State of the Banks

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

FY 2019 edition
KPMG Netherlands

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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.
As we are finalizing this issue of the State of Banks, we already near the third week of very impactful societal measures such as social distancing, remote working and prohibition of public events all in response to the COVID-19 virus.

In only a few weeks the world has changed fundamentally and all of us are trying to cope as well as we can with this new reality. In these challenging times, it is wonderful to see the tremendous efforts governments, regulators and businesses to keep people safe and healthy. Business continuity plans are actually working at scale and therefore most businesses are able to operate.

Governments and banks have announced far reaching economic measures to proactively help businesses and consumers to economically weather this storm. Yet, even taking these packages into consideration there remains tremendous uncertainty and markets respond strongly to this, adding to the many challenges our clients are facing.

So only three months into the new year, in the context of today’s situation, the 2019 financials seem like a very distant past. 2019 proved to be a challenging year for the four major Dutch banks. The banks’ financial results reflect the impact of the low interest environments, with interest margins on all products, including mortgages – which have historically been a primary driver of income for Dutch banks - continuing to be under considerable pressure. A competitive market driven by the strong demand of institutional investors for long-term fixed rates on mortgages combined with the anticipated impact on capital requirements have led to banks consider alternatives such as the Originate-to-Distribute model in order to continue serving customers demand whilst also increasing fee income.

In our previous edition published in October 2019, we addressed the challenge facing the Dutch banks; i.e. incurring significant costs as a result of being the gatekeeper of the financial system while also trying to grow shareholder value. Increased attention on the responsibility of banks in combating money-laundering - among other financial crimes - and the associated investments and costs to manage this, have in general hampered banks’ ability to reach their targeted cost-to-income ratios. Only ING was able to report a slight increase in net income over 2019, but still none of the banks under review were able to report an increase in Return on Equity, other than Volksbank.

If 2019 proved to be a challenging year for banks’ top- and bottom line, 2020 is likely to become even more challenging. The outbreak of COVID-19 has already proven that banks must be extremely flexible in addressing short-term challenges, and will need to plan diligently in order to assess this phenomenon’s medium- and longer-term impact on their business.

Longer term concerns are obviously related to the wider economic impact of the crisis. Most economic commentators are pointing at the very real risk of a recession. How deep and how long it will take before we can see an economic recovery all depends on how successful we can be in containing COVID-19. Fortunately, Dutch banks are financially resilient and willing and able to proactively help their clients to face the challenges that lie ahead.

Ferdinand Veenman
Head of Financial Services
KPMG Nederland
How banks can deliver value in a digital world

As new challengers emerge and customer expectations shift, many are asking how traditional banks can deliver value in a digital world.

For years, a number of pundits have anticipated the death of the traditional bank. Some have predicted that Big Tech will leverage their large existing customer base, deep pockets of capital and sophisticated analytics and technology capabilities to muscle their way into the industry. Others suggest that changing customer expectations and the rise of whizzy new financial technologies will lead to the disintermediation of banks. Traditional banks will be relegated to providing the basic infrastructure, they often decry.

While each of these scenarios is certainly plausible, I believe that – in the midst of all of this disruption and disintermediation – banks are starting to rebuild their value proposition as ‘re-aggregators’ of financial services. And that will bring them even closer to the lives of their customers. Rather than fade into obscurity, the traditional bank is about to undergo something of a renaissance.

The flight to simplicity

The shift towards the re-aggregation of services is evident across a range of industries. The so-called ‘platform plays’ and ‘super apps’ are perhaps the most obvious manifestation of this – consumers are flocking to apps and solutions that combine multiple innovative tools and services into a single user experience.

Financial services are moving in the same direction. Indeed, there is growing evidence that consumers are getting tired of living in a financially disaggregated world.

Open up the average person’s smart phone today and you are sure to find a handful of apps all focused on different aspects of financial services. You may find a personal financial assistant; a financial data aggregator; a budgeting tool; a selection of different digital payment solutions; and a few ‘traditional’ banking apps. If you are a Millennial or a Gen Z, you probably have dozens more lurking on your phone, all with unique and cumbersome, albeit important, security sign-on requirements.

While there has certainly been a proliferation of new FinTechs and financial apps, it is becoming increasingly clear that customers aren’t necessarily looking to leave their traditional banks. The reality is that banks remain highly valued by customers for three things in particular: trust, financial acumen and stability. And these are precisely the characteristics that many FinTechs and challenger banks struggle to demonstrate today.

Customers may not be flocking away from their banks. But they are looking to enjoy some of the innovations and tools that the FinTechs are delivering. Were their bank able to provide the same services – either through their own infrastructure or through partnerships with others – it seems clear customers would be less inspired to explore other options.

Aggregating value

My view suggests the top banks of the future will be those that act more like financial service aggregators than originators. They will be the ones who leverage their deep customer relationships and data to truly understand their customers’ financial needs. They will use their extensive financial and regulatory expertise to create bundles of solutions that safely meet customers’ changing life needs. They will ensure that trust and security remain front and center.

Many banks are already well on their way towards this future. Some are building or buying the very technologies that, only recently, seemed set to replace them. Others are partnering with FinTechs to deploy new capabilities and to co-create new products and solution sets. KPMG professionals in my network are now working with a number of bank CEOs to help them shift their mindset towards more of an aggregator role.

How can banks deliver value in a digital world? My view suggests it will be by combining their historic capabilities with new and innovative technologies to create suites of financial services that are tailored to the unique needs of individual customers. And, from my perspective, the leaders are likely be those that focus on the re-aggregation of financial services.

Judd Caplain
Head of Global Banking & Capital Markets
KPMG International
Macroeconomic Trends

In an increasingly interconnected world, global economic developments affect the Dutch economy and banking sector, as do local developments. Whether it is the threat of international trade wars and protectionism affecting business confidence, or the threat of a global pandemic in COVID-19, the Dutch economy and banking sector are directly affected. A modest growth forecast, driven by consumer and public spending but hampered by lower export growth, characterizes the resilient Dutch economy.

Dutch economic growth slowing down as response to European and global trends

From outperforming Eurozone growth to matching it: Despite having reached a healthy 2.6% growth in GDP over 2018, relative to the Eurozone average of 1.8%, the Dutch economy reduced growth to 1.6% in 2019, relative to 1.2% growth in the Eurozone. The reduction in growth, and relative reduction vis-à-vis the Eurozone, can be attributed to the strong domestic demand for imported goods growing at a quicker rate than neighboring markets’ demand for Dutch exports. Other factors influencing this decline are the tightening in the construction industry due to regulatory stringencies and a reduction in issuance of building permits. Weaker business confidence - as measured by the CBS to have declined steadily by 4% from Q1 2019 to Q4 2019 – is also expected to cause a reduction in private-sector spending going forward. The ECB henceforth said that they expect Dutch GDP to grow by 1.3% in 2020 and 2021. However, this was prior to the emergence of COVID-19, and all its economic implications.

COVID-19 uncertainty places pressure on economy and banking sector: Next to considerable equity-market losses, COVID-19 has already prompted bankruptcies and may place pressure on businesses’ and entrepreneurs’ ability to repay loans; potentially impairing banks’ loan portfolios and rising NPL figures. The Bureau for Economic Policy Analysis (CPB) forecasted that GDP will decrease by between 1.2% and 7.7% in 2020; likely spilling over into 2021, depending on the continuing severity of the situation. This ongoing uncertainty must be factored into banks’ and business’ operations.

Nominal interest rates very low, prompting negative interest rates: In September 2019, the ECB announced that it decreased its deposit rates by 10 bps to -0.50%, with the intention to leave it as such until a healthy inflation rate of around 2% in the Eurozone is recorded – in December 2019 this was recorded as being 1.3% year-on-year. However, to relieve banks’ pressure to offer negative interest rates, an exemption has been offered by the ECB on a section of banks’ deposits to curb the effect on liquidity, next to the general alleviations following COVID-19. The news confirmed that negative interest rates are to remain for the medium-term, prompting several responses in The Netherlands – including several major banks announcing negative interest rates on savings accounts of High Net Worth Individuals (HNWI).

Financial stability affected by (inter)national developments

Low interest rates directly affecting pensions and insurances: In its report on financial stability, the DNB reported that continuity of a stringent monetary policy can deter financial stability in The Netherlands. Pension funds reported a 7.3% decrease in funding ratio, while asset impairment and losses by pension and insurance funds can pose a contagion risk to the economy.

High-risk debt and deterioration in underwriting standards: The global trend of leveraged finance and deterioration in underwriting procedures, through collateralized loan obligations (CLO), can remind some of pre-crisis conditions. In fact, the worldwide outstanding stock of CLO doubled in size to USD 1.2 trillion since 2012 while the Dutch banks’ share of CLOs stands at 1.5%; a considerable increase requiring regulatory attention.

Housing prices rise faster than wages: Systemic risk stemming from the housing market has increased, and indications of overvaluations are present. In the past 3 years, nominal prices increased by an average of 8% which significantly outpaced wage growth. This, combined with limited supply and low interest rates, also led buyers to take larger loans relative to income (LTI) especially relative to standards in other European countries.

Macro-prudential policies are in place and will be introduced to ensure resilience: Next to the ECB-enforced regulations which aim to improve the financial sectors’ stability and resilience under stress, the DNB also wants to implement measures to reflect the current environment. In fact, the DNB is looking to enforce a minimum floor for the risk-weight placed on mortgages, to ensure that the risk-weight assigned to a loan reflects its true systemic risk. Also, stricter limits on LTI ratios will also be explored, together with the AFM.

Energy transition risks still a talking point

Exposure of banking sector to transition risk can be sizable, but manageable: The DNB has made it a strong priority to assess the extent to which systemically important banks are exposed to transition risks. Next to this, the DNB continues to urge financial institutions to translate ESG-policies into operating models and management, through a proactive and measurable approach.

Consumer confidence

For the first time since 2013, annual consumer confidence levels in The Netherlands averaged negative at -1.33 for the entirety of 2019; meaning that more consumers are pessimistic than optimistic on economic climate and/or willingness to buy. Nevertheless, consumer confidence still remains above the twenty year average (-4) with an all time high in January 2000 (36) and an all time low in March 2013 (-41).

Dutch sentiment indicators suggest that economic growth is slowing down, contrary of what we have seen only six months ago. Whilst consumer confidence is slightly above the long term average, the recent developments in relation to COVID-19 will most likely cause a drop in consumer confidence and might impact consumer behavior and cause a (temporary) halt on economic growth, as elaborated upon on Page 5.

Interest Rates

As of December 2019, 3M Euribor has been negative for more than 4 and a half consecutive years with the goal to battle deflation and stimulate lending to both individuals and companies. Where Dutch savings accounts, on average, yielded interest rates around 0.33% in June 2015, they dropped to 0.06% in December 2019. Saving rates remained relatively stable around this number for 2 and half years now. In 2019, ING, ABN AMRO, and Rabobank announced plans to charge negative interest rate fees for consumers depositing fund over a certain threshold.

In 2019, mortgage rates decreased to 2%, the lowest number seen in more than 17 years. Adversely, real estate investments (residential mortgages) were nearing 2012 record levels, however COVID-19 has currently halted this growth.

Global economic turbulence decreasing Dutch YoY GDP growth

The Dutch economy is nearing its capacity limits. In 2019, GDP growth was 1.58%, down from over 3% in 2016. Being among the top 10 largest export economies, the decrease in Dutch GDP growth can largely be attributed to a global downturn in manufacturing activity and geopolitical tensions, among other factors discussed on Page 5.

In the coming year, it is expected that domestic spending will become the most important contributor to Dutch GDP growth as higher wages and lower taxes on income will prompt Dutch consumption rates. Besides, it is also expected that governmental spending will make a more solid contribution to GDP growth in 2020. The DNB expects that the EMU balance will fall to 0.5% of GDP in 2020, following three years featuring surpluses of 1.3% to 1.5% of GDP. Naturally, the recent COVID-19 developments are likely to affect both Dutch and global growth, as explained in Page 5, resulting in a depreciation of Dutch YoY GDP growth.
Hot topic: Rebuilding customer trust
Rebuilding Customer Trust through Remediation

As the banking sector has been changing rapidly, banks have worked on developing future-proof business models to meet altering customer demands. At the same time banks continue to face issues requiring “customer remediation” due to regulatory breaches, changing duty of care requirements and IT failures. Sector-wide examples from previous years include corrective actions and compensation for interest rate derivatives, mortgage interest rate penalties and insurance products. These cases have demonstrated the high degree of complexity associated with compensating customers. Banks continue to face other event-driven issues requiring one-off corrective actions of past wrongdoings. In trying to deal with these issues, banks often use ad-hoc ‘fire-fighting’ approaches resulting in client-dissatisfaction, high costs and extended project durations. By getting customer remediation right, however, banks have an opportunity to turn negative client experiences into positive memories.

An Important and Challenging Puzzle

Negative customer experiences have six times greater influence on future customer behavior and year-on-year sales than positive experiences. As such, swift and adequate resolution of past wrongdoings is key to re-engage customers in the present and keep them loyal in the future. This is particularly applicable to banks as the sector has suffered from deteriorating trust following the financial crisis and large scale and explosive media attention around various issues.

In our experience, banks tend to not always adequately recognize and acknowledge remediation issues. Middle management often ignores initial signals such as customer complaints, and address these through settlement or litigation on a case-by-case basis. In the meantime, broader developments may force banks into customer remediation on a much wider-scale, compared to an initial proactive and client-centric approach.

There are several factors leading to complexity in dealing with remediation projects. These include the (lack of) available historical data and documentation of sufficient quality, intense public scrutiny and the pressure to deliver quick results. If not dealt with adequately, these factors result in substantial delays and significant costs, while they also often further dent customer trust.

Ownership for resolving remediation issues is often entrusted to the respective business line, leading to an ad-hoc ‘fire-fighting’ approach. This approach may be effective for smaller remediation issues, but is particularly limited when a bank has to deal with multiple, larger and/or more complex remediation issues.

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9 KPMG Nunwood
Regardless of the scale of required remediation, an early and detailed impact and scenario analysis can facilitate management in making adequate decisions on how to tackle the (potential) issue at hand. Once customer remediation is initiated, it is important to invest adequate time in the design and testing of required processes. Banks tend to rapidly transition into execution, leading to insufficient quality and inconsistencies in processes. At the same time, there are high expectations to deliver quick results. To effectively address these issues, iterative but robust approaches are required such as a phased go-live of processes, the prioritization of customers who are impacted most as well as offering advance compensation payments based on initial assumptions.

Effective remediation requires specialized knowledge and skills for, amongst others, the gathering and analyses of historical data and documentation as well as performing calculations. When dealing with larger, multiple and/or more complex issues it is particularly important to set up a separate and specialized organization, to avoid losing management focus and hampering ‘business-as-usual’ activities.

In addition to people and processes, technology plays an important role in facilitating customer remediation. When designed and implemented adequately, technology ensures quality and auditability while it simultaneously accelerates the execution. Spreadsheet solutions are not fit for this purpose. Today’s low-code workflow platforms can offer the flexibility required. As KPMG, we have pre-configured solutions available with an Appian workflow tool at its heart.

Above all, customer remediation is about rebuilding trust. Customers should be at the heart of the design and execution of remediation. By providing transparency and engaging with clients, banks can demonstrate empathy throughout the remediation journey.
Financial performance
RoE and Total Net Income are under pressure, whilst the net interest margin remains healthy

The last six months of 2019 have shown that banks were not able to increase net income. Volksbank and ING have shown that growth can still be attained from other income such as fee & commissions. However, the question is how much the banks can increase banking fees for retail customers on a continuing basis. For now they still rely heavily on interest income. Margins on mortgages are still very positive, although in 2019 public attention increased on mortgage rates. Increased competition leads to declining mortgage rates, which will place further pressure on margins for banks. Banks still rely heavily on cost-cutting to lower the C/I ratio and increase operational efficiency and report that these programs are successful. Despite these efforts, the increased workforce and provisions in relation to Know your Customer (KYC) and Anti-Money Laundering (AML) activities will more likely lead to a higher cost base than a further decrease.

Return on Equity

Over the last five years, Return on Equity (RoE) has declined significantly for ABN AMRO and Volksbank albeit to very different numbers. Nevertheless, the general trend is a declining RoE. ABN AMRO is outperforming its Dutch counterparts with an RoE of 10%; a decline of 1.4% due to lower operational income but still at the (lower) end of their target (10-13%). But is still at the higher end together with ING.

Volksbank, on the other hand, has a lower target (8%) and due to being one of the best capitalized banks in Europe, their RoE lagged at 7.7%. In the current situation (being a state-owned bank) less emphasis could be put on RoE. However, in the event of an IPO or sale, new owners may look stricter to RoE and cost/income targets.

In our half year update10, we noted that attaining the RoE goals is a main focus of the now departing CEO Ralph Hamers. However, ING has dropped below the target of 10% with a RoE of 9.4%. ING indicates that with more digitalization (e.g. in Germany) they plan to decrease costs and as
management, they will increase efforts to add a larger fee and commission income stream. However, the target of 10% remains challenging with higher capital requirements, increased regulatory costs and the low interest environment.

**Cost-to-Income ratio**

C/I ratio targets for 2020 seemed out of range at the half year mark, and at the end of the year, we conclude that the targets are unlikely to be attained due to both increased operational costs and decrease of top-line income.

The main factors at the cost side that have impacted the C/I ratio more than expected are: regulatory, compliance and IT costs. Regulatory costs of ING have surpassed EUR 1 bln (mainly contributions to DGS, local resolution funds and bank taxes) and represent 10% of the total cost base. The Dutch banks have little to no influence on these costs. However, the Dutch Banking Association (NVB) has publicly expressed that the Dutch implementation of the banking tax is increasingly affecting the bottom line of the banks and hopes the Dutch government will reflect on the current situation for the financial institutions.

Additionally, the investments in KYC for both people and IT are here to stay. In the coming years we expect part of these costs to normalize, most investments happen up-front and are a reaction to fines of both Dutch and Foreign administrations. The personnel costs could slow down as much recruiting has happened in 2019 and therefore could be projected for future years.

**Income**

Total net income is still down for three out of four banks (in line with the half year reports). ING has managed to increase its total net income and is the only bank that sees an increase in both net interest income and net other income. ABN AMRO has the biggest decline for both total net income and fee and commission income. The decline in

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

- Rabobank¹
- ING²
- ABN AMRO³
- Volksbank⁴

Source: Annual reports

¹Cost/income ratio including regulatory levies
²Underlying cost/income ratio
³Cost/income ratio adjusted for the impact of regulatory levies
⁴Cost/income ratio adjusted for the impact of regulatory levies

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

<table>
<thead>
<tr>
<th>Year</th>
<th>ING</th>
<th>Rabobank</th>
<th>ABN AMRO</th>
<th>Volksbank</th>
</tr>
</thead>
<tbody>
<tr>
<td>2015</td>
<td>18,306</td>
<td>11,915</td>
<td>8,605</td>
<td>929</td>
</tr>
<tr>
<td>2016</td>
<td>17,984</td>
<td>11,879</td>
<td>8,550</td>
<td>929</td>
</tr>
<tr>
<td>2017</td>
<td>17,653</td>
<td>11,834</td>
<td>8,495</td>
<td>929</td>
</tr>
<tr>
<td>2018</td>
<td>17,322</td>
<td>11,789</td>
<td>8,439</td>
<td>929</td>
</tr>
<tr>
<td>2019</td>
<td>17,001</td>
<td>11,743</td>
<td>8,383</td>
<td>929</td>
</tr>
</tbody>
</table>

Y-o-Y change | NII | Net other income |
-------------|-----|------------------|
Rabobank    | -0.9%| -0.8%            |
ING         | 1.2% | 1.3%             |
ABN AMRO    | -1.9%| -14.6%           |
Volksbank   | -3.6%| 8.0%             |
fee and commission income is largely due to the decline in fees from Corporate & Institutional Banking clients.

Other operating income decreased due to the divestment of Stater (service provider for mortgages).

In our last report, we made mention of the expectation that the emergence of PSD2 and Fintech should create possibilities for gaining more fee and commission income. Most banks have started investing in blockchain solutions paving the way to new sources of income. When banks assume the aggregator role (also see interview with Judd Caplain on page 4) they could benefit from the services related to financial planning, financial resilience, brokerage and similar product advice. However, the increase of net other income seen in the beginning of the year (ING increase of 8.2% and Volksbank increase of 16%) may have been incidental as the consumer may express doubts on ever rising banking fees. Furthermore the recent economic developments caused by COVID-19 are likely to impact the housing market, and thus fees associated with mortgage advice, at least temporarily.

**Net interest margin**

Net interest margins (NIM) vary greatly between the banks. ABN AMRO exhibits a very positive trend, with a slight decline (1 bps) last year. The bank has warned for declining interest income from 2020 onward.

Volksbank on the other hand has difficulty maintaining the net interest margin. Especially for a smaller retail bank, that is mostly dependent on the difference in interest it can make on mortgages, and pay on deposits (both to the customer as to the ECB), the current interest environment is a challenging one. Volksbank has chosen not to charge negative rates to clients so has to devise other ways of attaining new income streams. Social banking, with a focus on sustainability and responsible investments can provide differentiation up to a certain level. It is likely that this positioning, and earning a premium as such, is used by the majority of the Dutch consumer market.

Additionally, the interest in fixed term mortgages of 20 years and up has increased competition in the Dutch banking landscape. Non-Financial Institutions (NFIs) can make use of a competitive advantage for these longer term loans due to the absence of banking-specific capital restrictions, for the time being at least. Furthermore, banks have more difficulty matching the short term deposits to those long term fixed rates. To withstand the margin that pressure banks are using the originate-to-distribute model in order to increase servicing fees whilst being able to provide a full product offering to the customer.
A closer look at individual performance
ING full year results

Despite higher operational costs and risk costs, ING reported an underlying net result of EUR 4.8 bln, which is 1.7% higher than FY18. The share price dropped immediately after publishing the somewhat disappointing Q4 and FY19 results, but recovered quickly as analysts concluded that ING’s underlying income, both interest and other, slightly increased on an annual base.

Net interest income and net interest margin

ING’s total income grew, driven by stronger net interest income as well as net fee and commission income, with 1.2% to EUR 18.3 bln, which means total income growth for the 7th consecutive year since 2012. Net interest income increased, despite continuous margin pressure on customer deposits in the Benelux and Germany, with 1.2% to EUR 14.1 bln due to volume growth in retail lending and efficient mortgages pricing. Net other income grew 2.3% mainly due to higher fee and commission income in Retail Banking, particularly in Challengers & Growth Markets (Retail C&GM).

Net interest margin remained stable in the second half of 2019 resulting in 154 bps for FY19, equaling FY17, the highest post-crisis result. Higher net interest income in Treasury, higher interest results in financial markets and improved lending margins were main drivers.

Return on Equity

Due to higher operational expenses, risk costs and higher tax rates, ING’s increased underlying expenses offset its total income growth. Resulting in an underlying net result of EUR 4.8 bln, slightly up 1.7% from FY18. However, ING’s return on equity dropped below the banks 10.0%-12.0% ambition to 9.4% due to its increased equity base.

ING sets FY19 dividends at EUR 0.69 per share, which adds EUR 0.45 to the interim dividend paid out in August 2019.

Cost-to-Income ratio

Major focus on KYC (Know Your Customer) and regulatory pressure continued to have significant impact on ING’s underlying expenses in 2019, while at the same time staff expenses increased significantly during 2019 (+6.2%), leading to the largest staff base since end of year 2015. Higher loan loss provisions particularly in Wholesale Banking and higher risk costs in Retail NL drove an increase in risk related expenses. This led to a 4.4% increase in underlying expenses compared to FY18 which partly offsets ING’s 1.2% total underlying income increase. Consequently the C/I ratio increased with 180 bps to 56.6% (incl. regulatory costs). ING’s ambition to have a C/I 50%-52% ratio by 2020 does not seem to be feasible.

Business Innovation

ING keeps investing in its innovative business solutions. She does this by developing fintech solutions in-house, by teaming up with partners and by participating in start-ups and solutions via ING Ventures.

- ING supported Katana, an advanced analytics platform supporting trading portfolio managers in investment decision making, to become an independent company.
- ING Ventures has invested in US-based regulatory technology company Ascent, which builds technological solutions to improve compliance in a rapidly changing regulatory environment.
- Yolt, ING’s in-house personal finance tool, reached 1 million users and won the International Payments Awards 2019.

Loan book quality

The quality of ING’s loan book remained fairly stable as the increase in outstanding loans classified as substandard or non-performing (NPL) was offset by the increase of the overall loan book. ING’s NPL ratio remained at 1.35% compared to 1.34% in FY18, while its combined substandard and NPL ratio stabilized at 2.0%. Provisions for loan losses slightly increased with 2.2% due to amongst others a EUR 40 mln legal provision in Retail C&GM and several large individual files in Wholesale Banking, mainly in the Americas, Belgium and Asia.

ING’s risk-weighted assets increased with EUR 12.1 bln (3.9%) to EUR 326.4 bln, mostly explained by supervisory impact on its RWA due to TRIM revisions.

KYC Developments

KYC remains a high priority within ING, continuing efforts to improve the management of its non-financial risks. Main results with regard to KYC:

- During 2019 ING increased the number of FTE working globally on KYC related activities to ~4000, up ~1000 as from 2018. Operational costs increased accordingly.
- ING implemented its systematic integrity risk analysis globally, enabling ING to perform consistent customer risk assessments.
- Negotiations with Banca d’Italia on improvement of its KYC management continued. However, for now ING is still prohibited from accepting new customers in Italy.

1 Underlying cost/income ratio
2 See ING’s 2019 Annual report
Figure 9: Net interest margin development (in bps)

Source: Annual reports

Figure 10: Cost-to-Income ratio development

Source: Annual reports

*Underlying cost/income ratio

Figure 11: RoE development

Source: Annual reports

Figure 12: CET1 ratio development

Source: Annual reports

Figure 13: FTE development

Source: Annual reports
Rabobank full year results

Rabobank’s net result has dropped by 27% compared to FY18. This decrease from EUR 3.0 bln to EUR 2.2 bln can be attributed to the increase of impairment charges relating to the banks’ stake in Achmea, the negative impact of the low interest rate environment, and the absence of income from divested non-strategic assets. The bank managed to further lower its costs leading to an improved C/I ratio, however is still lagging behind its domestic peers.

Net interest income and Net interest margin

The low interest rate environment had a minor effect on the net interest income in FY19, resulting in a decrease of 0.9% to EUR 8,483 mln. The negative impact of low interest rates was almost fully diminished by the increased margin on mortgage production and an increase in the volumes of loans. However, Rabobank’s net interest margin slightly decreased from 141 bps in FY18 to 139 bps in FY19.

Rabobank has the most diversified source of income compared to its Dutch peers (20.8% of net income is non-interest income), resulting in a more robust income structure when facing current low interest rates. 28.8% of Rabobank’s income is generated through net other income in FY19. Compared to FY18, the level of net other income remained stable. The bank’s income is diverse due to its fee and commission income, and leasing and real estate activities in the domestic and international market.

Return on equity

Rabobank has the ambition to achieve a RoE of 6-7% in the short term. This ambition embodies the required additional capital build up in order to comply with the introduction of Basel IV in 2022 and impacting the bank’s RoE performance. From 2022 onwards, the bank aims to achieve a RoE of >8%. In 2019, Rabobank’s RoE has dropped from 7.3% to 5.3%. This significant drop can be attributed to the decrease of net profit by 27% in FY19 compared to FY18. Consequently, Rabobank is lagging behind its domestic and international peers regarding RoE performance (9.2%).

Net profit

The decrease of net profit by 27% in FY19 is mainly driven by impairment charges on financial assets (EUR 975 mln) and investments in associates (EUR 300 mln). The latter charge can be attributed to the consequences of low interest rates at Dutch Insurer Achmea where Rabobank has a 30% equity stake. FY19’s impairment charges are significantly higher than the period 2016-2018, however the level of impairment charges in this period were exceptionally low. The current level of charges are comparable with FY15 (EUR 1.0 bln).

Next to impairment charges, the sale of non-core assets in the last years (e.g. FGH’s CRE loan portfolio and BPD Marignan), led to a decrease in net profit compared to FY18 as well. This decrease of the asset base, in combination with a decrease in other results, led to a drop of underlying total income of 4% in FY19.

KYC developments

CDD/AML activities have become one of the top priorities of the bank in the last couple of years. In order to fulfill this core task, Rabobank has hired 1,750 new specialists in 2019. Consequently, Rabobank currently employs up to 3,000 CDD/AML specialists worldwide.

The bank expects that additional investments in AML/CDD will be necessary in the following years (i.e. investments in IT and risk management resulting in an increase in FTE). This year’s investments have already influenced the administrative expenses and can have a negative effect on Rabobank’s C/I ratio goals in the long term.

Cost-to-Income ratio

Last year, the operational costs of Rabobank were lowered by 4%, mainly due to cost containment measures (e.g. the transformation of Domestic Retail Bank) and the sale of international subsidiaries. Consequently, the C/I ratio has improved to 63.8% (including regulatory levies). As a result, Rabobank is outperforming its international peers for the first time in years (62.1%), but the bank still has a higher C/I rate compared to its Dutch peers (59.7%). Rabobank wants to further decrease its C/I rate to low in 60% in the short term and around 55% in the long term.

Mutations in subsidiaries’ portfolio

In 2019 Rabobank introduced several new market initiatives to expand its product portfolio as reported in our HY19 update (e.g. Fundr, Rabo&Co and Vista Hypotheken). Simultaneously, existing offerings were divested or spun-off.

Vista Hypotheken: Last April, Vista was introduced next to the existing offering of mortgages under the Rabobank and Obvion label. At the end of its inaugural year, the Vista mortgage label had a total committed funding of EUR 3.0 bln.

International retail banking: Following its strategy, Rabobank has spun-off non-core business activities by the divestment of RNA, ACC and retail portfolios in Indonesia in 2019. With these divestments, the bank aims to optimize its balance sheet and invest in core business activities. The sale of these subsidiaries had a positive impact on the bank’s FY19 CET1% and net profit.
ABN AMRO full year results

ABN AMRO reported a 13% decrease in profits to EUR 2.0 bln, relative to 2018. The continued cost-cutting efforts through a reduction of personnel expenses, and an IT transformation to improve operational management, were offset by the strong pressure on deposit and mortgage margins stemming from low interest rates, and costs associated with AML/KYC; which may remain and grow going forward. At 18.1%, however, the capital position is strong; showcasing the resilience of ABN AMRO in uncertain conditions, relative to Dutch and European peer banks.

Net Interest Margin

A continued, low interest rate environment placed pressure on deposit as well as mortgage volumes and margins, leading to a 1.9% decrease in net interest income (NII) in 2019, relative to 2018, translating to a decrease in Net Interest Margin (NIM) of 1bps to 164bps. ABN AMRO’s NIM is highest of all banks.

Other Operating Income (OOI) and Net Fee Commission Income (NFCI) also decreased significantly vis-à-vis 2018 by 37% and 4%, respectively. Negative impacts on OOI like significantly lower equity stakes – including the divestment of and the partial sell-off of public loan portfolios were partially offset by the income generated from the sale of MoneYou Belgium’s portfolio in July 2019 to KeyTrade Bank. Alternatively, NFCI decreased by 4% – mainly attributed to the lower commissions charged in Clearing, attributable to lower market volatility.

All segments within the bank reported declines in profit relative to 2018, other than Commercial Banking which increased by 1%, driven largely by a personnel reorganization. Private Banking and Corporate Banking segments, on the other hand, reported a loss of 37% and 32% respectively. Changes to models leading to asset revaluations, margin pressures, and loan-impairments led by transition risks are key deterents.

Return on Equity

Similarly to all studied banks other than the Volksbank who reported an increase, ABN AMRO’s ROE decreased by 1.4% to 10% for 2019, which is still the highest of all Dutch banks and also outperforms European peers. The decline is primarily due to the decrease in net income and, in line with this decrease, EPS decreased by 12.3% to €2.06 which significantly outperforms that reported by ING. However, while the book-value of the shares sit at €20.73, ABN AMRO has traded below this book-value for the majority of the year in 2019. The dividend per share has consequently also been adjusted to €1.28 from €1.45 in 2018.

Cost-to-Income ratio

In 2019, ABN AMRO exhibited an increase in C/I ratio to 61.2%\(^1\) relative to 58.8% in 2018. While overall operating expenses decreased by 2% as a consequence to continuous cost-cutting efforts, this was offset by the decline in overall income by 5%. Relative to European Peer Banks, ABN AMRO – similarly to other Dutch banks – exhibit a healthy comparatively healthy C/I ratio, primarily due to a more proficient operational and efficient management in the Dutch banking industry. However, the current figure is still below ABN AMRO’s target of reaching 56-58% by FY20, which remains a challenge. Cost-reduction programs and a decrease in provisions are causing operating expenses to trend downwards – projected to be below EUR 5 billion in 2021 from EUR 5.2 billion in 2019.

Continued strategic focus on Sustainability

In line with the strategy dubbed “Banking for Better”, ABN AMRO places considerable strategic focus on KPIs related to sustainability, also in an effort to improve NPS scores which have slightly suffered, particularly in the Private Banking domain. In fact, ABN AMRO is targeting to more than double its sustainable AuM to EUR 30 billion by 2022. To curb the effect of energy transition risks, renewable energy investments should constitute 26% of all energy-portfolio investments, by 2022. Also, ABN AMRO forged partnerships to aid mortgage-buyers in creating a sustainable household and, similarly, they enable corporate clients to view their environmental footprint and take appropriate measures through an integrated dashboard.

Impact of Regulatory Environment

Similarly to all major Dutch banks, regulatory pressures are impacting financial and operational KPIs. ABN AMRO exhibits a strong CET1 ratio of 18.1%, second only to the Volksbank of the studied banks. However, pressure due to the increase of risk-weighted assets (RWA) by EUR 10 billion as a result of TRIM, and an expected further increase in 2020 of EUR 7.5 bln was due. Recently DNB has announced that the introduction of a minimum risk-floor on mortgages will be postponed due to COVID-19. Running derivatives-related provisions totaled nearly EUR 30 million in 2019, as well. This, combined with the 2,000 (and growing) employees working on DFC activities - for which a EUR 259 million provision has been made available – places further pressures on costs and liquidity management, going forward.

\(^1\) Underlying cost/income ratio
Figure 19: Net interest margin development (in bps)

![Net interest margin development graph]

Source: Annual reports

Figure 20: Cost-to-Income ratio development

![Cost-to-Income ratio development graph]

Source: Annual reports
1 Underlying cost/income ratio

Figure 21: RoE development

![RoE development graph]

Source: Annual reports

Figure 22: CET1 ratio development

![CET1 ratio development graph]

Source: Annual reports

Figure 23: FTE development

![FTE development graph]

Source: Annual reports
De Volksbank full year results

In 2019, state-owned Volksbank’s net profit increased at a 3% growth rate to EUR 275 mln; net interest income decreased by 4% while operating expenses were 6% lower. The bank made a capital distribution of EUR 250 mln to NLFI in December 2019 and proposes to pay out a dividend of EUR 165 mln. The bank showed its highest income growth on net fee and commission income at 16% because of an increase in fees on payment transactions and mortgage advice. Additionally the bank welcomed both a new COO and CFO.

Net interest income and Net interest margin

In 2019, Volksbank’s net interest income declined by 4% from EUR 908 mln in 2018 to EUR 875 mln in 2019 mainly as a result of lower interest margins earned on (new) mortgages and an increase of early renewals. Lower interest income on mortgages has partly been compensated by lower interest expenses achieved by hedging interest rate risks and the reduction of interest rates on saving accounts. Volksbank’s relative net interest income to total net income is exceptionally high at a rate of 94% making it more susceptible to changes in the interest rate environment than other banks. Volksbank generates most interest income from mortgages; its portfolio increased by EUR 0.9 bln to EUR 48.2 bln in 2019 (mainly as a result of EUR 0.7 bln IFRS value adjustments). Commercially, Volksbank is losing market share in new mortgages generation with high competition of non-bank institutions (6.1% in 2019 (EUR 5.5 bln) and 7.2% in 2018 (EUR 5.9 bln)). Volksbank increased its retail savings by 2.7% to EUR 38.4 bln in 2019 with a slight decrease in market share (10.4% in 2019 from 10.6% in 2018). It is notable that, unlike banks such as ING and Rabobank, Volksbank is not planning to charge a negative interest fee on retail savings in 2020. At current Euribor rates of -0.38% and ECB deposit rates at -0.50% this impacts the bank’s net interest margin being at 137 bps in 2019. To overcome such an impact, the bank might want to increase lending volumes in 2020 to offset the adverse effect of negative rates on funding cost and bank profitability.

Cost-to-Income ratio

Volksbank cut operating expenses by EUR 35 mln to a total of EUR 574 mln (6% decrease). Of this cut, EUR 29 mln is related to a reduction of staff by 149 FTE in 2019. It is notable for the first time since 2016, this decrease in FTE almost fully entails externally hired employees. The reduction leads to a Cost-to-Income ratio improvement to 57.3% (adjusted for the impact of regulatory levies).

CET1 ratio and RoE

CET1 ratio at Volksbank dropped from 35.5% in 2018 to 32.6% in 2019 due to both a decline in CET1 capital (EUR 157 mln) and an increase in RWA (EUR 800 mln). CET 1 ratio is high compared to other Dutch banks being more than double that of Rabobank (16.3%) and ING (14.6%). Volksbank is fully owned by the Dutch State (NLFI) and subsequently follows a risk-adverse strategy exhibited in a high CET1 ratio. Based on the balance sheet position as of 31 December 2019, Volksbank estimates that CET1 capital ratio will decrease by approximately 9 percentage-points to 24% in 2020, as a result of the full phase-in of Basel IV. The capital floors regarding (high Ltv) mortgages hits the bank severely. This is still well above the bank’s own target of 19% and the Basel IV’s requirement of 14%. Volksbank’s RoE has been relatively stable in 2019, RoE was 7.7% at year end 2019 and 7.6% at year end 2018.

Social Image

As a utility, and mainly Retail bank, Volksbank puts high emphasis on the combined social character of their brands being: SNS (emphasis on financial resilience), ASN Bank (sustainability), RegioBank (quality of life in local communities) and BLG Wonen (home ownership for everyone). With these brands and underlying propositions, Volksbank aspires to play an important role in social cultural themes of the Dutch society such as an population ageing (e.g. longer independent living and freeing up capital from property via reversed mortgages) and sustainable housing (e.g. overcoming mortgage rules imposed by Dutch government making over-crediting very difficult) and thus further contributing to its mission “banking with a human touch”.

Privatizing Volksbank

Volksbank is a state owned bank after being nationalized in 2013 during the financial crisis. In November 2019, political debates have started relating to privatizing Volksbank. The Minister of Finance sees little benefit in selling the bank to the highest bidder, emphasizing the importance of the social role the bank is currently fulfilling. At this moment, the Ministry of Finance is investigating multiple scenario’s for the future of the bank. Following challenging market conditions (e.g. negative interest rates) the government takes at least one more year before coming to a final decision on its future. Until then no radical changes are expected at Volksbank.
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.

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- Data export and delivery
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