# Progress report on strategy adopted by de Volksbank

NL Financial Investments

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NL financial investments

**Contents**

**Unofficial and partial translation – Dutch version prevails**

## Summary and conclusions

In its 'Advisory report on the future direction of SNS Bank' published in June 2016, NLFI concluded that there is a widespread interest in the future strategic position of de Volksbank being that of a safe retail bank offering simple, transparent and fairly priced financial products, operating on the basis of an operationally excellent business model and delivering a competitive dividend yield. To achieve this, the bank has to undergo a transition, which is incorporated into the 'Spot On' strategic plan. The Minister of Finance followed this advice.

In his letter to the House of Representatives dated 1 July 2016[1], the Minister of Finance asked NLFI to report once a year on the progress made on the implementation of the strategic plan adopted by de Volksbank and on how ready de Volksbank is for an exit so that a decision about its future can be taken. In September 2017, NLFI complied with this request for the first time (the first progress report, or PR1).[2] This letter is the second progress report (PR2).

Two years ago, it was estimated that the bank would need two to three years to bring about the aforementioned transition and arrive at optimum long-term value creation. The transition in any event includes a consideration of the following focus areas:

1. Optimising the interests of stakeholders ('Shared Value' strategy);
2. Strengthening de Volksbank's identity as a 'social bank';
3. Lowering the cost structure;
4. Improving risk management;
5. Making further adjustments to the range of products and standardising production processes;
6. Making adjustments and streamlining the bank's capital structure where possible on the basis of future regulations (Basel IV, IFRS 9 and MREL); and
7. Becoming a smart adopter of innovation.

De Volksbank has executed its strategic programme in the past two years; PR1 explained in respect of the year 2016 and the first six months of 2017 that the bank's identity had been strengthened further, that the organisation had been made simpler and more efficient, and that the bank had formed provisions and made investments to enable sustainable cost reductions in future. For the present PR2, NLFI has once again addressed the aforementioned seven focus areas and analysed the current situation at de Volksbank.

NLFI has found that de Volksbank has made progress both in the area of non-financial risk management and in the area of financial risk management (focus area 4). In the Dutch Central Bank's opinion, the risk management improvements that de Volksbank introduced to prevent money laundering and terrorist financing were adequate, for which reason it lifted the instruction it had issued previously. De Volksbank also started implementing a number of initiatives in 2018 with regard to operational risk management and data management. When completed, they will contribute to risk management. The risk profile of de Volksbank's loan portfolio also improved.



[1] Parliamentary Papers, House of Representatives, session year 2015-2016, 33532, no. 61.
[2] NLFI has published it on its website; see: http://www.nlfi.nl/dynamic/media/43/documents/Voortgangsrapportage%20strategie%20de%20Volksbank.pdf

De Volksbank also made progress on focus areas 5 and 7. De Volksbank has demonstrated that it is able to implement innovative technology expeditiously and that it is making progress in standardising products and processes.

However, in this progress report NLFI will explain that its analysis does not allow the conclusion that de Volksbank is ready for privatisation on conditions that are acceptable to the State. 'Acceptable conditions' entail that de Volksbank has developed its strategy in more detail and that a convincing proposition for privatisation is possible. They also mean that the preconditions for privatisation are met. More time to make progress would help de Volksbank. In summary, NLFI bases this opinion on the following considerations.

NLFI is of the opinion that de Volksbank needs more time to further develop the Shared Value strategy and further strengthen its identity as a social bank (the first two focus areas mentioned above). These two focus areas require de Volksbank to continue to work towards the targets applied and develop further initiatives. PR2 discusses in more detail the current status of the targets identified in connection with the bank's Shared Value strategy and identity, in terms of '*creating benefits for customers*', '*providing meaning for employees*', '*taking responsibility for society*' and '*achieving returns for shareholders*'. A few developments, such as those related to '*creating benefits for customers*' and '*taking responsibility for society*', have not been completed but are in line with strategic projections. De Volksbank may also make progress on '*providing meaning for employees*', and NLFI seeks to continue the dialogue on '*achieving returns for shareholders*' in the near future. This is because, when this progress report was drafted, de Volksbank was working on identifying and implementing adjustments in its capital structure in response to the new capital requirements (Basel IV) and new requirements for own funds and eligible liabilities (MREL requirements) and the implementation of IFRS 9 (focus area 6). These adjustments must be fleshed out completely and implemented in de Volksbank's capital structure before the capital structure can be considered in an opinion on any readiness for privatisation. This capital structure also impacts dividend yields and return on equity, which are also subject to targets. These are important parameters for private investors.

Moreover, it is desirable that de Volksbank's cost programme will demonstrably result in a sustainable reduction of costs (focus area 3). De Volksbank's strategy includes a major ambition to reduce costs. Given the delay in cost reduction explained below and the upward trend in the cost/income ratio, de Volksbank must pay considerable attention to the cost-reduction focus area.

In summary, the analysis does not permit NLFI to conclude that de Volksbank is ready for a decision on its future. The transition process that de Volksbank initiated in 2016 is not sufficiently complete and does not produce any convincing proposition for privatisation at this point in time. This is true for every form of privatisation. In the period ahead, NLFI will continue discussions with de Volksbank about the focus areas described above and the targets pursued.

In the 2016 Advisory Report, NLFI expressed its expectation that de Volksbank would need a period of approximately two to three years for the transition described above in order to arrive at optimum long-term value creation, after which preparations for the actual privatisation could commence. NLFI explained in PR1 that de Volksbank would certainly need the rest of this period. NLFI still holds this view. The relevant period will end around mid-2019. As soon as de Volksbank is ready for privatisation, NLFI will advise the Minister of Finance accordingly. If de Volksbank is not ready by this time, in mid-2019 NLFI will once again issue a progress report to discuss the timing expected by then.

## 1. Introduction

*Background*

This letter constitutes the report of Stichting administratiekantoor beheer financial instellingen (NLFI) to you, the Minister of Finance, on the progress made with the strategic plan adopted by de Volksbank,[3] in accordance with the request made by your predecessor in his letter of 1 July 2016 to the House of Representatives ('Toekomst SNS Bank' – 'Future of SNS Bank').[4]

When drafting this letter, NLFI used the objects clause in NLFI's articles of association as guidance. In exercising its statutory mandate and the rights attached to the shares it holds, NLFI is guided primarily by the financial and economic interests of the State, taking into account the interests of the company, the entities affiliated with it and the employees concerned.

In accordance with NLFI's statutory objective, as laid down in the enabling act (Wet stichting administratiekantoor beheer financial instellingen, or NLFI Act), NLFI has advised you about de Volksbank's strategy and its future options. In its 'Advisory report on the future direction of SNS Bank' published in June 2016 (the Advisory Report), NLFI explained that there is a widespread interest in the future strategic position of de Volksbank being that of a safe retail bank offering simple, transparent and fairly priced financial products, operating on the basis of an operationally excellent business model and delivering a competitive dividend yield. In its Advisory Report, NLFI concluded that de Volksbank needed more time to gain a strong position in the Dutch banking landscape and was not yet ready for a decision about its future.

In your letter dated 1 July 2016 to the House of Representatives, you asked NLFI to report once a year on the progress of the implementation of the improvements under the strategic plan and on how ready de Volksbank is for an exit, so that a decision can be taken about de Volksbank's future and the House of Representatives can be informed. By submitting this letter, NLFI complies with this request for the second time.

In its Advisory Report, NLFI concluded that the implementation of de Volksbank's strategy is in line with the Van Hijum/Nijboer motion on safeguarding the utility character of de Volksbank as passed by the House of Representatives.[5] In addition, NLFI explained that the execution of the desired improvement plan does not result in irreversible measures being taken or options being precluded in respect of future ownership structures. Accordingly, this letter – just like the first progress report, or PR1 – does not deal in detail with the Merkies/Van Hijum-Nijboer motions on having de Volksbank remain in State hands.[6]

*PR1*

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[3] On 1 January 2017, SNS Bank N.V. changed its name as given in the articles of association to de Volksbank N.V. In this report, the name 'SNS Bank' is used in references to advisory opinions, letters to Parliament and so on from the period prior to 2017, otherwise the name 'de Volksbank' is used.
[4] Parliamentary Papers, House of Representatives, session year 2015-2016, 33532, no. 61.
[5] Parliamentary Papers, House of Representatives, session year 2015-2016, 34346.
[6] Parliamentary Papers, House of Representatives, session year 2015-2016, 34346.

In its 2016 Advisory Report, NLFI concluded that de Volksbank was not yet ready for privatisation. It was set out in PR1 that this was related to "(...) *uncertainty about the extent to which the capital structure needs to be adjusted to reflect the bank's future capital requirements, while at the same* [time] efforts to improve operational efficiency needed to be started. *NLFI believed that if de Volksbank's strategic plan – known as Spot On – were executed successfully, the bank could, in time, position itself strategically as a simple retail bank with a low risk profile [that] is (or seeks to be) efficient. NLFI believed that Spot On would have to be executed over a period of two to three years (starting from mid-2016) in order to bring about optimum long-term value creation. In any event, during this period the bank has to build up a good track record in the area of cost reductions and generate an adequate dividend yield, based on a balance sheet comprising safe assets and a solid liquidity and capital structure.* (...)" It was noted in PR1 that de Volksbank's business model translated "(...) *into a significant contractual term mismatch between assets (mortgages with long terms to maturity) and liabilities (mostly savings that can be withdrawn immediately)* (...)." NLFI identified seven focus areas for de Volksbank's consideration of these topics and performed an analysis for PR1. PR1 then paid attention to the current situation regarding de Volksbank's strategy, the results for the year 2016 and the first six months of 2017, and assessed the progress made on de Volksbank's strategic programme and the preconditions for privatisation. This produced a picture of the extent to which the envisaged transition of de Volksbank had taken place. PR1 explained in respect of the year 2016 and the first six months of 2017 that the bank's identity had been strengthened further. The organisation had also been made simpler and more efficient, including by a successful simplification of the structure by merging the companies SNS Bank N.V. (presently de Volksbank N.V.), ASN Bank N.V. and RegioBank N.V. with effect from 31 December 2016. Furthermore, the bank had formed provisions and made investments to enable sustainable cost reductions in future.

The bank's objectives in the area of strengthening its identity, lowering the cost level permanently, improving risk management and standardising production processes have been translated into a number of long-term targets (see section 2.3). NLFI concluded in PR1 that the efforts de Volksbank had made in 2016 and the first six months of 2017 had resulted in the variables generally being in line with the projections from the Spot On strategic plan, or were moving in the right direction towards the long-term target. At the same time, PR1 noted, achieving the medium-term targets, which were ambitious on the whole, would still require a relatively major effort on the part of management.

*PR2*

Chapter 2 of this progress report once again assesses the progress made on de Volksbank's strategic programme. It discusses the current situation with regard to the aforementioned focus areas that NLFI has worded. As such, the assessment follows the structure of PR1. Next, in Chapter 3, NLFI describes its current perspective on whether de Volksbank meets the preconditions for privatisation that your predecessor has formulated.[7]

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[7] Although the period of restructuring de Volksbank has ended, this analysis is once again performed along the lines of the previous PR. See also European Commission - The Netherlands – Restructuring Plan SNS REAAL 2013, C(2013) 9592, 19 February 2013, available online: http://ec.europa.eu/competition/state_aid/cases/249726/249726_1544400_217_2.pdf.

## 2. Assessment of progress made on strategic programme

### 2.1 De Volksbank's strategic programme

NLFI's Advisory Report dating from 2016 was discussed in the Introduction. A transition of the bank was necessary in order to arrive at the position of de Volksbank referred to in the Advisory Report. De Volksbank has implemented this transition by means of a strategic programme combining a detailed version of the Shared Value concept with other initiatives.[8] In NLFI's annual assessment of the extent to which de Volksbank has completed the transition, NLFI formulated a number of focus areas:

1. Optimising the interests of stakeholders ('Shared Value' strategy);
2. Strengthening de Volksbank's identity as a 'social bank';
3. Lowering the cost structure;
4. Improving risk management;
5. Making further adjustments to the range of products and standardising production processes;
6. Making adjustment and streamlining the bank's capital structure where possible on the basis of future regulations (Basel IV, IFRS 9 and MREL); and
7. Becoming a smart adopter of innovation.

NLFI monitors de Volksbank's progress. In doing so, NLFI uses the targets formulated by de Volksbank – as explained below – as a starting point and also assesses the extent to which de Volksbank performs adequately in these qualitative focus areas.

De Volksbank has made good progress in the focus areas identified in PR1, in respect of improving risk management, making further adjustments to the range of products and standardising production processes, and becoming a smart adopter of innovation (focus areas 4, 5 and 7). This is explained in section 2.2.

However, the analysis does not permit NLFI to conclude that de Volksbank has created optimum long-term value and is ready for a decision on its future. De Volksbank is not yet ready for privatisation on conditions that are acceptable to the State. 'Acceptable conditions' entail that de Volksbank has developed its strategy in more detail and that a convincing proposition for privatisation is possible. They also mean that the preconditions for privatisation are met.[9] A convincing proposition for privatisation encompasses both a solid long-term view of the future and an acceptable value proposition. The transition that de Volksbank commenced in 2016 is not sufficiently complete and therefore does not produce any convincing proposition for privatisation at this point in time. This is true for every form of privatisation.

Currently, a number of considerations in particular are decisive for NLFI's opinion that de Volksbank would benefit from more time before a decision may be taken about its future. Firstly, this opinion ensues from de Volksbank's progress in respect of optimising stakeholders' interests (Shared Value) (focus area 1) and strengthening its identity as a social bank (focus area 2) and the reflection of this progress in the returns for the State. These topics are discussed in section 2.3. Secondly, the bank's

[8] The 'strategic programme' is defined, in summary, as the strategic intentions from 'Spot On' and de Volksbank's other strategic initiatives pertaining to the required transition.

capital structure must be adjusted (focus area 6). This is addressed in detail in section 2.4. Thirdly, this opinion ensues from the progress made on lowering the cost structure (focus area 3). This topic is discussed in section 2.5.

In the near future, NLFI will engage in intensive dialogue with de Volksbank about the manner in which these focus areas may be implemented and the relevant targets may be achieved, partly in view of the current timing. In the 2016 Advisory Report, NLFI expressed its expectation that de Volksbank would need a period of approximately two to three years for the transition described above in order to arrive at optimum long-term value creation, after which preparations for the actual privatisation could commence. NLFI explained in PR1 that de Volksbank would certainly need the rest of this period. NLFI still holds this view. The relevant period ends around mid-2019. As soon as de Volksbank is ready for privatisation, NLFI will advise the Minister accordingly. If de Volksbank is not ready by this time, in mid-2019 NLFI will once again issue a progress report to discuss the timing expected by then.

## 2.2 Progress made on risk management, simplification of products and processes and smart adopter

De Volksbank has made good progress in the focus areas identified in PR1 of 'improving risk management' (focus area 4), 'making further adjustments to the range of products and standardising production processes' (focus area 5), and 'becoming a smart adopter of innovation' (focus area 7).

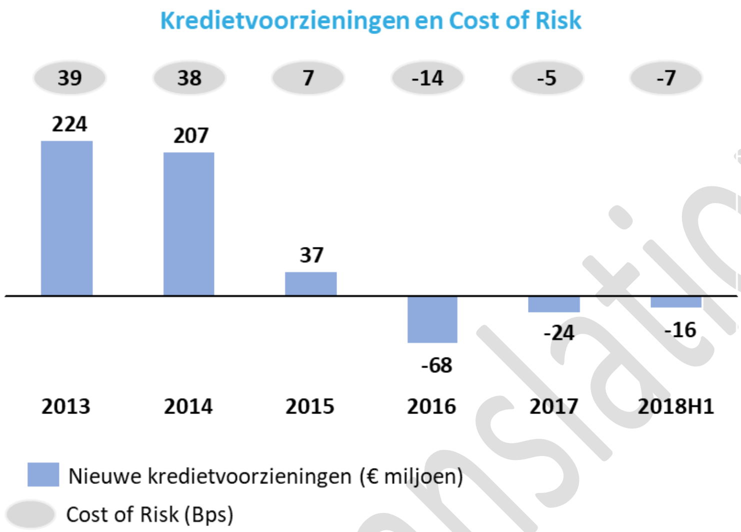
### *2.2.1 Risk management*

De Volksbank has a 'monoliner business model' with a focus on mortgage and savings products in the Netherlands and 95% of its income consists of net interest income. As a result, the bank has little diversification and is sensitive to macro-economic fluctuations. Therefore, de Volksbank pursues a moderate risk profile with sound financial and non-financial risk management as well as an adequate capital buffer (see also section 2.4).

It is noted in respect of non-financial risk management that PR1 explained that the Dutch Central Bank (DNB) had conducted a thematic examination at de Volksbank in 2016, which focused on the measures de Volksbank had taken to prevent money laundering and terrorist financing. Based on this examination, DNB concluded that de Volksbank needed to take additional measures with regard to monitoring transactions and reporting unusual transactions.[10] That is why DNB imposed an instruction and a penalty on de Volksbank. DNB's examination was one of the factors that led de Volksbank to launch several initiatives in 2016 to tighten up processes and measures that ensure customers and transactions are constantly monitored. DNB now considers the improvements implemented by de Volksbank to be adequate and has lifted the instruction it had imposed in this regard. A few important initiatives were also introduced in 2018 within the context of operational risk management and data management. A number of processes are ongoing within de Volksbank. When completed, they will contribute to risk management.

[10] See also the "Interim financial report 2017 – Press release" of de Volksbank published on 24 August 2017.

De Volksbank has also made progress with regard to the management of financial risks, including by tightening the acceptance criteria for new loans. The risk profile of the loan portfolio has improved as a result of progress in this area. Another consequence is that de Volksbank has seen a release of loan loss provisions in the past few years. The releases are partly related to favourable macro-economic conditions. The loan loss provisions are expected to stabilise in the next few years, at a level that is customary for the Dutch market.




*2.2.2 Standardisation/simplification*

De Volksbank is making progress on standardising products and processes and simplifying the product range. When processes are simplified and standardised, they can be automated. For instance, de Volksbank is now implementing automation involving improved processes for handling mortgage applications.

*2.2.3 Smart adopter'*

De Volksbank has demonstrated that it is able to implement innovative technology expeditiously. In this process, de Volksbank has taken a smart adopter approach, in which it seeks to implement innovations of other banks in its own bank within a short period of time. Successful examples are the introduction of payment authorisation in mobile banking by means of a fingerprint (seven months after the introduction of this technological innovation, de Volksbank was the first bank in the Netherlands to implement this) and the introduction of a name/IBAN combination check.



**2.3 Progress made on optimising the interests of stakeholders ('Shared Value' strategy) and strengthening de Volksbank's identity as a social bank**

De Volksbank seeks to achieve objectives focusing on optimising the Shared Value for the four essential stakeholder groups – customers, employees, society and current and future shareholders. A number of targets have been formulated in order to monitor whether de Volksbank is optimising stakeholder interests (Shared Value) and is further strengthening its identity as a social bank. The targets were formulated by de Volksbank and examined by NLFI to ensure compatibility with de

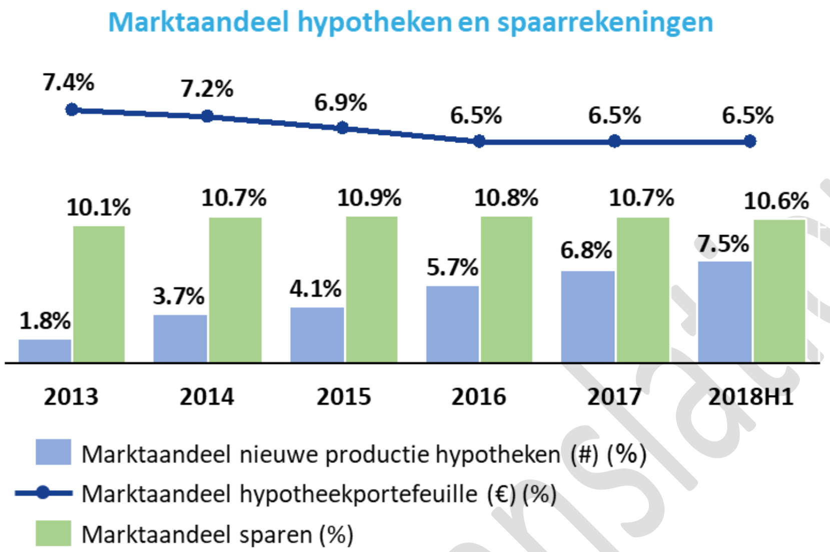
Volksbank's ambition. They were approved by your predecessor and subsequently included in PR1. The table below presents the targets for 2020 and the results achieved in the past few years until the first six months of 2018. Below, NLFI concludes that de Volksbank is making progress on some aspects, but needs more time to achieve these targets before it is ready for privatisation. As explained, NLFI has engaged in intensive dialogue with de Volksbank on this issue.

| | | Actueel | | | | Targets |
|---|---|---|---|---|---|---|
| | | 2015 | 2016 | 2017 | 2018H1 | Target |
| Klanten | NPS voor klanten | -12 | -8 | -3 | 0 | 10 |
| | Aantal betaalrekening-houders (#x1000) | 1.240 | 1.328 | 1.409 | 1.442 | 1.500 |
| Werknemers | eNPS werknemers | 34% | 30% | -2% | -14% | 40% |
| Maatschappij | Klimaatneutrale balans (%) | 20% | 22% | 27% | 33% | 45% |
| | Financiele weerbaarheid | n/a | n/a | 40% | n/a | >50% |
| Aandeel-houders | ROE (%) | 10.8% | 10.7% | 8.7% | 8.5% | 8.0% |
| | Dividend payout (%) | 30% | 41% | 60% | NA | 40-60% |

*2.3.1 Creating benefits for customers*

To measure benefits for customers, the bank chiefly uses the Net Promoter Score (NPS). The Net Promoter Score is a general measure of customer satisfaction. To determine this score, customers are asked periodically how likely they are to recommend de Volksbank's services to others. The score is calculated by subtracting the percentage of customers giving a low score (detractors) from the percentage giving a high score (promoters). A negative score means that more customers would strongly discourage others from using de Volksbank's services than would strongly recommend they do so. The target for 2020 is a customer-weighted NPS of +10. The NPS score is measured at brand level. The target for de Volksbank as a whole is the weighted average of the NPS scores for the individual brands. The customer-weighted NPS improved from -8 to -3 in 2017, with the NPS scores for BLG Wonen, Regiobank and SNS Bank all rising by 5 points. The score for ASN Bank 'only' rose by 3 points, but it had the highest NPS score of the four brands in 2017. The customer-weighted NPS score further rose to 0 in the first six months of 2018, which means that the number of promoters is equal to the number of detractors. Boasting an NPS score for customers of 0 in June 2018, de Volksbank is well on its way to reaching the 2018 target and, as a result, the long-term score of +10.

Furthermore, the increase in current accounts is an indicator for the bank, which has a target of 1.5 million current account customers in 2020. The number of current account holders has grown strongly in recent years, with 81,000 new account holders in 2017 and 88,000 new account holders in 2016. This means that the increase in current account customers is in line with the progress that must be made in order to reach the long-term target. Another indicator of 'benefits for customers' is mortgage origination. In the past few years, the bank's origination of new mortgages (in numbers) exceeded market growth in mortgage origination in relative terms. As a result, the market share of mortgage origination rose from 5.7% in 2016 to 7.5% in the first half of 2018. Although the share in origination increased, the share in the total volume remained virtually flat on 2016 (6.5%), which may be explained by the origination of smaller-than-average mortgages.




*2.3.2 Providing meaning for employees*

With respect to providing meaning for employees, de Volksbank measures the employee Net Promoter Score. The employee Net Promoter Score is a general measure of employee satisfaction. To determine this score, employees are asked how likely they are to recommend de Volksbank as a place to work. The score is calculated by subtracting the percentage of customers giving a low score (detractors) from the percentage giving a high score (promoters). A positive score means that more employees would strongly recommend working for the employer than would strongly discourage others from doing so. The aim is to improve this score to a level of +40. The eNPS has dropped substantially since 2016. The eNPS dropped from a score of +30 in 2016 to -14 in the first half of 2018. This means the number of critical employees has increased strongly, i.e. more employees give de Volksbank a score of 6 or lower and fewer employees give a score of 9 or higher. De Volksbank has noted that this may be explained by the reorganisation within de Volksbank. Furthermore, according to de Volksbank, a general decrease in jobs in the sector may be another factor. In view of the above, it seems unlikely at this point that the bank will reach its +40 target in 2020, as the cost reduction programme continues at least until 2020.

*2.3.3 Taking responsibility for society*

As a bank with a social profile, de Volksbank wants to devote attention to the interests of society in the context of 'Shared Value'. De Volksbank has set itself the goal of having an entirely climate-neutral balance sheet in the future (2030).[11] It aims for a 45% climate-neutral balance sheet in 2020. In 2017, the share of climate-neutral investments on the balance sheet rose by 5% to a level of 27%. In order to make 45% of the balance sheet climate-neutral in 2020, the bank would have to invest an

[11] The principle of the climate-neutral balance sheet is based on a methodology developed by ASN Bank, and works along the lines of a balance scale of weights. On one side are the carbon profits, i.e. investments made to avoid emissions (wind turbines, solar parks, etc.). On the other side are the carbon losses, i.e. investments that cause emissions (mortgages, government bonds, investments in businesses, etc.). These two sides need to be in balance in 2030. In order to achieve this target, de Volksbank is investing in renewable energy projects and energy savings, and is helping homeowners to make their homes more sustainable.

additional 6% of the balance sheet in a climate-neutral way every year. The bank has prepared an action plan to achieve this objective in any event. This aspect rose by 6% in the first half of 2018, which means that the bank is well on its way to reaching the targets on this point.

PR1 explained that de Volksbank was in the process of setting a target for strengthening customers' financial resilience in addition to the targets included in PR1 that de Volksbank had defined and that your predecessor had approved. In 2017, de Volksbank formulated a target in respect of the number of customers who believe that the bank is ready to help them when they have financial stress. The bank measures the percentage of customers who say they agree with the statement "I think that the bank would be there for me when I run into financial difficulties". The aim is for more than 50% of customers to agree with this statement in 2020, from 40% in 2017. In 2017 and in the first six months of 2018, the bank launched initiatives to achieve this. The progress made on this target cannot be properly assessed at this time, as it was set only recently.

*2.3.4 Achieving returns for shareholders*

Targets have also been set for the stakeholder group 'shareholder', being the current and future providers of equity. These targets are an important aspect of the analysis determining whether a value proposition attractive for private investors is possible. The target Return on Equity or ROE (i.e. return for the shareholder) has been set at 8%. This target ROE is underpinned by a set of financial targets in the areas of costs, risk, capital and liquidity. These include a minimum Common Equity Tier 1 ratio (CET1 ratio) of 15%, a minimum leverage ratio of 4.25%, and a cost/income ratio of between 50% and 52%. In the past few years and in the first half of 2018, the bank's ROE consistently remained above target: the ROE was 8.7% for 2017 and 8.5% for the first half of 2018. However, the bank faces a declining ROE compared with 2016, which is a reflection of the same trend seen in profits as a result of increasing pressure on net interest income.

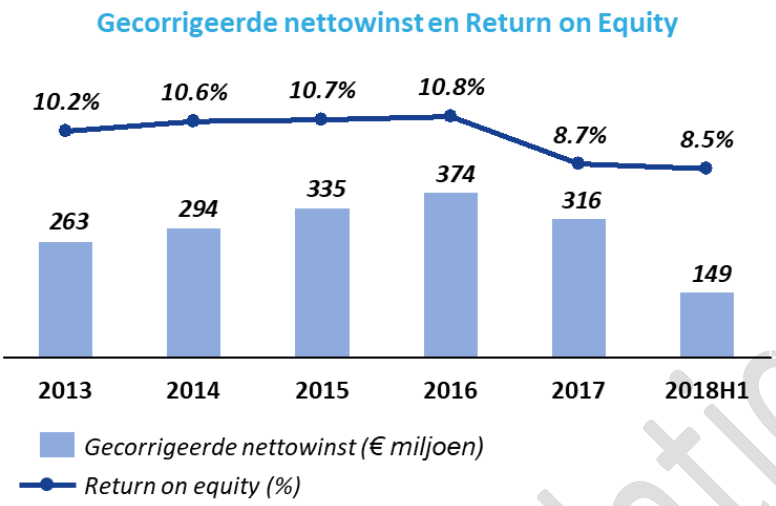
A target ROE of 8% was agreed with de Volksbank at the time, based on de Volksbank's capitalisation and taking into account the projections concerning future net profits based on regulations in force at that time. No account was therefore taken of the potential effects of Basel IV, IFRS 9 and the determination of MREL requirements at the time the target ROE was fixed. The background to these regulations is explained in the next section. This is an independent focus area (focus area 6) among the seven focus areas that NLFI has identified, but it is indissolubly linked with the envisaged returns for shareholders as part of the stakeholder model. NLFI is engaged in dialogue with de Volksbank about the return aspect in view of de Volksbank's analysis of the effects that these capital regulations have on capital and will also include market developments and de Volksbank's characteristics and vision in this dialogue.

a) *Profit*

Adjusted net profit for 2017 totalled € 316 million, down 16% from 2016. This was mainly attributable to i) lower net interest income (€ 14 million decrease), ii) a lower release of loan loss provisions (€ 24 million released in 2017 compared to € 68 million released in 2016), and iii) a swing in one-off items.[12] In the first half of 2018, net profit stood at € 149 million, a 20%

[12] The swing in one-off items affected unrealised gains on former DBV mortgages and related hedging.

decrease compared to the first half of 2017. This was partly driven by lower returns on fixed-income investments.

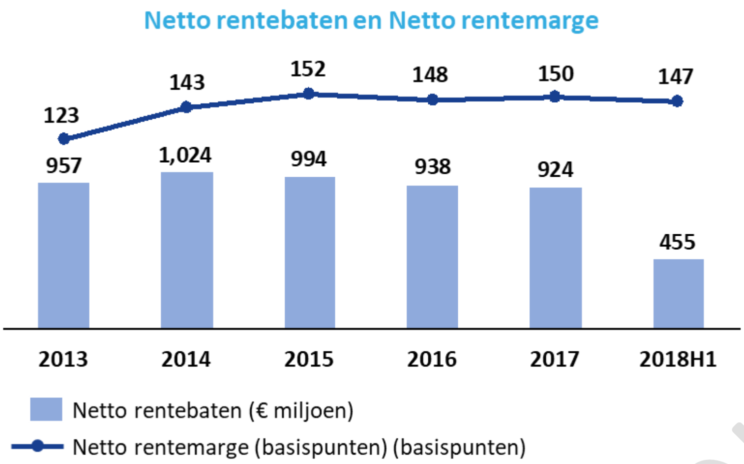



*b) Net interest income*

The drop in net profit was partly driven by lower net interest income – which has shown a downward trend ever since 2014 – partly due to persistently low interest rates and renewed accumulation of subordinated debt. Since average interest rates paid on subordinated debt are higher than those paid on savings, for example, the increase in subordinated debt puts downward pressure on net interest income. In 2017, the bank succeeded in slightly slowing down the sharp decline in net interest income seen in the previous year, partly by lower savings rates and partly by growth of the mortgage portfolio.

However, net interest income still dropped by € 14 million (-1%) to € 924 million in 2017 and by € 21 million in the first half of 2018 (a 4% decrease compared to the first half of 2017). This drop was mostly the result of a large number of renewals of mortgages with lower fixed interest rates. Fiercer competition on mortgage prices also put higher pressure on the average interest rate on mortgages. This resulted in new mortgages being arranged at significantly lower rates than those of the mortgages that expired. On top of this, interest expenses also rose due to the cost of hedging.

The interest margin is net interest income as a percentage of assets, which means that it reflects the extent to which the bank is able to earn net interest income on its assets. This margin remained virtually the same as in 2016. This indicates that, in addition to lower net interest income, assets declined as well, producing a roughly equal ratio. Assets declined mainly on the back of the sale of investments and a lower carrying amount of hedging products.




Given the market expectation of interest rates, de Volksbank's net interest income is expected to continue to decline until at least 2020. This may put further pressure on the ROE, unless the bank makes substantial progress on its cost reduction programme. This will be discussed in more detail in section 2.5.

*c) Dividend yield*

In its Advisory Report, NLFI explained that a competitive return must be realised. This is assessed by the European Commission on the basis of the market economy investor principle. Under this principle, a Member State must treat the organisation in the same way as a private investor would in similar circumstances. PR1 explained that a dividend yield structure could be applied in order to comply with the basic principle of ensuring a competitive return for the State.

Taking the average dividend yield of similar banks in the Netherlands and Europe as a calculation basis and adjusting this figure for de Volksbank's moderate risk profile, it was determined in 2016 that a minimum annual dividend yield of 5% on the State's capital investment in de Volksbank at a 2015 selling price of EUR 2.7 billion was adequate. In addition, NLFI explained in the Advisory Report that in future the nominal dividend should grow progressively in line with growth in Dutch GDP. This should result in an average annual dividend yield of at least EUR 135 million on the investment in de Volksbank during the next few years.

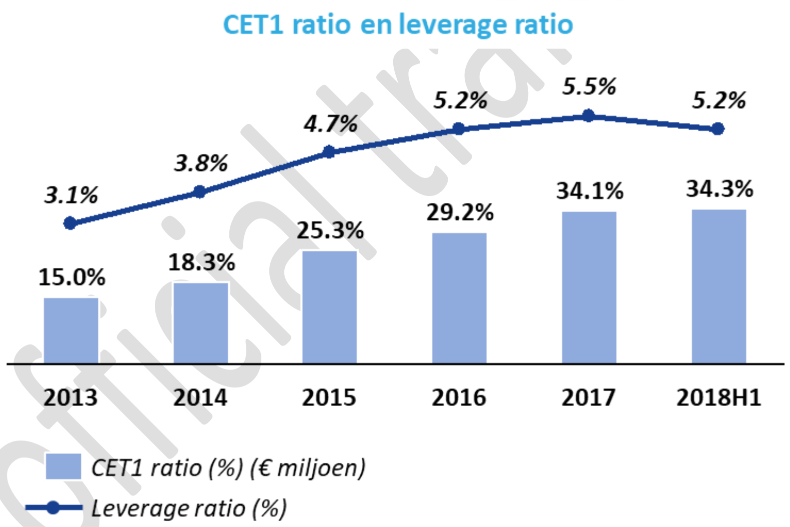
It goes without saying that, where appropriate, the aforementioned dividend distributions are subject to compliance with applicable solvency requirements and permission being granted by DNB/the European Central Bank. The above principles have been incorporated into de Volksbank's dividend policy. The principle of a dividend yield of at least 5% on an investment of EUR 2.7 billion has been translated into a target bandwidth for the pay-out ratio of 40% to 60% of adjusted net profit.

De Volksbank distributed a dividend of EUR 135 million for 2016, which corresponds to 41% of adjusted net profit. De Volksbank distributed a dividend of EUR 190 million for 2017, which corresponds to 60% of adjusted net profit.

Based on the updated analysis of de Volksbank's capital position (see section 2.4 below), NLFI will engage in a dialogue with de Volksbank about the target dividend pay-out and the target ROE. It is important that the targets are in line with the market, as the financial sector has developed in the past few years. Benchmarks will be used to discuss the targets with de Volksbank in more detail. Obviously, de Volksbank's characteristics and vision will be borne in mind. Until the dialogue on these aspects continues, the current dividend policy and the current targets are taken as a basis.

### 2.4 Progress made on adjusting and streamlining the bank's capital structure on the basis of regulations (Basel IV, IFRS 9 and BRRD/MREL)

De Volksbank has a strong capital position, which has improved even more since 2016. The leverage ratio remained relatively stable and stood at 5.2% in the first half of 2018. The CET1 ratio was 34.3% at the end of June 2018, compared to 29.2% in 2016. This was possible thanks to retained earnings and a decrease in risk-weighted assets. The ratio is twice as high as the minimum target of a CET1 ratio of 15%.




Part of this capital position is held as a buffer for changes in risk-weighted assets resulting from regulatory changes. On 7 December 2017, the Basel Committee on Banking Supervision reached agreement on the completion of the Basel III capital framework (Basel IV). The agreement includes further clarification concerning the harmonisation of risk-weighted assets and the capital floor, which indicates the minimum amount of capital to be held in relation to standardised models. The Single Resolution Board (SRB) also gave a more detailed definition of MREL requirements ('Minimum Requirement for Own Funds and Eligible Liabilities'). The purpose of the MREL requirements is to improve the resolution of failing banks. In order to comply with the MREL requirements, a bank must retain a certain amount of liabilities that may absorb losses or can be converted into capital relatively easily. The purpose is to cushion any problems a bank may encounter. The resolution authority (SRB) that may act when a bank becomes distressed imposes this requirement on banks.[13]

As at the end of June 2018, de Volksbank had a CET1 ratio of 34,3%. This is well above the minimum CET1 ratio of 15% that the bank currently applies. De Volksbank is investigating whether its minimum capital target should be adjusted as a result of the regulatory changes described above. In this process, account is taken of the bank's aim to retain a moderate risk profile. The estimate of the impact on capital ratios will be further refined in 2018.[14]

As from 1 January 2018, de Volksbank has also been required to apply the IFRS 9 Classification and Measurement and the IFRS 9 Expected Credit Loss (ECL) impairment requirements. The consequences are being analysed and will be implemented. This, too, is subject to a stress analysis.

NLFI expects that, at the end of 2018, de Volksbank will be able to offer a better understanding of the impact that the aforementioned issues will have on de Volksbank's capital structure and that de Volksbank will report on this at an opportune time. NLFI will include these issues in its assessment of whether de Volksbank is ready for privatisation.

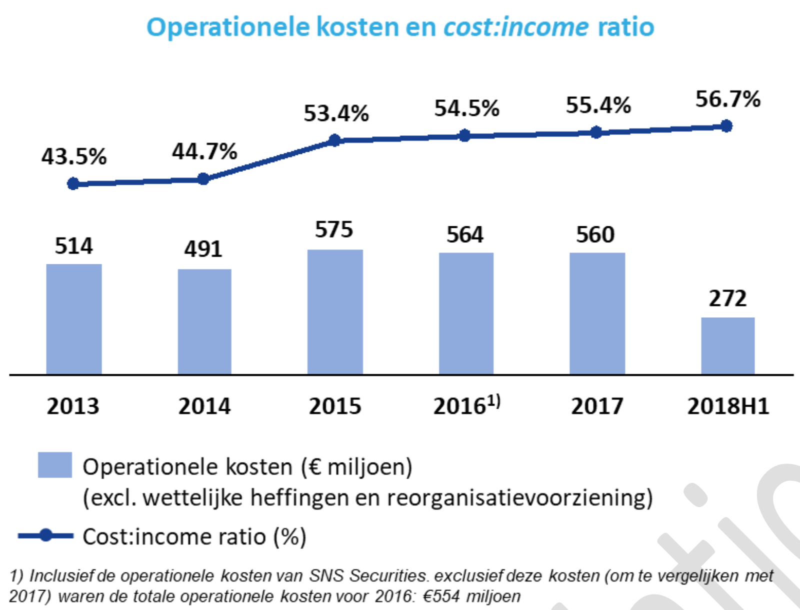
### 2.5 Progress made on lowering the cost structure

De Volksbank's strategic programme includes a major ambition to improve efficiency and effectiveness, which translates into lower costs and other benefits. This is a prerequisite for retaining the bank's profitability in view of the anticipated decline in net interest income. Based on the current targets, costs should have been reduced to € 467 million per year (excluding regulatory levies) by 2020.

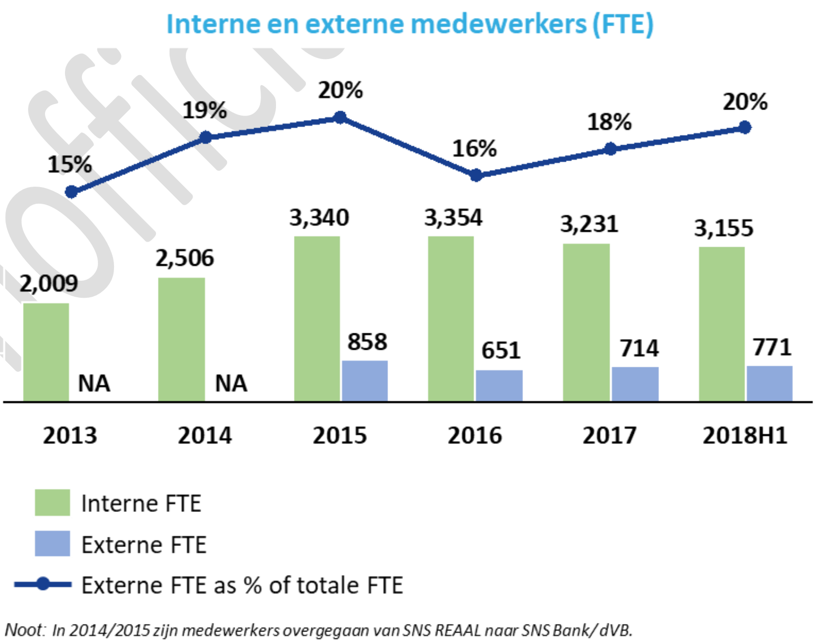
In order to achieve cost reduction, the bank has set up a cost reduction programme containing several initiatives for cutting costs. The most substantial cost savings are expected from initiatives for simplifying and automating processes, standardising the product range and a reorganisation. Several smaller initiatives are being implemented at department level.

The bank is making progress on cost savings within the cost reduction programme, which is monitored centrally. However, most of these savings under the programme are cancelled out by additional costs resulting from regulatory and compliance-related projects, a growing volume of new mortgages, rising labour costs (including social security contributions) and investments in the strategy. Total operating expenses stood at € 564 million in 2016. However, SNS Securities was sold on 30 June 2016. Adjusted for the sale of SNS Securities, operating expenses totalled € 554 million in 2016. This means that the costs rose by € 6 million in 2017, to € 560 million. In the first half of 2018, the costs were virtually flat on the first half of 2017, i.e. € 272 million, which translates into a cost/income ratio of 56.7%. The costs realised in 2017 and in the first half of 2018 do not prove that the cost reduction programme is successful in achieving the projected objectives.

[13] See also PR1, p. 5.
[14] Annual Report 2017 of de Volksbank N.V., p. 103 et seq.




This potential conflict between savings on the one hand and additional costs on the other is also reflected in the number of FTEs. The total internal headcount has dropped by 199 since the end of 2016. However, the number of external FTEs has increased by 120. The total number of internal FTEs is currently 3,155 (end of June 2018). The decline was the result of efficiency and reorganisation measures, including a simplification of the senior management structure (-38 FTEs). The increase in the number of external FTEs is the result of additional transaction monitoring activities, the filling of temporary vacancies and an increased workload.




In view of the delay in the reduction in total costs explained above and the above-target cost-income ratios, NLFI is unable to assess at this moment whether the bank will in fact be able to reach the targets. If de Volksbank is to reach the targets, it must place a substantial focus on them.

## 3. Preconditions for privatisation

### 3.1 Introduction

In 2016, NLFI stated that since the split-off from SNS REAAL it had carefully monitored whether the sale of de Volksbank could be considered, keeping in mind the preconditions for privatisation:

i. the company in question is ready for privatisation;
ii. the financial sector is stable; and
iii. there is sufficient market interest in the relevant transaction.[15]

In addition to these preconditions, the aim is to recoup as much as possible of the total capital expenditures in the company that will be privatised, plus the State's financing costs, less the dividend distributions received. In the context of this PR2 and the agreement made with the European Commission that an annual assessment of market conditions will be performed to determine whether de Volksbank can be privatised, NLFI has once again assessed the extent to which the bank is ready for privatisation on the basis of these preconditions. NLFI's current perspective on the extent to which these preconditions are fulfilled with respect to de Volksbank is explained below.

### 3.2 Is de Volksbank ready for privatisation?

In its 2016 Advisory Report, NLFI explained that de Volksbank was not yet ready for privatisation. This conclusion was based on NLFI's opinion that the bank was facing a number of operational and structural challenges. The current situation regarding the focus areas identified has been explained in Chapter 2. As set out in Chapter 2, NLFI concludes that de Volksbank is not ready for privatisation at this time on conditions that are acceptable to the State. 'Acceptable conditions' entail that de Volksbank has developed its strategy in more detail and that a convincing proposition for privatisation is possible. They also mean that the preconditions for privatisation are met.[16] In summary, NLFI is of the opinion that more time to make progress would help de Volksbank. De Volksbank needs more time to further develop the Shared Value strategy and strengthen its identity as a social bank (section 2.3). Currently, de Volksbank is also working on identifying and implementing adjustments in its capital structure (Basel IV, IFRS 9 and BRRD/MREL (section 2.4)). The analysis also shows that de Volksbank has not been sufficiently successful in its efforts to cut costs to the target set for 2020. Although de Volksbank has succeeded in bringing about cost reductions within the cost reduction programme, these are partly cancelled out by rising costs in other areas. Cost reduction is a prerequisite for privatisation (section 2.5).

A convincing proposition for privatisation encompasses both a robust long-term view of the future and an acceptable value proposition. The transition process that de Volksbank initiated in 2016 is not sufficiently complete and therefore does not produce this convincing proposition for privatisation at this point in time. This is true for every form of privatisation. As also explained in Chapter 2, NLFI keeps an open dialogue with de Volksbank about these issues.

[15] Parliamentary Papers, House of Representatives, session year 2010-2011, 28165, no. 117.
[16] This strategy pursued by de Volksbank is discussed in more detail in Chapter 2 of PR2. The preconditions for privatisation are addressed in this chapter.

> *Conclusion*
> De Volksbank is well on its way and is making efforts to make progress. However, the analysis does not permit NLFI to conclude that de Volksbank is ready for privatisation on conditions that are acceptable to the State. The transition process that de Volksbank initiated in 2016 is not sufficiently complete and therefore does not produce any convincing proposition for privatisation at this point in time.



### 3.3 Is the financial sector stable?

Macro-economic conditions in the Netherlands have improved in the past few years. In 2016, the economy grew by 2.1%, which was the first time in many years that growth surpassed the 2% mark. The Dutch economy grew by 3.2% in 2017. This was the highest growth experienced since 2007. Statistics Netherlands (CBS) explained this as follows: "This growth is strongly dependent on exports, but investments in fixed assets and consumption has also made considerable contributions in recent years. However, the growth in household consumption has been lagging behind GDP growth for years, partly because the real disposable income of households falls behind. Businesses reported record profits in 2017. The labour market, too, experienced a year of records in 2017. The cyclical upturn of 2017 continued in the first few months of 2018."[17] In its publication Economic Developments and Outlook of June 2018, DNB stated that "[e]conomic recovery peaked in 2017, with GDP growth reaching 3.3%. For the years 2018 to 2020 we project growth at gradually slowing rates of 2.5%, 2.2% and 1.9%, respectively. This means economic activity is set to remain above its trend level, and all signs point to a sustained boom."[18] IMF projections point to a period of economic growth on a global scale.[19]

Furthermore, DNB explained in its Financial Stability Report, Spring 2018 (FSR), that the financial resilience and the profitability of the Dutch banking sector have been boosted considerably over the past years. Owing to the favourable economic conditions, the profitability of the majority of Dutch banks has also been picking up again since 2015.[20]

The recovery of the housing market has been a factor in the growth of the Dutch economy during the past years. In the FSR, DNB explained that, although a sharp rise in house prices was seen, growth in the mortgage market remained subdued. DNB also explained in the FSR that interest rates are likely to rise at some point in the future.

It is noted in relation to the above that macro-economic conditions and financial stability are also affected by special issues such as the tapering of quantitative easing by central banks, Brexit, trade relations, geopolitical relations, etc.[21] It has been announced that the asset purchase programme will

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[17] See https://www.cbs.nl/nl-nl/achtergrond/2018/19/de-nederlandse-economie-in-2017.
[18] See Economic Developments and Outlook, June 2018, number 15, of DNB: https://www.dnb.nl/binaries/113104_EOV_juni_15_2018_NL_WEB_tcm46-376886.pdf.
[19] See the IMF's publication: https://www.imf.org/en/Publications/WEO/Issues/2018/03/20/world-economic-outlook-april-2018.
[20] Financial Stability Report, Spring 2018, of De Nederlandsche Bank: https://www.dnb.nl/binaries/OFS%20voorjaar%202018_tcm46-376348.pdf.
[21] See, for example, the Financial Stability Report, Spring 2018, of De Nederlandsche Bank, previous footnote.

be cancelled with effect from late December 2018. After this, we will see how this will affect macro-economic conditions and financial stability. Recent developments, such as in diplomatic relations between the United States and Turkey, illustrate the impact that acute political discord has on macro-economic conditions.

> *Conclusion*
> During recent years, macro-economic conditions in the Netherlands have improved while at the same time the financial markets have become less volatile. The financial sector as a whole is stable at this moment and, as such, is not an impediment to the privatisation of a medium-sized bank.

### 3.4 Is there sufficient market interest in a privatisation of de Volksbank?

Given the challenges for de Volksbank described in section 2.3, it is currently expected that we will see insufficient interest in de Volksbank from potential investors on conditions that are acceptable to the State (see section 2.1 in this respect). NLFI does not consider it expedient at this moment to proactively set up a process for gauging market interest in a form of privatisation of de Volksbank.

> *Conclusion*
> NLFI expects that the market is currently insufficiently interested in a sale of de Volksbank on conditions that are acceptable to the State; NLFI expects that such an interest may be seen when de Volksbank has made sufficient progress on the focus areas discussed in Chapter 2. NLFI therefore believes that proactively setting up a process for gauging any market interest in a form of privatisation of de Volksbank would not be expedient at this time.

### 3.5 Will capital expenditures be recouped?

In addition to the three preconditions described in the previous three sections, the aim is to recoup as much as possible of the total capital expenditures in de Volksbank, plus the State's financing costs, less the dividend distributions received. In addition, when privatising its associates, NLFI seeks a yield that is at least equal to the equity that the State has provided as shareholder. As soon as NLFI advises you that de Volksbank is ready for privatisation, NLFI will also consider this issue in greater detail. At this moment, it is uncertain whether the capital expenditures plus the financing costs less the dividend distributions received and the carrying amount of equity can be recouped in full by privatising de Volksbank.

> *Conclusion*
> At this moment, it is uncertain whether the capital expenditures less the dividend distributions received and plus the financing costs for de Volksbank and the carrying amount of equity can be recouped in full by privatising de Volksbank.

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| Further results achieved on the focus areas discussed specifically in Chapter 2 and progress made on the other focus areas may have a positive impact on the bank's return and value. |

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