Transcript Credit Update call 4Q2023

Presentation

Operator
Good afternoon. This is Jessica welcoming you to ING's fourth quarter 2023 Credit Update Call. Before handing this conference call over to Sjoerd Miltenburg, head of Investor Relations of ING Group, let me first say that today's comments may include forward-looking statements such as statements regarding future developments in our business, expectations for our future financial performance and any statement not involving in a historical fact.

Actual results may differ materially from those projected in any forward-looking statement. A discussion of factors that may cause actual results to differ from those in any forward-looking statement is contained in our public filings, including our most recent annual report on Form 20F filed with the United States Securities and Exchange Commission and our earnings press release as posted on our website today. Furthermore, nothing in today's comments constitutes an offer to sell or a solicitation of an offer to buy any securities. Good afternoon, Sjoerd. Over to you.

Jaap Kes (Head of Group Treasury)
Thank you, Operator. Welcome all and thank you for joining us today for the ING Credit Update Call around our fourth quarter 2023 results. My name is Jaap Kes and I'm the Group Treasurer for ING Group. Today I'm here together with Sjoerd Miltenburg, the head of Investor Relations. In this call, we will take you through the high-level 4Q results, ING's capital position and issuance plans for the coming year. At the end of the call, we will have some time for Q&A.

Before we get started, I would like to point out that the credit update slides to accompany this call are available for download from our website. After the presentation, we'll be happy to take your questions. With that, let me hand over to Sjoerd.

Sjoerd Miltenburg (Head of Investor Relations)
Yes. Thank you, Jaap. Let me start with slide two to explain how we were impacted by the developments in the world around us. So in many respects, 2023 was a challenging year, as geopolitical, as well as economic shocks affected many of our clients and thereby also the societies we operate in. We experienced heightened economic uncertainty, which put increased pressure on supply chains and thereby led to subdue growth. But at the same time, on a more positive note, most economies also proved resilient with low unemployment, inflation coming down, and in addition to that, we saw rates turning positive at an unprecedented pace.

On the regulatory side, we have seen increased volatility following the collapses of Silicon Valley Bank and Credit Suisse. In the aftermath, the European banking sector has proven its strength. And last on this slide, what I would like to highlight is we see a continued and accelerating transition to a more sustainable economy, also reinforced by a promising outcome of COP 28. And given our strong ESG focus, this transition offers significant opportunities for ING and we look forward to continuing our frontrunner role.

If I can then take you to the next slide. So slide three. We've shown exceptional results in this challenging environment, which I just alluded to. And more importantly, we are well positioned to deliver value through the cycle. The bank is built on healthy fundamentals with a highly insured retail funding base, a senior well-diversified and mostly collateralized loan portfolio, which results in the lowest risk cost in our Eurozone peer group. Next, our capital position is strong with ample buffer to our target ratios. And all of this has resulted in an excellent track record of delivering value with strong capital generation, and we're confident that we'll be able to continue to do so.

So on slide four, the next slide, I would like to highlight ING's outstanding results in 2023. We've achieved significant growth in primary customers, which reflects the appreciation our customers have of our products and services, and which is also highlighted by market leading Net Promoter Scores in both retail and wholesale banking. On sustainability, we are increasingly integrating climate into our decision making and business processes. The volume mobilized to help our clients transition to more sustainable business models, grew to €115 billion in 2023, which is 14% higher compared to 2022.

Our balance sheet remains strong and over 64% is funded by customer deposits. Our strong asset quality is reflected in low risk costs, which came at only 8 basis points over average customer lending this year, well below through the cycle average of around 25 basis points. And last, our return on equity was 14.8%, despite still operating at a high 14.7% CET1 ratio. Our capital ratio strengthened again while we also distributed almost €6.5 billion to shareholders in 2023.

If I can then take you to slide 10 where I would like to zoom in on our total income for the year. And what clearly stands out is that ING benefits from a positive rate environment. That is particularly visible in the strong increase of the liability NII that has had a significant impact on total income, which is now roughly 25% higher than in the 2018-2021 period, which was still impacted by negative rates. This increase was somewhat offset by subdued loan demand, which has impacted our lending NII. We do see first signs of loan demand recovering, which obviously bodes well for future income growth.

If I can then take you to the next slide, so slide 11, where you can see that the impact of the sharp increase of interest rates is evident, especially when looking at the margin we make on liabilities. The average liability margin in 2023 was 119 basis points compared to a historical level of around a 100 basis points. This was driven by the positive impact from reinvesting part of our replicating portfolio at higher rates, which more than offset the increase of the core rates throughout the year.

In the fourth quarter, we paid a core rate of around 120 basis points, which corresponds to a pass through of roughly 30%. We also recorded significant growth in our core deposits, which was driven by particularly strong contributions from our retail franchises in Germany, Spain, and Poland. Lending NII was notably impacted by subdued demand for loans. Yet we were able to increase our market share in the mortgage market and capture some growth opportunities.

Then onto the slide on expenses, which is slide 13. Operating expenses, excluding regulatory costs and incidental items increased by 6.8%. This increase was mostly driven by the effect of high inflation on staff expenses reflecting indexation and CLA increases across most of our markets. We also continued investing in our business, which benefits all of our stakeholders and we will continue to do so. As we indicated during our Investor Day two years ago in 2022, regulatory costs have come down from their peak in 2021 and were roughly €200 million lower than in 2022, partly directed by lower contributions to the deposit guarantee scheme and the single resolution fund.

In 2024, regulatory costs will decrease by another a €100 million despite additional bank taxes in various countries. Despite the growth in expenses, we have seen positive jaws, resulting in a 51% cost-income ratio in 2023. Going forward, we will continue to be impacted by inflationary pressure, which will partially be offset by efficiencies on the back of our continued focus on operational excellence.

And then from expenses, I would like to move to slide 14 on risk costs. So in 2023, our strong asset quality and robust approach to risk management resulted in low provisions for new defaults and effective recoveries. In addition, we saw a significant reduction of our Russia-related exposure, resulting in a release of provisions taken in 2022. Total risk cost in wholesale banking amounted to €-92 million for the full year. Total risk cost for the bank amounted to only €520 million or eight basis points over average customer lending. So all in all, a very benign year in terms of risk cost. However, we also are vigilant as the cost of living and doing business increases for our customers, but we remain confident in the quality of our loan book.

And then onto the last slide which I would like to share with you, and that is on slide 26 which deals with the outlook for 2024. So to recap, 2023 was an exceptional year with strong growth of primary customers, income growing 16% and a low cost-income ratio of 51%. A further strengthening of our CET1 ratio despite announcing €4 billion of share buybacks and a very healthy return on equity of 14.8%.

For 2024, we expect total income to remain strong as we continue to benefit from a normalised interest rate environment. Income will however likely be somewhat below the level of 2023, driven by an expected normalisation of the liability margin. We reiterate our 5-10% growth ambition for fees in 2024. We maintain our focus on cost control and operational efficiency. In 2024, we expect expenses to reflect the elevated inflation levels we've seen in 2023. We will continue to make selective investments in the business, and together with cost discipline and expected savings from earlier investments, we aim to moderate the growth in total expenses.

Our CET1 ratio will continue to converge towards our target at around 12.5% and we will update the market on this with our next quarterly results. Further, we aim for a return on equity of 12%. So going forward, I'm confident that we'll continue to deliver robust financial results while successfully executing our strategy, and we will take a longer term view on all of this at our Capital Markets Day on the 17th of June. Over to you, Jaap.

Jaap Kes (Head of Group Treasury)
Thanks, Sjoerd. So let's start by looking at the quarterly risk weighted asset development, for which we need to turn to slide 28 for the key messages there. Overall risk weighted assets were relatively stable, coming down by €-1.6 billion to €319 billion. Zooming in, into the individual components, we see the following: credit risk weighted assets were down by €4.5 billion of

which €1 billion was driven by FX. Operational risk weighted assets were up by €3.5 billion, reflecting updates to the AMA model. Market risk weighted assets were relatively stable with a small decline of €0.7 billion.

If you now look at the credit risk weighted assets, which are by far the biggest component, we see the following drivers besides the mentioned FX impact. Volumes were up by €2 billion reflecting solid growth primarily on the retail side. The overall profile of the loan book resulted in €1.4 billion lower risk weighted assets. Also, here its primarily visible on the retail side. And we had a sizable model update in Germany on the rating side, which brought risk weighted assets down.

Bringing these developments together with the quarterly profitability and equity distributions, we will look at the capital developments on slide 29.

The bar chart on this slide shows the quarterly development of our capital ratios. Firstly, the CET1 remains strong at 14.7%. The additional distribution of €2.5 billion as announced in November 2023 has almost been completed. The impact from this was partially offset by the inclusion of our quarterly profit and by lower risk weighted assets. Looking forward, at the end of the fourth quarter of last year, €2.5 billion has been reserved out of CET1 for future dividend distribution. Second, our AT1 ratio, still strong at 2.2%, was slightly down reflecting FX impacts while our Tier 2 ratio was stable at 2.9%. As a result, our total capital at almost 20% is very comfortable.

Now, let's go to slide 30 where we also take a full year view on our CET1 ratio developments. This slide shows the development of our CET1 capital ratio during 2023, which strengthens from 14.5% to 14.7%, despite €6.4 billion of distributions to shareholders. This increase in CET1 ratio was primarily driven by our strong capital generation. RWA decreased, driven by disciplined capital management and a better overall profile of our loan book. Also during 2023, our fully loaded CET1 SREP requirements decreased by 22 basis points, driven by an announced 50 basis points reduction of the SIFI buffer and lower Pillar two requirements. These decreases were only partly offset by a higher countercyclical buffer, which increased by 34 basis points. As a result, the buffer to both our target ratio and the regulatory requirement increased during 2023.

Moving now from total capital to total loss absorbing capacity, let’s move to slide 33 on TLAC and MREL. On this slide we show both the TLAC and the MREL requirements measured against RWA, left, as well as against leverage on the right-hand side. We reported the year-end 2023 actuals against the final TLAC requirements and preliminary MREL requirements for 2024. As you can see, we are amply meeting these metrics, RWA and leverage, with sizeable buffers. Although all metrics are relevant, it is clear RWA-based MREL is the binding constraint, so this is the measure for us to manage. The roughly 3.5% delta between actuals and requirements provides a comfortable buffer of around €11 billion against the requirements.

Clearly, to maintain this buffer, we will need to come to the market in 2024, which we can see if we turn to slide 34. In 2024, we plan to issue around €6 to 8 billion of senior HoldCo paper, which compares to roughly €6 billion equivalent issued in 2023. So you can see we are roughly in a steady state here. The planned issuance is driven by €3 billion of refinancing needs, to accommodate risk weighted asset growth, and the continued aim to optimize our capital structure by replacing CET1 by senior HoldCo over time.

For AT1 and Tier 2, we are comfortable with the Tier 1 and Tier 2 ratios at 2.2% and 2.9% respectively. So any issuance is driven by replacement needs or to accommodate RWA growth. For AT1, the first upcoming call date for an AT1 instrument is April 2024, and that's the $1.25 billion US note. For Tier 2, we have two bonds totaling €1.75 billion with the first call date in 2024, in February and September respectively. For the February instrument we have provided notice to redeem last week. So that very much details our plan on the capital side.

Now, if we move to the secured issuing side, we expect to issue between €7 and 9 billion, which in line with the €8.3 billion issued in 2023. Clearly, this will be coming from different issuance entities we have and also includes RMBS. At the start of 2024, we already took the opportunity to use ING's very short window and issued €2.5 billion covered bonds from ING Bank. So this is already realized from the €7 to 9 billion plan.

On Senior Opco, we have been absent for quite some time but did our first deal in September 2023 again. We will mainly use this instrument for internal ratio management and general funding purposes. Clearly, the issuance needs will be looked at constantly in light of balance sheet developments. We still think it'll be a busy year in terms of issuance. Finally, and perhaps zooming out a bit further to the liability side of a balance sheet, let's look to slide 40.

ING has a very stable liquidity profile where around two-thirds of our balance sheet is funded by customer deposits, of which retail deposits are the main components. Roughly 80% of the retail deposits are covered by deposit guarantee schemes, so considered to be very stable.

With an LCR of 143% we feel we have a robust liquidity position. So while we are happy with the stable funding source, we've seen the dynamics in the deposit markets change over the last 12 months driven by various factors. The rate environment for example, but also the effects of quantitative tightening, the phasing out of TLTRO, some idiosyncratic events like Silicon Valley Bank and Credit Suisse, and also some governments targeting the retail markets to attract funding.

Consequently, over the last year we've put even more attention to managing our funding sources. We ran several disciplined savings campaign in various countries, but also increased our liquidity buffers. Next to our LCR, which is supported by a conservative bond portfolio and sizable cash position, we maintain large pools of ECB eligible assets consisting of retained covered bonds, retained securitizations, and also credit claims. Also in 2024, it'll be our focus to increase these pools of assets that can be transformed to liquidity rapidly if needed. It's always better to be safe than sorry. With that I've provided my key points and suggest we open the floor for some questions. Operator.

Q&A

Operator
Thank you. If you would like to ask a question, please press star one on your telephone keypad. Please ensure your line is unmuted, as you will be advised when to ask your question. In the interest of time, we kindly ask each analyst to limit yourself to two questions only. So once again, that's star one if you would like to ask a question. The first question comes from the line of Daniel David from Autonomous. Please go ahead.

Daniel David (Autonomous)
Good afternoon. Congratulations on the results and thanks for taking my questions. I have one on the replication portfolio and one on issuance a bit more generally. So just to start on the replication portfolio. I understand from the earlier call that you're looking to shorten the duration of that replication portfolio and I think there was some comments made that it's matching customer behavior. Now, please correct me if I'm wrong. I'm just interested if you can give us an insight into that customer behavior because it's slightly contrary to what I would expect, but anything you can say here about the shortening of that portfolio would be interesting.

And then just on issuance, I guess last year we saw you target subordinated issuance quite heavily earlier in the year. And then kind of later on there was a bit more HoldCo senior, just interested in whether that could be replicated or whether there's likely to be more of a pattern of kind of regular issuance across maybe a few different types of debt. And then just finally just on ESG, again, correct me if I'm wrong, but I think last year you didn't issue any green instruments. We've seen you've been quite prominent in that market. Was there a reason and are you likely to issue anything more in the green space? Thanks.

Jaap Kes (Head of Group Treasury)
Thanks, sir. Thanks for the questions. So the first one on replication and the duration. So I think what was meant in the call is that the duration when rates moved up very substantially, actually that caused – that dynamic caused our duration to shorten which can be explained by a situation where rates are a negative, and we actually pay out zero to mass clients and then the repricing necessity or the sensitivity of the savings is very low. So we were in a very low environment, hardly any sensitivity to the savings.

Obviously, when rates move up and also materially above what we pay as banks, then the sensitivity increases and also the necessity to reduce the duration. So that dynamic in itself is cause in our model for the duration to shorten. So going forward, we will look, okay, what are the dynamics, what are the client expectations, and then we will look what will happen to our duration. So it's not being said that going forward also our duration will shorten.

That was on the first element. In terms of our issuance strategy, typically, first, we take a little bit more the capital heavy instruments out of the market, and followed by other instruments. We will see what our strategy will be this year. We still have ample room also in our capital levels, so we are not forced to go to the markets. So we will look at these markets but we will certainly use them. Then on green issuance. Green issuance will also be part of our issuance strategy, so it's foreseen that we will also do some green issuance this year. Thank you.

Operator
The next question comes from the line of Robert Smalley from UBS. Please go ahead.

Robert Smalley (UBS)
Hi. Thanks for taking my question and thanks for doing this call in New York hours. Two topics, one on slide 45, you outline that on the right side, 11% of wholesale banking was in commodities, food and agriculture. Could you talk about developments

there? Certainly we've seen the sector garnering lot of headlines particularly in Netherlands. And wondering what kind of pressures you're seeing there and not only directly in that sector, but how that might spill over in some secondary impacts to other sectors. That's my first question. Second question on slide 62 around Turkey, could you just update us on your view on prospects for Turkish banking? We've seen a number of commentators turn positive on Turkey. Also walk through the mechanics of the accounting here so we can just have a good understanding of the puts and takes in the P&L and on capital. Thank you.

Sjoerd Miltenburg (Head of Investor Relations)
Yeah. Thanks. Maybe to start off with your first question on our agricultural exposure. I'm not sure whether we do see any credit risk trends in the sector, because on that front we do not. So there are not particular risk cost or risk trends that we see in the sector. So actually over the fourth quarter we saw a pickup in the TCF (trade commodity finance) volumes within wholesale banking.

Then on Turkey and on your question on what we see there, I think few things to mention. Well, first of all, on the accounting that's quite technical, but we apply IAS 29 under IFRS. I don't know if there are any particular questions which you have, but because of that volatility under IAS 29, we always update and also report both including as well as excluding the impact for ING Turkey. And other than that Turkey is part of our franchise and and will be continued to do so.

Maybe one thing to add to that, on the IAS 29, it is neutral on a capital base, so that's why we adjust our resilient net profit for it.

Robert Smalley (UBS)
So the results just flow through the P&L or? I just was unclear on the bullet point – the third bullet point on the page with the impact and capital slightly positive with a negative impact and P&L offset by a positive adjustment. How exactly does that work?

Sjoerd Miltenburg (Head of Investor Relations)
Yeah. So the P&L impact is indeed offset within the capital.

Robert Smalley (UBS)
So it's a contra item?

Sjoerd Miltenburg (Head of Investor Relations)
Correct.

Robert Smalley (UBS)
Okay. Great. Thanks very much.

Sjoerd Miltenburg (Head of Investor Relations)
Thank you.

Operator
We currently have no questions in the queue, so as a reminder, please press star one if you would like to ask a question. The next question comes from the line of Robert Thomas from T. Rowe Price. Please go ahead.

Robert Thomas (T. Rowe Price)
Hi there. Thanks for taking my question. Maybe just, can you give me a reminder or a bit more insight into the sort of way forward for your CET1 ratio? And the guidance is post Basel IV of 12.5%? You're at 14.7%, what's the timeframe I should be thinking about to get this to 12.5%, and how much of that is predicated on just the risk weight inflation under Basel IV? Thanks.

Jaap Kes (Head of Group Treasury)
So our guidance is that we will move our CET1 towards 12.5% by the end of 2025. The impact of Basel IV has been largely already absorbed in our final numbers, although we will see some volatility along the way, amongst others by the turn to the standard measurement approach for operational risk.

Robert Thomas (T. Rowe Price)
Okay. So that suggests quite a large capital return in a fairly short period of time, right?

Jaap Kes (Head of Group Treasury)
So we will look at this in a quarterly rhythm like we've done last year, and we will try to get to our target of 12.5%. That's currently the guidance we give.

Robert Thomas (T. Rowe Price)
Okay. Thanks.

Operator
There are no further questions in the queue, so I'll now turn the call back over to your hosts for some closing remarks.

Jaap Kes (Head of Group Treasury)
Thank you, Operator, and thank you all for joining this call today. The Investor Relations team is available for potential follow-up questions, or else, we are looking forward to see you during our roadshows in 2024. Have a great day. Thanks very much. Bye-bye.

Operator
Thank you for joining today's call. You may now disconnect your lines.