Q2 2018 Analyst Call Transcript

ABN AMRO Investor Relations
Wednesday, 8 August 2018
11:00 CET

Participants: **Kees van Dijkhuizen:** , CEO; **Clifford Abrahams**, CFO; **Tanja Cuppen**, CRO; **Ruud Jaegers**, Deputy head of Investor Relations

Conference call replay:
https://www.abnamro.com/en/images/Documents/050_Investor_Relations/Financial_Disclosures/2018/ABN_AMRO_Analyst_and_Investor_Conference_Call_Replay_2018_Q2.mp3

Kees van Dijkhuizen: Good morning and welcome to the analyst and investor call for ABN AMRO's Q2 results. I am joined by Clifford Abrahams, our CFO and Tanja Cuppen, our CRO.

Today, I will run through the Q2 results and also update you on CIB, as promised.

Turning to slide 2, I will highlight the main points. I am pleased with our financial results for the second quarter with a solid net profit of EUR 688 million. Our operating income remained strong and impairments have reduced significantly compared to the previous quarter. Our capital ratio has improved strongly to 18.3%, reflecting balance sheet management and is now well placed within our target range. We have declared an interim dividend of EUR 0.65 a share, in line with last year.

We are also progressing with our strategic agenda and are well on track to achieve our 2020 financial targets. We are taking action on CIB, our corporate bank. I will go thru the details later but will summarise here. We will refocus the global sectors of CIB and reduce RWAs by 5 billion by 2020. Together with cost reductions of EUR 80 million, we will deliver an ROE of 10% by 2021. Last week, we announced the acquisition of a private bank in Belgium. This adds 6 billion of assets under management, strengthening our position in this attractive market.

I would also like to take this opportunity to announce an Investor Day on November 16th, to be held in London.

I will now highlight our sustainability activities and then update you further on CIB.

Within Private Banking, sustainable investments are now the default option for our clients in the Netherlands. I am delighted that over 80% of new Dutch clients are happy with this default. We will introduce this approach in Germany and France shortly. We are targeting at doubling our sustainable assets under management to EUR 16 billion by 2020 and making good progress. On the corporate side, we are involved in many interesting projects. We launched a EUR 200 million energy transition fund, which will focus on sustainable energy and carbon reduction. During Q2, we financed a 110 MW solar project in Chili, shown on this slide. We are committed to building out further our franchise around sustainability.

Now turning to our plans for CIB. I want to be clear with you that we have some very good client franchises. Our corporate franchise holds a top-3 position in the Netherlands. We also leverage our strong sector knowledge and domestic platform to serve selected corporate clients in North West Europe. Clearing is a top-3 global player, predominantly in derivatives contracts. The global sectors – which we often refer to as

ECT – have a strong client base, including many industry leaders. Finally, we have a number of product units which support the clients franchises. We have leading capability here, as evidenced by our top Extel ratings in the Benelux. However, CIB's financial performance has not been good enough. We have steadily grown CIB over the years – I am on slide 5 now- however cost have followed top line growth, which means that we achieved only limited benefits of scale. RWAs have also increased but to a lesser extent. Consequently, ROE has been disappointing over the years, remaining structurally below our group target of 10%-13%.
This conclusion does not change if we look through the recent elevated impairments and the cost for SME derivatives. We have Basel IV coming, so we will also be faced with high capital requirements in the future. All this means that we need to look hard at where and how we compete in CIB.

Turning to the next slide, I want to go into more detail on the individual sectors. Over recent months, we have done that in depth analysis. You see here on the left our sectors spotted against the key drivers of cost efficiency and margins. this allows us to view the sector's ROE in relation to these metrics. As you can see, generally our sectors deliver a return above 10% through the cycle. The two exceptions are TCF – Trade & Commodity Finance – and Global Markets. Global Markets will focus on a limited product offering, tailored to our core domestic clients further reducing its costs and RWAs. We announced this with the Q1 results. We have taken a careful look at our global sectors. Within TCF we will address low-return clients, de-risk the diamonds portfolio further and downsize the organisation reflecting these changes. Natural Resources and Transport & Logistics sectors meet the return target. Nevertheless, we want to reduce our exposure to highly cyclical sectors as well. This will mainly impact Energy Offshore and Shipping. We will continue to develop the business where we have both strong franchises and good returns, which is the Corporates Netherlands, Clearing and Private Equity.

Now turning to the financial impact of these plans. We will improve the return on CIB through three main levers. Reducing capital, lowering cost and transforming the business model. We plan to refocus global sectors and global markets and reduce RWAs by EUR 5 billion to EUR 34 billion by year-end 2020. This will benefit the group CET 1 ratio by 90 bps. We estimate revenues will be impacted by around EUR 100 million by 2021. We will right size the organisation to reflect that we will be servicing fewer clients. We will reduce cost by EUR 80 million through a reduction of CIB's staff of 250 FTEs, IT rationalisation and scaling down our international presence. CIB will take the restructuring charge of around EUR 50 million during the second half of the year. Reducing RWAs and cost are important but we also need to transform the business model to stay competitive, as we transition to Basel IV. We will further optimise capital usage, putting more emphasis on distribution. Our focus will be on core clients spanning multiple products and the sustainability franchise will be further expanded.

So to recap. CIB is core to ABN AMRO, serving an international active client base. Most sectors meet the group return target but CIB overall does not. We will reduce capital, lower cost and embark on transforming the business model.

Within global sectors, we will reduce capital in TCF and highly cyclical sectors leading to a net reduction of RWAs of EUR 5 billion. We will bring cost down by EUR 80 million, reflecting a more focussed CIB. You can see here –I am on slide 8- these measures will deliver an acceptable ROE of 10% by 2021 and better position us for Basel IV. Furthermore, the group as a whole these plans are also capital accretive, benefitting the CET1 ratio by 90 bps.

Now, I would like to hand over to Clifford to take us through our second quarter results.

Clifford Abrahams: Thank you. As Kees mentioned, we are pleased with the second quarter result of a net profit at EUR 688 million.

Last year, we booked the sale of Private Banking Asia, which explains the movement you see here in operating income. Expenses have trended down on the back of our cost saving programmes and impairments were down significantly compared to the first quarter of this year. Tanja will discuss these in more detail later.

I would describe the individual line items on the next slides, but first I will show the trends in our client lending on slide 10.

You see here mortgage volumes remain fairly stable over the quarter. We see house prices continuing to rise, however transaction volumes are lower. Competition remains strong, especially longer-dated mortgages and we remain price disciplined and have allowed our market share to decline slightly to 19%. Commercial Banking is growing well at attractive margins. We see growth across most sectors, reflecting the strong Dutch economy. Our outlook remains positive for the Dutch SME sector. Kees set out our plans to refocus CIB and we have already started to reduce the loan book during the second quarter. The rise in loan volumes measured in euros within CIB that we have delivered during Q2, you see for CIB is in fact wholly driven by dollar appreciation.

Turning now on NII on the next slide 11. NII was up compared to Q2 last year, mainly due to higher mortgage penalty fees. Corporate loans showed both volume and margin growth, mortgage volumes and margins remain broadly stable. This was offset partly by headwinds from the low interest rate environment. Our income related to our equity duration declined as a result. In addition, we have lowered our equity duration to position ourselves for future rate increases. This feeds into our NII outlook for the full year. We expect NII to increase compared to 2017, supported by mortgage penalties but partly offset by the effects of continuing low rates.

Moving now to fee income on the next slide 12. I mentioned last quarter that the Q1 2018 fee income is a fair reflection of our current underlying run rate. This quarter’s fee is pretty much at the same level as last quarter. While other income remained above trend, this quarter Private Banking had a gain on a disposal related to an earlier divestment. This quarter – that is Q2 – accounting effects were also modest and private equity showed a decent result of EUR 29 million, following the very large gain in Q1 this year.

Now moving to costs on slide 13. As you can see from the left-hand chart, personnel expenses continued to trend down. FTEs have decreased by over 1,500 since Q2 last year and 400 since Q1 this year. During the second quarter we closed another 28 branches, bringing the total down to 151 branches by the end of Q2.

Other expenses are stable, excluding incidentals.

The right-hand chart shows how operating costs are declining, reflecting our cost savings programmes and divestments. The divested activities had an annual cost base of around EUR 100 million, so in this bridge around only EUR 25 million is due to the lower run rate and that is because we took EUR 56 million of transaction costs in Private Banking last year in relation to the disposal of Private Banking Asia. So, underlying cost savings improved by EUR 44 million compared to Q2 last year and cumulative savings now stand at EUR 570 million versus our target at EUR 900 million, which we announced at the end of 2016.

So, I am pleased with our costs performance so far but we have more to do.

I now want to say a few words on cost/income ratio going forward. Turning to the next slide 14. I am pleased with the declining cost/income ratio on the left-hand chart. Our cost reduction programmes are delivering, as I said earlier, and our run rate for the first half of the year is already in line with our EUR 5.2 billion cost guidance for 2020. Since we announced this guidance, we have divested our private bank in Asia and today, we have announced the CIB refocus, reflecting these developments that cost guidance can be resharpened to around EUR 5 billion. So, despite the impact on revenues from the CIB refocus, we are on track to achieve our target cost/income ratio of 56% to 58% by 2020.

I will now hand over to Tanja to update on impairments.

Tanja Cuppen: Thank you, Clifford. I am now on slide 15. Second quarter impairments were significantly lower than the previous quarter, in line with our guidance. Impairments taken this quarter are in the same industry sectors as Q1. On a number of clients in the onshore and upstream energy sectors, we booked some additional provisions. Healthcare-related impairments are concentrated on new files. We see these impairments as sector and file specific and not as indicative of a broader trend.

For drilling, offshore service vessels and crude tankers the market is challenging but it seems to have bottomed out. I do not expect substantial impairments for health care for the remainder of the year.
The indicators for the Dutch economy remain strong and the outlook here remains positive. As a result, we expect the overall defaulted portfolio to decline further.

The outlook for full year impairments continued to be below the through-the-cycle cost of risk of 25 bps to 30 bps. Of course, we can never exclude sizable impairments on individual clients.

I will now hand back to Clifford.

Clifford Abrahams: Thank you, Tanja. We are pleased with the strong increase in our CET1 ratio over the quarter. We have actively managed our RWAs, including the first effects of the CIB refocus.

RWAs reduced by EUR 3 billion during the quarter, reflecting credit quality improvements, reduced risk in our investment portfolios and lower volatility in global markets, reducing market risk.

Kees set our ambition to reduce CIB's RWAs by EUR 5 billion or 90 bps to Group CET1 ratio. We have already achieved around EUR 1.5 billion and so expect further benefits of around 65 bps to CET1 ratio. These will materialise over time more gradually through 2021. The leverage ratio improved to 4.1%, as we carefully manage our exposures here. As you are aware CRR2 will boost the leverage ratio once implemented.
I will now hand back to Kees.

Kees van Dijkhuizen: Thank you, Clifford. Looking at our targets, I am pleased with our ROE. I am on slide 17. We are committed to all our business units, delivering on group target. We are announcing action on CIB today in line with this commitment. We have worked hard to lower our cost/income-ratio but have more work to do to bring it structurally within the target range, as Clifford said. CIB refocus impacts our top line, so we will work even harder on reducing expenses.

Our CET1 ratio is 18.3%, well placed within the 2018 capital target range. We expect capital formation to continue. The CIB update strengthens capital generation further in the coming years. We are clearly more comfortable on the prospects of additional distributions this financial year. We maintained our interim dividend of EUR 0.65 a share, reflecting an increase in our interim payment to 50%. Our final decision on additional distributions will be made towards the end of the year. Following any potential additional distributions we want to remain within our CET1 target range.

We are well on track to deliver what we said out to achieve since the IPO and have made a number of adjustments to our initial plans, as there is a new team at the helm. Coming November is therefore a good moment for senior management to present ourselves and run through our plans in more details. I hope to see you all there.

Before we go into Q&A, I would just like to briefly recap the highlights on slide 18.

We delivered a strong quarter with a solid net profit of EUR 688 million. Impairments decreased significantly from Q1. We are showing good progress in bringing down the cost base. I have updated you on CIB and how this will benefit the capital position of the group.

Now, I would like to ask the operator to open the call for questions. Thank you.

QUESTIONS AND ANSWERS

Stefan Nedialkov (Citi): Good morning, I have two questions. In terms of the EUR 5 billion of overall CIB reduction could you let us know what is the associated Basel IV inflation that would have been there if you had not got rid of those EUR 5 billion of RWAs?

And the second question, in terms of potential capital return, how would you think in terms of buy-backs versus dividend? And what would be the timeframe determined for them, end of year or half year going forward?

Kees van Dijkhuizen: Thank you very much Stefan. I think it is a bit too early to say exactly what the effect on the EUR 5 billion would be. We have given a general update on that but we can ask Clifford of course. With respect to the capital return, as mentioned before, it can be an increase of the pay ratio but it could also be buy backs, although for both we need regulatory approval. We keep all options open. Clifford, can you say something on the Basel IV inflation?

Clifford Abrahams: Yes. As you know Stefan we have a Basel III target this year, of 17.5-18.5%. We announced in February that we thought the Basel IV impact was 35% in terms of RWA inflation at year-end 2017. Now it is clear that CIB has a higher RWA inflation than average and so, by targeting EUR 5 billion RWA reduction on CIB we should see the benefit of that coming through our numbers for Basel IV. We are managing the business for Basel III but clearly ensuring a good transition through Basel IV, as we set out in February this year.

Stefan Nedialkov: Thank you very much.

Farquhar Murray (Autonomous): Good morning, gentlemen, just two questions from me. First, on the CIB restructuring you have found obviously EUR 50 million of restructuring cost related to cost cutting but should we expect any upfront losses from the EUR 5 billion RWA reduction? I am just wondering if there is an element to that and indeed what is the chance of that in the second quarter, given you have made some progress there?

Secondly, a little bit of a follow-on from Stefan's question actually: given the CIB and the EUR 5 billion probably has more than average of Basel IV inflation but equally you have done this kind of balance sheet kind of clear-up and we obviously have seen a reduction in Basel III RWA in the quarter, are we still comfortably able to take the 17.5-18.5% indication from Basel III as a good indication of where you want to be ultimately under Basel IV or should we think of that as you wanting to drift up within that target range? Or can we just take the 17.5-18.5% pretty cleanly for the end of the year? Thanks.

Kees van Dijkhuizen: Thank you for your question. No, we do not expect any losses on portfolios besides the restructuring cost when we take actions on the EUR 5 billion.

With respect to the EUR 5 billion the question is that we would like to stay in that bandwidth. I think it is important to stress that in the past we guided on all the portfolios differently. We said that on mortgages it was flat, on the Dutch corporates we set more or less Dutch GDP – that is higher these days, by the way, 7% in the first half year and 5% last year – and we guided around world trade, which is a bit 5%+ on this ECT portfolio. It is important to notice that the EUR 5 billion is a nominal reduction from the figure we are at right now in Q1 of 39 to 34 at the end of 2020. Presumably you have all taken in your models an increase of 5% or EUR 2 billion a year. So, the decrease presumably is in your models a bit bigger but we do it as a nominal decrease.

With respect to the margin we have said that we wanted to update that every year. We will do that accordingly at the end of this year or the beginning of next year.

Clifford Abrahams: Just maybe just chipping in a little bit on Basel IV and how we think about that. As Kees said, we have a Basel III target for this year of 17.5-18.5%. We think the right way to manage capital this year is Basel III and we have set that by reference to our Basel IV views. So clearly, the difference between Basel IV and Basel III is going to vary over time, for example where we see credit improvements in the mortgage portfolio we get the benefit in Basel III and we do not see the benefit in Basel IV because of the very rigid approach there. So, you will see some pluses and minuses around Basel IV but we want to give confidence to the market that we have clear metrics. We are still in the Basel III – world and that is why we have a Basel III target. We are well placed in that range and Kees indicated our appetite for distributions around that. At the end of the year we will have another look at that Basel III target to reflect developments. They could be developments around the regulatory world, the prospects for the systemic risk buffer and so on, how we are thinking about mitigations. There are a number of factors there that will factor into that target range. But we want to give clarity that we are focused on the Basel III target range, which underpins the statements we have made this morning.

Farquhar Murray: Ok, thank you very much indeed.

Bruce Hamilton (Morgan Stanley): Good morning. In terms of the phasing of the RWA reduction, obviously you are off to quite a fast start in Q2. Do you think it is possible that you deliver the RWA reduction quite a lot earlier than 2021 or because you want to try and avoid any sort of losses on routes and that is why it is a kind of a slow phase? Then, I guess you are saying that all capital above 18.5% should come back to shareholders and you will determine that on an annual basis. And I guess the only other constraint would be the leverage ratio. I presume you always want to be above 4%. Could you just clarify on that?

My second question is on the new guidance for 2020. I guest costs are EUR 200 million lower and revenues, because of CIB, are EUR 100 million lower. It feels like an embedded upgrade though your cost/income guidance implies revenues at EUR 8.6 billion to EUR 8.9 billion. So, is there just a bit of caution around NIM or am I trying to read too much into that? It looks like it should be a slight upgrade but then your cost/income is implying a slight revenue downgrade. So, I am trying to understand the dynamics there.

Kees van Dijkhuizen: Bruce, I will take your first two questions and then Clifford will take your third question. As mentioned by Clifford, we have EUR 1.5 billion in Q2 for RWA's. As already mentioned our RWA reduction is focused in TCF and Global Markets, which of course are – on average – relatively shorter-term transactions. That is the reason why we started and have a good effect in the second quarter already. So we might deliver earlier than end of 2020 with respect to RWAs. We will of course look into that to see what is possible. Regarding the leverage ratio we indeed want to stay above 4%. That is correct. Clifford, can you say something on the last question?

Clifford Abrahams: Yes. I broadly agree with you, Bruce. In terms of upgrades you are referring to your and your peers' views. We remain committed to 56-58%, I know consensus was slightly outside that range ahead of this call. We thought it was helpful to clarify that we are committed to EUR 5.2 billion, that we sold Asia and if you factor in today's announcement, we are very much targeting around EUR 5 billion. I think, there probably is a little bit more caution around the income than recent quarters, partly reflecting sustained low interest rates. You are seeing that in the comments I made regarding NII but also, that we are taking capital out of CIB. We have been growing that strongly recently and so do not expect income to power ahead in CIB as we take capital out, but we do expect sustained increase in ROE, which we think is in the interest of the business.

Bruce Hamilton: Great. Helpful, thank you!

Bénoît Pétrarque (Kepler Cheuvreux): Good morning. I have two questions, the first being on assets quality. You seem to be a little bit more positive than you were last quarter. So, I just want to confirm this view. You have commented that HealthCare will not be an issue in H2 potentially, Offshore Services have been turning the cycle and I do not see any big impairments in Shipping, which was also problematic last quarter. I just want to understand better what changed your view. Are you happy now with the clean-up process you have done in the past two quarters? What is specifically the outlook for H2? I think you are guiding for less than 25-30bps for the full year but specifically for H2, how do you see the loan loss provisions moving?

My second question is on the CIB. I just want to understand how you will actually address the lack of scale benefits you have seen at the CIB operation over the past years, because you want to reduce cost by EUR 80 million but top line you will also shrink by EUR 100 million, so a limited effect on the cost/income ratio for the CIB operation. Excluding the EUR 80 million of cost reduction, how do you see cost moving at CIB going forward?

Just to come back on your growth outlook: is your 5%, rebased from the EUR 5 billion, still a good proxy for future loan growth for the CIB operation? Thank you very much.

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

Tanja Cuppen: Thank you for your question. As indicated in the first quarter, we were cautious on several sectors. I will talk you through the different sectors. You have seen that indeed the impairments are significantly lower in Q2 versus Q1. If I look at the sectors. In Energy upstream we have seen some impaired clients where we had to add some provisioning but our outlook is more optimistic. We remain cautious with the Offshore segments where we see investments not fully coming back. In Shipping we expect to stick to the same provisioning levels as we have seen in the first half of this year and we also remain very cautious with respect to the segment related to Offshore. TCF is quite stable. Within TCF we have the diamond sector and that is a segment we monitor very closely, given the developments in that segments and also given the decision that we close our Dubai portfolio. All in all, our outlook is quite stable for the rest of the year. We do expect that we continue to be below 25 – 30 bps cost of risk through the cycle. I forgot to mention the Healthcare sector, where we did a review of our portfolio and we do not expect any new substantial impairments in the second half of this year.

Bénoît Pétrarque: If I understand correctly you are now putting 22 bps cost of risk in Q2 but with quite a substantial amount coming from HealthCare. Can we expect something lower than 20 bps for H2?

Tanja Cuppen: If you listened carefully to my guidance and did the math, we indeed expect a lower cost of risk for the second half than for the first half.

Clifford Abrahams: I will pick up the outlook for CIB. It is important to emphasize that we have reset the outlook for CIB. The 5% growth that we have seen historically we do not expect that going forward. We have seen income growing but we have also seen RWAs growing quite strongly in CIB. The statements that Kees made are in respect of the current position. So, we are looking to take EUR 5 billion of RWAs out. In absolute terms from Q1 to the end of 2020 it will have a reduction of income of EUR 100 million, so not a change in growth per se but we are guiding to EUR 100 million impact of that. We are being realistic; if we are reducing the capital base we need to recognise that will have an adverse impact on income. Clearly, the teams are going to work hard on that to see if we can mitigate that but fundamentally we are planning for a decline in income in CIB, which is why we need to work hard on costs. The EUR 80 million cost savings and those are expressed in the same way as our original EUR 900 million. So, we will take those costs out and then maybe some residual inflation in terms of wages and so on. We are not expecting a dramatic reduction in the cost/income ratio in CIB. This is really about refocus and redeployment of capital rather than transformation of the cost/income ratio. We are not looking for that and I think it reflects a realistic plan and one that is focused on de-risking, rightsizing and positioning the business and Basel IV rather than as a step change in earnings.

Bénoît Pétrarque: If you just strip out the EUR 5 billion RWA reduction and also the cost reduction you are planning, what will be the underlying growth of the CIB business going forward? Just stripping out all the restructuring you are planning to do in the next three years, what will be the underlying growth of the division going forward?

Clifford Abrahams: That is not the way we are thinking about it. Kees has indicated that we are targeting 5 billion RWA reduction, from 39 billion to around 34, and that is what we expect: 34. The same is in costs. In costs you have some underlying inflation around that but we are not going to come back and say that we have delivered on our restructuring but that the business has changed in the interim and so it is a different business. That is not what we mean. We are being clear; we are looking for the business to change trajectory and that will release the capital we have indicated.

Bénoît Pétrarque: Ok. Clear. Thank you!

Benjamin Goy (Deutsche Bank): Good morning. I have two questions. The first is on Dutch mortgages. You mentioned you slipped below the 20% market share, so any thoughts on this going forward are appreciated. Do you see more potential for off-balance sheet measures in case competition remains intense?

Secondly, on the SME derivatives provision. There was another charge in Q2. You only said you had 600 clients that have received compensation, so much more to come still. I assume some of the provisions you have already booked, also for the files under review. So, any thoughts about potential H2 charges and whether we can close this chapter by the end of 2018?

Kees van Dijkhuizen: Thank you very much Benjamin. What we said about Dutch mortgages is that indeed we have been disciplined and have accepted a bit lower market share to keep margins in place, as you also see reflected in our NIM. We will continue to do that. We sometimes think about off-balance sheet perhaps in the 20-years domain but it is not a main focus point at this moment in time. As said, we will stay disciplined on ROE margins and alike and market share is a secondary one.

With respect to derivatives, we do not expect an extra amount to be taken in the second quarter. Indeed, we have sent letters to 800 clients and we are in the process of sending a lot of additional letters now. We have already sent letters to our auditor for audit and we have been in agreement with the AFM sending these also to our clients. That is over 1,500 letters, so hopefully we can do that in the coming weeks so that we are able to send much more letters to clients. We have provisioned for all 7,000 derivatives we have on our files.

Benjamin Goy: Thank you.

Kiri Vijayarajah (HSBC): Good morning, everyone. A couple of questions on the CIB refocusing. Could you give us the loan losses associated with the 5 billion RWAs to be exited, the normalised number or the 1H number? You have given us the revenue and the cost, so the loan loss number there would be helpful.

Then going back to the bubble chart on slide 6 and the impact of Basel IV: I am just curious why there is no action or shrinkage plan to the corporates NL because that is right on the cusp of your curve for 10% ROE. Presumably, it slipped downwards under Basel IV, so really your thought process there while there is no sort of action on that quite sizeable bubble for corporates NL.

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

Tanja Cuppen: On the loan losses related to the CIB refocusing: we assume going forward in our projections a through-the-cycle cost of risk of 40 bps for CIB. You have seen it has been elevated over the past period but that is what we assume. We do not assume additional provisioning because of the reduction, as we take a gradual approach here to minimise losses.

Clifford Abrahams: And just picking up your second question Kiri. Just looking at the chart, we have plotted the various businesses in respect of Basel III. Basel III remains the current regulatory basis for the next few years and it is important that all our businesses are delivering on Basel III, which is why we are taking particular action. The third element of our strategy is transforming the business model. We recognise for those businesses that delivering under Basel III they will need to do better under Basel IV. We have time to transition those franchises. The sorts of things we are working through is, as you would expect, is looking very closely at the rules, particularly when they crystallise. So, for example, shifting our franchise to more rated issuers and away from collateralised lending. There is work within the structures of the new regulation to mitigate the direct impact but also, as we have said, we really need to do more distribution of risks rather than just us warehousing those risks. So, I think we are a fairly traditional corporate bank where we maintain very largely on our balance sheet the loans we originate. We need to work the franchise harder, both here in the Netherlands and overseas, to distribute more of those risks whilst serving our client franchises well. We can make that transition over time, as we see some of our peers further along in that journey.

Kiri Vijayarajah: Ok. Great, thanks.

Pawel Dziedzic (Goldman Sachs): Thank you for the presentation. I wanted to ask you if you can give us a little bit more clarity on the timing of the reduction in RWAs and associated loss in income and then reduction in cost? We know the end point but how should we think about getting there? For instance, you managed to upfront quite sizeable cuts in your RWAs already in Q2; should we expect anything similar for Q3 and should we expect any income loss in Q3 on the back of the cut in RWAs in Q2? So, any details around that would be very helpful.

Then a follow-up on cost of risk as well. You mentioned that overall you expect lower impairments in the second half of the year. Obviously, they came down in this quarter but also on the back of the releases in the retail segment. Should we expect more of that going forward as well?

Kees van Dijkhuizen: Thank you Pawel. No, we do not expect a similar decline in the third quarter as in the second because 1.5 billion was a very significant one, 30% of 5 billion. We have mentioned the end of 2020, so that is when we want to have the result anyhow. We will see if we can do things quicker but it is too early to say. Of course, income losses are related to that timeframe.
With respect to your second question, Tanja?

Tanja Cuppen: With respect to cost of risk, indeed, we have seen some releases in retail in the first half of this year. The outlook is good, so we expect that to continue but it will be to a lesser extent given the low levels of provisions that we see. We are reaching the top of the cycle, so implicitly in my messages is that we expect lower additions in the other segments.

Pawel Dziedzic: That is clear. Thank you. Can I just come back to the RWA evolution? You expect some growth and the 5 billion number is net of growth, if I understand correctly. So, should we think about a reduction of RWAs as a gradual process from now to 2020 or is there a possibility that RWA-reduction related to CIB would be somewhat frontloaded, which means that your RWA will dip below 34 billion and then grow subsequently?

Clifford Abrahams: I can see this is an area of focus. The 5 billion is net, so we are withdrawing capital from those particular sectors that we have identified while looking to see growth elsewhere. We expect the 5 billion to come out, as Kees said, by the end of 2020. I think it is important to recognise that RWAs can be volatile and we are pleased with the progress in Q2 but we definitely do not expect to see that repeated in Q3 and Q4. To some extent we manage to act on some of the short-term business and we are mindful of the impact and the quality of the book through an accelerated reduction, so we want to manage that sensibly over time. If you run the numbers, if the RWAs come out by the end of 2020, then the full income benefits you will not see until 2021, as you get the full run rate benefit of that. On costs, we are looking to deliver that through 2021 but very largely by 2020. So hopefully that gives you the guidance you are looking for.

Pawel Dziedzic: Okay. That is very helpful. Maybe just once more a clarification. On your 3 billion RWA move just this quarter, we know what is related to CIB but can you comment for instance on Group Function, what drove the change there and do you expect any volatility in the second half of the year?

Clifford Abrahams: Yes, in Group Functions we have done some de-risking so we have exited some low-rated sovereign positions. It had jumped up in Q1 and we wanted to bring that down as we were focused on capital, as we should be. There are one or two other things going on in Group Functions, so we wrote down the value of an investment, which hits a capital but benefits RWAs. I would emphasize that we are very focused on capital and RWAs, Basel III and increasingly Basel IV but we see volatility quarter-on-quarter, which can hide the underlying trends. We will be keeping a close eye as you will on RWAs thru 2020.

Pawel Dziedzic: That is very clear. Thank you.

Johan Ekblom (UBS): Can we just talk a little bit about the NII on a divisional basis? I am trying to understand the trends. We saw quite a meaningful reduction in Retail Banking and I was wondering whether this is the kind of pace of NIM decline we should be expecting there, given where savings rate is and the competitive position you talked about in the mortgage space?

Then if we look both in CIB and in Commercial Banking we saw a relatively good performance in terms of both NII and NIM quarter-on-quarter. Are there any timing differences, for example in CIB in terms of running off some of these RWAs? It looks like quite a large sequential improvement in margins.

Finally, and sticking to the NII: if we look at the underlying NII in Group Functions I think it is multi-year low this quarter. Can you say anything about what we should expect there, going forward?

Clifford Abrahams: There are a few things going on quarter-on-quarter. In Retail Banking we have taken a hit in relation to our credit card business ICS that runs through the NII line, so you would need to strip that out. If you do that, to me it looks pretty flat in Retail, in NII. We see headwinds over time in Retail and if you look at margins they are still pretty strong. You can see we are defending margins by taking market share loss. So, I think you should not expect margin expansion from here in Retail Banking.

In terms of the Corporate Bank we have grown over recent quarters, prior to the refocus we have just announced. That has benefitted NII in terms of NIM. We have lightened up on some of our leverage ratio-heavy areas and that would have benefitted NIM.

Finally, on Group Functions, as you rightly say, looking through some of the incidentals, you see some negatives coming through and that reflects a couple of things that I mentioned on the presentation, which is the effect of low interest rates on the earnings that we make. We call it our equity duration but it is effectively the earnings on our capital position. We have a duration so we benefit from an upward sloping yield curve on the EUR 20 billion of our equity. Now that yield curve has flattened, so earnings are going down. We have also reduced the duration of our equity because we think we want to be better positioned for higher rates when they come through. So that will have reduced it. It costs us money to maintain our liquidity buffer and the costs of that are material and they come through the Group Functions line and get hit by low rates.
It was those factors that I was thinking about when I talked about headwinds of low rates. Now I have talked it through and you see where it appears.

Johan Ekblom: If I understand correctly we should not be expect any immediate improvement in the Group Functions, but maybe I can come back to CIB and Retail. On CIB, when do you start to run off more of these RWAs? Should we expect not only that NII will go down because of volumes but also because of NIM contraction from the Q2 level? On Retail, you had exactly the same credit card provision in Q1, so I guess the reduction of EUR 14 million in NII quarter-on-quarter is predominantly margin driven. The volumes are essentially flat, right? Or am I missing something there?

Clifford Abrahams: On CIB, we have announced the 5 billion in RWAs and EUR 100 million income reduction. That largely reflects net interest income. The loan impact is of that order of magnitude, so you get a feel for the revenue margins. We are focusing the contraction in some of the low-revenue-margin product areas, as Kees talked through. That should give you a feel. We are hoping to improve the quality of our book on a risk-adjusted basis by downsizing in areas of low-revenue margins but also downsizing in areas of high volatility, some of which have quite good revenue margins. So overall, you need to do that to deliver on the cost of risk improvement that Tanja talked about.

In terms of NII I am going to refer you offline to the IR team to talk through the incidentals because I cannot see the ICS that you refer to. There is a bunch of other things going on quarter-on-quarter, but overall we are seeing in Retail quarter-on-quarter is flattish through incidentals, but over time headwinds relating to the things that we discussed earlier, the continuing low rates.

Johan Ekblom: Perfect, thank you.

Tarik El Mejjad (Bank of America Merrill Lynch): Good morning. I have a couple of questions. First on your deleveraging or the restructuring of CIB. I think it is a very good initiative to get rid-off or deleverage some of the low-profitability businesses but I was a bit surprised that you could not actually point to any area where you could reallocate some of this capital or RWAs that deliver higher returns. There has been a lot of discussion today about shrinking but not really a perspective for growth. That gives two roads, one is for M&A, so can you discuss your ideas there for a bit and which area outside Private Banking you could expand non-organically. And then the dividend. So I understand from the big focus on RWAs deleveraging pattern it would be more progressive, because I guess you have done all the low-hanging-fruit already in Q2. Would that mean that any capital return increase or higher pay-out or share buy-back will be more towards 2020 and beyond or progressively growing or will that be like a more radical change in dividend policy once we get to 18.5% or so by the end of the year?

Kees van Dijkhuizen: Thank you, Tarik. Indeed, we talked mostly about the decline because that is centrepiece in our approach at this moment in time. Of course there are some areas and especially the ones that are on the left-hand side of the chart where we feel comfortable to grow. We definitely are going to grow, because it is a net figure of 5 billion RWAs. We will see where we can do deals where we can make good returns and do that. Now, for us it is important to focus on the decline of the 5 billion. That is our main target at this moment in time.

You made a remark about the Private Bank. As you have seen now with Société Générale in Belgium and the EUR 6 billion of assets under management, we have mentioned since the IPO that could be a possibility in Belgium, France or Germany. Definitely, if we see areas of growth, also inorganically in Private Banking, we will do that. I already mentioned Commercial Banking in the Netherlands doing better. I gave guidance before of 7% in the first half year, so there is some growth there.

With respect to dividend, we have always said we would have a gradual approach in the sense that it is of course a yearly approach. At the end of the year we will look at this year what we can do with respect to 2018, as said pay-out higher than 50% and/or buybacks. So, it will be a gradual approach and not a back loaded 2020 approach.

Tarik El Mejjad: So the guidance will be on a year-by-year basis. I have just one follow-up question on costs. I am a bit surprised by the Private Banking in Asia and the new guidance on EUR 100 million lower costs from that. That deal was done one year ago, so why is this coming now? I just want to understand the rationale.

Clifford Abrahams: Frankly, we have always been clear on the EUR 5.2 billion and we have noted consensus, I do not know what you had pencilled in for us. I think we got more comfortable that we can manage down costs and we think it is important to come up with a new target and new clarity around the EUR 5 billion. Our primary target has always been cost/income ratio and we think it is helpful to give you a sense of how we are going to get there. Given the revisions to income that we have talked about, particularly in respect to CIB, we thought it was helpful to be clear on the EUR 5 billion.

Tarik El Mejjad: Thank you very much.

Alicia Chung (Exane BNP Paribas): Good morning, just a couple of very quick questions. First, of these 5 billion RWA reduction can you break down what proportion comes from each of the CIB subsectors and then, to the remainder, where you are not reducing, what is your outlook in terms of loan growth by subsectors, even if it is just very high level?

Then on costs, looking at 2018 specifically. What can we expect in terms of investment and cost savings this year? Can you give any guidance on cost growth? You have talked about the restructuring cost but that aside. Thank you.

Clifford Abrahams: I will try and be helpful. I am not going to give numbers in respect of the segments but the 5 billion is net, as Kees has said. We expect most of that from TCF, which includes Diamonds. We do expect some further reduction on the Global Markets side, so they were the bubbles on the right-hand side. Kees indicated we are looking to de-risk pockets of Energy and Shipping, where we see the risk adjusted returns as not what we are looking for.

In terms of growth within that net figure, we are comfortable with the franchises in the top left, so we will continue to grow in North-West Europe. So, we are pleased with the progress that we are making in Belgium, the UK and Germany in particular. You will see incremental growth there. We have set out our appetite to grow in new Energy, so that would be within Natural Resources. So, we do see some areas of growth but we are committed to the net 5 billion and the gross reductions will clearly be bigger than that 5 billion. Together with some incremental growth takes us down to a net 5 billion. Hopefully, that gives you some colour.

In terms of costs, just reflecting on your questions, I think we are pleased with the cost/income ratio for the half year of a little over 56%. There will be some incremental restructuring in the second half of the year. We have announced something in respect to CIB but then maybe further restructuring with respect to the work that other parts of the business are doing. We saw levies up a little bit in Q1, so there are a few things going on but we are feeling comfortable around our progress on costs and are fully on track to meet our 56% to 58% cost/income ratio-target with the new income outlook, as set out on this call.

Alicia Chung: Thank you.

Marcel Houben (Crédit Suisse): Good morning, I have two questions left. Can you tell us a little bit about the expectations regarding your Investor Day? What to expect, the hard financial targets are already set. Secondly, there was some press coverage on the financial vehicles, some potential benefits from lower funding cost. Is this already in this CIB update or is it incrementally? Thank you.

Kees van Dijkhuizen: Thank you Marcel. No, let’s manage expectations here upfront with respect to the Investor Day. After three years after the IPO it is to show you the new team, so that we are able to present ourselves and tell you about all the things we have done in the last 1.5 year. That is what we are aiming for and not all kinds of expectations about new targets and alike.

With respect to the press coverage, indeed that was yesterday. Those are vehicles that we are looking into ourselves. We do not expect material effects of them on our figures.

Marcel Houben: Thank you.

Maxence Le Gouvello Du Timat (Jefferies): Good morning. I have a question for you regarding the investment banking on the revenues on RWAs. In 2017 you had a margin of 4.85 and taking into account the adjustment that you have announced this morning in terms of RWA reduction and the EUR 100 million of revenue loss you are now moving to 5.10. This quarter you have achieved 5.3. What is your goal in terms of revenue on RWAs going forward as you mentioned that you are going to optimise some portfolios and get rid of some clients that are not really profitable? Any kind of colour would be much appreciated. Thank you.

Clifford Abrahams: We are looking for making a better use of our capital, so improving our income over RWAs. You have seen some mixed benefits that you refer to and we expect to see those to continue. I mentioned on the previous question that it is a bit of a Barbell-approach, so we are looking to reduce in areas of low income to RWA where we are just not getting the returns we are looking for. But we are looking to lighten up on what our quite high income to RWA is where we do not like the risk profile. So you see the two effects going on. Those should net out. Actually it is a sort of improving income over RWA or further improvements, modest improvements. The challenge for the business and the sector is to build more fee income. It is not just about mix and moving to high income, which can often be a high risk as well; it is sharing more of the risk we originate, so that we are leveraging our own capital. That is what I would like to see the business doing over time and I think we have the time ahead of Basel IV to deliver on that. But that is the third part of our strategy, to transform the business model and that will help those income margins.

Maxence Le Gouvello Du Timat: So you want to accelerate in terms of originate-to-distribute. You are not the first one to think about it. The question on those elements in terms of strategy is the distribution capacity. Do you have some pre-agreement with some asset manager of life insurer to give some ability to accelerate on that part or not yet?

Clifford Abrahams: You are right. We are not the first to talk about it but the good news is that we are behind in that area. There are peers that are perhaps further ahead, so that we can learn from an adopt best practice. There are market templates out there. I think we have a very strong financial institution's franchise in Europe and in the Netherlands in particular, so we feel we have all the elements to make that transformation. We need to do that over the next few years and that will help the economics of that business. Frankly, that is the way corporate banking in Europe needs to go, which is a little bit more of a US model but under Basel IV we clearly believe that this is the right business model to succeed and be relevant to our clients going forward.

Maxence Le Gouvello Du Timat: It is exactly what Natixis did five years ago, they moved from revenues on RWAs below 5 to well above 6. It that reachable for you?

Clifford Abrahams: I am not going to comment on the numbers. I am familiar with Natixis. We really do have strong client franchises, both with corporates and financial institutions. So, we think we have the elements to really succeed in this space if we focus on this.

Rajesh Kumar (Société Générale): Thanks for taking my question. The first question is on MREL. You mentioned that your MREL target is at 29.3%, based on own funds and subordinated instruments. I am just curious about why you have not included preferred senior as well? Are you expecting any changes in stance and you might have to fill the whole MREL bucket using own funds and sub debt only?

My next question is on issuance. I believe there is no plan for NPS in H2. What about AT1 any plans on that?

Clifford Abrahams: We have adopted a prudent approach, as you say. You have the prospect of RWA inflation around Basel IV, so we think this is the right way to prudently manage the transition. We do not have current plans in respect of AT1 this year.

Rajesh Kumar: Okay, fair enough. Just to be very clear on MREL. Going forward, are you going to include preferred senior or not? You very clearly said that you intend to fill to 29.3% just by own funds and sub debt only. What is your stance there.

Clifford Abrahams: I do not have a lot to add. We are aware of the rules and we are very comfortable. The fact that we are relying already on more junior instruments I think demonstrates the strength of our balance sheet.

Rajesh Kumar: Ok, fair enough. Thank you.

Nick Davey (Redburn): Good morning, I have two questions. The first is on the CIB plan but it is a simpler question, which is whether it is enough. Looking at the >10% ROE in 2021, it has struck off 13.5% CET1 allocated. If you have to run the group at 18-18.5% that is really a plan to get the divisional returns to maybe 7 or 7.5% a few years away. You are taking 5 billion of RWA out but Basel IV probably puts them back again. I guess the question is why not more. Are EUR 80 million of cost reductions really getting you down to the bone? Do you not see this business still being a drag on valuation three or four years from now? I am sorry for the direct question but it is just not evident to me.

The second question will be on rates sensitivity. Thanks for the earlier discussion about the EUR 20 billion of equity and shortening the duration, but could you just help us with a few more bits of information, so we understand which points on the yield curve we are watching and at what point things are being a drag and when become a positive? Could you give us any more disclosure on the overall swap position and at what duration? Just some ingredient parts, so we know what we are watching for.

Kees van Dijkhuizen: Thanks for the question. Is it enough? No, it is not enough. We clearly stated that this is what we should do and we want to repair the roof when the sun is shining. That is what we are doing with respect to getting as quick as possible above 10% ROE in the Basel environment, which these days for European banks, corporate banks, CIB banks and other banks is already a serious challenge. Indeed and as mentioned by Clifford, we have to take further action as well. We mentioned the distribution model, we think about the rating, there is much more to do which we will do. We have some time for that but it is definitely not the case that three years from now we are not going to do anything else than what we have said today.

Clifford Abrahams: We give a little bit more colour on rate sensitivity on page 34 of our quarterly report where we quote the duration of our equity in years of 1.6 down from 2.2 in December. That is the movement I referred to earlier. So, if you do double it you think about the maturity. So, it is low single-digit. Those are the areas with the yield curve to look at. There is obviously more going on in those lines, but that should give you a feel for the income opportunity related to our equity duration.

Kees van Dijkhuizen: Sorry Nick, my microphone was not okay, I heard from people, so I will repeat my answer to your question. It is not enough ROE so indeed we have to do more originate to distribute and look for rated loans instead of unrated. So, we are definitely going to do more in the coming years than what we just mentioned.

Nick Davey: Thank you. Can I just ask a quick question on the rate sensitivity? Clifford, if I understand well 1.6 years, you are using basically 3-years swaps, is that right, on average?

Clifford Abrahams: Yes, on that element of income but I also mentioned costs of liquidity. So, there are other things going on that are impacted by the low interest rate environment. You will recognise the way we manage our risk. We lock in rates over time but as those swaps roll off we then move into the current low interest rate environment. That headwinds sort of grinds through our P&L.

Nick Davey: So, where do you think the net of all of that is? At what point can we stop worrying about the low-interest rate environment or when do you think you are positively geared to rising rates?

Clifford Abrahams: I have given an indication earlier in our NII guidance. We are looking for rates to start moving up in these sorts of durations at the end of next year. To the extent that it gets further out, that will have an adverse impact on our margins. That is how we think about it.

Nick Davey: Ok, thank you.

Alex Koagne (Oddo BHF): I have two follow-up questions. The first is on your CET1 ratio. I am sorry if I missed the answer but I am assuming you hit the 18.5% by the end of the year. Should I consider that everything above that number should be given to shareholders or used for acquisitions, meaning that you do not want your capital to be over the 18.5%?

The second question is on the Other income line. You were able to beat your target on the quarterly basis, so why don't you update this target going forward?

The third question is on the distribution in the CIB. Is the FTE reduction a net number or do you need to hire people to build your distribution platform? Thank you very much.

Kees van Dijkhuizen: thank you very much Alex. Definitely we will give CET1 above 18.5% back to investors. I would say the distribution is a figure that is attached to the operation we are doing now. Of course, if we need other people or if you would need other people for distribution, we can do it as we are. But if necessary then we will do that.

Clifford Abrahams: Regarding Other income I think that is a fair comment. We like to be prudent here. I think you got that message throughout the call. There are quite some volatile items, so I think we are comfortable with the current guidance and we reflect on that going forward.

Just one comment, just to build on Kees comments. Our current target is 17.5-18.5%. When we are in that range, we will consider additional distributions. So, we are not waiting until it is above 18.5% in order to consider that. Obviously, we are well placed in the range, so you are seeing we are more comfortable with the prospect of additional distributions. That should give you a feel for our decision making towards the end of the year.

Alex Koagne: Yes, but at the same time I can say that when you hit the 18.5% you could be in the position where 100% of your net profit could be returned to shareholders. Is that something that you may consider?

Clifford Abrahams: Kees was very clear. As a CFO I would say that we would certainly consider it but if there is a credit crisis looming we need to be looking out the windscreen and not through the rear view mirror.

Alex Koagne: Sure! Thank you very much.

Kees van Dijkhuizen: That is why I am happy with my CFO.

Bénoît Pétrarque (Kepler Chevreux): Just a final question. Could you disclose the gross RWA reduction from CIB, just to get a feel about the underlying growth embedded in that figure? I am looking for the growth of the RWA reduction.

Clifford Abrahams: We have not disclosed that, so the growth is somewhat bigger than the 5 billion. We have not disclosed it. We also need to recognise the business needs to trade through, so market conditions, opportunities will change between now and 2020, so the business needs flexibility to trade through that. What we are committed to is a net reduction of 5 billion.

Bénoît Pétrarque: Great. Thanks!

Kees van Dijkhuizen: As there are no further questions, thank you very much for your questions. This then concludes our Q2 results update. Hope to talk to you again next quarter and definitely with some of you at an earlier occasion. Thank you very much and good bye!

---End of call