

Funding mortgages when you don't have the money

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Contents

1. Introduction

2. Starting the crisis

3. What did we do in 2009 / 2010 and 2011?

4. Conclusion

1 Introduction

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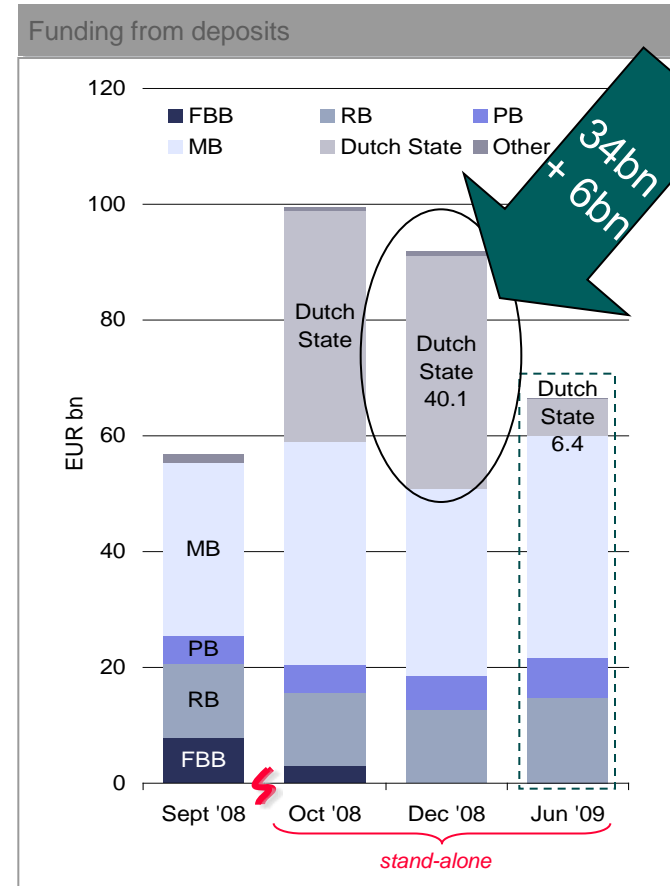
6 yrs AEGON – Control / ALM / Treasury
6 yrs Fortis - Treasury / Board Direktbank
2 yr ABN AMRO – ALM / Treasury

2 Starting the crisis; Eur 34bn funding missing and no organisation

October 2008 FBN had:

- No money markets
- No CP/CD
- No EMTN
- No liquidity buffer

i.e. No treasury



Important notes

§ On 5 October 2008, the Dutch State replaced the funding that was cancelled by Fortis Bank SA/NV (FBB)

§ Dutch State funding in June 2009 is adjusted for EUR 15.5bn relating to the repayment of the short-term debt facility of EUR 34bn. The balance of EUR 6.4bn relates to the long-term (subordinated) debt

2 Starting the crisis; explaining the products

**Funding needs on the side of Fortis Bank Nederland,
not on the Dutch arm of ABN AMRO due to high deposits.**

Different products to raise money

Product to fund the bank	maturity	exposure investor	programme (FBN)
CP / CD / Money market	<1yr	Bank	Not existing
Senior unsecure (EMTN)	2-5 yrs	Bank	Not existing
Senior secured (Covered Bond)	5-20 yrs	Bank + mortgages	Not existing
Securitisation (MBS)	2-6 yrs	Mortgages	Some existing

2009

3. 2009; Where did the bank stand?

MISSION

- **Organisation not ready**

FBN + ABN AMRO not yet merged
Programmes not in place

2. **Insufficient long term funding**

filled by 34bn Dutch state; Eur 20bn additional long term funding needed

3. **Unhealthy balance sheet**

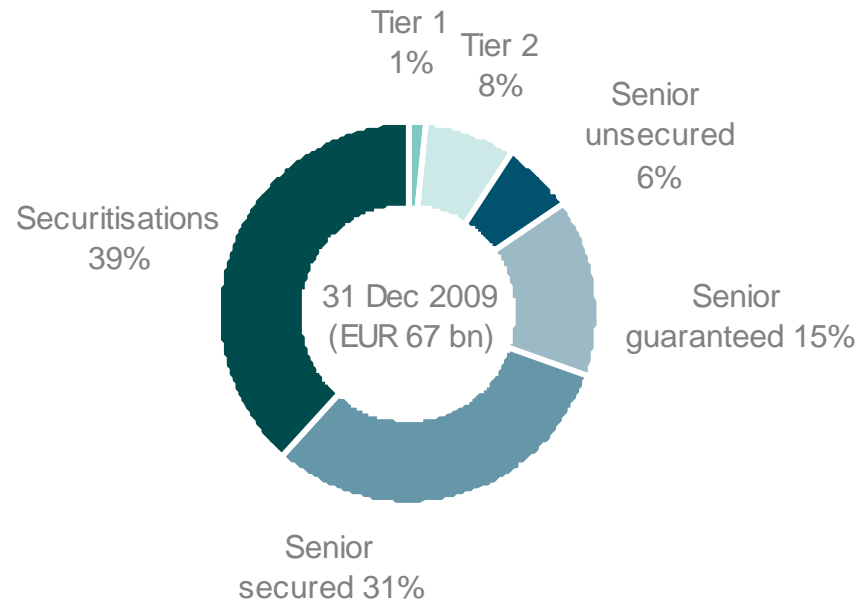
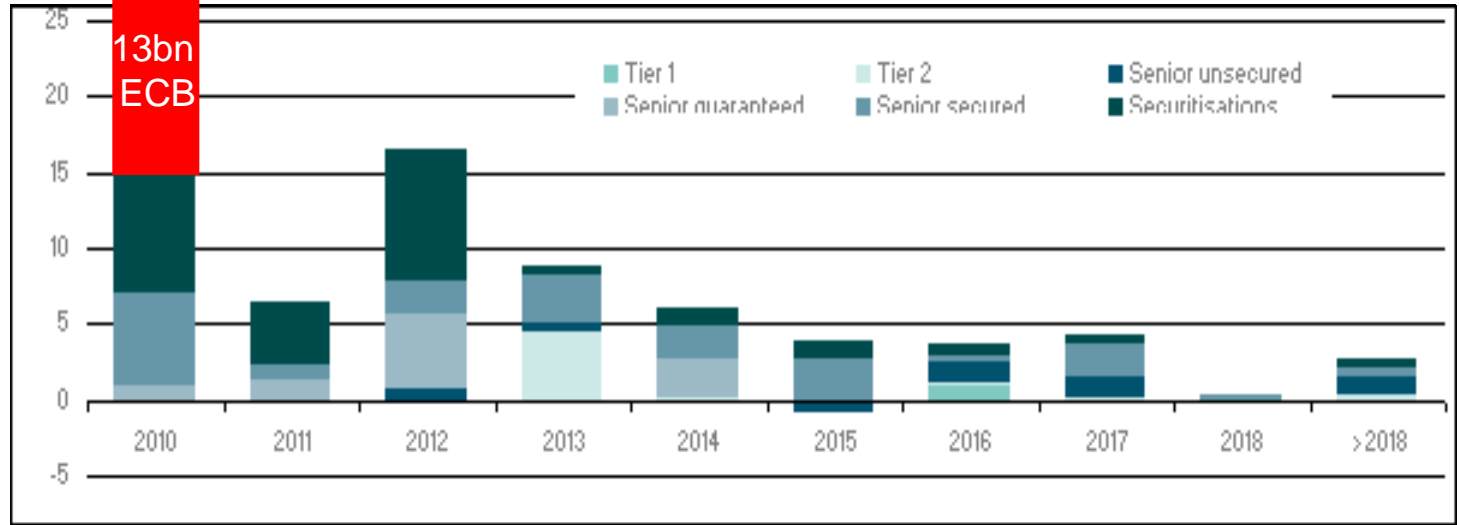
No liquidity buffer at all
increasing mortgage book
mortgages are not pricing in whole sale funding costs

3. 2009; How Min Fin was redeemed and replaced by ECB

Actions 2009

- All programmes put in place (CP / French CP / EMTN etc)
 - Set up MM from 0 to Eur 15bn short term
 - Issue retained MBS Eur 25bn short term **(31-12-09 Eur 13bn ECB)**
 - issue EMTN with guarantee Eur 10bn medium term
 - Covered Bonds Eur 2bn long term
-
- Total Eur 52bn issuance, resulting in **sufficient cash to redeem Min Fin by 30-6**
 - But no money to grow the business
 - Except for Eur 12bn with not such long term character all the rest was short term
 - **52% Mortgage related funding**
 - Liquidity buffer created Eur 22bn

3. 2009; Maturity profile 31-12-09 shows too much short term funding



3. 2009; Mortgage business needs to change from volume to margin steering

Impact crisis on mortgage business in 2009

- Overall Market share dropped
- Complications due to many different labels to stop growth on all labels (Direktbank)
- But liquidity spread not fully re-priced for new loans
- **Growth total balance sheet mortgages comes to a hold**
- Mortgage bank spends significant time to use assets as collateral for funding purposes

2010

3. 2010; Volume strategy for long term funding implemented

In July 2010 FBN and ABN AMRO merged legally

Eur 82bn Wholesale funding for a Eur 380bn balance sheet

15bn short and

67bn long term getting shorter every day

of which 15bn is maturing in 2010

**Focus no longer on generating cash,
but on improving maturity profile (volume strategy).**

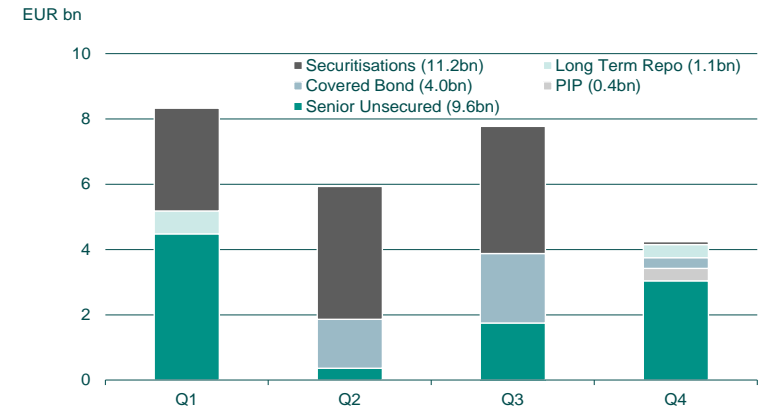
3. 2010; Results of this volume strategy

Actions 2010

• MBS	11bn
• Covered bonds	5bn
• <u>EMTN</u>	10bn +
Total long term issuance	26bn
<u>Maturing funding</u>	15bn -/-
Difference	11bn
• CP / CD /MM	small increase

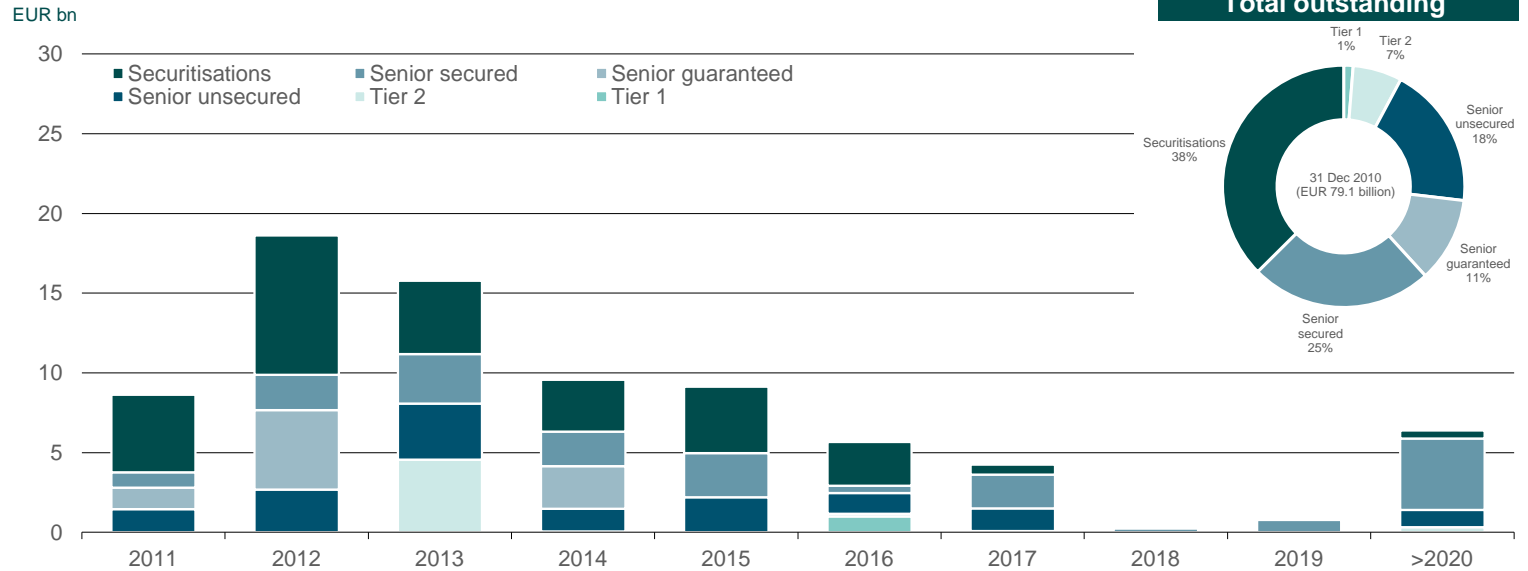
- No longer government guarantee
- **Away from ECB**
- Massive improvement on maturity profile
- **62% mortgage related funding**

Long term funding raised 2010



3. 2010; Maturity profile massively improved

Maturity calendar long-term programme funding



3. 2010 Mortgage business turns to margin strategy resulting in shrinking portfolio

Impact crisis on mortgage business in 2010

- Overall Market share declined further / Market shrinks
- Complications due to many different labels to stop growth on all labels overcome
- **Liquidity spread used to re-price mortgages**
- **Total balance sheet mortgages no growth and during 2010 starts to shrink**

2011

3. 2011 Continuation of volume strategy

Actions 2011

• MBS / Repo	1bn
• Covered bonds	6bn
• <u>EMTN</u>	<u>8bn +</u>
Total long term issuance	15bn
<u>Maturing funding</u>	<u>8bn -/-</u>
Difference	7bn

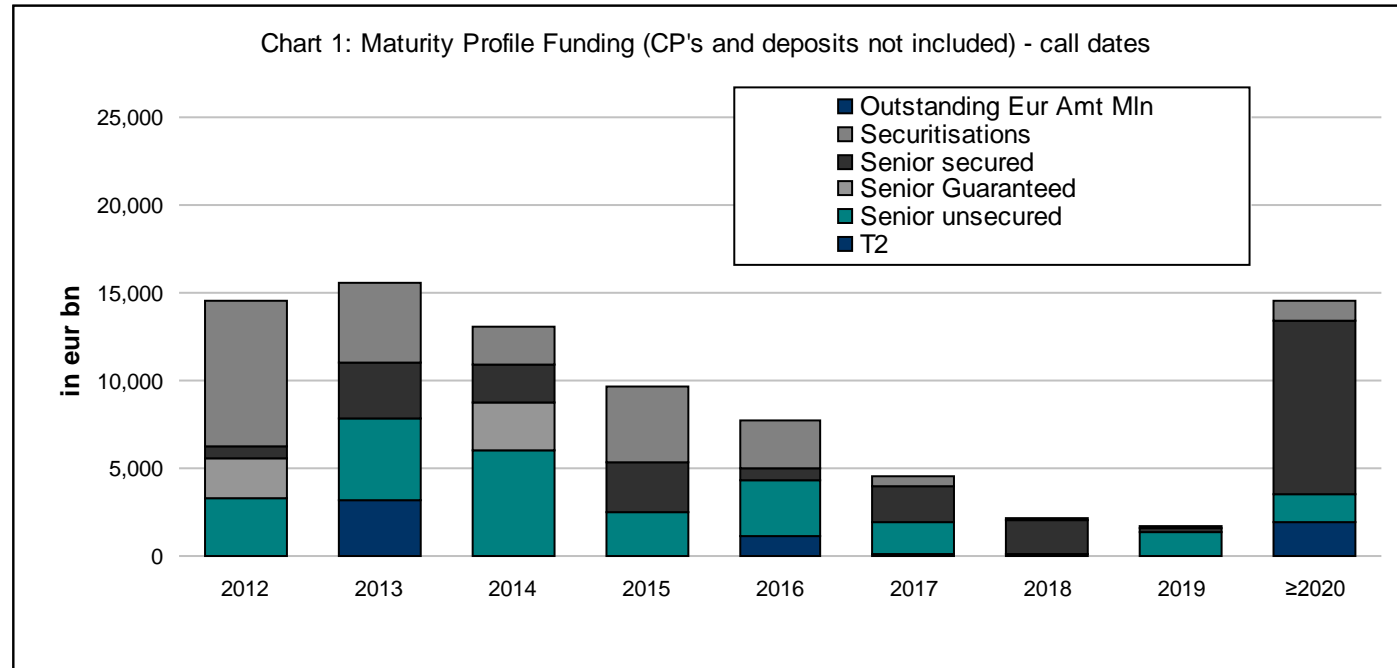
- Eur 25bn retained MBS for liquidity buffer generated bringing buffer to Eur50bn (12.5% of balance sheet, sufficient to meet funding needs for several years)
- Further improvement on maturity profile
- Liability exercise for Subordinated debt and government guaranteed bonds
- **43% mortgage related funding**

3. 2011 Mortgage business steering on margin leads to lower volumes

Impact crisis on mortgage business in 2011

- Overall Market declined further / Market shrinks further
- Integration efforts ex-Fortis & ex-ABN AMRO well on track
- **Liquidity spread used to re-price mortgages**
- **Total balance sheet mortgages starts to decline further under pressure of LTD steering (Basle3).**

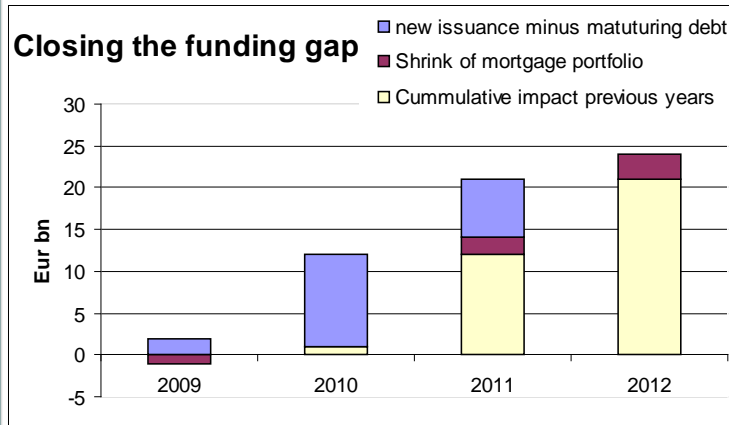
3. 2011 Maturity profile long term debt improved but ...



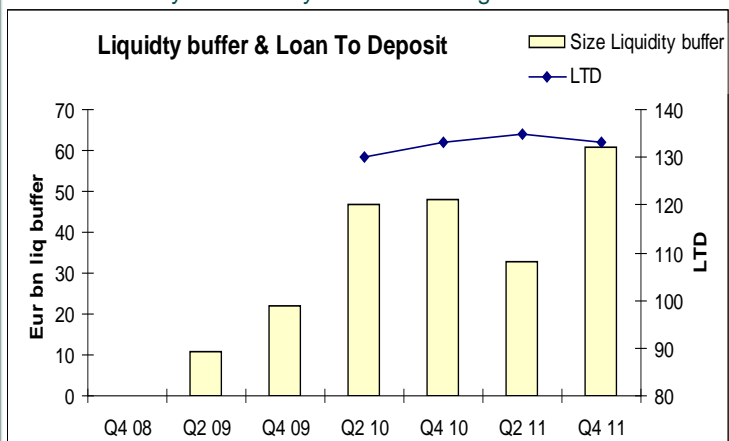
But structural whole sale dependency does not significantly decline

Conclusion

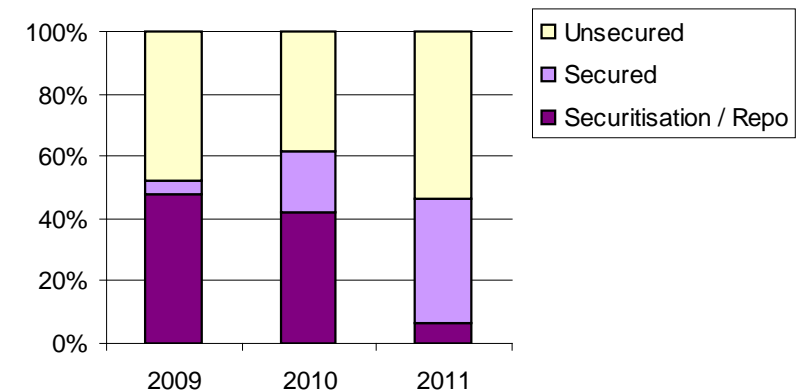
4. Conclusion; 3 years work and it is nearly ready ...



- Assuming for 2012 the same decline in portfolio of mortgages as in 2011
 -January 2012 nearly Eur 4bn funding issued



1. Organisation & programmes in place
2. Initial gap closed
3. Healthy balance sheet
 - LTD declines
 - Liquidity buffer in place
 - Mortgage book declines
 - Mortgages reprised



4. Conclusion; But what if (perception) of credit quality mortgages declines?

If mortgages are to be less attractive; so if the credit losses go up from 6bps to 27bps (times 4.5), similar to the worst year ever seen in 1983 (27bps), two effects occur:

a) So next to $(27-6)*160\text{bn} = \underline{336\text{mln}}$ higher credit losses in a single year. On a Eur 1bn profit in 9 months in 2011, this is manageable.

b) Funding efforts will shift from CB / MBS to EMTN. The pricing difference today for ABN AMRO equals roughly 1%. Over 10bn funding with WAL 5yrs, this were to put a burden of $1\%*10\text{bn}*5\text{yrs} = \underline{500\text{mln}}$ higher funding costs for every year of issuance at a higher spread.

The latter will also occur when losses are not increasing but the perception that losses are going to spike / MBS are being penalised in Basle3.

Resulting into a pressure to use the ECB funding for P&L reasons rather than funding reasons.

The perception of increasing credit losses, even when it is not likely to go up to the level of 1983 is detrimental to the funding costs, more than the actual credit loss.

4. Conclusion; likelihood of credit losses mortgages is moderate

	1983	2012
Credit losses	27bps	? bps
Mortgage interest rates	>10%	<6%
Unemployment NL	>10%	5%
House price decline since peak	20%	<10%
Stimulation real estate market		0% “overdrachtsbelasting” NHG criteria

Fundamentals Dutch real estate market significantly better than in begin of the eighties.

However, **perception** of higher credit losses is more threatening to impact P&L and consequently solvency position for Dutch banks.

4. Conclusion – where does this bring us?

PERCEPTION

IS

REALITY