

ISSUER COMMENT

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Rabobank

Rabobank's €310 million provision related to conduct investigations is credit negative

From [Credit Outlook](#)

Last Tuesday, Netherlands-based [Rabobank](#) (Aa2/Aa2 negative, a2¹) announced that its California-based US subsidiary Rabobank, National Association (Rabobank NA) took a provision of approximately €310 million in the fourth quarter of 2017, a credit negative. The provision is in anticipation of the settlement of previously disclosed investigations of Rabobank NA by the Department of Justice (DOJ), the Office of the Comptroller of the Currency (OCC) and the Financial Crimes Enforcement Network (FinCEN). The provision partly alleviates litigation uncertainties and we estimate its after-tax effect on Rabobank's earnings will reduce 2017 net income by approximately 8%.

The DOJ investigations have been ongoing since 2013 and are related to possible violations of the US Bank Secrecy Act (BSA) and other regulations in relation to Rabobank NA's anti-money laundering (AML) compliance programme. Rabobank had considered the litigation a "contingent liability" until now and made no provision because the investigations were still ongoing. As the investigations and discussions with US authorities have progressed, Rabobank NA is now able to book a provision. However, the final settlement could result in a different amount.

Rabobank believes that the investigations will come to a final conclusion in the first quarter of 2018. A potential settlement will likely include a guilty plea by Rabobank NA to a single offense related to former employees withholding information from the OCC. The settlement is apt to address the investigations of all three US regulators, the DOJ, the OCC and the FinCEN. A criminal complaint was also filed with the Dutch Public Prosecutor (DPP) in February 2017, but the DPP's decision over the admissibility of the complaint is still pending.

The BSA/AML case, for which €310 million has been set aside, follows other conduct costs that affected Rabobank's results in the recent past. Rabobank paid €774 million to settle the Libor investigation in 2013 and provisioned €664 million to compensate small and medium-sized enterprises (SMEs) for alleged mis-selling of interest rate derivatives in a Dutch industry-wide scheme in 2015-16. The potential settlement for alleged misconduct next year points to a risk that continues to be material for banks.

To that end, the European Banking Authority required banks to factor conduct risk (e.g., mis-selling, market manipulation and money laundering) into estimated operational risk losses in its 2016 European Union-wide stress test. The aggregate cumulative conduct risk losses amounted to €71 billion for European banks in the adverse scenario, 15 banks having estimated an effect of conduct risk above €1 billion. Again in 2018, the joint European

Banking Authority/European Central Bank stress test will include conduct risk and other operational risks, which seems to indicate that these risks remain important for European supervisors.

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Endnotes

¹ The bank ratings shown in this report are the bank's deposit rating, senior unsecured debt rating and baseline credit assessment.

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