Dutch Banking Landscape

Assessing industry trends and key performance metrics of the four largest players

HY 2019 edition
KPMG Netherlands

kpmg.nl/financialservices
<table>
<thead>
<tr>
<th>Contents</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>Foreword</td>
<td>3</td>
</tr>
<tr>
<td>Macro economy</td>
<td>4</td>
</tr>
<tr>
<td>Hot topic: Anti-Money Laundering</td>
<td>6</td>
</tr>
<tr>
<td>Financial Performance</td>
<td>9</td>
</tr>
</tbody>
</table>

Note: the analysis in this document is solely based on public available data and information reported by the institutions such as the company’s website, interim accounts, investor day presentations and press releases.
The first half year of 2019 has again been a dynamic period for banks. In our last banking update just 6 months ago, the four Dutch banks that we analyze in our report, shared a common voice on PSD2 and Open Banking, innovative customer-centric initiatives, sustainability and digitalization as key topics in their annual reports.

Progress on customer-centric initiatives is actually being made: After NIBC and Rabobank, now ABN AMRO has also implemented an originate-to-distribute model for mortgages in order to be able to provide their customers with compelling rates (for mortgages with long-dated interest reset periods). This will help the banks on two sides: adding fee income to their revenues and maintaining their client base. This development is fundamentally changing the competitive landscape for mortgage origination.

Over the first half year, the attention in (investor) reporting has shifted from these new commercial initiatives to the financial performance of ING, Rabobank, ABN AMRO and Volksbank, and increased scrutiny on KYC and AML programs.

The effect of a continuing low interest environment on total income and net interest income is felt by most banks. The four banks rely heavily on income generated by the mortgage portfolio which has healthy margins. Simultaneously pressure is felt on decreasing their cost base in order to keep a healthy cost-to-income ratio. This last element is important when wanting to keep the rates on (retail) savings and payment accounts positive (whilst depositing money at the central bank occurs at a cost). However, this may prove challenging, additional to the needed investments in KYC programs and ongoing digitalization of the current and new business.

Continued investments in anti-money laundering and sanctions compliance are needed as well. The public and the regulator place increased responsibility at banks to take on the gatekeeper role of preserving the integrity of the financial system and preventing the increase of risks associated with fraud, terrorist financing and money laundering.

In the next half year we expect the banks will continue to deal with this cost-intensive gatekeeper role on the one side and their growth ambitions on the other side.

Ferdinand Veenman
Head of Financial Services
KPMG Nederland

“Revenue generation at the four banks relies heavily on income generated by the mortgage portfolio but their margins are negatively affected by the consequences of the low interest rate environment and increased costs for compliance programs.”
Global economic developments have dominated the news cycle of the last year. The looming Brexit, the US-China trade war, multiple European elections and (European) government crises, they all have an impact on the playing field of (Dutch) banks. While the Dutch economy may seem to continue growing, a closer look provides mixed signals. Growth can be ascribed to an increased level of employment and an above average consumer consumption, but a weakness can be found in the Dutch manufacturing.

Economic slowdown: While the Dutch economy has been outperforming itself consistently over the past years, the EU believes that a weaker external environment leading to lowered incoming Foreign Direct Investment, a cramped labor market, and declining exports due to weakness in global trade, will lead to a decrease in GDP growth, with 1.4% forecasted in 2020 versus 2.6% in 2018. Dutch consumers have indicated to be less optimistic regarding the economic climate for the next 12 months and the financial situation of the past half year.

Negative interest rates costs banks money: Since the ECB implemented a -0.4% rate to place deposits with the ECB, a total of EUR 21 billion was transferred by European banks to the ECB, with Germany, France and The Netherlands accounting for 70% of this figure and increasing the banks capital costs. This is part of the ECB’s wish to pressure banks into handing out more credit to consumers, to in turn stimulate the economy. This phenomenon poses an issue on the liability side where the cost for savings increase and makes banks question whether they should in turn provide negative interest rates to consumers which, for now, is a highly unpopular opinion. At the publication of their half year results, ING has not denied that the step to a negative interest rate for consumers is one of the possibilities in the future, resulting in backlash in the media.

Favorable economic conditions by monetary stimulus: Interest rates will remain at their current, or even lower, rates at least in the first half of 2020. Despite the risk of recession in the region being low, Mario Draghi explained how low interest rates are still required for a healthy economic status of the Eurozone. Markets initially reacted to this news, with the euro hitting a two-year low, as did the German 30-year bond.

Shift in Dutch housing market remains big risk for Dutch economy: De Nederlandsche Bank (the Dutch Central Bank, ‘DNB’) identifies multiple factors in the Dutch housing and commercial real estate market which influence the financial stability. A house price correction can have a significant impact on both the economy and the needed amount of capital for Dutch banks.

Rising housing prices: Real housing prices are already 17% above the previous peak due to a housing market in which, at the moment, the demand outperforms the supply. Dutch housing prices are amongst others driven by the low interest environment, mortgage interest tax relief and high LTV/LTI limits in the Dutch market which influence the financial stability. A house price correction can have a significant impact on both the economy and the needed amount of capital.

Amplifying cyclical fluctuations: Due to the relation between housing prices and private consumption growth, DNB expects that developments in the housing market will have a strong impact on the economic prosperity.

As illustrated before, the Dutch economy is driven mainly by consumption. The volatility of consumption creates uncertainty and increases the impact on the economy when consumption or housing prices are affected.

Dutch LTV/LTI limits are high by international standards: Low interest rates combined with relatively high LTV/LTI limits in the Dutch market increase the indebtedness of Dutch homeowners. Currently, banks are expanding their lending policies, mainly due to the higher margin on mortgage products. Banks could be hit on their balance sheet by the economic downturn. A hit in prices impacts the level of provisioning under IFRS9 needed by the banks.

Implications of climate-change regulations for financial stability and institutions talking point of supervisory bodies

The mass re-evaluation of assets following the implementation of policies such as environmental sustainable governance (ESG), can have significant implications for balance sheets of financial institutions and, therefore, on wider financial stability. As shown in the paper of NGFS report have been published by national and international groups urging a gradual and controlled transition, to prevent unwanted consequences.
Consumer confidence

Consumer confidence dropped further in the beginning of 2019, even hitting a worrying negative confidence level from February until May. It is the first time since February 2015 that the consumer confidence drops below 0, however, it is still higher than the 20-year average of -3.

In June 2019, consumer confidence recovered due to improved consumers’ outlook on the economic climate and a less negative consumer willingness to buy thereby increasing consumer spending. Consumers’ confidence in their future financial situation improved.

The indicators show that consumers are becoming less negative but a lower level than the last years.

House prices

House prices continue to increase, resulting in an impressive price increase of 30.9% since 2015. Although regional differences can be observed, all Dutch provinces show growth.

It is noteworthy that the average year-on-year price increase decreased from 8.7% in December 2018 to 7.0% in June 2019. This may be a sign that housing prices in the Netherlands have reached their top and will flatten accordingly, despite the low-interest environment.

Inflation and Unemployment

As from September 2016, the Dutch Consumer Price Index, which may be seen as an important indicator of inflation, continued to increase, hitting 2.8% in March 2019. This is the highest rate since 2013 and is significantly higher than its European equivalent, the European Harmonized Consumer Price Index. Possible explanations are the introduction of a higher VAT rate and a higher tax rate on energy in January 2019.

In May 2019, unemployment decreased to 4.1%, the lowest rate since 2008. Since then the Dutch unemployment rate is steadily increasing, to a 4.3% in June 2019. It is uncertain how far unemployment can continue the downward trend. Long term unemployment is decreasing.
Hot topic: Anti-Money Laundering
Anti-Money Laundering & Sanctions Compliance

The need for effective anti-money laundering (AML) and sanctions compliance systems and controls is evident, as are the severe penalties for institutions failing to comply. Increased regulatory scrutiny and the extra-territoriality of US and UK laws are driving greater focus in this area, providing additional challenges for regulated firms. In addition to the challenge of managing the immediate interaction with the authorities, this scrutiny is also exposing weaknesses in these regulated institutions’ underlying infrastructure, data, documentation, systems & controls and resources.

Utilizing a framework for compliance

Utilizing a framework for compliance financial institutions should, as part of their compliance program, strategically invest in initiatives focused on the long term, while concurrently prioritizing immediate program needs and effectiveness. To assist financial institutions in maintaining and refining their compliance programs, KPMG has developed a proprietary Financial Crimes Program framework that consists of eight components, with governance and culture at its core6.

As financial institutions advance in their financial crimes compliance journey, their compliance activities shift from responding and remediating to more proactive prevention and detection. This allows for greater effectiveness, efficiency, sustainability, and agility. And it also helps institutions to think about compliance not just as a cost of doing business, but as a competitive advantage.

Key elements in modern compliance programs are the AML and Sanctions models used to improve risk management. These models consist of both the technical systems (e.g. a post-transaction monitoring solution) as well as the elements interacting with the model like governance, policies and resources. The use of such models introduces model risk within institutions. For this reason, KPMG has, as part of the overall Financial Crimes Program framework, an underlying AML and Sanctions model validation methodology.

6 The KPMG Framework integrates the U.S. Federal Sentencing Guidelines suggestions for compliance programs as a foundation and goes beyond those concepts to incorporate international regulatory AML, Sanctions and Anti-Bribery and Corruption (ABC) requirements, guidance, and leading initiatives by peers.
In August 2017, DNB issued its guidance on the ‘Post-event transaction monitoring process for banks’. Additionally, DNB conducted a series of sanctions-related thematic examinations. Recent signals from the market show a trend, as the regulator is now taking the next step by explicitly mentioning model validation in the updated guidance on AML/CTF and Sanctions and displaying its interest vis-à-vis banks to evaluate the performance and effectiveness of implemented transaction monitoring, for anti-money laundering and counter-terrorist financing (AML/CTF) and sanctions client screening and transaction filtering systems. This trend continues to place the financial industry under further increased regulatory scrutiny.

Different banks have been approached by regulators to provide more insight into the maturity level of the transaction monitoring, client screening and transaction filtering systems in place. Performing a model validation of the compliance models will provide the bank with the confirmation it seeks and – if performed adequately – this will also enhance performance and increase effectiveness of the corresponding compliance systems.

A proven model validation methodology

Our methodology is designed in line with AML/CTF and Sanctions regulatory requirements and industry standards and has been created based on our extensive experience in transaction monitoring validation engagements with a number of global financial institutions, including (system) banks in the Netherlands.

Our methodology is based on five key pillars:

A. Governance – Review the bank’s governance framework related to transaction monitoring, transaction filtering and client screening, including policies and procedures, roles and responsibilities, resources and training, for comparison against existing authoritative standards for compliance and controls programs.

B. Conceptual soundness – Assess the quality of the model design and construction, and validate that the documented judgments used in model design follow sound regulatory requirements and industry practice. Review the risk evaluation, rules/settings assessment and the assessment of developmental evidence (or supporting analysis) that supports the model development.

C. Data, system and process validation – Assess whether data feeds and information from ancillary systems are appropriately integrated into the monitoring and filtering systems. Test the systems to assess its core functionality is working as intended. For example for a transaction monitoring system, rules may be (independently) replicated based on documentation to determine if they are implemented and working as designed.

D. Performance and effectiveness – Determine whether model limitations and assumptions are still appropriate. Key activities of this component will include ongoing verification, sensitivity testing, performance tuning, and quantitative and qualitative benchmarking. For Sanctions transaction filtering as well as client screening, both exact terms as well as list name permutations are applied to the Sanction systems for benchmarking purposes.

E. Outcomes analysis and reporting – Evaluation of the alert investigation processes as well as a detailed review of the MI reporting, suspicious activity reporting and escalation processes.

Technical testing activities

Model Validations include highly technical testing activities to determine whether the model functions as designed. Examples are:

Technical code review
Technical code is reviewed, based on both the description as well as the implementation of the code in the system. Technical implementation needs to be a correct representation of the conceptual setup.

Control structure testing
Designing and applying test cases to exercise the different logical conditions specific to the business rules and technical rules based on the conceptual design, including boundary value analysis and replication of rules elements.

Sensitivity testing
System thresholds are increased/decreased in discrete intervals and alerts are compared to the baseline number of alerts.

Fuzz testing
Testing input data containing potentially invalid or illogical variables, or input around the edges of equivalence classes to determine if the system can gracefully handle these cases.

Rule replication
A selection of scenarios and related technical rules will be independently replicated based solely on the documentation containing the scenario’s design, logic and parameters.

© 2019 KPMG Advisory N.V.
Financial performance
Interest margins remain positive for banks, costs and total income are more volatile

In the first half of 2019, the Dutch banks had difficulty maintaining their level of net income. ING and Volksbank have increased their income from non-interest earning activities, but Dutch banks remain reliant on interest bearing assets. Banks rely heavily on new mortgage production to increase margins and accompanying income, but the question is for how long this will be sustainable. If growing income may become more difficult in the future, increased focus will be needed on the costs involved in running the business. Up until now, half of the banks is close to their target ratio.

Return on Equity

Return on Equity (RoE) has been a difficult KPI to perform well on for the last few years. For the Dutch banks, RoE is an interesting KPI to compare, due to their different nature of ownership.

ING and ABN AMRO, the two listed Dutch banks, have a RoE target of a minimum of 10%. They outperform compared to their target and also outperform their peers (see figure 11 & 21, resp.) but have difficulty improving their return in this challenging environment. Ralph Hamers, CEO of ING Group, states that RoE is foremost improved by focusing on the return, and that the Cost-to-Income (C/I) ratio is of less concern.

Volksbank, on the other hand, has a more conservative RoE target of 8%. The rationale behind this is the large capitalization, however, the RoE has been declining for years. Volksbank’s targets have to be seen in conjunction with their strategy and their owner: the Dutch state. In the second half of 2019 the state (by means of the NLFI) will give an update on the current affairs regarding

*Rabobank does not publish RoE data for HY 2016 and HY 2017

© 2019 KPMG Advisory N.V.
a possible IPO. Possible buyers will take the RoE into consideration.

**Cost-to-Income ratio**

Getting a grip on the C/I ratio – the amount of euros spent for every euro of revenue – remains difficult in the industry. Historically, banks have had difficulty getting the C/I ratio down to their own set targets. Based on the current figures, all banks will likely have their 2020 objectives out of range due to multiple factors. Main factors that influence the C/I ratio are:

- **Regulatory costs**: Increased regulatory costs (levies) and effort needed to comply to reporting regulations and oversight.

- **Compliance costs**: Expected increase in compliance costs following fines in the recent years and KYC programs where scaling up on FTE is apparent.

- **IT costs**: Continuing investments in customer-centric environments (e.g. OneApp for ING in Belgium), maintenance and downscaling of legacy systems, and digitalization of the inner and outer workings of the bank.

Compared to the peer group, ING, ABN AMRO and Volksbank are outperforming. Rabobank needs more time lowering the C/I ratio but already came a long way since a few years ago. Total FTE has been declining since a few years now, due to reorganizations, but has somewhat stabilized in 2019. The extra manpower needed for AML, CDD, Compliance and IT, will put Rabobank’s target at risk in terms of their C/I ratio.

Based on the analyst presentations, ING and ABN AMRO clearly see the improvement of the C/I resulting from an increase in income. Rabobank focuses on costs, and incremental changes are noticed every year. Volksbank is very close to their target of 50-52%.

**Figure 6: Total Net Income (EUR mln)**

Total net income & Y-o-Y change

- **ING**
  - +3.1% [9,241]
- **ABN AMRO**
  - -4.4% [5,763]
- **Volksbank**
  - -4.6% [4,403]
- **Rabobank**
  - -1.9% [471]

**Dutch Banking Landscape**

HY 2019

Interestingly, total net income is down for three out of four banks. The paradox is that banks name the low interest environment as the main actor for this decrease but also state that new production of mortgages may offset the decrease.

However, redemptions on mortgages have increased and continuous competition from (non-bank) mortgage lenders creates a difficult environment to increase lending and offset the reduction of loan books.

**Figure 5: Cost-to-Income ratio (HY 2015 – HY 2019)**

- **Rabobank**
- **ING**
- **ABN AMRO**
- **Volksbank**

Source: Half year reports

© 2019 KPMG Advisory N.V.
Net interest income vs. Other income

Figure 7 shows the stark difference between the three large (international) banks and Volksbank in terms of income. Volksbank has a sole focus on retail customers and therefore has less diversification in terms of income streams separate from interest income.

The expectation is that with the introduction of PSD2 and competition from Fintechs, banks should create possibilities of gaining other fee, commission and other income (e.g. for services related to financial planning, financial resilience, brokerage and other product advice).

ING and Volksbank have seen an increase in other income (8.2% and 16%, resp.). Volksbank attributes the increase mainly to higher income from payment transactions and higher commissions earned from mortgage advice. ING attributes this to higher retail fees, mainly because banks are experimenting with offsetting the costs they have on deposits (due to the low interest rate environment) by increasing (retail) banking fees.

Rabobank has seen a decline in other income due to the sale of FGH and BPD Marignan activities. Commission on payment accounts increased somewhat (2%), as seen at ING.

Net interest margin

The net interest margin (NIM) is an important indicator, especially with the increased emphasis by bank directors to put forth the low interest environment. Thus far the results indicate that banks do well on transferring the costs of the low interest rate environment to the client (e.g. by not pegging the interest rates on mortgages to the ECB rate).

Volksbank and Rabobank have trouble maintaining NIM growth. Rabobank marks that this is due to a low margin on savings and payment accounts. Volksbank argues that new mortgage lending causes lower net interest margin.

Although ABN AMRO is outperforming its competitors in terms of NIM, they have issued a warning for the coming year. With the current interest rate environment continuing, they expect net interest income to decrease by EUR 20 mln for every quarter, starting in 2020, reflecting lower deposit margins.

On top of that, analysts indicate that they are not sure if the continued higher spreads on mortgages can persist for a long term if interest rates remain this low. The Netherlands shows a higher mortgage spread than surrounding countries, indicating that it might not be possible to keep increasing NIM by new mortgage production.
A closer look at individual performance
ING half year results

ING showed decent results for HY 2019. Continued business growth, higher treasury-related revenues and a single receivable of EUR 79 mln related to the insolvency of a financial institution drove higher net income. However, this was offset by an increase in operating expenses, resulting in a slightly lower net profit of EUR 2,556 mln, down 3.7% from HY 2018.

Net interest income and net interest margin

Net interest income (NII) increased by 0.8% to EUR 6,953 mln, which was mainly driven by higher interest results on customer lending due to volume growth and improvement of residential mortgages’ interest margin. This reflects the Dutch trend of banks putting more focus on mortgage production as a consequence of higher margins. This also affects the net interest margin (NIM). Volatile results in Financial Markets and lower interest margins on non-mortgage lending and customer deposits were offset by improved interest results on residential mortgages and a lower average balance sheet. As such, the NIM increased from 151 bps in HY 2018 to 154 bps in HY 2019.

Business innovation

ING’s innovation activities focus on enhancing the customer experience. In the first half of 2019, ING introduced several innovations, i.e.:
- personal money management features in Germany & Poland;
- Apple Pay functionality in the Netherlands, Romania and Spain;
- integration of voice-activated Google Assistant in Belgium and Poland.

Furthermore, the UK-based Yolt app surpassed 900,000 users and expanded to France and Italy.

Return on Equity

Net income of ING increased from EUR 8,940 mln in HY 2018 to EUR 9,241 mln HY 2019, which reflects a 3.4% increase. ING’s underlying RoE remained stable at 10.8%, which is up from 10.4% Q2 2018 and slightly higher than the average RoE of its peers of 10.5%. This is still in line with its financial ambition to realize an RoE of 10-12%.

CET1 ratio

Due to revisions of internal models following Basel IV regulation, Operational RWA went up by EUR 6.4 bln quarter-on-quarter, resulting in a HY 2019 CET1 ratio of 14.5%, compared with 14.1% HY 2018. This is above the SREP requirement of 11.81%, but still lower than the peer average of 21.4%.

ING’s leverage ratio of 4.3% is exactly the same as on 30 June 2018 and well above ING’s goal of 4.0%.

With the first stage of Basel IV coming into effect on 1 January 2022, ING strives to meet a CET1 ratio ambition of 13.5%. With the HY 2019 results, ING has a strong capital base and is well positioned to meet this ambition, although management actions are deemed necessary to continue in 2020.

Cost-to-Income ratio

ING’s HY 2019 net operating expenses increased by 4.1%, compared to HY 2018, to EUR 5,238 mln. This is mainly due to an increase of EUR 105 mln in expenses excl. regulatory expenses, which was partially driven by higher KYC-related costs (global increase to >3,000 employees) and a restructuring provision related to agile transformation in Germany. Regulatory expenses remain stable with a decline of EUR 1 mln YoY. The Cost-to-Income ratio remained fairly stable at 56.7% for HY 2019 compared to 56.3% for HY 2018. This is considerably lower than its peers and reflects ING’s ambition to have a stable C/I ratio of 50-52% in 2020. This target is still very ambitious.

KYC Deep dive

Initially launched in 2017, the KYC program will run until the end of 2020. Managing non-financial risks has the highest priority within ING. As mentioned above, in the first half of 2019, ING increased the number of FTE working globally on KYC-related activities to >3,000. The global KYC enhancement program includes, e.g.:
- internal assessments;
- streamlining of KYC operations;
- cooperation with authorities, other banks, law enforcement and regulators to increase and improve ‘know your customer’-related activities;
- development of (AI-based) tools.

KYC remains a politically relevant subject where problems from the past need to be resolved in order to be compliant.

See next page for financial performance ...
For HY 2017 and HY 2018, the results of only four out of five peer banks are available and therefore included in this peer bank average.

Due to the unavailability of HY results of the majority of the peers, peer banks are not included.

For HY 2017 and HY 2018, the results of only four out of five peer banks are available and therefore included in this peer bank average.

Due to the unavailability of HY results of the majority of the peers, peer banks are not included.
Rabobank half year results

Rabobank’s net profit has decreased to EUR 1.2 bln in HY 2019. Increased (provisions for) credit losses, the absence of non-strategic income from FGH and BPD Mariignan, together with the low interest environment, explain the decrease in net profit. Continued attention to costs provide a lower C/I ratio, which is still higher than its Dutch counterparts.

**Net interest income and Net interest margin**

Interest income has increased, mainly due to loans and advances to customers (2.2%). However, Rabobank’s costs on cash deposits from customers have increased (10.5%), due to a higher inflow of deposits (and a higher average balance sheet total) and the fact that the ECB rate is below zero but Dutch banks still pay a positive savings rate to its retail customers (0.03% p.a.).

Margins on new lending are stable, leading to a compensation for the costs spent on savings and current accounts.

This resulted in a decrease by 1% of NII to EUR 4,212 mln in the first half year of 2019, with a slightly lower NIM of 140 bps (HY 2018: 141 bps).

**Cost-to-Income ratio**

As shown in our previous updates, Rabobank puts great focus on cost reduction but shows fluctuating results. The first half year of 2019 was positive in that regard; C/I ratio is 62.3% compared to 62.9% last year due to lower staff costs (-2%) whilst total staff increased by 65 FTE compared to year-end 2018, which is still lower than one full year ago. Administrative expenses (accounting for 37% of total operating expenses) have dropped by 10%. The main reason for the decrease lies in Leasing and Real Estate. This is due to the phasing out of non-strategic operations and integration of certain business activities.

**KYC Deep dive**

Similarly to other banks, Rabobank is also increasing its efforts in the KYC programs. Increased scrutiny from the government and regulatory bodies, including fines (e.g. Rabobank’s EUR 1 mln fine in February 2019), have made this a top priority.

Rabobank indicates that higher investments for Compliance/CDD are expected (e.g. for smart software – robotics) as well as further enlargement of the group by 1,600 CDD specialists worldwide. This year it has already influenced the administrative expenses.

**Introduction of Vista, Fundr and Rabo&Co**

New initiatives were introduced to the market aimed at widening the product offering of Rabobank.

**Vista Hypotheken**: Vista has been introduced in April this year next to the existing offering of mortgages under the Rabobank and Obvion label. Interestingly, Vista is not available at the regional offices but can only be found at the intermediary offices throughout the Netherlands. The target group is first-home buyers and will be financed by external funders. Noteworthy, ABP has pledged an investment of EUR 800 mln (of which 500 mln is directed to sustainable mortgages) through APG.

**CET1 ratio**

The CET1 ratio decreased by 0.2% to 15.8%, which is still well above the 14% target. The decrease is mainly due to an increase in RWA.

**Fundr**: Fundr is the direct lending venture of Rabobank that has been established this year. It is expected that thus far the loan origination is marginal, but Rabobank has not started marketing this venture much yet. Loans up to EUR 250,000 can be requested online and within 15 minutes a pre-approval is shared. Compared to competitors (i.e. New10, Funding Circle), Fundr is late to the market but has high potential due to the large SME customer base of Rabobank.

**Rabo&Co**: In the previous update, we stated that increasing non-interest income is of the outmost importance to banks, due to the dependency on the large mortgage book and the influence of the low interest rate environment. With Rabo&Co, Rabobank initiates a platform where entrepreneurs can connect to private individuals for financing needs. These loans are offered together with Rabobank themselves.

© 2019 KPMG Advisory N.V.
For HY 2017 and HY 2018, the results of only four out of five peer banks are available and therefore included in this peer bank average. Rabobank does not publish RoE data for HY 2016 and HY 2017.

Due to the unavailability of HY results of the majority of Rabobank’s peers, peer banks are not included.

© 2019 KPMG Advisory N.V.
ABN AMRO reported EUR 1,171 mln in net profits over the first half year of 2019, with Q2 2019 profits largely exceeding the expectations of analysts. These higher profits were the result of increased interest income, one-off receivables (one of which was the sale of mortgage administrator Stater) and moderate level credit provisions. However, ABN AMRO’s half year results mainly dominated headlines because of a EUR 114 mln provision the bank was forced to recognize in order to re-evaluate the CDD status of its retail clients.

**Net interest margin**

Despite challenging interest rates, Q2 2019 net interest income increased by 2% to EUR 1,681 mln, reflecting lower liquidity management costs and various other incidental effects. NII is largely Dutch based, with 84% being generated in the Netherlands, 9% in the rest of Europe and the remaining 7% in the rest of the world. However, NII for HY 2019 has decreased by 2.2%. With an accompanying decline in net other income (-10.9%), total net income decreased by 4.6%.

The net interest margin 4Q rolling average slightly increased to 164 bps in HY 2019, from 162 bps in HY 2018.

**CET1 ratio**

ABN AMRO’s capital position remains relatively strong, with a CET1 ratio of 18.0%; the CET1 ratio showed a slight decrease from 18.3% for Q2 18. The Basel IV CET1 ratio remained largely unchanged versus year-end 2018 (13.5%), excluding profit over the first half year. ABN AMRO has set its internal CET1 ratio target at 17.5% to 18.5%, but will adjust its ambition depending on possible new requirements from regulators.

The leverage ratio remained stable at 4.2%.

**Return on Equity**

Net income of ABN AMRO increased by 1% year-on-year (YoY) to EUR 2,321 mln in Q2 2019. The underlying return on equity slightly decreased to 11.4% from 12.5% over HY 2018. Interim dividends are set at EUR 0.60 per share, totaling 50% of the bank’s profit over the first half year.

**Cost-to-Income ratio**

Over the first half year of 2019, ABN AMRO improved its C/I ratio. The bank started the year with a ratio of 63.8% (or 60.2% if regulatory levies would have been equally divided over the year), but managed to decrease that number to 56.4%. That is still higher than its Q2 2018 figure of 52.9%. The average C/I ratio over the first half year was 59.9%, which is still higher than – but on track for – its ambition of 56% to 58% for 2020, reflecting a cost base of EUR 5,000 mln. Personnel expenses continue to trend down, reflecting lower FTE levels. IT expenditure will be lowered until an IT C/I ratio of 12% to 13% is achieved. ABN AMRO will continue its cost savings programs and remains focused on its financial targets in a more challenging environment, dominated by historically low interest rates, a volatile global economy and increased regulatory and compliance costs. ABN AMRO recognized an additional provision of EUR 114 million, which reflects the bank’s commitment to strengthen KYC/AML capabilities across all its businesses and Retail in particular.

**KYC Deep dive**

Similar to its peers in the Netherlands, ABN AMRO has increased its CDD operations. Since 2013, CDD headcount has tripled, currently employing over 1,000 FTE. Its operations focus on four main topics:
- Client identification and verification;
- Know Your Client;
- Risk Assessment;
- Transaction Monitoring.

ABN AMRO has reviewed the CDD status of its main Corporate and Institutional Banking, Private Banking and high-risk retail clients. DNB has now determined that the bank has to review all Dutch retail clients. Consequently, ABN AMRO was bound to make an additional provision. Upon non-compliancy, sanctions such as instructions or fines may be imposed by authorities.

‘Banking for better’

ABN AMRO’s strategy – Banking for better – focuses on three main pillars: Sustainability, Customer experience and Future-proof bank. As a result, ABN AMRO has, among other initiatives, introduced a front-office tool to improve sustainability dialogues with its clients, improved NPS by further increasing its exposure in video banking for all segments, and progressed in centralizing, standardizing and automating its mid- and back-offices. Current CEO Kees van Dijkhuizen will step down at the end of his period in 2020. The Supervisory Board is currently in the process to recommend his successor to the General Meeting of Shareholders.
For HY 2017 and HY 2018, the results of only four out of five peer banks are available and therefore included in this peer bank average.

Due to the unavailability of HY results of the majority of ABN AMRO’s peers, peer banks are not included.

Source: Half year reports
Volksbank half year results

True to the intentions of the current Dutch cabinet, state-owned Volksbank is exhibiting a conservative performance, improving its cost/income ratio and exceeding the internal and external capital ratios targets by far. Interest income has decreased by 3% but non-interest income has grown. Volksbank has a high reliance on retail activities and may therefore be hit even harder if retail deposit rates will drop below zero, or if mortgage rates will eventually follow the steep decline of interbank/market rates. Only time will tell.

Income and reliance on mortgages
Volksbank is the only of the four banks where net interest income has not increased compared to HY 2018. A decrease of 3% (EUR -13 mln) is mainly due to the lower margin on new mortgage production compared to the existing book, as well as increased (early) renewals. This also influences the net interest margin (NIM), which drops from 147 bps to 140 bps over the last year. Six months ago, Volksbank had a YoY decrease of 2% in net interest income (NII).

Volksbank earns most of its interest income from its mortgage book, whereas other banks have more resilience due to their wholesale lending activities.

Even though the redemptions are higher than expected, Volksbank still managed to expand its mortgage portfolio, but lost market share due to the fierce competition that is going on in the current Dutch housing market. Unlike Rabobank, Volksbank has not seen an increase in impairments on the mortgage portfolio and the average LtV of mortgages declined again to 68% (FY 2018: 70%) which is probably attributable to rising housing prices.

Cost-to-Income ratio
In the last update, Volksbank had an increase in the C/I ratio to 58.7% for the full year. In the first half year 2019 it declined to 54.3%, which is getting closer to their 50% to 52% target range. It should, however, be noted that Volksbank tends to have a significantly higher C/I ratio in the second half year (approx. 3% to 4% higher).

In terms of cost control, Volksbank seems to be on the right path. The number of external employees has decreased by 16% to 678 FTE and overall personnel and marketing costs have decreased too.

CET1 ratio and Return on Equity
Volksbank has a very high CET1 ratio (37.1%), mainly due to the significant capital position that was initially funded by the state. Volksbank has restated its CET1 target at 19% in order to comply with the new Basel IV regulation.

This gives room for a possible dividend payout to the state and reducing the CET1 ratio.

Furthermore, the Return on Equity (RoE) of 8.6% is fairly low. However, with a smaller Tier1 capital position, this KPI will automatically rise.

KYC Deep dive
Volksbank is the only of the four banks with little to no news around KYC and/or compliance issues. Volksbank has a very small portfolio of credit granted to SMEs (EUR 3 bln) but still has 1.53 mln retail customers. Volksbank states that the ongoing changes in new laws and regulations urges them to review their compliance function in the coming period.

Shift in focus
Interestingly, Volksbank put a lot of focus on the financial resilience and innovation in their FY 2018 update, but this is hard to find in their 2019 interim report. In the current communications, climate-related subjects are important. Volksbank has published a ‘Green bond framework’ which is the groundwork for the launch of such a bond. They have a 41% climate neutral balance sheet and ASN is targeting a positive impact in terms of biodiversity in 2030.

Volksbank’s financial resilience app, is still in its Beta version and other innovative projects are still in the startup phase, and will focus on the mortgage chain and digital identity. It will be difficult for Volksbank to distinguish themselves from the competition in this regard.

See next page for the financial performance ...
Figure 24: Net interest margin development (in bps)

Figure 25: Cost-to-Income ratio development

Figure 26: RoE development

Figure 27: CET1 ratio development

Figure 28: FTE development

14 For HY 2017 and HY 2018, the results of only four out of five peer banks are available and therefore included in this peer bank average.

15 Due to the unavailability of HY results of the majority of Volksbank’s peers, peer banks are not included.
KPMG Peer Bank has been built using data starting in 2013 from European Banking Authority (EBA) stress tests and transparency exercises, which provide detailed bank-by-bank data on capital positions, risk exposure amounts and asset quality on over 130 banks from 24 countries of the European Economic Area, yielding over 150,000 different data points.

KPMG Peer Bank offers a number of distinguishing features:

- Basel IV Calculator
- Flexible Peer Grouping
- Ratios and indicators benchmarking
- Data export and delivery
Contact KPMG’s Banking Update team for more information

Ferdinand Veenman  
Head of Financial Services  
Partner, KPMG Nederland  
Tel: +31 (0)20 656 8586  
Mob: +31 (0)6 2254 7497  
E-mail: Veenman.Ferdinand@kpmg.nl

Lennart de Vries  
Strategy & Operations FS  
Director, KPMG Nederland  
Tel: +31 (0)20 656 2930  
Mob: +31 (0)6 1187 8596  
E-mail: DeVries.Lennart@kpmg.nl

Joost Lensen  
Financial Risk Management  
Senior Manager, KPMG Nederland  
Tel: +31 (0)20 656 8455  
Mob: +31 (0)6 2128 4207  
E-mail: Lensen.Joost@kpmg.nl

Jelle Dijkers  
Strategy & Operations FS  
Senior Consultant, KPMG Nederland  
Tel: +31 (0)20 656 7620  
Mob: +31 (0)6 1064 3981  
E-mail: Dijkers.Jelle@kpmg.nl

Maarten den Dunnen  
Strategy & Operations FS  
Senior Consultant, KPMG Nederland  
Tel: +31 (0)20 656 7109  
Mob: +31 (0)6 8260 7135  
E-mail: DenDunnen.Maarten@kpmg.nl

Nick Reijnen  
Strategy & Operations FS  
Consultant, KPMG Nederland  
Tel: +31 (0)20 656 8608  
Mob: +31 (0)6 2228 2796  
E-mail: Reijnen.Nick@kpmg.nl

kpmg.com/socialmedia