mortgage book) are treated only as standard mortgages, the RAC methodology is conservative where a bank, such as KBCI, that uses an internal rating-based approach (IRB) for regulatory capital purposes has heavily provided against its nonperforming loan exposures.

Funding and liquidity: Continued strong focus on deposit-gathering

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

KBCI's funding position remains underpinned by the role of KBC. Parental funding--sourced directly from Head Office and via customer deposits placed with KBC 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 contractually short term in nature, KBCI's Standard & Poor's stable funding ratio of 37% at end-2013 remains relatively weak (and its liquidity ratio is similarly negatively affected). However, our overall assessment includes a qualitative overlay where we reflect the demonstrated stability of this funding. KBCI opportunistically used the European Central Bank's LTRO facility but repaid the €3.6 billion of drawings in 2013.

Over the past three years, group-sourced funding has been generally reducing in absolute terms because KBCI is deleveraging and because it is seeing steady growth in retail deposits. Over the 12 months to the end of March 2014, the retail deposit base grew by €0.7 billion, to €3.1 billion. Overall, 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 in nature. While we expect the size of the customer deposit base to continue to grow, we see deposit quality as a longer-term development.

The bank's pool of eurozone government securities and ability to generate collateral from its mortgage book supports its liquidity. These provide scope for further access to contingent external sources, such as from monetary authorities. We understand that the group also remains willing to provide the bank with liquidity, should this be needed.

Table 5

KBC Bank Ireland PLC Funding And Liquidity					
		--Year-ended Dec. 31--			
(%)	**2013**	**2012**	**2011**	**2010**	**2009**
Core deposits/funding base	25.9	17.2	9.8	14.5	15.3
Customer loans (net)/customer deposits	357.4	522.6	921.8	677.9	648.9
Long term funding ratio	32.6	24.0	44.1	23.4	42.3
Stable funding ratio	36.9	27.9	48.8	26.8	N.A.
Short-term wholesale funding/funding base	71.9	80.2	58.5	80.1	61.0
Broad liquid assets/short-term wholesale funding (x)	0.2	0.2	0.2	0.2	N.A.
Short-term wholesale funding/total wholesale funding	94.3	94.1	64.8	93.7	72.1

Table 5

KBC Bank Ireland PLC Funding And Liquidity (cont.)
N.A.--Not available.

External Support: Ratings benefit from continued strong KBC support

The long-term counterparty credit rating is three notches higher than the 'bb-' SACP, reflecting our view that KBCI is "strategically important" to its parent, KBC, in accordance with 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 assessed as 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 preprovision earnings. However, we consider that any potential sale is highly unlikely within 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 in Ireland and we factor no Irish government support into its ratings.

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 Hybrid Capital Methodology And Assumptions, Nov. 1, 2011
- Bank Capital Methodology And Assumptions, Dec. 6, 2010

Related Research

- 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 21, 2014)

KBC Bank Ireland PLC	
Counterparty Credit Rating	BBB-/Negative/A-3
Senior Unsecured	BBB-
Counterparty Credit Ratings History	
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-/Positive/A-2
Related Entities	
CSOB Pojistovna a. s.	
Financial Strength Rating	
Local Currency	A-/Negative/--
Issuer Credit Rating	
Local Currency	A-/Negative/--
KBC Bank N.V.	
Issuer Credit Rating	A/Negative/A-1
Certificate Of Deposit	A/A-1
Junior Subordinated	BBB-
Preferred Stock	BBB-
Senior Unsecured	A
Short-Term Debt	A-1
Subordinated	BBB+

Ratings Detail (As Of July 21, 2014) (cont.)	
KBC Group N.V.	
Issuer Credit Rating	A-/Negative/A-2
Junior Subordinated	BB
Senior Unsecured	A-
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/--
K&H Bank (Unsolicited Ratings)	
Issuer Credit Rating	
Local Currency	BBpi/--/--

*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.

Additional Contact:
Financial Institutions Ratings Europe; FIG_Europe@standardandpoors.com