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Research Update:

ABN AMRO Bank N.V. Outlook Revised To Negative On Weaker Expected Earnings Amid COVID-19 Outbreak; Ratings Affirmed

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S&PGR Revises ABN AMRO Bank Outlook To Negative

PRIMARY CREDIT ANALYST

Nicolas Hardy
Paris
(33) 1-4420-7318
nicolas.hardy
@spglobal.com

SECONDARY CONTACTS

Sylvie Dalmaz, PhD
Paris
(33) 1-4420-6682
sylvie.dalmaz
@spglobal.com

Philippe Raposo
Paris
(33) 1-4420-7377
philippe.raposo
@spglobal.com

Pierre Gautier
Paris
(33) 1-4420-6711
pierre.gautier
@spglobal.com

Overview

- Dutch-based ABN AMRO Bank N.V. announced in late March 2020, amid intense market volatility, that it will book about €180 million in net loss related to its usually low-risk clearing activities as part of its first-quarter results.
- We also expect the bank's impairment charges to rise in 2020 due to its exposure to some cyclical corporate sectors, and other sectors, which are under more stress due to the COVID-19 pandemic.
- This comes at a time where ABN AMRO is engaged in a vast and costly overhaul of its customer due diligence processes, and subject to an investigation from the Dutch public prosecutor, with an uncertain outcome that could mean a fine.
- We believe this combination of events will likely erode the bank's earnings and affect its relatively robust financial profile, so we are revising the outlook on ABN AMRO to negative from stable.
- We are also affirming our 'A/A-1' long- and short-term issuer credit ratings on the bank.

Rating Action

On April 9, 2020, S&P Global Ratings revised its outlook on Dutch-based ABN AMRO Bank to negative from stable. At the same time, S&P Global Ratings affirmed its 'A/A-1' long- and short-term issuer credit ratings on the bank. Our issue ratings on debt instruments are unchanged.

Rationale

The outlook revision reflects S&P Global Ratings' views that ABN AMRO's robust financial profile, notably earnings and capital, will likely be eroded by bank-specific and systemic events, amid the COVID-19 pandemic and ensuing capital markets and economic challenges. We expect the bank's asset quality to deteriorate, given the more adverse operating environment. We also take into account the unexpected one-off loss related to the clearing business announced in late March 2020. In addition, ABN AMRO continues to face heightened challenges to preserve its credit standing, and is coping with existing high priorities, namely the overhaul of its customer due diligence systems.

Macroeconomic forecasts are rapidly changing. Under our base-case scenario, the eurozone economy will face a GDP contraction of 2% for 2020, and 1.7% for the Netherlands, both forecasts being subject to downside risks. The recovery that we expect to start in the second half of 2020, at the earliest, will take time, as job losses and weaker business sentiment will slow the return to previous levels of consumption, investment, and trade in the region. The size and kind of policy responses countries take now are key to avoiding permanent economic damage later (for more information, see "COVID-19: The Steepening Cost To The Eurozone And U.K. Economies," published March 26, 2020, on RatingsDirect), but we believe the Netherlands has sufficient fiscal flexibility to provide appropriate relief.

ABN AMRO believes that the part of its lending portfolio the most exposed to COVID-19 represents about 10% of its total exposure at default at year-end 2019, or about €39 billion. It relates to borrowers active in the transport and logistics, manufacturing, oil and gas, travel and leisure, and retail sectors. After years of unsustainably low cost of risk, even positive contributions to income statement in 2017 because of provision reversals, cost of risk started to normalize in 2018-2019. ABN AMRO already publicly announced that it expects first-quarter 2020 cost of risk to be materially higher than its through-the-cycle cost of risk range of 25-30 basis points.

Lending to international corporates has been a strategic objective to increase the bank's business diversification and the bank has a strong franchise in this segment in the Benelux region. ABN AMRO turned to a more selective approach in recent years with an orderly de-risking roadmap in some cyclical sectors, including those now more immediately exposed to the COVID-19 outbreak. But despite this proactive reduction in exposures, we expect higher credit losses to emanate from this book. The majority of the bank's customer loans relates to historically low risk mortgage loans in the Netherlands, a book we expect to continue to perform strongly even during a recession.

Due to the extreme volatility of the financial markets at the end of March 2020, ABN AMRO announced that it closed the positions of one of its clearing clients in the U.S., triggering a US$250 million pretax loss (€183 million net). We understand the counterparty, active in trading U.S. options and futures, failed to meet minimum risk and margin requirements following exceptional market volatility. The bank decided to close out the position to prevent further losses.

This tail-risk event in a traditionally low-risk business activity, with a good track record of both operational and credit risk management, brings into question ABN AMRO's risk tolerance framework. We understand the bank has taken measures and is further reviewing actions in this area. With the combined effects of the one-off credit event linked to the clearing business and the expected deteriorating cost of risk, ABN AMRO already announced that it expects to report a loss for first-quarter 2020.

Positively, the bank displayed otherwise sound credit metrics and prudent capital management, allowing it to enter this period with a strengthened balance sheet. In particular, it strengthened its

CET1 ratio (18.1% at year-end 2019) to accommodate changes to the Basel framework, and an estimated 25% risk-weighted asset inflation. However, ABN AMRO's profitability was down at year-end 2019 compared with a year before, due to lower interest income and lower other operating income in CIB and private banking. Cost-saving initiatives mitigated additional project costs due to ongoing remediation plans for the compliance and "know your customer" investigations the bank is under. The bank will likely reconsider some financial targets: the reported 61.2% cost-to-income ratio for 2019 stood above its 56%-58% cost to income target; its 10% reported return on equity (RoE), although well above that of many European peers, was just within its own target of 10%-13%. According to our metrics, and current baseline scenario for the eurozone, we expect RoE to be closer to 7-8% in 2020, and a rebound in 2021 will likely depend on the economic slowdown's duration. We expect risk-adjusted capital to remain above 10% in the next two years as well. The still-good, although under some pressure, profitability and strong capital explains our views to affirm the rating, while recognizing that the longer the crisis, the tougher the impact on the loan book.

The Dutch government remains the majority owner of ABN AMRO. Its stake has decreased gradually since the IPO in 2015, whenever capital market conditions were supportive, which is no longer the case. We continue to believe that the gradual return to the private sector is neutral for the rating, because it does not have a material effect on the bank's risk appetite or business strategy, given that it already operates fully on commercial terms. ABN AMRO has high systemic importance in the Netherlands, mainly reflecting its material market share in retail deposits. Still, we regard the prospect of extraordinary government support for Dutch banks as uncertain in view of the country's well-advanced and effective resolution regime. We include in our ratings a notch of additional loss absorption capacity, above the 'a-' group stand-alone credit profile (SACP) to factor in the sizable buffer of MREL-eligible debt issued by the bank, protecting senior creditors in resolution. This buffer was mainly made of tier 2 instruments until January 2020, when ABN AMRO closed an inaugural €1.25 billion senior nonpreferred debt issue. We expect this diversification strategy to continue.

Outlook

The negative outlook on ABN AMRO Bank reflects our views that the bank's earnings are under rising pressure due to heightened risks in its lending portfolio, and other business areas sensitive to financial market volatility, and ongoing costs to remedy the compliance and know-your-customer case. Some of these risks are common to peers in Europe, but others are more bank-specific, notably exposures to cyclical sectors and risk tolerance in the clearing business.

We would consider lowering the rating if the recession proves longer and weakens the bank's asset quality for more time than we expect, with credit losses remaining durably high, beyond 2020. Downward pressure could come as well from the emergence of operational or conduct/reputational issues.

We would revise the outlook to stable if ABN AMRO manages to contain credit risk stemming from its exposure to cyclical corporate sectors and other customer lending areas, while preserving its core franchise and a sound risk profile in other segments like private banking, asset management, and clearing activities.

Ratings Score Snapshot

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

Related Criteria

- General Criteria: Hybrid Capital: Methodology And Assumptions, July 1, 2019
- General Criteria: Group Rating Methodology, July 1, 2019
- 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
- General Criteria: Principles For Rating Debt Issues Based On Imputed Promises, Dec. 19, 2014
- 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

Ratings List

Ratings Affirmed; Outlook Action

	To	From
ABN AMRO Bank N.V.		
Issuer Credit Rating	A/Negative/A-1	A/Stable/A-1
Ratings Affirmed		
Resolution Counterparty Rating	A+/--/A-1	
Senior Unsecured	A	
Senior Subordinated	BBB+	
Subordinated	BBB	
Junior Subordinated	BBB-	
Junior Subordinated	BB+	
Commercial Paper	A-1	
Certificate Of Deposit	A/A-1	
ABN AMRO Funding USA LLC		
Commercial Paper	A-1	