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Summary:
ABN AMRO Bank N.V.

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Summary:

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Credit Rating: A/Stable/A-1

Rationale

The ratings on Dutch bank ABN AMRO Bank N.V. (ABN AMRO), which completed its merger with Fortis Bank Nederland N.V. (FBN) on July 1, 2010, principally reflect Standard & Poor's Ratings Services' view of the bank's full ownership by The Netherlands, combined with its good market position in Dutch banking, moderate credit risk profile, and sound capital position. However, we believe that the merger's execution risk and the likelihood that profitability and funding will remain mediocre in the coming years are weaknesses for the ratings.

The ratings incorporate two notches of uplift for potential extraordinary support above our assessment of ABN AMRO's stand-alone credit profile (SACP), in line with our expectation that the Dutch state would provide support if needed. We see Dutch State ownership as temporary and we understand that the government's intention remains to privatize ABN AMRO in the near future. We consider ABN AMRO as being of high systemic importance in The Netherlands, a country we classify as "supportive" to its financial system.

ABN AMRO is a leading player in The Netherlands, in particular in the retail and commercial banking markets. At end-June 2010, the bank had pro forma €405 billion in total assets, €265 billion in loans (excluding security lending), and €202 billion of customer deposits concentrated in the Dutch market

ABN AMRO's financial profile is currently significantly weaker than its business profile, in our view, with low profitability and high funding needs offsetting sound capital and adequate asset quality.

The profitability of ABN AMRO's constituent parts has weakened since the end of 2008. These include the former FBN and the state acquired businesses of the former ABN AMRO Holding N.V. (for further details, see our report on "ABN AMRO Bank N.V.," published March 12, 2010). In our view, the reasons are the more difficult economic environment and the break-up costs associated with each of these businesses that were spun off before merging together.

In the first half of 2010, ABN AMRO posted a pro forma €968 million loss stemming from exceptional costs linked to the merger with FBN. Underlying profit improved significantly to €325 million, but against a low comparison base in the first half of 2009. We expect underlying profit to continue strengthening gradually in the second part of this year and in 2011, while exceptional costs drop sharply. These factors could enable the bank to report positive profits in 2011.

The scope of improvement in ABN AMRO's profits will mainly depend on the sustainability of the current recovery in its net interest income and its decline in credit losses. The bank's unlocking of synergies, leading to cost savings starting in 2011, is an additional contributor. Still, we believe that the bank's reported performance will likely remain mediocre in the next two to three years, compared with that of main European peers focused on domestic retail and commercial activities.

ABN AMRO has emerged with a weakened funding position following its link-up with FBN, which had much lower customer deposits relative to its loan book and a higher reliance on short-term funding. We expect the bank to continue improving its funding mix in 2010-2012 through moves to increase its share of medium-term resources, including issuing residential mortgage-based securities, covered bonds, and senior unsecured debt. We also anticipate that ABN AMRO will continue progressively replacing the large amount of debt that FBN issued under the Dutch state guarantee in 2009 with new, longer term unguaranteed funding.

Thanks to the state shareholder's capital injection at year-end 2009, ABN AMRO presents a sound capital position. We estimate our risk-adjusted capital (RAC) ratio, pro forma for the combined bank, at slightly below 9% before diversification adjustments and just above 9% after diversification on Dec. 31, 2009. The ratio includes the benefit of the conversion to common equity on April 1, 2010, of the mandatory convertible notes that the Dutch state provided. We estimate that our RAC ratio for ABN AMRO on Sept. 30, 2010, would likely stand slightly lower given the loss posted in the first half and the partial repayment of the Upper Tier 2 debt that we included in our capital measure. We expect the bank's capital position to remain sound.

Outlook

The stable outlook on ABN AMRO reflects the possibility that we might increase our assessment of the bank's SACP to the level of the current long-term counterparty credit rating in the next two to three years, assuming the merger's smooth execution. We also expect ABN AMRO to continue benefiting from support from its shareholder in case of need. In addition, we consider that the outcome of the European Commission's current investigation into alleged state aid to ABN AMRO will not materially affect its business position or financial profile.

We would consider a negative rating action in the unlikely case that ABN AMRO's SACP deteriorates significantly and durably--for instance due to higher credit losses or a more difficult-than-expected integration process--and in the absence of support from the bank's shareholder.

We view an upgrade in the medium term as remote, given the gap between our assessment of the SACP and the long-term counterparty credit rating. Raising the rating would assume not only a smooth integration process, but also an unexpectedly strong jump in the bank's earnings generation-- closing the gap with peers--and confirmation of its improved risk profile.

Related Criteria And Research

- Principles Of Corporate And Government Ratings, June 26,2007
- Bank Rating Analysis Methodology Profile, March 18, 2004
- How Systemic Importance Plays A Significant Role In Bank Ratings, July 3, 2007

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