

Non paper Dutch ministry of Finance about the situation of SNS Reaal

Executive summary¹

SNS Reaal is a financial services provider located in the Netherlands, consisting of subsidiary SNS Bank (the fourth largest bank in the Netherlands) and subsidiary Reaal (the second-largest life-insurer (Reaal Leven and Zwitserleven) and the fifth-largest non-life insurer (Reaal Schade) in the Netherlands). SNS Bank, Reaal and SNS Reaal face several problems. The main problem is SNS Bank's relatively large property finance portfolio and (the uncertainty around) the level of upcoming impairments on this portfolio. The ratio between SNS Bank's balance sheet total and its property finance portfolio (approximately 10%) is large compared to its competitors. Moreover, SNS Bank faces substantial refinancing obligations in the near future. Reaal also faces problems, e.g. the uncertainty whether the endowment provisions will be sufficient. Given the problems of SNS Bank and Reaal and the limited capacity of SNS Reaal to generate earnings in the current macro-economic circumstances, it is very unlikely that the holding company SNS Reaal will be able to raise the necessary funds on the financial markets to refinance its double leverage (due March 2013) and to repay the support received from the Dutch State (due at the end of 2013). Moreover, DNB has indicated that it is not likely to grant approval for further internal funding through SNS Bank or Reaal.

The aforementioned deadlines of SNS Reaal are approaching, which make the situation more and more urgent. Moreover, DNB has indicated that it likely has to be explicit in its January 2013 SREP analysis about the fact that SNS Bank cannot autonomously raise sufficient capital, which could trigger a crisis situation. A scenario analysis has taught the ministry of finance that a default scenario should be avoided, because it would pose unacceptably high risks to the Dutch financial system. A situation where nationalisation would be necessary should preferably be avoided, considering the large budgetary impact it would have on the Dutch State.

Therefore, a scenario is currently explored in which the Dutch State and the private sector (the three largest Dutch banks) cooperate to pre-emptively stabilize the situation regarding SNS Reaal. In this public-private scenario the uncertainties regarding the property finance portfolio would be addressed and SNS Reaal's capital would be strengthened and restructured. In our view, the public-private scenario provides the opportunity to stabilize the situation regarding SNS Reaal through a significant level of private sector involvement, thereby minimizing the budgetary impact on the Dutch State. A possible divestiture of Reaal and the run-down of SNS Bank's property finance portfolio would mean that SNS Reaal withdraws from these markets, hence making these market positions available for competitors. A viable competitor to the three largest Dutch banks would remain, which eventually could be exited through a private sale, an auction sale to a third-party or a re-IPO.

We would like to structure the public-private scenario in such way that it satisfies the criteria of the European Commission. For that reason, we are interested in the views of the European Commission regarding the questions raised in this non paper about an Asset Protection Scheme guarantee or bad bank structure, the conversion of the core tier 1 securities of the Dutch State, and ABN AMRO's and ING's acquisition bans.

¹ Please note that this non paper of the Dutch ministry of Finance does not present any formal position. SNS Reaal has not been involved in writing this non paper and has not provided any view whether it considers the scenarios set out in this paper realistic or feasible.

1. Current situation

This chapter describes the current situation of SNS Bank, Reaal and SNS Reaal.

1.1 General

SNS Reaal is a financial services provider located in the Netherlands, consisting of subsidiary SNS Bank (the fourth largest bank in the Netherlands) and subsidiary Reaal (the second largest life-insurer (Reaal Leven and Zwitserleven) and the fifth largest non-life insurer (Reaal Schade) in the Netherlands). The consolidated balance sheet of SNS Reaal totalled approximately €134 billion as per half year 2012.

SNS Bank is the fourth largest bank in the Netherlands, with a consolidated balance sheet total of €83 billion as per half year 2012. Next to its own banking operations, SNS Bank is the holding company of RegioBank, ASN Bank, SNS Securities and SNS Property Finance (the latter being the legal entity comprising both the international and the Dutch portfolio of real estate loans²). Given the size of its operations, DNB has categorised SNS Bank as a 'domestic systemically important financial institution'. SNS Bank has approximately 1 million account holders, representing around €35,5 billion of deposits. About €32 billion is guaranteed by the Deposit Guarantee System ("DGS").

Reaal, in which all insurance activities are combined, is the third largest life-insurer in the Netherlands. The consolidated balance sheet total of Reaal was approximately €55 billion as per half year 2012. Reaal uses, among other brand names, the brand name Zwitserleven. Reaal has approximately 6 million policyholders.

The share capital of SNS Reaal consists of ordinary shares (a majority of which is held by the Stichting Beheer SNS Reaal ("Foundation")) and B shares (€600 million, 100% of which is owned by the Foundation). In addition, in 2008 the Dutch State (€750 million) and the Foundation (€500 million) bought core tier 1 securities issued by SNS Reaal in order to strengthen the capital position of SNS Reaal. In November 2009, SNS Reaal paid back €185 million to the Dutch State and €65 million to the Foundation. SNS Reaal has committed itself to repay the outstanding amount of support from the Dutch State including a premium of 50% (€848 million in total) by year end 2013.

In October 2008, the Dutch State introduced a credit guarantee scheme of €200 billion for the issuance of medium term debt instruments by banks. SNS Bank has applied for several guarantees and these guarantees have been granted. An amount of approximately €5.7 billion has been assigned to SNS Bank, of which an amount of around €2.75 billion is still outstanding, which is due for repayment in 2014.

The following paragraphs elaborate on the problems of SNS Bank and Reaal, and the implications of these problems on SNS Reaal's ability to (re)finance itself.

1.2 Current situation of SNS Bank

The main problems of SNS Bank have their root cause in (the uncertainty around) the level of upcoming impairments on its property finance portfolio. In addition, SNS Bank faces substantial refinancing obligations in the near future.

² Please note that in its financial disclosures, SNS reserves the name "Property Finance" for that part of the real estate portfolio that in 2009 has been put in run-off/earmarked as 'non-core', i.e. all project development loans, all international loans and those Dutch property loans that were in default at the time of the separation. The legal entity Property Finance BV contains both the non-core and the – up till now – core part of the property portfolio. The decision to put the core portfolio in run-off too has been taken recently, however this has yet to be disclosed publically.

For the first half of 2012, SNS Bank reported a net loss of €53 million (first half year 2011: net profit of €8 million). SNS Retail Bank (the business unit focussing on retail customers) posted a lower net profit of €75 million (-18%) due to higher loan impairments and lower commission income. SNS SME (the business unit focussing on small and medium enterprises ("SME"), but also containing the core part of the property finance portfolio) posted a limited net profit of €3 million compared to €34 million for the first half of 2011. This decrease was driven by a lower total income (-23%) and higher impairments. The net loss of SNS Property Finance (i.e. the non-core part of the portfolio) increased markedly: a net loss of €131 million compared to a net loss of €118 million over the same period in 2011.

The ratio between SNS Bank's balance sheet total and its property finance portfolio (approximately 10%) is large compared to its competitors. As can be seen from the table below, the size of the property finance portfolio (both core and non-core) has been reduced in recent years. Despite the reduction in the size of its portfolio, SNS Bank still has a sizable exposure to the commercial real estate market. Deterioration of the domestic and international commercial real estate markets over the last few years and disposals of large numbers of loans, have led to substantial losses on the property finance portfolio of SNS Bank. The entire property finance portfolio is being put in run-down³ in order to reduce the risk profile of SNS Bank.

Data per year end						
Property Finance	2007	2008	2009	2010	2011	31 aug. 2012
Credit exposure	11.637	13.681	13.435	12.128	9.412	8.141
of which international			3.558	2.573	2.262	1.969
RWA	11.912	14.613	14.238	12.283	9.660	7.955
provisions	62	98	239	739	674	782

Early 2012, DNB established (on the basis of 2011 financial information) that given the expected losses in the property finance portfolio, SNS Bank has a capital shortfall of €850 million.⁴ In the spring of 2012, DNB concluded that SNS Bank will need even more additional capital in order to realise the necessary reduction of the property finance portfolio. This is because the developments in the Dutch commercial real estate market are likely to result in a continuing high level of losses on the property finance portfolio. Those losses will put pressure on the current and future profitability of SNS Bank.

Despite the developments mentioned above, the core tier 1 ratio for SNS Bank improved in the first half of 2012 to 9.6% (year end 2011: 9.2%). This improvement was mainly due to the ongoing decline in risk-weighted assets, driven by the decline of commitments at SNS Property Finance, and due to a capital downstream of €63 million from SNS Reaal into SNS Bank. The deterioration of the domestic commercial real estate market will likely result in increasingly high impairments on SNS Bank's property finance portfolio, which will negatively impact the capital position of SNS Bank in the coming quarters.

Given the size of the available liquidity buffer (€11 billion) it is unlikely that SNS Bank will not be able to meet its short term liabilities. However, it should be kept in mind that the size of the liquidity buffer is increased by the use of the ECB LTRO facility. In 2014 around €2.75 billion of government guaranteed bonds have to be redeemed next to €5 billion drawn under the ECB LTRO. Before that time, SNS Bank will have to refinance these amounts. Unless its capital levels and reputation in the market improve substantially, it is hard to see how the company would be able to do so.

³ The decision to put the core portfolio in run-off too has been taken recently, however this has yet to be disclosed publicly.

⁴ This capital shortfall reflects the actual capital that SNS Bank needs to buffer future adverse events. It is unrelated to regulatory minimum capital requirements (which are still met by SNS Bank).

1.3 Current situation of Reaal

In general, Reaal has been performing relatively well in recent years. SNS Reaal has used profits generated by Reaal to absorb the losses on the property finance portfolio. In the first half year of 2012 Reaal reported total net profits of €216 million, of which €164 million relate to the individual life business conducted under the Reaal brand, and €52 million to the collective life and pension business of Zwitserleven. The regulatory solvency of Reaal slightly decreased from 203% at year end 2011 to 199% at half year 2012.

The main problems of Reaal are related to certain investment based insurance policies which many Dutch insurers have sold – at a large scale – in the past at very high cost (endowments also referred to as “woekerpolissen”). It has become clear that many insurers have charged policyholders excessive costs for which these policyholders are now partially being compensated. In November 2011, the ministry of Finance evaluated six major insurers on how they have dealt with the woekerpolissen issue and identified ‘best-in-class’ settlement practices. SNS Reaal has indicated it will adjust its compensation practices in order to comply with those practices. SNS Reaal’s business plan for 2012-2014 assumes additional woekerpolissen provisions of approximately €100 million (on top of an amount of approximately €300 million which has already been paid out to policyholders). However, it is unclear whether this is sufficient to fully cover potential additional losses arising from woekerpolissen since there are still legal cases pending. That being said, more and more court cases are decided in favour of insurers, making it increasingly likely that no significant additional provisions need to be taken.

Due to the upheaval around the woekerpolissen the reputation of the individual life insurance sector in the Netherlands has been damaged. The woekerpolissen issue comes on top of the already limited prospects for the individual life insurance sector in the Netherlands. The life insurance sector suffers from fierce competition by the banking sector due to changes in tax legislation allowing banks to enter the market for long term pension plans (“banksparen”). As a result, the profitability of the Dutch life insurance sector is likely to decrease further going forward and in DNB’s view a consolidation in this sector is inevitable.

1.4 Current situation of SNS Reaal (group activities)

SNS Reaal has raised debt, which it has subsequently down-streamed as equity capital into its operating companies SNS Bank and Reaal.⁵ This so-called “double leverage” is a key problem of SNS Reaal.

The rationale behind double leverage is the assumption that the required amount of capital for a bancassurance group, is smaller than the sum of the stand-alone capital requirements for the bank and insurer. This is due to the implied diversification between both lines of business. During the current crisis, not only banks have suffered high losses on their assets (due to impairments) but also insurers have seen their assets decline in value (due to historically low interest rates). Therefore, during times in which the company faces significant headwinds in both lines of business, its double leverage turns into an additional burden. Where double leverage in the past was generally accepted, mainly because of the above mentioned, investors and regulators nowadays consider the use of double leverage in financial conglomerates as adding risk to the profile of a company.

Due to doubts regarding the capital position of SNS Reaal and the sequence of credit rating downgrades, it is very difficult for SNS Reaal to (re)finance itself in the market. This has more or less forced SNS Reaal to resort to SNS Bank and Reaal for its funding. This in turn has led to further entanglement of SNS Reaal as a whole (through an increase in intra-group positions). It

⁵ Per half year 2012 the amount of double leverage of SNS Reaal was €850 million, the double leverage ratio was 117.7% (year end 2011: 115.1%).

thereby weakened the position of the policy and deposit holders in the regulated entities as they – in fact – are funding part of the equity that is meant precisely for their protection. In March 2013, €550 million of external debt (which has funded part of the double leverage) becomes due. In this respect it is unlikely that SNS Reaal will be able to refinance the aforementioned €550 million in the market and will probably have to resort (again) to SNS Bank and Reaal to provide these funds. DNB has indicated it is not likely to grant regulatory approval to SNS Bank or Reaal for providing the funds needed to refinance the double leverage.

The problems of SNS Bank and Reaal and the limited capacity of SNS Reaal to generate earnings in the current macro-economic circumstances (commercial real estate, low interest environment), raise doubts whether SNS Reaal will be able to repay the outstanding amount of the support received from the Dutch State by year end 2013 (€848 million in total, including a 50% redemption premium.⁶). Besides that, market participants and the press have started to speculate about the strategic steps that SNS Reaal will have to take in order to meet this repayment deadline. According to SNS Reaal's financial report of midyear 2012, the company has started to explore a broad range of scenarios for both strategic restructuring and the enhancement and simplification of its capital base. The strategic restructuring scenarios could involve the sale of parts of its business activities.

1.5 Urgency of the situation

As mentioned above, SNS Reaal's deadlines to refinance its obligations are approaching, which makes the situation more and more urgent. Moreover, DNB has indicated that in its next Supervisory Review and Evaluation Process (SREP) analysis, that is due in January 2013, it likely has to be explicit about the fact that SNS Bank cannot autonomously raise sufficient capital to overcome the capital shortage.⁷ According to DNB, this will likely result in a crisis situation with a high risk of depositors withdrawing their savings in a short period of time. It is of importance that such a situation is avoided, considering the impact it would have on SNS Reaal's customers, the stability of the Dutch financial system and the Dutch economy as a whole.

1.6 Conclusion

The main problem of SNS Bank is its relatively large property finance portfolio and (the uncertainty around) the level of upcoming impairments on this portfolio. Moreover, it faces substantial refinancing obligations in the near future. Reaal faces uncertainty whether the endowment provisions will be sufficient, which comes on top of limited prospects for the life insurance sector in the Netherlands. SNS Reaal has to refinance a large part of its double leverage by March 2013 and it also has to repay its outstanding amount of support received from the Dutch State by the end of 2013. Given the problems of SNS Bank and Reaal and the limited capacity of SNS Reaal to generate earnings in the current macro-economic circumstances, it is very unlikely that SNS Reaal will be able to raise the necessary funds on the financial markets. Moreover, DNB has indicated that it is not likely to grant approval for further internal funding through SNS Bank or Reaal.

SNS Reaal's deadlines to refinance its obligations are approaching, which makes the situation more and more urgent. Moreover, DNB has indicated that it likely has to be explicit in its next SREP

⁶ The capital injection by the Dutch State of 2008 was approved as rescue aid by the European Commission under the condition that the Dutch State would renotify in case no dividend was paid out for a period of two consecutive years. This was the case in 2011 and the Dutch State carried out the renotification to the Commission in December 2011. The renotification was accompanied by the first monitoring report of SNS Reaal (for the period January 2010 / January 2011) which included an amended repayment schedule and a commitments letter stating specific contingency measures.

⁷ The SREP analysis is one of the key processes in the supervisory cycle. DNB is obliged to perform a SREP analysis at least every year. Under this heading 'Basel' and the EU Capital Requirement Directives require supervisors to holistically assess the capital position of banks, taking into account their current and future risk profile.

analysis about the fact that SNS Bank cannot autonomously raise sufficient capital, which could trigger a crisis situation.

2. Scenario analysis

2.1 Introduction

Despite SNS Reaal's reasonable performance, capital ratios and liquidity position, the developments over the period 2009-2012 have led to a precarious situation at SNS Reaal which is untenable according to DNB. DNB has indicated that this situation cannot be turned around without substantial help from external parties.

At DNB's request, the ministry of Finance and DNB have set up a project team in December 2011 in order to analyse several conceptual scenarios for SNS Reaal. A range of conceptual scenarios has been analysed, varying from a default to a wide range of private and public scenarios and combinations thereof.

To assess the consequences of the scenarios the ministry of Finance has used the following criteria:

- Safeguarding financial stability: Does the scenario safeguard the stability of the financial system?
- Minimizing budgetary impact on the Dutch State: What are the immediate and future costs and risks to the Dutch State? Does the Dutch State only absorb the downside risk, or does it also share in the upside potential?
- Maximizing private sector involvement: In what way and to what extent is the private sector involved?
- Maximizing burden sharing by existing financiers: In what way and to what extent are the existing financiers involved?
- Sustainability: Is the scenario sustainable? Does the scenario provide for an orderly exit by the private sector or the Dutch State?
- Proportionality: Is the scenario proportional to the problem? Are the incentives of parties involved rightly aligned?

2.2 Default

Assessment

- Highly detrimental to financial stability
- Large budgetary impact on the Dutch State
- High burden sharing by existing financiers

A default of SNS Reaal will most likely be caused by SNS Reaal's inability to pay its creditors or a default of subsidiary SNS Bank. A default of SNS Bank will not only be detrimental to SNS Reaal, but also to the subsidiaries of SNS Bank, especially ASN Bank and Regiobank that are fully financially and operationally integrated with SNS Bank.

A default of SNS Bank would have serious social consequences and therefore it has been categorized by DNB as a 'domestic systemically important financial institution'. In the event of a default of SNS Bank the DGS would come into effect. This means that DNB, as executor of the DGS, would have to pay out €32 billion of guaranteed deposits to approximately 1 million account holders. Mainly because of the large number of account holders and the large amount of deposits, several weeks would lapse before account holders would be paid out and would be able to access their deposits again.

DNB would have to divide the €32 billion among the other Dutch banks that participate in the DGS ("participants"). However, according to DNB, this amount would be too large to be immediately paid up by the participants (the own financial resources of the participants would not be sufficient and they would not be able to fund such amounts externally in such a short period of time). Because DNB is not allowed to lend the money for this extended period of time, the Dutch State would have to lend the money instead.

Assuming a recovery rate of 85%⁸, the DGS (and its participants) would suffer a loss of approximately €5 billion. According to DNB a loss of this magnitude is too large for the participants to bear and would directly undermine the viability of these participants.

A default of a financial institution of the size of SNS Reaal has never occurred in the Netherlands. Public confidence in the sector would likely get a substantial blow and large deposit withdrawals at other banks could not be excluded. For that reason it is not unlikely that a default of SNS Reaal would result in a loss of confidence in the entire Dutch financial system, the consequences of which could not be overseen.

A default of SNS Reaal, and the DGS coming into effect, would also lead to very considerable costs for the Dutch State. Being forced to lend the money for the DGS, the Dutch State would have to pay approximately €1.2 billion of interest charges. Besides, the Dutch State would also suffer a loss on its core tier 1 securities (€565 million face value, €283 million premium) and it would have to pay out on the State guaranteed bonds (approximately €400 million⁹). A default however results in maximum burden sharing by the existing financiers.

2.3 Private merger or acquisition

Assessment

- Safeguarding financial stability
- Small budgetary impact on the Dutch State
- High private sector involvement
- Sustainable, in case of merger with/acquisition by stable party
- Most likely unfeasible without involvement of the Dutch State

Through involvement of a stable private party financial stability would be safeguarded, while the budgetary impact on the Dutch State would be limited. Therefore a merger with or an acquisition by a stable private party is a preferred scenario. However, given SNS Reaal's weak financial position and the current negative market conditions, such a merger or acquisition is not very likely.

The ministry of Finance has learned from SNS Reaal that there is little domestic or foreign interest in acquiring SNS Reaal as a whole; apart from the question whether the prudential supervisor would be able to grant permission. This low level of interest was validated by the ministry's financial adviser. The companies that have shown preliminary interest did so on the condition that the uncertainties concerning the property finance portfolio would be taken away.

The same applies to subsidiary SNS Bank. Private parties will only be interested in a merger with or acquisition of SNS Bank if the uncertainties concerning the property finance portfolio would be taken away. Notwithstanding the problems of the property finance portfolio, it is understood from the ministry's financial adviser that interest in SNS Bank, especially foreign interest, will also most likely be low because of weak capital positions across the board and the general tendency to deleverage. Besides, even if SNS Bank could be sold, the divestment is to yield not nearly enough capital to simultaneously pay off the double leverage, repay the Dutch State and strengthen the capital position of the remaining insurer.

Insurance subsidiary Reaal has attracted preliminary domestic and foreign interest, albeit sometimes on the condition of a guarantee regarding the woekerpolissen issue. However, unofficial indicative offers of interested parties show that the double leverage and the split-up costs could probably be covered, but that little would remain to repay the Dutch State and capitalize the remaining bank.

⁸ DNB has stated that, apart from exceptions, the recovery rate in past bank bankruptcy cases in the Netherlands amounted 80-90% and that it is not likely that SNS Reaal would have such a recovery rate that the resulting loss can be borne by the participants of the DGS.

⁹ (1-recovery rate of 0.85) * 2,75 billion.

For the sake of completeness, we note that an alternative scenario is currently being explored whereby State owned company ASR would merge with or acquire SNS Reaal or a part thereof.

2.4 Capital injection by private sector and capital restructuring

Assessment

- Safeguarding financial stability
- Moderate budgetary impact on the Dutch State
- High private sector involvement
- Sustainable, but interest of private sector in competitor can be an issue
- Unfeasible without the involvement of the Dutch State

Currently the main problem is the level of and the uncertainties around the impairments on SNS Bank's property finance portfolio. DNB has considered that SNS Bank has a large capital shortfall, given the expected future losses on its property finance portfolio. SNS Reaal could issue new shares to overcome the shortfall. Additionally, to simplify SNS Reaal's current capital structure the core tier 1 securities held by the Dutch State and the Foundation as well as the B-shares held by the Foundation could be converted into ordinary shares. This seems to be a preferable scenario as it would likely safeguard financial stability and would have a moderate budgetary impact on the Dutch State.

However, given the weak financial position and low share price of the company, a regular equity offering to the general public would very likely not be successful. The three largest Dutch banks (ABN, ING, Rabobank) have expressed that, under conditions, they are willing to participate to stabilize the situation at SNS Reaal. This willingness can be explained by the fact that in case of a default of SNS Reaal the banking sector would likely suffer a loss of approximately €5 billion through the DGS. One of the conditions of the three largest Dutch banks is that the uncertainties around the property finance portfolio should be dealt with. In addition to the three largest Dutch banks, a private investor has indicated to SNS Reaal its interest in the company, however also under the condition that the uncertainties around the property finance portfolio should be dealt with.

2.5 Asset/liability transfer

Assessment

- Detrimental to financial stability
- Large budgetary impact on the Dutch State
- Private sector involvement
- High burden sharing by existing financiers
- Operationally highly complex

Recently the Dutch Intervention Act has come into force. This Act gives DNB the authority to prepare a plan to transfer deposits, other liabilities or assets, or shares of a bank or insurer to a private third party or bridge institution in case of irreversible financial problems at the institution. It also provides the possibility to use resources of the DGS to enable a transfer of deposits, up to the amount otherwise paid out under the DGS. In theory, this makes it possible to transfer deposits and consequently grant deposit holders (almost) continuous access to their accounts, hence safeguarding this aspect of financial stability.

Although the Dutch Intervention Act provides this possibility, it could not be applied in this situation. Given the number of deposit holders, approximately 1 million, and the size of the guaranteed deposits, €32 billion, it would make it operationally very challenging to transfer the deposits to a third party. It could not be ruled out that a large number of account holders would not be able to access their accounts for a significant period of time.

In addition, the financial impact would be similar to a default scenario. In case only the deposits would be transferred, it is still highly likely that the Dutch State would have to lend the money to the DGS, resulting in approximately €1.2 billion of interest charges, and the participants of the DGS would suffer a loss of approximately €5 billion. In case deposits and an amount of mortgages are transferred, the Dutch State would not have to lend the money to the DGS, but the participants of the DGS would still suffer a loss of approximately €5 billion. According to DNB a loss of this magnitude is too large for the participants to bear.

Also similar to a default scenario, the Dutch State would suffer a loss on its core tier 1 securities (€565 million face value, €283 million premium) and it will have to pay out on the State guaranteed bonds (approximately €400 million¹⁰).

2.6 Nationalisation

Assessment

- Safeguarding financial stability
- Large budgetary impact on the Dutch State
- No private sector involvement
- Moderate burden sharing by existing financiers
- Sustainable; potential negative impact on competition

The Dutch Intervention Act also provides for the authority of the minister of Finance to expropriate assets and liabilities of or securities issued by a financial institution. The minister is allowed to use the authority only in case there is a serious and immediate threat to financial stability. However, this criterion is currently not met, which means that this scenario will only be an option if the financial situation of SNS Reaal worsens (e.g. there is (danger of) a bank run). This scenario can be perceived as a fall-back scenario.

Even if it would be necessary for the minister to expropriate SNS Reaal to safeguard financial stability, the financial problems of the company would still have to be addressed after the expropriation. Since the Dutch State would then be the sole owner, it would have to solve SNS Bank's capital shortage, Reaal's woekerpolissen issue, and SNS Reaal's double leverage. This would have a large budgetary impact on the Dutch State.

2.7 Conclusion

The analysis of conceptual scenarios using the assessment criteria financial stability, burden sharing, sustainability and proportionality, has taught the ministry of Finance the following:

- A default scenario poses unacceptably high risks with an eye to the stability of the Dutch financial system;
- The ongoing losses on the property finance portfolio are an impediment to a private sector solution;
- There are unlikely to be potential buyers for SNS Bank, given that potential buyers, mainly foreign banks, face capital shortages and are under pressure to deleverage;
- There are probably sufficient potential buyers for Reaal, however the sale price will likely be insufficient to properly capitalize the remaining bank;
- Nationalisation on the basis of the Dutch Intervention Act is only possible in case of a serious and immediate threat to financial stability. This criterion is currently not met. In case the criterion is met nationalisation seems inevitable, although it would have an impact on the stability of and confidence in the Dutch financial system.

A default scenario should be avoided, because it would pose unacceptably high risks to the Dutch financial system. A situation where nationalisation would be necessary should preferably be

¹⁰ (1-recovery rate of 0.85) * 2,75 billion.

avoided, considering the large budgetary impact it would have on the Dutch State. Therefore currently options are explored to pre-emptively stabilize the situation regarding SNS Reaal, among which a scenario in which the Dutch State and the private sector (the three largest Dutch banks) cooperate to stabilize the situation regarding SNS Reaal. This scenario, explained in more detail in Chapter 3, could safeguard financial stability, effectuate a high level of burden sharing and limit the budgetary impact on the Dutch State.

3. Public-private scenario

3.1. Components of the public-private scenario

Currently a public-private scenario is explored to pre-emptively stabilize the situation regarding SNS Reaal. The scenario consists of several building blocks that follow from the scenario analysis as set out in Chapter 2.

The public-private scenario that is currently explored, consists of three elements:

1. De-risking and ring fencing of SNS Bank's property finance portfolio;
2. Recapitalization of SNS Reaal or SNS Bank;
3. Restructuring of SNS Reaal's capital structure.

Burden sharing

An important assessment criterion is the budgetary impact on the Dutch State. This criterion is closely linked to the criteria concerning the burden sharing by existing financiers and the involvement of the private sector. A high level of private participation would lower the budgetary impact on the Dutch State, and vice versa. It is our belief that the public-private scenario provides the opportunity to let the existing financiers and the private sector bear a significant part of the burden.

Due to the level and uncertainty of future impairments on SNS Bank's property finance portfolio, SNS Bank has to strengthen its capital position. Since SNS Bank's profits from its retail and SME business units are not high enough to strengthen the capital position, SNS Bank or SNS Reaal has to attract fresh capital. As mentioned before, it is very unlikely that SNS Reaal will be able to raise this capital externally from the financial markets. The three largest Dutch banks (ABN, ING, Rabobank) have expressed that under conditions they are prepared to participate in order to stabilize the situation regarding SNS Reaal. Any unexpected losses – the so-called remaining tail risk – could be addressed through an Asset Protection Scheme guarantee ("APS") or a bad bank structure. The private sector could be involved in both the recapitalization and the APS or bad bank structure. The recapitalization will result in a significant dilution of the current shareholders of SNS Reaal. The current majority shareholder, the Foundation, would only be left with a small stake in the company. Besides, the Foundation's core tier 1 securities and B shares would practically become worthless.

Competition

In Chapter 2 it has been indicated that there is initial interest in Reaal. However, unofficial indicative offers of interested parties show that the double leverage and the split-up costs could probably be covered, but that little would remain to repay the Dutch State and capitalize the remaining bank. It could nevertheless be sensible to divest Reaal (upfront or over time). The problems of Reaal (i.e. the woekerpolissen issue and the limited prospects for the life insurance sector) would no longer be responsibility of the parties involved when Reaal would be divested. Moreover, the exposure of the Dutch State to the Dutch insurance sector would stay limited. At the same time, a divestiture of Reaal would mean that SNS Reaal withdraws from the insurance market, hence making this market position available to competitors. Furthermore, the run-down of SNS Bank's entire property finance portfolio means that this market position becomes available to competitors.

Viability

If the public-private scenario would be realized, the situation regarding SNS Reaal would be stabilized and as a result the Dutch financial system as a whole would be safeguarded. A viable lean and mean retail bank with a sizable Dutch mortgage portfolio would remain, which would preserve an important competitor to the three largest Dutch banks. Once SNS Reaal would be stabilized and the financial markets have normalized, an exit for the parties involved should be

effectuated. A capital restructuring could be helpful in this respect. According to us, in this way a sustainable solution is achieved.

The next paragraphs provide more detailed information about the elements of the public-private scenario.

3.2 De-risking and ring fencing property finance portfolio

The de-risking and ring fencing of SNS Bank's property finance portfolio could be done by way of an APS or a bad bank structure. Both options are currently analyzed in more depth.

APS

The basic principle of an APS is that a first loss piece (equal to the conservatively estimated expected loss on the property finance portfolio) remains with the company, i.e. SNS Reaal. Potential losses beyond this point (the so-called attachment point) could be (partly) guaranteed by the Dutch State, in exchange for a fee paid by SNS Reaal. This remaining tail risk could be divided between the Dutch State and SNS Reaal in order to align the interests of SNS Reaal with those of the Dutch State (e.g. 80% for the Dutch State and 20% for SNS Reaal). The ministry of Finance is aware of the Impaired Assets Communication and the Commission's decisional practice regarding this subject.

A capital injection upfront would be required to buffer future property finance losses that remain for the account of the company (the first loss piece). This capital injection could be provided by the private sector (i.e. the three largest Dutch banks) and/or the Dutch State. In case of an APS the property finance portfolio remains on the balance sheet of SNS Bank and continues to be managed and funded by SNS Bank. Due to losses on property finance, SNS Bank and consequently SNS Reaal might show losses for at least 2 to 5 years. This could dissuade private parties from investing in the company, which might be a complicating factor in an exit.

Bad bank structure

The basic principle of a bad bank structure would be that the property finance portfolio is sold at a discount (equal to the conservatively estimated expected loss on the property finance portfolio) to a separate entity. The ministry of Finance is aware of the Commission's decisional practice regarding bad bank structures.

The sale of the property finance portfolio would translate into an immediate loss on the balance sheet of SNS Bank, which would need to be mitigated by a capital injection. This capital injection could be provided by the private sector (i.e. the three largest Dutch banks) and/or the Dutch State. The larger the devaluation of the property finance portfolio, the higher the capital injection required in SNS Reaal or SNS Bank. In case both the private sector and the Dutch State equally contribute to the bad bank and to SNS Reaal or SNS Bank (which is an option under consideration), the interests of the private sector and the Dutch State are aligned with respect to the valuation of the property finance portfolio.

The required funding for the bad bank could be provided by SNS Bank, the Dutch State and/or the private sector. The Dutch State and/or the private sector could provide a guarantee on a part of the tail risk in the bad bank in exchange for a guarantee fee. The proportions (the division among the capital injection in SNS Reaal or SNS Bank, the funding of the bad bank and the equity injection in the bad bank) have to be explored further. After the sale of the property finance portfolio to the bad bank, SNS Bank will have a "clean" financial profile, which is easier to communicate to stakeholders (clients, general public, rating agencies, debt investors, shareholders) and which will facilitate an exit.

Competition

SNS Bank achieved its highest market shares in property finance (ranging from 10 to 30%)¹¹ before it started to run-down parts of this portfolio in 2010. SNS Bank has recently decided to put the core part of its property finance portfolio in run-down too. From a competition perspective, this means that SNS Bank's market position in property finance becomes available to its competitors.

Due diligence property finance portfolio

For both an APS and a bad bank structure an assessment of the property finance portfolio is needed. An expert has recently been commissioned by SNS Reaal to carry out an assessment of property finance, assuming an 'orderly run-down'. The report is expected to be finalized by the end of October 2012. The ministry of Finance has nearly commissioned its own independent expert, who at short notice will start reviewing the work of the expert retained by SNS Reaal, to perform an independent analysis and to run different scenarios. As has recently been indicated, the ministry of Finance will liaise with the European Commission about the methodology and the scenarios that have to be used by the independent expert in assessing the value of the property finance portfolio.

Question

The de-risking and ring fencing of SNS Bank's property finance portfolio could be done by way of an APS or a bad bank structure. Although both options have their own characteristics, in principle the ministry of Finance has not yet formed a view regarding the relative attractiveness of one over the other. Does the European Commission have particular considerations in mind regarding a choice between the two options?

3.3 Recapitalization of SNS Reaal or SNS Bank and the restructuring of SNS Reaal's capital

In our view there is scope to effectuate a significant level of burden sharing. It is our intention to significantly dilute existing shareholders (including the Foundation). This could be done by the recapitalization of SNS Reaal or SNS Bank by way of a capital injection by the private sector. Additionally, the core tier 1 securities and the B shares of the Foundation and the core tier 1 securities of the Dutch State could be converted into ordinary shares.

It should be avoided that the private sector would benefit too much from their involvement. However, the level of private sector involvement should not be that sizable that it would harm the repayment obligations of two of the three largest banks to the Dutch State or threaten the viability of the three largest banks. Additionally, some scope is likely to exist to impose burden sharing on holders of subordinated debt instruments (for example through liability management exercises). The extent to which this is possible, is a factor of the exact terms of the loans (which is being assessed at the moment).

Governance is an important consideration, given the mandatory offer requirements and the participation of the three largest Dutch banks. It is our intention to limit the control that the private sector would have over SNS Reaal in order to avoid triggering the mandatory offering requirements and to confine the involvement of the three largest Dutch banks in the day-to-day business of SNS Reaal. This could for example be done by issuing shares to the private sector with limited voting rights in the general meeting of shareholders. Furthermore, adequate safeguards will need to be put in place in order to prevent any exchange of commercially sensitive information among the parties involved in the public-private scenario.

The ministry of Finance is of opinion that the divestiture of Reaal upfront or over time could be one of the building blocks of the public-private scenario. The problems of Reaal (i.e. the woekerpolissen issue and the limited prospects for the life insurance sector) would no longer be responsibility of the parties involved when Reaal would be divested. Moreover, the exposure of the Dutch State to the Dutch insurance sector would stay limited. At the same time, a divestiture of Reaal would mean

¹¹ Commission decision of 28 January 2010, Case N 371/2009 Viability plan SNS Reaal, para. 12.

that SNS Reaal withdraws from the insurance market, hence making this market position available for competitors. A divestiture of Reaal would mean that SNS Reaal withdraws from the life insurance sector, a sector where it achieves its highest market shares (ranging from 10 to 20%). The three largest banks have also indicated that they prefer an option in which Reaal would be divested.

The Dutch authorities are aware of the fact that the European Commission imposed acquisition bans on two of the three largest Dutch banks. Those acquisition bans might be an obstacle for the success of the public-private scenario, because the acquisition bans prohibit the two Dutch banks to make certain acquisitions for a limited period of time. For both banks the Commission has indicated in its decisions that in exceptional cases it can approve derogation of the acquisition bans. Compared to a "normal" acquisition, the involvement of the private sector in the public-private scenario has distinguishing characteristics. First, this involvement would not be pursued out of ordinary commercial reasons. Rather, the objective would be to ensure an adequate level of private sector involvement to stabilize the situation regarding SNS Reaal (in order to safeguard the stability of the Dutch financial system). The intention is not to increase the market position of the three largest Dutch banks. Second, it is our intention to minimize the control that the private sector would have over SNS Reaal. Third, once the market circumstances have normalized again, an exit for the parties involved in the public-private scenario should be effectuated, hence the private sector involvement is temporary.

Questions

The ministry of Finance would welcome an exchange of views with the European Commission on the following:

- Under what conditions would a conversion of the core tier 1 securities of the Dutch State into ordinary shares of SNS Reaal be permitted?
- The acquisition bans of two of the three largest Dutch banks might be an obstacle for the success of the public-private scenario. Under what conditions would the European Commission be willing to grant derogation from those acquisition bans?

3.4 Future viability and exit

Future viability

In case the public-private scenario as set out above would be realized, a bank with the following characteristics would remain:

- **Lean and mean:** The business model would be non-complex and focussed, in short: retail banking and mortgages for private and SME customers. There is clearly a business case for a bank with such a profile. A part of the potential clients may well prefer dealing with a smaller bank, with a more local and accessible image and feel than the three largest Dutch banks. Moreover, the bank has a number of strong brands which enables it to target specific client groups.¹²
- **Efficient:** From an operational perspective, the bank is well positioned since it has one of the highest efficiency ratio's in the sector due to the fact that its different brands make use of one single IT-platform and a single back office.
- **Properly capitalized and access to capital markets:** After the recapitalization and capital restructuring, the bank would comply with applicable regulatory requirements. From a funding perspective, the size of SNS Bank should be able to access the capital markets (as for example Van Lanschot and Leaseplan currently are able to do as well).
- **Retaining competition:** From a competition perspective, remaining a competitor to the three largest Dutch banks is desirable. Without such a competitor, only the three largest Dutch banks and a number of small banks would remain on the retail banking market in the Netherlands. In

¹² For example, ASN Bank targets at clients conscious of sustainability and Regiobank targets at more traditional clients. The demand for alternative banking offerings has already been illustrated by emergence of new 'challenger banks' (Aegon initiative; NIBC renewed focus on retail banking).

this respect it may be relevant that a number of fringe players have left this market and there have hardly been any new entrants.

DNB is currently assessing the long-term viability of SNS Reaal (after restructuring) in more detail. The results (including quantitative analyses) will be shared with the European Commission as soon as they are available.

Exit

The purpose of the public-private scenario is to pre-emptively stabilize the situation regarding SNS Reaal in order to safeguard the stability of the Dutch financial system. Therefore the involvement of the Dutch State and the private sector (the three largest Dutch banks) should ideally be confined to this purpose. It is important that there is a possibility for the Dutch State and these private sector parties to 'exit' in an orderly manner once SNS Reaal is stabilised and the markets have normalized.

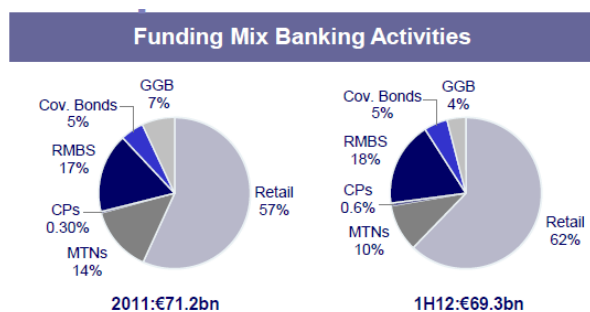
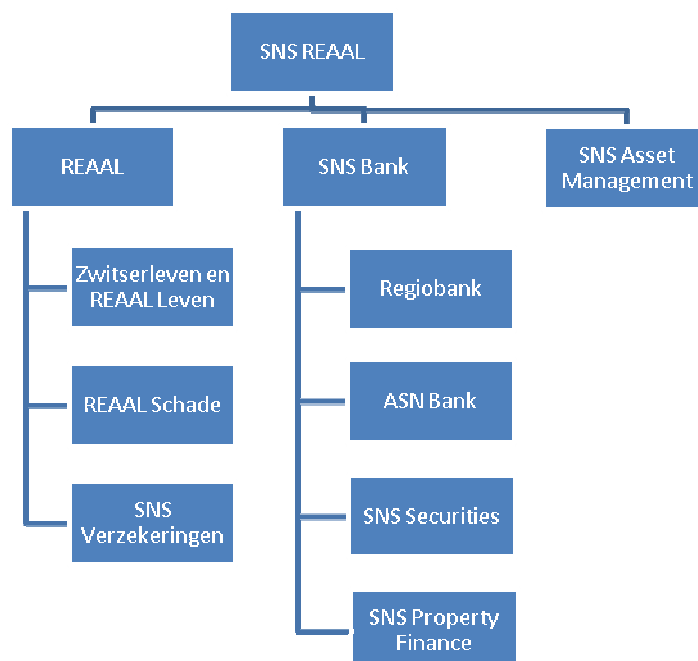
As has been indicated in paragraph 3.2, an APS might be a complicating factor in case of an exit. Due to the fact that no asset transfer will take place, SNS Reaal might continue to show losses for at least 2 to 5 years. This could dissuade private parties from investing in the company. With a bad bank structure the property finance portfolio would be sold at a discount to a separate entity. As a result the remaining bank would have a clean profile which might ease its equity story.

An exit could be effectuated as soon as the situation regarding the remaining bank is stable and the market circumstances allow for an exit. An exit could be effectuated through a private sale or an auction sale to a third-party (e.g. a foreign bank or a Dutch bank not yet active in retail banking). Another option would be a re-IPO. However, the appetite of equity investors for a re-IPO of SNS Reaal will likely be limited for the next few years. We would, however, like to stress that it is difficult to assess upfront which of these options would turn out to be the most feasible.

3.5 Conclusion

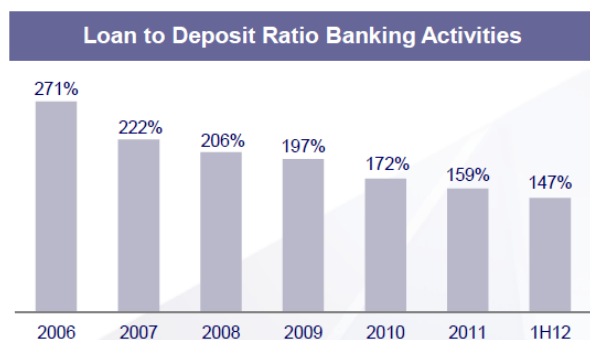
Currently a public-private scenario is explored, in which the uncertainties regarding the property finance portfolio would be addressed and SNS Reaal's capital would be strengthened and restructured. In our view, the public-private scenario provides the opportunity to stabilize the situation regarding SNS Reaal through a significant level of private sector involvement, thereby minimizing the budgetary impact on the Dutch State. A possible divestiture of Reaal and the run-down of SNS Bank's property finance portfolio would mean that SNS Reaal withdraws from these markets, hence making these market positions available for competitors. A viable competitor to the three largest Dutch banks would remain, which eventually could be exited through a private sale, an auction sale to a third-party or a re-IPO.

Appendices



Liquidity Position (€m)

	1H11	2011	1H12
Cash	4,078	4,217	7,651
Liquid Assets	8,626	6,861	3,797
Total liquidity position	12,704	11,078	11,448



- ### Comments
- Loan-to-Deposit ratio almost halved during the past 5 years as savings doubled
 - €2.6bn of government guaranteed bonds issued in 2009 were redeemed
 - Main sources of funding were increase of retail savings (+€2.2bn), LTRO1 of €1.5bn and an undisclosed amount from LTRO2
 - Ambition for Loan-to-Deposit ratio is 125% - 150%

Source: SNS Reaal

