FITCH UPGRADES DE VOLKSBANK TO 'A-'; STABLE OUTLOOK

Fitch Ratings-London-24 November 2017: Fitch Ratings has upgraded de Volksbank N.V.'s (de Volksbank) Long-Term Issuer Default Rating (IDR) to 'A-' from 'BBB+' and Viability Rating (VR) to 'a-' from 'bbb+'. The Outlook on the Long-Term IDR is Stable. A full list of rating actions is at the end of this rating action commentary.

The upgrade reflects de Volksbank's continued strong financial metrics and Fitch's view that these will be maintained. This is based on our expectation that de Volksbank will continue to pursue a domestic retail strategy focused on low-risk mortgage lending. We believe that the risk of a dramatic change in the bank's strategic direction is remote as we expect that de Volksbank will remain majority state-owned in the medium term.

Our expectation of the bank's continued strong performance is also underpinned by the generally positive outlook on the Dutch economy, including a decreasing unemployment rate and a growing housing market. We believe that given de Volksbank's concentration on domestic mortgage lending, the bank will benefit more from these trends than the more diversified three largest Dutch banks.

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

KEY RATING DRIVERS
IDRS, VR, DERIVATIVE COUNTERPARY RATING AND SENIOR DEBT
De Volksbank's ratings reflect the bank's sound asset quality and overall moderate risk appetite, with a focus on a single but low-risk product. The ratings also reflect high risk-weighted capital ratios and reasonable leverage. The ratings are constrained by the bank's concentrated business model and hence Dutch retail banking franchise, which is also significantly smaller than at the three largest Dutch banks.

The bank's asset quality continued to improve and is in line with peers that have a similar asset mix. Impaired loans stood at a low 1% of gross loans at end-June 2017, reflecting a loan book largely made up of residential mortgage loans. We view de Volksbank's underwriting standards in mortgage lending as reasonably conservative and largely in line with major Dutch banks'. We also believe that the growth of the housing market will allow the bank to maintain its recently increased loan issuance volumes without loosening its standards.

Operating profitability is sound, with operating profit/risk-weighted assets (RWA) of 4.7% and return on equity of 10% in 1H17. Profitability is supported by an unsustainably low level of loan impairment charges (LICs). In 1H17, the bank reported releases of impairment provisions for the fourth consecutive semi-annual period. We expect LICs to gradually normalise, but given the bank's low-risk asset mix and the benign environment, they should remain low. De Volksbank is reliant on net interest income, and we expect margin pressure to persist, particularly since the bank needs to build up a buffer of eligible debt to meet the upcoming minimum requirement for own funds and eligible liabilities. We expect costs to decrease, although the bulk of the cost improvement is likely to occur after 2018 given the timing of planned staff reductions.

De Volksbank's risk-weighted capital ratios are solid, with a fully loaded common equity Tier 1 (CET1) capital ratio of 32.8% at end-June 2017, boosted by low risk-weights on residential mortgage loans. Leverage ratio (5.5% on a fully-loaded basis) is reasonable for a retail-focused bank. Our assessment takes into account that the bank targets a leverage ratio above 4.25%, which should support the CET1 capital ratio at above 20%, provided risk-weights remain stable. In addition, although the introduction of risk-weight floors would significantly affect de Volksbank's risk-weighted capital ratios, we expect the bank will maintain its CET1 capital ratio above the stated target of 15%.

De Volksbank is predominantly deposit-funded, with a loans-to-deposits ratio of 102% at end-June 2017. The bank also accesses the secured and unsecured wholesale funding markets, and recently issued a three-year EUR500 million senior unsecured benchmark bond. Overall we believe de Volksbank's funding is stable, but it is more confidence-sensitive than at larger banks and may become more expensive during periods of stress. Liquidity is sound, underpinned by a large buffer of high-quality liquid assets well in excess of debt repayments coming up in the next two years.

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

The Short-Term IDR of 'F2' is the lower of the two options mapping to an 'A-' Long-Term IDR. This reflects that although we view de Volksbank's liquidity as sound, it is not outperforming similarly rated peers'.

SUPPORT RATING AND SUPPORT RATING FLOOR
The Support Rating of '5' and Support Rating Floor of 'No Floor' reflect Fitch's view that senior creditors cannot rely on receiving full extraordinary support from the sovereign if de Volksbank becomes non-viable. The EU's Bank Recovery and Resolution Directive and the Single Resolution Mechanism for eurozone banks provide a framework for resolving banks that is likely to require senior creditors participating in losses, if necessary, instead of or ahead of a bank receiving sovereign support.

SUBORDINATED DEBT
Subordinated debt is rated one notch below de Volksbank's VR, reflecting the higher-than-average loss severity of this type of debt. Fitch does not apply additional notching for incremental non-performance risk relative to the VR given that any loss absorption would only occur once the bank reaches the point of non-viability.

RATING SENSITIVITIES
IDRS, VR, DCR AND SENIOR DEBT
A further upgrade is unlikely within the constraints of de Volksbank's franchise and business model. While currently not Fitch's base case, de Volksbank's ratings could come under pressure if risk appetite increases, for example through a loosening of underwriting standards or a significant and rapid shift in the business model, particularly if that would worsen asset quality and capitalisation in the longer term. Less prudent liquidity management would also be negative for the ratings.

SUPPORT RATING AND SUPPORT RATING FLOOR
An upgrade of the Support Rating or upward revision of the Support Rating Floor would be contingent on a positive change in the Dutch sovereign's propensity to support its banks. This is highly unlikely, in Fitch's view.

SUBORDINATED BEBT
Subordinated debt is sensitive to changes in de Volksbank's VR. It is also sensitive to a change in Fitch's assessment of loss severity or non-performance risk.

The rating actions are as follows:

Volksbank
Long-Term IDR: upgraded to 'A-' from 'BBB+'; Outlook Stable
Short-Term IDR: affirmed at 'F2'
Support Rating: affirmed at '5'
Support Rating Floor: affirmed at 'No Floor'
Viability Rating: upgraded to 'a-' from 'bbb+'
Derivative Counterparty Rating: upgraded to 'A-(dcr)' from 'BBB+(dcr)'
Long-term senior debt rating: upgraded to 'A-' from 'BBB+'
Short-term senior debt rating: affirmed at 'F2'
Commercial paper: affirmed at 'F2'
Subordinated (Tier 2) debt: upgraded to 'BBB+' from 'BBB'

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Applicable Criteria
Global Bank Rating Criteria (pub. 25 Nov 2016)
https://www.fitchratings.com/site/re/891051