Q4 2019 Analyst Call Transcript

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Conference call replay:
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Kees van Dijkhuizen: Good morning everybody, welcome to ABN AMRO's Q4 results. I am joined here by Clifford Abrahams, our CFO, and Tanja Cuppen, our CRO. I will update you on where the bank stands and take you through key developments in the last quarter. Clifford will go through the details on our fourth quarter results and run you also through capital. Tanja will update you on the developments in our loan portfolio.
This is my last quarterly statement and before I brief you on our Q4 results, I want to give you my perspective on my time at ABN AMRO, our progress and the actions we are taking to position the bank even better.

Over the last three years, together with the Executive Committee, I have worked diligently to deliver on our strategy and targets and the bank is financially in good shape. Sustainability is now the core of our purpose. Banking for better, for generations to come. I see sustainability as a clear business opportunity but it is also the right thing to do for all stakeholders. I have accelerated the digital performance of the bank over the last few years. We have built successful platforms including Tikkie and Grip and Tikkie alone has more than 6 million active users. I have sharpened the focus of the private bank to a scalable onshore franchise in North West Europe. Though clearly there is more work to be done I have undertaken steps to improve profitability at CIB, reducing RWAs by 5 billion. I have delivered on our cost savings and our ROE has been consistently 10% or above since the IPO. The highest ROE of large Dutch banks and in the top of European banks. We have a strong capital position, having anticipated Basel IV well ahead of time.

Of course, we have challenges and here we are taking firm action. We were the first bank to announce that smaller savers would be protected from charging negative rates. We were also the first large bank in the Netherlands to announce negative rates for clients with deposits over 2.5 million. We have a detailed delivery plan in place now for both remediation and building a future-proof organisation for detecting financial crime.

Our 5.3 billion cost level 2019 is 2% lower than 2018 and will decline further this year and the years thereafter. So, further cost savings will enable us more than to mitigate higher regulatory and compliance cost.
TRIM is imminent and will be substantial but we have a high capital buffer to deal with this.

All in all, ABN AMRO is a solid bank and is ready to face the current headwinds when I hand over to Robert Swaak at the end of April.

Let me now summarise the key highlights of the last quarter on the third slide.

Net profit in Q4 is EUR 316 million, reflecting high impairments and in line with Q4 2018. Our full year result was solid with a ROE of 10%. We are on track to deliver on our cost programmes. Capital remains strong with a Basel III of over 18% and Basel IV CET1 of over 14%, even after RWAs add-ons anticipating TRIM and model reviews of 10 billion. We propose to keep the dividend pay-out ratio stable at 62%, which leads to a full year dividend of EUR 1.28.

Let me now update you on strategy execution. You will recognise our three strategic pillars, sustainability, customer experience and building a future-proof bank.

On sustainability I am pleased that we were once again in the top 10% banks in the Dow Jones Sustainability Index. We are now at 19 billion sustainably invested client assets in the private bank, well ahead of our target a year early. I am also pleased with the pace at which we are moving away from fossil energy. 15% of energy commitments in CIB are now renewable, compared with 7% in 2018. We are heading for 20% year-end.

At the same time, we are making good progress on enhancing the customer experience. Video banking is increasingly used in all segments, including our private banks in Germany and France. We team up with partners to broaden our product range. Last year we entered into partnerships on cyber security, corporate finance and accounting software. New mortgage products, such as the fund for 30-year mortgages and the mortgage facility to invest in energy efficiency have made a good start.

Also good progress is made in building a future-proof bank. 125 teams have now moved to DevOps, already providing efficiency gains by increasing automation further. We increasingly move applications to the off-premise Cloud. We are one of the first banks to do so. We are making progress in product rationalisation, aiming for a reduction of more than 50%, for example in loan products in the retail bank. In the last couple of years we got rid of 2,000 applications.

Let's move on to how we are tackling the challenges the sector is currently facing. We have been focused on detecting financial crime – or DFC – for many years. We have built a solid foundation and continue to make progress. The review of CIB and private banking clients is concluded. We have centralised all our DFC activities. A detailed DFC plan has been developed, incorporating external findings. This plan has been shared with the regulator. The remediation programmes in retail, including ICS, and the commercial bank are up and running and we expect to complete them by 2022.

Currently, over 2,000 FTEs are working on DFC both on remediation and business as usual. We have invested in state of the art tooling, including Fenergo, in which we now also participate through the ABN AMRO Venture Fund. We have a very good engagement with the authorities on the DFC industry approach and we are keen to increase further cooperation both with authorities and other banks. There is no update on the investigation by the Dutch public prosecutor and of course, we fully cooperate. As we have said before, strict compliance is a license to operate. We remain vigilant in detecting financial crime and continue to make the necessary investments.

Now, I will update you on cost developments on slide 7. In the past few years, we have demonstrated strong cost discipline, keeping cost relatively flat despite increasing regulatory cost, wage inflation and investments in digitalisation and process optimisation. In 2019, the cost run rate was around EUR 5 billion, excluding incidentals. Clearly, further ramping up of DFC activities creates material cost pressure. In 2019 we spent around EUR 400 million on DFC, including EUR 174 million on remediation provisions. Future DFC cost are mostly business as usual, as we have already largely funded remediation through our provisions which currently amount to over EUR 220 million in total. We expect total DFC cost to stabilise around the 2019 levels and then decline over time, as remediation activities are completed and we automate the business as usual. We currently assume only limited benefit from automation.

In mitigation, we have a pipeline of savings initiatives underway, mainly in IT, as already flagged at our Investor Day in 2018. We are working on further rationalising the IT landscape, making the move to DevOps and off-premise Cloud. Also, we are optimising the offshore delivery model. We see further cost savings opportunities to up and round EUR 300 million by 2022, lowering our IT-spend towards the sweet spot. This will mitigate the DFC cost pressure and we are on track for costs of EUR 5.1 billion in 2020 and below EUR 5 billion thereafter.

On slide 8, I will discuss the CIB refocus and impairments. In CIB we have some good client franchises and the majority is performing well. For instance, the core Dutch clients, North West Europe and Clearing. However, CIB is facing cyclical and long-term challenges. Mid 2018 we decided to refocus CIB to improve our profitability to a ROE of above 10% by 2021. I am pleased that we have reduced our RWAs by EUR 5 billion. In the diamond sector, where exposures have been reduced, we have seen significantly lower impairments in 2019. We are also making progress on taking out costs and transforming CIB to a more capital efficient operating model. However, this has not yet resulted in a structurally improved ROE, as impairments in Q4 were very disappointing. A prolonged downturn in the offshore sector has led to high impairments in Q4 and though the bulk in CIB impairments were in sectors we have been actively de-risking; it is clear we need to do more. We will continue to de-risk highly cyclical sectors and we will review digital measures needed to structurally improve CIB's profitability.

I would now like to hand over to Clifford to take you through our fourth quarter results.

Clifford Abrahams: Thank you, Kees. Let's turn to slide 9. As Kees mentioned, Q4 profit was EUR 316 million, reflecting high impairments while full year profit was solid at EUR 2 billion, despite the low interest rate environment and low private equity results in 2019. NII was impacted by deposit margin pressure, both in the quarter and for the full year. I am pleased to say expenses continue to trend down, reflecting cost savings, lower FTEs and lower restructuring costs despite the ramp-up of detecting financial crime activities. I am disappointed with the high impairments in Q4, mainly in offshore. Tanja will give more background on this.

I will now guide you through the individual items on the next slides but first our client lending on slide 10. As background I can say that the Dutch economy remains strong with low unemployment. For 2020 we expect GDP growth positive at around 1%. The housing market remains resilient and the housing shortage combined with low rates has led to a further rise of house prices. In this context I am pleased with our mortgage performance in 2019. We introduced some successful new products, including the platform for 30-year mortgages together with a facility allowing homeowners to invest up to EUR 25,000 in energy-efficient measures for their homes. So after a very strong performance in the second and the third quarter, market share normalised in the fourth quarter to 18%, which meant overall for 2019 we had a market share also of around 18%. The mortgage market remains competitive and we maintain our pricing discipline. Due to the seasonal increase in voluntary redemptions, the mortgage book declined modestly during Q4. CIB's loan book decreased also due to the CIB refocus, as Kees mentioned, while the commercial banking loan book is up slightly for the year, despite our focus on margins in a competitive environment and our tight risk limits.

Turning now to NII on slide 11. In line with our guidance, net interest income held up well in Q4. The impact from low rates was around EUR 20 million during the quarter, also in line with our guidance. Compared to Q3 however, liquidity management costs were higher, as last quarter saw some larger FX-positions roll off. Looking ahead for 2020, we expect NII in the range of EUR 1.5 billion to EUR 1.6 billion per quarter but it will not be a linear movement. We are taking action on deposit margin pressure by charging negative rates to clients with balances above EUR 2.5 million and reducing deposit rates to 0% for other clients as of April 1. We are also moving on rates in Germany.

This means that as of April we will charge negative rates on around one third of deposits over EUR 100,00 previously not charged, which is equal to around EUR 30 billion of deposits. This leads to an additional EUR 150 million of income on a yearly basis. The remaining two thirds of deposits between EUR 100,000 and EUR 2.5 million or around EUR 60 billion, are currently not subject to negative pricing. Of that EUR 60 billion, around 14 billion of deposits are between EUR 1 million and EUR 2.5 million. So negative pricing, together with the ECB deposit tiering, will dampen the deposit margin drag from Q2 and beyond.

Fees in Q4 were lower due to modestly lower Clearing fees. Fees in all other businesses were largely unchanged. We continue to work on fee initiatives across all sectors, for example in investments and insurance.

Other income was in line with our guidance of EUR 125 million for the quarter. Going forward however, we are lowering the guidance for other income to around EUR 100 million per quarter, as we expect lower private equity results reflecting the current outlook of the portfolio.

Now moving to costs on slide 13. I continue to be pleased with our cost development. We have delivered on the planned reduction in FTEs, as these have decreased by 19% since year end 2015, despite the increase over the last quarter in both internal and external FTEs reflecting detecting financial crime activities.

Adjusted for restructuring and remediation provisions, costs continued to trend down despite higher DFC costs and wage inflation. On the right-hand chart you see that we have increased cost savings by EUR 45 million delivered, bringing total delivered cost savings since 2015 to EUR 900 million. We continue our disciplined cost focus and expect further savings in 2020 of around EUR 200 million towards a total of EUR 1.1 billion of cost savings. As Kees mentioned, we expect costs of around EUR 5.1 billion in 2020. That is including DFC costs. Thereafter, we aim for total costs to be below EUR 5 billion, again including DFC costs.

I will now hand over to Tanja, to pick up impairments on slide 14.

Tanja Cuppen: Thank you, Clifford.

The fourth quarter impairments were high at EUR 314 million, despite the generally sound economic environment in the Netherlands. The impairments in the Retail bank of in total EUR 55 million are largely a result of changes in calculations of models impairments. Impairments for the Commercial bank were at benign levels with a cost of risk of 55 bps.

In CIB impairments were high, predominantly in the offshore sector, as it experiences a severe prolonged downturn due to the low oil price. In the past few years, we have been actively de-risking the offshore portfolio and we will continue to do so.

Despite the high Q4 impairments the cost of risk for 2019 still ended below the through-the-cycle level as guided. For 2020, we expect the cost of risk to be within the through-the-cycle cost of risk of 25 – 30 bps.
I now hand back to Clifford to discuss capital developments.

Clifford Abrahams: Thank you, Tanja.

Our Basel III capital position remains strong with a CET 1 ratio of 18.1%, reflecting the retention of full-year profit offset by 5 billion additional RWAs for TRIM and model reviews in Q4 and an increase in operational risk. The additional RWAs for TRIM and model reviews reduce the CET1 ratio by approximately 90 bps in Q4. So without this effect, the CET1 ratio would have been around 19%.

To date, we have booked around EUR 10 billion in total or 200 bps of TRIM and model reviews ahead of receiving the final TRIM letters later this year. Nonetheless, with the 18.1% we are well above our current SREP-requirement of 12%, despite the increase of 25 bps. reflecting required improvements in credit risk models and processes and our DFC-activities.

Alongside capital, the leverage ratio was strong at 4.5%. As the SA-CCR methodology for Clearing guarantees becomes effective in 2021, this will add another 70 bps to the leverage ratio, bringing it to 5.2%, well in line with our peer group. So, our capital position is strong but we need to consider forward developments which are relevant for how we manage our capital position today.

Looking at the top left, we are focused on Basel IV and are well positioned to absorb the associated RWA inflation under Basel IV, given our ratio of over 14% at year end 2019. It is a clear positive that the uncertainty on NHG mortgages is now addressed and they will be treated as sovereign under Basel IV. We update our

Basel IV figures regularly and we will update these again when the European Commission comes with its proposal for Basel IV implementation during the summer.

Turning now to Basel III, the graph on the right shows the approximately 10% of RWA inflation that we have already taken from TRIM and model reviews. You can see that the effect of this is to reduce the RWA inflation arising from Basel IV from around 35% in 2017 to around 25% in 2019. We expect a significant further impact on Basel III RWAs over and above our current add-ons from the final TRIM letters in 2020. There will also RWA inflation arising from the DNB mortgage add-on and the implementation of the new 'definition of default' in 2020.

Generally, all these developments will not impact our fully-loaded Basel IV position, for which we are already well placed. So, the effect of these developments will be to increase Basel III RWAs further, bringing them closer to Basel IV levels, thereby reducing again the incremental RWA inflation for Basel IV. So, that is the grey box on the far right of that chart, which you can see narrows further from 25% in 2019 into 2020 and beyond. We expect clarity on these developments later this year and we will update you on capital in the second half of this year. I will now hand back to Kees to update you on dividend.

Kees van Dijkhuizen: Thank you. Every year, we have demonstrated a solid ROE of at least 10% since 2014, underpinning our commitment to deliver strong capital generation. I am proud of our track record on pay-out. As indicated by Clifford, our Basel III capital position remains strong with a CET 1 ratio of 18.1%, one of the highest in the sector, enabling us to pay an additional amount on top of the 50% of sustainable profit.

Clifford explained that TRIM, additional model reviews and the announced risk weight floors on mortgages will have a very significant impact on RWAs in 2020, lowering predominantly our Basel III CET. As he also mentioned, in the second half of 2020 we will update you on capital. There is also the transition to Basel IV and we remain subject to an investigation by the Dutch public prosecutor. We are also mindful of the current economic outlook. We have decided to maintain the pay-out ratio of 62%, an additional distribution of 12% of sustainable profit. So, we propose a dividend of EUR 1.28 per share for the year.

As you can see, we have again delivered on our ROE target despite the low interest environment. Not many banks in Europe have realised a double-digit return for 2019. Also, we have delivered on our CET 1 target despite TRIM and model reviews. We recognise that the sector is currently facing major challenges, especially the continuing low interest rate environment. I expect that the ROE in 2020 will be below the target range. Given these circumstances, it will also take longer to reach our cost/income target of 56% - 58%, as mentioned before.

Before we go into Q&A, I would like to briefly recap on slide 19.

On slide 19 I will give you the highlights in my final analyst presentation. Our full-year was solid with a ROE of 10%, one of the highest in Europe. I am pleased that cost declined in 2019 despite extra DFC cost and continued to further trend own. Capital remained strong with a Basel III CET 1 of over 18% and a Basel IV CET of over 14%. The bank is in good shape and the full Executive Committee continues to diligently focus on the execution of our strategy. We maintain the dividend pay-out at 62% and propose a full-year dividend of EUR 1.28, an additional pay-out of 12%. Now, I would like the operator to open the call for questions and answers.

QUESTIONS AND ANSWERS

Farquhar Murray (Autonomous): Good morning, just two questions if I may, both really focused on the Basel IV capital position. Starting with slide 16, I just wondered if you could clarify. Presuming that in essence that 25% RWA inflation applies to the full year 2019 position based only on recognising the 10 billion of TRIM so far, I think that is the right way of understanding what you were just saying because I see a little bit of ambiguity there.

Then, specifically moving on to the 'definition of default', can you just confirm for me that this will be incremental to the Basel IV RWA and can you yet give a bit of a sense of the broad magnitude around that impact? And then more broadly, is that the only upcoming regulatory change that is going to impact on Basel IV RWA over 2020?

Clifford Abrahams: I will answer that and Tanja will chip in if there is anything further to add. Your first question is correct; the 2019 sort of dark greenish blue reflects our 10 billion TRIM and model reviews that we have anticipated, the final letters. In terms of assumptions I will ask Tanja to comment on DOD. We continue to finetune our Basel IV assumptions, so DOD is something we will reflect on. TRIM may have a read across into constrained IRB. So, when we talk about Basel IV we are talking about the revised standardised approach under the output floor, which is a much simpler methodology. We will, for example, look at the EC's proposal when it comes over the summer and finetune further if necessary our assumptions, whether it is the numbers themselves or timing or various approaches. So, you should not see Basel IV as a fixed calculation but something that evolve over time to ensure we have a smooth transition into its implementation.

Tanja Cuppen: And on the 'definition of default', we expect to be able to implement that in the next quarter. We have applied for a two-step approach under the definition of default and expect to get some add-ons in RWAs for that. That will be based on the Basel III models. It is very hard to say whether there is any implication for Basel IV as well but for sure you cannot aggregate the Basel III impact into the Basel IV numbers. That will not be the case.

Kees van Dijkhuizen: There was a third question, whether there is more to come around Basel IV.

Clifford Abrahams: As I indicated Kees, it is possible that the EC proposals cause us to revise our assumptions. We feel we are up to date on our assumptions for EBA. Let me give an example. We slightly strengthened our approach to operational risk, so our multiplier is above 1 in our calculations. We will continue to finetune things because we do not want to see jumps, either up or down, in our estimation as we glide through to implementation.

Farquhar Murray: Ok, and then just a follow-on. In terms of being as up to date as we possibly can, given the way the Basel IV landscape stands, am I right that are guiding me to about 14.5% Basel IV ratio?

Clifford Abrahams: Yes, you can work it out from the 25%, as you have done. We feel confident to say it is above 14 at the full year. Our balance sheet is always a little bit smaller at the year end than it is during the year but we feel good about being in a position of above 14%. I think estimates to the nearest 0.1 are not all that sensible, given that there still are some moving parts around this number, both on assumptions but also on how we implement it in the business.

Farquhar Murray: Ok. Thanks!

Stefan Nedialkov (Citigroup): Good morning, a couple of questions on my side. When it comes to impairments you are already taking a cumulative 1 billion deduction through capital at the insistence of the ECB. How should we think about the provisioning in Q4 2019 and future provisioning? Is this basically taking the capital deduction and converting it into an actual provisioning item or is the provisioning that we are seeing in 4Q2019 and potentially later in 2020 on top of the EUR 1 billion ECB deduction?

Secondly, when it comes to thinking about negative rates on deposits of more than 2.5 million, yes, you were the first but then somebody else came up in the Netherlands and announced negative rates on deposits above EUR 1 million. Could you potentially go down to EUR 1 million down the road and how fast could that be?

Kees van Dijkhuizen: Tanja, could you answer the first question? I think that question is NPE related, non-performing exposure, the minus 1 billion?

Tanja Cuppen: That is my expectation as well, with the 1 billion you refer to …

Stefan Nedialkov: NPEs, yes!

Tanja Cuppen: The prudential backstop. The provisioning that we take, we take on existing exposure and new exposure in default, so it is not related to the prudential backstop in itself because that is only on existing stock and only on the older stock in non-performing loans. So, the provisioning level you really need to see as developments in the offshore sector that I was referring to.

Kees van Dijkhuizen: Does that cover your question?

Stefan Nedialkov: The NPE question, yes. So, the EUR 1 billion capital deduction which you are taking at EUR 200 million at a time per year, is separate from the 4Q2019 and the potential 2020 provisioning strengthening?

Tanja Cuppen: Correct. The guidance on the impact of NPE has been unchanged.

Stefan Nedialkov: Great!

Kees van Dijkhuizen: Thank you. I will respond to your question around negative rates. We were the first indeed and I have said that EUR 30 billion of deposits as Clifford said is related to the area above EUR 2.5 million for us, meaning EUR 150 million on a yearly basis, this year not fully because we start 1st April of course, but on a yearly basis EUR 150 million, 50 bps times EUR 30 billion. The amount left between EUR 2.5 million and EUR 100,000 is EUR 60 billion deposits. If you would have 50 bps on that, it would mean another EUR 300 million but we are not allowed to guide in this sense when we will do whatever, so EUR 1 million or 100K or whatever. We are not allowed to guide there. What you can do of course is compare not only the EUR 2.5 million bracket we use, but we also gave an amount. I think other banks also gave on the one hand a bracket and also an amount there.

Stefan Nedialkov: Great. Thank you, Kees, and good luck!

Kees van Dijkhuizen: Thank you

Robin van den Broek (Mediobanca): Good morning everybody, thank you for taking my questions. The first question is more about the NII guidance. I think the range you have given – 6.0 to 6.4 billion – is rather wide. I was just thinking about the narrative you have put in place before today and to what extent that still stands. If I take your underlying run rate of today at the fully-phased level for tiering in there, then you are basically at 1590.

If I expect that to degrade by 20 million per quarter and add 35 million to 40 million as of Q2 on the back of the rate mitigations that you have already announced, that will get me closer to 6.3 billion, which is more on the upper side of your range obviously. I was just wondering if you could retake us through the asset side effects. In the past you have been fairly clear that these effects should be positive for your NII but in the last few quarters we have not really seen that. So I am just thinking, are you building in some cautiousness on the CIB de-risking for NII or maybe the mortgage volume drop on the amortisation side of the balance sheet is starting to kick in, so more colour there would be very helpful.

My second question I'll keep it as a smaller one. You mentioned the Ex/Cum litigation in Germany and I was just wondering why you are making that so specific. I think the largest lender in Germany settled that for 4 million or something like that. So, why are you bringing this forward so specifically at this stage?

Kees van Dijkhuizen: Clifford, will you take the first one?

Clifford Abrahams: On NII, I think there is not a huge amount of new information on what we conveyed in our guidance. You have analysed it but we have given the NII per quarter rounded to the nearest 0.1 billion. We wanted to convey that we see it as lower than 1.6 going into 2020, reflecting that deposit margin pressure.

You have gone through the calculation, which I think is perfectly reasonable but we expect for example negative pricing to kick in from Q2, so it will go down. That Q2 negative pricing will support it and then we will get the drag thereafter on the deposit margins. I think on the asset side, it is very early in the year but you have seen our balance sheet broadly stable. That reflects our caution in the current interest rate environment and our focus on defending our margins. So, that is really what is going on around NII.

We also wanted to move away from the guidance of a drag per quarter because at this point we have already got tiering in our numbers and we have announced negative deposit pricing. So, just focusing on one component being the deposit margin pressure we did not think it was very helpful to you and we thought it was better to just guide to total NII. I think you will need to take your own view on the roundings within that range. Finally, we always see a little bit of volatility during any quarter. We saw that again this quarter in our NII. I think you need to factor that in and understand when we give a range we want to make sure that there is a high degree of confidence of landing within that range.

Robin van den Broek: Maybe, you can, if you lower the deposit threshold to 1 million could you confirm that that is roughly 15 billion of the remaining 60 billion that you still have available to charge negative rates to?

Clifford Abrahams: I said it was 14 billion.

Kees van Dijkhuizen: Correct.

With respect to our question on litigation in Germany and one party settling for 4 million, this is related to what is related the Cum/Ex files, meaning trading around dividend dates. A lot of those things are looking back to the period before 2012. The reason we have mentioned it is that prosecutors have stepped up in Q4 in Germany, so we see a legal risk there. We have a lot of information about this on our website, so if you want you can look there. We have settled with tax authorities but as said, there is a legal risk. Regarding the 4 million you mentioned, there are a lot of cases out there so, it is too early to tell if and when prosecutors will decide on this.

Robin van den Broek: Thank you.

Benoit Pétrarque (Kepler Cheuvreux): Good morning, Benoit from Kepler. Coming back on the NII, if you want to get my view I would rather get NII drag guidance. I think that is very useful and we can figure what impact of lower and negative rates there will be on NII. But if you look at.. Obviously, negative rates will not stop at the end of 2020. Can we expect a further drag on NII from low rates, around the 20 million you have guided before in 2021? If I work from that assumption, NII before mitigations like negative pricing on deposits, will actually be below the 6 billion level. So to come back to the previous question, is the 6 billion to 6.4 billion range also translating a bit the downward pressure also going further in 2021? That is the first question.

My second question is on the dividend, the EPS of EUR 1.28. I just wanted to understand why you have set it at this level. I looks as if a stable pay-out was something you had in mind. I just wanted to confirm that 62% was a requirement on your side to keep it stable or is there any reason behind it? Also, did you take any settlement risk into account in setting the DPS?

Clifford Abrahams: Benoit, on NII thanks for the feedback on the guidance approach. One way to think about this if you want to analyse in further detail is to look at the 5-year swap-rate and you need to look at the delta between what it is now and what it was five years ago. This is quite a simplistic approach but it will give you a sense of the severity of the drag and how it ebbs and flows. So, when you look at that you can see that it moves around a bit but actually we expect that drag pressure to be roughly stable into round about the half point of this year and then get a little bit better, as in more beneficial to the company as we head into the second half of the year. But you can run the numbers and draw your own conclusions but there are a few moving parts. That gives you a sense.

The other thing that I would pick up is that we know consensus. Consensus was about 6.3 billion of NII. I heard the range earlier of 6.0 to 6.4. I think our guidance, what we are trying to telegraph is that we see some softening of the 6.4. We know that consensus is 6.3 but 6.0 would mean 1.5 every quarter this year and that is not our expectation. So, we expect to operate in that range and sort of drift within that range, reflecting the margin pressure but mitigated by the deposit actions in tiering that we have communicated. That should give you a little bit more colour as you think about consensus and how you might want to change our estimates for this calendar year.

Benoit Pétrarque: But if I understand correctly, we could get towards the 1.5 billion run rate towards Q4 or towards the end of the year. Will that be the new run rate for 2021?

Clifford Abrahams: I think it is possible. Rates can go up as well as down. You will note that rates are higher than they were in Q3 last year. I do feel, we talked about the benefit of the deposit margin pricing that we put through. That is roughly two quarters of drag. I am not going to give another decimal point on the 1.5 billion but I think it would clearly be too cautious for you to assume 1.5 every quarter. That is just not what we are saying.

Kees van Dijkhuizen: Thank you, Clifford. With respect to dividend, Benoit, and the 62% I would say we did not lower that percentage because we have a good capital position and we did not higher it because of the uncertainties that are around at the moment.

Benoit Pétrarque: Great! Thank you very much.

Albert Ploegh (ING): Good morning, two questions from my end. First, I want to come back to the impairments and the outlook for 2020. You guide basically, you expect to stay within the 25 – 30 bps through-the-cycle range but with a bump in Q4 that has been well explained. You are still a bit cautious, given what the state of the economy is. So, is this more a reflection of general caution on the economic outlook or are you still concerned that maybe the further de-risking of CIB could result in some more impairments, a bit to frame that line of thinking in terms of the guidance?

My second question is on the operating cost base guidance, which is quite helpful also for the coming years. I appreciate that. But to be clear, also linked to the review of the CIB division and any other things you may still contemplate, it does not include any restructuring costs? It is only the operating cost base including all the DFC cost, to make that point clear. Should we also expect any restructuring cost comings out of the CIB review or is that more on portfolio optimisation and not so much on the cost base?

Kees van Dijkhuizen: Tanja, can you take the first and Clifford, the second?

Tanja Cuppen: Yes. Thank you for your question on the cost of risk guidance. Indeed, on the one hand that is reflecting a slow-down of the economy but also importantly the way we look at the CIB portfolio. We continue to be negative on the outlook for the offshore sector and we are also cautious on the oil and gas sector and that is included in our guidance for the coming year.

Albert Ploegh: Maybe one small follow-up on that: can you give us a little bit of the latest numbers in terms of sizes of these different loan books and what these stage-3 ratios are?

Tanja Cuppen: If you look at offshore I do not have the exact percentages but the offshore segment is mentioned in the presentation on page 8. About half of that is in stage 3. For the oil and gas sector that is a much lower percentage, so that sector is definitely doing a lot better. But we see a downside in that sector, given the development of oil and gas prices.

Clifford Abrahams: I will pick up on the cost side. We have given the pipeline of future cost savings. Those largely relate to IT. We gave further detail on the IT plans at our November Investor Day and subsequent analyst lunches. You will recall Christian, our IT Director, talked about what he was planning to do. Kees described that we are making good progress on those. Most of those initiatives are not restructuring cost-heavy, so they involve changing our relationships with our outsourcing partners to have more of that support offshore, or moving to the Cloud, or restructuring the way we go about our change. So, you should not expect very material restructuring cost to emerge associated with that pipeline of savings, the 0.1, 0.2, 0.3. It think it is too early to say where any review CIB might get to in terms of restructuring costs. I think the goal of further review would be to reduce exposure to cyclical sectors and volatility of impairments and to give us comfort that that business will deliver on its return targets in due course.

Albert Ploegh: Thank you.

Benjamin Goy (Deutsche Bank): Good morning, two questions please. One follow-up on CIB and then one on cost. On CIB you have reduced your portfolios in the troubled sectors quite a bit. Is there some level where you say that it is critical from a scale point of view, meaning that you have in-house all the capabilities to be able to do offshore lending, to do diamonds or to do oil and gas and it would be part of the review? Maybe you say that there are some portfolios you are in and there are some you are really out instead of just running it down. Secondly, on the client due diligence and its impact on costs. You say that retail banking is ramping up and the commercial bank is accelerating. What is the risk we get more provisions here as you go along in 2020?

Kees van Dijkhuizen: Around the CIB this minimum lending level is something we will also look into when we analyse and review, not something to update now at this moment in time. It will definitely be part of our review. With respect to the CDD, we have done our analysis and we feel comfortable with the figures that are out there. So, we do not expect at this moment in time extra costs. That does not mean it cannot happen. We have seen it in the derivative file. That was also a difficult file. It is a big file, this one but at this moment in time we feel comfortable with what we have said to the market, not only on the CDD itself but also on the total cost level we have guided to you.

Benjamin Goy: Understood. Thank you.

Tarik El Mejjad (Bank of America Merrill Lynch): Hi, I have two questions. First of all on the dividend. You commented that given the uncertainty on AML issue, the rates, and the Basel IV, provisions, and so on, and 62% is probably fair enough, but consensus is still at 70% for 2020, so I presume that it is still high there or do you believe that 2020 could be a better year in terms of or at the end of the year you have better visibility and you could potentially increase the pay-out?

Secondly on the costs, I would like to understand what are the assumptions you put in terms of remediation plans to come with 5.1 and then below 5 in 2021, and especially how far you think the prosecutor will go into reviewing your books? That, I think, has direct implications on how much you need to spend to review these books.

Lastly, if you can give us an update on the AML case? I Know that you have put in your slides, there is no update but I am sure you can give us some flavour.

Kees van Dijkhuizen: Thank you for the questions. Clifford, if you take the second and then I will take one and three.

With respect to dividend, and as you said you understand stable because of the uncertainties but what would it be at the end of the year; can there be a higher pay-out? I think that with respect to that I would say and I have read it in analyst reports now more and more that we might have seen peak regulation around capital in the sense that we do not expect a lot of new regulation to come up in the coming period. It is more I would say the execution of existing regulation, be it from the European Commission, finalising Basel IV in the summer, be it TRIM – we get letters this year and presumably earlier this year than later this year – the 'definition of default', Tanja referred to Q1 and of course the mortgage add-on from the Dutch Central Bank in Q3. All that stuff is more or less known somewhere around the second half of next year. We also need Basel IV and the European Commission is relevant. That is the reason why we have said that we will update you on capital. Now, it is too early to say that we can then increase the pay-out but I think in a way all options are open at that moment in time, because we have then to update you on where we stand with capital, what we expect from regulators at that moment in time. We feel and hopefully we know also perhaps a bit more about the AML case. We feel we are then in a better shape to say more than we can do right now. Of course, CRD5 coming up next year is also a relief. We think there is more clarity around that and that is the reason why we guide now to have a capital update at that moment in time, without being able to say anything about direction at this moment in time. We really need to have all the figures in place.

Clifford Abrahams: So, Tariq, your question about our level of confidence in our DFC cost. I am looking at page 7 in the presentation. To give you a bit more colour on the process we went through and you will understand how that relates to our last quarterly update.

So, we commissioned an independent expert to review our DFC activities through the summer last year, during Q3. That process was looking at what our plans say, where we are and what the gap might be between what we are doing and best practice. It was an expert with a global expertise with obviously a focus on what we are doing here in the Netherlands. So, we are very clear on where there may be gaps and how and when we may choose to close those. Those plans were then further updated and shared with the regulator. That process bridged our November Q3 results process. And so, we have detailed plans in execution now to reflect our dialogue with the regulator and our judgment about where we are with respect to best practise and priorities. I think, that is what behind page 7 and you can see the bars. There is actually relatively limited remediation in 2021 and that reflects the fact that we have over 200 million of remediation provisions on the balance sheet in 2019. We kept the grey bars constant, as you can see there, at around 300 million. That reflects the fact that, based on our existing plans, we will do that manually. We believe that there is plenty of scope to automate and get more efficient with these activities, whether it is on our own or in combination in partnership, through utility with other banks in the Netherlands.

You raised the issue of the prosecutor and what the outcome of that process might be. I do not really want to speculate on that but what I can give you comfort on is that our comprehensive plans that we shared with the regulator reflected a well-informed view of current and best practice and those were constantly updated and landed in Q4 last year.

Tarik El Mejjad: And about an update? Or was that your last sentence on the case?

Kees van Dijkhuizen: Clifford said something and there is not more to be said unfortunately. We hope of course that we will know a lot more at the end of the year but we do not know now.

Tarik El Mejjad: Thank you very much and all my best wishes for the future, Kees. Thanks!

Kees van Dijkhuizen: Thank you very much, Tariq!

Grégoire de Salins (Morgan Stanley): Hi hello, two questions from me, please. The first is on asset quality. What kind of actions are you contemplating to reduce your exposure to offshore energies and other cyclical sectors, like through hedging, loan sales, et cetera, and what costs do you think will be associated with it? Also, finally, if you start reducing your exposure to these sectors, would you revisit your estimates of the impact related to the NPE guideline implementation from the ECB?

Tanja Cuppen: On your first question on how do we reduce our exposure to cyclical sectors, we do that actually in many different ways. We sell exposure if that is possible, we use insurance and hedges and also run off the portfolio at refinancing date. So, it is a combination of efforts and you have seen that in this way we have reduced the offshore exposure with 30% over the past two years and diamonds for example with 45%. So, we are very much focused on the cyclical sectors and we have been successful in reducing our exposure. I think your second question was …

Kees van Dijkhuizen: … Revisit NPE as a result.

Tanja Cuppen: So, the NPE guidance, it is early days. All the regulation has come in now and we will see the first impact at the end of this year. We will continue to revisit this. We are actively also managing the impact of NPE but, as said before, the impact only kicks in after five, six or seven years in default, so it takes some time. We very much look at the existing stock today and manage pro-actively the new assets in default. As said, we stick with the guidance that we have provided before and I think the current downturn will not impact NPE in the short run.

Grégoire de Salins: Thank you.

Kiri Vijayarajah (HSBC): Good morning. Firstly, can I just go back to the DFC provisions you just mentioned, Clifford? It is over 200 million of provision sitting there. Did I interpret that right that you are not really planning to utilise those provisions during 2020? Is it more about protecting that 5 billion cost target for 2021 and beyond? What is the timeline in terms of utilising the DFC provisions?

On capital: the Dutch mortgage risk weight floors that come in later on this year, it sounds like it is pretty neutral to the Basel IV capital ratio, so I imagine it probably does not really impact your behaviour or bank behaviour generally in the Dutch market. What is the risk the regulator tries to use other macro-prudential levers to cool down the housing and the mortgage market in the Netherlands?

Kees van Dijkhuizen: Clifford, can you take one?

Clifford Abrahams: I think you read too much into my comment on the provisions. On page 7 I was making the point that because we have that provision the little light blue bars in respect to remediation costs are quite small despite the FTEs going up quite a lot. So you can see the FTEs going from 2,000 to 3,000, although the remediation costs themselves are only going up modestly. That reflects our drawing down on the provisions. The point I was making regarding the provision is that you should not expect a further ramp-up in costs from 2019 to 2020 as we ramp up FTEs for example because we have already booked the provisions in 2019 and 2018. That will substantially mitigate that going forward. That was the point I was making. So, based on these figures on page 7 the effective DFC is flat to generally down on our total figures, so as the savings kick in, that gives us confidence that after a 'transition' year in this year, the 5.1, we'll see costs stabilised and then we expect to be below 5 billion in short order after that.

Kees van Dijkhuizen: With respect to your second question, the mortgage add-on of the Dutch Central Bank, indeed, it is more a macro prudential measure they take. We see it in practise indeed as a kind of frontloading Basel IV. Having said that, for of course the shorter tenors we now have to include in our pricing a bit of a different risk weight now from Q3 this year onwards, while it would kick in later normally with the phasing and Basel IV later. But for the longer maturities where most of the market is – 20 and 30 years – it will not make any difference in pricing at all.

Kiri Vijayarajah: Thank you.

Anke Reingen (Royal Bank of Canada): Good morning. My first question is just a follow-up on slide 7. Should we then understand that the cost bar shown for the next years are net of your taking the remediation provisions? And just to confirm, the in due course 5 billion basically starts in 2021?

Then, I have a second question on your loan loss charge guidance of the 25 – 30 bps. Relative to the 24 bps in 2019, that does not really look that conservative but I understand there were some one-offs in there as well as you no longer have these exposures. So, is there any way for us to look at an underlying 2019 loan loss ratio to say this is a step-up or otherwise it just might be flat and that comes from a very high Q4 level?

Clifford Abrahams: On slide 7, yes, 2020 and beyond DFC costs, is the P&L expense. So, if we draw on the provision then it would not affect our P&L. I think that is what you mean by 'net'.

Anke Reingen: Yes.

Clifford Abrahams: We wrote 'in due course' rather than 'in 2021', so we have not committed it to be in 2021. We can obviously can give more clarity on that as we get closer to the end of the year but our ambition and our plans are to bring cost down below 5 billion, but we are not giving a commitment regarding timing at this point.

Tanja Cuppen: And then on your question in relation to the guidance for cost of risk for next year. It is clearly the case that the Q4 impairment levels were disappointing and high, so we do not expect that for next year. But we do expect some elevation compared to the average for the full year of 2019 and that relates also to CIB and to the sectors that I have mentioned before. That is why we are somewhat more cautious.

Anke Reingen: Ok. Thank you very much.

Daphne Tsang (Redburn): Hi, two questions please, one on capital. I am just wondering you are waiting for more clarity from the authorities regarding the AML investigation. How much of your capital buffer would you hold back in case of any large fines coming up as a precaution? I wonder if you can give us a sense on that.

My second question on costs. You previously guided 1 billion on total cost savings by 2020. Now, it is pleasant to hear that you expect an additional 100, so next year it would be around 200 million of cost savings. Just wondering, because you are still running your DFC remediation programme, are you allocating your resources away from cost savings programme to a degree or are you completely adding new staff to work on the DFC programme if you have to i.e. leaving the current cost savings programme to run as planned? Also, just to clarify if the DFC provision you have taken so far has been fully utilised i.e. nothing is left now for next year and everything would go to the P&L. Or do you still have some provision left? Maybe I do not understand completely the slides.

Kees van Dijkhuizen: Let me take the first on capital and buffers for AML going forward. Internally, we have scenarios but externally we will not guide on that.

Clifford Abrahams: In terms of cost savings, as I said, that pipeline of cost savings is something we have talked about qualitatively but we have not given numbers before. Those programmes are well underway since 2018, so we thought it was about time to indicate some of the numbers as we now got close to that.
In terms of resource allocation, we are committed to ensuring we are fully compliant and delivering on our detecting financial crime activities. So in some cases we have added staff. You see we have recruited a lot of people, trained them and deployed them but yes, there is a limited bandwidth in terms of change. We need to stay compliant, reduce cost and innovate for our clients. I think it is always a balance and right now, it is a challenge to do all three. We are very focused on ensuring we are fully compliant.

In terms of the provision, you can see we have taken a total of 85 plus 174, so that is roughly 260 million of provision. We have at year end 2019 over 200 million of that provision remaining, so we have not spent it all year to date. And we will release that provision against the remediation activities that will take place in 2021 and 2022. Those provisions, as Kees mentioned, are for external costs. So when we hire contractors for example, we can book that as a provision but we will also undertake further costs, the little blue bars that you see there in respect of internal costs from remediation. I hope that answers your question.

Daphne Tsang: Very clear. Thank you!

Bart Jooris (Degroof Petercam): Hi, thank you for taking my questions. Most of them have been answered but I have two more clarification questions, if I may. Looking back at slide 7 you see around 300 million DFC cost, business as usual. You stated that that could be automated. Would that mean that there could be cost savings on top of the 100 million, 200 million and 300 million you foresee for the next three years?

Secondly, in the decision of the dividend you took into account the AML settlement. Could you confirm that if such a settlement would come that would not be included in the sustainable profit to calculate the dividend on?

Kees van Dijkhuizen: Clifford, you take the first? I will take the second.

Clifford Abrahams: The short answer to your first question is ‘yes’. We have clear plans in place that are very people-intensive and you can see that the FTEs are going up to over 3,000 because we are committed to doing this right, getting on with it and doing it at the right quality. Those plans extend through to 2022 and my expectation is that at least a good part of that be either automated or combined with other banks. There is much discussion here in the Netherlands regarding the utilities for this. It will take time to do that but frankly, while we are getting on and implementing we also have the time to think about the right end-state operating models for these activities. Those will come over and above the 0.3 billion that we set out. It is a long way off, so we need to consider other activities, other initiatives, both cost savings and also growth that we want to factor in through this period. But this should give you comfort that cost are well controlled, notwithstanding our commitment to DFC.

Bart Jooris: But that should be beyond 2022 then?

Clifford Abrahams: Yeah, in the latter part of that period and beyond. The remediation activity we expect to conclude during 2022. That is our current plan. You see that grey box, that represents the business as usual activity. We have almost doubled it and over a short period of time. You can see that in 18, 19, and 20 as we ramp up. I think we are doing the right things there but we have that in focus on speed and compliance and at this stage not on efficiency, effectiveness and in and end-state model. We have some time to work that through. That gives opportunity in those later years.

Kees van Dijkhuizen: With respect to your question on the AML taken into account in the sustainable dividend or not, I think in a year’s time the team will look into what’s the total capital position of the bank at that moment in time and of course, first of all if there is an AML fine at all in a year’s time and, if so, how big.

Bart Jooris: Thank you.

Jason Kalamboussis (KBC): Hi gentlemen, just a quick one on private banking fees. They have been better this quarter and I just wanted to have an idea on how you are looking at those next year. Also the assets under management. We have seen outflows but they have been within from what I understand structural moves that we may not see next year. Again, if you could comment on these two, it would be great.

I would like to come back to the pay-out ratio, the 62%. Given the negative surprise on earnings, this gives the signal that basically you just follow earnings because you probably are holding back just in case you have a relatively large fine. Is that the case? I would have thought that it would have been possible for you to at least give some positive signal by increasing slightly the pay-out without in a certain way endangering or having any issues on no matter what the fine will be, especially that you seem to be slightly more positive that at the end of the day it is not going to take 2.5 years and that it is going to come earlier, et cetera.

Kees van Dijkhuizen: With respect to fees and assets under management, let me start, Clifford and then you can take it from there? The assets under management decline indeed is a bit over 5 billion. Around 3 billion is related to less custody and on custody of course the fees are much lower than on mandates in general. And around 1.5 billion is cash. We actually do not have a problem with that. The decline is not all mandates and the stuff, where we really have bigger fees on. With respect to development, perhaps Clifford, you can say something on.

Then the pay-out ratio. In the past we have said that we basically have a pay-out approach, the 62%, and you mention all the time the fine. Actually, what we mentioned are all the developments that are unclear at this moment in time and that is much more related to TRIM actually, the 'definition of default' and the likes, Basel IV and EC decisions, and the fine also of course. It is not only related to the fine. That is not our reasoning.

Clifford Abrahams: I think we have covered fees. We were referring to the outflows. We are pretty pleased with how the private bank is performing. We are seeing new asset outflows, which were largely lower margin custody business. We have seen inflows elsewhere and a general uplift in the market. We have a strong market as well as a shift back from cash into discretionary assets that we saw in Q4. So net-net you see that pick-up in fees, which is pleasing to see. We always expect some volatility in that business and beyond, which is why we point out Clearing as the negative in Q4. Volatility goes both ways, so I would expect some normalisation of that going forward. Private banking is a business we like, we think we can grow and following the decision to charge negative rates. And that benefits the private banking in particular, where those clients have large balances. Clearly, it is for clients to decide what they do with their money and we want them to do the right things. But by passing on negative rates we and our peers are demonstrating call it the cost of low risk right now. That is what the ECB is trying to do and that should encourage the switch into riskier but potentially higher return assets that we will benefit from.

Jason Kalamboussis: Thank you. May I have just a quick follow up? The cash into discretionary assets, is it something that we should be continuing to think about 0.5 billion to 1 billion per annum?

Clifford Abrahams: I was making a comment about portfolio management, so it reflects our clients risk appetite and not the switch from the retail bank to the private bank. We all have views on this but as markets have got higher, our clients have been quite cautious last year through volatility but I think – we all got views on this - we are seeing increasing signs that as the cost of holding cash comes through – in the Netherlands there is also a wealth tax – we may see more risk appetite on the part of our clients and we want to support them in that. That should benefit the business.

Jason Kalamboussis: Great. Thank you very much. All the best, Kees!

Kees van Dijkhuizen: Thanks!

As there are no more questions, thank you very much all for all the questions you raised. This then concludes the Q4 results update, my last one as CEO. I would like to thank you all for all your questions and valuable feedback in the last few years. It was a real pleasure to work with you in the last seven years as CEO and CFO. Thank you very much and goodbye!

End of call