

# RatingsDirect®

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## BNG Bank N.V.

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### Table Of Contents

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Major Rating Factors

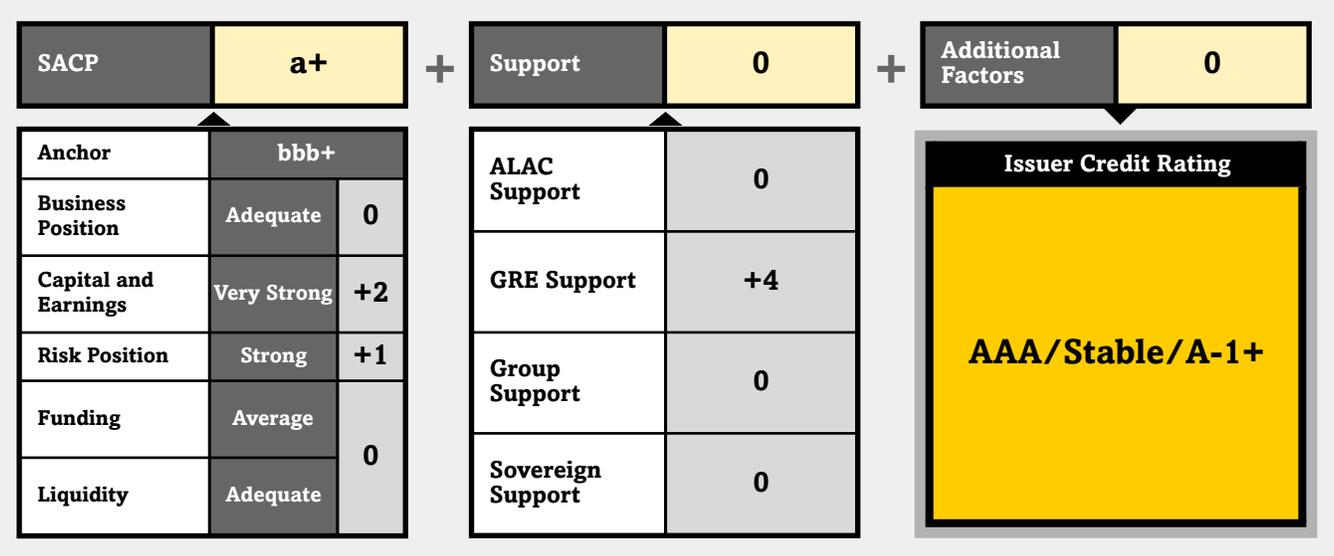
Outlook

Rationale

Related Criteria

Related Research

# BNG Bank N.V.



## Major Rating Factors

Strengths:	Weaknesses:
<ul style="list-style-type: none"> <li>• Almost certain likelihood of extraordinary government support.</li> <li>• Leading lender to Dutch public authorities, supporting very strong asset quality.</li> <li>• Very strong capitalization.</li> </ul>	<ul style="list-style-type: none"> <li>• Sector and geographic concentration with limited diversification of income sources.</li> <li>• Moderate profitability due to low lending margins.</li> <li>• Mostly wholesale funded.</li> </ul>

## Outlook: Stable

S&P Global Ratings' stable outlook on BNG Bank N.V. 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 BNG 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 BNG Bank. That said, we expect BNG Bank's financial profile will remain strong in the next two years, even though the cost of funding may rise from its current unsustainable lows.

We could therefore downgrade BNG 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

BNG Bank is one of the two publicly owned banks that fund local authorities, social housing, and healthcare corporations in the Netherlands. We base our ratings on our classification of BNG Bank as a government-related entity (GRE) with an almost certain likelihood of extraordinary government support.

BNG Bank's 'a+' stand-alone credit profile (SACP) is one of the strongest among entities 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 this strong SACP. That said, business and geographic concentration offset this strength.

Typical for banks with a large balance sheet comprising very low-risk assets, BNG Bank displays very high Common Equity Tier 1 ratios but modest leverage metrics. Although it currently complies with regulatory requirements and is likely to benefit from future waivers for promotional lenders, the leverage ratio is still low, in our view.

Low-risk lending, 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 BNG Bank an entity with an extremely low credit risk profile. That said, we recognize that BNG Bank bases its business model on its continued capacity to access funding at very low costs, given the structurally low asset margins.

BNG Bank remains wholesale funded, in line with public sector-focused peers, although funding sources are well diversified by source and maturity.

We equalize the long-term issuer credit rating on BNG 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 The Netherlands (50%) and other Dutch public authorities (50%).

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

We use our Banking Industry Country Risk Assessment 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 believe 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 substantial restructuring efforts in exchange for state aid. Cost optimization programs continue 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**

<b>BNG Bank Key Figures</b>					
<b>-- Fiscal year-ended Dec. 31--</b>					
<b>(Mil. €)</b>	<b>2018*</b>	<b>2017</b>	<b>2016</b>	<b>2015</b>	<b>2014</b>
Adjusted assets	144,136	140,025	154,000	149,511	153,505
Customer loans (gross)	84,377	85,380	87,346	88,605	89,705
Adjusted common equity	3,961	3,618	3,384	3,111	2,941
Operating revenues	321	643	554	499	291
Noninterest expenses	49	117	117	113	97
Core earnings	188	391	349	232	131

\*Estimates as of June 30.

### **Business position: A stable public sector financing franchise offset by business and geographic concentration**

BNG Bank's business position reflects its sound market position and its stable activities. As of 2017, BNG Bank had a strong 56% market share dominance in the Dutch public sector, followed by NWB Bank with 34%. In 2017, BNG Bank registered stable market shares on new loan production compared to 2016: 66% on public entities, 48% on social housing, and 35% on healthcare. We do not expect this to change substantially in the next two years. This is because competition from private 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.

BNG Bank's new loan production stood at €5.8 billion for the first half of 2018--an increase on the €4.4 billion in the first half of 2017--supported by high refinancing volumes. Negative trends affecting the bank's main asset classes include municipal and provincial budgets that are under pressure, and budget cuts compounded by regulatory uncertainties regarding the care sector. Furthermore, The Netherlands' social housing guarantee fund, Waarborgfonds Sociale Woningbouw (WSW; AAA/Negative/A-1+), is subject to increasingly strict regulatory rules. This is driving the decline in social housing loan production.

Concentration risks offset BNG Bank's focus on low-risk loans, since the bank invests its entire loan portfolio in The Netherlands on a nearly one-sided government-risk asset class.

BNG Bank has an unchanged strategy centered on its exclusive Dutch public financing mandate. BNG Bank focuses on minimizing the cost of financing to the public sector while achieving a reasonable return for shareholders and complying with regulatory requirements. In our view, the stability and predictability of the business model support stable underlying earnings generation and prevent excessive risk-taking by maintaining business in areas of long-standing expertise. As long as we consider the financing role of BNG to be pivotal for the Dutch government, its

business model is likely to remain largely shielded from competition.

**Table 2**

<b>BNG Bank Business Position</b>					
<b>-- Fiscal year-ended Dec. 31--</b>					
<b>(%)</b>	<b>2018*</b>	<b>2017</b>	<b>2016</b>	<b>2015</b>	<b>2014</b>
Return on equity	9.0	9.9	9.9	6.2	3.6

\*Estimates as of June 30.

### **Capital and earnings: Very strong risk-adjusted capitalization due to low-risk assets**

BNG Bank displays extremely strong capital ratios, above the level typically exhibited by commercial banks. That said, the leverage ratio (with the assets non-risk-weighted) is low and earnings are modest, due to its business model. We expect BNG Bank's risk-adjusted capital (RAC) ratio before diversification and concentration adjustments will remain very comfortably above the 15% mark. At year-end 2017, it stood at 26.6% compared with 24.7% at year-end 2016, and we expect the ratio will remain above 25% over the next 24 months.

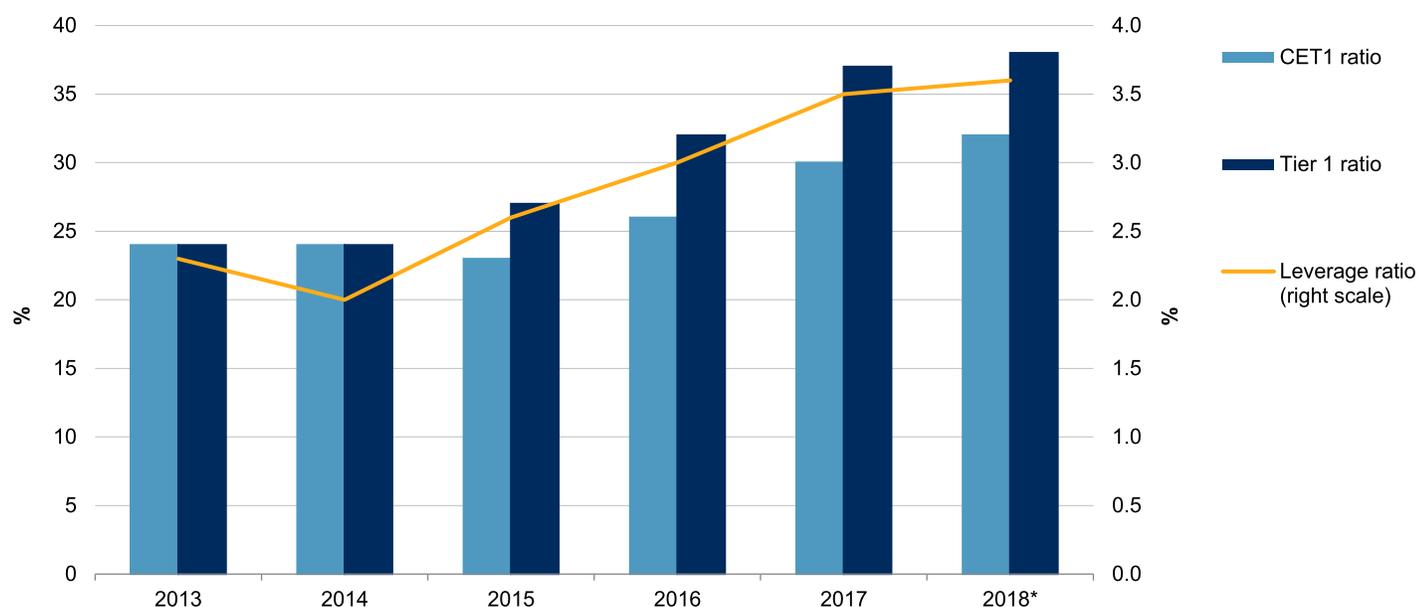
We base our RAC ratio projections on steady retained earnings of about €150 million-€180 million per year in 2018 and 2019, and a slight increase in S&P Global Ratings' risk-weighted assets (RWAs). We assume BNG Bank will maintain distributing dividends because it shows a leverage ratio above the 3% Basel III requirement. We include in our forecasts for the next two years a stable outstanding loan book, net interest margins in the 30-45 basis point (bp) range, and a stable cost-to-income ratio of 20%-25%. International Financial Reporting Standard 9 implementation has led to a slight increase in credit loss provisioning, but cost of risk remains below 5 bps: allowances on loans and advances accounted for €48 million as of mid-2018, of which €25 million were for stage 2 and €18 million were for stage 3.

BNG Bank hedges interest risk and foreign exchange risk through derivatives, and most of the counterparties are large financial institutions in Europe. We note that balance-sheet volatility--stemming from interest rate and foreign exchange rate fluctuations--directly affects our capital metric. However, this volatility is not material for our capital assessment.

Earnings are stable, but undiversified. Recurring interest income represents most of BNG Bank's total operating revenues, although results on financial transactions from realized and unrealized market value add material volatility to the bottom line. However, relatively low noninterest expenses and reduced staff costs support the bank's efficiency, even when we take into consideration regulatory expenses. Net interest income stood at €220 million as of June 2018, and the bank booked €13 million of income from commissions and a €85 million gain on financial transactions on the same date. For the full year 2017, net interest income was €435 million, while the commission income and income from financial transactions were €23 million and €181 million, respectively. Income from financial transactions remains volatile since it includes the unrealized gains or losses on financial assets at fair value through the income statement.

Typical for banks with a large balance sheet comprising low-risk assets, meeting leverage ratios is more of constraint for BNG Bank than meeting capital ratios, which are based on RWAs. As of June 2018, BNG Bank registered a Basel III leverage ratio of 3.6%, which is low when compared to commercial banks but in line with regulatory requirement for

commercial banks. Furthermore, if European regulators implement the waiver for promotional lenders, BNG Bank's leverage ratio will be largely above the minimum requirements. Now that BNG Bank has completed its migration plan to achieve a leverage ratio of 3%, the bank has increased its dividend payout.

**Chart 1****Evolution Of BNG Bank's Capital And Leverage Ratios**

CET1--Common Equity Tier 1. \*Data as of June 30.

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**Table 3****BNG Bank Capital And Earnings**

	-- Fiscal year-ended Dec. 31--				
(%)	2018*	2017	2016	2015	2014
Tier 1 capital ratio	38.00	37.00	32.72	28.00	26.00
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	26.64	24.72	23.42	17.85
S&P Global Ratings' RAC ratio after diversification	N/A	21.46	19.71	20.40	15.81
Adjusted common equity/total adjusted capital	84.38	83.15	82.20	88.01	100.00
Net interest income/operating revenues	68.54	67.65	73.10	90.18	152.58
Fee income/operating revenues	4.05	3.58	4.33	5.61	9.97
Market-sensitive income/operating revenues	26.48	28.15	21.30	3.21	-64.26
Noninterest expenses/operating revenues	15.26	18.20	21.12	22.65	33.33
Provision operating income/average assets	0.38	0.36	0.29	0.25	0.14

**Table 3**

<b>BNG Bank Capital And Earnings (cont.)</b>					
<b>-- Fiscal year-ended Dec. 31--</b>					
(%)	2018*	2017	2016	2015	2014
Core earnings/average managed assets	0.26	0.27	0.23	0.15	0.09

\*Estimates as of June 30. N/A--Not applicable. RAC--Risk-adjusted capital.

**Table 4**

<b>BNG Bank Risk-Adjusted Capital Framework Data</b>					
(Thousand €)	Exposure*	Basel III RWA	Average Basel III RW (%)	S&P Global Ratings RWA	Average S&P Global Ratings RW (%)
<b>Credit risk</b>					
Government and central banks	94,693,576	392,888	0	3,320,484	4
Of which regional governments and local authorities	36,255,961	101,425	0	1,382,750	4
Institutions and CCPs	3,391,674	738,888	22	703,456	21
Corporate	7,970,908	7,103,738	89	6,074,188	76
Retail	45,423	45,425	100	13,009	29
Of which mortgage	45,423	45,425	100	13,009	29
Securitization§	3,422,903	1,094,638	32	1,496,413	44
Other assets†	157,296	27,075	17	172,412	110
Total credit risk	109,681,780	9,402,650	9	11,779,963	11
<b>Credit valuation adjustment</b>					
Total credit valuation adjustment	--	1,210,288	--	2,893,181	--
<b>Market risk</b>					
Equity in the banking book	77,102	77,100	100	551,493	715
Trading book market risk	--	0	--	0	--
Total market risk	--	77,100	--	551,493	--
<b>Operational risk</b>					
Total operational risk	--	950,713	--	1,109,470	--
(Thousand €)		Basel III RWA		S&P Global Ratings RWA	% of S&P Global Ratings RWA
<b>Diversification adjustments</b>					
RWA before diversification		11,640,750		16,334,106	100
Total diversification/concentration adjustments		--		3,938,221	24
RWA after diversification		11,640,750		20,272,327	124
(Thousand €)	Tier 1 capital	Tier 1 ratio (%)	Total adjusted capital	S&P Global Ratings RAC ratio (%)	
<b>Capital ratio</b>					
Capital ratio before adjustments	4,265,996	36.6	4,351,000	26.6	
Capital ratio after adjustments‡	4,265,996	36.6	4,351,000	21.5	

**Table 4****BNG Bank Risk-Adjusted Capital Framework Data (cont.)**

\*Exposure at default. §Securitization exposure includes the securitization tranches deducted from capital in the regulatory framework. †Other assets includes deferred tax assets (DTAs) not deducted from ACE. ‡Adjustments to Tier 1 ratio are additional regulatory requirements (e.g. transitional floor or Pillar 2 add-ons). CCP--Central counterparty. RAC--Risk-adjusted capital. RW--Risk weight. RWA--Risk-weighted assets. Sources: Company data as of Dec. 31, 2017, S&P Global Ratings.

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

Our assessment of BNG Bank's strong risk position reflects our view of its continued focus on very low-risk lending issued to, or guaranteed by, public authorities. Government risk dominates the portfolio, which comprised the following as of Dec. 31, 2017: 49% social housing, 37% public sector, 9% healthcare, and 5% other sectors. WSW and Waarborgfondsen voor de Zorgsector (WfZ) guarantee longer-term lending to social housing corporations and healthcare institutions, respectively. De Nederlandsche Bank, the central bank, considers these exposures to be equivalent to risk arising from the Dutch state, resulting in a 0% risk weight. In terms of loss experience, BNG Bank only booked one exceptional impairment over the last few years, not in its lending but rather in its fixed-income portfolio, following the restructuring of a €125 million bond issued by the former Austrian bank Hype Alpe Adria. The NPL ratio should remain excellent, below 0.5%.

A large share of highly rated instruments temper credit risk in BNG Bank's securities portfolio: the bank invested 64% of the portfolio in 'AAA' rated securities as of June 30, 2018 (with 22% and 8% in 'AA' and 'A' rated securities, respectively). Inevitably, this creates some concentration risk for the highest quality sovereigns. At mid-year 2018, BNG Bank reported €1.75 billion of total exposures to peripheral eurozone countries, down from €1.9 billion one year earlier. BNG Bank has indicated that it does not intend to increase its long-term exposure in these countries in the future. Most of the nonsovereign exposures to peripheral eurozone countries are in asset-backed securities.

The bank does not undertake any trading activities, and the board approves a framework of limits, which controls interest rate risk. BNG Bank's policy is to fully hedge the exposure from all foreign currency debt issuance.

We note 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, essentially regarding Dutch risk.

**Table 5****BNG Bank Risk Position**

(%)	-- Fiscal year-ended Dec. 31--				
	2018*	2017	2016	2015	2014
Growth in customer loans	(2.35)§	(2.25)	(1.42)	(1.23)	(1.42)
Total diversification adjustment/S&P Global Ratings' RWA before diversification	N/A	24.11	25.40	14.82	12.91
Total managed assets/adjusted common equity (x)	36.39	38.70	45.51	48.06	52.19
New loan loss provisions/average customer loans	(0.01)	(0.01)	(0.04)	0.07	0.01
Gross nonperforming assets/customer loans + other real estate owned	0.07	0.04	0.15	0.14	0.13
Loan loss reserves/gross nonperforming assets	87.27	106.25	32.56	38.28	45.30

\*Data as of June 30. §Annualized rate. N/A--Not applicable.

### Funding and liquidity: Wholesale-funded with well-diversified sources

We view funding as average and liquidity as adequate, despite BNG Bank's main funding and liquidity metrics being weaker than Dutch peers'. In particular, we view negatively the large share of short-term wholesale funding in BNG Bank's funding base--which has decreased to slightly below 30% over the past three years--because this funding resource is more confidence-sensitive in nature. However, we understand BNG Bank mostly uses this short-term funding to finance short-term loans to clients, cash collateral for hedging operations, cash holdings, and short-term, highly rated securities that act as a liquidity buffer. This recourse to short-term funding supports the low cost of liabilities, which is an absolute requirement for an efficient business model. We consider this to be acceptable for a government-owned bank because ownership should remain unchanged, and we think that there is a strong correlation between the bank's own risk and the sovereign's. We would view such a reliance on short-term wholesale funding more negatively for a private bank.

In line with public sector-focused peers, BNG Bank is almost entirely wholesale funded because it does not take deposits, which deprives it of a stable funding source. We estimate that BNG Bank's stable funding ratio improved to 81.5% and that its broad liquid assets to short-term wholesale funding was 0.54x as of mid-2018. That said, we do not incorporate any negative rating adjustments regarding BNG Bank's funding profile and liquidity position because we also take into account many qualitative factors. BNG Bank enjoys a large and diversified investor base, demonstrated by its currency funding mix (44% euro, 37% U.S. dollar, and 9% British pound sterling), its geographic funding mix (40% Europe not including the U.K., 24% North America, 23% Asia, and 6% U.K.), and its investor type funding base (28% banks, 25% central banks, and 23% asset managers). The bank's liquidity position is also more resilient than our metrics show, thanks to its €9 billion untapped European Central Bank facility and its large investment portfolio comprising highly liquid securities. Lastly, in contrast with most banks we rate, the majority of BNG Bank's loan book is solvency free and could be pledged as collateral at De Nederlandsche Bank in case of liquidity stress.

**Table 6**

BNG Bank Funding And Liquidity					
	-- Fiscal year-ended Dec. 31--				
(%)	2018*	2017	2016	2015	2014
Long-term funding ratio	69.13	72.53	69.97	68.08	65.48
Stable funding ratio	83.08	78.80	82.48	78.63	75.95
Short-term wholesale funding/funding base	32.14	27.02	28.39	30.96	32.30
Broad liquid assets/short-term wholesale funding (x)	0.56	0.51	0.59	0.45	0.41
Short-term wholesale funding/total wholesale funding	31.94	26.84	28.22	30.85	32.30
Narrow liquid assets/three-month wholesale funding (x)	1.07	1.24	1.11	1.11	0.93

\*Estimates as of June 30.

### Support: Almost certain likelihood of support from the Dutch government

We equalize the long-term issuer credit rating on BNG 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 the Dutch state (50%) and other Dutch public authorities (50%). For this reason, we view BNG Bank as a GRE with an almost certain likelihood of extraordinary government support. In accordance with our GRE criteria, we base our rating approach on our view of BNG Bank's:

- Critical role as one of two public sector banks with a public policy role. In our view, BNG Bank plays a vital role in providing low-cost and stable, constant financing to the Dutch public sector. Private sector commercial banks are typically willing to finance only a small part of the public sector's financing needs and are not able to compete with the low-cost financing that BNG Bank provides. In the absence of public sector banks, the government would likely have to finance the public sector directly. We think BNG Bank's links with other entities, such as WSW and WfZ--both of which benefit from government guarantees--increase the government's incentive to provide extraordinary support.
- Integral link with the government, since we consider the bank to be an extension of the government. The bank's articles of association limit BNG Bank's ownership and lending activities to the public sector, which supports our view of the link between BNG Bank and the government. We note that although the government is not involved in the day-to-day running of BNG Bank, it maintains close oversight over the bank's strategy and capital policy.

Nevertheless, we will monitor ongoing developments 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 BNG 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 1, 2019)

### BNG Bank N.V.

Issuer Credit Rating	AAA/Stable/A-1+
Commercial Paper	A-1+
Senior Unsecured	AAA
Short-Term Debt	A-1+

### Issuer Credit Ratings History

24-Nov-2015	<i>Foreign Currency</i>	AAA/Stable/A-1+
27-May-2015		AA+/Positive/A-1+
02-Dec-2013		AA+/Stable/A-1+
24-Nov-2015	<i>Local Currency</i>	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+
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\*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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