Q3 2018 Analyst Call Transcript

ABN AMRO Investor Relations
Wednesday, 7 November 2018
11:00 CET

Participants: **Kees van Dijkhuizen:** , CEO; **Clifford Abrahams**, CFO; **Tanja Cuppen**, CRO; **Dies Donker**, head of Investor Relations

Conference call replay:
https://channel.royalcast.com/abnamroinvestors/#!/abnamroinvestors/20181107_1

Kees van Dijkhuizen: Good morning everybody and welcome to the investor and analyst call for ABN AMRO's Q3 results. I am joined here by Clifford Abrahams, our CFO, and Tanja Cuppen, our CRO.
This update is shorter than our usual quarterly presentation because next week we are hosting our Investor Day. So today, we will focus on the Q3 financial results.

On slide 2 I will highlight the main points of the third quarter. I am pleased with our financial results for the third quarter. They were good. Our net profit was EUR 725 million. Our NII increased, supported by corporate loan growth in our strong domestic market. Costs are well controlled and impairments continue to trend down. Our capital position strengthened further to 18.6% and as a result we decided to accrue 60% of the year-to-date net result to create flexibility to pay additional dividends over 2018.

I am also very pleased with our performance under 2018 EBA stress test, showing strong capital resilience under adverse circumstances.

We also scored well in RobecoSAM's annual sustainability review and we are one of the best performing banks in sustainability across the world again.

We have renewed our purpose in banking for better, for generations to come and refreshed our strategy. We will focus on three pillars: supporting our clients' transition to sustainability, reinventing the customer experience, and building a future-proof bank. We will discuss these strategic themes in more detail during our Investor Day next week. Furthermore, the members of the Executive Committee will give an update on achievements and outlook for their businesses.

Slide 3, like I said, we are pleased with the third quarter result and the net profit of EUR 725 million, up 8% on last year. The operating income increase on the back of higher NII and private equity gains. Operating expenses were marginally higher.

It is also good to see that impairments are lower compared to previous quarters. Tanja will discuss these in more detail later.

Now, I would like to hand over to Clifford to take you through the details on the financials.

Clifford Abrahams: Thank you, Kees. I will start with the development in client lending on slide 4.

The trends we see in the mortgage market are that house prices continue to rise, but with lower transactions volumes due to a housing shortage. We also see that long-dated mortgages remain the most popular choice, given the low interest rate environment and competition from banks and non-banks is still strong.

Because we remain disciplined in pricing, we have seen a decrease in our market share to 16% over the last quarter and 18% year to date. This is below our natural market share.

On the other hand, commercial banking continues to grow, driven by the strong Dutch economy leading to credit demand across all sectors.

CIB loan book showed a small increase. That is our corporate and warrants an explanation. We announced in August that CIB would lower its RWAs by EUR 5 billion by 2020. We also said that the decline would not be linear and you can see that this quarter. The dollar appreciation was responsible for our 0.1 billion increase, while loans in the Netherlands and natural resources also showed an increase. On the other hand, volumes in commodities and transportation were lower, reflecting our business refocus. We expect the effects of the CIB refocus to be more evident in coming quarters.

Finally, we are encouraged by the increasing consumer loans, given our efforts to grow steadily in this market.

NII (slide 5) was up versus Q3 last year, mainly due to corporate loan growth and higher mortgage penalty fees. Margins remained broadly stable across products, compared to Q3 last year. These effects were partly offset by headwinds from low interest rates. Our income related to our equity duration is declining. We also lowered duration to better position ourselves for higher rates and margins on deposits were under pressure, as most client rates cannot be lowered further.

These headwinds led to marginally lower NII versus Q2 and we expect a further marginal decline for Q4.

We also updated our model for non-maturing deposits. This has led to lower internal compensation for deposits raised by our business lines, lowering NII for business segments with a consumer deposit base and benefitting Group Functions.

From now on, interest income of Group Functions will be distributed to the business lines, in line with our allocated equity. The combined effect of all this had led to some intragroup shifts in NII and the numbers you can see relating to this are in the appendix to this presentation. I would emphasize that the overall impact for the group is limited to only around EUR 10 million additional hedging costs per quarter, from the rebalancing we have made to our interest rate exposure.

Next slide, the third quarter fee income was largely unchanged from previous quarters. Trading volumes in the financial markets were relatively low, negatively impacting fee income and clearing. Securities volumes in Private Banking were also somewhat lower. This was offset by an increase in payment package fees in Retail Banking.

Our other income has remained above trend. EUR 80 million of other income was due to hedge accounting and various other valuation accounting effects and private equity showed a strong gain of EUR 107 million in Q3. Currently, we are the sole investor in our private equity funds; we are in the process of exploring possibilities to enable external parties to participate in existing and new funds. I expect to update you regarding this in the coming weeks.

Let’s move on to costs on slide 7. As you can see from the left-hand chart, personnel expenses continued to trend down. FTEs have decreased another 500 since the last quarter and by 1,500 over the year. We took a restructuring provision of EUR 27 million in Q3 and expect to take a further provision in Q4.

Other expenses, excluding incidentals and levies, are up. This was due to somewhat higher external staffing and cost related to completed M&A activities within Private Banking. External staffing is up due to higher levels of temporary staffing and some regulatory projects currently underway.

On the right hand chart you see we are delivering on our cost saving programs. Since year end 2015, our cost saving initiatives reduced costs by EUR 640 million. As you know, we are targeting EUR 1 billion cost reduction including in relation to the corporate bank. So, we are well on track here.

I now hand over to Tanja to pick up impairments on slide 8.

Tanja Cuppen: Thank you, Clifford. I will update you on three topics that have your attention: loan impairments, conduct and the stress test.

Let me start with impairments. The third quarter showed a further decline. Within CIB some additional impairments were taken within natural resources on already impaired files, mainly offshore clients. In Commercial Banking, impairments were largely on existing shipping files. This quarter, we had a release in Healthcare and I do not expect substantial impairments here for the remainder of the year.

The lower coverage ratio is largely due to our write off of fully-provisioned Madoff files. I am still confident with the outlook we gave for full year impairment and expect to end below the through-the-cycle cost of risk of 25 to 30 basis points.

The indicators for the Dutch economy remain strong and the outlook remains positive. The defaulted portfolio continues to decline, though challenges remain in the sectors we have identified.

With regards to conduct, we are transparent with regulators and have an open dialogue. We have made significant investments in our transaction monitoring processes and systems, and continuously use actual cases to improve. We have also made significant investments in KYC over the last years. Our decision to divest offshore private banking activities was partly related to reduce our exposure to conduct risk. The Executive Committee is actively engaged in these topics.

Let me now move to the results of the EBA stress test on slide 9.

I am pleased with our recent EBA stress test results, where ABN AMRO performed really well. Under the adverse scenario our CET1 declines by around 270 basis points, reflecting the resilience of our capital position. This number compares favorably with the 48 banks in scope for this stress test. At 14.5% in the adverse scenario, the CET1-ratio remains above the 2018 SREP-requirement of 10.4%. The same applies to the leverage ratio, which remains above 4% in the adverse scenario.

Now, handing back to Kees.

Kees van Dijkhuizen: Thank you, Tanja.

As you can see on slide 10, CET1 is up to 18.6%, held by lower RWAs, something we also saw last quarter. I would like to point out that most of the drivers responsible for this decline of RWAs under Basel III do not improve Basel IV RWAs. For example, higher collateral values for residential and commercial mortgages lower Basel III RWAs but do not impact Basel IV RWAs. So, our Basel III CET1 has improved materially during 2018 but Basel IV CET1, excluding mitigations, remained broadly flat around 13%. Nevertheless, we have decided to accrue 60% of the total year-to-date result. This gives us the flexibility to pay an additional dividend over 2018. We prefer an additional dividend over a share buy-back.

Our final decision on the dividend pay-out will be made at the full year results in February of 2019, when we will also reflect on our SREP targets for 2019, which we expect by January 2019 at the latest. We want to know the SREP because ECB is currently formulating industry-wide guidance on provisioning backstops for non-performing loans. If these backstops turn out more stringent than accounting standards, this will lead to capital reductions or a higher SREP capital requirement. In addition, the leverage ratio requirement of 4% is, for the time being, also a constraint in the short term we have to deal with.

We will update you further on our Investor Day on capital management, returns and our Basel IV management response including mitigating.

Now moving on to our targets on slide 11. As you can see on this slide, we are well on our way to achieving our financial target for 2020. We have already for some time been consistently meeting three of the four targets being ROE, capital and dividend.

The cost/income ratio of the first three quarters also meets our target. However, the full year number will be impacted by seasonally higher regulatory levies in the fourth quarter. And already mentioned, we also expect some additional restructuring charges in Q4. So, here we still have some work to do to bring our C/I ratio structurally within the target range.

Before I go to Q and A, I would like to briefly recap the highlights on slide 12.

We delivered a good quarter with a strong net profit of EUR 725 million. NII remains resilient, helped by domestic corporate loan growth. Impairments show a further decrease from last quarters. Costs are well controlled.

We have focused on the Q3 results so far. As we have an Investor Day next week, I will most likely refer you to next week for questions on strategic themes and the outlook of the various businesses. Now, I would like to ask the operator to open the call for questions.

QUESTIONS AND ANSWERS

Pawel Dziedzic (Goldman Sachs): Good morning and thank you for the presentation. Two questions from me. The first is quite basic, I guess, and it goes back to your pay-out accrual. Can you help us understand how you decided on 60% for this quarter? Is it simply a figure that leaves your CET1 slightly above the upper end of your capital targets or is there perhaps more to it? Related to that, how flexible do you intend to be when you announce your final dividend recommendation, for example your guidance on Basel IV that including mitigation changes a little bit?

The second question is just on your mortgage market shares dropping. You mentioned that competition is ongoing but how should we think about your tactics here over the next couple of quarters? How long are you willing to see this market share erosion and at what point in time do you think you may need to adjust your pricing?

Kees van Dijkhuizen: Thank you very much. The pay-out accrual of 60% is a figure we have taken now into the figures, not so much because it is exactly leading to an 18.6% or something like that; it is just a percentage we feel comfortable with to accrue today. We are flexible in fact.

With respect to the market share in mortgages, of course we will look into this carefully but it is also important – we have seen that actually ten years ago when there was also a lot of competition in the mortgage area – to stay disciplined here, especially when you talk about 20-years and 30-years mortgages. As we swap the interest, you actually ‘lock in’ a margin for a long period and we do not want to have margins below hurdle. So, we will be disciplined here in our margin approach but of course we will watch it every quarter how we are exactly going to manoeuvre in the quarters.

Pawel Dziedzic: Thank you. Maybe just one follow up and then on leverage. You mentioned you still want to be above 4%; when do you expect to realise this 50 basis points uplift under CRR2 and does it impact the way you think about dividend payment when you announce the dividend early next year? Is this one of the things that you consider?

Kees van Dijkhuizen: The leverage ratio related to clearing is actually in the figures now for 2021, so that is late. There are negotiations at the moment going on in Brussels to open up a possibility for national regulators to early adapt but that is not done yet. So at the moment it is 2021.

Pawel Dziedzic: And would you be willing to drop below 4% in the meantime or should we see 4% as a real floor?

Kees van Dijkhuizen: I think the 4% is seen by regulators as a floor.

Pawel Dziedzic: Understood. Thank you very much.

Farquhar Murray (Autonomous): Good morning, ladies and gentlemen, just two questions if I may. Firstly, the impact from Basel IV seems to have increased by 100 basis points versus the indication we had at the end of 2017. Could we just decompose what drove that increase? I clearly understand that some of the risk migration we have seen in the year probably will not carry through to Basel IV but I do not think this can explain all the change there?

And then secondly, coming back on the Dutch mortgage margin: we seem to have some commentary towards positivity on margins there and obviously you seem to be losing market share to hold things flat but what exactly are you seeing in terms of margin trends in recent quarters by product? Also, what is your appetite with regards to the longer duration, particularly in terms of the split of production you' re are doing?

Clifford Abrahams: Farquhar, I think you are right to point out the approximate steps. We do have volatility in RWAs under Basel III particular quarter on quarter, but I will just explain the reason for the variance. There are a few things. We continue to refine our methodology regarding Basel IV and that was an element over the course of this year. The rules are not enacted yet; we need to make judgements and we continue to refine that. We have highlighted the credit quality improvements as one driver, so that flows straight through in Basel III. In Basel IV were using the floored standardised approach, so it does not directly impact that. Our data is also an element that we have been working on, improving what we know about our loan book and that flows to the benefit of Basel III.
Finally, on business mix. While our overall loan book is roughly flat through the year, our mix has changed a little bit to corporate. That has an impact because the capital intensity of some of the corporate businesses is really quite high under Basel IV. So, you put all that together and that drives that delta. So, while RWAs have come down under Basel III, they are sort of flattish under Basel IV and we are calling around 13%. So, it is a marginal increase but it is approximately 13%. So, a number of drivers.
We are working hard on a few things. One is business mix. As you know, in August we announced that we would reduce the size of our Corporate Bank. That will flow through and that will reverse some of the effects we have talked about through mix. We are also working on business response: across the business we are working very hard on Basel IV, including specific mitigations where we are working through the rules. So, it is not just the rules; we want to adapt the business to Basel IV. Combined with that effort we are feeling really quite comfortable with Basel IV. It is around 13%. We said we wanted to be 13.5% early in the phasing. We have some years to achieve that, so we do not consider Basel IV as a hard constraint in terms of running the business and thinking about our flexibility around additional distributions currently.

Kees talked about some of the other factors that we are reflecting on.

Kees van Dijkhuizen: Thank you, Clifford. With respect to Dutch mortgages I would say that the margins across the board are a bit under pressure for all the maturities. With respect to the longer durations, our market share is clearly lower there as I think banks in general. It is more for pension funds and insurance companies. Not a sweet spot. Especially there of course, these days, a lot of clients go there in the area of 20-30 years because they expect higher interest rates going forward and they would like to take an interested-fixed period of 20 to 30 years. As said, that is an area where our market share is lower compared to 5 and 10 years.

Farquhar Murray: Just a quick follow-on. Coming back to the three or four drivers you have identified for Basel IV, could you give us a sense of which is the most significant? Is it the refinement in methodology and can you be specific to what have changed there in particular? Does that pick up any change on the NHG-treatment?

Clifford Abrahams: I gave three elements and I would just highlight they are all meaningful in terms of accounting for that difference. On NHG, our current treatment in our estimate of around 13% includes the benefit of NHG. We see that as a sovereign guarantee and our planning is that this would transition into Basel IV. You highlight a theme here which is that we are making judgments about Basel IV although the rules – 200 pages – sound like a lot. We have to make judgments about how to apply them. Our peers are doing the same. We will continue to refine that. We think the best way of signalling financial flexibility remains through our Basel III target of 17.5% and 18.5%. We are a little bit above that today, so we are feeling well positioned on Basel III and comfortable on Basel IV but continuing to work hard on this. We will update on this further on our Investor Day next Friday.

Farquhar Murray: Great. Thank you.

Stefan Nedialkov (Citi): Good morning, I have a couple of questions. Just to continue on Basel IV versus Basel III, did the previous methodology include input floors and to what extent do input floors play a role in terms of Basel IV previous estimates and today's estimate?

Secondly, some banks have told us how much they can mitigate Basel IV. Are you comfortable giving us some guidance out of this 560 basis points or so of Basel IV impact? How much can you mitigate via management actions on day one versus over time?

Lastly, you mentioned the ECB industry-wide NPL coverage guidelines that are coming up. Are we talking about the 2-year unsecured 100% coverage, 7-years secured NPL coverage-type of guideline or do you have anything else in mind? Any color you can provide us in terms of numbers.

Clifford Abrahams: I will take the first two and Tanja the third. We are talking about the output floors, so the figures that we have provided are based on the output floor, so the revised standardised approach times the 72.5%. That is how we are thinking about it. They are the numbers that we quote. Clearly, other banks are influenced by other things but the output floors are the binding constraint for us. We work through the input floors but for our constraint IRB that is meaningfully lower than our capped standardised approach. So, that is why we are focused on that standardised approach as the constraint.

In terms our responses and mitigations, as others are we working hard on that. We expect that our mitigations would mitigate some of that RWA inflation and we will give more colour on that next week. We see there are a few elements around Basel IV, so we call it 'business response'. The mitigations are working through the rules and the application, thinking about our products, but I call that 'behind the scenes work' and we think there is scope for that, as others have commented on. We call it business response, which is how we are managing our business in terms of the mix of business, can we distribute more? We have announced a material step in that direction in August. That is separate. Finally, pricing. Mitigations is around can we reduce our Basel IV RWA? I think we can meaningfully but a lot of our work now is thinking about how to deliver adequate ROE on all our business going forward. Across that, we will update you and give further insight in our thinking next week.

Tanja Cuppen: I will respond your question on the NPL guidance. It is indeed the guidance related to the percentages you just mentioned. We see a few developments in this area. The ECB has come with NPL guidance and EBA has sent out a proposal and also the European Commission is working on regulation for non-performing loans. So, we see quite some developments but it is still uncertain how all this will pan out. We see that regulators are developing their regulatory expectations. Of course, the ECB guidance is already in place but that is applicable to new exposures. So, it is hard to say at this stage what the implications will be but we are preparing for that and doing our analysis.

Stefan Nedialkov: Thank you.

Nick Davey (Redburn): Good morning, everyone. I have two questions, please. The first is on the private equity business, first in terms of its contribution this year and second in terms of the comment you have made about seeking external funding. If I look at the first nine months of this year, the private equity business has contributed nearly 10% of earnings. It is almost needing its own division pretty soon. If I go back just a couple of years to 2016, it contributed basically nothing. So, could you just help us understand what is going on here and why the really strong results this year and maybe make some comments about how comfortable you are in terms of this unit, introducing this P&L volatility and, maybe related to that, just talk about this comment about seeking external funding? Are you trying to beef it up? Are you trying to reduce it by moving it to third parties, just to understand what is going on there, please?

Then a second question on the replicating portfolio. I am sorry it is a bit of a perennial question from this side. We obviously had a helpful update what you are doing with the non-maturing deposits but I am still struggling a little bit to understand the outlook here, because on the one hand on the NII slide you are talking about the headwinds from this replicating portfolio and on the other hand you are talking about now being better positioned into interest-rate rises. I am just trying to understand the attrition from this portfolio if rates stay low for as long as rates stay where they are and what you hope starts to happen as rates start to rise. I hope that is clear.

Kees van Dijkhuizen: Thanks, Nick. With respect to private equity, as you mention very good results this year and less in earlier years, it is also one of the reasons – it is quite cyclical – that we would like to also have external funding here from third parties. It is by the way also market practice; it is not new. We think that indeed it will lower a bit our private equity exposure when we have third parties in the private equity area and less cyclical movements as well. Clifford?

Clifford Abrahams: The replicating portfolio is complex area. I would say two things. We are exposed to low rates around the three themes. One is that it comes through the mortgage market, which Kees talked about, but the two things we are talking about here in this question are deposit margins and the money we make on our equity. Those are two different things. So, in terms of our deposit margins, as you said we recognise our margins via the replicating portfolio. That introduces a lag in terms of interest rates are coming down over time. So, if rates develop as expected there will be a natural feed-through into our replicating portfolio or in the way we think about margins, that will reduce margins moderately over time. We know what the forward market is saying about rates. Rates have consistently come down and that works its way through. So, our outlook has been some modest further deposit margin pressure over the next year or so and based on our view of interest rates – we expect those to pick up at the end of next year, the short rates. If rates pick up sooner or later you will get variance around that. But that is one effect. There is not a lot we can do about that other than lower the rates we pay to clients. We feel that has pretty much run its course.

The third thing you talked about is how we position ourselves to rate increases. That relates to the money we make on our equity, our equity duration. There we have shortened somewhat, less than two years, as disclosed at the half year. Our money is locked in for a shorter time period and as rates pick up, we should see the benefit of that. We will report it through Group Functions and then allocate it out to the businesses. I hope that gives a bit further clarity. We are happy to pick this up offline as well and we will touch on it next week at the Investor Day.

Nick Davey: That is really helpful, thank you. Could I just have one follow-up then, back on the private equity contributions which you are obviously trying to produce. Could you give us a sense of the capital tied up in the private equity operations currently and maybe the capital benefit you get from seeking third-party investments.

Clifford Abrahams: The total assets we have is just under one billion and there are different risk weights associated with that portfolio, so the RWAs are somewhat more than that. If we end up engaging with third-party money, I think at least in the short term you should see it as an opportunity to leverage the capability in the business more than a material reduction in RWAs, at least in the short term.

Nick Davey: Thank you. I am going to try my luck on the deposit margin pressure. I can see you are still avoiding giving us numbers, which I sympathize with. But if I interpret your language on modest for the deposit margin pressure over the next year or so, my suspicion is that you are running something like a 5-year swap book then and 5-year swap rates are in line with the rolling average of the last five years, which means for the next year or so the swaps you put on five years ago are reinvesting lower but at some point, in 12 to 18 months from now, you reach net neutral. Am I wide of the mark?

Clifford Abrahams: First, you are trying your luck, I agree with that! We have not disclosed deposit margins. I do not think any bank will do that. I think it is a bit less than five years and we will give a bit more colour but we do not want to give forecasts, for obvious reasons, on particular elements. But we have guided the effect of this in our historical remarks around ‘flattish NII’ and we have indicated early today what we see of Q4. We will give a bit more colour on that next week to help folks to understand it. It is really so that you are in a position to come up with your view of interest rate, because people have different views.

Nick Davey: Absolutely. Certainly, we have to make the forecast. Thank you very much!

Adrian Cighi (RBC Capital Markets): Hi there. I just have one follow-up question on capital. Your average risk weighted assets for mortgages increased marginally quarter on quarter. As you noted earlier, house prices have increased and the LTVs have declined. Is there any impact from TRIM or are there any other drivers? More broadly speaking, do you see any impact from TRIM coming through the numbers?

Tanja Cuppen: I will take that question. What came through in the Q3 numbers is a small move of portfolio from one to the other. That had some impact on RWAs, so I think there is no significant change there.
In terms of TRIM, we do see some impact there but it is also not material. The slight change that you see can be part of that because we are addressing the TRIM findings over time, but it is not significant.

Adrian Cighi: Thanks very much.

Benjamin Goy (Deutsche Bank): Good morning. I have two questions, please. One on loan growth and the other on fees. Maybe starting with fees, In particular in retail you saw an uplift. I am just wondering whether this repricing is basically a turnaround of what we have seen in 2017 and how sustainable you think it is. What are your assumptions about behavioural effects from clients?

My second question is on your commercial banking loan growth. It has slowed down further in the quarter. Do you expect some new trends here? In the past you said that growth was largely in line with GDP.

Clifford Abrahams: On fees I agree with your comment. We did reverse some of the fee reductions we took 18 months or so ago. We follow the market; we want to give our clients competitive products, so that we feel that it is in line. We have no plans to change that and no material impact on our client base. That was behind some of our comments earlier. We think we have rebased fees. There will continue to be volatility but we are looking to over time grow fees from here. On the commercial bank you are right. It was slower growth in Q3. I think there are a few drivers to that. The economy remains strong, so we are looking to support our clients into the growing economy, as Kees indicated. In parts of the market it can be quite competitive and we are very focused on maintaining our discipline, both on pricing and terms. So, we are looking at leverage finance, real estate, as particular areas of continuing discipline. Finally, the market is just a bit slower in Q3 where you have the lagged effect of the summer. So going forward, we are looking to continue to grow that book nicely but looking to remain cautious on particular segments as we get to the later stages of the credit cycle.

Benjamin Goy: Thank you.

Kirishanthan Vijayarajah (HSBC): Good morning. My first question is going back to the RWAs in CIB and the lack of progress there. Are you having any issues with the originate-to-distribute model, that you are finding it maybe harder to offload assets than you previously thought or do you need to build out your originate-to-distribute platform further to get the volume done?

My second question is just very quickly on the private equity and reducing your exposure there. I know you said 'short term' and 'not much RWA release' but when you look out to your overall RWA targets, am I right in thinking that this is additive to what you have earmarked, the 5 billion reduction? Is that additive to your plans from last quarter?

Clifford Abrahams: In terms of RWAs, we were pleased with the initial progress in Q2 that addressed the shorter-term business. We have made a good start there. Going forward, we wanted to bring this down over time, we do not want to disrupt our client franchises and we will do that through 2020. We have a pipe line of business. Business takes a while to run off, so there is no particular issue around the performance in Q3. In fact, in CIB it has gone up largely as a result of the operational risk, which has moved out of Group Functions, which Tanja referred to earlier. So, these are quite small movements. We are very much on track.
At originate-to-distribute we see great opportunity there. This will take place over a number of years, not quarters. We have distributed in the past but we are looking to build our capability meaningfully and our activity here. We will update further on that next Friday.

On private equity, as Kees said the business is cyclical. We have not committed to anything but intuitively we feel it is smart to lighten up what we think is towards the top of the market in terms of the asset cycle. And we will look to manage that portfolio in a smart way over time. We are not going to commit to dramatic reductions in RWAs but with third-party money we have much more flexibility to reduce our capital allocated in what we might think is a sort of riskier environment going forward. That will give us flexibility as we consider meeting our commitment of the 5 billion RWA reduction on the timescale I referred to earlier.

Kirishanthan Vijayarajah: Thanks.

Bruce Hamilton (Morgan Stanley): Good morning. Thanks for taking my questions. I have one just on the topic of private equity. You have had a few on this. You think you are pretty good at private equity and therefore, it is an area that will look to grow but with third-party money i.e. it is a kind of fee growth driver in the future. Or do you want to keep the capital intensity no more than a billion and hopefully a bit less over time, so there is no real plan to grow? I am just trying to make sure I fully understood that.

Then on the distribution guidance and just to get clarity. So, you are saying that 60% pay-out should be the base line now but anything above that will be heavily dependent on any progress on Basel mitigation, which we will learn about next week, or on the leverage ratio, both of which are a constraint for expecting anything more than that in the short term.

Clifford Abrahams: As you say, we are good at private equity, so we are exploring whether we can make that track record available to external parties as you say as a fee opportunity. We do not have plans to grow that business on our own balance sheet materially, because of the capital issues. I think we like the profit but we recognise it is cyclical. So, in order to better leverage that business whilst maintaining reasonable allocation from a balance sheet management perspective, we are exploring third-party money. So, we do not plan to materially grow the capital allocated to that business in terms of our on-balance sheet allocation.

Kees van Dijkhuizen: Thanks, Clifford. Bruce, on your 60% base line question, I would say that the 60% is of course a signal but it is not a promise. That means that we in the end will decide in Feb but of course it gives a kind of indication. It is a signal, that is true.

Bruce Hamilton (Morgan Stanley): Great. Thank you.

Marcell Houben (Crédit Suisse): Good morning. I have two questions left, please. One is on the capital discussion again. Could you discuss with us the capital build year to date this year on Basel IV? It seems to me that on Basel III you are building quite a significant amount of capital while on Basel IV it seems flattish.

My second question is on costs. Can you highlight any variable costs which were driven by the other income revenues there? Is there any variable compensation or variable costs that are associated with the higher other income?

Clifford Abrahams: On those questions, yes, you are right, the Basel IV position was flattish and that reflects the standardised approach with the floor. It is a very mechanical calculation. While business has not materially changed in three quarters you would not be surprised if the number was roughly the same. I have given the factors behind that delta with Basel III, including some minor methodology changes. So, what I would emphasize is that these are pro forma figures based on our view of the rules. We have not applied any mitigations to those numbers. We are very focused on how the business as a whole is responding to Basel IV and we will update you on that next week.

In terms of costs associated with other income, I think there are no specific variable costs. We have flagged what they were, a sort of hedging benefits, accounting effects and the private equity. We clearly have a cost base associated with private equity but it is fairly modest and largely fixed. Those gains reflect the benefit of deals entered into some years ago.

Marcell Houben: Thank you. I have just one follow-up on the leverage ratio, if I may. Again, if you are accruing roughly 60% of the year to date, of the profit, your leverage ratio does not seem to grow that much. Do you think the 60% is a ceiling then, regarding the pay-out ratio?

Clifford Abrahams: The leverage ratio is solid 4.1%. It is 4+ this year and it has been less than that. In early years we had the EBA Q&A, so that had been a constraint. The leverage ratio, as Kees said, remains an important constraint for us. It is not an economic one, but one that we manage to. I think the 60% accrual reflects our target capital and our various constraints. The two primary ones relate to the target capital range. With Basel III we are well placed. The leverage ratio, which remains a constraint. 4.1% is better than 4%, but it is a modest buffer. We have talked about how we see that progressing in the medium term. Basel IV, despite this volatility, we remain comfortable at around 13% with some years to meet our target early in the phase in. Hopefully, that gives you a sense of why, as Kees mentioned, we are comfortable accruing at 60% and giving ourselves flexibility for the end of the year.

Marcell Houben: Thank you, very helpful!

Maxence Le Gouvello Du Timat (Jefferies): Good morning. I have one last question for Tanja on the CIB cost of risk. Can you give a bit more colour on the dynamic into that part, because there seems to be some additional sides that are deteriorating and on the other side some write backs and also, what can we expect going forward?

Tanja Cuppen: Thank you for that question. You still see somewhat elevated impairments but a lot lower than in the first quarters of this year. It is also more evenly divided within the organisation, so in Corporate Banking between Commercial Banking and CIB. In CIB we mainly see still provisioning in the energy sector related to offshore. We see clients still either struggling with the recovery or missing out on contracts or being impacted in another way , indirectly from investments not happening in the offshore industry. That is what we see. We are very much on top of this sector and, as said, I am also confident with the outlook for the rest of the year to stay below these 25 to 30 basis points cost of risk. I also do not see any other developments in other sectors that cause concern right now in CIB.

Maxence Le Gouvello Du Timat: Okay. That means that you feel confident because you have a few files regarding Healthcare in the two last quarters and also regarding the offshore. Is it a specific part of the world or is the full sector?

Tanja Cuppen: I would say it is the full sector, so it is not related to a specific region.

Maxence Le Gouvello Du Timat: Thank you. See you next Friday!

Tanja Cuppen: Thank you.

Jason Kalamboussis (KBC): Hi there, I have three quick questions. The first is on the cost side. Looking at the fourth quarter you mentioned restructuring regulatory charges. Is there anything else or should we expect to continue to see the impact of the lower FTEs on the personnel expenses?

My second question is just checking on the diamonds: can you confirm that you basically comfortable that there is nothing coming from that end?

The third thing is on the SMEs and mid-corporates. You had good growth over the last four or five quarters but it slowed down a bit in Q3. What is the outlook and can you also comment on the market also more in general?

Clifford Abrahams: On costs, the answer is that there is nothing else than the two things you talked about.

Tanja Cuppen: On diamonds, we talked about it earlier in the year, because we have seen some additional provisions there. We continue to monitor this portfolio very closely. We also see the portfolio reducing over the years and that is all I can say at this stage.

Kees van Dijkhuizen: And with respect SME and Q3 I think indeed, as Clifford already mentioned, there is a bit of a summer effect and also margin discipline. Going forward, I would say that guidance is still in line with the Dutch economy.

Jason Kalamboussis: Thank you.

Kees van Dijkhuizen: As there are no more questions, I would like to thank you all for your questions. This concludes our Q3 results update. We hope to see you all in person next week at our Investor Day. Thank you and goodbye!

---End of call