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Research Update:

Van Lanschot Kempen Wealth Management N.V. Outlook Revised To Negative On Profit Concerns; Ratings Affirmed

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Overview

- Despite Netherlands government measures to contain the COVID-19 pandemic, the economy faces an unprecedented challenge and there are substantial downside risks.
- We expect the decline in markets, and COVID-19-pandemic-related weaker economic outlook, to affect Van Lanschot Kempen Wealth Management's (VLKWM) profitability and asset quality.
- On April 23, 2020, we therefore revised the outlook on VLKWM to negative from stable and affirmed our 'BBB+/A-2' issuer credit ratings.
- The negative outlook reflects weakened short-term earnings prospects and asset-quality risks.

Rating Action

As announced on Aril 23, 2020, S&P Global Ratings revised its outlook on Van Lanschot Kempen Wealth Management NV (VLKWM) to negative from stable. At the same time, we affirmed our 'BBB+/A-2' long- and short-term issuer credit ratings.

Rationale

The rating action on April 23, 2020, follows a review of several Western European banking sectors, under which we revised our economic risk trend for the Dutch banking sector to negative from stable (see "Negative Rating Actions Taken On Multiple Benelux Banks On Deepening COVID-19 Downside Risks" published on RatingsDirect). The revision of our outlook on VLKWM to negative from stable reflects market and economic stress prompted by the COVID-19 pandemic. We expect that the company's profitability will weaken in the coming quarters, owing to the combination of lower fee income because of lower assets under management (AuM), weaker merchant banking activity, and potential credit losses on its legacy lending book.

In addition to the human cost, the pandemic has caused large parts of global economic activity to grind to a halt, and markets valuations to fall significantly. With isolation strategies still very much in force, we expect a sharp economic contraction in 2020, with a forecast 7.3% GDP decline in the eurozone (see "COVID-19 Deals A Larger, Longer Hit To Global GDP," published April 16, 2020). We project a rebound in 2021 but risks will likely persist, and the effects of COVID-19 will be evident long after the crisis subsides.

We have affirmed the ratings on VLKWM because we believe the bank is on the right path toward delivering its strategic objectives and transitioning into a pure wealth manager. The economic weakness and market volatility caused by the pandemic could slow down the realization of strategic objectives. Of note, efficiency programs started to deliver promising results in 2019 with cost to income improving to 75% from the 80%-85% seen in previous years. We also view positively the continuous de-risking of the legacy corporate loan portfolio, and the group's strong capitalization, with a risk-adjusted capital (RAC) ratio before diversification expected to remain above 10% in the next 24 months.

Nevertheless, we expect VLKWM's earnings prospect will be seriously subdued this year, and the pace of recovery remains uncertain as it will partially depend on market valuations. This is because a large part of fee income is based on AuM levels. In addition, with little to no corporate activity in Europe currently, VLKWM's merchant banking activity revenue could also be severely hit. As a private bank and asset manager group focusing on off-balance sheet activities, we consider VLKWM to be better positioned than traditional banks in the Netherlands regarding potential credit losses. However, we still anticipate additional impairments on its legacy corporate lending book. All combined, we expect VLKWM's profitability to fall significantly in 2020 despite some cost flexibility, before gradually recovering in the coming years, but downside risks remain in these projections.

Outlook

The negative outlook on VLKWM primarily reflects our expectation of a deterioration in profitability in 2020, especially due to heightened risk to revenue generation capacity.

Downside scenario

We would take a negative rating action if the bank cannot restore its profitability in the medium term, after likely lows in 2020. Specifically, this would mean not being able to return cost to income to 80%-85% in 2021, and below 80% afterward. This would signal that the crisis is longer and deeper than currently expected, with durably lower interest and fee income. We could also downgrade VLKWM if the RAC ratio falls below 10% on a sustained basis--for example, because of much higher losses than expected in the legacy loan portfolio, or a departure from a relatively conservative capital policy.

Upside scenario

We could revise the outlook to stable if, despite difficult market and economic conditions, VLKWM demonstrates profitability in line with local and international private banking peers in 2021 and beyond, and its franchise in asset-gathering businesses remains intact.

Ratings Score Snapshot

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

Related Criteria

- General Criteria: Hybrid Capital: Methodology And Assumptions, July 1, 2019
- General Criteria: Group Rating Methodology, July 1, 2019
- 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
- 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

- Negative Rating Actions Taken On Multiple Benelux Banks On Deepening COVID-19 Downside Risks, April 23, 2020
- Negative Rating Actions Taken On Various French Banks On Deepening COVID-19 Downside Risks, April 23, 2020
- Europe’s AT1 Market Faces The COVID-19 Test: Bend, Not Break, April 22, 2020

- How COVID-19 Is Affecting Bank Ratings, April 22, 2020
- Europe Braces For A Deeper Recession In 2020, April 20, 2020
- European Banks' First-Quarter Results: Many COVID-19 Questions, Few Conclusive Answers, April 1, 2020
- COVID-19: The Steepening Cost To The Eurozone And U.K. Economies, March 26, 2020
- COVID-19 Countermeasures May Contain Damage To Europe's Financial Institutions For Now, March 13, 2020
- The Coronavirus Will Shave 50 Basis Points Off Eurozone Growth, March 4, 2020
- Van Lanschot N.V., Sept. 26, 2019

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. A description of each of S&P Global Ratings' rating categories is contained in "S&P Global Ratings Definitions" at https://www.standardandpoors.com/en_US/web/guest/article/-/view/sourceId/504352 Complete ratings information is available to subscribers of RatingsDirect at www.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column. Alternatively, call one of the following S&P Global Ratings numbers: Client Support Europe (44) 20-7176-7176; London Press Office (44) 20-7176-3605; Paris (33) 1-4420-6708; Frankfurt (49) 69-33-999-225; Stockholm (46) 8-440-5914; or Moscow 7 (495) 783-4009.