Commentary

Dutch Banks: Solid H1 2021 Performance Following Loan Loss Reversals

DBRS Morningstar
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Issuer	Debt	Rating	Trend
ABN AMRO Bank NV	Long-Term Issuer Rating	A (high)	Stable
Coöperatieve Rabobank UA	Long-Term Issuer Rating	AA (low)	Stable
ING Group NV	Long-Term Issuer Rating	A (high)	Stable

This commentary focuses on the H1 2021 results of the large Dutch banks: ABN AMRO Bank NV (ABN AMRO), ING Group NV (ING), and Coöperatieve Rabobank UA (Rabobank) (collectively the “Banks”).

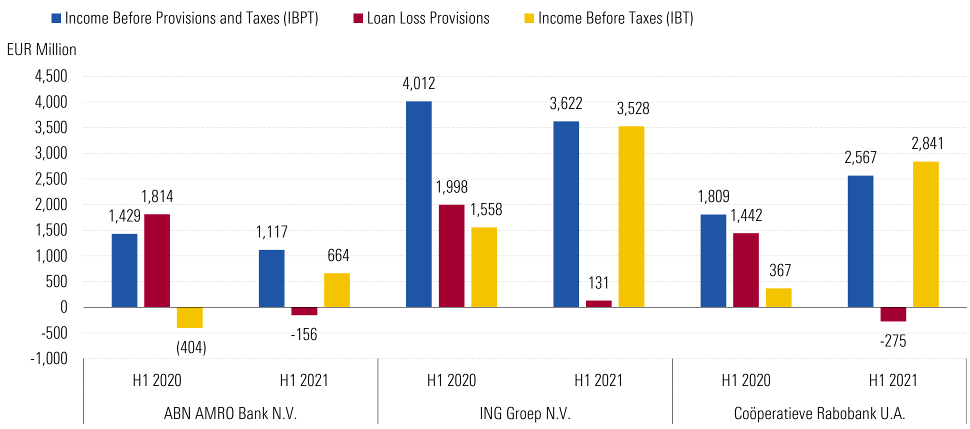
Overview

- H1 2021 results of the major Dutch banks were solid, as reserve releases, fee income growth and positive valuation results compensated for lower net interest income (NII).
- Asset quality continued to improve, however, uncertainty surrounding asset quality developments persists and the Banks remain cautious, as support measures are being withdrawn. Compliance and investments in effective anti-money laundering (AML) systems remain an important area of focus for all Banks, with one bank incurring a fine during H1 2021.
- DBRS Morningstar considers all the large Dutch banks to have solid capital levels. We expect those capital ratios to decline, once the current economic uncertainties subside and regulatory changes take effect. However, we expect the Banks to remain well capitalised given the Banks’ robust capital cushions, recurrent profit generation, as well as the relatively long implementation timeframe of regulatory changes.

Margin Pressure Continues, But Fees Improve

On an aggregate basis, the large Dutch banks reported pretax profits of approximately EUR 7.0 billion in H1 2021, up from EUR 1.5 billion in H1 2020, thanks to a reversal in the cost of risk. Aggregate operating income also increased by 3.3% YoY, despite lower NII, due to healthy fee income and increases in other income such as fair value adjustments on securities and investments. Aggregate NII decreased by 2.8% YoY, reflecting deposit margin pressure from ultra-low rates, only partly mitigated by TLTRO III and the charging of negative rates on deposits. In addition, in the Netherlands many of the support measures were administered by the government directly, thereby lowering demand for commercial loans. Going forward we see some positive momentum. As government measures are phased out, loan demand should pick up, which in turn should help Dutch banks meet the lending thresholds for additional TLTRO III benefits. Also, starting July 1, 2021, all Banks have introduced negative rates for deposits above EUR 100,000 and EUR 150,000 respectively, compared to previous thresholds of EUR 250,000 to EUR 500,000.

Exhibit 1 Earnings Profile – Major Dutch Banks



Source: Company Reports, DBRS Morningstar.

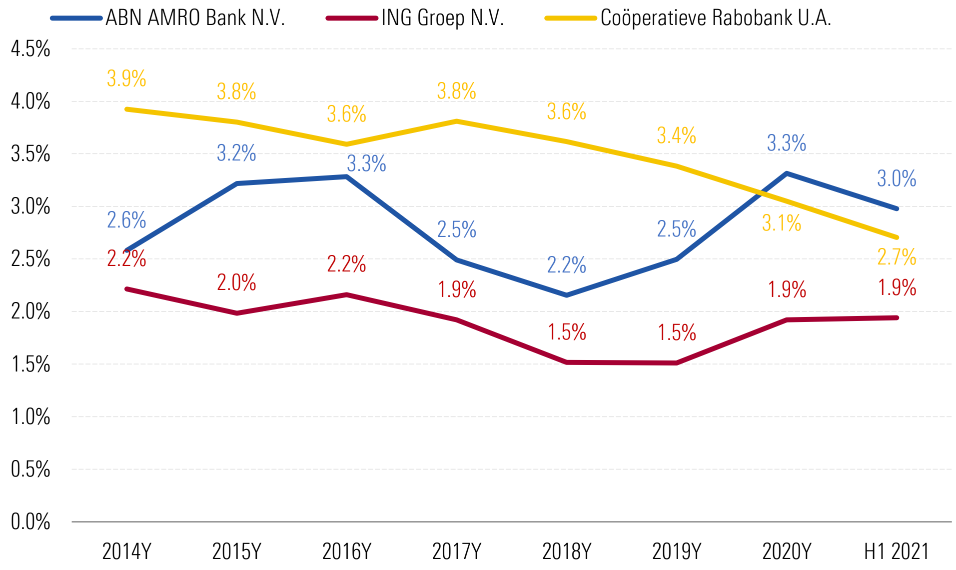
Expenses Affected by Regulatory Costs and Restructuring

On an aggregate basis (excluding a EUR 480 million settlement at ABN AMRO), total operating expenses increased by 0.9% YoY in H1 2021, largely driven by AML-related investments, regulatory costs, and restructuring costs, as efforts to reduce costs have been implemented. The aggregate cost-to-income ratio for the year was 59.9% compared to 61.3% in H1 2020. All Banks plan on taking advantage of the increased demand for digital services that resulted from the pandemic in order to accelerate the reduction of their branch network and have been refocusing their footprint. However, headwinds remain, and for the foreseeable future we anticipate compliance and AML-related costs to remain elevated. Regulatory costs are relatively high in the Netherlands and not likely to come down.

Cost of Risk Drives Results

On an aggregate basis, the Banks' impairment charges swung from EUR 4,673 million in H1 2020 to a release of EUR 300 million in H1 2021. This was primarily driven by the fact that credit impairments remained low as shown in Exhibit 2 and an improved macroeconomic outlook, that led to a general reduction in Stage 1 and Stage 2 loan loss reserves. However, all Banks have maintained sizeable management overlay buffers to safeguard against potential future credit quality deterioration, which we consider prudent. For the remainder of the year we anticipate an increase in the cost of risk, but we expect the full-year numbers to remain below the through-the-cycle average range of about 25-30 bps for the three Banks.

Exhibit 2 Impaired Loans / Gross Customer Loans - Dutch Banks

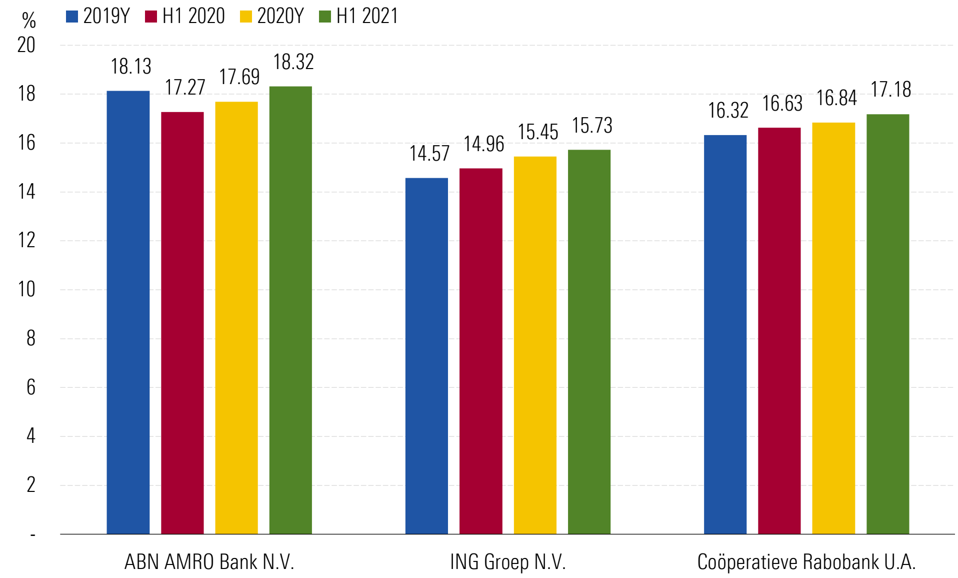


Source: Company Reports, DBRS Morningstar.

Capital Ratios Strong, But Likely to Come Down

Dutch banks reported strong capital ratios at end-H1 2021, supported by internal capital generation and certain regulatory measures that have been postponed, suspended or pulled forward by regulators in order to support bank capital ratios during the pandemic. With banks in the Netherlands well positioned, the Dutch Central Bank has decided to introduce the previously announced mortgage risk weight floor in the Netherlands as of January 1, 2022, which is expected to lead to lower capital ratios. In addition, some further reductions are expected from the targeted review of internal models (TRIM). Starting in 2023, the gradual introduction of finalised Basel III rules ("Basel IV") will further increase risk weighted assets (RWA). Currently, the Banks estimate additional RWAs of approximately 15-18% on average as a result of the "Basel IV" implementation. ABN AMRO estimates that the application of the Basel IV framework would result in a CET1 ratio of approximately 16%, compared to an actual Basel III ratio of 18.3% and current SREP requirements of 9.6%. The Bank has a longer-term Basel IV target of at least 13%. Rabobank expects RWA inflation at the lower end of 15-18%. An increase in RWAs of 15% would translate into a CET1 ratio of ca. 15% at end-H1 2021, everything else being equal, compared to a 2024 target of 14% and current SREP requirements of 10.0%. ING has guided towards a longer-term Basel IV CET1 ambition of 12.5% versus the current Basel III ratio of 15.7% and a SREP requirement of 10.51%. Overall, DBRS Morningstar views the three Dutch banks well positioned to absorb upcoming regulatory changes by relying on solid capital generation as well as healthy buffers.

Exhibit 4 CET1 Ratios - Major Dutch Banks



Source: Company Reports, DBRS Morningstar.

Dutch Banks Proved Resilient in 2020 EBA Stress Test

The EBA published 2021 stress test results in July, which included an adverse an scenario, that was based on a prolonged severe Covid-19-related economic downturn leading to a cumulative drop in EU real GDP of 3.6% from 2021 to 2023, a significant decline in residential real estate and stock prices and an extended period of negative rates. Under the severe scenario, the EU banking sector would stay above a CET1 ratio of 10% compared to a CET1 ratio of 15% at the beginning of the measuring period, with the drop mainly caused by credit losses, but also due to a decline in revenues.

Dutch banks started the stress test exercise with higher capital ratios than many other European peers, and, as a result, on average ended with higher capital ratios, except for Rabobank which saw its CET1 ratio decline to 10.02%, in line with the European average. ING's CET1 ratio dropped to 10.99% under the adverse scenario, while ABN AMRO saw its ratio fall to 13.51%. Credit losses and a reduction in NII were the main drivers for the decline in capital ratios for the Banks, though credit losses would be most severe for Rabobank under this scenario. All three banks saw their NII decline by 20-30% by the end of 2023 compared to 2020, with ING at the higher end.

Related research:

• DBRS Morningstar Confirms the Kingdom of the Netherlands at AAA, Stable Trend, 16 July 2021.
• European Banks' Q1 Cost of Risk Almost Back To Pre-Pandemic Levels, But Unlikely to be Sustained, 27 May 2021.
• ABN AMRO Q1 2021: Putting AML-Related Uncertainty Behind, 14 May 2021
• ING Q1 Results: Gradually Reverting to Normal, 7 May 2021.
• ESG Factors for Financial Institutions, Part One: Environmental Factors, 27 April 2021.
• DBRS Morningstar: Dutch Banks' CRE Exposure – Risks Contained, 30 March 2021.
• European Banks Report High FY20 Cost of Risk, but Little Impact on Asset Quality To Date, 30 March 2021.
• Gender Diversity at European Banking Boards: Still a Long Way to Go, 22 February 2021.
• European Banks' Outlook Remains Challenging in 2021, 14 January 2021.

Notes:
All figures in EUR unless otherwise noted
Sources: ABN AMRO Bank Interim Report Second Quarter 2021 and Q2 2021 Roadshow Booklet, Cooperative Rabobank Interim Report 2021 and Investor Presentation H1 2021, ING Group Interim Report for the six month period ended 20 June 2021 and Q2 2021 Investor Presentation, and European Banking Authority 2021 EU-Wide Stress Test.

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