25 Oct 2019 | Rating Changed Outlook to Negative

Fitch Revises ABN AMRO's Outlook to Negative; Affirms at 'A+'

Fitch Ratings-Paris-25 October 2019:

Fitch Ratings has revised the Outlook on ABN AMRO Bank N.V.'s Long-Term Issuer Default Rating (IDR) to Negative from Stable and affirmed its Long-Term IDR at 'A+' and its Viability Rating (VR) at 'a'. A full list of rating actions is at the end of this rating action commentary.

The rating actions are part of a portfolio review of major Dutch banking groups rated by Fitch.

ABN AMRO's Long-Term IDR and senior debt ratings benefit from a one-notch uplift above its VR due to a large buffer of qualifying junior debt (QJD), which would protect the bank's senior debt from default in case of failure. The Outlook revision reflects the increased uncertainty over whether the QJD buffer will be maintained at the level that we view as sufficient to protect from default all senior obligations, including senior non-preferred debt, the reference liability for the Long-Term IDR.

This is driven by the uncertainty over the issuance volumes of subordinated (primarily Tier 2) instruments given the relative attractiveness of senior non-preferred debt for the purposes of meeting the minimum requirement for eligible liabilities and own funds (MREL).

It also reflects the likely rise in capital requirements because of a regulatory-driven increase of the bank's risk-weighted assets (RWAs) as a result of ECB's targeted review of internal models and the potential introduction of risk-weight floors on Dutch mortgage loans proposed by the Dutch central bank. These would partly bring forward the impact of Basel III end-game rules, which would have otherwise been subject to a long phase-in.

Key Rating Drivers

IDRS, SENIOR PREFERRED AND DERIVATIVE COUNTERPARTY RATING

ABN AMRO's Long-Term IDR and senior debt ratings are one notch above the bank's VR because Fitch believes the risk of default on senior obligations, as measured by the Long-Term IDR, is lower than the risk of the bank failing, as measured by its VR. This is due to the bank's significant QJD buffer, which could be made available to protect senior obligations from default in case of failure, either under a resolution process or as part of a private-sector solution (i.e. distressed-debt exchange) to avoid a resolution action.

Without such a private-sector solution, we would expect a resolution action to be taken on ABN AMRO when it breaches minimum capital requirements. We have assumed that the intervention point would be around the bank's minimum common equity Tier 1 (CET1) requirement of 6.25% (Pillar 1 and Pillar 2, excluding the combined buffer requirements (CBR)).

We further assume ABN AMRO would need to meet its total minimum capital requirements immediately after a resolution action, which on a fully loaded basis, including the CBR but excluding the countercyclical buffer, amounts to 15.25%. Taking also into account additional undisclosed Pillar 2 guidance as well as a potential risk weight increase in a stress scenario, a QJD buffer of 10% of total RWAs would most likely be sufficient to restore the bank's viability without affecting senior creditors.

At end-June 2019, the QJD buffer was 11.2% of RWAs. The bank has been building up its buffer of eligible liabilities to meet MREL, set at 29.3% of RWAs. ABN AMRO will look to issue senior non-preferred debt towards the end of 2019 subject to market circumstances. Senior non-preferred debt, which is not included in Fitch's QJD could also be used for MREL purposes and could over time partly replace the more expensive Tier 2 instruments. We calculate that EUR2.5 billion of instruments that comprise ABN AMRO's QJD (of which EUR1.5 billion/1.4% of RWAs in Tier 2 instruments) either mature or can be called until end-2020.

Redeemed issues could be partly refinanced with subordinated instruments, supporting the absolute amount of QJD, although issuance volumes are uncertain given the increased role that senior non-preferred debt is expected to play in meeting MREL. ABN AMRO's RWAs also face headwinds from the ECB's targeted review of internal models and the potential introduction of risk-weight floors for mortgage loans not covered by the Dutch mortgage guarantees from late 2020, as proposed by the Dutch central bank. These measures effectively bring forward part of the RWA inflation from Basel III end-game rules. The latter have a high estimated impact on ABN AMRO's RWAs of close to 30%. As a result, we expect that over the medium term it will be more difficult for ABN AMRO to maintain its QJD buffer sustainably above 10% of RWAs.

The Derivative Counterparty Rating (DCR) is at the same level as the Long-Term IDR because under Dutch legislation, derivative counterparties have no preferential status over other senior obligations in a resolution scenario.

The Short-Term IDR of 'F1' is baseline option-mapping to the 'A+' Long-Term IDR and reflects our assessment of ABN AMRO's funding and liquidity of 'a+'. This is below the level required for a higher Short-Term IDR under Fitch's criteria.

VR

ABN AMRO's VR reflects its strong domestic universal banking franchise complemented by European private banking and international corporate and institutional banking franchises, which provide a degree of revenue diversification. The bank's solid risk-weighted capitalisation and sound funding and liquidity profile are rating strengths. The VR also factors in ABN AMRO's well-executed strategy, healthy asset quality and sound earnings.

ABN AMRO's profitability is good and compares well with similarly rated peers'. The operating profit/RWAs ratio was 2.7% in 1H19, and the return on average equity of 12.2% was in line with the bank's target range of 10%-13%. However, we believe the outlook for earnings has deteriorated. We expect a more difficult revenue environment from low-for-longer interest rates, as well as cost pressures relating to the bank's investments in customer due-diligence remediation programmes to weigh on earnings in the coming years.

The bank is subject of the investigation by the Dutch public prosecutor office in relation to requirements under the Act on the prevention of money laundering and financing of terrorism. Any potential outcome is difficult to assess at this stage, and the investigation is likely to take time. ABN AMRO's VR factors in Fitch's view that the bank's earnings and capital provide a material buffer against most outcomes.

The bank's Stage 3 loans/gross loans ratio of 2.3% at end-June 2019 was in line with similarly rated European peers, reflecting a large and well-performing Dutch mortgage loan book. We expect that ABN AMRO's asset quality will remain sound with the bank maintaining conservative credit standards and with loan impairment charges remaining below their through-the-cycle average in the near term.

ABN AMRO's capitalisation is conservatively managed and is a rating strength. Risk-weighted capital ratios are sound and compares well with peers', with a fully loaded CET1 ratio of 18%, excluding 1H19 retained earnings, at end-June 2019. The bank is well positioned for the Basel III end-game rules since its 17.5%-18.5% CET1 ratio target (for 2019) already takes into account likely RWA increases. In light of this, we expect the impact from the recent proposals to introduce risk-weight floors for Dutch mortgage loans not covered by the national mortgage guarantee from late 2020 to be easily manageable.

ABN AMRO's leverage ratio is moderate at 4.2% at end-June 2019 and is affected by the regulatory treatment of certain derivative exposures in ABN AMRO's clearing business. A change in regulatory approach to cleared derivatives could in the medium term increase the leverage ratio by about 0.6pp.

ABN AMRO's funding is diverse and the bank maintains good access to the wholesale markets. With a loans/deposits ratio of 114% at end-June 2019 (as calculated by Fitch, with gross loans in the numerator and including public sector loans and deposits), ABN AMRO uses wholesale funding to fund part of the loan book. The large mortgage loan market in the Netherlands combined with significant pension savings resulting in limited inflow of deposits into the banking system means that this is unlikely to change in the medium term. ABN AMRO's liquidity buffer is ample (EUR83.1 billion at end-June 2019) and of high quality.

SUPPORT RATING AND SUPPORT RATING FLOOR

The Support Rating of '5' and Support Rating Floor of 'No Floor' reflect Fitch's view that senior creditors can no longer rely on receiving full extraordinary support from the sovereign in the event that ABN AMRO becomes non-viable. The EU's Bank Recovery and Resolution Directive and the Single Resolution Mechanism for eurozone banks provide a framework for resolving banks that is likely to require senior creditors participating in losses, if necessary, instead of, or ahead of, a bank receiving sovereign support.

SUBORDINATED PREFERRED AND OTHER HYBRID SECURITIES

Subordinated debt and hybrid securities issued by ABN AMRO are notched off the bank's VR. Subordinated (Tier 2) debt is rated one notch below ABN AMRO's VR to reflect above-average loss severity of this type of debt.

ABN AMRO's CRD IV-compliant perpetual non-cumulative additional Tier 1 instruments are notched five times below the bank's VR. The notching reflects two notches for loss severity in light of the notes' deep subordination and three notches for additional non-performance risk relative to the VR given their fully discretionary coupons.

SUBSIDIARY AND AFFILIATED COMPANY

ABN AMRO Funding LLC is a US-based funding vehicle fully owned by ABN AMRO. The rating of the US commercial paper debt securities issued by the vehicle is aligned with ABN AMRO's Short-Term IDR, based on Fitch's view of an extremely high probability of support from ABN AMRO if required. This view is underpinned by ABN AMRO's guarantees on the securities issued by ABN AMRO Funding LLC.

RATING SENSITIVITIES

IDRS, SENIOR PREFERRED AND DERIVATIVE COUNTERPARTY RATING

ABN AMRO's Long-Term IDR and senior debt ratings are sensitive to a change in its VR as they are notched up from the VR.

The Long-Term IDR is likely to be downgraded by one notch if there is a clear indication that the QJD buffer will fall below 10% of RWAs on a sustained basis. The DCR and preferred senior debt may in this case receive a one-notch uplift from the Long-Term IDR, provided the combined buffer of QJD and non-preferred senior notes exceeds 10% of RWAs at that point, which is likely given ABN AMRO's need to meet MREL.

VR

ABN AMRO's VR could be downgraded if the investigation by the authorities results in a higher-than-expected fine that would materially dent the bank's capital base. While not expected, a significant deterioration of earnings generation or asset quality that would put pressure on capital or affect access to/cost of wholesale funding could also be rating negative.

ABN AMRO's long-term strategy includes maintaining a moderate risk appetite. Fitch does not expect changes to the bank's strategy, but significant deviations from the moderate risk appetite could also put ratings under pressure.

Upside rating potential is limited in the near term in light of the investigation and its uncertain outcome. Should the outcome have limited implications on ABN AMRO's financial profile, then an extended record of strong performance against stated targets could be rating positive over time.

SUPPORT RATING AND SUPPORT RATING FLOOR

An upgrade of the Support Rating or upward revision of the Support Rating Floor would be contingent on a positive change in the Dutch sovereign's propensity to support its banks. While not impossible, this is highly unlikely, in Fitch's view.

SUBORDINATED DEBT AND OTHER HYBRID SECURITIES

Subordinated debt and other hybrid capital are all notched down from the bank's VR in accordance with Fitch's assessment of each instrument's respective non-performance and relative loss severity risk profiles, which vary considerably. Their ratings are primarily sensitive to a change in ABN AMRO's VR.

Additional Tier 1 securities are also sensitive to Fitch changing its assessment of the probability of their non-performance risk relative to the risk captured in ABN AMRO's VR.

SUBSIDIARY AND AFFILIATED COMPANY

ABN AMRO Funding LLC's debt rating is aligned with ABN AMRO's short-term debt rating and is therefore sensitive to changes to ABN AMRO's Short-Term IDR.

Public Ratings with Credit Linkage to other ratings

ABN AMRO Funding LLC's debt rating is aligned with ABN AMRO's short-term debt rating and is therefore sensitive to changes to ABN AMRO's Short-Term IDR.

ESG Considerations

Unless otherwise disclosed in this section, the highest level of ESG credit relevance is a score of '3' - ESG issues are credit neutral or have only a minimal credit impact on ABN AMRO, either due to their nature or the way in which they are being managed by ABN AMRO. For more information on our ESG Relevance Scores, visit www.fitchratings.com/esg.

ABN AMRO Funding USA LLC
----senior unsecured; Short Term Rating; Affirmed; F1
ABN AMRO Bank N.V.; Long Term Issuer Default Rating; Affirmed; A+; RO:Neg
; Short Term Issuer Default Rating; Affirmed; F1
; Viability Rating; Affirmed; a
; Support Rating; Affirmed; 5
; Support Rating Floor; Affirmed; NF
; Derivative Counterparty Rating; Affirmed; A+(dcr)
----subordinated; Long Term Rating; Affirmed; A-
----subordinated; Long Term Rating; Affirmed; BB+
----Senior preferred; Long Term Rating; Affirmed; A+
----Senior preferred; Short Term Rating; Affirmed; F1

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Additional information is available on www.fitchratings.com

Applicable Criteria
Bank Rating Criteria (pub. 12 Oct 2018)
Short-Term Ratings Criteria (pub. 02 May 2019)

Additional Disclosures
Dodd-Frank Rating Information Disclosure Form
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