Q2 2022 Analyst Call Transcript

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Conference call replay:
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Robert Swaak: Good morning and welcome to ABN AMRO's Q2 results. As always, I'm joined by Lars Kramer, our CFO, and Tanja Cuppen, our CRO. I'll update you on the main topics for this quarter before we start the Q&A session.

So let's turn to slide two for the main events of this quarter. Although the outlook is indeed uncertain, the Dutch economy continued to perform well during the second quarter. We managed to add new business to our lending portfolio, both for mortgages and corporate loans. And as we know, on 27th July, the ECB ended a negative rate environment. So as a result, our deposit margins are rapidly recovering, and this led to an improvement in our outlook for the full year NII.

Fee income increased strongly year-on-year, driven by good results in our credit card business and clearing. And on costs, we are dealing with higher investments in regulatory levies. The full year 2022 costs are now expected at around €5.3 billion, which I'll further detail shortly.

We did have a quarter of net impairment releases, and this contributed to a strong net profit of €475 million. Now we set our interim dividend at €0.32 per share, which represents 40% of our half year results, which is in line with our dividend policy. Our capital position remained strong with a 15.5% Basel III CET 1 ratio.

And we have obtained approval for a share buyback of €250 million. Now this approval is conditional and can only be used in case of a potential sell down by the Dutch government. The approval does not come with an explicit end date, so we are able to support a potential sell down at short notice, if and when it may come.

So let's turn to slide three, where I'll say a few words about our delivery of the strategy execution.

Starting with the first strategic pillar, the customer experience. Tikkie started out as a peer-to-peer payment app. We are continuously broadening its use. Recently, we entered a partnership which offers restaurants contactless ordering and payments, which are handled through Tikkie.

Our Chatbot Anna is continually being upgraded, now allowing SME clients to check on the progress of their account request. The digital experience is highly valued by our clients with high net promoter scores. Our relational net promoter score for SMEs is, however, impacted by a new fee structure, where we pass on some of the KYC costs, which we incurred to clients.

With regards to sustainability, we continue to make good progress in our overall climate strategy. We will present the climate strategy later to you this year.

Straight-through processing is an important aspect of making our bank future growth. Currently, 63% of our high volume products and services are now processed straight-through, and it includes payments, savings and mortgages within Personal & Business Banking. Our target is to have 90% of our high volume processes working straight-through by 2024.

Let's talk a little bit about the Dutch economic indicators on the next slide, slide four.

Looking at consumer spending, bankruptcies and house price developments, these are all holding up. Our low impairment levels during the first half of the year reflect these macro indicators. However, looking at the low consumer confidence level, which is a good forward indicator, we do see a slowdown in economic growth from the impact of higher energy prices in the war in Ukraine. We expect a recession in Eurozone with GDP contracting in the coming quarters, and we expect the Dutch economy to follow a similar trajectory. Inflation will remain high in 2023, but expected to drop towards the end as higher energy prices begin to feed through into the economy.

Turning to our second quarter results. This is on slide five. During the second quarter, our mortgage share increased to 17.5%, making us market leader in the Netherlands. Our mortgage portfolio grew by €1.7 billion. Commercial momentum in corporate lending remained high with the loan book growing by €1.1 billion. Around one-fifth is due to new clients, and this includes further growth from our Northwest Europe strategy. Deposits grew by €2.1 billion during the second quarter held by payment of holiday allowances. And now that the interest rates are back in positive territory, deposit growth will benefit NII.

Turning to slide six. I'll update you how positive rates are feeding through into our NII.

During the second quarter, deposit margins improved strongly as the yield of the replicating portfolio is rising. As we flagged previous quarter, higher rates lead to lower prepayment penalties. Also, as rates rise, we assume clients with a low coupon mortgage will be less inclined to refinance their mortgage. The effect is an increase in the expected maturity, and leads to higher hedging costs. Lower prepayment penalties and higher hedging costs more than offset the increase in deposit margins this quarter.

Now looking forward to the second half of the year, we expect a further increase in deposit margins, but to a lesser extent as negative client rates will be removed in two steps. On 1st August, our negative rate was increased to minus 25 basis points. And as of 1st October, we will cease charging negative rates.

We did not offer any repayment of TLTRO, and this will support NII in the coming quarters. Prepayment penalties are close to bottoming out and will lead to limited further pressure on NII going forward. The impact of hedging costs for the mortgage portfolio is harder to predict as this depends on how interest rates will continue to move from here.

All in all, we now expect full year NII around €5.2 billion and the NII to bottom out some time during the second half of this year.

Turning to slide seven on fees. Fees are up 12% year-on-year and all client units have contributed to this result. Both clearing and payment services fees showed strong performance. Stock markets were down in Q2, leading to less trading activity and lower asset management fees. Although slightly down from last quarter, Other income was again strong, driven by hedge accounting related results at ALM and decent private equity results.

So turning to costs then on slide eight. This quarter, we added €34 million to the AML remediation provision. We agreed with our regulator to incorporate some additional requirements and are committed to finalise the remediation in 2023. And as you can see from the chart, underlying costs are stable, showing small declines over the past two quarters. We are making good progress on cost savings, though this is not fully showing through due to an increase in investment spend.

These additional investments are, for example, in the area of data sourcing. We have also faced with – we are also faced with the delay in migrating applications to the cloud, amongst others, caused by Schrems 2 developments. And as a result, we're bolstering our on-prem cloud infrastructure, which was not in our original plan.

So looking ahead to the second half of the year, we plan to bring down IT costs by reducing external FTEs and decreasing our spend on contractors. In addition, we expect to make a good step in bringing down our business as usual AML costs, again, by reducing external FTEs. Many processes are still manual, and we will increasingly automate processes and focus our efforts on areas with the highest AML risk. Now, partially offsetting these savings will be, amongst others, higher regulatory costs as we face higher contribution for local bankruptcy and some inflationary pressure.

Taking all factors into consideration, I expect the underlying cost base to start declining, leading to full year cost of around €5.3 billion, of course, excluding the incidentals.

Now that takes us to our 2024 cost target on the next slide, slide nine. Shown here on the left is our expected cost base for 2022 of €5.3 billion. We split out the €1 billion of costs for non-core, regulatory levies and AML. On this part of our cost base, we are looking to achieve an aggregate over 40% cost reductions towards 2024. This is versus our original strategic plan. We now assume the SRF and DGS contributions to decline in 2024 once these funds are filled, resulting in around €200 million lower regulatory levies. And I discussed how we plan to bring down AML costs, and this will contribute to over €100 million.

In addition, the non-core wind-down is on track, delivering another €100 million. So then moving to the main cost base at €4.3 billion for the full year 2022. Here, we're looking to achieve a cost reduction of around 5% by 2024 or around €200 million. Overall, our cost savings programmes need to exceed inflation by around

€100 million. Savings will be achieved through a lower IT run and change costs and further organisational and product simplifications, for example.

The final component I already mentioned being the heightened investment spend for strategic initiatives. So we assume a normalisation further reduction towards 2024 of around €100 million. So I remain optimistic we can drive our costs below €4.7 million by 2024.

Turning to loan impairments. Our impaired loan portfolio decreased compared to previous quarters by around – I should say, to the previous quarter by around €0.5 billion as we saw repayments, sale of non-performing loans and cured loans. This led to impairment releases, which were partly offset by model adjustments related to our residential mortgage portfolio. These adjustments captured some of the effects of the strong rise in house prices and increased refinancing risk for interest-only mortgages.

We continued an overlay for the uncertainties following from the war in the Ukraine on the economic developments. So looking ahead, we expect the cost of risk to remain below the through the cycle rate of 20 bps in the second half of 2022.

Now turning to slide 11 on our long term financial targets. Let me just recap the main messages. We have two good quarters, leading to an ROE of 7% over the first half year. This result was helped by impairment releases this quarter.

And we are at an important junction in terms of our operating income. The positive interest rate environment means NII is indeed bottoming out and underlying costs are peaking as our cost savings are delivering. These positive jaws will lend support to our results as we go into an uncertain future.

We are well prepared in terms of capital buffers, given our strong capital ratio. So far this year, including final dividend, the completed share buyback in this interim dividend, our total distributions amounted to around 40% of our current market cap. With the approval for a €250 million share buyback, we can support our majority shareholder in a potential drawdown if and when they decide to do so.

Our intention to use share buybacks to optimise the capital position has not changed. We will evaluate next steps on capital distributions, as we talked about previously in the fourth quarter. And of course, we will then take into account the capital position and the outlook at that time.

Now that brings me to the end of our Q2 presentation. I'd like to ask the operator to open the call for questions.

1 Questions and Answers

Operator: If you would like to ask a question, please press star one on your telephone keypad. Please ensure your line is unmuted locally, as you will be advised when to ask your question. We ask that you please limit yourself to two questions at a time. So once again, that's star one if you would like to ask a question. The first question comes from the line of Robin van den Broek from Mediobanca. Please go ahead.

Robin van den Broek (Mediobanca): Yes. Good morning, everybody. Two questions I have to pick. First of all, on NII. I was just wondering if you could give us an update on the constant rate scenario that you've given at the Q1 stage. So basically, what kind of uptake can we expect on NII from replication treasury in 2023 and 2024, if rates stay flat per certain date? And in relation to that, I was just wondering if there's any changes going on considering your hedging strategy. In the past, you've always talked about the barbell with an average maturity of five years. I was wondering if that's still the same or did you have a view there and are moving it around a bit?

Then the second question, I'll concentrate on costs. You're below €4.7 billion as you reiterated, but as opposed to before, you're now also leaning on lower regulatory levies. So it does sound like the underlying narrative on cost has deteriorated year-to-date. I was just wondering what exactly was that? Was it inflation? Were there other factors that were driving that? And what can give us the certainty that this does not continue to slip? Thank you.

Robert Swaak: Yeah, Lars, could I ask you to take the question on NII and give a little bit further detail on cost, the assumptions?

Lars Kramer: So on the NII, I mean, we haven't updated our sensitivities that we shared in the first quarter. What we have obviously done is upgraded the guidance for the current year. And that guidance is driven by the non-early repayment of the TLTRO. So that is one of the bigger contributors as well as, as we did say in the last quarter with the sensitivity, there is a component of additional pickup even this year and we are seeing that coming through.

Now in terms of future expectations, I think we need to see what the forward rates do actually pan out to be. I mean the one thing I can say is that our current forward rates, we do continue to see that we will get to a 10% ROE if they play out by the end of 2024.

In terms of the hedging strategy, no, we haven't really changed our hedging strategy at the moment. I mean that – it is dynamic. It will – it's very sensitive, obviously, to how things are evolving in terms of customer behaviour. But at the moment, we haven't changed any strategies materially. I mean, we're obviously doing more hedging as the curves steepen.

And then on the costs, the deterioration in terms of our longer term prospects, we are still firmly sticking to and committed to our €4.7 billion. And what we've tried to give you this quarter is a little bit of line of sight as to how we expect to get there. And you're right, the levies that we are including at a lower amount of €200 million, but we've also looked at the core cost base that Robert was referring to.

And in that core cost base, net of inflation, we are seeing – we are building an additional reduction. And the inflation that we've built in there for some insights is around 2-3%. So that is something that we are also having to take into account. So that's probably where the deterioration comes from that you're referring to.

Robin van den: Okay. That's very helpful. Thank you.

Robert Swaak: Thanks.

Operator: The next question comes from the line of Tarik El Mejjad from Bank of America. Please go ahead.

Tarik El Mejjad (Bank of America): Hi. Good morning, everyone. Two questions, please. First of all on NII. Can you please clarify why you couldn't go back to zero in terms of charging for retail deposit rates way, given ECB went to zero in July? How confident you are that from a political point of view you don't have any resistance to that? And I think some of your competitors already moved to zero straightaway. So – and what would be then the guidance on NII if you have to move to zero in August instead of October?

And then second question, maybe I will then focus on capital. So in your final remarks, you reiterated the 50% threshold for buyback. But last year – I mean this year, in February, when everything was fine before the war, we were expecting you to return everything above 15% and be constructive on capital return. You didn't deliver on that. What – why would you – why do you still keep this policy of 15% above the share buyback, where clearly you are building way above that – way above that 16% plus by year-end? And how you can give us confidence that you will distribute that capital? Thank you.

Robert Swaak: So let me take the question on NII. Lars, do you want to reflect on the threshold, the 15%?

Yeah, on NII, as far as I'm aware, there's only one competitor that's moved directly to 0%. We communicated a very clear two-stepped approach. We moved up 25 bps – we would remove 25 bps of negative interest around 1st August, and remove the remaining 25 bps 1st October. That doesn't change our NII guidance, those steps that we have taken. So we were – including the steps we are currently taking to bring off the negative rates, we would still stick to the guidance around the €5.2 billion.

Then maybe, Lars, on threshold.

Lars Kramer: Yeah, in terms of the thresholds, at the moment and what we also have reiterated in Q1 is that this threshold is not a constrained factor for us at the moment. And therefore, our framework stays in place. As you can see in terms of our conditional share buyback that we've worked on this quarter, we are still committed to returning capital. We've also been consistent in saying that we want to have a deliberate but moderate strategy of capital return over time and that it is a multiyear approach. So the intention was never to immediately return everything above the 15%. So – and I think we are still continuing with that sort of approach.

Tarik El Mejjad: Sorry, just to follow up on this last point. I mean, if I remember well, the idea was that you return above 15% and then conversions from 15-13% will be done over time. So what you're saying now is that even going to 15% will be gradual?

Lars Kramer: Well, going to 15% was in terms of also where we set the first share buyback at about €500 million. At that point, we said that we would try to come back on a multiyear approach and the €500 million to become something a bit more consistent. So from the perspective of the €500 million over how many steps and when does it hit the 15%, that's – I wouldn't say the two are instants immediately linked. It's only when it becomes a constraining factor that we would then address it.

Tarik El Mejjad: Okay. Thank you very much.

Robert Swaak: Thank you.

Operator: The next question comes from the line of Giulia Aurora Miotto from Morgan Stanley. Please go ahead.

Giulia Aurora Miotto (Morgan Stanley): Yes, hi. Good morning. One clarification first on capital distribution. I believe previously you said that to launch the new tranche of the buyback, you will need clarity or visibility on the full year results. And my read of that was that it was open between basically Q3 results or full year results. Is this still the case? Or would you say that really we should expect any new – we should not expect any new capital announcement before the full year results, which will be most likely in February I guess? So that's the first question.

And then the second question, I know the Netherlands is not particularly reliant on Russian gas, but if there was a cut-off, of course, this would have an effect on overall macro assumptions and I guess potentially also the link that the economy has with other European countries. So have you run a scenario of a Russian gas cut-off and what that could mean for cost of risk for ABN? Thank you.

Robert Swaak: Yeah, I'll ask Tanja to address the second question, Giulia. Thank you for your questions.

On your first question, it is still our intention to review the capital return, as we talked about in Q4 or around the period in Q4, having then full visibility on full year results. So the share buyback that we've now announced, which is conditional on NLFI, doesn't change that intention at all.

Giulia Aurora Miotto: So that would be – can be also in November because then you would have enough visibility or not really? It would be –

Robert Swaak: When we have sufficient – so when we have sufficient visibility on the full year results. And I don't want to – that could be November, but it really depends on how this year further evolves, as I'm sure you appreciate.

Giulia Aurora Miotto: Okay. Perfect. Yes.

Tanja Cuppen: Yes. And Giulia, on your question with respect to dependency on Russian gas, indeed, the Netherlands is not that dependent on Russian gas, but of course, is an open economy and will be impacted by the developments in Europe more broadly. We do – we have run a scenario to include a complete cut-off in Europe from Russian gas. That's actually our negative scenario. That's also included in our quarterly reports. And that impact is mainly learned through the macroeconomic variables that deteriorate. And you will see that it leads to a recession in the Netherlands in case that would happen.

Of course, it's very difficult to estimate what – which individual companies will be impacted because that depends very much also on all kind of supply chain effects that we will see at that point in time.

Giulia Aurora Miotto: And do you quantify it? Sorry, I might have missed it.

Tanja Cuppen: No. We don't quantify it externally. The only thing that you can read in our report is the effect of the negative scenario for Stage 1 and Stage 2 provisioning. So that would lead to additional Stage 1, Stage 2 provisioning of, I think, around €75 million.

Giulia Aurora Miotto: Okay. Thank you.

Operator: Next question comes from the line of Farquhar Murray from Autonomous. Please go ahead.

Farquhar Murray (Autonomous): Good morning, all. Just wo questions, if I may. Firstly, thanks to the details on slide nine on cost. That's actually really helpful. I'd like to focus on the net cost savings figure of €0.1 billion that you flagged on the core cost base. Could you possibly decompose that between inflation and actual cost saving elements that you currently anticipate? And could you also update me on how this compares or tell the original cumulative cost saving target, €700 million? I'm presuming you've possibly incorporated some incremental savings to offset inflation. But I just wanted to understand that.

And then finally, and apologies if I missed this earlier. But how did you arrive at the €250 million buyback approval figure? Was there any math around that? Or is it just an informed guesstimate that might you seek incremental approvals later this year, if necessary? Thanks.

Robert Swaak: All right. Thanks for the questions. Lars, can you take the cost question and I'll address the €250 million.

Lars Kramer: Yeah, on the net cost of saving of €0.1 million, what we've done there is effectively looked at an inflation amount of about €200 million, which translates into roughly about 2-3% on that core base and then looking at savings of around €300 million. And these savings are pretty much in terms of the underlying initiatives are very much broadly part of the same underlying initiatives that you're referring to in terms of the €700 million. So we just continue with those and execute.

Farquhar Murray: Okay.

Robert Swaak: Yeah. And then on the €250 million, basically, we took a view, as you recall in Q1, we came off of our inaugural share buyback. We wanted to have – for any further decision on share buybacks, we needed to have more clarity on full year results. We knew because the minister had signalled that she had asked NLFI to investigate conditions under which a potential sell down could occur. We then took a view that in order to support if and when such a sell down would occur in order to support it, we would have to come up with a number for in terms of a potential share buyback.

That number of €250 million was predicated on the fact that it's an open-end permission that we have from the JST, from the regulator. Because clearly, this is an approval that is conditioned on a sell down by the government. So it's, in that sense, open end.

We also take into consideration the uncertain economic times, clearly that we're up against and that we're all up against. And therefore, we came to a number of €250 million. We feel that this is a number that would adequately support a potential sell down by NLFI.

Farquhar Murray: And just as a follow-on, how does that 2-3% inflation assumption compare to, say, what you've achieved in terms of the CLA conversations to-date?

Robert Swaak: Well, we're yet to have the CLA conversations. So those conversations are due to start at the end of August.

Farquhar Murray: Okay. All right. Thanks.

Robert Swaak: Thank you.

Operator: The next question comes from the line of Benoît Pétrarque from Kepler Cheuvreux. Please go ahead.

Benoît Pétrarque (Kepler Cheuvreux): Yes, good morning.

Robert Swaak: Good morning.

Benoît Pétrarque: So yeah, a couple of questions on my side. So first of all, on NII. So if I understand correctly, you still guide for €0.2 billion incremental in 2023 versus 2022. Probably we need to adjust for the lower TLTRO benefits than coming in 2023. So if you could just confirm that?

And also, what is your view on the pass-through going forward? It seems that the exit of negative rates went a bit faster than expected. Does that change potentially your view on a potential pass-through above the 0% a bit more intensive versus your expectations?

And then also on NII rates to go up – far to go further on that. But what is your view currently on the mortgage market? Clearly, we see extremely high margins on front book margins. But we also see volumes coming down. So others that play into NII for the rest of the year, will that be a net positive on NII, or will that be broadly neutral? So that's the first set of questions on NII.

And then the second one is more on cost. I think you have this €5.3 billion for 2022. Do you expect restructuring costs for the second part of the year, also may be linked to a potential agreement on the CLA?

And just very final, I don't understand why a regulator approves the buyback conditional to, well, the exit of this state on the sell-off of the state. I mean, could you still be able to execute a buyback in the states say in a couple of days or weeks? Well, it's not the right timing for first to exit. Just wanted to understand why a buyback can be conditional to a shareholder selling basically. Thank you.

Robert Swaak: Okay. I'll take the share buyback questions. Lars, do you want to address NII costs?

The – so yeah, that condition is just indeed predicated on the – on a decision that the NLFI will take. So if they don't take a decision, there is no share buyback. There's no €250 million in share buyback. If they do take that decision, then we are – we have permission and approval to execute the €250 million share buyback. I think you should see that irrespective of an overall consideration that we will have towards the end of the year, as we discussed this previously on share buybacks.

So this is a specific share buyback approval conditioned on a sell down. So if the sell down occurs, there's a share buyback. And if the sell down does not occur, there's no €250 million share buyback. In that sense, it is indeed open ended.

Lars Kramer: Okay. And on the NII, if I remember your first question was about a €200 million impact next year. I mean that €200 million, I think, if you're referring to what we showed as a sensitivity, I mean we haven't updated our sensitivities for next year. But what we have done is apart from upgrading the current year to €5.2 billion on NII, we've also moved forward the bottom of the NII from first half of next year to the end of this year. So I think that gives some indication that things have improved.

In terms of mortgage markets, you're right. I mean the margins at the moment are elevated in terms of over the past six months, but definitely the more – the volumes are well down. And you can see that also in terms of refinancing volumes and the prepayments that we were talking about. If I take a sort of combination of margins and volumes, I would say that on this one, I'm looking forward for the rest of this year, I'm pretty neutral because the bulk of our – the bulk of the movement really comes from margin improvement on the deposit book and then any offsets to that. And that probably links through in terms of your negative rate question is the negative rates will start feeding through partially in Q3 and then pretty much the full catch-up in Q4. And on an annualised basis, it will be up fully next year.

In terms of reorganisation provisions, we'll flag reorganisation provisions as and when they come. At the moment, I don't have a line of sight yet.

Benoît Pétrarque: Yeah. Thank you very much.

Robert Swaak: Okay. Thank you.

Operator: The next question comes from the line of Benjamin Goy from Deutsche Bank. Please go ahead.

Benjamin Goy (Deutsche Bank): Yes. Hi. Good morning. Two questions from my side, please. First, on net interest income. You booked €41 million of TLTRO III benefit in the second quarter. Should we expect the same run rate in the second half? And for how long would you book this benefit going forward?

And then secondly, just a quick one on management overlays. Could you update us on the total amount you have reserved so far? Thank you.

Robert Swaak: Thank you. Lars on TLTRO, and then Tanja.

Lars Kramer: Yes, in terms of the TLTRO, the €41 million we expect to see that coming through for second half of this year as well as probably through until June next year when we have contractual maturity. So we'll have to – that's the best prognostication.

Tanja Cuppen: And then maybe on the management overlays. Total management overlays amounts €350 million, and about 40% of that is related to Russian-Ukraine. And so 10% still COVID-related for the smaller end of our corporate portfolio.

Benjamin Goy: Very clear. Thank you.

Robert Swaak: Thank you.

Operator: The next question comes from the line of Kiri Vijayarajah from HSBC. Please go ahead.

Kiri Vijayarajah (HSBC): Yes. Good morning, everyone. A couple of questions. So firstly, in terms of the NII outlook for the second half, you've given us some really helpful guidance there. But I was just wondering between the third quarter and the fourth quarter, is it fair to assume it's going to be a bit of a V shape that the 3Q is going to dip a bit, and then it's really fourth quarter when we see meaningful improvement? Or is it going to be a bit more kind of linear between 3Q, 4Q? So just some colour on the timing of the NII evolution.

And then just quickly turning back to the management overlays on the mortgage book. Could you just tell a bit more detail on what you've changed in terms of your assumptions there, say, in terms of what your expectations are for future house price declines that you've now baked into the numbers? And have there been any specific triggers within the mortgage portfolio that's been the prompt here? Or is it more just a kind of forward-looking kind of general caution in terms of the outlook? Thank you.

Robert Swaak: Tanja, do you want to start on mortgages? And I'll take the NII question.

Tanja Cuppen: Yes. So on mortgages, maybe first on overall, what you see on the provisioning levels for mortgage, the first item that has an impact on the levels that we provision is the economic outlook. That, of course, is more negative than what we have seen before, and that is well in models. Then additionally, we indeed take a haircut on the house price projections, and we do that already consistently over time, but that you need to see this in combination.

And then the third item that we also include in the management overlay, the €350 million that I just mentioned, is looking at the refinancing risk for interest-only mortgages. And so at the end of the term of an interest-only mortgage, the principal is still outstanding and we – with the increased interest rates, it needs to be refinanced at a – well, an increased interest rate. And therefore, for some of our clients that will mean an increased risk.

And for that, there is a calculation we also do every quarter, but because rates have gone up, that amount is bigger. You see that also in the coverage ratio for mortgages that went up from 4.5% to 7.2%. So we are better protected there for downturn risks.

Kiri Vijayarajah: Thank you, Tanja.

Lars Kramer: Yeah. And then in terms of the NII evolution over the next two quarters, I mean I'd rather just stick with the fact that we are going to hit bottom in the second half. I mean, again, there are quite a few moving parts in terms of where prepayments go. If rates go up sharper and we have to do more hedging, it could have an impact. I think the negative rates clearly will have a bigger impact in the fourth quarter than they will in the third quarter because in the third quarter, it's 25 basis points for effectively two months, and then you get the full 50 basis points coming for the last pretty much for three months. So those are going to be the impact factors. So we are comfortable saying things are going to turn around by the end of the year, but I don't want to really go into the shape on a quarterly basis.

Kiri Vijayarajah: Okay. Great. Thanks guys.

Operator: The next question comes from the line of Anke Reingen from RBC. Please go ahead.

Anke Reingen (RBC): Yeah. Thank you. Good morning. Thank you for taking my question. The first is on the €250 million. I mean how quickly, or is it possible for you to scale it up in case the government decides to sell a larger stake and you could take more of those shares up? And on your comment to gradually reduce your excess capital, could further – I mean, I'm not sure if you can comment, but could basically further placing of government stakes accelerate that production excess capital?

And then secondly, on costs. How quickly should we get to the €4.7 billion apart from the levies? Is it pretty much back-end loaded or should we think about a gradual decline? Thank you very much.

Robert Swaak: Yeah, let me take capital, and Lars will back on cost. Yeah, on the €250 million, the €250 million right now is the €250 million. So we will await when and if NLFI communicates. And then clearly, we'll see what we need to do next. But the share buyback in relation to a sell down by the government as we've communicated today will remain €250 million.

Now what may happen in the future, any potential other sell downs at any given point in time. Clearly, we will have to assess then what we then need to do. For now this is the €250 million associated with a potential sell down of the government yet to be communicated. Lars?

Lars Kramer: Yeah. Again, in terms of the cost trajectory, the €4.7 billion is clearly our goal for the end of 2024, so full year cost 2024. In terms of trajectory, we are now getting into that window where initially a year ago, we were talking about things would be more back-end loaded into years two and three. And we are now approaching years two and three. So I would say there will be a bit more of a – I won't say a perfectly even path, but there will be step downs in 2023 and 2024 rather than it all being loaded into 2024.

Anke Reingen: Okay. Thank you very much.

Robert Swaak: Thank you.

Operator: The next question comes from the line of Guillaume Tiberghien from BNP Paribas Exane. Please go ahead.

Guillaume Tiberghien (Exane BNP Paribas): Yes. Good morning. I've got two questions. The first one relates to AML costs on the slide nine. If I understand correctly, you want to go from €500 million to just less than €400 million in 2024. That still seems quite a huge number as it would be like about 8% or 9% of your overall cost base. So any more room to cut beyond that level?

The second one is with regard to the NII in the corporate centre. You highlight the steering costs. Should we expect that this will now be allocated to the divisions from Q3 onwards?

And maybe a final one, if I may. On the RWA, any more headwinds to come either from models or from regulation, please? Thank you.

Robert Swaak: Okay. I'll take AML remediation, steering cost, Lars, and then RWA, Tanja.

I think what you're seeing the reduction we're looking at here in a more efficient AML process. This is the BAU. So this is the business as usual process that we are continuously upgrading. And that will come through the automation that we're currently investing in. Again, this is AML related to our business as usual activities. We are continuously looking at improved risk-based approaches, which will make our work on AML much more effective. And we'll continue to put those – the risk-based approach to you.

So we do expect and we've actually seen a continuous improvement around our AML BAU processes. So that's why we are quite confident on the number that we've included here.

On steering costs, Lars?

Lars Kramer: Yeah, I think in terms of steering and the accounting or the allocation of steering, I think we are being quite consistent in our accounting. I mean, this steering is not something new. It's elevated at the moment because of the interest rate dynamic. But we do steering on a continuous basis. So we're not planning on changing any of our allocations.

Tanja Cuppen: Yeah. And then on RWA. Yes, so maybe, first of all, to mention that how you see already for some time that our Basel III and Basel IV RWAs are converging. The Basel III number is coming up, that has to do with redevelopment of models. We will continue to redevelop models, but everything that we can see right now and have visibility on that, we have included in our RWAs. Also, we take steps to go to less advanced approaches to standardised approach our foundation ahead of Basel IV and also the visibility that we have there, we incorporate to the extent possible.

I think there's no new regulation on the horizon with respect to Basel III. And of course, for Basel IV, the translation into regulation is happening as we speak. And we hope that in the course of next year, we will get full visibility on the impact of that. I hope that answers your question. Yeah?

Guillaume Tiberghien: Thank you.

Robert Swaak: Thank you.

Operator: Next question comes from the line of Robin van den Broek from Mediobanca. Please go ahead.

Robin van den Broek: Yes. Sorry for coming back in the queue. The first question is actually, I mean, I don't really understand why the ECB cares about the NLFI participating in a buyback. Could you maybe specify clearly what kind of participation does that entail? Can I just do one share and still basically raise their overall stake? Or does the stake have to come down in that scenario? And if you do further buyback initiatives with your – in Q4, would that have a similar restriction, or can that just be a normal buyback?

And on fees, I noticed that there was still a bit of an uptick in wealth management – sorry, there was some net new money in wealth management. Just wondering what was driving that and how that would affect your outlook? Because I think in Q3, there's also a €50 million annualised bump from the increase in payment packages. So just wondering how you are thinking around the development side. Thank you.

Robert Swaak: I'll take the buyback, and Lars will take the second question. This is a buyback that we had applied for a share buyback of €250 million. And as you know, the regulator has to approve the requests that we've put in for share buybacks. It is conditional on the – on a potential sell down by the government. And clearly, that aspect plays into the open-ended approval that we then get from the JST.

We have to get permission and the reasoning for the regulator leads to the regulator. We got the permission. It is open-ended, and it is contingent on the state selling down or beginning the sell-down process.

Does this decision impact in any way potential other conversation we may have on share buybacks? When and if we decide to proceed with share buybacks at the end of the year, then we will have, again, the conversation that we continue to have with the regulator, which is a very constructive dialogue. So I would expect that at that time to occur as well.

Robin van den Broek: So just to be clear, in this specific buyback approval, you yourself added this restriction into the mix. And when you go for other buyback approvals, you're going to leave that out?

Lars Kramer: Yes. This is a very special – because it was basically, we wanted to anticipate also the approval timings would be very tight. So to get something done, so that we have it on the shelf actually required us to have something conditional to have something which was tailor-made in terms of size as well, taking into account the existing risks that we will face with the structure prices. I mean we still have a lot of unknowns coming our way.

Robin van den Broek: And the conditionals is – that the NLFIs stake goes down or –

Lars Kramer: Yes, the conditionality is that they actually do a sell down and trigger a sell down.

Robin van den Broek: But is that in absolute number of shares? Or is that in percentage the overall?

Lars Kramer: No, it's basically triggering a sell down, is the trigger.

So on the NNA for wealth, the net new money there was predominantly in our custody business. So – and there was a little bit of additional cash that was coming in, that wasn't really in discretionary portfolio management. So I don't expect that to have a significant boost to the overall fees in the second half. But it is still pleasing to see that there is new money coming in. I mean, obviously, on the wealth side, we're getting much more negative impact as a result of the whole portfolio under management coming down in value. But really, if you look at fees overall, we are now getting the final, I guess, tailwind of the card activity coming back to sort of pre-COVID levels also for the international component, not just the local component.

And with the volatility in the markets, really our earnings in the clearing space are holding up very nicely. So that more than offsets. Certainly on a year-to-year basis, it offsets and on a quarter-to-quarter basis, we were able to maintain fee levels overall.

Robin van den Broek: Thank you for that colour. Cheers.

Robert Swaak: Thank you.

Operator: The next question comes from the line of Omar Fall from Barclays. Please go ahead.

Omar Fall (Barclays): Hi there. Just two questions, please. Sorry, I must be a bit slow or I've missed something. But the conditionality around this specific €250 million buyback is that there would be no transactions with minority, well, non-NLFI shareholders. Is that correct that this is an entirely targeted buyback with NLFI? That's the first question.

And then second question, just going back to NII and slide six and those two components, the mortgage prepayment, sequential minus €40 million and then the steering costs, minus €50 million. You've highlighted that we're near the bottom for mortgage prepayments, which is kind of in line with one of your peers. And then the steering costs, I understand the bulk of that is front-loading of changing in the swaps supporting the mortgages.

So to be clear, mechanically, if rates don't move, these two components don't see any sequential change. Is that right? I'm not asking for guidance, just the mechanics of how those two elements work that if rates don't move, and therefore, you don't get a change in duration of the average mortgages and/or changes in prepayment activities that those two components don't move at least Q-on-Q. Thanks.

Robert Swaak: Okay. Let me take your first question. Lars, you can take the second question. We can – the way the transaction, what we structured will be by the NLFI. But we can do minority shareholders. That is included. So this is predicated on a transaction that the NLFI will instigate. And we don't know what the transaction would look like. It is for the NLFI then to decide and communicate. And then we will take next steps as to how we would structure the share buyback.

Lars Kramer: In terms of the prepayment impact and the hedging impact, yeah, if everything stays perfectly stable and pari passu in terms of no more prepayments or no more additional sort of significant interest rate rises, then you could say if we're comfortable with our position now, yes, then it stays stable. But again, these things are dynamic. We may take some views on duration management, which are different to today.

Omar Fall: And maybe, sorry, just a quick follow-up. So I think the prepayment penalties were just over €250 million or so last year. What's the run rate at now?

Lars Kramer: Look, I would say what we anticipate is that these prepayment penalties would probably drop back down to about €70 million a year. So we're not fully there yet.

Omar Fall: Got it. Thank you very much.

Robert Swaak: Thank you.

Operator: There are currently no questions in the queue. So as a reminder, please press star one if you would like to ask a question. And the next question comes from the line of Raul Sinha from JP Morgan. Please go ahead.

Raul Sinha (JP Morgan): Hi. Good morning. Thanks for taking my question. I've just got one follow-up on costs. I was just trying to understand what has changed relative to your previous cost trajectory in terms of you are now assuming €200 million of additional reduction in your costs from DGS in 2024. What was the offsetting increase on the other side in your original plan? If you can clarify that, that would be really helpful to understand where the costs might have changed or gone up relative to your previous sort of targeting.

And then related to that, can I just ask the basis for the assumption of 2-3% inflation? Is that linked to any kind of external indicators that you're tracking? Just to understand what might cause that to move higher or lower going forward. Thanks.

Robert Swaak: Lars?

Lars Kramer: Yeah. I mean the main thing that has changed in terms of our initial estimate is obviously the impact of that inflation number that you're talking about. And in terms of linking to external indicators, I mean, we do try also to look at what is the sort of core inflation over time rather than just the headline inflation. And obviously, that is in terms of our economic bureau as well as part of the information that we would use. So that inflation increase is about 2-3% per annum that we included that.

Raul Sinha: Got it. Thank you. And that's 2-3% per annum until 2024?

Lars Kramer: Yeah.

Robert Swaak: Correct.

Raul Sinha: Got it. Thank you.

Operator: There are no further questions in the queue. So I'll hand the call back to your host for some closing remarks.

Robert Swaak: Okay. Thank you very much. Thanks, everyone, for all the questions. I look forward to speaking again very soon. For now, goodbye.

Operator: Thank you for joining today's call. You may now disconnect your lines.

End of call