S&P Global Ratings

RatingsDirect®

Research Update:

KBC Bank Ireland 'BBB-/A-3' Ratings Affirmed On Improved Capitalization; Outlook Stable

Primary Credit Analyst:
Sadat Preteni, London (44) 20-7176-7560; sadat.preteni@spglobal.com

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

Table Of Contents

Research Update:

KBC Bank Ireland 'BBB-/A-3' Ratings Affirmed On Improved Capitalization; Outlook Stable

Overview

- We have revised our capital and earnings assessment for KBC Bank Ireland PLC (KBCI) to adequate from moderate as a result of an increase in our risk-adjusted capital (RAC) ratio to 8.9%. The increase follows a €160 million capital injection from parent KBC Group N.V. in 2015, as well as reduced risk-weighted assets due to corporate deleveraging.
- The action has a neutral impact on the ratings on the bank, as we do not consider the capital increase to be an enhancement to the bank's creditworthiness in light of the large stock of nonperforming assets (NPAs) the bank has to work through.
- We are therefore affirming our 'BBB-/A-3' long- and short-term counterparty credit ratings on KBCI.
- The outlook is stable, reflecting our view that the improving macroeconomic environment and reducing impairments will support KBCI's capital position over the coming 18-24 months.

Rating Action

On June 28, 2016, S&P Global Ratings affirmed its 'BBB-/A-3' long- and short-term counterparty credit ratings on Ireland-based KBC Bank Ireland PLC (KBCI). The outlook is stable.

Rationale

The revision of KBCI's capital and earnings to adequate from moderate, following an increase in the bank's risk-adjusted capital (RAC) ratio to 8.9% at end-2015 from 5.6% at end-2014, has no impact on the ratings. In our view, moderate and adequate capital and earnings assessments are neutral to stand-alone credit profiles (SACPs) that are at the 'bb' level, such as in the case of KBCI. Moreover, KBCI still manages a large stock of NPAs when compared to peers which, in our view, weighs on its creditworthiness.

KBCI received a capital injection of €160 million from KBC in the first quarter of 2015 to support the bank's capitalization. After the capital injection, the bank's Tier 1 capital ratio increased to 13.3% at end-2015 from 12.7% a year earlier. The action led to an increase in our RAC ratio calculation to 8.9% at end-2015, up from 5.6% at end-2014. In addition to KBC's capital injection, other drivers behind this increase were deleveraging of commercial loans, reduced risk-weights on government exposures following the upgrade of Ireland in June 2015, and the higher amount of hybrids allowed in total adjusted capital as the capital injection increased adjusted common equity. We project that KBCI's RAC will remain within 9.0%-9.5% within our 18-24 month rating horizon, with the parent supporting its capitalization where needed.

We view KBCI's business position as less competitive than that of peers, because it lacks the franchise and diversity of larger banks in Ireland. We consider KBCI's capital levels to be stabilizing and expect that the bank will likely maintain a RAC ratio above 7% through end-2017, with the parent supporting its capitalization where needed. Our assessment of KBCI's risk position also takes into account its geographical concentration and loss experience, which we consider to be broadly on par with peers and our view that embedded losses have now been largely recognized. When we assess KBCI's funding and liquidity, we view the support provided to KBCI by its parent KBC favorably, which has enabled KBCI to deal with any refinancing risk despite the growing but still-modest nature of its deposit-taking franchise.

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. While KBC remains highly supportive of its Irish subsidiary, including in the current phase of investments, we note group management has publicly stated that it is considering various options for KBCI and intends to communicate further on this matter before year-end 2016. While we do not currently consider KBCI to be integral to the group's long-term strategy, we consider that a potential sale is unlikely within the two-year outlook horizon given KBCI's funding reliance on KBC, and we expect that KBC will continue to provide operational, capital, and funding and liquidity support to KBCI.

The rating is one notch lower than that implied by the three notches of uplift for group support, reflecting the group's still-short track record of improvements in financial performance. Results for full-year 2015 showed a return to modest profitability and an improvement over 2014 in terms of lower loan loss provisions--a positive trend which we expect 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 peers. We consider that KBCI is likely to narrow that gap within the next two years. Therefore, we would likely remove the one-notch downward revision if the bank demonstrates a return to sustained profitability within our expected 18-24 month time horizon, while continuing to make progress in working through its NPAs.

Outlook

The stable outlook on KBCI reflects our view that the improving macroeconomic environment and reducing impairments will support KBCI's capital position over the coming 18-24 months, which we forecast to remain sustainably above 7%, as measured by our projected 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 believe that the bank is lagging peers in terms of working through its large stock of NPAs or if we consider that management is unlikely to develop KBCI into a retail-focused bank that can generate solid and sustainable earnings. We could then revise our risk position to moderate from adequate or our business position to weak from moderate.

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 the bank is able to generate recurring and sustainable profits and the strategic repositioning is working successfully.

Ratings Score Snapshot

KBC Bank Ireland PLC

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

Related Criteria And Research

Related Criteria

- Criteria - Financial Institutions - Banks: Bank Rating Methodology And Assumptions: Additional Loss-Absorbing Capacity, April 27, 2015
- Criteria - Financial Institutions - Banks: Bank Hybrid Capital And Nondeferrable Subordinated Debt Methodology And Assumptions, Jan. 29, 2015
- General Criteria: Group Rating Methodology, Nov. 19, 2013
- Criteria - Financial Institutions - Banks: Quantitative Metrics For

Rating Banks Globally: Methodology And Assumptions, July 17, 2013

- Criteria - Financial Institutions - Banks: Revised Market Risk Charges For Banks In Our Risk-Adjusted Capital Framework, June 22, 2012
- Criteria - Financial Institutions - Banks: Banks: Rating Methodology And Assumptions, Nov. 9, 2011
- Criteria - Financial Institutions - Banks: Banking Industry Country Risk Assessment Methodology And Assumptions, Nov. 9, 2011
- Criteria - Financial Institutions - Banks: Bank Capital Methodology And Assumptions, Dec. 6, 2010
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009
- Criteria - Financial Institutions - Banks: Commercial Paper I: Banks, March 23, 2004

Ratings List

Ratings Affirmed

KBC Bank Ireland PLC	
Counterparty Credit Rating	BBB-/Stable/A-3

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

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. 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 the S&P Global Ratings public website at www.standardandpoors.com. Use the Ratings search box located in the left column. Alternatively, call one of the following S&P Global Ratings 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.