Financial Institutions Ratings
KBC Bank NV – T2 rating report

Security Ratings

Outlook	Stable
8% USD 1bn contingent capital securities	BBB+

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

Rating rationale

We have assigned a rating of BBB+ to KBC Bank's 8% USD 1bn contingent capital securities based on the following:

- Senior unsecured debt rating (eligible for MREL): A, Stable Outlook
- Minimum notches down from senior unsecured debt rating: 2
- Additional notches: 0

In accordance with our recently updated rating methodology, the starting point for notching down when rating capital instruments is the senior unsecured debt rating and no longer the issuer credit-strength rating (ICSR). Please refer to Scope's *Bank Capital Instruments Rating Methodology* published in May 2016 for more details.

Under the Bank Recovery and Resolution Directive (BRRD), Tier 2 capital instruments should be written-down or converted when the issuer has reached the point-of-non-viability (PONV). While the security has a 7% trigger, we take the view that the PONV may be below or above this level. Therefore, the minimum of two notches for KBC's Tier 2 securities in our opinion sufficiently captures the potential principal loss absorption risks.

Issuer credit profile

The ICSR of A+ for KBC is underpinned by the Belgian group's solid franchise as a leading bancassurer at home and in the Czech Republic. The group has successfully put the crisis years behind them. State aid has been fully repaid ahead of schedule and the group's overall risk profile has materially declined with the disposal of legacy activities. Further, asset quality continues to steadily recover supported by improving macro conditions in Ireland. Solvency has strengthened to solid levels and the group's liquidity position remains sound.

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Summary terms

Issuer	KBC Bank NV
Issue Date	January 2013
Amount	USD 1bn
Coupon	• 8% fixed until call date, reset thereafter • Payable semi-annually in arrears
Format	Contingent capital securities due 25 January 2023, callable 25 January 2018
ISIN	BE6248510610

Capital Treatment	Tier 2
Principal Loss Absorption	• Upon trigger event, the full principal amount of the securities will automatically be written down to zero and there will be no payment of accrued interest • Subject to determination by the regulator, all or part of the principal amount of the securities, including accrued interest, may be written off or converted into common equity or otherwise be applied to absorb losses
Trigger for Principal Loss Absorption	Consolidated group CET1 < 7% on transitional basis

Source: Prospectus, Scope Ratings

Key risk: principal loss absorption

The principal amount of the security will be permanently written down when KBC Group's consolidated CET1 ratio breaches the 7% trigger (on a transitional basis). The CET1 ratio which will be used to determine whether the trigger has been breached will take into account KBC Group's insurance business through the computation of RWAs, rather than through deductions (i.e. the Danish compromise). In addition, the securities may also be subject to write-down or conversion subject to determination by the regulator.

Distance to trigger

As of 31 March 2016, KBC Group's transitional CET1 ratio under the Danish compromise was 14.6%, compared to the trigger level of 7% on a transitional basis in the security. Therefore, the distance to trigger was over 7% or EUR 6.8bn (based on RWAs of EUR 89bn). In light of the group's minimum CET1 requirements (SREP plus national buffer), we expect the group to remain comfortably positioned against the trigger level.

Table 1: Distance to trigger

	2015	2016	2017	2018	2019
Trigger level	7.0%	7.0%	7.0%	7.0%	7.0%
KBC Group CET1	14.9%	14.6% (1Q16)			
Gap (%)	7.9%	7.6%			
Gap (EUR bn) [1]	6.9	6.8			

Note: 1. Based on RWAs of EUR 87bn at end-2015 and RWAs of EUR 89bn at end-March 2016.
Source: Company data, Scope Ratings

Other outstanding capital instruments

Within the group, we note that KBC Group NV has issued EUR 1.4bn in AT1 securities while the above Tier 2 securities were issued by KBC Bank NV. There is some uncertainty about how the two securities would be treated when the group is under financial stress and needs additional capital:

The 7% trigger on the Tier 2 security is higher than the 5.125% trigger on the AT1 security, with both triggers being measured against the consolidated CET1 ratio of the group.

However, the AT1 security is issued by KBC Group NV, a holding company, while the Tier 2 security is issued by the operating company KBC Bank NV. Therefore, the AT1 security is structurally subordinated.

We further note that the Tier 2 security is callable in January 2018 and the group has said that it expects legacy Tier 2 issued by KBC Bank to disappear over time. Recent capital issuance (AT1 and Tier 2) has been at group level and this will continue in the future.

Regulatory Disclosures

Information pursuant to Regulation (EC) No 1060/2009 on credit rating agencies, as amended by Regulations (EU) No. 513/2011 and (EU) No. 462/2013

Responsibility

The party responsible for the dissemination of the financial analysis is Scope Ratings AG, Berlin, District Court for Berlin (Charlottenburg) HRB 161306 B, Executive Board: Torsten Hinrichs (CEO), Dr. Stefan Bund and Dr. Sven Janssen.

The rating analysis has been prepared by Pauline Lambert, Executive Director

Responsible for approving the rating: Sam Theodore, Managing Director

The rating concerns a newly-issued financial instrument which was evaluated for the first time by Scope Ratings AG.

The rating outlook indicates the most likely direction of the rating if the rating were to change within the next 12 to 18 months. A rating change is, however, not automatically ensured.

Information on interests and conflicts of interest

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Key sources of Information for the rating

Website of the rated entity/issuer, Annual reports/quarterly reports of the rated entity/issuer, Current performance record, Data provided by external data providers, Other public information.

Scope Ratings considers the quality of the available information on the evaluated company to be satisfactory. Scope ensured as far as possible that the sources are reliable before drawing upon them, but did not verify each item of information specified in the sources independently.

Examination of the rating by the rated entity prior to publication

Prior to publication, the rated entity was given the opportunity to examine the rating and the rating drivers, including the principal grounds on which the credit rating or rating outlook is based. The rated entity was subsequently provided with at least one full working day, to point out any factual errors, or to appeal the rating decision and deliver additional material information. Following that examination, the rating was not modified.

Methodology

The methodologies applicable for this rating “Bank Rating Methodology” (May 2015) & “Bank Capital Instruments Rating Methodology” (July 2015) are available on www.scoperatings.com. The historical default rates of Scope Ratings can be viewed on the central platform (CEREP) of the European Securities and Markets Authority (ESMA): http://cerep.esma.europa.eu/cerep-web/statistics/defaults.xhtml. A comprehensive clarification of Scope’s credit rating, definitions of rating symbols and further information on the analysis components of a rating can be found in the documents on methodologies on the rating agency’s website.

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