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Research Update:

Netherlands-Based De Volksbank Long-Term Rating Raised To 'A-' On Recovering Franchise; Outlook Stable

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Overview

- De Volksbank continues to deliver on the agreed development plan with the Dutch government, and we do not expect any ownership changes before end-2018.
- We believe that the bank has stabilized its commercial franchise--after years of balance sheet deleveraging--reinforcing its stand-alone creditworthiness, and its capitalization continues to increase, with an exceptionally strong common equity tier 1 ratio close to 30%.
- We are raising our long-term credit rating on De Volksbank to 'A-' from 'BBB+' and our issue ratings on the bank's subordinated tier 2 note to 'BBB-' from 'BB+'.
- The stable outlook reflects our expectation that De Volksbank will continue to gradually improve its market position and sustain adequate profitability, despite low interest rates, while maintaining very strong capital ratios in the next two years.

Rating Action

On June 7, 2017, S&P Global Ratings raised the long-term rating on The Netherlands-based De Volksbank N.V. to 'A-' from 'BBB+'. The outlook is stable. At the same time, we affirmed our 'A-2' short-term rating on the bank.

We also raised our issue rating on the bank's subordinated tier 2 debt to 'BBB-' from 'BB+'.

Rationale

The upgrade of De Volksbank is underpinned by our view of the bank's gradual franchise recovery and the enhanced predictability of its revenues. The upgrade reflects our anticipations that the bank will be able to marginally grow its mortgage loan book while preserving its margins in the next two years. We also factor into our assessment that De Volksbank will maintain very strong capitalization and will sustain comfortable additional loss-absorbing capacity (ALAC) over our outlook horizon. This led us to revise up our assessment of De Volksbank's stand-alone credit profile (SACP) to 'bbb+' from 'bbb'. As a result, we raised the long-term rating to 'A-', which is one notch above the SACP, on the back of our view of the bank's comfortable ALAC level.

De Volksbank's competitive position in the Dutch retail market is gradually recovering, after a sharp drop due to the bank's rescue by the Dutch government in 2013. At that time, market shares on new mortgage lending fell to about 2%, well below the bank's 7% stock market share. Market shares on new mortgage production gradually increased to 5.7% by end-2016, and we expect the trend to continue in the next two years, setting a stock market share in the 6.5%-7.0% range by end-2018 despite increasing competition from nonbank lenders and smaller players such as insurance group-owned banks. With new mortgage lending exceeding redemptions since the second half of 2016, this book, net of reserves, is now stable, and we project a marginal increase over our rating horizon. We anticipate that the overall loan book will remain broadly stable due to the shrinking loan books of the public sector and small and midsize enterprises. In contrast, the retail savings franchise has been more resilient since 2012, with a stable deposit market share between 10.5% and 11.0%, supporting the valuable retail franchise of the bank even in difficult times.

We believe the low interest rates will continue to constrain the bank's net interest income for the next years, like for most retail banks in Europe, but that De Volksbank will be able to cope with the decrease thanks to lower funding and operational costs. We estimate therefore that core earnings will remain between €225 million and €275 million for the next two years, in line with the past three years if adjusting for non-recurring items. This profitability level compares adequately with that of peers of similar size and retail focus, but the bank's business profile remains narrow, demonstrated by its focus on mortgages in the asset size and the low proportion of fees in the revenues mix (less than 10%). Even if the bank performs well in the low-risk market in which it operates, its inherent business concentration and limited sources of revenues remain a rating constraint, in our view.

De Volksbank's capitalization remains exceptionally strong for a commercial bank with an S&P Global Ratings' risk-adjusted capital (RAC) ratio of 21% as of end-December 2016, and a regulatory common equity tier 1 ratio at 29.6% at the same date. We acknowledge that our elevated RAC projection and the bank's substantially higher regulatory capital measures compared with domestic peers are unlikely to be fully sustained over the long term if De Volksbank transitions back to the private sector. Nevertheless, the transition will occur over the medium term, and we do not expect any ownership change before end-2018. We are therefore confident that De Volksbank's capitalization will remain broadly stable over our two-year outlook horizon, given that the Dutch government agreed that the bank needed to fully implement its strategic plan before making a decision on the bank's ownership. We project that retained earnings will cover potential risk-weighted assets (RWAs) growth after a 50%-60% dividend payout and our RAC ratio projection is likely to stay above 20%. In addition, we note that the high loan-to-value (LTV) profile exhibited by the bank, and mirroring market trends, exposes the bank to higher-risk weights as part of potential upcoming Basel reforms (which involve risk-weight floors). Given the bank's mortgage focus, the extent of the rise of mortgage risk-weights--and therefore the decline in regulatory capital ratios--could be substantial. However, we understand the bank's management believes its 15%

internal minimal target common equity tier 1 ratio, well above regulatory minimum, should not be at risk despite future higher requirements. We will monitor from a business, margin, and capital policy perspective how the bank could mitigate those risks in the next two to three years.

We believe that, since December 2015, extraordinary government support for the Dutch banking sector is uncertain following the full implementation of the EU Bank Recovery and Resolution Directive. We view the Dutch resolution regime as effective under our ALAC criteria because, among other factors, we believe it contains a well-defined bail-in process under which authorities would permit non-viable systemically important banks to continue critical functions as going concerns following a bail-in of eligible liabilities. As a result of the excess total adjusted capital above our 15% threshold for our very strong capital and earnings category, and the €500 million tier 2 debt issue in November 2015, we evaluate the ALAC ratio already exceeds and will remain well above the 6% threshold we deem appropriate for a one-notch uplift in the long-term rating on De Volksbank, but below the 10% threshold we apply for a second notch of uplift. These thresholds are above our standard 5% and 8% levels, respectively, reflecting a concentration of maturities, as this buffer currently comprises common equity and a single tier 2 instrument callable in 2020. We calculate that ALAC was 9.2% of our RWAs at year-end 2016, and anticipate the ratio will remain broadly stable, in line with the RAC ratio over the next two years. We do not include additional ALAC-eligible instruments in our forecasts at this time because we think further issuance will depend on the still unclear definitive standards for minimum own funds and eligible liabilities, nor do we factor in the still uncertain potential impacts of regulatory and accounting evolutions, such as IFRS9 on the capital base.

Outlook

The stable outlook on De Volksbank reflects our view that the bank's commercial franchise will continue to recover. We also factor in our assumption that the bank will deliver stable recurring earnings and maintain a very strong capital policy over the next two years. Our base-case projection for 2017-2018 is that De Volksbank will maintain broadly stable earnings assets while preserving its margins and low cost of risk.

We see limited potential for an upgrade in the next two years because we would need to have more clarity on the future ownership and regulatory changes that will shape the bank's strategy and capital management. In addition, we view the bank's concentrated business model as a constraint for a higher rating even if we believe that the bank operates in a very low-risk market.

We could lower the ratings if a more aggressive capital policy were to materially weaken De Volksbank's financial profile or if the bank, due to its business concentration, is unable to sustain its sizable franchise and stable earnings.

Ratings Score Snapshot

	To	From
Issuer Credit Rating	A-/Stable/A-2	BBB+/Stable/A-2
SACP	bbb+	bbb
Anchor	bbb+	bbb+
Business Position	Moderate (-1)	Weak (-2)
Capital and Earnings	Very strong(+2)	Very strong(+2)
Risk Position	Moderate (-1)	Moderate (-1)
Funding and Liquidity	Average (0) Adequate	Average (0) Adequate
Support	(+1)	(+1)
ALAC Support	(+1)	(+1)
GRE Support	(0)	(0)
Group Support	(0)	(0)
Sovereign Support	(0)	(0)
Additional Factors	(0)	(0)

Related Criteria

- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings , April 7, 2017
- Criteria - Financial Institutions - Banks: Bank Rating Methodology And Assumptions: Additional Loss-Absorbing Capacity, April 27, 2015
- Criteria - Financial Institutions - Banks: Bank Hybrid Capital And Nondeferrable Subordinated Debt Methodology And Assumptions, Jan. 29, 2015
- General Criteria: Group Rating Methodology, Nov. 19, 2013
- Criteria - Financial Institutions - Banks: Quantitative Metrics For Rating Banks Globally: Methodology And Assumptions, July 17, 2013
- Criteria - Financial Institutions - Banks: Revised Market Risk Charges For Banks In Our Risk-Adjusted Capital Framework, June 22, 2012
- Criteria - Financial Institutions - Banks: Banking Industry Country Risk Assessment Methodology And Assumptions, Nov. 9, 2011
- Criteria - Financial Institutions - Banks: Banks: Rating Methodology And Assumptions, Nov. 9, 2011
- Criteria - Financial Institutions - Banks: Bank Capital Methodology And Assumptions, Dec. 6, 2010
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009
- Criteria - Financial Institutions - Banks: Commercial Paper I: Banks, March 23, 2004

Ratings List

Upgraded; Ratings Affirmed

	To	From
De Volksbank N.V.		
Counterparty Credit Rating	A-/Stable/A-2	BBB+/Stable/A-2
Certificate Of Deposit	A-/A-2	BBB+/A-2
Senior Unsecured	A-	BBB+
Subordinated	BBB-	BB+
Certificate Of Deposit	A-	BBB+

Ratings Affirmed

De Volksbank N.V.	
Certificate Of Deposit	A-2
Commercial Paper	A-2

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Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. Complete ratings information is available to subscribers of RatingsDirect at www.globalcreditportal.com and at spcapitaliq.com. All ratings affected by this rating action can be found on the S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column. Alternatively, call one of the following S&P Global Ratings numbers: Client Support Europe (44) 20-7176-7176; London Press Office (44) 20-7176-3605; Paris (33) 1-4420-6708; Frankfurt (49) 69-33-999-225; Stockholm (46) 8-440-5914; or Moscow 7 (495) 783-4009.