ABN AMRO Bank N.V.

FY 2019: Weak revenue drives profit decline

All figures in this report relate to FY 2019 and are compared against FY 2018 figures, unless otherwise indicated.

Summary opinion

On 12 February, ABN AMRO Bank N.V. (A1 stable, baa1) reported a net profit of €2.0 billion for 2019, down 13% from the year before. The bank's net banking income fell 5% to €8.6 billion, the result of declines in net interest income (-2%) and in fees and commissions (-4%). It was also due to much lower gains on the sale of equity participations than in 2018.

The costs linked to the detection of financial crime, together with provisions booked for Customer Due Diligence (CDD) remediation programmes, negatively affected this year’s results. However, total operating expenses dropped by 2% for the year thanks to cost savings and lower restructuring costs. Loan loss impairments were stable at €657 million, or 24 basis points (bps) of gross loans. But the bank reported higher impairments in the corporate loan book in the fourth quarter, more specifically in the offshore sector, leading to an annualised cost of risk of 46 bps for Q4 2019 (Q4 2018: 27 bps). Overall, these results are credit neutral for bondholders.

Net banking revenues declined

Net banking revenues fell 5% in 2019 as a result of negative pressure on both net interest income (-2% to €6.5 billion, due to the prolonged low interest rate environment) and fees and commissions (-4% to €1.6 billion, mainly as a result of the divestment in Stater, its administrative mortgage services provider, in Q3 2019). The net interest margin was flat at 164 bps (165 bps in 2018), but still well above the EU average (around 1.40%, according to the European Banking Authority’s Q3 Risk Dashboard). Other operating income was also lower, dropping 37% to €504 million. Excluding exceptional items, this decrease was primarily due to lower private equity gains (€52 million versus €274 million in 2018) and lower hedge-accounting related income.

The bank increased its market share in new residential mortgages to 18% in 2019 from 17% in 2018. However, the residential mortgage book decreased slightly by 0.5% to €148.2 billion, mainly due to customers’ voluntary redemptions in the fourth quarter of the year. Net interest income for Retail Banking activities was down 7% compared with 2018, due to pressure on margins. The Commercial Banking loan portfolio slightly increased (+0.5%) as the bank continues to observe its tight risk appetite and conservative pricing. Net interest income generated by this activity was down 5%. Net interest income for Private Banking activities was also down 7% despite higher lending volumes.
Revenues in the Corporate & Institutional Banking (CIB) division declined by 12% compared with 2018 due to lower equity participation results. This was despite negative rates being passed on to clients with large deposits.

**Efficiency efforts were undermined by costly remediation programmes and rising impairments, providing little support for declining revenues**

The bank reported €165 million in expenses linked to the detection of financial crime and a €174 million provision booked for further acceleration of the customer due diligence remediation programme at the Commercial Banking division. These significant costs were offset by greater cost savings, lower personnel expenses and lower restructuring costs. Overall operating expenses decreased by 2% to €5.27 billion.

![Exhibit 1](image)

**The bank’s cost base is well contained but KYC-related expenses are on the rise**

Operating expenses (€ million; LHS) and cost-to-income ratio (%; RHS)

<table>
<thead>
<tr>
<th>Year</th>
<th>Expenses (LHS)</th>
<th>Regulatory costs (LHS)</th>
<th>Other one-offs*</th>
<th>Provisions for KYC**</th>
<th>Provisions for SME derivatives***</th>
<th>C/I ratio (RHS)</th>
</tr>
</thead>
<tbody>
<tr>
<td>2015</td>
<td>4,911</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>54.0%</td>
</tr>
<tr>
<td>2016</td>
<td>4,975</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>54.0%</td>
</tr>
<tr>
<td>2017</td>
<td>4,876</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>56.0%</td>
</tr>
<tr>
<td>2018</td>
<td>4,696</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>58.0%</td>
</tr>
<tr>
<td>2019</td>
<td>4,687</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>60.0%</td>
</tr>
</tbody>
</table>

*In 2017, this included €56 million related to the divestment of PB Asia.*

**In 2019, on top of those provisions, €40 million in remediation costs and €165 in “business-as-usual” (i.e recurring) expenses were booked for KYC-related actions. For 2020, the bank estimates that those recurring expenses will increase and stabilize around €300 million.**

***In 2016, only €89 million of provisions for SME derivatives were booked in operating expenses. The remaining provision (€271 million, net of tax) was booked under “special items”.

Sources: Company reports, Moody’s Investors Service

Cumulative recurring cost savings reached €900 million at end-December 2019 close to the €1.0 billion target for 2020. Nevertheless, the cost-to-income ratio was 61.2% for 2019, significantly above the business target of 56%-58%.

To mitigate the impact of low interest rates, the bank is currently applying negative rates on deposits of CIB clients as well as on the largest private banking and commercial banking clients. The bank said it would not impose negative rates on deposits below €100,000, which represent 95% of clients and 40% of total deposits. However, the bank will charge -50 bps as of 1 April 2020 for balances above €2.5 million, which will affect around €30 billion of deposits. This measure should yield around €110 million in revenues for 2020.

The cost of risk was stable at a low 24 bps of gross loans for 2019, but impairments rose significantly in the fourth quarter to an annualised 46 bps of gross loans (27 bps in Q4 2018). Most of this increase stems from specific sectors in the corporate loan book, while the rest is attributable to a rise in impairments in Retail Banking (€45 million). Loan-loss impairments totaled €314 million in the fourth quarter, including €119 million in the Natural Resources segment (primarily the offshore energy sector) and €82 million in the Global Transportation & Logistics segment (mostly in offshore service vessels).
Investigation by the Dutch public prosecutor may result in material sanctions
ABN AMRO announced on 26 September 2019 that the Dutch public prosecutor had started an investigation under the Dutch act on prevention of money laundering and financing of terrorism. The bank stated in its third-quarter results announcement that the investigation will focus on customer files, timely reporting of unusual transactions and discontinuation of client relationships. In view of the 2018 settlement by ING Groep N.V. (Baa1 stable) with Dutch authorities for shortcomings on customer due diligence, including total payment of €775 million, we believe that the risk of a material fine is substantial.

ABN’s CET1 capital ratio has fallen, while its CET1 capital requirement has increased
ABN AMRO’s Common Equity Tier 1 (CET1) ratio fell to 18.1% from 18.4% at the end of December 2019. The drop reflects an increase in risk-weighted assets (RWAs) due to add-ons anticipating supervisory requirements following internal model reviews (the European Central Bank’s TRIM)³.

The ECB has increased ABN’s Pillar 2 Requirement to 2.0% from 1.75% to reflect shortcomings related to the bank’s risk internal models and detection of financial crime. The bank also expects its RWAs to increase materially in the foreseeable future because of several factors: (i) additional TRIM adjustments; (ii) additional risks weights on domestic mortgages recently announced by the DNB⁶; and (iii) a new definition of default. While these increases anticipate the changes driven by “Basel IV” reforms, the bank has said it will revise its Basel III target range of 17.5-18.5%. At present, on top of the current SREP ² (12%), the bank adds a 4%-5% buffer, a management buffer and Pillar 2 Guidance to be able to absorb upcoming RWA increases.
Endnotes

1 The bank ratings shown in this report are the bank's senior unsecured rating and outlook, and baseline credit assessment.
2 The impact of this divestment is estimated to be a reduction of around €80 million in fee income per year.
3 The decrease is partly due to a lower number of full-time employees, down 853 to 17,977.
4 They amounted to €3 million in 2019 versus €129 million in 2018.
5 Targeted Review of Internal Models.
6 For more details about this measure, please refer to this sector comment.
7 Supervisory Review and Evaluation Process.
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