

## **Financial services: challenges and prospects**

**Sector research on the impact of globalisation  
on the financial services**

**Draft case study report – part 6:  
Case study 4: Companies with a “Sustainable Finance” approach**

Study for  
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## Abbreviations

ABF	Asset Based Finance (division of Commerzbank)
ABS	Asset-Backed Securities
AGM	Annual General Meetings
AM	Asset Management (division of Deutsche Bank)
ATM	Automatic Teller Machine
BaFin	German Federal Financial Supervisory Authority
BFSR	Bank Financial Strength Rating
BGI	Barclays Global Investors (division of Barclays)
bn	Billion = 10 <sup>9</sup>
bps	Basis points
BSA	Building Societies Association
CB&S	Corporate Banking & Securities (division of Deutsche Bank)
CCP	Central Counter Parties
CDO	Collateralized Debt Obligation
CEA	European Insurance and Reinsurance Federation
CEE	Central and Eastern European countries
CEIOPS	Committee of European Insurance and Occupational Pensions Supervisors

CIB	Corporate & Investment Banking (division of Unicredit)
CIS	Commonwealth of Independent States
CMBS	Commercial Mortgage-Backed Securities
CRM	Customer Relationship Management
CRO	Chief Risk Officer
CTA	Commodity Trading Advisors
DNB	Dutch Central Bank
EACB	European Association of Cooperative Banks
EBF	European Banking Federation
ESRB	European Systemic Risk Board
ESRC	European Strategic Risk Council
ETN	Exchange Traded Note
ETP	Exchange Traded Product
EURIBOR	Euro Interbank Offered Rate; Euro based interest rate for interbank credits
FIC	Fixed Income & Currencies
FICC	Fixed Income, Currency and Commodities
FSA	Financial Services Authority in the UK
FSB	Financial Stability Boards
FSCS	Financial Services Compensation Scheme
FT	Financial Times
FTD	Financial Times Deutschland
FTE	Full-Time Equivalents
FYE	Fiscal Year End
GRCB	Global Retail and Commercial Banking (division of Barclays)
GTB	Global Transaction Banking (division of Deutsche Bank)
H109	First half of 2009
HB	Handelsblatt
HR Treasury	Her Majesty Treasury
HVB	Hypo Vereinsbank
IASB	International Accounting Standards Board
IBIM	Investment Banking and Investment Management (division of Barclays)
ICAAP	Internal Capital Adequacy Assessment Process
IFRS	International Financial Reporting Standards
IIF	Institute of International Finance
IMF	International Monetary Fund
IPO	Initial Public Offer
LBO	Leveraged Buyout
LIBOR	London Interbank Offered Rate; the interest rate for interbank credits
LOHAS	Lifestyle of Health and Sustainability
m	Million = $10^6$
M&A	Mergers & Acquisitions
MIB	Markets & Investment Banking (division of Unicredit)
NPL	Non-Performing Loans
OCG	Office of Governmental Commerce
OTC	Over-the-Counter trade
PLC	Public Limited Company
PPL	Potential Problem Loans
PRU	Portfolio Restructuring Unit (Division of Commerzbank)
PWM	Private Wealth Management (division of Deutsche Bank)
REIL	Risk Elements in Lending
RMBS	Residential Mortgage-Backed Securities
RWN	Rating Watch Negative
SGB	Social Code
SIV	Structured Investment Vehicle
SME	Small and Medium-sized Enterprises
SoFFin	Financial Market Stabilization Fund in Germany
SZ	Süddeutsche Zeitung
TITF	Too Important to Fail
VaR	Value at risk

Counting convention Million =  $10^6$ ; billion =  $10^9$ ; trillion =  $10^{12}$

### List of reports

This report is part of the study “Financial services: challenges and prospects. Sector research on the impact of globalisation on the financial services” which contains the following reports:

- Part 1: Draft final overview report
- Part 2: Case study methodology and annex
- Part 3: Case study 1: Building societies in the UK
- Part 4: Case study 2: Generali
- Part 5: Case study 3: Companies with a “Liberal” approach
- Part 6: Case study 4: Companies with a “Sustainable Finance” approach
- Part 7: Case study 5: Companies with a “State Ownership” approach

## 1 “Sustainable Finance” approach – Summary

Banks which follow a “sustainable finance” approach are mainly characterised by a conservative and very risk-sensitive business approach. Their key segment is retail banking and a focus on good customer relations is a high priority. Some of them, such as Santander and Rabobank, are also active in the area of asset management, investment or insurance. This group of banks were not seriously affected by the crisis. Other banks in this type of scenario follow a social-ecological business approach, for example the German GLS Bank, Umweltbank or the Dutch Triodos bank all benefitted from the financial crisis regarding an increase in the number of customers.

There are different reasons why institutions with a “sustainable finance” approach have not been as badly affected by the crisis compared to other competitors. The reasons for this are because these particular banks;

- Are not allowed by law to engage in risky markets. Spanish and Polish banks, for example, had to follow legal restrictions which curbed profits during the expansion of financial markets. In the course of the crisis these restrictions appeared as a fundamental advantage which avoided substantial losses. Another example is building societies in the UK which not allowed by law to trade derivatives.
- Are strongly decentralised – like the German savings banks or the mutual banks (Sparkassen, Volksbanken) – and were thus limited by size to participate in proprietary trading. As in the German case, however, their central organisations – the Landesbanken in particular and to a lesser degree the DZ Bank – were strongly engaged in trading risky products and now have to cope with substantial losses from these engagements. Similarly, the Spanish savings banks are presently coming under massive pressure from their real estate investments. The entire systems of savings and cooperative banks can therefore only be classified as sustainable as long as a substantial reform of their lead organisation has been implemented.
- Took a deliberate decision to concentrate on basic financial services rather than approaching new markets. The Svenska Handelsbanken is a good example of such a business model. The decision not to engage in the Baltic States and to apply a conservative approach avoided the burdens which were experienced by the Swedish competitors Swedbank, SEB and Nordea. These institutes are now strongly affected by their investments in Estonia, Lithuania and Latvia.
- Applied a risk-aware investment strategy as the basis of their business. This includes most of the insurance companies which adapted their investment operations to continuous financial flows rather than short-term investment opportunities.

The business model of mutual (or cooperative) banks can be classed into the “sustainable finance” approach. As they are owned by their members they do not have shareholders and are not driven by a focus on short-term profits and increasing dividends. Without pressure to show high quarterly profits, business can be done with a long-term perspective and with a focus on the interests of members and customers. European cooperative banks have been hit relatively less severely by the direct effects of the crisis than private and investment banks. Their losses and writedowns appear to be relatively moderate and mainly concentrated in the international activities – more than 95 % of writedowns registered worldwide were due to commercial banks and some public banks.<sup>1</sup> Moreover, cooperative banks are experiencing increasing membership. The number of members of cooperative banks as a percentage of the total population in 6 European countries (Austria, Finland, France, Germany, Italy and the Netherlands) increased from 14 to almost 17 percent between 1996 and 2008.

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<sup>1</sup> EACB (2010): European Cooperative Banks in the financial and economic turmoil [\[web\]](#)

There is also partial information available for 2009 which indicates further advances regarding the number of clients. According to the German central organisation of the cooperative banking group, BVR (*Bundesverband der Deutschen Volksbanken und Raiffeisenbanken*), the number of members of cooperative banks in Germany increased by 1 % in 2009 to 1.6 million. This corresponded with the growth rates of previous years. Rabobank Nederland, the umbrella organisation of local Rabobanks in the Netherlands, reported a 3.2 % increase to 1.7 million members in 2009, which was a slight acceleration of the growth rate. In Italy, however, the Associazione Nazionale fra le Banche Popolari stated a decline of around 1 % in 2009.

For this case study, three representatives were selected: Rabobank; a large cooperative bank from the Netherlands with a long history of excellent customer relations and tight risk management, Santander; a large international financial group with high cost efficiency, and GLS Bank; a small and dynamic bank from Germany which can be classified as an ethical bank and operates in the specific market segment of ecological and social projects with a strong focus on sustainable investments. The stylised facts for these companies are given in Table 1.

**Table 1** "Sustainable" approach companies

Financial institution (source)	Economic performance 2009	Income structure 2009	Business model
Rabobank NL	Net profit: € 2.3 bn Tier 1 capital ratio: 13.8 % Employment total: 59,311 Employment 2009/08: -2 %	Net profit by segments: Domestic retail banking (53 %), Wholesale banking and international retail banking (28 %), Asset management and investment (1 %) Leasing (5 %) Real estate (3 %) Others (10 %)	Target: to become the Dutch market leader in all financial services and an international food and agri bank, the retention of a high credit rating and high standards in respect of a corporate social responsibility (CSR) policy Operation: strong customer-focus, increased efficiency due to cost reduction programme
Santander Group ES	Net profit: € 8.9 bn Tier 1 capital ratio: 10.1 % Employment total: 169,460 Employment 2009/08: -0.9 %	Net profit by segments: Retail banking (70 %) Global wholesale banking (26 %) Asset management and insurance (4%)	Target: large international financial group, which provides high returns to shareholders and meets all the financial needs of its customers. Operation: customer-focused business model with geographical diversification, high efficiency and strong risk-awareness
GLS Bank DE	Net profit: € 0.202 m Employment total: 254 Employment 2009/08: +20 %	Business volume by segments: Customer loans (51 %) Bank deposits (29 %) Fixed-interest securities (17 %) Investments (1 %) Others (2 %)	Target: to deliver transparent socio-ecological banking services to the increasing number of customers Operation: strong customer-orientation, focus on sustainable projects, expanding to Austria

Source: Company information, press media

## 1.1 Response to the crisis

None of these three banks relied on public financial support during the crisis because they did not experience any severe losses. All of them showed a strong overall performance. Nevertheless, they are being affected by the generally worsened economic circumstances. The two large representatives in this scenario group, Rabobank and Santander, experienced an increase in impairment losses in 2009. As a response to the crisis both banks increased their Tier 1 ratios.

Santander states in its Annual Report 2009: 'The last two years of economic and financial crisis have made it clear that a bank's profitability must be measured on a long-term basis. This means having a recurrent and sustainable business which shows responsibility to shareholders, employees, customers and society at large.'<sup>2</sup> The bank showed a good business result (net ordinary attributable profit was 0.7 % higher at € 8,943 m) despite the occurring challenges in 2009 and compared to peers. Thus it feels confirmed in its strategy.

Moreover, Rabobank decided to scale down its non-client-related operations undertaken at global financial markets as a result of the financial turmoil. Since the bank needs an adequate Tier 1 ratio and stable profit growth in order to maintain its high credit rating, it has set the following long-term financial targets: a Tier 1 ratio of at least 12.5 %; a minimum return on equity of 8 % and a 10 % net profit growth.

GLS Bank has been affected by the crisis in a positive way and it is now confronted with the challenge to manage the continuously increasing number of customers. This is due to the increasing favour of ethical banking which has become visible in recent years. The trend has been strongly supported by the crisis as an increasing number of savers are questioning the unbroken growth-orientation and profit-orientation of traditional banks and are looking for alternatives. Between 2008 and 2009 GLS Bank's customer base increased by 18 % and its business volume increased by 33 %. One of GLS Bank's important responses to the crisis has been the need to hire more employees. This trend is expected to continue. The results of GLS Bank show a much better performance than German cooperative banks on average: The business volume of all cooperative banks in Germany increased by 3.3 % between 2008 and 2009 and the number of members increased by 1 %.<sup>3</sup>

## 1.2 Business models

All three banks have a large retail banking division which is the major source of revenues. At Santander the retail division contributed 70 % to net profit and at Rabobank 53 %, respectively. At GLS Bank the retail and commercial banking segment is dominant. Customer relations have always been a core element in the business strategy of all three banks, even before the crisis.

Santander and Rabobank see themselves as international financial service providers. One key element of Santander's business model is efficiency. Santander states that it 'has one of the most cutting edge technology and operations platforms in international banking, which allows it to turn cost savings into greater value for the customer. It is one of the most efficient banks in the world, with a cost/income ratio of 41.7 % (37.6 % excluding depreciations and amortisations).'<sup>4</sup> Rabobank also implemented a cost reduction programme to increase the efficiency of the bank (the efficiency ratio which is equivalent to a cost/income ratio was 61.5 % in 2009).

Transparency is a very important characteristic of GLS Bank and can be interpreted as its source of success. Customers appreciate that they can decide which area their money should be invested in and they receive detailed information about all initiatives supported. For example, GLS Bank's commercial papers are chosen and continuously monitored with strict criteria determined by a financial investment committee (*Anlageausschuss*). Due to a number of particular criteria companies involved in the following areas are excluded from the GLS Bank portfolio – nuclear power, controversial economic or ecological practices, animal experiments, production of tobacco and drinks with high alcohol content.

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<sup>2</sup> Santander Annual Report 2009, p.6

<sup>3</sup> Bundesverband der Deutschen Volksbanken und Raiffeisenbanken (2010): Entwicklung der Volks- und Raiffeisenbanken Ende 2009 [\[web\]](#)

<sup>4</sup> Santander website: „Business model“ [\[web\]](#)



The banks differ regarding their ownership structure and their geographical diversity. Rabobank and GLS Bank are mutual banks and are owned by their members who have the right to actively take part in the decision making process. Each member has one vote at the annual general meeting, independent of the number of cooperative shares they have. This enables the bank to pursue long-term goals rather than short-term profits – which is a typical characteristic for the "sustainable finance" approach. As Santander has shareholders it is part of their strategy to provide satisfying dividends to them. Santander announced to pay out a 2 % higher dividend in 2009 compared to the previous year. Santander can be categorised in the "sustainable finance" approach due to its risk-averse business model and its low cost income relation.

While GLS Bank is a small bank with seven branches in Germany and plans to open its first branch in Austria this year, the other banks have branches spread all over the world. Santander is proud to be an international bank with the most branches in the world, serving 92 million customers. Its principal geographical areas are Continental Europe, UK and Latin America. Rabobank has a dominant position in the Dutch market (it is the market leader in the Dutch agricultural market as well as in retail savings and residential mortgages), and it additionally operates in 30 other countries.

### 1.3 Employment

At Santander and Rabobank the number of employees has decreased by 0.9 % and 2 %, respectively. Reasons for job cuts at Rabobank are decreased activity levels and the implementation of cost cuts. In domestic retail banking the full-time equivalent (FTE) employment level has dropped by 1 % and in the wholesale banking and international retail banking division it has dropped by 5 %. In order to reduce costs and increase efficiency the 'Rabobank 2010 Vision' programme was introduced. This is targeted at updating and improving customer services at substantially lower costs in combination with a process redesign. Staff of local Rabobanks therefore took part in support programmes.

At Santander Group the total number of employees decreased by 0.9 % (- 1501 jobs) in 2009. The newly acquired bank Sovereign added 8,847 employees in 2009. In Latin America the number of employees declined by 10,000, mainly due to the disposal of America Banco de Venezuela. In the UK 1430 jobs were cut in 2009. According to the newspaper the Telegraph, the bank stressed that the job losses were not a reaction to the financial crisis but instead part of the planned £ 180 m (€ 208 m) of annual cost savings after the acquisition of the UK bank Alliance & Leicester.<sup>5</sup>

Due to the strong growth of the business, GLS Bank has continuously increased the number of employees within the last years. It currently employs about 250 persons and plans to hire 60 additional employees in 2010. Recruitment is easy for the bank as many excellent job candidates apply for vacant jobs. In particular some job candidates previously worked for large private banks. These candidates seem to prefer the reasonable ethical concept of GLS Bank over the financial incentives of large private banks.

### 1.4 Remuneration

None of the three banks had to implement a new remuneration model as an answer to the financial crisis.

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<sup>5</sup> The Telegraph 12.12.2008 [[web](#)]

According to the Rabobank Annual Report 2009 'the remuneration structure within the organisation has never been such that it might encourage irresponsible risks being taken'<sup>6</sup>. At Rabobank the remuneration of the executive board distinguishes salaries, variable compensation and pension provisions. No variable compensation is awarded in the form of an option and/or as share packages. A short-term and long-term (three years) variable compensation of 15 % of fixed income exists for the executive board. A variable compensation component exceeding 30 % of fixed income is only paid to a small number of individuals in highly specialised positions within Rabobank International.

At Santander the variable part of executive directors' remuneration varies between 56 % and 65 %. The variable component is paid out in cash and shares while the shares are deferred for three years. The number of shares paid out is linked to the bank's total shareholder return. An obligatory investment plan also exists which obliges executive directors to invest 10 % of their gross variable remuneration of the previous three years in shares. Thus, incentives are given to target the company's long-term success.

GLS Bank's remuneration system distinguishes eight different functional groups, whereby number 8 refers to the management board members who earn around € 160,000 per year. The lower functional groups 1 to 4 are paid better than in private banks, and wages at higher functional groups are often lower. Bonus payments do not exist at GLS Bank.

## 1.5 Risk management

The crisis did not cause the risk management methodology to be adapted in any of the three banks. Santander pursues a risk policy which focuses on maintaining a low-medium predictive profile in all risks and Rabobank has a long tradition of a very conservative approach to risk and credit management.

For GLS Bank the most important risk is the counterparty (or loan default) risk. Therefore a rating method is used which classifies all customer loans into internally defined risk classes. The grouping of loans regarding risk class is adjusted if the creditworthiness of the borrower changes. The credit default rate of 0.3 % in 2009 was very low. In order to control risks associated with changes in interest rates, GLS Bank used an interest rate swap with WZG Bank to the amount of € 80 m in 2009. However, the diversification of the credit portfolio is limited due to the bank's ethical selection process of projects. In the case of worsening economic conditions, for example in the environmental sector or public finance, this could affect the bank in a negative way. This is also reflected in Fitch's A rating which stands for safe investment, unless unforeseen events should occur in the economy at large or in that particular field of business.

At Santander and Rabobank economic capital is used as a principal approach to calculate the capital needed to absorb severe and unexpected losses arising from exposures. It is calculated for credit risks, market risks including traded default risks, operational risks and general business risks. At Rabobank it dropped by 2 % in 2009 to € 22 bn. The reduction was primarily caused by a decrease in interest rate risk in the banking book. At Santander economic capital was € 44 bn in 2009 (and € 40 bn in 2008).

Santander and Rabobank use the analysis of scenarios and stress testing in order to complement the analysis of market and credit risks. They are also used to evaluate the impact of changes in general economic conditions on credit risks and the effect of extreme market developments on asset values.

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<sup>6</sup> Rabobank Group Annual Report 2009, p. 76

Table 2 shows risk-weighted assets and Tier 1 ratios for the selected banks.

**Table 2** "Sustainable" approach – Risk management

In € bn	Rabobank	Santander	GLS Bank
Total assets	608	1110	1.35
Risk-weighted assets	233.4	561.7	0.704
Core capital	/	48.4	0.066
Tier 1 capital	32.3	56.7	0.076
CC/ RWA (%)	/	8.6	9.4
T1/ RWA (%)	13.8	10.1	10.7

CC = Core capital; T1 = Tier 1 capital; RWA = Risk-weighted assets

Source: Company information, Economix

## 1.6 Ratings

GLS Bank has an A+ rating from Fitch (safe investment unless unforeseen events should occur in the economy at large or in that particular field of business) and an A rating from the rating agency Ethibel in 2005 for being the first ethical bank in Germany. Moreover, GLS Bank was awarded "Sustainable Bank of the Year in Germany" in April 2009 by the British magazine *The New Economy*.

The A rating from Ethibel is the highest rating possible, which ranges between A and E. Ethibel is a rating agency located in Brussels which – in addition to financial performance – evaluates the sustainability of financial institutions. GLS Bank's strategy of ethical banking is seen as enrichment for the financial services sector. Ethibel appreciates GLS Bank's high degree of transparency, its focus on ecological, social and innovative projects as well as its microfinance fund. GLS Bank's employment shows a high degree of stability. High commitment to vocational education and training within the bank, close communication within working teams and the application of trust-based working hours are all reflected in the A rating. Salaries are categorised as social and well-balanced. The operating efficiency of the bank is also evaluated to be very good. Provisions for risks are comprehensive and well-documented. GLS Bank is a member of BVR, the German central organisation of the cooperative banking group, thus customers' deposits are protected to the full extent.

The credit rating of the large rating agencies for Rabobank Nederland is AAA (credit risk almost zero) and has been for a long time, and Santander has had a AA (safe investment, low risk of failure) rating in recent years. These positive and stable ratings reflect the stable business profiles with strong retail divisions, comparably resilient performance during the crisis and strong risk management capabilities. However, Moody's downgraded the long-term rating of Santander from Aa1 to Aa2 due to concerns regarding the 'broad deterioration of the Spanish economy, to which Santander remains heavily exposed, as well as its recently increased exposure to the UK and the US'<sup>7</sup>, which both also face severe economic disruptions.

Santander and Rabobank Nederland both have strong risk management capabilities. In particular, the cautious approach regarding risk appetite and management philosophy of Rabobank Nederland is appreciated by rating agencies. Moreover, as it is a mutual bank it is not driven by short-term performance indicators. The liquidity management is seen as strength due to the bank's large retail deposit base. However, even the bank has a conservative selection of exposures and it has high group exposure to other financial institutions. Moody's also appreciates that Rabobank Nederland

<sup>7</sup> Moody's Rating, 30 July 2009 [[web](#)]

has decided to 'scale down its non-client-related operations undertaken at global financial markets as a result of the financial turmoil'<sup>8</sup>.

Regarding Santander, the rating agencies appreciate the culture of independent and tight risk management. 'The bank strictly separates risk and commercial areas and has a committee decision-making process. Its risk function has a high status within the bank. Santander has passed on its risk culture and organisation to its subsidiaries and developed integrated risk standards and a credit organisation while rotating experienced managers within its subsidiaries.'<sup>9</sup>

Both of these large banks had good ratings regarding asset quality, even though the agencies saw a deteriorating asset quality for Santander. For Rabobank Nederland it was evaluated as being strong due to its 'conservative underwriting criteria with a stable and low level of impaired loans'<sup>10</sup>. Rabobank Nederland's asset quality is strengthened by the high proportion of domestic loans to individuals. Reported losses on this portfolio were 2 bps in the first half of 2009, below the historic average of 3 bps. 'For Santander further asset quality pressures are expected as non-performing loans will increase. However, the bank's consolidated assets in Spain are likely to be less affected than the overall system due to the diversification of its book by region and by sector. Risk premiums stand to increase substantially in the consumer finance business and across all of Latin America, particularly in Mexico and Brazil.'<sup>11</sup>

## 1.7 Outlook

According to the rating agencies, the operating environment will continue to be difficult in 2010. The outlook for Rabobank is negative due to expected subdued macroeconomic conditions in the Netherlands which could affect the bank's profitability, asset quality and capital adequacy. Impairment losses are expected to remain high in 2010. Considering Santander, the rating agencies observed increasing credit deterioration in most markets Santander is present in. Any additional acquisition could have negative implications for the ratings.

The banks expect 2010 to be a challenging year and that effects of the financial crisis will remain visible in the real economy. For Santander the priorities remain the same: management of spreads and control of costs, risk control and management of loan-loss recoveries. Santander expects that pre-crisis growth rates will not be reached. Non-performing loans will increase and the bank will suffer the double impact of both low demands for loans and pressures on spreads associated with repricing. Nevertheless, there will also be chances to gain market shares by means of organic growth and acquisition opportunities in some markets.

Rabobank will prioritise tight cost management and high-quality customer contacts. It has therefore set the following core objectives:<sup>12</sup>

- become the Dutch all finance market leader (or retain this position, as appropriate)
- build on its position as the world's leading international food and agri bank
- achieve greater commercial synergy with subsidiaries

Moreover, it expects that the level of bad debt costs will remain high. Rabobank intends to maintain its provision on the savings and the mortgage markets and strengthen its position in the corporate

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<sup>8</sup> Moody's 12.03.2010 [[web](#)]

<sup>9</sup> Standard & Poor's Rating, 30 July 2009, [[web](#)]

<sup>10</sup> Standard & Poor's Rating, 30 July 2009, [[web](#)]

<sup>11</sup> Standard & Poor's Rating, 30 July 2009, [[web](#)]

<sup>12</sup> Rabobank Group Annual Report 2008, p. 11

and private banking market. In the second biggest business segment, Wholesale Banking and International Retail Banking, activity with structured financial products will be reduced while renewable energy & infrastructure finance will develop further.

GLS Bank expects that the trend of sustainable and responsible use of money will continue and will influence the development of the business positively. Until now, the client sectors have developed positively in spite of the financial and economic crisis. GLS Bank wants to continue its engagement in all areas with a particular focus on independent schools and kindergartens, trade of organic food and renewable energies. Growth is expected to continue, even rising interest rates and growing competition in financial services will lead to a continued trend of declining interest margins in the medium term. For the next years a growth of at least 25 % - 35 % per year is expected –particularly regarding the deposit and credit business. Turbulent times on capital markets will increase risk costs in the future and will increase risk management's importance in the company. The bank also plans to expand to Austria by the end of the year. Another important task will be the integration of new employees in the continuously growing company.

## 2 GLS Bank

### 2.1 Economic performance

#### *Business development*

Founded in 1974 GLS Bank was the first social and ecological bank in the world. GLS stands for “Gemeinschaftsbank für Leihen und Schenken” which means “community bank for loans and gifts”. It is a cooperative bank with a transparent socio-ecological business approach as investments are chosen on social, ecological and economical criteria. A list of all new loans is regularly published in the GLS customer magazine.<sup>13</sup>

At the moment GLS Bank has 254 employees and more than 77,000 customers. It currently finances around 6,500 projects and businesses.<sup>14</sup> The bank has experienced strong growth in the last few years which was additionally boosted by the financial crisis in terms of a growing number of members and customer deposits. In the years before the crisis the yearly growth rate of the business volume was between 18 % - 25 %. In 2009 it increased even more (by 33 %) and for 2010 a growth of 38 % is expected. According to Thomas Jorberg, the Management Board spokesperson, the bank did not grow stronger in 2009 because capacities could not be extended accordingly.<sup>15</sup> These results point out a much better performance than German cooperative banks on average: The business volume of all cooperative banks in Germany increased by 3.3 % between 2008 and 2009 and the number of members increased by 1 %.<sup>16</sup>

Currently, the bank has 1,200 - 1,400 new customers per month.<sup>17</sup> About one and a half years ago the bank had about 2,000 - 3,000 calls of potential customers per week. Now the number of calls is four times higher. According to Christof Lützel, head of public relations at GLS Bank, many of the new customers had already heard of GLS Bank, but the financial market crisis was the trigger for them to finally switch banks and become customers of GLS Bank. Customers who are convinced of the business strategy generally stay for a long time with a bank.

**Table 3 GLS Bank – Performance data**

	2009	2008	2007
Business volume (bn €)	1.38	1.037	0.813
Loan portfolio (bn €)	0.718	0.603	0.478
Customer deposits (bn €)	1.15	0.830	0.660
Equity capital (m €)	67.5	54.5	45.5
Net retained profit (m €)	0.202	0.152	0.120
Number of customers	73,000	62,000	55,000

Source: GLS bank Annual Report 2008, Lagebericht für das Geschäftsjahr 2009 der GLS Gemeinschaftsbank eG (forthcoming)

<sup>13</sup> GLS Bank website [web]

<sup>14</sup> Numbers were provided in an interview with Christof Lützel, head of public relations at GLS Bank on 09.04.2010

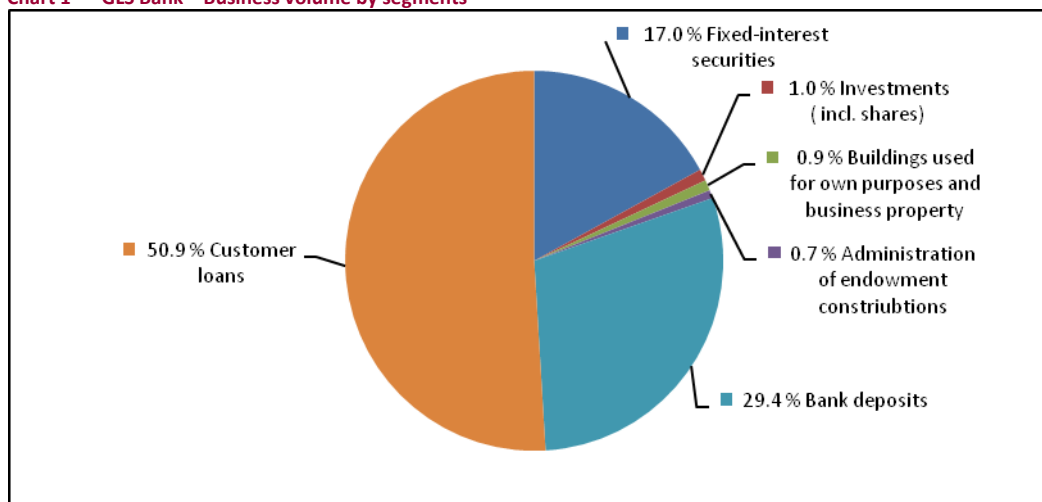
<sup>15</sup> Öko-Test (2010): „Alternative Banken -Moral oder Masche“ 01.03.2010, p.1.

<sup>16</sup> Bundesverband der Deutschen Volksbanken und Raiffeisenbanken (2010): Entwicklung der Volks- und Raiffeisenbanken Ende 2009 [web]

<sup>17</sup> Information provided in an interview with Christof Lützel, head of public relations at GLS Bank on 09.04.2010

A business volume of € 1.3 bn (as per 30.09.2009) was gained in the following segments:

**Chart 1 GLS Bank – Business volume by segments**



Source: GLS Bank website [\[web\]](#)

### *Provided services and products*

GLS Bank offers a wide range of products: current accounts, financial investments, asset management, financing, shareholding and foundation consultancy services. Due to GLS Bank's membership in the Federal Association of Cooperative Banks, all bank deposits are fully guaranteed.<sup>18</sup> The transparent concept enables customers to make informed decisions and to take on responsibility. Moreover, savers can choose the area in which their money will be invested. Customers also have the possibility of choosing reduced interest payments for their savings, which enables GLS Bank to grant loans to charitable projects with an interest rate only covering the basic loan administration costs of the bank.

## **2.2 Employment and branches**

By the end of 2009, 227 employees were working at GLS Bank (see Table 4).<sup>19</sup> Today it employs 254 persons and GLS Bank plans to hire 60 new employees this year. The workforce at GLS Bank is relatively young as 68 % are younger than 46 years old. More than half of the employees have done a vocational bank training and the rest have a university degree or a comparable qualification.

**Table 4 GLS Bank – Workforce**

	2009	2008	2007
Number of employees			
Employees	227	189	180
Thereof part-time employees	58	50	46
Thereof in training	13	11	8
Skills structure			
Number of employees with vocational bank training	132	105	90
Number of employees with university degree and/or an adequate additional qualification	110	98	77
Age structure			
Below 25 years old	32	22	24
Between 25 and 35 years old	65	51	48
Between 36 and 45 years old	57	54	57

<sup>18</sup> GLS Bank Annual Report 2008, p. 3

<sup>19</sup> GLS Bank Annual Report, p. 11



46 years and older	73	62	51
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Source: GLS Bank Annual Report 2008, Lagebericht für das Geschäftsjahr 2009 der GLS Gemeinschaftsbank eG (forthcoming)

GLS Bank is not required to pay any compensation in accordance with the Social Code (SGB) IX because it employs a total of 13 persons with severe disabilities.

In 2009 € 258,000 was spent on vocational education and training measures.<sup>20</sup> Training measures are steered by yearly development meetings where further qualifications, e.g. through seminar attendance, are planned. Employees are offered to participate in technical and management seminars. These are carried out by third parties but also by staff development.

The employees did not elect a works council until now. The company follows a different approach which is governed by a close management-employee relationship. For example at GLS Bank trust-based worker's hours are applied.<sup>21</sup>

### *Business structure and branches*

GLS Bank comprises three parts: GLS Gemeinschaftsbank eG for banking, GLS Treuhand e.V. for foundation affairs, and GLS Beteiligungs AG. GLS Bank, whose headquarters are in Bochum, has branches in Berlin, Frankfurt, Freiburg, Hamburg, Munich and Stuttgart. By the end of the year the bank will open its first branch in Austria.

## **2.3 Ownership structure**

GLS Bank is a cooperative bank and is thus owned by its approximately 16,500 members who own cooperative shares amounting to € 16.8 m. GLS Bank is a member of the German central organisation of the cooperative banking group, the BVR (*Bundesverband der Deutschen Volksbanken und Raiffeisenbanken*). As GLS Bank levies contributions to the BVR protection scheme, deposits of customers are protected to the full extent.<sup>22</sup>

Cooperative shares form the fundament of a cooperative bank as it is allowed to lend an amount of money 12.5 times higher than its equity capital.<sup>23</sup> One cooperative share at GLS Bank is valued at € 100 and one member can acquire up to 20,000 shares. A member is allowed to quit the membership at the end of a fiscal year by taking a five year period of cancellation into account.

The *Satzung* of GLS Bank describes the rights and duties of members:<sup>24</sup> members have the right to actively take part in decision making. Each member has the right to attend and vote at the annual general meeting and to inquire information about the bank's business. Every member has one vote. At the general meeting members vote, for example the board of management, for the use of annual net income or the coverage of an annual deficit. Members also have the duty to follow the cooperative society act and the decisions made at the general meeting.

## **2.4 Important business events**

<sup>20</sup> Lagebericht für das Geschäftsjahr 2009 der GLS Gemeinschaftsbank eG (forthcoming), p. 11

<sup>21</sup> Information provided in an interview with Christof Lützel, head of public relations at GLS Bank on 09.04.2010

<sup>22</sup> BVR Website [\[web\]](#)

<sup>23</sup> GLS Bank, Bankenspiegel, 1/2009, Heft 205 [\[web\]](#)

<sup>24</sup> GLS Bank: „Satzung der GLS Gemeinschaftsbank eG vom 16. Juni 2007“ [\[web\]](#)

Due to the takeover of Ökobank in Frankfurt in 2003, GLS Bank acquired two further branches in Frankfurt and Freiburg. The service portfolio of GLS Bank has been expanded by checking accounts, sustainable construction financing and ecological investment funds.<sup>25</sup>

In 2007 GLS Bank took over the IntegraBank eG – an initiative of a catholic community with a cooperative concept. The takeover gave them the chance to intensify their engagement in a Christian-church segment and adds a further branch in Munich.<sup>26</sup>

## 2.5 Strategy

### *Market and consumers*

In recent years a boom of the organic segment has become visible, for example customers have become more interested in more environmentally friendly cars, organic food or natural cosmetics. Customers are aware of “green” alternatives in all segments, which is what also increased the awareness of sustainable financial investments.

Sinus sociovision, a German research institute for psychology and social science, analysed the milieu of LOHAS (Lifestyle of Health and Sustainability) who are interested in sustainability, social responsibility and ecological consume. The core group of LOHAS is estimated to be 10 % of the population in Germany and a further 10 % with weaker preferences.<sup>27</sup> LOHAS are also an interesting target group for social-ecological banking. Moreover, the financial consultancy group ZED expects an increase in the number of potential customers of social banks: due to the loss of confidence in the banking sector and a change of ideals in society, the number of potential customers for social banking will be between 10 - 12 million persons in 2020. This is a large potential compared to the current number of customers (around 200,000) of ethical-ecological banks in Germany.<sup>28</sup>

### *GLS Bank's Strategy*

According to the mission statement of GLS Bank, its core values and work processes are defined as followed:<sup>29</sup>

#### 'Core Values

The fundamental principle guiding the work of GLS Bank is respect for life and concern for a peaceful coexistence of all cultures that are rooted in individual freedom and responsibility. Human beings are taken seriously in their totality as body, soul and spirit. The actions are geared towards maintaining and enhancing the prospects and life chances of their own and future generations. The bank sees ecology as the holistic concept of a life-fostering unity of nature and civilisation development.

#### The People GLS Bank Works With

GLS Bank addresses people who pursue ecological, social or cultural goals and who want to actively and creatively help to shape the society. With these people GLS Bank works on developing new forms of banking that are guided by solidarity and responsibility for the world around them. GLS Bank works with people and organisations that, like GLS Bank itself, are socially committed and assume responsibility for themselves and for others, regardless of

<sup>25</sup> GLS Bank website [web]

<sup>26</sup> GLS Bank website [web]

<sup>27</sup> Sinus sociovision: „Lohas in Theorie und Praxis“, Bericht zur 1. new ethics Marketing Konferenz am 24. und 25. November 2009/12.01.2010 [web]

<sup>28</sup> ZEB/ Pressemitteilung: „Konsequenz der Finanzkrise: Kreditinstitute sollten wachsende Nachfrage nach „Social Banking“ ernst nehmen“, 30.11.09 [web]

<sup>29</sup> GLS Bank (2009): „Mission statement“ [web]

origin and philosophy. The bank welcomes everybody who shares the goal of a fairer, more just society and who sees collaboration in networks as a means to achieving that goal.

#### Methods and Tools

Money is used as a social tool that allows combining professional financial services with current topics. By publishing regular reports on lending, investments and donations, the bank brings about transparency in the banking business, thus giving its investors the opportunity to keep track of the social effects of their investment decisions. The employees at GLS Bank seek a dialogue with their customers which is not limited to the quality of service, friendliness, speed of response, availability or professional expertise. Thus, the bank is also explicitly interested in a dialogue on the social relevance of its financing projects.

#### Work environment

An open, honest work environment exists at GLS Bank and it is dedicated to a respectful dialogue within a framework of well-thought-out organisational hierarchies. The leadership philosophy is based on a holistic view of human beings. On the basis of trust in the common ideals, people are involved in processes that concern them and decisions are communicated in a transparent manner.

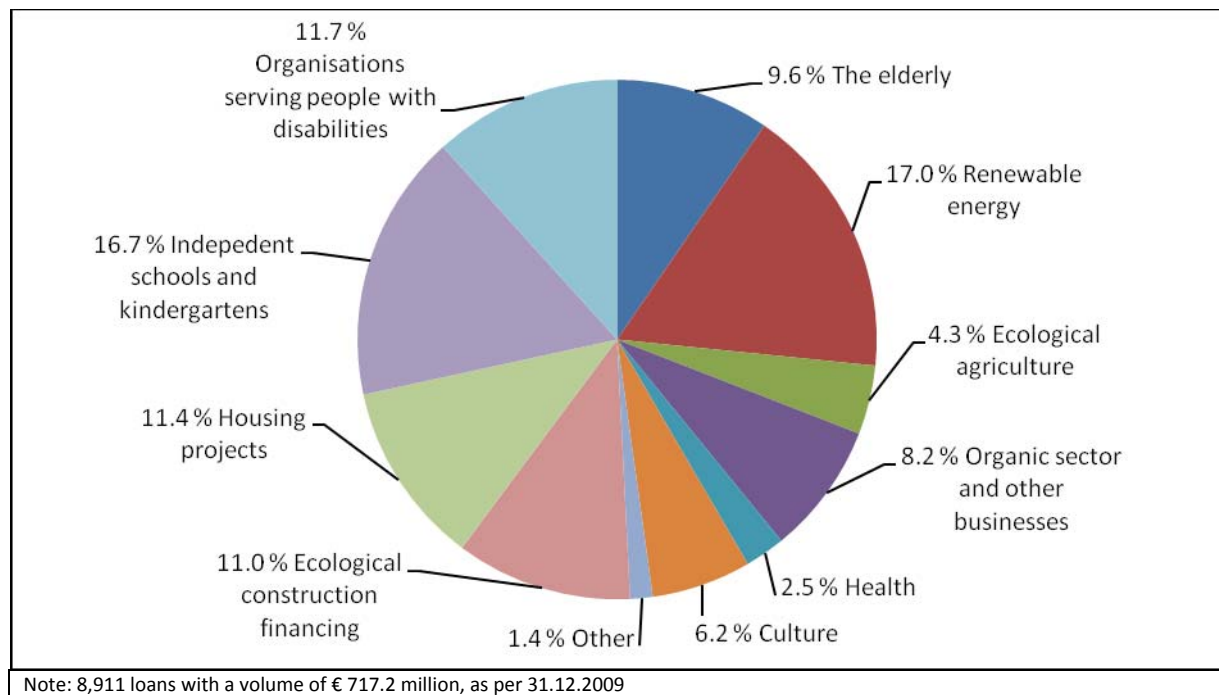
#### Success

GLS Bank puts sense before gain in all areas. The managerial goal is the long-term stability of the business and its ongoing development. The bank seeks to foster the social impact of a transparent, purpose-oriented banking business through qualitative and quantitative growth. Business processes are clearly structured, intelligible to all stakeholders and organised with a view to resource protection and effectiveness. GLS Bank is constantly working on its further development and optimisation in a collaborative process designed to create space that allows customers to use their money in a different way.'

#### *Transparency*

The GLS Bank focuses on cultural, social and ecological projects. Secure investments, credit policies and monetary transactions that make sense are the core business of the bank. Loans, for example, are offered to independent schools or kindergartens, organic farms, nursing homes, projects for the unemployed, health food shop and communal living projects as well as sustainable businesses. Thereby, transparency is very important and the details of all initiatives supported by loans are published in the customer magazine, *Bankspiegel*, together with information on developments of the GLS Bank. In 2009, loans were given to the following segments:

#### **Chart 2 GLS Bank – Lending by GLS Bank**



In the segment of asset management, commercial papers are chosen and continuously monitored by strict criteria determined by the financial investment committee (*Anlageausschuss*).<sup>30</sup> This committee comprises seven members – external experts and employees of GLS Bank – who decide which new commercial papers can be included in the GLS Bank portfolio. This work is also supported by the rating agency *oekom research AG* which provides comprehensive information about the social and ecological performance of companies and countries. Due to a number of criteria companies involved in the following areas are excluded from the GLS Bank portfolio: nuclear power, controversial economic or ecological practices, animal experiments, production of tobacco or production of drinks with high alcohol content.<sup>31</sup>

## 2.6 Competitive situation of GLS Bank

As a consequence of the financial market crisis an increasing number of savers are questioning the unbroken growth-orientation and profit-orientation of traditional banks.<sup>32</sup> Due to this and a growing trend of green banking, ethical-ecological banks which focus on a traditional credit business rather than speculations and profit maximisation have experienced a strong increase in the number of customers since the end of 2008.

A publication of *Öko-Test* compared ethical-ecological banks: in Germany, for example, GLS Bank, Ethikbank, Triodos Bank, Umweltbank and Noa Bank all benefitted from this trend and now the large private banks are trying to also jump on the ecological bandwagon. However, for selecting the right ethical-ecological financial investment it is crucial to study the details of institutions. Smaller banks differ in their degree of transparency and the diversity of services and traditional large institutions sometimes pretend to be more ecological than they actually are.

<sup>30</sup> GLS Bank website [[web](#)]

<sup>31</sup> For more details see [www.gls.de](http://www.gls.de)

<sup>32</sup> *Öko-Test* (2010): „Alternative Banken - Moral oder Masche“ 01.03.2010, p.1.

GLS Bank stands out compared to other social-ecological banks in Germany. First of all, it was awarded “Sustainable Bank of the Year in Germany” in April 2009 by the British magazine *The New Economy*.<sup>33</sup> Moreover, according to the *Öko-Test* article, GLS Bank showed the highest degree of transparency compared to other ethical-ecological banks in Germany. Umweltbank, whose business volume also substantially grew by 30 % to about € 1.65 bn, and Triodos Bank do not give detailed information about their own investments and the Ethikbank does not give detailed information about the use of loans. Noa Bank was suspected by *Öko-Test* and *Spiegel online* that the bank would only be used to refinance the owner’s former company Quorum AG.<sup>34</sup> Moreover, transparency about financed projects was evaluated by *Öko-Test* as not being sufficient.

Larger banks also show “green” ambitions. For example Deutsche Bank, Hypo-Vereinsbank, Commerzbank or DZ bank represent themselves as sustainable institutions. Deutsche bank shows its sustainability on a website<sup>35</sup> where information is given about ethical-ecological investments and their new environmentally friendly green towers in Frankfurt. However according to *Öko-Test*, international sustainability research agencies do not rate the business approach of large German banks as being consistently sustainable.

## 2.7 Remuneration

GLS Bank’s remuneration system distinguishes eight different functional groups, whereby number 8 represents the management board members who earn around € 160,000 per year. Thus, GLS Bank does not have a collective agreement. According to Christof Lützel, head of public relations at GLS Bank, the functional groups 1 to 4 are paid above average and wages at higher functional groups are often lower compared to private banks. Bonus payments do not exist at GLS Bank.

Nevertheless, this remuneration system is not a competitive disadvantage. In April 2009, GLS Bank has been hiring new employees and many excellent job candidates who previously worked at large private banks for a long time are now applying for jobs at GLS Bank. They seem to prefer the reasonable business concept of GLS Bank compared to the financial incentives of large private banks.

## 2.8 Evaluation of rating agencies

GLS Bank has an A+ rating from Fitch (safe investment unless unforeseen events should occur in the economy at large or in that particular field of business)<sup>36</sup> and an A rating from the rating agency Ethibel in 2005 for being the first ethical bank in Germany.<sup>37</sup> Ethibel is a rating agency located in Brussels which evaluates – in addition to the financial performance – the sustainability of financial institutions.

The A rating from Ethibel is the highest possible rating from a range between A and E. GLS Bank’s strategy of ethical banking is an enrichment for the financial service sector. Ethibel appreciates GLS Bank’s high degree of transparency, its focus on ecological, social and innovative projects as well as its microfinance fund.

GLS Bank’s employment shows a high degree of stability. High commitment to vocational education and training in the bank, close communication within working teams and the application of trust-

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<sup>33</sup> GLS Bank website [[web](#)]

<sup>34</sup> Spiegel online (2010): „Noa in der Kritik – „grüne“ Bank mit dubiosen Gründern“, 08.04.2010 by Günter Heismann [[web](#)]

<sup>35</sup> Deutsche Bank: banking on green [[web](#)]

<sup>36</sup> GLS website [[web](#)]

<sup>37</sup> GLS press release, *GLS Bank erhält die beste Bewertung in Deutschland*, 2005

based working hours are reflected in the A rating. Salaries are categorised as being social and well-balanced.

The operating efficiency of the bank is also evaluated as being very good. Provisions for risks are comprehensive and well-documented. GLS Bank is a member of BVR, the German central organisation of the cooperative banking group, meaning customer deposits are therefore protected to the full extent.

## 2.9 Risk management

The GLS Bank Annual Report 2008 (p. 14) describes risk management as a central task. Four categories of risk are distinguished: counterparty, market price, liquidity and operational risks, in which a particular focus lies on counterparty risks. In order to control risks associated with changes in interest rates they used an interest rate swap with WGZ Bank to the amount of € 80 m in 2009. To manage the counterparty risk a rating method is used with which all customer loans are classified into internally defined risk classes. If the creditworthiness of a borrower changes, the grouping of loans into the respective risk class is adjusted..

According to GLS Bank there was no need for them to adapt their risk management in light of the crisis, as the bank did not experience any losses. The credit default rate of 0.3 % in 2009 was very low.

However, the diversification of the credit portfolio is limited due to the bank's ethical selection process of projects. In the case of worsening economic conditions, for example in the environmental or public finance sector, this could affect the bank in a negative way. This is also reflected in Fitch's A+ rating that stands for safe investment unless unforeseen events should occur in the economy at large or in that particular field of business.

## 2.10 Outlook

According to the *Lagebericht für das Geschäftsjahr 2009 der GLS Gemeinschaftsbank* the bank expects that the trend of sustainable and responsible use of money will continue and will influence the development of the business positively. The sectors the bank finances will develop positively in spite of the financial and economic crisis. GLS Bank wants to continue its engagement in all areas with a particular focus on independent schools and kindergartens, trade of organic food and renewable energies.

Growth is expected to continue, raising interest rates and growing competition in financial services will lead to a continued trend of declining interest margins in the medium term. For the next few years a growth of at least 25 % - 35 % per year is expected – in particular regarding the deposit and credit business.<sup>38</sup> On one hand, the company benefits from economics of scale, but on the other, strong growth demands considerable efforts to expand capacities.

Turbulent times on capital markets will increase risk costs in the future and will make risk management a very important part of the business. Moreover, the improvement of counselling competences will continue. In 2009 the bank expanded all communication channels – written, by phone, electronic and personal counselling – in the branches. All channels are planned to be expanded further in the

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<sup>38</sup> The Annual Report 2009 expects a growth rate of at least 20 %. The information of expected growths of 25-35 % was given by the GLS Bank press department in April 2010.

future. An important task will be the integration of new employees in the continuously growing company. This will also result in further recruitment and the continuing vocational training of employees. The bank also plans to expand to Austria by the end of the year.

### 3 Santander Group

Santander Group is the fourth largest bank in the world in terms of profits and eighth in terms of stock market capitalisation. The bank wants to consolidate itself as a large international financial group, which provides an increasingly high return to its shareholders and meets all the financial needs of its customers. In order to achieve this, it combines a strong presence in local markets with corporate policies and global capacities.<sup>39</sup>

Santander has 92 million customers around the world, more precisely 29 % in Continental Europe, 27 % in the UK, and 43 % in the Americas.<sup>40</sup>

#### 3.1 Economic performance

Santander has performed extraordinary well with continuously improving key figures in recent years. The net profit increased by 0.7 % between 2008 and 2009 and was € 8.9 bn in 2009. The net interest income rose considerably by 25.6 % between 2008 and 2009 and by 45.0 % between 2008 and 2007. The net operating income continuously rose and was € 22.9 bn in 2009. The Tier 1 capital ratio also increased and was 10.1 % in 2009. The number of assets rose and was at 1,110 bn in 2009.

**Table 5 Santander Group – Performance data**

In € bn	2009	2008	2007	2006
Total assets	1,110.6	1,049.6	912.9	833.9
Profit before taxes	10.6	10.9	11.0	9.0
Net profit	8.9	8.9	8.1	7.6
Net interest income	26.3	20.9	14.4	11.2
Net operating income	22.9	18.5	14.4	11.2
Tier 1 capital ratio	10.1	9.1	7.7	7.4

Source: Santander Group, Annual Report 2008-2009 [web]

#### 3.2 Employment and branches

##### *Number of employees*

Santander Group had 169,460 employees in 2009 – a decrease of 0.9 % compared with 2008. The newly acquired bank Sovereign added 8,847 employees in 2009 while in Latin America the number of employees declined by 10,000 mainly due to the disposal of America Banco de Venezuela. In the UK 1,430 jobs were cut in 2009. According to the newspaper the Telegraph, the bank stressed that the job losses were not a reaction to the financial crisis but instead part of the planned £ 180 m (€ 208 m) of annual cost savings after the acquisition of the UK bank Alliance & Leicester.<sup>41</sup>

Between 2007 and 2008 a strong increase of employment of around 36.5 % occurred. Of these additional employees the highest increase was also related to Latin America (+30,777, which is 63.4 % of total increase) due to the acquisition of the Brazilian bank Banco Real.

**Table 6 Santander Group – Number of employees by region**

	2009	2008	2007	2006
Total	169,460	170,961	131,819	123,731
Continental Europe	49,870	48,467	47,838	44,216
UK	22,949	24,379	16,827	17,146
Latin America	85,974	96,405	65,628	60,871
Sovereign	8,847	-	-	-
Corporate Activities	1,820	1,710	1,526	1,498

<sup>39</sup> Santander website [web]

<sup>40</sup> Santander Annual Report 2009, p. 22

<sup>41</sup> The Telegraph 12.12.2008 [web]



Source: Santander Group, Annual Report 2008-2009

### *Human resource strategy*

Santander Group follows a human resource strategy involving a series of policies and projects which establish common and homogenous guidelines for the group's employees. The strategy aims at the following four targets:<sup>42</sup>

- Prepare executives and leaders to face the challenges of the future
- Attract and retain the best talent by being the top-of-class reference employer in international banking
- Reinforce the corporate culture and transmit strategic knowledge throughout the group
- Have tools and processes which facilitate human resource management

All in all 126,875 employees took part in training programmes in 2009. On that account, around € 93 m were totally invested.<sup>43</sup>

### *Branches*

The number of branches has progressively increased in recent years and currently lies at 13,660 in total. Especially in the UK the number of branches rose by 87.8 % between 2007 and 2009 due to two acquisitions in the UK in 2008. Moreover, in 2009 the branches of the Sovereign Bank were included.

**Table 7 Santander Group – Number of branches**

	2009	2008	2007	2006
Total	13,660	13,390	11,178	10,850
Continental Europe	5,871	5,998	5,976	5,772
UK	1,322	1,303	704	712
Latin America	5,745	6,089	4,498	4,368
Sovereign	722	-	-	-

Source: Santander Group, Annual Report 2008-2009

## **3.3 Ownership structure**

### *Main figures*

The number of shares in circulation increased from 8,222 m in 2008 to 7,994 m in 2009. The total number of shareholders remained stable at around 3 m.

The share price decreased between 2007 and 2008 but recovered on a higher level in 2009.

**Table 8 Santander Group – Santander's shares**

	2009	2008	2007
Number of shares in circulation (million)	8,222	7,994	6,254
Total number of shareholders	3,062,633	3,034,816	2,278,321
Shares price in €	11.55	6.75	13.79

Source: Santander Group, Annual Report 2009, p. 2

The dividend per share has remained stable over recent years and was € 0.60 in 2009 (2008: € 0.63)

### *Capital stock owner distribution 2009*

Shareholders can be divided into institutional investors (64.0 %), individuals (32.6 %) and the board of directors (3.4 %) holding Santander's shares.<sup>44</sup> The following institutions held more than 3 % of share capital for their client's accounts:<sup>45</sup>

<sup>42</sup> Santander Group, Annual Report 2009, p. 22

<sup>43</sup> Santander Group, Annual Report 2009, p. 22

<sup>44</sup> Santander Group, Annual Report 2009, p. 21

<sup>45</sup> Santander Group, Annual Report 2009, p. 55

- Chase Nominees Limited (12.51 %)
- EC Nominees Ltd. (6.91 %)
- Bank of New York Mellon (5.57 %)
- State Street Bank & Trust (9.06 %)
- Société Générale (3.59 %)
- Caceis Bank (3.42 %)

Of the total capital stock 84.6 % is located in Europe, 15.1 % in the Americas and 0.3 % in the rest of the world.<sup>46</sup>

### 3.4 Important business events

#### *Acquisitions and disposals*

- 2007 The Brazilian bank Banco Real was purchased by Santander making it now the third biggest retail bank in Brazil. It is assumed that the Brazilian subsidiary will be more important in terms of gains in 2011 than the total European business. In 2008 16 % of Banco Real went public in Sao Paulo and Santander gained € 4.76 bn which the bank used to make provisions for loan defaults.<sup>47</sup>
- 2008 In the UK Santander acquired the bank Alliance & Leicester as well as branches and deposits of Bradford & Bingley which is a mortgages financier. Together with Abbey, which was purchased in 2004, Santander is now the third biggest bank in the UK in terms of deposits.<sup>48</sup> In 2008 Santander also acquired the US bank Sovereign Bancorp.
- 2009 In Latin America the Santander Group sold Banco de Venezuela (5,600 employees; 285 branches).<sup>49</sup>

### 3.5 Strategy

Santander's current business model is customer-focused: The model is supported by five pillars which are also shown in Chart 9:<sup>50</sup>

- Commercial focus: Provision of a wide range of financial products and services through its large branch network
- Efficiency: Santander uses innovative technology and operation platforms which allows for cost savings
- Geographical diversification: Santander's business is evenly balanced between emerging and developed markets
- Prudence in risk: Low levels of bad debt and managing risk is involved in the whole organisation of the bank
- Capital discipline and financial strength: Capital ratio of 8.6 % and a liquidity based on medium and long-term funding

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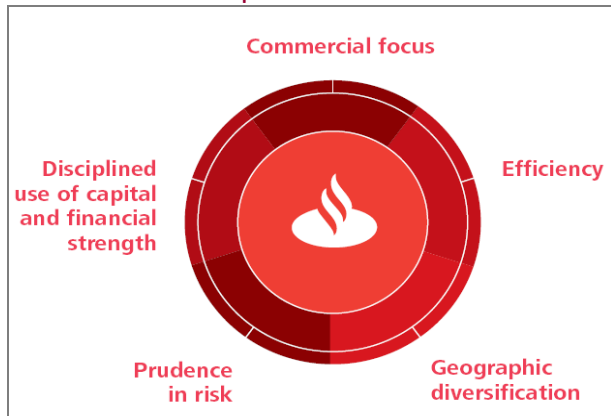
<sup>46</sup> Santander Group, Annual Report 2009, p. 21

<sup>47</sup> Handelsblatt, 'Spanien stellt Europas Nummer 1', 13.01.2010

<sup>48</sup> Handelsblatt, 'Spanien stellt Europas Nummer 1', 13.01.2010

<sup>49</sup> Santander Group, Annual Report 2009, p. 99

<sup>50</sup> Santander Website, [[web](#)]

**Chart 3 Santander Group – Business model**

Source: Santander Group, Annual Report 2009, p. 26

The business model was developed in 2008 and changed slightly compared to 2007. Santander was already focussing on a conservative risk strategy and use of capital before the financial crisis in 2007 (and 2006) and still pursues this strategy today.

In 2007 the business model focussed on the following pillars<sup>51</sup>:

- Retail banking: 86 % of revenues were generated by retail banking
- Geographical diversification: Balanced between mature and emerging markets
- Prudent risk management and maximum transparency: A strict and prudent risk policy for a low and predictable risk. Retail banking perceived 91 % of total credit risk
- Efficiency: Same pillar as above
- Disciplined use of capital: Capital ratio of 12.7 %

### 3.6 Performance of business segments

The Santander Bank differs with regards to two levels: The principal level which divides the bank's activities into regions and the secondary level which divides the business activities into business levels.<sup>52</sup>

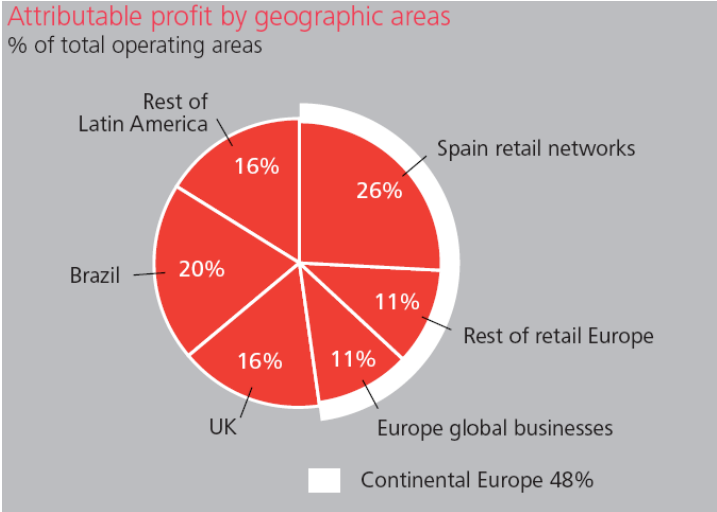
- Principal (geographical) levels:
  - Continental Europe
  - United Kingdom
  - Latin America
- Secondary (business) levels
  - Retail Banking
  - Global Wholesale Banking
  - Asset Management and Insurance

In the following chart the bank's attributable profit (net profit) is illustrated by region: While Continental Europe obtained 48 % of net profit, the UK and Brazil attained 16 % and 20 %, respectively. The rest of Latin America achieved 16 % of net profits.

**Chart 4 Santander Group – Attributable profit by geographic areas**

<sup>51</sup> Santander Group, Annual Report 2007, p. 18-19

<sup>52</sup> Santander Group, Annual Report 2009, p. 98



Source: Santander Group, Annual Report 2009, p. 25

### Retail banking

Retail Banking comprises all customer banking businesses (except Corporate Banking).<sup>53</sup> Retail Banking generated 70 % of attributable profit of the operating areas' total attributable profit. The profit was 0.7 % higher than in 2008. The net interest income increased by 24.4 % and net operating income increased by 23.8 %.

**Table 9 Santander Group – Retail Banking**

In € m	2009	2008	2007 <sup>b)</sup>
Net profit	7,397	7,349	-
Net interest income	25,942	18,542 <sup>c)</sup>	15,339
Net operating income	20,649	16,685	13,026
Note: retail Banking includes dividends, income from equity-accounted method and other operating income/expenses			
<sup>b)</sup> All values for 2007 can differ from total values given in Table 5 as the calculation base has changed due to adaptations to acquisitions			
<sup>c)</sup> Annual Report 2008: without adaption to acquisitions			

Source: Santander Group, Annual Report 2009 p. 128-129, Annual Report 2007 p. 110

### Global Wholesale Banking

Global Wholesale Banking comprises the revenues from Global Corporate Banking, Investment Banking and Markets including all treasuries managed globally and equities business.<sup>54</sup>

Global Wholesale Banking generated 26 % of attributable profit of the operating areas' total attributable profit. The profit rose by 58.8 %. The good performance was – according to Santander's Annual Report 2009, p. 130 – supported 'by a customer-focussed business model, the area's global reach and its connection with local units, and strict control of expenses and risks.'

Net interest income increased by 15.9 % due to strong activity and higher spreads and net operating income rose by 32.8 %.

**Table 10 Santander Group – Global Wholesaling Banking**

In € m	2009	2008	2007 <sup>b)</sup>
Net profit	2,765	1,741	-
Net interest income	2,376	2,095 <sup>a)</sup>	1,492
Net operating income	3,850	2,899	1,928
<sup>a)</sup> Annual Report 2008: without adaption to acquisitions			
<sup>b)</sup> All values for 2007 can differ from total values given in Table 5 as the calculation base has changed due to adaptations to acquisitions			

Source: Santander Group, Annual Report 2009 p. 129-130, Annual Report 2007, p. 110

### Asset Management and Insurance

Asset Management and Insurance includes the contribution of the various units to the Santander Group in the design and management of mutual and pension funds and insurance.<sup>55</sup>

Asset Management and Insurance generated 4 % of attributable profit of the operating areas' total attributable profit. The profit decreased by 14.2 %. The decline was mainly caused by Asset Management as its revenues fell by 27.6 % because of the preference for liquidity and deposits by financial agents. The net operating income fell by 2.8 % mainly because of extraordinary negative results and higher tax fees.<sup>56</sup>

**Table 11 Santander Group – Asset Management and Insurance**

<sup>53</sup> Santander Group, Annual Report 2009, p. 98

<sup>54</sup> Santander Group, Annual Report 2009, p. 98

<sup>55</sup> Santander Group, Annual Report 2009, p. 98

<sup>56</sup> Santander Group, Annual Report 2009, p. 133

In € m	2009	2008	2007 <sup>b)</sup>
Net profit	404	471	-
Net interest income	201	57 <sup>a)</sup>	52
Net operating income	697	718	553

<sup>a)</sup> Annual Report 2008: without adaption to acquisitions  
<sup>b)</sup> All values for 2007 can differ from total values given in Table 5 as the calculation base has changed due to adaptations to acquisitions

Source: Santander Group, Report 2009 p.133-134, Annual Report 2007 p. 110

### 3.7 Remuneration system

#### Remuneration policy

Since 2002 Santander has published the individual remuneration of non-executives and executive directors by items. Since 2005 a report is presented at the general meeting of shareholders by the Appointments and Remuneration Committee and since 2007 this report comprises the remuneration policy of both the current and previous years. In 2008 the transparency of directors' remuneration became obligatory.<sup>57</sup>

According to Santander, as regards remuneration, the bank's policy is aligned with the recommendations of the main international institutions in this sphere.

The directors' remuneration from 2008 has remained unchanged. The annual bonus for executive directors was also kept at the same amount as in 2008 and was, on average, 14 % lower than the one a year prior.

#### Remuneration of executive directors

Remuneration for executive directors comprises a fixed remuneration, a variable remuneration in the form of cash or a bonus which is performance-related and a variable deferred remuneration in shares which is implemented through a performance shares plan and an obligatory investment plan with a matched deferred bonus in shares. The deferral is for three years and linked to the creation of value for the shareholders.<sup>58</sup>

**Table 12 Santander Group – Fixed remuneration of executive directors**

Thousand €	2009	Change (%)	2008	2007
Mr Emilio Botín-Sanz de Sautuola y García de los Ríos	1,344	3.0	1,305	1,187
Mr Alfredo Sáenz Abad	3,703	3.0	3,595	3,126
Mr Matías Rodríguez Inciarte	1,710	3.0	1,661	1,510
Ms Ana Patricia Botín-Sanz de Sautuola y O'Shea	1,294	2.0	1,269	1,133
Mr Francisco Luzón López	1,505	3.0	1,461	1,271
Mr Juan Rodríguez Inciarte	987	3.0	958	-
Total	10,543	2.9	10,249	8,227

Source: Santander Group, Report of the Appointments and Remuneration Committee 2009 [web], p. 6

'The variable remuneration in cash (or as a bonus) represents 145 % of fixed remuneration for all executives' directors.<sup>59</sup>

**Table 13 Santander Group – Annual variable remuneration of executive directors in cash (or bonus)**

Thousand €	2009	Change (%)	2008	2007
Mr Emilio Botín-Sanz de Sautuola y García de los Ríos	1,987	0.0	1,987	2,337
Mr Alfredo Sáenz Abad	4,745	0.0	4,745	5,582
Mr Matías Rodríguez Inciarte	2,503	0.0	2,503	2,945
Ms Ana Patricia Botín-Sanz de Sautuola y O'Shea	1,786	0.0	1,786	1,985
Mr Francisco Luzón López	2,753	0.0	2,753	3,239
Mr Juan Rodríguez Inciarte	1,466	0.0	1,466	-

<sup>57</sup> Santander Group, Annual Report 2009, p. 17

<sup>58</sup> Report of the Appointments and Remuneration Committee 2009, p. 6-8

<sup>59</sup> Report of the Appointments and Remuneration Committee 2009, p.6

Total	15,240	0.0	15,240	16,088
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Source: Santander Group, Report of the appointments and remuneration committee 2009, p. 6

Each year within the performance shares plan the executive directors obtain a number of shares based on the achievement of targets and compliance within the conditions thereof. The shares are deferred for three years. In 2007 and 2008 the targets 'were linked to the bank's total shareholder return and increase in earnings per share'.<sup>60</sup> In 2009 only the shareholder's return was taken into account.

**Table 14 Santander Group – Variable deferred remuneration of executive directors**

Maximum number of shares	2009	2008	2007
Mr Emilio Botín-Sanz de Sautuola y García de los Ríos	82,941	68,848	62,589
Mr Alfredo Sáenz Abad	228,445	189,628	164,894
Mr Matías Rodríguez Inciarte	105,520	87,590	79,627
Ms Ana Patricia Botín-Sanz de Sautuola y O'Shea	56,447	46,855	41,835
Mr Francisco Luzón López	92,826	77,083	67,029
Mr Juan Rodríguez Inciarte	60,904	50,555	64,983

Source: Santander Group, Report of the Appointments and Remuneration Committee 2009, p. 7

The variable deferred remuneration, according to the obligatory investment plan with matched deferred bonus in shares, is implemented by a mandatory investment in shares by the executive directors. This investment comprised 10 % of the gross variable remuneration in cash (or as a bonus) for the years 2007 - 2009. Limits are approved by the shareholders at the general shareholder's meeting.<sup>61</sup>

The mandatory investment for each executive director is illustrated in Table 15:

**Table 15 Santander Group – Mandatory investment for executive directors**

Number of shares	2009	2008	2007
Mr Emilio Botín-Sanz de Sautuola y García de los Ríos	20,515	19,968	16,306
Mr Alfredo Sáenz Abad	49,000	47,692	37,324
Mr Matías Rodríguez Inciarte	25,849	25,159	20,195
Ms Ana Patricia Botín-Sanz de Sautuola y O'Shea	18,446	16,956	13,610
Mr Francisco Luzón López	28,434	27,675	22,214
Mr Juan Rodríguez Inciarte	15,142	14,738	14,617

Source: Santander Group, Report of the appointments and remuneration committee 2009, p.7

### 3.8 Evaluation of rating agencies

The main rating agencies gave high ratings for Santander in 2009 (AA). 'Santander is one of only four international banks with the AA rating from the three main agencies.'<sup>62</sup>

**Table 16 Santander Group – Ratings**

	Long-term			Short-term			Financial strength		
	2009	2008	2007	2009	2008	2007	2009	2008	2007
Standard & Poor's	AA	AA	AA	A1+	A1+	A1+			
Fitch ratings	AA	AA	AA	F1+	F1+	F1+	A/B	A/B	A/B
Moody's	Aa2	Aa1	Aa1	P1	P1	P1	B-	B	B
DBRS	AA	AA	AA	R1(alto)	R1(high)	R1(high)			

Note: An explanation of rating codes can be found in the Annex

Source: Santander Group, Annual Reports 2007-2009

#### Rationale

The rating of Standard & Poor's<sup>63</sup> reflects Santander's 'sharp strategic focus and strong management capabilities, well-diversified geographic spread and business profile, solid presence in core markets,

<sup>60</sup> Report of the Appointments and Remuneration Committee 2009, p. 7

<sup>61</sup> Report of the Appointments and Remuneration Committee 2009, p. 7

<sup>62</sup> Santander Group, Annual Report 2009, p. 63

and sound operating profitability. Standard & Poor's ratings services also factor [on the bank's] deteriorating asset quality, its economic risk linked to Latin American operations, and inherent execution risks stemming from Santander's appetite for acquisitions.'

Also Fitch's<sup>64</sup> rating 'reflects the group's strong retail banking franchises in its core markets of Spain, Portugal, the UK, Brazil, Chile and Mexico, its sound management approach and a coherent and focused strategy with acquisitions centred in retail banking, its robust profitability, a diversified and well-structured business mix, good risk-management systems, and adequate capital. They also factor in Latin American exposure and declining asset quality.'

Moody's<sup>65</sup> downgraded the long-term rating from Aa1 to Aa2 and the financial strength from B to B-. According to Moody's, the downgrade of Santander's 'rating expresses [the] concerns about the broad deterioration of the Spanish economy, to which Santander remains heavily exposed, as well as its recently increased exposure to the UK and the US', which both also face severe economic disruptions.

### *Asset quality*

Standard & Poor's believes 'the bank's non-performing loans will increase significantly in Spain and more moderately in the U.K. In addition, risk premiums stand to increase substantially in the consumer finance business and across all Latin America, particularly in Mexico and Brazil. (...) Santander will face significant asset quality deterioration in Continental Europe, with more pronounced weakening in the consumer finance business, mostly comprising auto loans, and in Santander's Spanish network partly due to the weight of small and medium sized enterprises. Still, the bank's consolidated assets in Spain are likely to be less affected than the overall system due to the diversification of its book by region and by sector.'

Moody's expects that Santander will 'continue to face further asset quality pressures from both Sovereign and Alliance & Leicester as well as from its home market. This will lead to quite significant future provisioning requirements, which in turn would affect Santander's earning power and ability to strengthen its capital levels internally.'

### *Risk management*

According to Standard & Poor's, 'Santander is exposed to credit risk mainly through its European commercial banking business which accounts for 85 % of total loans. It is also exposed to the higher risk inherent in its Latin American subsidiaries. The Banco Real purchase has increased Santander's exposure to Brazil, which now accounts for 7 % of total loans. In Europe, the group has a widely diversified banking business in the Iberian peninsula and a comparatively lower risk profile in its residential mortgage lending business in the U.K. Compared with that of other international banks, Santander's international corporate lending has a relatively low weight in the balance sheet, so major international bankruptcies in the past have not affected the bank materially. Santander's market risk exposure is also lower than that of peers. Santander has strong risk management capabilities based on its culture of independent and tight risk management. The bank strictly separates risk and commercial areas, and adheres to a committee decision-making process with its risk function having a high stature within the bank. (...) Santander has passed on its risk culture and organisation to its subsidiaries [and] has developed integrated risk standards and a credit organisation, while rotating experienced managers within its subsidiaries.'

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<sup>63</sup> Standard & Poor's Rating, 7 April 2009, [[web](#)]

<sup>64</sup> Fitch's Rating, , 13 July 2009 [[web](#)]

<sup>65</sup> Moody's Rating, , 30 July 2009 [[web](#)]



Moody's also believes that in the short and medium term the shift towards the UK and the US, away from Latin America, has increased Santander's risk profile.'

### 3.9 Risk management

Santander Group pursues a risk policy which 'is focussed on maintaining a low-medium and predictive profile in all risks.'<sup>66</sup> Quality management of risk is thus a priority in the bank's activities. The bank combines prudence in risk with the use of risk management techniques. The risk management is based on the following pillars:<sup>67</sup>

- Involvement of senior management in global supervision in risk taking
- Independent working from the business areas (risk takers) and the risk areas responsible for measurement, analysis, control and information
- Collective decision making
- Joint responsibility for decisions on credit operations between risk and business areas
- Clearly defined functions for risk taker and risk manager
- Risk measurement
- Use of a series of integrating metrics, e.g. consumption on risk capital and RORAC (risk adjusted return)
- Limiting risk in setting maximum risk levels for the various risk measures
- Setting policy and risk procedures as a regulatory framework
- Defining and assessing risk methodologies to provide internal risk models for evaluation

#### *Credit Risk*

The distribution of credit risk is shown in Chart 11. It was distinguished by geographical region - total and standardised, type of risk, and product.

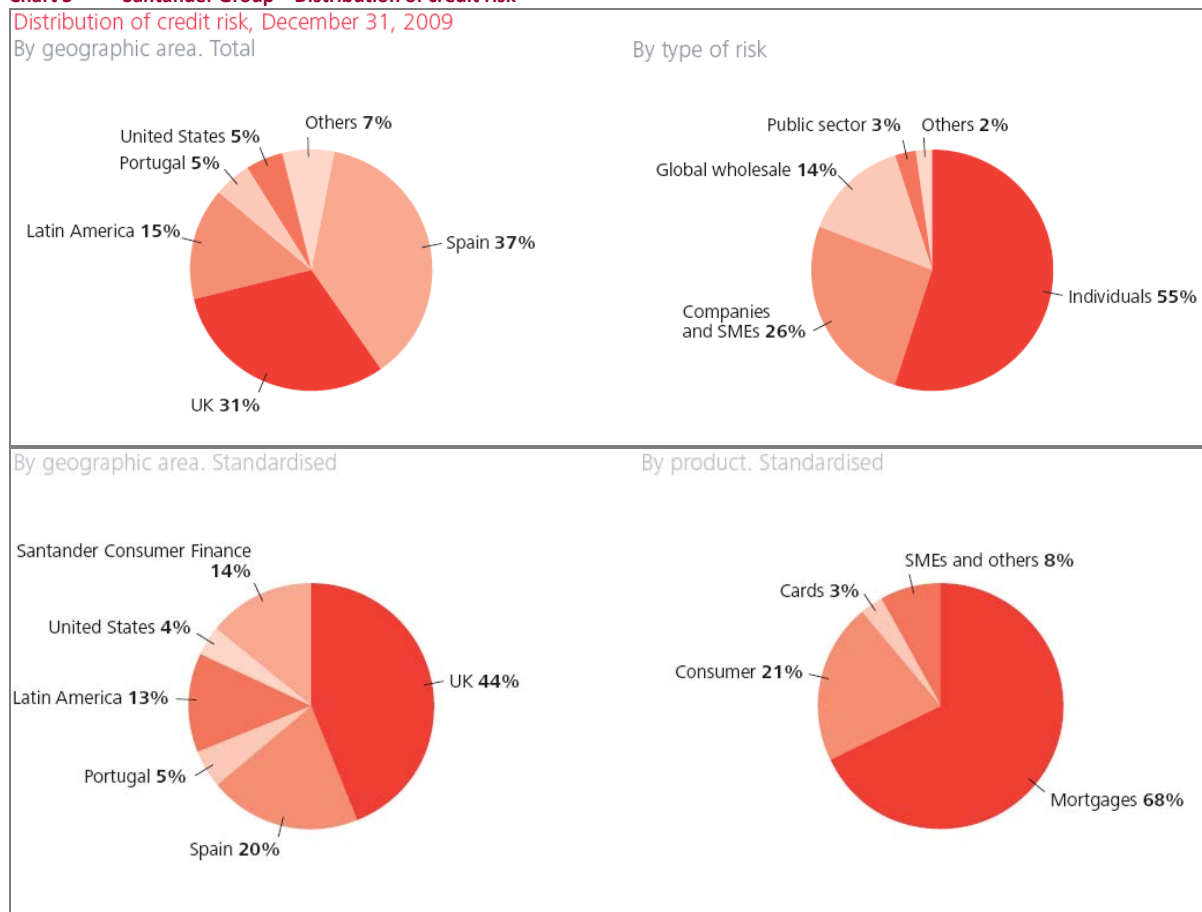
The credit risk is highest in Spain and the UK for total and standardised, while Latin America also has a higher rate than the remaining areas. The highest risk in terms of type originates from individuals (55 %). The credit risk from companies and SMEs lies at 26 % and for wholesale banking at 14 %. The highest credit risk by product is given by mortgages with 68 % of risk.

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<sup>66</sup> Santander Group Annual Report 2009, p. 140

<sup>67</sup> Santander Group, Annual Report 2009, p. 140-141

**Chart 5 Santander Group – Distribution of credit risk**



Source: Santander Group, Annual Report 2009, p. 148

**Non-performing loans**

‘The global recession pushed up the Group’s [amount and] ratio of non-performing loans.’ The amount of non-performing loans (NPL) totalled € 24,554 m in 2009, which was 73 % more than in 2008 (€ 14,191 m). The NPL ratio, which defines the amount of non-performing loans to total loans (credit default rate), accounted for 3.24 % in 2009 and for 2.04 % in 2008. The NPL ratio was the highest for Latin America (4.25 %).<sup>68</sup>

**Table 17 Santander Group – NPL ratio by geographical areas**

In %	2009	2008	2007
Continental Europe	3.64	2.31	0.90
thereof Spain	3.41	1.95	-
UK	1.71	1.04	0.60
Latin America	4.25	2.95	1.87
Total	3.24	2.04	0.94

Source: Santander Group, Annual Report 2009, p. 147, Annual Report 2007 p.83

**Market risk**

Santander maintained, according to the Annual Report 2009 (p. 138), a low risk profile in activities subject to market risk. The value at risk (VaR) fluctuated between € 21.9 m and € 45.1 m. The average was € 30.2 m and was € 9.8 million lower than in 2008, due to lower volatility in markets.

<sup>68</sup> Santander Annual Report 2009, p. 93

**Table 18 Santander Group – VaR statistics**

In € m	Minimum	Average	Maximum	Year end
Total trading total VaR	21.9	30.2	45.1	27.5
Latin America total VaR	9.0	19.6	33.8	16.6
US and Asia total VaR	1.0	3.3	11.0	1.2
Europe total VaR	11.2	14.6	23.9	13.5

Source: Santander Group, Annual Report 2009, p. 172

The average VaR was spread over the following components in Table 19. Most important was the fixed income VaR.

**Table 19 Santander Group – VaR statistics by risk factor**

In € m	Average
Diversification effect	-24.8
Fixed income VaR	20.0
Equity VaR	6.9
FX VaR	15.5
Credit spread VaR	11.9
Commodities VaR	0.8

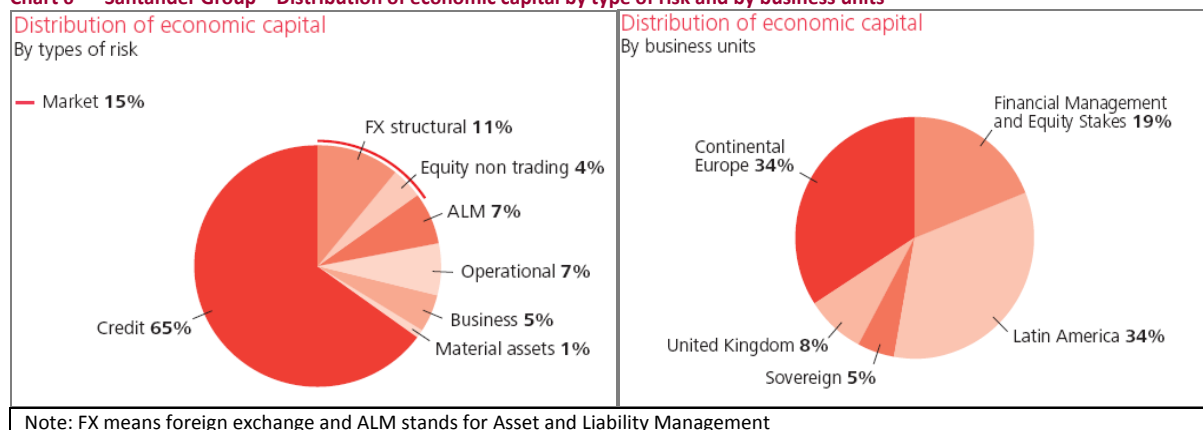
FX stands for foreign exchange

Source: Santander Group, Annual Report 2009, p. 172

### Economic capital

'While Pillar I of the Basel II capital framework determines the minimum regulatory capital requirements, Pillar II quantifies, via economic capital, the Group's global solvency position. [Thus], the Group's model of economic capital quantifies the consolidated risk profile taking into account all significant risks of activity, as well as the consubstantial diversification effect.'<sup>69</sup>

'The Group's risk profile at December 31 2009, measured in terms of economic capital, is distributed by types of risk and the main business units' and is shown in the chart below.<sup>70</sup> The economic capital at December 31 2009 was € 43.0 m, including minority interests.

**Chart 6 Santander Group – Distribution of economic capital by type of risk and by business units**

Source: Santander Group, Annual Report 2009, p. 192

According to Santander, 'the distribution of economic capital among the main business units reflects the diversification of the group's activity and risk, which increased in 2009 after the acquisition of Sovereign in the US (5 % of the group's capital).'71

<sup>69</sup> Santander Group Annual Report 2009, p. 192

<sup>70</sup> Santander Group Annual Report 2009, p. 192

<sup>71</sup> Santander Group Annual Report 2009, p. 192

'Continental Europe and Latin America each account for around one third of risk, the UK for 8 %, while financial management and equity stakes (...), which assume the risk from the structural exchange rate position (derived from stakes in subsidiaries abroad denominated in non-Euro currencies) and most of the equity stakes, account for 19 %.'<sup>72</sup>

### 3.10 Outlook

#### *Company's outlook*

Santander Group assumes that due to economic recovery the environment will be more favourable in 2010 than 2009. Nevertheless, pre-crisis growth rates will not be reached meaning the upcoming years will be difficult.<sup>73</sup> Non-performing loans will increase and the bank will suffer the double impact of both low demands for loans and pressures on spreads associated with re-pricing. There will however, according to the Annual Report 2009 (p. 12), be chances to gain market shares through organic growth and acquisition opportunities in some markets.

The priorities will remain similar: management of spreads and control of costs, risk control and management of loan-loss recoveries.<sup>74</sup>

The bank expects another difficult year for Santander Consumer Finance, nevertheless, a stabilisation of non-performing loans is also expected. In Corporate Banking, Santander will continue to gain market shares and will focus on clients in core markets.<sup>75</sup>

#### *Rating agencies' outlook*

Standard & Poor's valued Santander's outlook as negative which could also result in a downgrade of Santander if credit conditions in the bank's main markets deteriorate, having a significant impact on the bank's financial performance. 'Santander has weathered the crisis relatively well so far. However, [the rating agency] observes an increasing credit deterioration in most economies in which Santander is present (...). [The bank will suffer] profitability pressures from increasing provisioning charges, negative repercussions from exchange rate fluctuations, lower business volumes, and higher funding costs. Any meaningful acquisitions could also carry negative implications for the ratings. [The rating will be improved to] stable, all other things being equal, if Santander is able to maintain its resilient asset quality and strong earnings throughout the economic slowdown', according to Standard & Poor's.<sup>76</sup>

Moody's also assessed the bank's BFSR negatively '(which was then also translated into a negative outlook on the bank's other ratings) [which] primarily indicates the continuing credit challenges and uncertainties in the markets that Santander operates in, as well as its expansive acquisition strategy. This notwithstanding and despite some high borrower concentration, Moody's believes that the bank's retail focus, diversification and integration track record of past acquisitions should offset some of these pressures and underpin the current BFSR.'<sup>77</sup>

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<sup>72</sup> Santander Group Annual Report 2009, p. 193

<sup>73</sup> Santander Annual Report 2009, p. 8

<sup>74</sup> Santander Annual Report 2009, p. 12

<sup>75</sup> Santander Annual Report 2009, p. 13

<sup>76</sup> Standard & Poor's Rating, 7 April 2009

<sup>77</sup> Moody's Rating, 30 July 2009

## 4 Rabobank

Rabobank Group is an international financial services provider which operates on the basis of cooperative principles. It offers retail banking, wholesale banking, asset management, leasing and real estate services.

### 4.1 Economic performance

#### *Performance of Rabobank Group*

In the Netherlands Rabobank has a strong position on the market: in the Dutch agriculture sector it has a dominant market share of 84 %. It is also the market leader in Dutch retail savings (40 % market share) residential mortgages (30 %), and small and medium sized enterprises banking (41 %).<sup>78</sup>

According to the Annual Report 2009, the net profit of Rabobank Group decreased by 17 % and was € 2.288 m in 2009. In addition, the difficult economic situation caused increased bad debt costs. The drop in activity level led to cost cuts throughout the group.

The Tier 1 ratio increased by 1.1 percentage points to 13.8 % in 2009 due to retained earnings and the issue of hybrid capital instruments. The economic situation caused demand for loans to drop with lending growth levelling off, particularly in the second half of 2009.

The private sector loan portfolio increased by almost 2 %, while the amounts due to customer decreased by 6 % at the group. Businesses and retail clients deposited more money at local Rabobanks, while at Rabobank International amounts due to customers decreased.

**Table 20 Rabobank Group – Performance data**

In € m	2009	2008	2007	2006
Total assets	607,698	612,120	570,491	556,455
Income	11,867	11,652	11,022	10,049
Net profit	2,288	2,754	2,696	2,345
Private sector loan portfolio	415,748	408,620	368,709	324,110
Amounts due to customers	286,338	304,214	276,610	234,917
Tier 1-ratio (%) <sup>a)</sup>	13.8	12.7	10.7	10.7

<sup>a)</sup> These figures have been based on Basel II requirements since 2008.

Source: Rabobank Group Annual Report, p. 2

#### *Description of the group*<sup>79</sup>

Altogether, Rabobank Group encompasses 147 independent local Rabobanks plus Rabobank Nederland, their umbrella organisation, as well as a number of subsidiaries. Overall, Rabobank Group has about 60,000 employees (in FTEs: full-time equivalents), who serve approximately 9.5 million clients in 46 countries.

- In the Netherlands Rabobank has 147 local Rabobanks which build the core business. Together, they employ approximately 28,000 FTEs and serve about 6.7 million retail clients and around € 800,000 of corporate clients in the Netherlands. Because of its mutual character clients can become members of their local Rabobank. Thus the local Rabobanks, for their part, are members and shareholders of Rabobank Nederland, the umbrella cooperative.
- Rabobank Nederland monitors, on behalf of the Dutch Central Bank, the business practices, outsourcing, solvency and liquidity of the local Rabobanks. It also acts as the holding company of

<sup>78</sup> Rabobank Group Annual Report 2009, p. 2

<sup>79</sup> Rabobank website „Profile of Rabobank group“ [[web](#)]

a number of specialist subsidiaries, both in the Netherlands and abroad. Rabobank Nederland has an employee base of about 6,200 FTEs.

- Rabobank International – the wholesale banking and international retail banking divisions of Rabobank Group – has an employee base of about 14,500 FTEs, including the foreign subsidiaries. Rabobank runs a network in 30 countries and 528 foreign places of business. The non-Dutch activities are primarily focussed on financing the food and agricultural sectors. Therefore, its international network is focussed on major agricultural centres in Europe, the Americas, and Australasia. It also conducts wholesale, commercial, and retail banking outside the Netherlands.
- Rabo Development supports the advancement of a banking infrastructure in developing countries by acquiring non-controlling interests in rural banks and offering them expertise and human capital.
- Moreover, a Rabobank Foundation exists in order to help vulnerable and underprivileged groups both in and outside of the Netherlands by contributing funds, human resources and knowledge.

## 4.2 Employment and branches

### Employment

The number of employees at Rabobank Group slightly decreased (by 2 %) between 2008 and 2009 due to a decreased activity level and a critical examination of costs. The implemented cost cuts throughout the group are also reflected in a 10 % reduction in staff costs. Rabobank regularly conducts employee satisfaction surveys. In 2009, 41 % of employees took part in this survey at Rabobank Nederland and the local Rabobanks. Of these employees, 88 % said they were satisfied with their job.<sup>80</sup>

Encouraging more women to reach top ranks remains an important issue at Rabobank. In 2009 the proportion of females in senior positions increased from 22.1 % in 2008 to 23.2 %. Moreover, the first appointment of a woman to the executive board of Rabobank Nederland took place as well as the appointment of a second woman to the supervisory board in 2009.<sup>81</sup>

**Table 21 Rabobank Group – Information about employment**

Amounts in millions of €	2009	2008	2007	2006
Number of employees (in FTEs)	59,311	60,568	54,737	50,573
Staff costs (€ m)	3,869	4,290	4,400	4,115
Employee satisfaction (%)	88	86	85	87
Absenteeism (%)	3.8	3.8	3.8	3.6
Females employed (%)	54.8	55.1	55.4	55.6
Females in senior positions (> scale 7) (%)	23.2	22.1	20.7	19.9
Training expenses (€ m)	86.8	99.9	98	76.9
Training expenses in € per FTE	1,464	1,649	1,790	1,518
FTE = Full-time equivalent				

Source: Rabobank Group Annual Report, p. 3

**Table 22 Rabobank Group – Employee base by job level and age**

	% of women	% of part-time workers	% of employees with indefinite employment contracts	% of employees aged 24 and under	% of employees aged 25 to 34	% of employees aged 35 to 44	% of employees aged 45 to 54	% of employees aged 55 and over
Total employee base	54.8	38.5	92.9	2.9	26.8	38.7	22.9	8.6
Employees in salary scale 1 to 7	71.1	49.8	90.5	4.3	32.3	34.5	20.8	8.1
Employees in salary scale 8 to 11	24.7	13.5	97.5	0.1	17.1	48.3	25.4	9.1
Senior managers	12.3	8.9	100	-	1.2	41.8	42.5	14.5

<sup>80</sup> Rabobank Group Annual Report 2009, p. 81

<sup>81</sup> Rabobank Group Annual Report 2009, p. 79

Executive managers	6.5	2.9	99.3	-	0.3	18.0	52.9	28.8
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Source: CRS Reporting 2009 Rabobank Group; Working together towards a sustainable future, Appendix 1, p. 35 [\[web\]](#)

Vocational education and training plays an important role at Rabobank. According to Rabobank's Annual Report 2009 performance of banks is being closely scrutinised by society, the Netherlands Authority for the Financial Markets introduced an initiative in order to ensure 'that any financial services provided to clients are well considered and reliable.'<sup>82</sup> Rabobank considers this programme as very important in order to ensure that they have qualified and capable employees in advisory roles.

Rabobank's relationship with its employees is based on sound labour relations. 'Working arrangements are intended to be flexible and goal-oriented on both sides to ensure the best possible results.'<sup>83</sup> This means that employee satisfaction is crucial. Table 23 presents the opinion of Rabobank employees regarding development options within the company.

**Table 23 Rabobank Group – Key figures employee development policy**

As a %	2009			2008			2007			2006		
	LB	RN	RG	LB	RN	RG	LB	RN	RG	LB	RN	RG
Rabobank offers me ample opportunity for personal development	79	69	76	78	71	75	76	68	74	74	66	73
Rabobank offers me ample opportunity to receive training for my current job	88	73	84	88	78	81	87	74	84	86	75	84
Total number of employees with PDP	76	75	72	76	67	71	76	67	75	69	72	69

LB = Local Rabobanks, RN = Rabobank Nederland and RG = Rabobank Group  
 Not every group entity of Rabobank Group conducts an annual survey. The column RG comprises:  
 in 2006: all questions relating to Rabobank Nederland, local Rabobanks, Schretlen & Co  
 in 2007: 'personal development' and 'training opportunities' relating to Rabobank Nederland, local Rabobanks, Schretlen & Co  
 in 2007: 'PDP' relating to Rabobank Nederland, local Rabobanks, Schretlen & Co, Robeco NL, Obvion and Rabo Real Estate Group  
 in 2008: 'personal development' and 'training opportunities' relating to Rabobank Nederland, local Rabobanks, Orbay, DLL INT and RI INT  
 in 2008: 'PDP' relating to Rabobank Nederland, local Rabobanks, Orbay, Robeco NL, Bouwfonds NL and INT, DLL INT, RI INT, Sarasin  
 in 2009: 'personal development' and 'training opportunities' relating to Rabobank Nederland, local Rabobanks, Sarasin  
 in 2009: 'PDP' relating to Rabobank Nederland, local Rabobanks, Robeco, Rabobank International (outside NL), De Lage Landen (outside NL), Sarasin

Source: CRS Reporting 2009 Rabobank Group; Working together towards a sustainable future, Appendix , p. 371 [\[web\]](#)

According to the Strategic Framework 2009 - 2012 Rabobank emphasised that people are crucial for success as 'the strategic aspirations can be achieved only with talented, vibrant and motivated people'.<sup>84</sup>

- *People are an important part of the Strategic Framework:* Particularly in senior management positions and specialisations, there is a growing demand for highly educated and highly qualified staff. In times of structurally tighter labour market, the inflow from outside is becoming less of an assumption that can be relied on. Thus Rabobank wants to develop in-house talent and remain these talents. 'In alignment with the Strategic Framework, there is a special programme to ensure succession at the senior and executive levels. Its further aim is to facilitate succession management for senior and executive managers and to promote internal mobility. Rabobank Group intends to develop similar programmes for middle management. In light of internal developments such as Rabobank 2010 and Rabo Unplugged, a properly functioning training programme with clear roles and responsibilities should ensure an adequate training option, which aligns with the organisational need for highly educated and highly qualified staff.'<sup>85</sup>

<sup>82</sup> Rabobank Group Annual Report 2009, p. 78

<sup>83</sup> Rabobank Group Annual Report 2009, p. 77

<sup>84</sup> Rabobank Groups Annual Report 2008, p.10

<sup>85</sup> Rabobank Group Annual Report 2008, p. 10



- *Vision for 2010*: 'Almost all local Rabobanks are actively involved in the Rabobank 2010 Vision, participating in at least one of the five support programmes (Differentiation in Customer Service, Business Practices with a Future, Virtually Nearby, Customer Relationship Management (CRM), and Processes and Management). Rabobank 2010 is aimed at updating and improving customer services at substantially lower costs in combination with a process redesign. This has consequences for the employees as jobs will change, will be cut or will disappear. The local works councils are involved in all developments affecting the local Rabobanks as a matter of course.'<sup>86</sup>
- *New ways of working*: At Rabobank Nederland a so called 'Unplugged' concept exists, which means fewer rules and greater individual responsibility for employees. The concept was evaluated in 2009 and revealed predominantly positive feedback. 70 % of employees who work with the new concept stated clear benefits – especially more flexibility and a favourable impact on the work-life balance. The freedom to decide where and when to work was reflected in Intermediar magazine's survey of the best employers of 2009, in which Rabobank came first.<sup>87</sup>

### Branches and members

Within the last few years the number of local Rabobanks has decreased while the number of foreign places of business has increased. The number of members has progressively increased since the beginning of the financial crisis. Between 2008 and 2009 the number of members increased by 3.2 %.

**Table 24 Rabobank Group – Branches and members**

	2009	2008	2007	2006
Local Rabobanks	147	153	174	188
Offices	1,010	1,112	1,159	1,214
Cash-dispensing machines	3,063	3,097	3,107	3,139
Members (x 1,000)	1,762	1,707	1,638	1,641
Client satisfaction private individuals	8	8	8	8
Foreign places of business	624	569	349	330

Source: Rabobank Group Annual Report, p. 2

## 4.3 Ownership structure

As Rabobank is a cooperative bank it does not have any public shareholders. Without the pressure to bring quarterly successes, business can be done with a long-term view that takes into account the best interests of the bank, the members and the customers. Rabobank's profits are retained in the business to be reinvested towards the growing strength of the bank, the continued growth of the business and to service the customers even better.<sup>88</sup>

Rabobank Group is a cooperative organisation comprising of:

- 147 independent local cooperative Rabobanks
- the central cooperative Rabobank, of which the local Rabobanks are a member
- a large number of specialised subsidiaries

Local member banks are owned by 1.76 million members.

Neither the central cooperative nor the local cooperative Rabobanks have owners/members with an interest of more than 5 %.<sup>89</sup>

<sup>86</sup> Rabobank Group Annual Report 2009, p. 78

<sup>87</sup> Rabobank Group Annual Report 2009, p. 78

<sup>88</sup> Rabobank website [\[web\]](#)

<sup>89</sup> Rabobank website [\[web\]](#)

## 4.4 Important business events

### *Situation of banking sector in the Netherlands*

As in other countries, the Dutch banking sector suffered from the financial crisis and led to measures being taken by the Dutch government and the Dutch Central Bank in order to safeguard financial stability. According to a report of Rabobank about cooperative banks in the new financial system, about 50 % of the Dutch banking sector received government support, which has changed the competitive environment. Rabobank experienced losses and writedowns of 6 % of its total equity, but the bank did not need any state aid.<sup>90</sup>

### *Acquisitions and disposals*

2007 Rabobank Nederland decided to sell the subsidiary Alex Beleggersbank to the listed internet broker BinckBank.<sup>91</sup> The sale of Alex Beleggersbank, a market leader in the field of online investment, is the consequence of Rabobank's review of Alex's possibilities inside and outside the group in 2007. Alex will stay a separate brand under the ownership of BinckBank and will maintain its own positioning.

2008 In April 2008 the Polish Financial Supervision Authority permitted that Rabobank received official permission to achieve a majority position in the Polish BGZ Bank. 'Rabobank will cross the 50 % threshold in BGZ by acquiring a 12.87 % stake currently held by the European Bank for Reconstruction and Development (EBRD). This will enable Rabobank to gain a majority stake of 59.35 % in BGZ. Rabobank first acquired a 35.4 % stake in BGZ in 2004. The bank then increased its stake to 46.48 % mainly by converting bonds into shares.'<sup>92</sup>

2008 On 12<sup>th</sup> June Banque Populaire du Rwanda (BPR) and Rabo Development agreed Rabobank's 35% interest in BPR – Rwanda's leading retail bank.<sup>93</sup>

## 4.5 Strategy

### *Group strategy*

Rabobank's strategy mainly focuses on mutual values and growth. According to its website Rabobank's strategic framework for 2005 - 2010 is founded on the following indisputable principles:<sup>94</sup>

'Rabobank is and remains:

- Dutch, with its dominant market position based in agribusiness, among private individuals and in small and medium-sized enterprises
- a cooperative, exceptions may only be made for Group subsidiaries
- AAA worthy
- Independent, a complete sale is not an option. In any merger agreement with any other party, Rabobank will only accept a majority interest only.

The strategic framework characterises Rabobank as 'the global food & agri bank with its roots in the Netherlands' and distinguishes three growth areas:

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<sup>90</sup> Rabobank Group (2009): "Cooperative banks in the new financial system", October 2009 [\[web\]](#)

<sup>91</sup> Rabobank Investor news, 31.10.07 [\[web\]](#)

<sup>92</sup> Rabobank Press release 04.04.2008 [\[web\]](#)

<sup>93</sup> Rabobank Press release 13.06.2008 [\[web\]](#)

<sup>94</sup> Rabobank website [\[web\]](#)

- growth in the Dutch all finance market, particularly through further collaboration with Eureka/Achmea and through further strengthening of Rabobank's position at the top end of the private and corporate markets
- continued expansion abroad as a leading international food & agri bank
- further growth of and synergy between the group subsidiaries.<sup>95</sup>

As a consequence of the financial crisis, the 2005 - 2010 Strategic Framework was reviewed but the business principals remained the same. Therefore, the 2009 - 2012 Strategic Framework was presented in Rabobank Group's Annual Report 2008.<sup>96</sup>

Due to the crisis the opportunities for expansion open to Rabobank Group have become more restricted. In view of developments, Rabobank Group is increasing its strategic focus on its core activities. These focus on the operations of the local Rabobanks, which are at the heart of the organisation and perform the primary task of providing customer value to members and clients.<sup>97</sup>

The bank's strategic starting points, as described in the Annual Report 2008, are its cooperative identity, its ambition to become the Dutch market leader in all finance services and as an international food and agri bank, the retention of a high credit rating, and high standards in respect of corporate social responsibility (CSR) policy (see below).

It has therefore set the following core objectives:<sup>98</sup>

- 'become the Dutch all finance market leader (or retain this position, as appropriate)
- build on its position as the world's leading international food and agri bank
- achieve greater commercial synergy with subsidiaries'

Since Rabobank Group needs an adequate Tier 1 ratio and stable profit growth in order to maintain its high credit rating and to be able to serve members and clients on an ongoing basis, it has set the following long-term financial targets:<sup>99</sup>

- 'a Tier 1 ratio of at least 12.5 %
- a minimum return on equity of 8 %
- 10 % net profit growth'

According to the annual Report 2009 (p. 10) 'adjusting the target return on equity from 10 % to 8 % is in line with the increase in [Rabobank's] capital position that [the group] has wanted to bring about since 2008, the anticipated lower growth in lending, and the shift towards activities with a more moderate risk/return profile.'

### *Corporate Social Responsibility (CRS)*

At the Rabobank Group a Corporate Social Responsibility Directorate exists which is the central driver of CSR within the Rabobank Group. The CSR policy is an integral part of the strategy and focuses on increasing the sustainability of both financial products and services as well as of business processes.<sup>100</sup>

<sup>95</sup> Rabobank website [[web](#)]

<sup>96</sup> Rabobank Group Annual Report 2008, p. 9

<sup>97</sup> Rabobank Group Annual Report 2009, p. 10

<sup>98</sup> Rabobank Group Annual Report 2008, p. 11

<sup>99</sup> Rabobank Group Annual Report 2008, p. 11

<sup>100</sup> Rabobank website [[web](#)]

The policy focuses on:<sup>101</sup>

- 'Sustainable behaviour as the standard for financial services
- The scarcity of natural resources
- The climate and efficient use of natural resources
- Increasing need to organise production more sustainably'

Four CRS themes classify projects and initiatives which are supported:<sup>102</sup>

- 'Introducing sustainability to food & agricultural chains
- Encouraging new production methods and renewable energy sources
- Promoting economic participation and diversity (e.g. equal opportunities)
- Fostering social cohesion and solidarity'

## 4.6 Performance of business segments

### *Business structure*

Rabobank's core business is located in the Netherlands where 147 local Rabobanks run 1,010 offices. The chart below provides information on Rabobank's business structure.

Chart 7 Rabobank Group – Group structure



Source: Rabobank, Situation as at 1 January 2010 [web]

### *Performance of business segments*

<sup>101</sup> Rabobank website [web]

<sup>102</sup> Rabobank Annual Report 2008, p. 65

Domestic retail banking provides 53 % of net profit and is thus the key segment of Rabobank. The segment Wholesale banking and international retail banking contributed 28 % in 2009, while Asset management and investment contributed less than 1 % of the group's net profit.

**Table 25 Rabobank Group – Performance of single business segments**

In € m	Domestic retail banking	Wholesale banking and international retail banking	Asset management and investment	Leasing	Real estate	Other	Total
Interest							
2009	4,360	2,926	104	590	182	(116)	8,046
2008	4,758	3,156	144	530	85	(156)	8,517
Fees and commission							
2009	1,261	488	757	59	44	(34)	2,575
2008	1,354	304	1,084	61	31	55	2,889
Operating profit before tax							
2009	1,507	824	30	110	90	43	2,604
2008	1,911	(497)	563	301	33	541	2,852
Net profit for the year							
2009	1,213	646	13	112	68	236	2,288
2008	1,433	27	438	235	24	597	2,754

Source: Rabobank Group Annual Report 2009, 106

According to the Annual Report 2009 the business segments performed as follows:

**Domestic retail banking:** Domestic retail banking is the key segment at Rabobank as it provides 53 % of net profit of the group. It's net profit declined by 15 % due to fierce competition in the savings market and an increase in bad debt costs (from 8 basis points in 2008 to 26 basis points in 2009). Nevertheless, the loan portfolio increased by 4 % to € 278 bn and total savings deposits rose by 6 % to € 121 bn.

**Wholesale banking and international retail banking:** There was a strong increase in net profit of the business segment wholesale banking and international retail banking 2009. In the year before the financial crisis there was a strong decrease in net profit from € 334 m in 2007 to € 27 m in 2009. 'The lending volume dropped [by 7 %] at Rabobank International due to the scaling down of loans to non-food and agri clients outside the Netherlands. The share of food and agri in the portfolio increased. Income from wholesale banking benefitted from developments in interest rates, although their impact levelled off in the second half of 2009. The poor economic conditions resulted in impairments on some private equity interests and in an increase in bad debt costs' (from 93 basis points in 2008 to 105 basis points in 2009).<sup>103</sup>

**Asset management and investment:** In 2008, the gain from the sale of Alex had been a significant boost to profit. Besides this, the net profit dropped significantly by 97 %. 'The lower result for 2009 was mainly due to lower performance related commission fees at Robeco's subsidiary Transtren. The positive cash flow and the recovery in equity prices caused an increase in assets under management and held in custody for clients [by 25 %]. At Robeco a cost reduction programme that was initiated in 2008 resulted in lower costs and lower staffing levels. Due to the poor economic situation, the asset management subsidiary Sarasin adjusted its growth rate in terms of hiring additional client relationship managers.'<sup>104</sup>

**Leasing:** In the leasing segment net profit nearly halved between 2008 and 2009 and was € 112 m in 2009. The loan portfolio slightly increased by 3 %. Due to the economic crisis an increase in bad debt costs was visible (2008: 56 basis points and 2009: 132 basis points) which also caused growth in lending to level off.

<sup>103</sup> Rabobank Group Annual Report 2009, p. 4

<sup>104</sup> Rabobank Group Annual Report 2009, p. 5

**Real estate:** ‘Rabo Real Estate group was adversely affected by the poor conditions in the property market in 2009. It sold 7,341 homes, 16 % less than in 2008.’<sup>105</sup>

#### 4.7 Remuneration

##### *Remuneration policy*

In the Annual Report 2009 Rabobank’s remuneration policy is characterised as follows:

‘Rabobank has a careful, controlled and moderate remuneration policy that benefits its strategy, the desired risk profile, the cooperative’s shared targets and its core values. The remuneration policy takes account of the bank’s long-term interests, the international context of the markets in which it chooses to operate and the socially accepted practices in that area.’<sup>106</sup>

Moreover, ‘the remuneration structure within the Rabobank organisation has never been such that it might encourage irresponsible risks being taken.’<sup>107</sup>

Table 26 presents the differences in annual salaries between different age groups of employees and Table 27 shows how the wage bill is distributed to management levels.

**Table 26 Rabobank Group – Breakdown of wage bill by age and gender**

In €	Male	Female
Aged 24 and under	23,317.58	22,850.68
Aged 25 to 34	34,255.37	29,769.24
Aged 35 to 44	50,556.51	32,953.19
Aged 45 to 54	52,640.29	31,991.38
Aged 55 and over	50,298.90	27,906.39
Average	46,520.73	31,133.23

Note: Based on median gross full-time annual salary

Source: CRS Reporting 2009 Rabobank Group; Working together towards a sustainable future, Appendix 1, p. 36 [web]

**Table 27 Rabobank Group – Breakdown of wage by management level**

In %	2009	2008	2007
Executive managers	3	3	2
Senior managers	6	6	6
Middle managers	41	40	39
Other (salary scale 1 to 7)	50	51	53
Total	100	100	100

Note: Based on gross full-time annual salary  
Rabobank Group in the Netherlands

Source: CRS Reporting 2009 Rabobank Group; Working together towards a sustainable future, Appendix 1, p. 36 [web]

##### *Remuneration of executive board*

In 2009, the remuneration of the members and former members of the executive board of Rabobank Nederland amounted to € 9.9 m. This amount comprises:

**Table 28 Rabobank Group – Remuneration of executive board**

In € m	2009	2008
Salaries	6.6	6.7
Pension charges	1.3	1.1
Performance-related pay	1.8	1
Other emoluments	0.2	0.2
Total	9.9	9.0

Source: Rabobank Group Annual Report 2009 , p. 75

<sup>105</sup> Rabobank Group Annual Report 2009, p. 5

<sup>106</sup> Rabobank Group Annual Report 2009, p. 67

<sup>107</sup> Rabobank Group Annual Report 2009, p. 67

'In compliance with IFRS requirements, this total amount specifies salaries, variable compensation and pension charges. Rabobank does not award variable compensation in the form of an option and/or share packages to members of either the executive board or senior management. The variable compensation of the executive board of Rabobank Nederland is therefore modest. There is a short-term variable compensation of up to 15 % of fixed income, which is paid annually, and a long-term compensation, which is equally maximised at 15 % but which is paid out after three years. until after a three-year term. A variable compensation component exceeding 30 % of fixed income is paid to only a small number of individuals at highly specialised positions within Rabobank International. This is in line with the remuneration practice used worldwide for this type of staff.'<sup>108</sup>

#### 4.8 Evaluation of rating agencies

Rabobank has a long tradition of Triple A credit ratings. 'Moody's (since 1981), Standard and Poor's (since 1981) and DBRS (since 2001) all give Rabobank Nederland a Triple A credit rating. Global Finance currently ranks Rabobank 6th in its survey of "the world's safest banks".'<sup>109</sup>

Rabobank's recent awards:<sup>110</sup>

- MTN-i awards, February 2010
  - Institutional Performance Award
- Global Finance awards, October 2009
  - Best Developed Markets Bank in the Netherlands
  - Best Investment Bank in the Netherlands
  - Best Foreign Exchange Provider in the Netherlands
- Euroweek Bond Market awards, May 2009
  - Most Impressive FIG funding official
  - Most Impressive FIG Issuer in Euros
  - Most Impressive FIG Issuer in Yen
  - Most Impressive FIG Issuer in Swiss Francs

**Table 29 Rabobank Nederland – Credit ratings 2009**

Rating Agencies	Long-term	Short-term	Outlook
Standard & Poor's (16.12.09)	AAA	A-1+	Negative
Moody's Investors Service (22.10.09)	AAA	P-1	Negative
DBRS (09.07.09)	AAA	R-1 (high)	Stable

Note: An explanation of rating codes can be found in the Annex

Source: Ratings of Standard & Poor's, Moody's Investors Service and DBRS available on Rabobank's website [\[web\]](#)

**Table 30 Rabobank Nederland – Rabobank's credit rating by Standard & Poor's and Moody's**

	Strengths	Weaknesses/ Challenges
Standard & Poor's (16.12.2009)	<ul style="list-style-type: none"> <li>• Stable business profile anchored by market-leading position in the Netherlands</li> <li>• Relatively resilient performance during economic downturn and market turbulence</li> <li>• Steady long-term earnings performance</li> <li>• Robust capital and liquidity positions</li> <li>• Cautious culture and management philosophy</li> <li>• High systemic importance in the Netherlands</li> </ul>	<ul style="list-style-type: none"> <li>• Cyclical increase in impairment losses weighs on current profitability</li> <li>• Legacy exposures to structured credit and monoline insurers</li> <li>• Mutual status constrains ability to raise capital, if required</li> </ul>
Moody's (12.03.2010)	<ul style="list-style-type: none"> <li>• Generally low-risk banking franchise, leading to predictable albeit modest earnings displaying low volatility</li> <li>• Strong and defensible domestic market shares</li> </ul>	<ul style="list-style-type: none"> <li>• Strategic flexibility somewhat constrained by "closed" capital structure</li> <li>• While in line with that of Dutch peers, Rabo-</li> </ul>

<sup>108</sup> Rabobank Group Annual Report 2009, p. 76

<sup>109</sup> Rabobank website [\[web\]](#)

<sup>110</sup> Rabobank website [\[web\]](#)



	<ul style="list-style-type: none"> <li>• Solid financial condition</li> <li>• Conservative underwriting culture, with limited market risk appetite</li> <li>• Excellent capital levels, albeit of slightly weaker quality than historically due to presence of hybrids</li> <li>• Group's cross-support mechanism, which ensure that resources of the whole Rabobank Group would be available should Rabobank Nederland, the rated entity, encounter difficulties</li> </ul>	<p>bank Nederland's operating efficiency is weaker than that of other banks in the B+ BFSR category</p> <ul style="list-style-type: none"> <li>• Managing risks inherent to its non-banking and international operations - including insurance (the group has a 39 % stake in Eureko), and more material property-development operations following the acquisition of Bouwfonds, the Dutch real estate development company, as well as leasing, following the acquisition of Athlon</li> </ul>
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Source: Standard & Poor's, 16.12.2009, Moody's 12.03.2010 [\[web\]](#)

### Rationale

The ratings from Standard & Poor's reflect Rabobank Nederland's 'strong financial position, closely controlled risk profile, and leading franchise in the Netherlands. Rabobank Nederland has demonstrated relative resilience to the unfavourable economic and market environment largely (...) due to its robust domestic retail business. However, following a strong overall performance in 2008, net earnings were 18 % lower in the first half of 2009 due to increased impairment losses in Ireland and in certain Dutch corporate sectors and domestic margin pressure caused by strong competition for deposits, which now appear to be abating.'<sup>111</sup>

'As a mutual with no equity market access, Rabobank Nederland has consistently maintained a strong capital position. It targets a Basel II Tier 1 ratio above 12.5 % and the level in June 2009 was 13.0 %. The pro forma risk-adjusted capital ratio after diversification adjustments was 8.3 % in June 2009, which compares favourably with peers. Its funding and liquidity positions are strong and anchored by its market-leading domestic retail deposit base, which received a strong net inflow in 2008 and the first half of 2009 according to reported figures.'<sup>112</sup>

Moody's gives a positive (Aaa) global local currency deposit rating for Rabobank Nederland due to its very high probability of systemic support. This is based on its leading position in the Dutch banking system. Thanks to Moody's, Rabobank Nederland has strengthened its market positions since the beginning of the crisis. Moreover, DBRS stated that Rabobank Nederland's franchise strengths remained intact which helps the group to operate in the challenging environment.<sup>113</sup>

### Asset quality

Moody's evaluates Rabobank Nederland's asset quality as strong due to its 'conservative underwriting criteria with a stable and low level of impaired loans.'<sup>114</sup> Rabobank Nederland's asset quality is strengthened by the high proportion of domestic loans to individuals (68 % of total loans at year end 2009). Standard & Poor's comes to a comparable assessment as Rabobank Nederland's good asset quality is 'anchored by its Dutch residential mortgage portfolio, which represents 45 % of gross customer loans. Reported losses on this portfolio were 2 bps in the first half of 2009, below the historic average of 3 bps. However, Rabobank Nederland's overall bad debt costs were 55 bps in the first half, above the 21 bps historic average, and a 31 bps charge in the full year 2008 due to the economic downturn in Ireland and, to a lesser extent, the Netherlands. The impairment allowances amassed in 2008 - 2009 should mitigate the risk of a further sharp increase in impairment losses in 2010, but Standard & Poor's expects the charge to remain elevated.'<sup>115</sup>

### Risk management

<sup>111</sup> Standard & Poor's 16.12.2009, p.1 [\[web\]](#)

<sup>112</sup> Standard & Poor's 16.12.2009, p.1 [\[web\]](#)

<sup>113</sup> DBRS press release 04.09.2009 DBRS Comments on Rabobank Nederland's H1 2009 earning –Ratings Unchanged [\[web\]](#)

<sup>114</sup> Moody's 12.03.2010 [\[web\]](#)

<sup>115</sup> Standard & Poor's 16.12.2009, p.1 [\[web\]](#)

According to the rating of Standard & Poor's (Dec 2009) Rabobank Nederland has a relatively cautious approach regarding risk appetite and management philosophy. Moreover, as a mutual bank it is not driven by short-term performance indicators. The general enterprise risk management is classified as strong. Moody's came to similar conclusions with its rating in March 2010 as it expects Rabobank Nederland to continue its tradition of a tight credit process in order to maintain its 'very good and historically stable credit quality.' Even the bank has a conservative selection of exposures as Moody's also sees its high group exposures towards other financial institutions. Nevertheless, liquidity management is seen as strength due to the bank's large retail deposit base. Moody's also appreciates that Rabobank Nederland has decided to 'scale down its non-client-related operations undertaken at global financial markets as a result of the financial turmoil'.<sup>116</sup>

#### 4.9 Risk management

'Rabobank operates a very conservative approach to risk and credit management, and has done so throughout its 110 year history.<sup>117</sup> This is partly due to the bank's cooperative structure and customer-focussed business model. The member banks and the cooperative Rabobank Nederland, including some subsidiaries, work with a cross-guarantee scheme by which participants are each liable for the obligations of the others. Mutual liability ensures the strength of the organisation as a whole.'<sup>118</sup> The strict risk and credit management is also reflected in its good credit rating history as shown above.

##### *Three pillar approach*

In order to implement a comprehensive prudent liquidity management the following three pillar approach is used:<sup>119</sup>

- 'Active cash flow management
  - Daily cash flow monitoring and projection over the next 30 days
  - Maximum cash outflow limit system by currency and by location
  - Detailed contingency plans and procedures
- Liquid securities buffer
  - Large portfolios of liquid securities and securities eligible for refinancing with central banks
  - Part of mortgages portfolio has been securitised. Tranches are held by Rabobank and are eligible for refinancing with the central bank
- Prudent funding policy
  - Stable and/or long-term funding sources to finance longer-term assets
  - Diversification of funding sources and currencies
  - Active Investor Relations role'

##### *Economic capital*

'Besides its external capital requirement, Rabobank Group uses an internal capital requirement based on its economic capital framework. A broad range of risks is measured in a consistent manner in order to obtain a more complete insight to the risks and to enable a better balance between risk and return.'<sup>120</sup> In addition, stress tests are used to assess capital adequacy according to Basel II's second pillar.

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<sup>116</sup> Moody's 12.03.2010 [[web](#)]

<sup>117</sup> Rabo Direct Blog [[web](#)]

<sup>118</sup> Rabo Direct Blog [[web](#)]

<sup>119</sup> Rabobank Investors Relations: „Advanced Risk Management framework” [[web](#)]

<sup>120</sup> Rabobank Group Annual Report 2009, p. 14

Economic capital dropped by 2 % between 2008 and 2009 to € 22 bn. Thus, economic capital is € 3.3 bn higher than the capital requirement of € 18.7 bn. The reduction in economic capital was primarily caused by the 'drop in economic capital for interest rate risk. The decrease in interest rate risk in the banking book was associated with developments in the absolute interest rate risk position and lower interest rates.'<sup>121</sup>

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<sup>121</sup> Rabobank Group Annual Report 2009, p. 14

**Table 31 Rabobank Group – Economic capital at year end 2009**

	%
Economic capital by group entity	
Domestic retail banking	34
Wholesale banking and international retail	34
Real estate	7
Leasing	5
Asset management and investment	4
Other	16
Economic capital by risk type	
Credit and transfer risk	65
Operating risk and business risk	16
Interest rate and market risk	10
Other Risks	9

Source: Report 2009 Rabobank Group, p. 14

### *Value at risk*

Value at risk is a measurement for market risks which relate 'to changes in the value of the trading portfolio as a result of price movements in the market', for example relating to interest rates, equities, credit spreads, currencies and certain commodities. 'In 2009 the value at risk fluctuated between € 23 m and € 50 m with an average of € 32 m.'<sup>122</sup> At the end of 2009 the value at risk was spread over the following components, while changes in interest rates and credit spreads were the most important.

**Table 32 Rabobank Group – Breakdown of value at risk**

In € m	%
Credit spread	15.0
Currency	0.7
Equities	1.5
Interest rate	22.0
Diversification	-11.9
Total	27.3

Source: Report 2009 Rabobank Group, p. 58

### *Impaired loans and loan loss provisions*

At year end 2009, impaired loans amounted to € 9,294 m compared to € 6,573 m in 2008. Impaired loans are loans for which a provision is formed. The allowance for loan losses amounted to € 4,569 m in 2009 and € 3,299 m in 2008. We have to keep in mind that Rabobank Group takes 'allowance at an early stage and applies the one-obligor principle, which means that the exposure to all counterparties belonging to the same group is taken into account. (...) Additionally, the total exposure to a client is qualified as impaired, even if adequate coverage is available for parts of the exposure in the form of security or collateral. At year end 2009, impaired loans corresponded to 2.3 % (in 2008 to 1.6 %) of the private sector loan portfolio.'<sup>123</sup>

## **4.10 Outlook**

### *Rabobank's outlook*

According to the Annual Report 2009 Rabobank expects 2010 to be a challenging year and that the effects of the financial crisis will remain visible in the real economy 2010. Therefore the level of bad debt costs will remain high. Tight cost management and high quality customer contacts will be prioritised in the group. In domestic retail banking, its main business segment, slight growth in lending is expected. Moreover, 'Rabobank intends to maintain its provision on the savings and the mortgages

<sup>122</sup> Rabobank Group Annual Report 2009, p. 57

<sup>123</sup> Rabobank Group Annual Report 2009, p. 53

markets and strengthen its position in the corporate and private banking market.’<sup>124</sup> In the second biggest business segment Wholesale banking and international retail banking the activity with structured financial products will be reduced while renewable energy & infrastructure finance will develop further. A ‘positive cash flow and further growth of assets under management’ is anticipated for the market segment Asset management and investment in 2010.<sup>125</sup> In the leasing business some cautious recovery is expected for the second-hand car market. In the insurance segment Rabobank wants to ‘strengthen its market position in the areas of non-life, care and disability insurances.’<sup>126</sup>

### *Outlook of rating agencies*

The weak economic environment is also reflected in the rating agencies’ evaluation of Rabobank: Moody’s changed its outlook of the bank’s financial strength rating from stable to negative in December 2009 due to expected subdued macroeconomic conditions in the Netherlands which could affect the bank’s profitability, asset quality and capital adequacy.<sup>127</sup> Standard & Poor’s evaluated the outlook of Rabobank negatively in December 2009. ‘Rabobank Nederland’s balance sheet and performance [were expected to remain] resilient relative to peers, but it is also likely to be adversely affected by recessions in its key markets. In particular, [Standard & Poor’s] expected impairment losses to remain elevated in the second half of 2009 and into 2010. A partial offset should come from an increasing net interest margin due to continued asset reprising and improved Dutch deposit spreads.’<sup>128</sup>

‘A negative rating action could result if [Standard & Poor’s] sees that credit losses remain persistently high and Rabobank Nederland’s risk adjusted earnings fail to strengthen from the current level.(...) In addition, a significant merger or acquisition would be likely to dilute its credit worthiness. The outlook could return to stable if [Standard & Poor’s] sees a normalisation of impairment losses and margins contributing to a strengthened underlying performance.’<sup>129</sup>

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<sup>124</sup> Rabobank Group Annual Report 2009, p. 24

<sup>125</sup> Rabobank Group Annual Report 2009, p. 35

<sup>126</sup> Rabobank Group Annual Report 2009, p. 49

<sup>127</sup> Moody’s 12.03.2010 [[web](#)]

<sup>128</sup> Standard & Poor’s 16.12.2009, p.2 [[web](#)]

<sup>129</sup> Standard & Poor’s 16.12.2009, p.2 [[web](#)]