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Research Update:

Belgian Bank Belfius Affirmed At 'A-'; Subordinated Debt Raised One Notch On Strengthened Balance Sheet; Outlook Stable

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Overview

- Belfius Bank has strengthened its business and financial profiles over recent years, and we therefore anticipate that the group's creditworthiness will remain supported by strong capitalization to cover its existing risks, even if it were to be partially privatized.
- We are raising our ratings on Belfius Bank's subordinated and hybrid capital instruments by one notch because of the bank's improved unsupported group credit profile, that is the group's creditworthiness before any additional loss absorbing capacity support.
- We are affirming our 'A-/A-2' long- and short-term ratings on Belfius, and on its senior unsecured debt.
- Our outlook remains stable, as we anticipate the bank will pursue its moderate growth strategy and strengthen its currently modest profitability, while maintaining a high level of capital and comfortable liquidity.

Rating Action

On Oct. 26, 2018, S&P Global Ratings affirmed its 'A-/A-2' long- and short-term issuer credit ratings on Belfius Bank. The outlook remains stable.

In line with our improved view of Belfius' stand-alone creditworthiness, we raised the ratings on all senior subordinated and subordinated debt, and hybrid capital instruments, issued or guaranteed by Belfius Bank (see Ratings List).

Rationale

Belfius Bank has achieved a steady improvement of its business and financial profiles over recent years, enhancing its capital base, gradually recovering its franchise in Belgium, and growing synergies between banking and insurance activities, while actively managing legacy risks stemming from the Dexia era.

Our revision of the unsupported group credit profile (UGCP) to 'a-' from 'bbb+' reflects our view of improved capitalization. The group's S&P Global Ratings risk-adjusted capital (RAC) ratio improved to just above our 10%

threshold for a strong assessment of capital at year-end 2017, and we now expect the bank to at least maintain its current position over the next two years. We previously assessed capital as only adequate because of our doubts about capital sustainability at this level, in part because the bank had already achieved its target in terms of the regulatory capital ratio, but also because of the uncertain amount of an eventual extraordinary dividend before the bank is partially privatized.

We have always considered that Belfius will gradually return to private ownership. We understand partial privatization was contemplated in recent months but postponed because market conditions were not favorable and because of persistent uncertainties with regards to the possible resolution of ongoing litigation linked to the Dexia era (the Arco file). We still include in our projections that a partial IPO will take place but not before a new government is formed after the 2019 federal elections in Belgium. Our base-case scenario is now that capitalization will remain at least at current levels even if an extraordinary dividend were paid in the context of an IPO. This is based on our reassessment of Belfius' future growth of risk-weighted assets (RWA)--which we anticipate as lower than in our previous projections--and the absolute capital base needed to meet Belfius' current 15.5% regulatory CET1 ratio target under the Basel framework.

Under our revised base-case scenario, we make the following assumptions for the next two years:

- Annual growth of the bank's RWA under our methodology of 2%-3%, stemming mainly from the growth of the commercial lending portfolio and the increasing weight of the corporate loan book. We also take into account that the public sector loan book would decrease, and that securities in the run-off book will grant additional RWA relief for the coming years.
- Annual net income of €650 million-€725 million, on the back of stable interest margins, improving commission income thanks to increased off-balance sheet savings and insurance businesses, contained cost of risk (high single digits in basis points), and improving efficiency.
- Inclusion in total adjusted capital of the €500 million additional tier 1 (AT1) instrument issued in January 2018 qualifying for an intermediate equity content.
- A stable dividend payout of 60% in our projections, which is line with that paid on 2017 results.
- A potential extraordinary dividend if the partial IPO were to take place in the next two years, as the bank's solvency ratios are already above the 15.5% target set by management. We acknowledge that Belfius will strengthen its RAC ratio in the meantime, and could sustain this level if no extraordinary dividend were distributed.

We therefore believe that the enhanced capital position adequately covers the bank's risks, in particular the concentration in a single competitive and mature market and the legacy tail risks from the run-off portfolios. The steps taken by the company to de-risk its balance-sheet after Dexia's collapse also support our decision, as does the strengthening of its franchise. For instance, the group is regaining market share in the corporate sector and maintaining shares of other asset classes while keeping stable margins, while it is gradually reaping profit from its bancassurance model and increasing assets under management, although starting from a relatively low base. Nevertheless, we view profitability as lagging behind peers' due to the high share of public sector in its lending book, which has a safer risk profile but generates lower yield. We don't anticipate Belfius will close the gap with best performing peers, but we expect it will show progress thanks to higher recurring revenues and the rising contribution of insurance, with costs remaining under control.

The improvement in our assessment of Belfius' stand-alone creditworthiness translates into a raising of our ratings on its subordinated debt and hybrid capital instruments by one notch.

The issuer credit rating remains at 'A-' as we no longer factor in any additional loss-absorption capacity (ALAC) support. This is because we believe Belfius no longer has a sufficient cushion of ALAC to protect senior creditors. We estimate that its ALAC buffer will stand between 3% and 3.5% in the next two years, hence short of the 5% threshold for a one-notch uplift. We include in this calculation the bank's excess capital above the 10% RAC ratio mark, and hybrid capital instruments that have capacity to absorb losses without triggering a default on senior obligations, such as the Tier 2 and senior nonpreferred instruments. At this time, we do not factor in any further issuance in our projections because the bank has communicated that it already complies with the minimum requirement of eligible liabilities set by the EU Single Resolution Board.

Outlook

The stable outlook on Belfius reflects our view that, over the next two years, the bank will continue benefitting from its combination of banking and insurance activities, improve its profitability, and maintain prudent capital and liquidity policies irrespective of the ownership structure.

We could consider raising the ratings if Belfius' ALAC buffer increased substantially, above 5.0%. However, an upgrade would also be subject to the bank further aligning its risk-adjusted profitability profile with that of 'A' rated peers.

We see a downgrade as remote in the next two years. Nevertheless, we could lower our ratings if we were to observe increasing economic imbalances or credit risk in Belgium, notably in the real estate sector or small and midsize enterprises, given the bank's pure domestic focus. We will also monitor to what extent an IPO could alter Belfius' business and financial strategies, whose conservative nature has supported the ratings so far.

Ratings Score Snapshot

	To	From
Issuer Credit Rating	A-/Stable/A-2	A-/Stable/A-2
SACP	a-	bbb+
Anchor	a-	a-
Business Position	Adequate (0)	Adequate (0)
Capital and Earnings	Strong (+1)	Adequate (0)
Risk Position	Moderate (-1)	Moderate (-1)
Funding and Liquidity	Average (0) Adequate	Average (0) Adequate
Support	(0)	(+1)
ALAC Support	(0)	(+1)
GRE Support	(0)	(0)
Group Support	(0)	(0)
Sovereign Support	(0)	(0)
Additional Factors	(0)	(0)

Related Criteria

- Criteria - Financial Institutions - General: Methodology For Assigning Financial Institution Resolution Counterparty Ratings, April 19, 2018
- Criteria - Financial Institutions - General: Risk-Adjusted Capital Framework Methodology, July 20, 2017
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings , April 7, 2017
- General Criteria: Guarantee Criteria, Oct. 21, 2016
- 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: Banks: Rating Methodology And Assumptions, Nov. 9, 2011
- Criteria - Financial Institutions - Banks: Banking Industry Country Risk Assessment Methodology And Assumptions, Nov. 9, 2011

- 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

Belfius Bank SA/NV	
Issuer Credit Rating	A-/Stable/A-2
Certificate Of Deposit	A-/A-2
Resolution Counterparty Rating	A/--/A-1
Senior Unsecured	A-
Certificate Of Deposit	A-
Certificate Of Deposit	A-2
Belfius Financing Co.	
Commercial Paper	A-2
Dexia Secured Funding Belgium N.V.	
Senior Secured	A-

Upgraded

	To	From
Belfius Bank SA/NV		
Senior Subordinated	BBB+	BBB
Subordinated	BBB	BBB-
Junior Subordinated	BBB-	BB+
Junior Subordinated (Deeply Subordinated AT1)	BB+	BB
Belfius Financing Co.		
Junior Subordinated	BBB-	BB+

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.capitaliq.com. All ratings affected by this rating action can be found on 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.