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Nederlandse Waterschapsbank N.V.

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Nederlandse Waterschapsbank N.V.

SACP	a+

Anchor	bbb+	
Business Position	Adequate	0
Capital and Earnings	Very Strong	+2
Risk Position	Strong	+1
Funding	Average	0
Liquidity	Adequate	

\+

Support	+4
ALAC Support	0
GRE Support	+4
Group Support	0
Sovereign Support	0

\+

Additional Factors	0

Issuer Credit Rating

AAA/Stable/A-1+

Major Rating Factors

Strengths:	Weaknesses:
• Focus on low-risk Dutch public sector lending, supporting very strong asset quality. • Extremely strong capital base. • Almost certain likelihood of extraordinary support from the Dutch Ministry of Finance.	• Limited diversification of income sources, with high reliance on interest income. • Moderate capital generation due to low lending margins.

Outlook: Stable

The stable outlook on Nederlandse Waterschapsbank N.V. (NWB Bank) reflects that on The Netherlands (AAA/Stable/A-1+). As long as we consider support from the Dutch government to be almost certain, and provided the bank maintains an adequate financial standing, the long-term issuer credit rating on NWB Bank is unlikely to diverge from that on the sovereign. In addition, any rating action on The Netherlands would likely result in a similar rating action on NWB Bank. That said, we expect NWB Bank's financial profile will remain strong over the next two years, even though the cost of funding may rise from its current unsustainable lows.

We could downgrade NWB Bank by one notch if we were to take a similar action on The Netherlands. We could also lower the ratings over the next two years if we saw a reduced likelihood of support from the Dutch government toward other majority-owned sectors. This could happen if the bank's role for the Dutch government diminished following a sharp increase in competition, or if we considered that the bank's link with the government had weakened.

Rationale

NWB Bank is one of the two major local government funding banks in The Netherlands. It is publicly owned and provides credit, among other services, to local and regional governments, water authorities, housing associations, and the health care sector. We base our ratings on our classification of NWB Bank as a government-related entity (GRE) with an almost certain likelihood of extraordinary government support.

NWB Bank's 'a+' stand-alone credit profile (SACP) is one of the strongest among banks we rate in The Netherlands. The bank's stable franchise as one of the principal lenders to the Dutch public sector through economic cycles underpins its strong SACP. That said, we still view the business as quite concentrated.

As is typical for banks that have a large balance sheet comprising very low-risk assets, NWB Bank displays a very high Common Equity Tier 1 ratio but a modest leverage metric. We expect that NWB Bank will benefit from the proportional treatment of the leverage ratio requirement. Nevertheless, we consider the current leverage ratio low.

Low-risk lending that is issued to or guaranteed by public authorities, combined with our expectation of high-quality securities and limited loan book expansion, dominates the asset base. This makes NWB Bank an entity that has an extremely low credit risk profile. Just like other government funding banks, we recognize that its business model is based on its continued capacity to access funding at very low costs, given its structurally low asset margins.

NWB Bank is wholesale funded and does not hold deposits. Its funding is well-diversified by source and maturity. Furthermore, NWB Bank holds a satisfactory liquidity buffer as well as a large portfolio of assets that are eligible for European Central Bank refinancing operations.

We equalize the long-term issuer credit rating on NWB Bank with the sovereign credit rating on The Netherlands. This reflects the support we understand the bank receives from the Dutch Ministry of Finance as a result of the bank's public sector mandate and combined ownership by domestic water authorities (81%), The Netherlands (17%), and Dutch provinces (2%).

Anchor: 'bbb+' for a commercial bank operating only in The Netherlands

We use our Banking Industry Country Risk Assessment (BICRA) economic and industry risk scores to determine a bank's anchor--the starting point in assigning an issuer credit rating. The anchor for a bank operating only in The Netherlands is 'bbb+'.

We base our assessment of economic risk on our view that the Dutch economy is wealthy, diversified, open, and competitive, as seen in its high income per capita, net external asset position, recurrent and elevated current account surpluses, and long track record of prudent and flexible macroeconomic policies. Following real GDP growth averaging 2.6% in 2016-2017, we consider that The Netherlands' real GDP growth will stand at 1.9% on average over 2019-2020. Strong domestic demand continues to fuel the ongoing recovery. We believe that economic imbalances are gradually decreasing due to supportive macroeconomic developments and the dynamics of the real estate markets--both residential and commercial. The legal reforms introduced since 2013, combined with the banks' own restructuring efforts in this context, have also helped reduce these imbalances. In our view, the trend for economic risk is positive.

Our assessment of industry risks for Dutch banks incorporates high domestic concentration and our view of a stable competitive environment. We consider that the prospective profitability of domestic banking activities is adequate. Some large banks have completed large restructuring efforts in exchange for state aid. Cost-optimization programs continue to operate in the context of the persistently low-interest-rate environment, and cost of risk has also improved, mitigating asset repricing. The system's relatively large reliance on wholesale funding is partly attributable to households' propensity to save in life insurance and pension products, rather than in bank deposits. We consider that Dutch systemwide funding benefits from the depth of the domestic capital market and the Dutch authorities' good track record in providing liquidity support, among other factors. We view the industry risk trend as stable.

Table 1

Nederlandse Waterschapsbank N.V. Key Figures

	--Fiscal year-ended Dec. 31--				
(Mil. €)	**2018***	**2017**	**2016**	**2015**	**2014**
Adjusted assets	87,156.0	87,121.0	94,412.0	91,311.0	88,246.2
Customer loans (gross)	62,320.0	60,973.0	64,496.0	63,576.0	64,665.6
Adjusted common equity	1,679.0	1,622.0	1,502.0	1,396.0	1,300.2
Operating revenues	98.4	218.0	193.0	171.0	101.0
Noninterest expenses	20.4	48.0	44.0	39.0	30.0
Core earnings	58.5	123.0	107.0	95.0	49.7

*Estimates as of June 30.

Business position: Franchise stability offset by business and geographic concentration

Our assessment of NWB Bank's business position is supported by its stable franchise as one of the principal lenders to the Dutch public sector, with a stable one-third market share. Social housing entities dominate NWB Bank's loan portfolio and represent 67% of the bank's total loans. Municipalities and water authorities follow, each accounting for 11%-12% of NWB Bank's €52 billion loan book. We do not expect this to change substantially in the next two years. This is because competition from commercial banks in these segments will remain modest due to the low asset margins and because most of the bank's clients have limited or no direct access to capital markets.

After loan increases in recent years, NWB Bank's loan portfolio will likely stabilize because new regulations have limited the underwriting policy of Waarborgfonds Sociale Woningbouw (WSW; AAA/Negative/A-1+)--the guarantor of social housing loans. Furthermore, loans to municipalities and provinces should stabilize, whereas those to water authorities--in which NWB Bank has a very high market share--will likely pick up due to new investments for water level controls and water quality.

NWB Bank's focus on low-risk loans is offset by concentration risks, since the whole loan portfolio is exclusively invested in The Netherlands on a limited number of asset classes. The bank has started to invest in different asset classes, such as public-private partnerships or government-guaranteed export credit financing. It has also implemented financing of renewable energy and Green government-guaranteed projects to further diversify its loan book.

NWB Bank has an unchanged strategy centered on its exclusive Dutch public financing mandate. It is part of a framework that aims to minimize the cost of financing to the public sector while achieving a reasonable return for the shareholders and complying with regulatory requirements. In our view, the business model's stability and predictability underpin stable underlying earnings generation and prevent excessive risk taking by maintaining a clear mandate in areas of long-standing expertise. As long as we consider the financing role of NWB Bank to be pivotal for the Dutch government, the bank's business model is likely to remain largely shielded from competition.

Table 2

Nederlandse Waterschapsbank N.V. Business Position

	-- Fiscal year-ended Dec. 31--				
(%)	2018*	2017	2016	2015	2014
Return on equity	7.1	7.8	7.4	7.0	3.8

*Estimates as of June 30.

Capital and earnings: Very high capitalization, but leverage is a constraint

NWB Bank displays an extremely high capital ratio, above the level typically exhibited by commercial banks. However, the leverage ratio (with the assets non-risk-weighted) is low and earnings are modest, due to the bank's business model. We expect NWB Bank's risk-adjusted capital (RAC) ratio before diversification adjustments will remain well above 15% in the next two years. At year-end 2017, it stood at 37.1% compared with 33.2% at year-end 2016, and we expect the ratio will remain above 35% over the next 24 months.

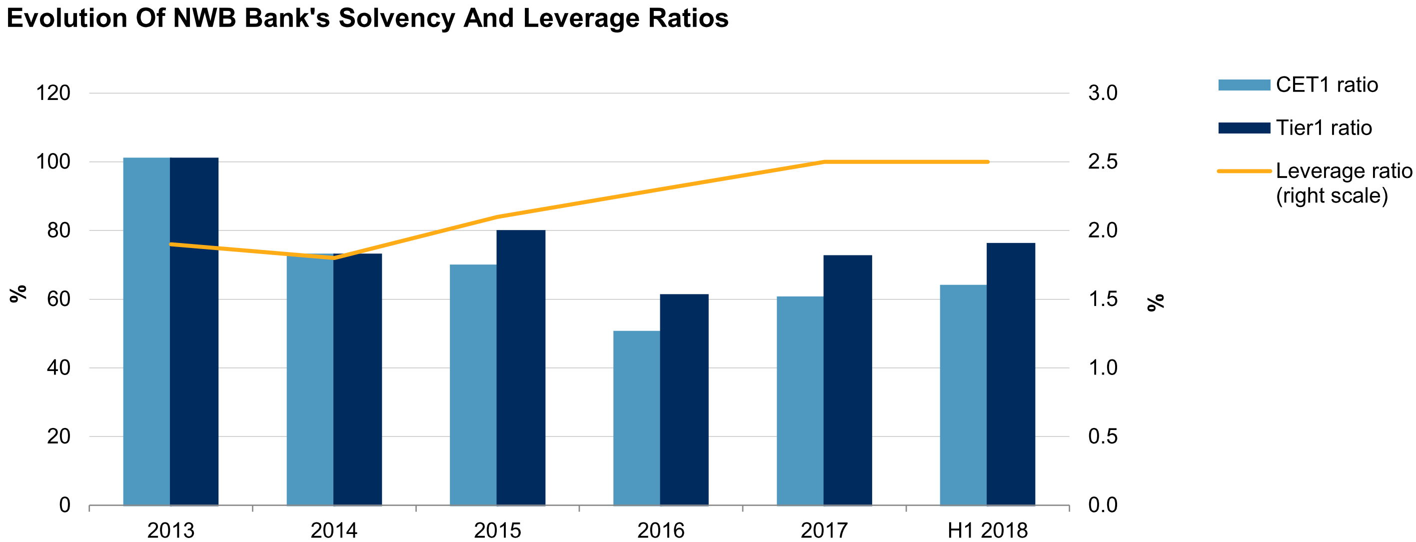
We base our RAC ratio projections on steady retained earnings of about €75 million-€100 million per year in 2018 and 2019, with an increase in risk-weighted assets (RWAs). We include in our forecasts for the next two years a stable outstanding loan book, net interest margin of 30-45 basis points (bps), and a stable cost-to-income ratio of 20%-25% (thanks to the bank's low cost structure).

NWB Bank fully hedges interest rate risk and foreign exchange risk through derivatives, and all counterparties are large financial institutions or pension funds. We note that the balance sheet has some volatility stemming from interest rate risk and foreign exchange rate fluctuations, which directly affects our capital metric. However, this volatility will not lead the bank's capital ratio to drop below our 15% threshold, nor will it change our very strong assessment of NWB Bank's capital.

Earnings are fairly stable, but undiversified. Recurring interest income represents most of NWB Bank's total operating revenues, although results from financial transactions can affect the bottom line. The bank benefits from a highly competitive cost-to-income ratio due to its low structure and reduced staff costs.

Typical for banks with a large balance sheet made of low-risk assets, meeting Basel III leverage ratio requirements is more of a constraint for NWB Bank than meeting the capital ratio requirements, which are based on RWAs. As of June 2018, NWB Bank registered a Basel III leverage ratio of 2.5%, which is below the 3% requirement for commercial banks. We understand the bank is awaiting a final agreement from the European Parliament regarding the amendment of the Capital Requirements Regulation application. The current proposal includes amendments to the leverage ratio calculation for promotional banks. If this proposal receives approval from European Parliament, NWB Bank will comply with the regulation.

Chart 1



CET1--Common Equity Tier 1. H1--First half.

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Table 3

Nederlandse Waterschapsbank N.V. Capital And Earnings

	-- Fiscal year-ended Dec. 31--				
(%)	**2018***	**2017**	**2016**	**2015**	**2014**
Tier 1 capital ratio	73.90	68.00	58.00	79.80	73.00
Criteria reflected in RAC ratios	N/A	2017 RAC Criteria	2017 RAC Criteria	2010 RAC Criteria	2010 RAC Criteria
S&P Global Ratings' RAC ratio before diversification	N/A	37.05	33.23	43.12	38.03
S&P Global Ratings' RAC ratio after diversification	N/A	23.66	23.69	28.22	23.91
Adjusted common equity/total adjusted capital	83.99	83.52	82.44	87.47	100.00
Net interest income/operating revenues	126.73	126.61	112.95	105.26	115.84
Market-sensitive income/operating revenues	(26.73)	(26.61)	(12.95)	(5.26)	(15.84)
Noninterest expenses/operating revenues	20.73	22.02	22.80	22.81	29.70
Preprovision operating income/average assets	0.18	0.19	0.16	0.15	0.09
Core earnings/average managed assets	0.13	0.14	0.12	0.11	0.06

*Estimates as of June 30. N/A--Not applicable.

Table 4

Nederlandse Waterschapsbank N.V. Risk-Adjusted Capital Framework Detailed Results

(Mil. €)	**EAD**	**Basel III RWA**	**Average Basel III RW (%)**	**S&P Global Ratings RWA**	**Average S&P Global Ratings RW (%)**
Government and central banks	75,033	2	0	2,064	3
Of which regional governments and local authorities	64,939	2	0	2,050	3

Table 4

Nederlandse Waterschapsbank N.V. Risk-Adjusted Capital Framework Detailed Results (cont.)					
Institutions and CCPs	11,290	503	4	605	5
Corporate	985	662	67	739	75
Retail	0	0	0	0	0
Of which mortgage	0	0	0	0	0
Securitization (1)	1,711	420	25	421	25
Other assets (2)	8	8	100	9	113
Total credit risk	89,027	1,595	2	3,837	4
Total credit valuation adjustment	--	800	--	1,040	--
Equity in the banking book	0	0	0	0	0
Trading book market risk	--	0	--	0	--
Total market risk	--	0	--	0	--
Total operational risk	--	291	--	364	--
RWA before diversification	--	2,686	--	5,241	100
Total diversification/concentration adjustments	--	--	--	2,965	57
RWA after diversification	--	2,686	--	8,206	157
		Tier 1 capital	**Tier 1 ratio (%)**	**Total adjusted capital**	**S&P Global Ratings RAC ratio (%)**
Capital ratio before adjustments		1,820	67.8	1,942	37.1
Capital ratio after adjustments (3)		1,820	67.8	1,942	23.7

(1) Securitization exposure includes the securitization tranches deducted from capital in the regulatory framework. (2) Other assets includes deferred tax assets not deducted from ACE. (3) For Tier 1 ratio, adjustments are additional regulatory requirements (e.g. transitional floor or Pillar 2 add-ons). CCP--Central counterparty. EAD--Exposure at default. RAC--Risk-adjusted capital. RW--Risk-weighted. RWA--Risk-weighted assets.

Risk position: The bank is likely to maintain its conservative risk profile

Our assessment of NWB Bank's risk position as strong reflects our view of its continued focus on low-risk lending issued to or guaranteed by, public authorities. Government risk dominates the portfolio, which comprised the following as of Dec. 31, 2017: 67% social housing, 12% water authorities, 11% municipalities, and 6% health care. WSW guarantees longer-term lending to social housing associations, and Waarborgfonds voor de Zorgsector (WfZ) guarantees longer-term lending to health care institutions. The central bank considers these exposures to be equivalent to risk arising from the Dutch State, resulting in a 0% risk weight. We anticipate that new non-solvency free production, such as public-private partnerships or lending to utility companies, will remain limited and will not change the underlying risk of the global portfolio. We also note that the bank has not suffered loss of principal or made loan loss provisions, and that its liquidity portfolio comprises highly rated securities. This further supports our assessment of NWB Bank's strong risk position.

Cross currency swaps fully offset foreign exchange risk stemming from the bank's foreign currency issuance. NWB Bank has a sizable €124 billion notional derivatives portfolio as of June 30, 2018. The bank resorts to interest rate swaps and cross currency swap instruments for hedging purposes only, which is inherent to the bank's business model and risk management. NWB Bank mitigates its counterparty credit risk by dealing exclusively with highly rated counterparties and by having a credit support annex with all counterparties. The bank has centrally cleared all new clearable swaps since May 2016.

We note that the bank's business model is dependent on continued access to low-cost liabilities given the structurally low yields on most of its assets. This creates a structural sensitivity to any negative market sentiment, regarding Dutch risk in particular.

Table 5

Nederlandse Waterschapsbank N.V. Risk Position

	-- Fiscal year-ended Dec. 31--				
(%)	**2018***	**2017**	**2016**	**2015**	**2014**
Growth in customer loans	0.71§	(5.46)	1.45	(1.69)	12.69
Total diversification adjustment/S&P Global Ratings' RWA before diversification	N/A	56.58	40.29	52.81	59.04
Total managed assets/adjusted common equity (x)	51.91	53.71	62.86	65.41	67.87

*Data as of June 30. §Annualized rate. N/A--Not applicable. RWA--Risk-weighted assets.

Funding and liquidity: The bank is wholesale funded with limited reliance on short-term funding

We view funding as average and liquidity as adequate, despite NWB Bank's main funding and liquidity metrics being weaker than Dutch banking peers'.

In line with public sector-focused peers, NWB Bank is entirely wholesale funded because it does not take deposits, which deprives it of a stable funding source. We calculate NWB Bank's stable funding ratio to be 68.23% and broad liquid assets to short-term wholesale funding to be 0.54x as of June 30, 2018. However, unlike with other 100% wholesale-funded entities, we do not incorporate any negative rating adjustment in our assessment of NWB Bank's funding because we also factor qualitative factors into our assessment. NWB Bank enjoys a large and diversified investor base across markets, products, currency, and tenors. NWB Bank has also reinforced its investor base by raising €2.7 billion in sustainable funding in 2018.

We also consider that the bank's liquidity position is more resilient than our metrics imply, owing to its untapped European Central Bank facility and its large liquidity portfolio that comprises cash at the Dutch central bank and highly liquid securities. Lastly, unlike most commercial banks we rate, almost all of NWB Bank's loan book is solvency free and could be pledged as collateral at De Nederlandsche Bank in times of liquidity stress.

Table 6

Nederlandse Waterschapsbank N.V. Funding and Liquidity

	-- Fiscal year-ended Dec. 31--				
(%)	**2018***	**2017**	**2016**	**2015**	**2014**
Long-term funding ratio	62.56	65.33	66.12	45.19	51.67
Stable funding ratio	68.23	68.36	64.71	45.13	46.23
Short-term wholesale funding/funding base	30.25	27.25	26.50	48.64	41.48
Broad liquid assets/short-term wholesale funding (x)	0.54	0.58	0.47	0.25	0.09
Short-term wholesale funding/total wholesale funding	30.13	27.13	26.39	48.51	41.48

*Estimates as of June 30.

Support: Almost certain likelihood of support from the Dutch government

We equalize our long-term issuer credit rating on NWB Bank with the sovereign credit rating on The Netherlands. This reflects the support that we understand the bank receives from the Dutch Ministry of Finance, due to its public sector mandate and combined ownership by domestic water authorities (81%), the central government (17%), and Dutch provinces (2%). Water authorities in The Netherlands are decentralized public authorities with a similar legal status to municipalities. On average, they receive 5% of their revenues from the government and the rest from taxes that they can levy. We view NWB Bank as a GRE with an almost certain likelihood of timely and sufficient extraordinary government support. We base our view on NWB Bank's:

- Critical role as one of the state's two public sector banks with a public policy mandate. In our view:

--NWB Bank plays a vital role in providing low cost financing to the Dutch public sector, which is a top public policy goal;

--Private sector commercial banks are typically willing to finance only a small part of the public sector's financing needs due to lower margins and increased illiquidity, and are not able to compete with the low-cost financing that NWB Bank provides;

--In the absence of public sector banks, the government would likely have to finance the public sector directly; and

--NWB Bank's interlinkages with other entities (for example, WSW) that benefit from government guarantees increase the government's incentive to provide extraordinary support; and

- Integral link with the government, since we consider the bank as an extension of the government. The bank's articles of association limit NWB Bank's ownership and lending activities to the public sector, which supports our view of the link between NWB Bank and the government. We note that although the government is not involved in the day-to-day running of the bank, it maintains close oversight over the bank's strategy and capital policy.

Nevertheless, we will monitor ongoing development in the Dutch social housing sector in case the state does not provide additional support to other Dutch GREs such as WSW as promptly as we expect in our current assessment. Beyond WSW's role for or link with the central government, we think a lack of timely support to WSW could affect our assessment of the likelihood of government support toward other GREs, including NWB Bank.

Our assessment also factors in the EU's Bank Recovery and Resolution Directive (BRRD). Our longstanding view is that the BRRD does not appear to prevent the Dutch government, in its capacity as existing shareholder of a bank, from granting support to Dutch-domiciled GREs in going-concern situations--even if the GREs are subject to BRRD. That said, in a gone-concern scenario, the BRRD could prevent the government from injecting capital into some GREs to correct an acute solvency problem without first bailing in senior liabilities.

Additional rating factors: None

No additional factors affect the ratings.

Related Criteria

- Criteria - Financial Institutions - General: Risk-Adjusted Capital Framework Methodology, July 20, 2017
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings, April 7, 2017

- General Criteria: Rating Government-Related Entities: Methodology And Assumptions, March 25, 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: Banks: Rating Methodology And Assumptions, Nov. 9, 2011
- Criteria - Financial Institutions - Banks: Banking Industry Country Risk Assessment Methodology And Assumptions, Nov. 9, 2011
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

Related Research

- The Netherlands Ratings Affirmed At 'AAA/A-1+'; Outlook Stable, Nov.16, 2018
- Dutch Social Housing Guarantee Fund WSW Outlook Revised To Negative; 'AAA' Rating Affirmed, July 20, 2018
- Banking Industry Country Risk Assessment: The Netherlands, June 11, 2018
- Various Dutch Bank Outlooks To Positive On Receding Economic Imbalances In The Netherlands, Sept. 15, 2017

Anchor Matrix

Industry Risk	Economic Risk									
	1	2	**3**	4	5	6	7	8	9	10
1	a	a	a-	bbb+	bbb+	bbb	-	-	-	-
2	a	a-	a-	bbb+	bbb	bbb	bbb-	-	-	-
3	a-	a-	**bbb+**	bbb+	bbb	bbb-	bbb-	bb+	-	-
4	bbb+	bbb+	bbb+	bbb	bbb	bbb-	bb+	bb	bb	-
5	bbb+	bbb	bbb	bbb	bbb-	bbb-	bb+	bb	bb-	b+
6	bbb	bbb	bbb-	bbb-	bbb-	bb+	bb	bb	bb-	b+
7	-	bbb-	bbb-	bb+	bb+	bb	bb	bb-	b+	b+
8	-	-	bb+	bb	bb	bb	bb-	bb-	b+	b
9	-	-	-	bb	bb-	bb-	b+	b+	b+	b
10	-	-	-	-	b+	b+	b+	b	b	b-

Ratings Detail (As Of February 18, 2019)	
Nederlandse Waterschapsbank N.V.	
Issuer Credit Rating	AAA/Stable/A-1+
Certificate Of Deposit	
Local Currency	A-1+
Commercial Paper	
Foreign Currency	A-1+
Senior Unsecured	AAA
Short-Term Debt	A-1+

Ratings Detail (As Of February 18, 2019) (cont.)

Issuer Credit Ratings History	
24-Nov-2015	AAA/Stable/A-1+
27-May-2015	AA+/Positive/A-1+
02-Dec-2013	AA+/Stable/A-1+
Sovereign Rating	
Netherlands	AAA/Stable/A-1+

*Unless otherwise noted, all ratings in this report are global scale ratings. S&P Global Ratings' credit ratings on the global scale are comparable across countries. S&P Global Ratings' credit ratings on a national scale are relative to obligors or obligations within that specific country. Issue and debt ratings could include debt guaranteed by another entity, and rated debt that an entity guarantees.

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