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ISSUER IN-DEPTH

25 April 2019

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RATINGS

ABN AMRO Bank N.V.

Deposit/Senior unsecured	A1/A1
Outlooks	Stable
Subordinated debt	Baa2
Additional Tier 1	Ba1(hyb)
BCA	baa1

Contacts

Guillaume Lucien-Baugas +33.1.5330.3350
VP-Senior Analyst
guillaume.lucien-baugas@moodys.com

Victor Henimann +33.1.5330.3352
Associate Analyst
victor.henimann@moodys.com

Alain Laurin +33.1.5330.1059
Associate Managing Director
alain.laurin@moodys.com

Nick Hill +33.1.5330.1029
MD-Banking
nick.hill@moodys.com

ABN AMRO Bank N.V.

On solid ground with stable prospects

Summary

ABN AMRO Bank NV, the third largest bank in the Netherlands in terms of assets, reported solid financial fundamentals for 2018. Its loan quality is sound despite an increase in loan-loss provisioning, and capital and profitability are strong. ABN AMRO has improved and stabilised its financial base in recent years, but further significant progress will be hard to achieve.

The bank has met capital requirements and capital accretion will slow. ABN AMRO's Common Equity Tier 1 capital ratio exceeds peers, standing at 18.4% at year-end 2018, although its Tier 1 leverage ratio was lower at 4.2%. The bank is among those most affected by the “Basel IV” regulation, which will tighten rules governing the calculation of capital risk weights. The regulation will increase ABN AMRO's risk-weighted assets by 36%[1] from 2022. This translates into a four to five percentage point drop in its Common Equity Tier 1 (CET1) capital ratio. Even incorporating the Basel IV impact, the bank remains around its internal capital target of >13.5%[2]. We therefore expect that the bank could distribute a large share of its earnings and slow capital accretion, given that the loan book will not grow materially in 2019. Further capital headwinds would limit such distributions, however.

Profitability will remain sound, despite revenue pressure. Net interest margins have widened steadily over the past four years, climbing to 165 basis points (bps) in 2018 from 146 bps in 2015. This was a strong achievement compared to most European banks. Net interest margins will narrow in 2019, however, because interest paid on deposits cannot fall much further and increasing competition in the Dutch banking sector will weigh on margins of new loans. The loan book will not grow materially and revenues will therefore likely be under pressure. Cost-cutting will continue to support profitability, however. The bank has lowered its recurring operating costs by almost €700 million over the last three years and targets a further €300 million reduction (around 6% of 2018 operating expenses) by 2020.

Asset quality is solid, but further improvement will be limited. Loan impairment charges will remain low due to the bank's focus on the domestic Dutch market, where operating conditions are favourable. ABN AMRO's loan book is predominantly retail, a traditionally stable lending segment, with 55% made up of Dutch mortgage loans. A smaller 34% of loans are to business clients, which are generally more volatile. The bank's loan-loss provisioning rose to 24 bps of customer loans in 2018 from -2 bps in 2017 as a result of credit deterioration in the corporate and commercial loan book. Despite the bank's strategy to refocus its Corporate and Institutional Banking (CIB) division on less risky, non-cyclical sectors, we expect loan quality to remain volatile in this segment and impairment charges to remain above the lows seen in 2017.

With capital constraints satisfied, we expect earnings retention to decrease and capital accretion to slow

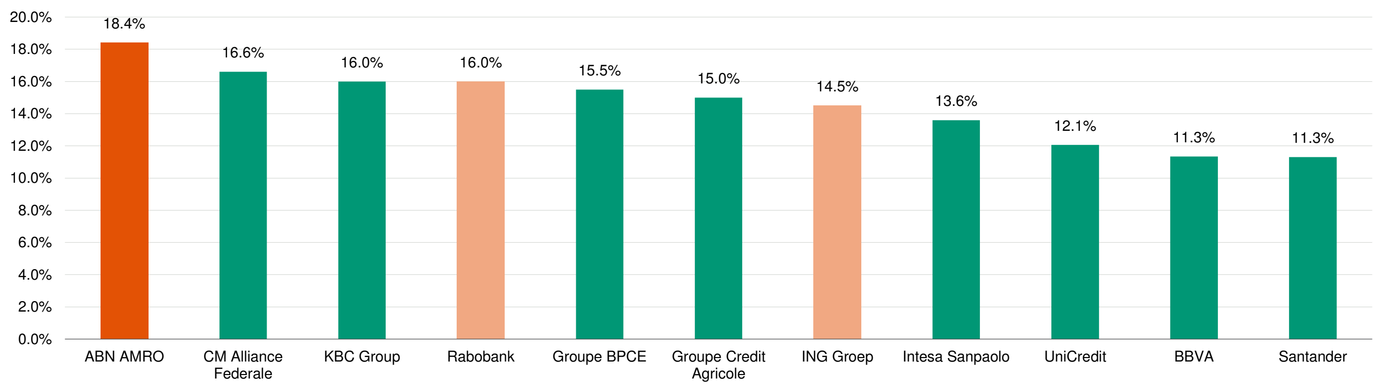
Risk-weighted capital appears strong but impact from Basel IV is among highest

ABN AMRO, the third largest Dutch bank with €381 billion of assets at year-end 2018, reported a fully-loaded Common Equity Tier 1 capital ratio (CET1 ratio) of 18.4% of risk-weighted assets (RWAs) at year-end 2018, a level than exceeds its main domestic and European peers (**Exhibit 1**). The ratio stands at the high end of the bank's public target of between 17.5% and 18.5% in 2018-2019 and is significantly above the minimum CET1 requirement (under SREP[3]) of 11.75%[4] for 2019 set by the European Central Bank.

Exhibit 1

ABN AMRO's CET1 capital ratio exceeds Dutch and European peers

Fully-loaded Common Equity Tier 1 ratios at year-end 2018



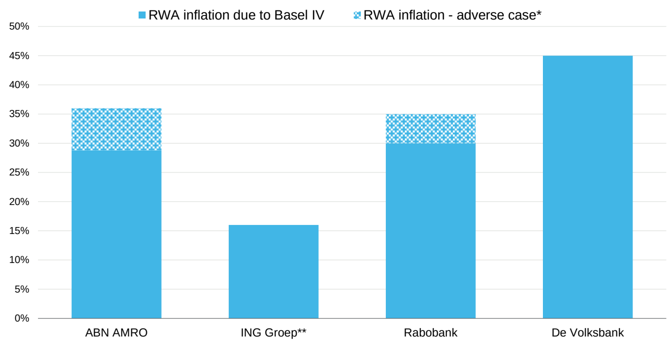
Note: Credit Mutuel Alliance Federale was previously known as Credit Mutuel-CM11.
Sources: company reports, Moody's Investors Service

The bank's ratio, however, needs to be viewed against the prospect of upcoming revised rules on capital. ABN AMRO is among the banks most affected by the so-called 'Basel IV' regulation[5]. From 2022, Basel IV will tighten rules governing regulatory risk-weighting calculations and any benefits stemming from the use of internal models for calculating the risk weights of assets will be capped. ABN AMRO estimates that full implementation of Basel IV will raise its RWAs by 36%[6]. This will correspond to a drop of between four and five percentage points in its CET1 ratio (**Exhibits 2 and 3**). The Basel IV impact takes ABN AMRO's capital to around its pro forma Basel IV early phase-in target of 13.5% CET1 ratio[7] and the bank has identified "mitigation measures" to reduce the impact of the new regulation to a RWA increase of 29% instead of 36%. This will leave the pro forma Basel IV CET1 ratio above 14%.

Exhibit 2

ABN AMRO is among those most affected by 'Basel IV' measures

Risk-weighted asset increase due to 'Basel IV' measures estimated at year-end 2018 (%)

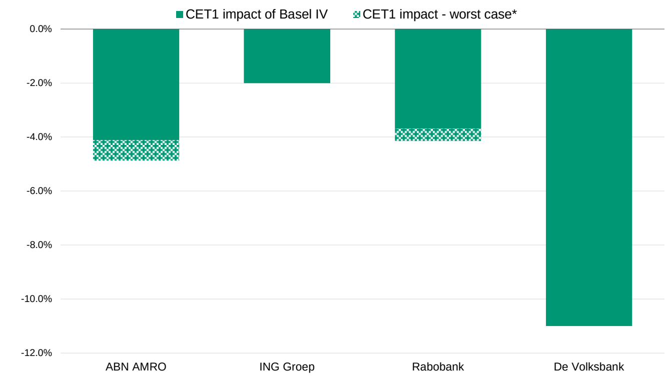


Notes: *Adverse case excludes mitigation measures taken by ABN AMRO and high end of range for Rabobank. ABN AMRO indicated RWA inflation of about 36% pre-mitigation and about 29% post mitigation. Rabobank gave a range of likely Basel IV impacts, on an indicative basis only. **ING Groep: RWA increase deduced from a two percentage point negative impact on capital disclosed by the bank at year-end 2018.
Sources: company reports, Moody's Investors Service

Exhibit 3

Capital erosion due to 'Basel IV' will be significant

CET1 ratio impacts due to 'Basel IV' measures estimated at year-end 2018 (%)



Note: * Worst case means pre-mitigation for ABN AMRO and high end of range for Rabobank.
Sources: company reports, Moody's Investors Service

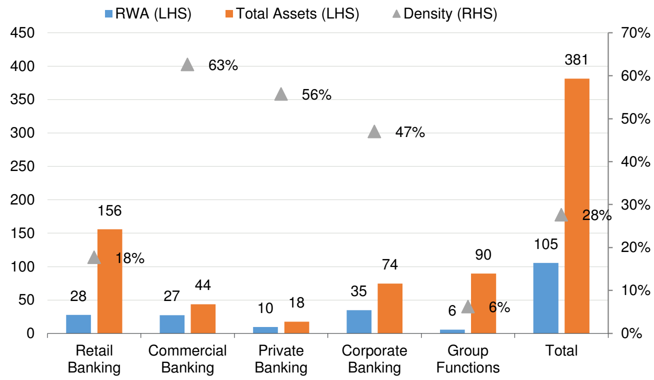
A high concentration of low risk-weighted residential mortgages and corporate loans exacerbates the impact of Basel IV

The significant impact of the Basel IV regulation on ABN AMRO's capital is largely driven by the low risk weights assigned to Dutch residential mortgages. These comprised 55% of ABN AMRO's loan book and 40% of its assets at the end of 2018. The average risk weight on mortgages for the calculation of the bank's regulatory capital ratios was just 11% in 2018[8]. The bank as a whole had RWAs of €105.4 billion at year-end 2018, implying an average risk weight of 28% of assets, a risk density which is low by European and indeed global standards (**Exhibit 4**).

With an eye on upcoming Basel IV measures and facing profitability constraints from persistently low interest rates, ABN AMRO has favoured maintaining strong commercial margins over lending growth. This strategy has been successful and is visible in the steady increase of net interest margins to 1.65% in 2018 from 1.46% in 2015. This is the most positive result among large Dutch banks and particularly impressive by European standards. The bank's loan book contracted by 1.4% in 2018 and we do not expect a material increase in lending volumes in 2019, particularly since economic growth in the Netherlands and in other parts of the European Union is slowing. Flat lending volumes will help the bank keep its risk-weighted assets under check, excluding the future Basel IV impact.

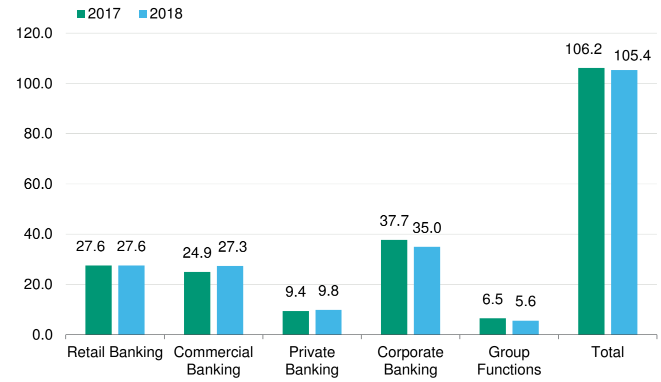
Alongside the Basel Committee's Basel IV regulation, the European Central Bank is separately reviewing the internal risk models used by euro-area banks. Known as the Targeted Review of Internal Models (TRIM), this review (as well as other model reviews) increased ABN AMRO's RWAs by €5 billion in the fourth quarter of 2018, and will likely continue to inflate RWAs in 2019. The impact, however, will not affect the Basel IV CET1 ratio and will be offset, at least partly, by the bank's current refocus of its Corporate and Institutional Banking division and other mitigation measures. Despite TRIM and other model reviews, the bank was able to lower its RWAs by around 1% in 2018 (**Exhibit 5**).

Exhibit 4
ABN AMRO's average RWA density of 28% is low by European standards
Assets, risk-weighted assets and density per business line at year-end 2018 (€ billion and %)



Sources: company reports, Moody's Investors Service

Exhibit 5
RWAs declined most in Corporate & Institutional Banking despite a €5 billion impact from TRIM and other internal risk model reviews
Evolution of risk-weighted assets per business line (2017-2018) in billions of euros

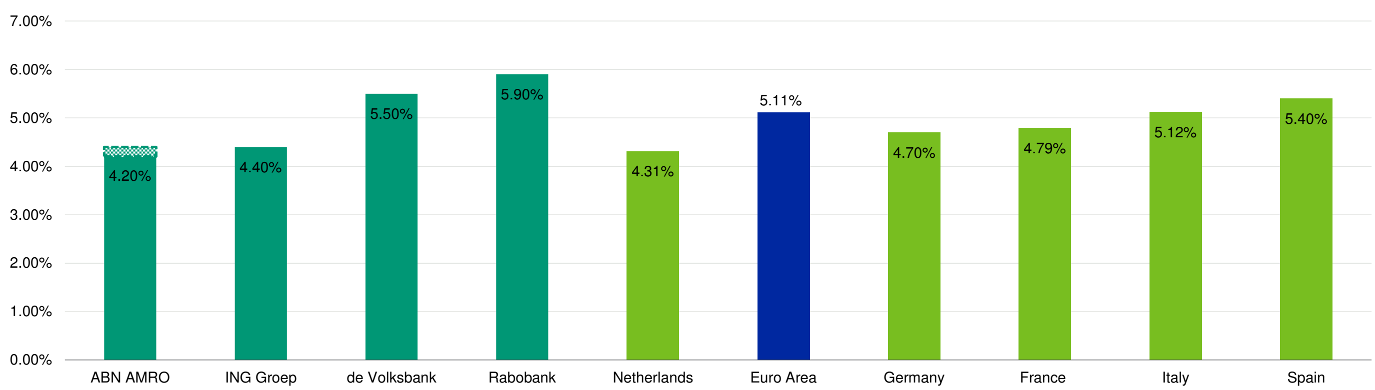


Sources: company reports, Moody's Investors Service

Tier 1 leverage ratio appears low, but no longer represents a significant constraint

ABN AMRO's Tier 1 leverage ratio remains relatively low at 4.2%, but it will increase to 4.4% with the approval and implementation of the legal merger of ABN AMRO Group N.V. and ABN AMRO Bank N.V[9], giving the bank more headroom above the 4% threshold set by the Dutch Ministry of Finance. Looking further ahead, the regulatory Tier 1 leverage ratio may increase by another 0.6 percentage points thanks to an expected exclusion of clearing guarantees from the denominator towards 2022 (**Exhibit 6**). Our tangible common equity (TCE) to tangible banking assets ratio, which is insensitive to regulatory treatments, was 5.6% at year-end 2018 and compared better with the equivalent ratios of ING Group and Rabobank at 5.6% and 6.5%, respectively.

Exhibit 6
ABN AMRO's Tier 1 leverage ratio will marginally improve thanks to the probable merger of ABN AMRO Group and ABN AMRO Bank.
Regulatory Tier 1 leverage ratios (%)



Notes: (1) ABN AMRO: 20 basis point gain with the merger of ABN AMRO Group and ABN AMRO Bank. (2) Figures as of year-end 2018 for the banks and Q3 2018 for countries and the euro area.
Sources: company data, Moody's Investors Service.

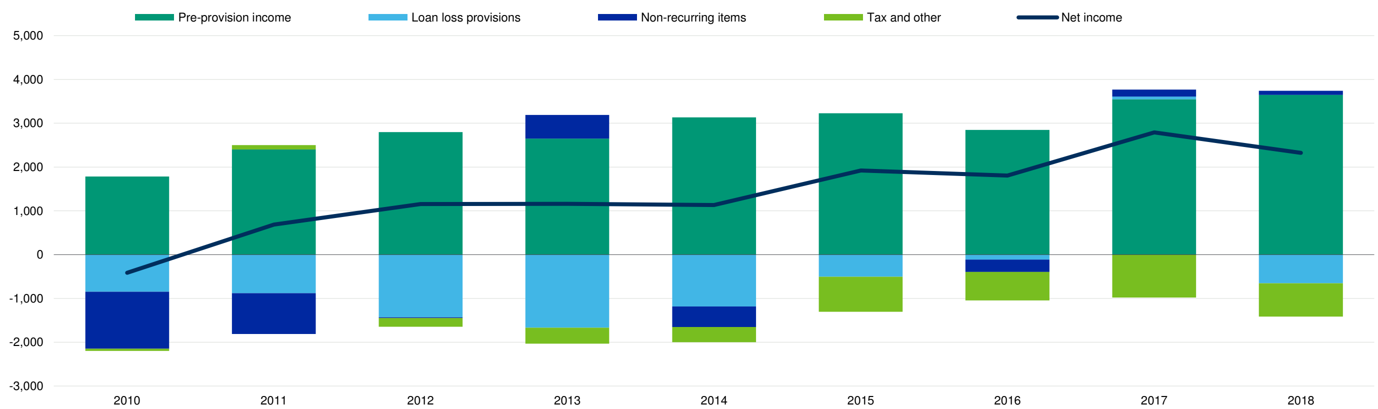
ABN AMRO retained a large portion of its earnings in recent years due to uncertainty about future capital requirements and its tight leverage position. Since future capital requirements have become clearer[10] and ABN AMRO has reached its Basel IV targets, the bank can return more capital to shareholders. As a result, its dividend payout ratio progressively increased to a planned 62% of 2018 earnings, from 40% of earnings in 2015. The bank is unlikely to embark upon share buybacks or exceptional dividends given the possibility of further European capital regulation. As such, capital ratios will remain solid despite likely lower capital retention.

Profitability will remain sound, despite revenue pressure

Despite broadly stable pre-provision income, net income fell due to higher impairment charges in 2018

ABN AMRO's net income declined by 17% to €2.3 billion in 2018. This material drop was primarily the result of a substantial increase in loan-loss provisioning charges (cost of risk)[11], which amounted to €655 million in 2018 versus a net release of €63 million in 2017 (**Exhibit 7**). The decline in net income was more severe at ABN AMRO than at other large Dutch banks. The aggregate bottom-line profit at the five largest Dutch banks fell 6% in 2018, largely because of ABN AMRO's lackluster performance. Although loan impairments of the five largest banks more than tripled, their aggregate cost of risk remained very low at 11 bps of customer loans, well below ABN AMRO's cost of risk of 24 bps.

Exhibit 7
Net income declined in 2018, after peaking in 2017, as a result of higher impairment charges
Composition of ABN AMRO's net income in million euros

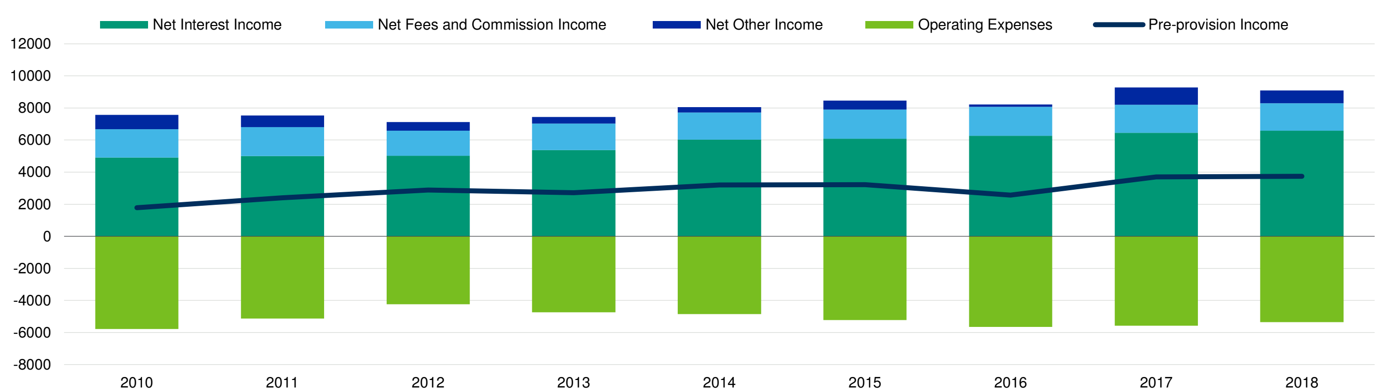


Sources: company data, Moody's Investors Service

Net interest margins have been very strong, but will likely start to narrow over our outlook horizon

ABN AMRO reported solid operating performance in 2018, thanks to strong net interest margins, which increased to 165 bps in 2018 from 157 bps in 2017, despite the low interest rate environment. This is a differentiating factor for ABN AMRO, which was able to increase net interest margins more than other Dutch banks. The bank also outperformed most European peers, which recorded declines in net interest margins in 2018. Accordingly, ABN AMRO's net interest income rose 2% year-on-year although the customer loan book contracted by 1.4%. At the same time, operating expenses fell 4%, leading to a slight 1% increase in pre-provision income (**Exhibit 8**).

Exhibit 8
Higher interest results and lower operating expenses led to broadly stable pre-provision income
Composition of ABN AMRO's pre-provision income in million euros

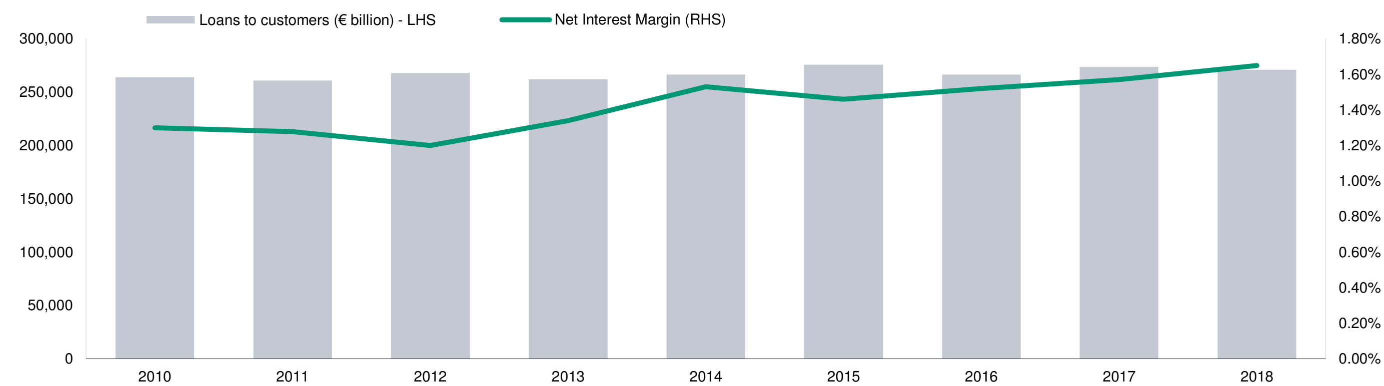


Sources: company data, Moody's Investors Service

Nonetheless, net interest margins will likely decrease in 2019, as there is little room for reducing deposit funding costs further and competition in the Netherlands will weigh on the bank's capacity to increase revenues. ABN AMRO has demonstrated an ability to generate strong earnings in recent years, notably through its capacity to sustain and often increase its commercial margins and also to successfully lower its funding costs. These actions will be more difficult over the coming quarters, however.

Interest paid on ABN AMRO's main saving accounts was only three basis points in the fourth quarter of 2018 versus 10 bps in Q4 2017, indicating limited reduction potential. Market funding costs are also largely optimised. Furthermore, given the limited prospects for lending growth due to increasing competition in the Netherlands, as well as a deceleration of the housing market and the Dutch economy, we expect net interest income to decrease in 2019 (**Exhibit 9**).

Exhibit 9
Net interest margins have been strong but will deteriorate in 2019



Sources: company data, Moody's Investors Service

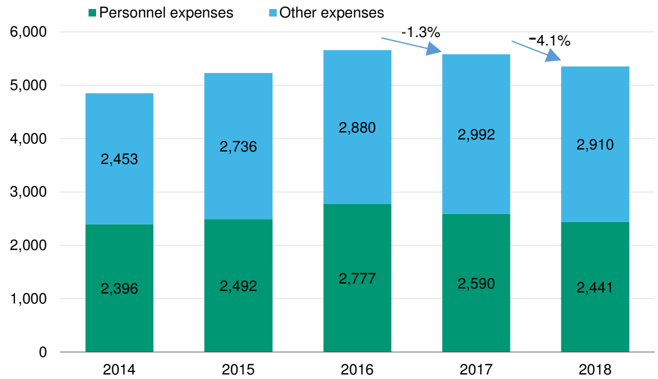
Cost-cutting has been successful and will continue to support profitability

Continuing efforts on cost savings have brought operating expenses down by 4%, including a 6% drop in personnel expenses. This resulted in a cost-to-income ratio of 58.8% for 2018, down from 60.1% in 2017. The bank was able to lower its recurring operating expenses by almost €700 million over the last three years and aims to reduce them by another €300 million (around 6% of operating expenses in 2018) by 2020 (**Exhibit 10**).

Restructuring provisions associated with the bank's efficiency programme were still moderately high at €129 million in 2018, against €185 million in 2017. In addition, ABN AMRO took an €85 million expense provision for the acceleration of its Customer Due Diligence remediation programmes in the fourth quarter of 2018. These costs are indicative of the continuous pressure stemming from regulators' expectations regarding internal controls and anti-money laundering procedures, a factor we expect to persist over our outlook horizon. Despite these headwinds, we believe that the bank will manage to continue to cut operating costs. As such, we believe that ABN AMRO's cost-to-income target of 56%-58% by 2020 is a credible goal despite revenue pressure which will hit banks in the Netherlands[12] (**Exhibit 11**).

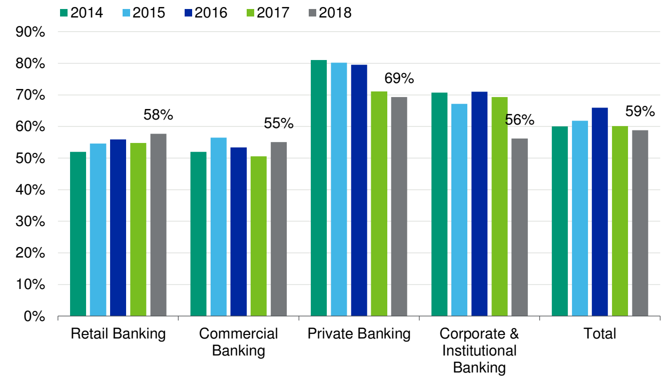
Investing in its digital transformation remains also a key priority for ABN AMRO, which will eventually result in cost savings, even though this will require near term investment. ABN AMRO's omnichannel distribution strategy enabled the bank to decrease the number of retail branches to only 135 nationwide at year-end 2018 from 469 branches at year-end 2011. The largest banks of the Netherlands, including ABN AMRO, have led technological advances, offering online banking services for many years. For Dutch banks, digitalisation of banking services is therefore a natural part of their IT development. Faced with a technologically adept and digitally agile Dutch population, they are more advanced than many other Western European banks. ABN AMRO aims to distribute 70%[13] of its products and services digitally in 2019 and to stay a front-runner in this market.

Exhibit 10
Significant cuts in operating expenses...



Sources: company data, Moody's Investors Service

Exhibit 11
...have resulted in efficiency gains



Sources: company data, Moody's Investors Service

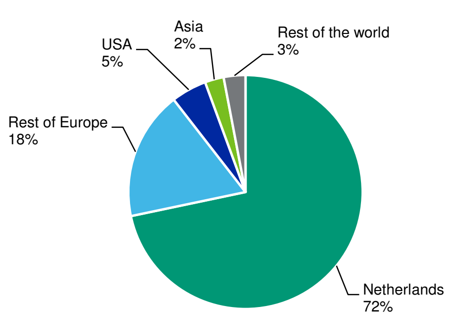
Asset quality is solid, with bouts of volatility in the CIB division, but improvements are likely to be limited

ABN AMRO benefits from the strong operating environment in the Netherlands

ABN AMRO has been publicly traded since its initial public offering on 20 November 2015 and the Dutch state still owns 56% of the bank via the state holding company NLFI.

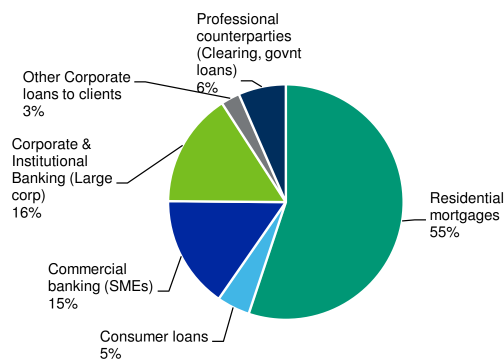
The bank's asset quality is solid, in part thanks to its focus on retail and commercial banking in the strong domestic economy, with 72% of exposures to customers in the Netherlands (**Exhibit 12**). In addition, ABN AMRO's loan book is predominantly retail, with 55% of made up of Dutch residential mortgage loans (**Exhibit 13**). In comparison, Dutch peer Rabobank's loan book comprises 46% mortgages, with 72% of total exposures extended to Dutch customers, while ING's loan book comprises 43% mortgages (only 40% of these are Dutch mortgages) and only 22% of its total exposures are to the Netherlands. Hence, ABN AMRO is slightly more retail than Rabobank and similarly focused on the Netherlands (**Exhibit 14**).

Exhibit 12
ABN AMRO's exposures are focused on the Netherlands
Geographical breakdown of exposures at default as of end-December 2018 (%)



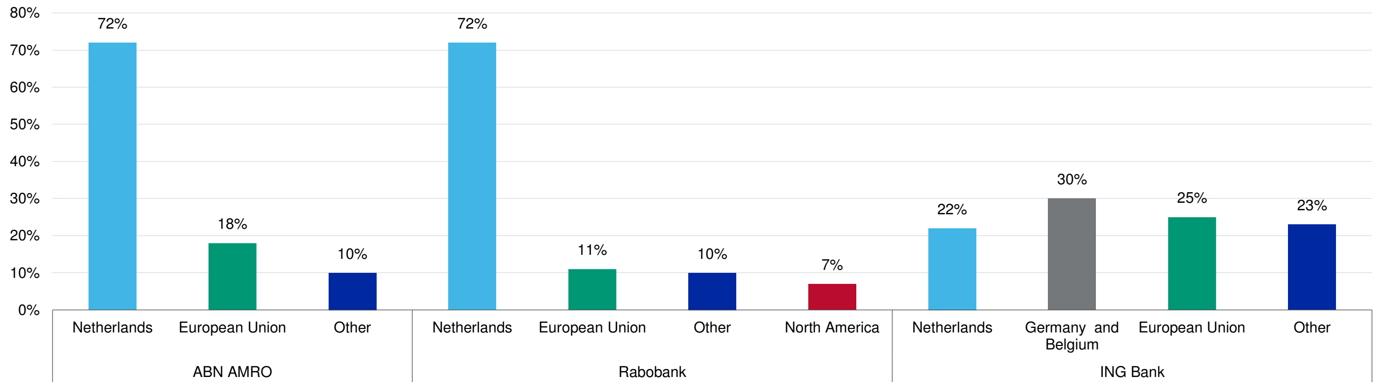
Sources: company reports, Moody's Investors Service

Exhibit 13
ABN AMRO's loan book is largely composed of Dutch residential mortgages
Breakdown of loan book to customers by nature as of end-December 2018 (%)



Sources: company reports, Moody's Investors Service

Exhibit 14
ABN AMRO's geographical mix of exposures is slanted towards its domestic market and western Europe
Breakdown of exposures at default at year-end 2018 (%)

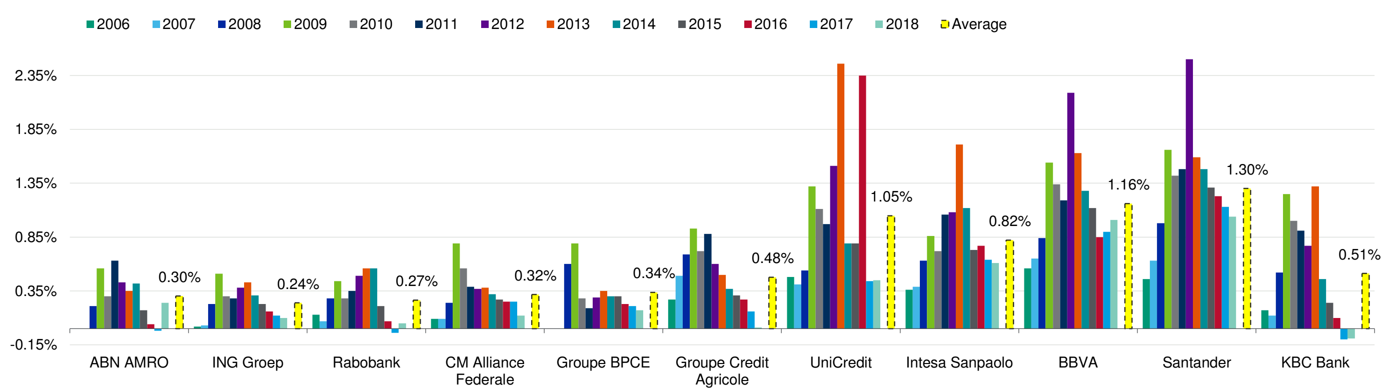


Sources: company data, Moody's Investors Service

We expect impairment charges to remain low overall, a reflection of low-risk assets

Lending risks have been low over a long period, which is consistent with the low capital requirements on the bank's exposures. We calculate that, over a 13-year period, impairment charges averaged 30 bps of gross customer loans at ABN AMRO. The bank itself estimates its long-term historical average cost of risk to be between 25 bps and 30 bps of gross customer loans. ABN AMRO's provisioning is moderately above Dutch peers ING and Rabobank, which recorded average impairment charges of 24 bps and 27 bps of gross customer loans over the last 13 years, respectively. Nonetheless, ABN AMRO's impairment charges are below most European peers over the long term (**Exhibit 15**).

Exhibit 15
ABN AMRO's impairment charges have been lower than European peers over a long period
Annual loan-loss impairment charges / gross customer loans and average over a 13-year period (%)



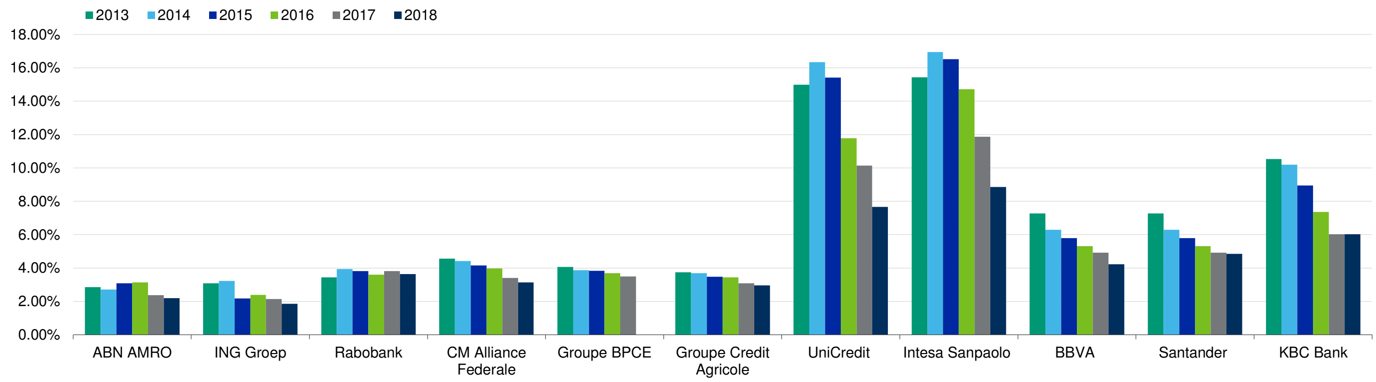
Sources: company reports, Moody's Investors Service

The bank's problem loans (recorded as loans in stage 3 under IFRS 9 accounting standards) were a low 2.2% of gross customer loans at the end of 2018, down from 2.5% at the end of 2017[14]. Past-due loans that are not yet impaired represented an additional 1.1% of gross loans. This compares favourably against European peers (**Exhibit 16**). Impairment allowance coverage of impaired loans (loans in stage 3) was 32%, a level similar to Dutch peers but much lower than many European banks. This is partly due to the fact that impairment allowances for mortgage loans, which represent a higher share of ABN AMRO's loans than at most peers, are traditionally lower.

Exhibit 16

ABN AMRO's problem loan ratios compare favourably against peers

Problem loan / gross customer loans (%)



Sources: company reports, Moody's Investors Service

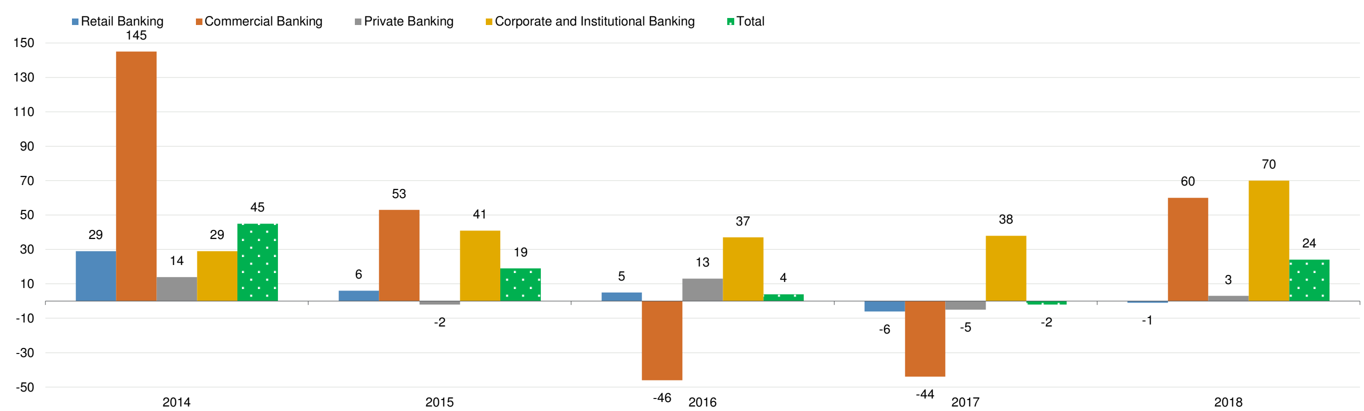
The bank's corporate loan book is more volatile

ABN AMRO's loan book includes 34% of lending to businesses, evenly split between Dutch small and mid-sized entreprises (SMEs), included in the Commercial Banking division, and large corporates, included in the Corporate & Institutional Banking (CIB) division. This portion of the loan book shows higher volatility. The CIB division in particular has exposures to risky sectors including the oil and gas sector, which represents 3.9% of the bank's total exposures, a small portion of the bank's loan book but which has generated outsized losses in the past. As a result of credit deterioration in the corporate and commercial loan book, impairment charges increased to 24 bps of customer loans in 2018, corresponding to €655 million, up from -2 bps in 2017 (**Exhibit 17**). This was above the impairment charges of Dutch peers Rabobank (5 bps in 2018), ING (10 bps) and de Volksbank (-4 bps), albeit still below ABN AMRO's long-term historical average.

Exhibit 17

Impairment charges are low overall

Loan-loss impairment charges / gross customer loans (bps)



Sources: company reports, Moody's Investors Service

Major improvements in asset risk are unlikely, despite CIB refocus strategy

Major improvements in the bank's asset quality and risk profile are unlikely over the next 12 to 18 months. ABN AMRO's retail banking activities have seen provisioning releases over the last two years and these releases will now diminish. In addition, as the Dutch economy slows down, we do not foresee improvements in the risk profile of private individuals. The bank also recorded higher provisioning on its Dutch SME loans at 60 bps of gross loans in 2018, although half of these impairment charges were linked to updates to its risk modeling. We do not expect major improvements in this area, as provisioning requirements were spread among a broad variety of sectors and may be indicative of a slowing Dutch economy.

Improvements could possibly come from the bank's strategy of refocusing its CIB activities away from cyclical sectors (such as energy offshore and offshore shipping), launched in the third quarter of 2018. The new strategy, which came after various loan losses notably in the oil & gas, transportation and diamond trade sectors, also aims to enhance the division's return on equity and pare back CIB risk-weighted assets by around €5 billion (-13%) in the context of Basel IV and the ECB's TRIM. But in our opinion, the CIB business, which still includes global corporate lending split into Trade & Commodity Finance, Global Transportation & Logistics and Natural Resources, will remain fundamentally a source of risk and earnings volatility with relatively concentrated exposures.

Moody's related publications

Press Release

» Moody's affirms ABN AMRO Bank's deposit and senior unsecured debt ratings of A1, stable outlooks, 25 March 2019

Sector Comment

» Banks' profits fall slightly on higher provisioning, despite resilient interest income and cost cuts, 8 March 2019

Banking System Outlook

» High loan quality and resilient profitability support our stable outlook, 11 December 2018

Endnotes

1 Bank estimate at year-end 2018.

2 Early in the phase-in

3 The Supervisory Review and Evaluation Process (SREP) sets individual bank-specific capital requirements.

4 The SREP of 11.75% includes a Pillar 1 of 4.5%, a Pillar 2 Requirement of 1.75%, a systemic risk buffer of 3% and a capital conservation buffer of 2.5%.

5 Please see Moody's publication **Basel IV will affect banks in diverse ways: Answers to frequently asked questions**, 1 April 2019.

6 Based on ABN AMRO's balance sheet at year-end 2018.

7 The pro forma Basel IV early phase-in target is "above 13.5%".

8 Risk weights for residential mortgages under Basel IV will range from 14.5% to 50.75% depending on loan-to-values (LTVs) after applying the output floor of 72.5%.

9 The legal merger of the holding and its operating subsidiary will simplify the group structure and optimise capital, giving the bank full regulatory capital benefit from its €2 billion Additional Tier 1 (AT1) issued by the group holding company in recent years.

10 The transposition of the Basel IV framework into EU legislation may entail material variations from the international standards.

11 The bank also reported lower incidental items in 2018.

12 ABN AMRO also aims to reduce its cost-to-income ratio below 55% by 2022

13 ABN AMRO claimed that 65% of its sales and services were digital in the first half of 2018.

14 The 31 December 2017 ratio is based on IAS 39 figures

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