# Financial Institutions Ratings
# KBC Group – AT1 rating report

## Security ratings

| | |
|---|---|
| Outlook | Stable |
| 5.625% EUR 1.4bn undated deeply subordinated Additional Tier 1 fixed rate resettable callable securities | BBB- |
| 4.25% EUR 1bn undated deeply subordinated Additional Tier 1 fixed rate resettable callable securities | BBB- |

The ratings were not solicited by the issuer; the analysis is based solely on public information.

## Rating rationale

**Scope assigns a rating of BBB-, with Stable Outlook, to the above-referenced, undated deeply subordinated AT1 notes issued by KBC Group NV. The ratings are based on the following:**

- Senior unsecured debt rating (eligible for MREL): A, Stable Outlook
- Minimum notches down from the senior unsecured debt rating: 4
- Additional notches: 0

In accordance with our rating methodology, the starting point for notching down when rating capital instruments is the senior unsecured debt rating. The minimum four notches reflect the deeply subordinated status of AT1 capital instruments in the priority of claims, their going-concern loss-absorbing features and investors' exposure to coupon-cancellation risks. We believe no other factors warrant additional notching at this time.

Please also refer to Scope's Bank Capital Instruments Rating Methodology published in May 2018 for more details.

## Issuer Credit Profile

The issuer rating reflects KBC's solid franchise as a leading bancassurer in its home market of Belgium and in the Czech Republic. The Belgian group has successfully put the crisis years behind them. State aid was fully repaid ahead of schedule, and the group's overall risk profile has improved materially with the disposal of legacy activities. Further, asset quality continues to recover steadily, supported by improving macro conditions in Ireland. Solvency has strengthened to solid levels, and the liquidity position remains sound.

The release of this rating report does not constitute a rating action. The last rating action was assigned on 3.12.2015. For further information on the last rating action and regulatory information please click here.

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## Summary terms

| Issuer | KBC Group |
|---|---|
| **Issue Date** | **March 2014** |
| **Amount** | EUR 1.4bn |
| **Coupon** | • 5.625% fixed until first call date, reset every five years thereafter<br>• After first call date, rate equal to 5Y EUR mid swap rate plus 4.759%<br>• Payable quarterly |
| **Format** | Undated deeply subordinated Additional Tier 1 fixed rate resettable securities, callable on 19 March 2019 and every interest payment date thereafter |
| **ISIN** | BE0002463389 |

| Issuer | KBC Group N.V. |
|---|---|
| **Issue Date** | **April 2018** |
| **Amount** | EUR 1bn |
| **Coupon** | • 4.25% fixed until first call date, reset every five years thereafter<br>• After first call date, rate equal to 5Y EUR mid swap rate plus 3.594%<br>• Payable semi-annually<br>• Semi-annually |
| **Format** | Undated deeply subordinated Additional Tier 1 fixed rate resettable securities, callable on 24 October 2025 and every interest payment date thereafter |
| **ISIN** | BE0002592708 |

| Main Risks | |
|---|---|
| **Coupon Cancellation** | • Fully discretionary<br>• Mandatory if coupon payments on all own funds instruments a) would exceed the Distributable Items of the issuer; or b) would cause the Maximum Distributable Amount (MDA) then applicable to the issuer to be exceeded. Cancellation is also subject to the competent supervisory authority's decision. |
| **Principal Loss Absorption** | • If the CET1 ratio falls below the trigger level, the issuer needs to reduce the current principal amount of each note by the relevant write-down amount, in a sufficient proportion to bring the CET1 ratio above the trigger<br>• If a positive consolidated net profit is recorded at any time then the issuer may, at its full discretion and subject to the MDA, increase the current principal amount of each note up to a maximum of the original principal amount on a pro-rata basis with the other notes<br>• Resolution authorities may reduce the principal amount of the notes to zero on a permanent basis or convert the notes into CET1 capital at the point of non-viability (PONV) or in any case in the context of regulatory bail-in. |
| **Trigger for Principal Loss Absorption** | Consolidated CET1 ratio < 5.125% on a transitional basis |

Source: Prospectuses, Scope Ratings

## Key risks

### A. Coupon cancellation

**Key risk: Coupon cancellation**

Coupon payments on the securities are fully discretionary and are subject to distribution restrictions

Furthermore, coupons are mandatorily cancelled if there are insufficient distributable items (based on issuer accounts on an unconsolidated basis) or if payments exceed the MDA. The MDA is calculated if the issuer does not meet its combined buffer requirement.

#### Available Distributable Items

Coupons are mandatorily cancelled if available distributable items (ADIs) are insufficient. The amount of available distributable items as of year-end 2017 for the issuer, KBC Group, was approximately EUR 6.4bn. KBC currently has two outstanding CRD IV compliant AT1 securities totalling EUR 2.4bn (the above issues). In 2018, KBC is expected to make EUR 100m of distributions related to the above notes.

#### Combined Buffer Requirement (CBR)

Article 141 of CRD IV imposes certain restrictions on discretionary distributions (dividends, variable remuneration and payments on AT1 securities) if the combined buffer requirement (CBR) is not met. The CBR comprises the capital conservation buffer, the countercyclical buffer and systemic risk buffers as applicable. The MDA needs to be calculated if banks supervised by the ECB do not meet both Pillar 1 and Pillar 2 capital requirements as well as the CBR.

By 2019, we estimate that KBC Group will need to maintain a CET1 ratio (under the Danish Compromise) of at least 10.6%, a Tier 1 capital ratio of 12.1%, and a total capital ratio of 14.1% to avoid distribution restrictions (Table 1). This assumes that the Pillar 2 requirement of 1.75% does not change, the capital conservation buffer is fully phased in to 2.5% and the countercyclical buffer (CCyB) increases to 0.35% (following the Czech and Slovak authorities' decisions to increase the CCyB to 1.25%).

The estimate also assumes that the systemic buffer requirement of 1.5% imposed by the National Bank of Belgium for 2018 does not change.

In Q1 2018 KBC Group's CET1 ratio, based on the Danish Compromise, stood at 15.9%[1], 600 bps or EUR 5.6bn above the requirement relevant for distribution restrictions.

[1] From 1 January 2018 no difference between fully loaded and phased-in ratio.

**Table 1: Distance to Combined Buffer Requirement**

| | 2017 | Q1 2018 | 2019 |
|---|---|---|---|
| **Required CET1 associated with distribution restrictions:** | **8.7%** | **9.9%** | **10.6%** |
| Combined buffer (CBR) | | | |
| - Capital conservation | 1.25% | 1.88% | 2.50% |
| - Systemic | 1.00% | 1.50% | 1.50% |
| - Countercyclical | 0.15% | 0.25% | 0.35% |
| Pillar 2 CET1 requirement | 1.75% | 1.75% | 1.75% |
| Pillar 1 CET1 requirement | 4.50% | 4.50% | 4.50% |
| | | | |
| KBC Group NV CET1, transitional (%) | 16.5% | 15.9% | 14% Target |
| **Distance to CET1 requirement incl. CBR (%)** | **7.8%** | **6.0%** | |
| **Distance to CET1 requirement incl. CBR (EUR bn)** | **7.2** | **5.6** | |
| | | | |
| KBC Group NV Tier 1, transitional (%) | 18.0% | 17.4% | |
| Required Tier 1 incl. CBR (%) | 10.2% | 11.4% | 12.1% |
| **Distance to Tier 1 requirement incl. CBR (%)** | **7.8%** | **6.0%** | |
| | | | |
| KBC Group NV total capital, transitional (%) | 20.4% | 19.7% | |
| Required total capital, incl. CBR (%) | 12.2% | 13.4% | 14.1% |
| **Distance to total capital requirement incl. CBR (%)** | **8.2%** | **6.3%** | |
| | | | |
| RWAs (EUR bn) | 92 | 93 | |

Source: Company data, Scope Ratings

## B. Principal loss absorption

**Key risk: Principal loss absorption**

The mechanism for loss absorption is temporary write-down

The rated securities have one trigger:

- Consolidated CET1 ratio < 5.125% on a transitional basis

Pursuant to the terms and conditions of the notes, the principal amount of the notes will be written down if KBC Group CET1 ratio breaches the 5.125% trigger. At its discretion, the group may write-up the principal amount of the notes if it reports a profit, subject to the constraint of the MDA.

### Distance to trigger

As of 31 March 2018, KBC Group's CET1 ratio (under the Danish Compromise) was 15.9%, well above the trigger of 5.125% (Table 2). Therefore, the distance to the trigger of 5.125% was 10.8% or EUR 10bn (based on risk-weighted assets of EUR 93.2bn). We expect KBC Group's CET1 ratio to remain comfortably positioned with regard to the trigger level.

**Table 2: Distance to trigger.**

| | 2017 | Q1 2018 | 2019 |
|---|---|---|---|
| Trigger level | 5.1% | 5.1% | 5.1% |
| KBC Group NV CET1, transitional (%) | 16.5% | 15.9% | 14% Target |
| **Distance to trigger (%)** | **11.3%** | **10.8%** | |
| **Distance to trigger (EUR bn)** | **10.4** | **10.0** | |

Based on EUR 92bn in risk-weighted assets as of YE2017 and EUR 93bn in risk-weighted assets at Q1 2018
Source: Company data, Scope Ratings

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