



NL financial investments

## Exit advice ABN AMRO

*May 2015*



# Content

Foreword	4
Summary and conclusions	6
1. NLFI Research	10
1.1 Preconditions	10
1.2 Parliamentary debate on the Exit Advice of 23 August 2013	10
2. Exit readiness of ABN AMRO	13
2.1 Results achieved and strategy of ABN AMRO	13
2.2 Internal readiness	16
2.3 Price expectations	17
2.4 Timing	19
3. Exit options and are the financial markets sufficiently stable?	22
3.1 Exit options	22
3.2 Stability of financial markets	23
4. Details of an IPO of ABN AMRO	25
4.1 Absorptive capacity of the market	28
4.2 IPO costs	29
5. Governance after initiating exit by means of an IPO	36
5.1 Introduction	36
5.2 Public interest	36
5.3 Further details on governance	37
5.4 Stable shareholder base	44
6. Conclusion	51
Attachment: IPO process outline	53



# Foreword

In this letter the Trust Office Foundation for the Management of Financial Institutions (Stichting administratiekantoor beheer financiële instellingen), acting under the name NLFI, advises the Minister of Finance on returning the ABN AMRO shares held by NLFI to the private sector. This advisory report is a follow-up to the report dated 23 August 2013, in which NLFI examined the various exit options for ABN AMRO Group NV and a.s.r. Nederland NV. The report contains an independent assessment by NLFI of the degree of ABN AMRO's readiness, the IPO as the recommended exit option and the recommended protection measure.

This advisory report is partly based on an intensive and constructive collaboration between NLFI and ABN AMRO.

NLFI is grateful to the Ministry of Finance for providing its opinion on draft versions of this report.

In addition, discussions were held with a number of investment banks, financial and legal advisors, umbrella organisations for institutional and other investors, as well as other experts who shared their views with us. NLFI is very grateful to all those who helped with the production of this document.

NLFI has noted with interest the report entitled *IPOs and Bookbuilding in Future HM Government Primary Share Disposals* recently published by the team led by Lord Myners in response to the privatisation of Royal Mail. NLFI will explicitly take the recommendations of the report into consideration in the process going forward.

NLFI

May 2015



## Summary and conclusions

On 23 August 2013, the Trust Office Foundation for the Management of Financial Institutions (Stichting administratiekantoor beheer financiële instellingen), acting under the name NLFI (hereinafter: NLFI), submitted an Exit Advice for ABN AMRO Group NV (hereinafter: (ABN AMRO) and a.s.r. Nederland NV. The exit of ABN AMRO was discussed extensively in the parliamentary debate on this Exit Advice and the letter 'Future plans for financial institutions ABN AMRO, ASR and SNS REAAL' from the Minister of Finance dated 23 August 2013. In response, the Minister asked ABN AMRO to prepare internally for an IPO without taking irreversible steps, concurrently with a request to NLFI to subsequently issue a new Exit Advice.

This letter contains NLFI's advice to the Minister on the exit strategy for returning the ABN AMRO shares held by NLFI to the private sector. The task complies with NLFI's legal purpose as laid down in the Trust Office Foundation for the Management of Financial Institutions Act (Wet stichting administratiekantoor beheer financiële instellingen, the NLFI Act).<sup>1</sup> On authorisation by the State of the Netherlands, NLFI shall implement this strategy in the name of the State.

In preparing this advice, NLFI acted in accordance with its purpose as described in its articles of association. In lawfully performing its duties and exercising the rights associated with the shares, NLFI has primarily focused on the financial and economic interests of the State,<sup>2</sup> while taking into consideration the interests of the company, its subsidiaries and affiliates and the employees. Among other things, this means that NLFI has taken the interests of the various stakeholders of ABN AMRO into consideration when drawing up this report.

Separate information will be provided on the exit options for SNS Bank NV (SNS Bank), a subsidiary of SNS REAAL NV. The (timing of the) exit of SNS Bank NV will have no influence on the exit possibilities for ABN AMRO. This is due to the fact that SNS Bank is a smaller and entirely different bank to ABN AMRO, additionally there is expected to be enough absorptive capacity in the market.

As discussed in the House of Representatives in 2011 and reiterated in the letter from the Minister dated 23 August 2013, ABN AMRO may return to the market when the financial sector is sufficiently stable, providing there is sufficient interest in the market and the company is ready. The objective is to recover as much as possible of the total capital expenditure of the State.

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<sup>1</sup> Article 3, second paragraph, section b, at 1° of the NLFI Act.

<sup>2</sup> The financial and economic interests of the State are linked to the exchangeable certificates for shares issued by NLFI (commercial name) rather than a shareholding in the companies.

These conditions are now met, a circumstance that will be further explained in this advisory report. If the Minister of Finance and the House of Representatives agree to the exit strategy proposed by NLFI, the exit will start from the fourth quarter of 2015.

In his letter of 23 August 2013, the Minister stated that the present (follow-up) report will re-examine whether the then intended form of sale is still preferred. In the last few months, NLFI has carefully explored and assessed the expected value to be obtained from the previously recommended 'dual track' approach, whereby an initial public offering (IPO) constitutes the baseline scenario, while the option of a private sale is kept open as long as possible. Serious interest of strategic partners and the potential of these parties to pay a reasonable price for an acquisition and at the same time add strategic value to ABN AMRO has not been found so far. In the opinion of NLFI, an IPO is still the optimal exit option for ABN AMRO. NLFI recommends that the external preparations for ABN AMRO's exit by means of an IPO are started, so that an IPO may occur from the fourth quarter of 2015.

Any exit by ABN AMRO initiated by an IPO will mean that there will be new shareholders. The interest and control of NLFI and the State in ABN AMRO will therefore decrease in favour of the new shareholders. To adequately protect the remaining interest of the State in this new situation, NLFI recommends the introduction of a statutory required qualified majority for important resolutions at shareholder meetings relating to the character and identity of ABN AMRO.

To protect the continuity of the bank prior to an IPO of ABN AMRO, NLFI recommends establishing a trust office in the form of a foundation to which the shares that the State intends to sell on the stock exchange are transferred. With the cooperation of ABN AMRO, the foundation (hereinafter: ABN AMRO Continuity Foundation) will provide investors with certificates for the shares of which they are then the beneficial owners.<sup>3</sup> The position of certificate holders is not materially different from shareholders. The voting rights on shares will automatically accrue to the certificate holders by means of the proxy right. Certificate holders can opt to vote themselves, indicate that ABN AMRO Continuity Foundation can vote on their behalf or abstain from voting. There is one exception: in certain cases of unwanted shareholder activism and a (potential) takeover on which no agreement is reached with ABN AMRO, the Foundation can temporarily assume the voting right of all certified shares by limiting, excluding or revoking granted voting proxies and thus providing temporary protection for the continuity of ABN AMRO. As long as the interest of the State is greater than one-third, the ABN AMRO Continuity Foundation can only undertake such an intervention with the approval of NLFI and the State.

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<sup>3</sup> If and insofar as the certification of shares is ultimately chosen as the manner of protecting the continuity of ABN AMRO, the listed ABN AMRO shares mentioned in this Exit Advice are in fact listed ABN AMRO certificates.

As a (systemically important) bank, ABN AMRO must give some consideration to society as a whole. NLFİ endorses the desire of ABN AMRO to anchor this social role in the articles of association at the start of the sale.

This combination of measures and existing legislation will, in the opinion of NLFİ, adequately protect the public interest, the remaining financial interest of the State and the interest of ABN AMRO, its affiliated companies and the employees.

Finally, in this report, NLFİ will discuss the option of introducing loyalty shares during the exit of ABN AMRO. Due to uncertainty regarding the benefits and application of loyalty shares, as well as the accompanying significant disadvantages and risks including from an investor perspective, NLFİ recommends that these are not introduced.





# 1 NLFI Research

## 1.1 Preconditions

As discussed in the House of Representatives in 2011, ABN AMRO may return to the market if the financial sector is sufficiently stable, there is sufficient interest in the market and the company is ready. The objective is to recover as much as possible of the total capital expenditure of the State. These preconditions were also specified in the coalition agreement in October.<sup>4</sup> In the state aid procedure of the European Commission, the State also denied any intention of willingly investing in ABN AMRO over the long term.<sup>5</sup> You also expressed this objective in your letter to the House of Representatives dated 23 August 2013.<sup>6</sup> NLFI has taken into account the mentioned preconditions in this recommendation.

## 1.2 Parliamentary debate on the Exit Advice of 23 August 2013

The exit options of ABN AMRO were extensively discussed in the NLFI Exit Advice dated 23 August 2013. The Minister also gave his vision on the exit possibilities in his letter of the same date. The exit of ABN AMRO was extensively discussed in a parliamentary discussion regarding this letter (written consultation (2013D45598), response to the Minister dated 25 November 2013, the general meeting on 27 November 2013 and the VAO Plans for the future of financial institutions ABN AMRO, ASR and SNS REAAL on 12 December 2013). Topics that were discussed include alternatives to an IPO, the timing of an exit, the costs associated with an exit, various protection measures and the possibility of a loyalty share and a volksaandeel (retail offering). All of these topics are addressed in this report.

In the VAO Plans for the future of financial institutions ABN AMRO, ASR and SNS REAAL (AO dated 27 November 2013), there are several motions relating to ABN AMRO. This concerns the motions Merkies (no. 43, 32013), Van Hijum (no. 44 32013)

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<sup>4</sup> '... ABN AMRO may only return to the market when the financial sector is stable. There must be adequate interest in the market, the business must be ready for this transition and as much as possible of the State's total investment must be recovered. Against this background, we are investigating the other options that exist alongside a full stock market flotation ...'. Coalition agreement between VVD – PvdA, 'Bruggen slaan' (Building bridges), 29 October 2012.

<sup>5</sup> Commission Decision of 5 April 2011 on measures C 11/09 (ex NN 53b/08, NN 2/10 and N 19/10) implemented by the Dutch State for ABN AMRO Group NV (created following the merger between Fortis Bank Nederland and ABN AMRO NV), point 87-88, OJ L 333/1, 15 December 2011 (<http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2011:333:0001:0046:EN:PDF>).

<sup>6</sup> Parliamentary paper: Tweede Kamer der Staten Generaal, vergaderjaar 2012-2013, 32 013, nr. 36 (House of Representatives, session 2013-2014, 32 013, no. 36).

and Nijboer (no. 46, 32013). Voting on them took place on 17 December 2013. Motions 43 and 44 were rejected and motion 46 (anchoring public interest in the articles of association) was adopted. Motion 46 has been incorporated in this report (chapter 5).

After the parliamentary debate, you asked ABN AMRO to prepare internally for an exit, with an IPO as the most likely option. The option of a strategic sale would be kept open.



## 2 Exit readiness of ABN AMRO

### 2.1 Results achieved and strategy of ABN AMRO

In its current form, ABN AMRO is the result of a merger of the Dutch divisions of ABN AMRO and Fortis Bank Nederland purchased by the State of the Netherlands (State) in 2008. Work started on integration immediately after the merger. The necessary progress has since then been achieved. The integration was accomplished well within time (in 3 years) and under budget (€ 1.6 billion before tax), while customers hardly experienced any inconvenience. The expected annual synergistic benefits amounting to € 1.1 billion before tax have been achieved. The capital position has strengthened, and the review of various programmes has led to cost savings on several fronts. It is expected that the cost / income ratio of the bank will become more stable in the future and will subsequently continue to improve.

The 'new' bank strategy has been defined and implemented over the past few years. The result is a bank that is one of the three largest banks in the Netherlands and provides products and services to both private and business customers, based on a 'full service bank' model.<sup>7</sup> Examples include mortgages, savings, payment services, loans, trade financing, financial advice, etc. The majority of revenue is generated in Netherlands. The bank is active internationally in a number of areas that are counted among the core competencies of the bank: private banking (services for wealthy clients), international lending in Energy, Commodities and Transportation ('ECT'), clearing of financial transactions on exchanges worldwide ('Clearing') and Asset Based Financing (such as leasing and commercial finance). The bank focuses on the following strategic topics: putting its customers' interests first, investing in the future, maintaining a moderate risk profile, selective international growth and improvement of profitability. NLFi trusts that ABN AMRO, when implementing the strategy, will ensure that achieving the financial objectives will coincide with a focus on customer's interests.

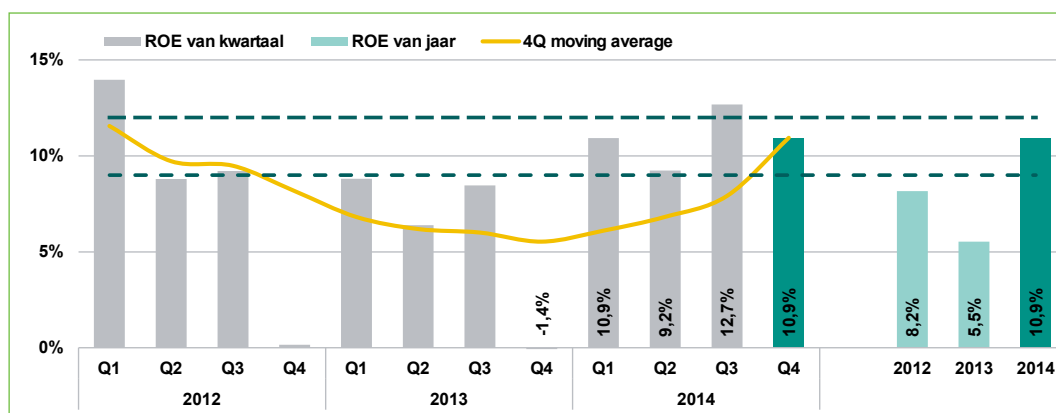
ABN AMRO has formulated a number of financial objectives for 2017:

- Return on Equity ('RoE' – the profitability of the bank) of 9-12%;
- Cost/income ratio ('C/I' – the efficiency measure of the bank) of 56-60%;
- Common Equity Tier 1 ('CET1' – the solvency of the bank) of 11.5-12.5%.

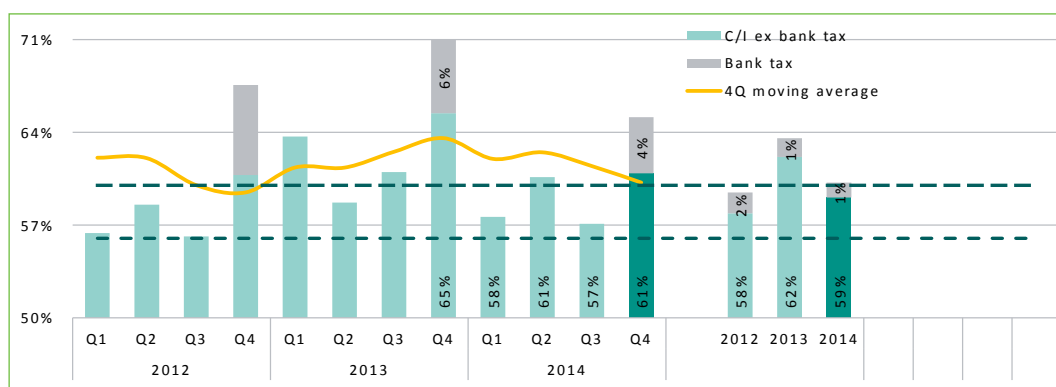
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<sup>7</sup> A 'full service bank model' means that a bank offers a varied product and service package to both business and private customers. ABN AMRO does this through its retail banking, private banking and corporate banking divisions.

RoE has displayed an upward trend since 2014, and the average RoE over the past four quarters has been within the stated target as of Q4 2014, as shown in the graph below:



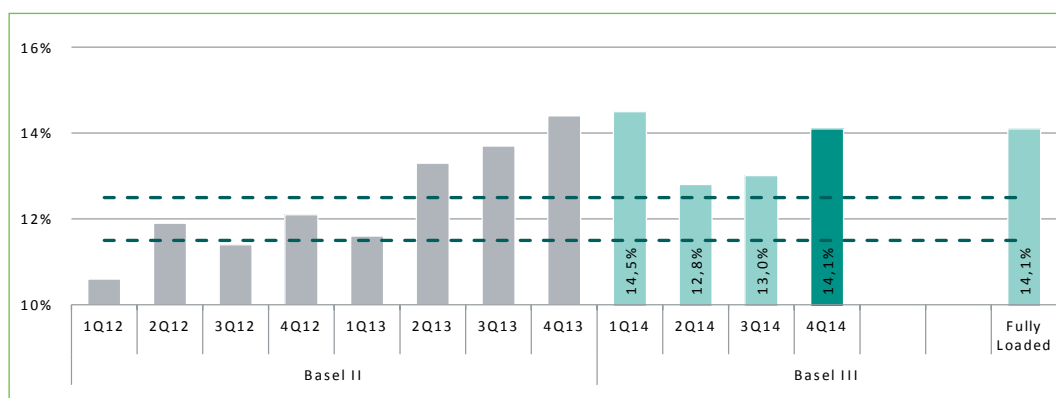
The results of Q4 2014 show that the control of costs has improved compared to Q4 2013. The cost / income ratio over the whole of 2014 is positioned at the top of the target range for 2017, which is 56-60%. It should be noted that savings in operating costs are partially offset by sharply increased costs for such items as the bank tax and the Asset Quality Review (AQR). The above percentages have been adjusted for the SNS resolution charge. In the years ahead, ABN AMRO expects rising costs associated with new contributions to the deposit guarantee scheme and the European Resolution Fund. The last quarter of 2014 also shows a positive turn in provisions as well as a continuation of the improving net interest margin.



The CET1 ratio of the bank is solid and above the target of 11.5%-12.5%. The outcome of the AQR and stress test shows that the balance sheet and capital position are robust. The impact of the outcome of the AQR on core capital as at 31 December 2013 was minimal at only 12 basis points (0.12%). With the current capital position, ABN AMRO can also adequately accommodate the impact of the outcome of the stress-tests.

The progress has been achieved despite core capital being negatively impacted in the second quarter of 2014 by the transition to a defined contribution pension plan. The negative impact on core capital amounted to approximately € 1.7 billion (*Base/*

III phased-in Common Equity Tier 1 capital). ABN AMRO undertook this transition in order to mitigate the volatility in the results due to changed accounting policies.



In the Exit Advice dated 23 August 2013, NLF I formulated a number of strategic challenges for the bank with a view to the possible exit by the State, including the necessary profitability in some divisions. Over the past year, ABN AMRO has made the necessary progress in this regard. The profitability in private banking has improved, and the results of the business divisions were already showing improvement in 2014 and are expected to further improve in the coming years, recuperating their costs in terms of equity capital. Equity derivative transactions are no longer taking place in the commercial division, Dutch treasury desks have been centralised and *market activities* in Asia are closed. This has reduced risk weighted assets so that, if the risk involved in existing activities remains constant, less capital investment will be required in the years ahead.

The bank has prepared a strategic plan for 2014 - 2017 that provides a good basis for the 'equity story' of the bank (a summary of the strategic plan including the reasons why investors should buy the shares of ABN AMRO). In the strategic plan, the bank outlines a vision of a universal bank with a top 3 position in the Netherlands in each of its three core activities: retail, private and corporate banking. Outside the Netherlands, selective growth is anticipated based on the core competencies of the bank in private banking, ECT, Clearing and Asset Based Financing. The position of ABN AMRO is underpinned by a continued focus on efficiency and cost control, a moderate risk profile and a strong capital position.

ABN AMRO shares could be presented to investors as 'dividend shares'.<sup>8</sup> Investors expect an attractive annual dividend from such a share. The strategic plan of ABN AMRO indicates that the bank will be able to pay a stable or increasing dividend, while maintaining a strong capital position and at the same time increasing its income and profitability.

<sup>8</sup> A 'dividend share' is different to a 'growth-share'. Shares in companies that expect strong growth in revenues and/or profitability for future years and are therefore able to pay little or no dividends, are called 'growth-shares'. The future value of such a company may increase significantly but is also associated with greater risk.

In terms of sustainability, the bank has developed a number of initiatives over the past years on account of which it is also ready for an exit in this area. These initiatives can be divided into three categories:

1. focusing on customer interests, building lasting relationships and committing financial expertise to society;
2. providing sustainable and responsible financing and advice;
3. implementing sustainable business operations.

## 2.2 Internal readiness

The management and supervisory boards of ABN AMRO have provided NLFI with confirmation of the bank's internal readiness for exit. NLFI has sufficient confidence in this conclusion, in part based on the information obtained from the ongoing dialogue that NLFI has held with the bank's management and supervisory boards in the course of its regular engagement with management activities over a period running back more than a year.

Should you and the House of Representatives agree to an IPO for ABN AMRO to occur from the fourth quarter of 2015, the future syndicate of investment banks that will be assisting the IPO will subsequently have to externally validate the final exit readiness based on the information at that time. The leading syndicate banks are often referred to as the '(joint) global co-ordinators' ('glocos'). These glocos will also have to perform due diligence for the other parties involved in the syndicate (see Annex 1) with respect to the company's key financial, tax-related, legal and commercial factors relating to its activities in the Netherlands and abroad. The syndicate banks will be assisted in this task by their consultants, including legal and financial advisors. This process will furthermore occur in collaboration with the company's accountant. The indicated advisors will also be asked by the bank syndicate to confirm the results of their investigations. This due diligence process should help to ensure that the prospectus contains information about everything that is reasonably important for an investor to know before making an investment decision. The prospectus is meant to focus extensive attention on the potential risks associated with an investment in ABN AMRO. This process is also intended to avoid possible prospectus liability of the company and syndicate members. The prospectus will ultimately have to be submitted for AFM approval. The company is primarily responsible for the creation of an accurate prospectus that deals fully with all essential points. NLFI, in its role as a selling shareholder, will engage its own advisors to oversee the process of preparing the prospectus undertaken by the company and its advisors along with the syndicate of commercial banks and their advisors. Besides the external investigation of the internal readiness of ABN AMRO for an IPO by the syndicate of investment banks, the European Central Bank and the Dutch Central Bank (hereinafter 'the Supervisor'<sup>9</sup>) will also make a judgement about

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<sup>9</sup> Starting on 4 November 2014, the ECB is responsible for the supervision of ABN AMRO under the Single Supervisory Mechanism (SSM). It will carry out this activity in close cooperation with DNB (Joint Supervisory Team).



the exit readiness of ABN AMRO shortly prior to its IPO. This will occur in the context of the application for a declaration of no objection (DNO). The process will include an assessment of the risk management systems and the effectiveness of internal control systems. In view of this DNO procedure, ABN AMRO and NLFi have held regular consultations with the Supervisor on the readiness of ABN AMRO in preparation for the exit. DNB / ECB have set a number of conditions for an IPO. ABN AMRO has already made the necessary progress towards meeting these conditions. Some sub-processes are still ongoing, but ABN AMRO is expected to complete most of them in the first half of 2015. In assessing the application for the DNO, the Supervisor will determine if ABN AMRO meets the specific conditions. The Supervisor is already in discussions with ABN AMRO about the DNO process to be followed at that time.

## 2.3 Price expectations

The valuation of financial institutions displayed a clear downward trend during the financial crisis. Since 2012, the downward spiral has been reversed into a positive trend, as shown in the graph below of the price-to-book multiples of European banks (based on IFRS capital). These multiples reflect how banks are valued.



\* The peers in this graph are: Lloyds, Nordea, Intesa Sanpaolo, Credit Agricole, Handelsbanken, Swedbank, DNB ASA, Danske Bank, KBC Group, Commerzbank, Société Generale, RBS, BNP Paribas, UniCredit and ING Group. The European Banks Index is the STOXX Europe 600 Banks index.

The financial results achieved by ABN AMRO in the past year also provide evidence of improvement. The solid positioning, the strategic plan and the projected results and

capital development in the coming years give rise to the expectation that a valuation at least equal to ABN AMRO's book value appears to be feasible, based on current market conditions. This ties in with the price ambition formulated by NLFi in the Exit Advice of 2013. For 2014, this would mean an amount of approximately € 15 billion, while it amounted to approximately € 13.6 billion in 2013. ABN AMRO has made progress towards achieving its plans for the coming years.

In the event of an IPO, a so-called 'IPO discount' should be taken into account. This is a discount on the price of the first part of the shares that are sold (first tranche) and is due to the fact that the share has no historical share price and the company has no track record as a listed company. This uncertainty for investors is reflected in the IPO price. Historical data suggests an average discount of 10% - 15%. The extent of the IPO discount for ABN AMRO is impossible to determine in advance. It largely depends on market conditions, demand for (banking) shares, stock market volatility, results of discussions with potential investors, trust of potential investors in ABN AMRO's strategic plan and financial objectives and clarity about the political intentions regarding the future of the bank (for example, in what timeframe does the State intend to have fully phased out its interests in ABN AMRO). A common method for calculating the IPO discount retrospectively is to compare the IPO price to the price development on the first day or week of trading in the shares.

The total proceeds from the exit of ABN AMRO will only be known once the full interest of the State has been sold.<sup>10</sup>

The proceeds of an exit of ABN AMRO are offset by the amount invested by the State in ABN AMRO. This amount is included in the table below. The cost of capital of the State are not included therein. The dividend payments or other sums received and (bank) taxes have also not been taken into account.

Description	Date	ABN AMRO
Nationalisation Fortis Nederland	Oct-08	€12,800 mln
Recapitalisation ABN AMRO	Dec-08	€4,320 mln
Mandatory Convertible Note (MCN) I	Jul-09	€800 mln
MCN II and conversion of loans in EV	Dec-09	€3,150 mln
Coupon payments MCN not received	Apr-10	€103 mln
Residual recapitalisation ABN AMRO	Jun-10	€490 mln
<b>Total expenditures</b>		<b>€ 21,663 mln</b>

<sup>10</sup> The privatisation of TNT (formerly PTT) lasted a total of 17 years, for example, and KPN lasted 12 years.

The Parliamentary Inquiry Committee of on the Financial System (*Parlementaire Enquêtecommissie Financieel Stelsel*) concluded<sup>11</sup> in 2012 that, while the investment certainly had economic value, it was unlikely that the total investment would be recovered. It is obviously the objective and legal role of NLFI to recoup the invested capital to the maximum extent possible.

## 2.4 Timing

The general meeting of 27 November 2013 included extensive discussions on the timing of an exit: 'What is the right time', 'why not wait a little longer' were questions that were asked. This section discusses the question of when is an opportune time to launch the exit.

Immediately after the rescue in 2008, it was clear that ABN AMRO should return to the market as soon as reasonably possible. You and your predecessors in office have been indicating since the rescue operation in October 2008 that the interim nature of the investments, which were made in the interests of securing the stability of the financial sector, has always been a main priority; a return to the private sector was and is the cabinet's intention.<sup>12</sup> The parliamentary debate on several letters from your predecessors concerning the future of ABN AMRO suggests that there has been political agreement since 2009 on the re-privatisation of ABN AMRO in the foreseeable future.<sup>13</sup> This is in line with the recommendation made by the Commission on the Structure of Dutch Banks (*Commissie Structuur Nederlandse Banken*) advocating normalisation of relations in order to stimulate competition in the Dutch banking sector by privatising state-owned banks as soon as circumstances allow. The State has also indicated on many occasions during the state aid procedure at the European Commission that it has no intention of investing in ABN AMRO over the long term.<sup>14</sup>

Section 2.1 (exit readiness) indicates that the internal preparation of ABN AMRO has now been completed. As indicated, the readiness of ABN AMRO will have to be validated externally by the assisting investment banks. In addition, the Supervisor must issue a DNO shortly before the IPO. In practice, these processes take a few months. If these processes are completed in a positive way and the market is still stable at that time (section 3.2), and the absorptive capacity of the market is of a sufficient level (section 4.3), NLFI is of the opinion that an IPO can occur from the fourth quarter of 2015. Not only does NLFI consider an IPO to be feasible but also

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<sup>11</sup> Findings of the Parliamentary Inquiry Committee on the Financial System, 11 April 2012.

<sup>12</sup> Parliamentary paper: Tweede Kamer der Staten Generaal, vergaderjaar 2010-2011, hoofddossier 28165, nr. 117 (House of Representative, session 2011-2012, main dossier 31789, no. 41).

<sup>13</sup> General meeting of 2 July 2009 on the letter from the Minister of Finance concerning Fortis Bank Nederland and ABN AMRO dated 26 June 2009 (31.789, no. 12) and general meeting of 8 December 2009 on the letter from the Minister of Finance dated 19 November 2009 (31789, no. 23).

<sup>14</sup> Commission Decision of 5 April 2011 on measures C 11/09 (ex NN 53b/08, NN 2/10 and N 19/10) implemented by the Dutch State for ABN AMRO Group NV (created following the merger between Fortis Bank Nederland and ABN AMRO NV), point 87-88, OJ L 333/1, 15 December 2011 (<http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2011:333:0001:0046:EN:PDF>)

important because when new shareholders join, they will add a new perspective to the future results of ABN AMRO.

NLFI recommends that you now approve the start of external preparation for a possible IPO of ABN AMRO from the fourth quarter of 2015. Following approval by you and the House of Representatives, NLFI and ABN AMRO will commence this preparation including forming a syndicate of investment banks so that an IPO can actually take place from the fourth quarter of 2015. In this phase, irreversible steps will be taken.<sup>15</sup> There will be ongoing monitoring of compliance with the aforementioned conditions. Should any pertinent changes occur in the coming period, the exit process can then be put 'on hold'. In addition, the Supervisor will assess the IPO of ABN AMRO before issuing a DNO.

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<sup>15</sup> Just as applying for a declaration of no objection from the Supervisor and hiring investment banks to assist in the IPO, writing a prospectus for which the approval of the AFM is required, etc.



## 3 Exit options and are the financial markets sufficiently stable?

### 3.1 Exit options

In the NLFI report of 23 August 2013 and the subsequent parliamentary debate, considerable attention was paid to the various exit options that NLFI envisaged for ABN AMRO. Each option was discussed extensively, and a conclusion was drawn on the suitability of each option for ABN AMRO. In the opinion of NLFI, an IPO was the most likely exit route for ABN AMRO. A sale to customers and a conversion to a cooperative structure appeared to be complex, reduced the bank's capacities to strengthen its capital in emergency situations and yielded proceeds for the State that were expected to be low. Given the size of ABN AMRO, a sale to a strategic partner or a private investor was not considered a viable option. In accordance with the recommendation of NLFI and after discussion with the House of Representatives, you requested ABN AMRO and NLFI to start the internal preparations for an exit of ABN AMRO via an IPO, without excluding the option of a private sale to a strategic party or private investor. As indicated in the previous Exit Advice, NLFI would, in this so-called 'dual track' approach, keep the option of a private sale open as long as possible without approaching parties pro-actively. Any interest from strategic parties or private investors would be examined and assessed, should it occur. In recent months, NLFI has carefully investigated and assessed the two 'tracks' in terms of expected value realisation. Strategic partners have yet to show any interest, to demonstrate any potential to pay a reasonable price for an acquisition and, from a strategic perspective with regard to ABN AMRO, to add any value. In the opinion of NLFI, an IPO is still the optimal exit option for ABN AMRO. Given the size of the company, both in terms of total assets and revenues as well expected valuation, ABN AMRO is a company that fits well into a stock exchange listed environment. A listing allows ABN AMRO access to the stock market to raise additional core capital (equity), should this be necessary in certain circumstances. The bank would therefore be not (entirely) dependent on the State. The ability to raise additional capital when needed has added value, especially for a systemically important financial institution. ABN AMRO has been active in the international bond market for years to attract subordinated capital and funding for the bank. The costs incurred by the bank for this purpose are in line with those of comparable banks.

If the exit of ABN AMRO is launched via an IPO, such a process does not rule out the possibility that the remaining interest of the State is then sold entirely or partly in one or more tranches and to one or more parties (including strategic party/ies and/

or private investor(s)) after the listing of the ABN AMRO shares on a regulated market (see chapter 4).

## 3.2 Stability of financial markets

According to DNB<sup>16</sup> calm has returned to the financial markets at a level comparable to before the crisis. Strong intervention by governments and central banks has contributed significantly to this. However, the recovery remains fragile and, according to DNB, a negatively changing market sentiment should not be ruled out. Therefore, it is clearly important that the financial sector is sufficiently prepared for future headwinds. To this end, crucial steps have been taken in the reform process at national and European level over the last year in order to strengthen the stability of the financial sector.

The results of the ECB AQR and stress test were published on 26 October 2014.<sup>17</sup> These analyses were needed before the ECB could assume bank supervision. The ECB AQR and stress test revealed that the seven surveyed Dutch banks; ING Bank, Rabobank, ABN AMRO, SNS Bank, BNG Bank, NWB Bank and the Royal Bank of Scotland N.V., are all well capitalized. It also found that these banks continue to have access to sufficient capital in case of adverse economic developments. Banks have failed the test elsewhere in the Eurozone. These are 25 banks with a total capital shortfall of € 25 billion. Twelve of these banks have already replenished € 15 billion of this shortfall. Several banks strengthened their capital position in anticipation of the ECB AQR by tapering risks or attracting additional capital. Financial markets reacted positively to the results of the ECB AQR and stress test. NLFİ has therefore concluded that the financial markets are sufficiently stable for an IPO of ABN AMRO.

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<sup>16</sup> DNB, Overview of Financial Stability, fall of 2014, no. 20.

<sup>17</sup> See in particular the letter from the Minister of Finance to the House of Representatives dated 26 October 2014, reference FM/2014/1645 N.





## 4 Details of an IPO of ABN AMRO

In the case of ABN AMRO, NLFI will sell the shares on behalf of the State, and receive the proceeds for the benefit of the State (a 'secondary offering'). A description of the process of a sale through the stock exchange is included as an appendix to this report.

NLFI recommends that the shares of ABN AMRO should be listed on the regulated market of Euronext Amsterdam. This fits in with the strong bond that the bank has with the Netherlands. All large Dutch listed companies are listed on Euronext Amsterdam. With a listing on Euronext, shares are accessible to all investors.

100% of the shares are not immediately sold in an IPO. Usually, in a company the size of ABN AMRO, the first part (the so-called first 'tranche') consists of 15% to 30% of the shares. The exact volume will be determined immediately prior to the IPO. This will depend on the demand from investors for the shares, the expected price and the minimum volume needed to generate sufficient trading after the IPO so that the shares are sufficiently liquid. Sufficient liquidity is important for the marketability of the shares. An additional factor is that it is advantageous to be listed in the AEX index and other leading indices soon after the IPO, so that investors who follow the indices automatically include the share in their portfolio.<sup>18</sup> Given the absorptive capacity of the market in relation to the size of ABN AMRO and the fact that the State wants to maintain sufficient shares to benefit from the expected future gains, the first tranche of ABN AMRO should be relatively small. NLFI advises not to sell more than 20% in the first tranche.<sup>19</sup> This will result in sufficient liquidity and, at the same time, there will be a sufficient holding left over for NLFI to benefit from a future sale of additional shares at a potentially increased rate. The cost of an IPO and the size of the IPO discount provide further reasons to keep the first tranche relatively small. The remaining shares will be sold in stages (later tranches) in subsequent years.

The exact price per share at IPO will be established in a phased process. A price range is determined based on syndicate bank valuations and the price ambition of NLFI and the State. In the ensuing period but prior to the IPO, investors will provide feedback on the price range and indicate at what price they would like to purchase a specific quantity of shares. The investors do not yet commit to anything; the seller cannot derive any rights from the feedback. As the IPO approaches, it is common for

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<sup>18</sup> One of the recommendations in the report *IPOs and Bookbuilding in Future HM Government Primary Share Disposals* dated 16 December 2014 which came into being under the leadership of Lord Myners following the privatisation of Royal Mail, is to focus on index investors as the most reliable long-term investors.

<sup>19</sup> This shall include any possible greenshoe.

the price range to narrow, based on the feedback received. This is a delicate process; the shares should not be offered at too low prices, or the seller will not maximise proceeds. If the shares are priced too high, it will be difficult to find enough investors and the share price may decline after the IPO. This outcome would give rise to disappointment among investors and may negatively impact sales of the remaining shares owned by the State.

The introductory price of the shares will be determined at the end of the roadshows and the bookbuilding process,<sup>20</sup> but prior to the IPO. NLFI considers this to be a fundamental and weighty decision, for which approval is required from the Minister of Finance. To this end, in consultation with its advisors and after consultation with ABN AMRO, NLFI will make a recommendation to the Minister.

After establishing the IPO offer price, the allocation of the shares among the bidders will also be determined. Basically all interested investors will be given the opportunity to subscribe for shares in the IPO of ABN AMRO. The actual IPO and first trade will take place after the allocation.

A 'greenshoe' is a tool used to stabilise the share price immediately after the IPO and to reduce short-term volatility of a stock after an IPO. A greenshoe is now a common tool and is used in most of the recent IPOs in Europe. Institutional investors will expect to have this option in an IPO of ABN AMRO. An IPO candidate without the option of a greenshoe is exposed to a higher price sensitivity among investors because there is more uncertainty about the pattern of trade following the IPO. With a greenshoe, underwriters<sup>21</sup> have the option of purchasing a specific number of shares from selling shareholder(s) on top of the number of shares sold in the IPO, or to buy shares back from the market. As a rule, this is limited to a maximum of 15% of the shares sold in the first tranche. With this instrument, the syndicate has the ability, if necessary and with sufficient demand, to stabilise the price up to 30 days after the IPO. That gives the shares sufficient time to achieve a normalised pattern of trade.

NLFI recommends the option of using a greenshoe of up to 15% as a stabilisation instrument for the IPO of ABN AMRO,<sup>22</sup> thus adhering to market practice.<sup>23</sup>

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<sup>20</sup> Bookbuilding is the most common method of determining the initial price per share. During bookbuilding, investors are invited to subscribe by specifying the number of shares and the price. The 'book' is the built up on this basis. Banks that keep books are called 'bookrunners'.

<sup>21</sup> Investment banks in the syndicate who assume the risk of the actual placement of and payment for the shares.

<sup>22</sup> In an initial tranche of 20% and a greenshoe of 15% of the tranche, the first tranche should not exceed 23%. In an initial tranche of 25% and a greenshoe of 15% of the tranche, the first tranche should not exceed 29%.

<sup>23</sup> This will be done in conformance with the Regulation (EC) no. 2273/2003 of 22 December 2003 implementing Directive 2003/6/EC of the European Parliament and of the Council, insofar as it applies to exemption for buy-back programmes and stabilisation of financial instruments.

The IPO of Royal Mail took place on 10 October 2013. Royal Mail was a government holding in the United Kingdom. In the weeks following the IPO, the share price rose significantly, thus raising questions about the correctness of the share price during the IPO. NLFi has studied this IPO and taken the lessons learned to heart. The most important lessons relate to valuation, pricing, allocation of shares to investors and the size of the first tranche.

For the valuation of ABN AMRO, a good comparison can be made with other listed banks. With Royal Mail, no comparison was possible, which meant that the valuation was difficult to make and the price formation was difficult to assess against the value measurement. Additionally, ABN AMRO has a good financial track record and a properly supported strategic plan. In the IPO, the option to adjust the price range upwards will be kept open as long as possible. In allocating the shares, we will also consider the investment style of investors. An optimal mix between the various investment styles will be sought. This was not done with Royal Mail. In the case of Royal Mail, the first tranche had a magnitude of 60%. It was therefore not possible to benefit fully from any subsequent rises. NLFi advises against the sale of more than 20% - 30% of the shares in the first tranche of an IPO of ABN AMRO (including any possible greenshoe). The report *IPOs and Bookbuilding in Future HM Government Primary Share Disposals* by Lord Myners dated 16 December 2014 also recommends that the first tranche should not be too large in size.

It is common for a selling shareholder to agree to a lock-up period after the IPO, during which time it may not sell additional shares. This gives investors certainty about the number of shares that can be traded initially, and they are insured against an oversupply of shares. This can prevent a potential downward pressure on the share price. European IPOs have a lock-up period of 180 days on average, but there are examples of IPOs with a longer lock-up period. NLFi recommends using a lock-up period of 180 days for the remaining interest in ABN AMRO held by NLFi and thus to conform to market practice.

Cornerstone investors have often been used in recent IPOs. These are investors who are approached early in the process of preparing an IPO to determine if they wish to invest in a company. A cornerstone investor can be considered as a form of pre-IPO investor. These are usually public commitments (published in the prospectus) to buy a specific number of shares in the IPO with the guarantee from the seller that the shares are actually allocated to the relevant investor. Another form of pre-IPO investor is represented by investors who invest a certain amount in a company shortly before the IPO, this in exchange for shares. Cornerstone investors are not critical to the success or failure of an IPO, but they may serve as a signal of approval of the investment case to the market. The use of cornerstone investors may lead to a broadening of potential investors. Adverse effects may be that the liquidity of the share decreases and that cornerstone investors may want a certain degree of additional control. Cornerstone investors have been used quite recently and successfully in

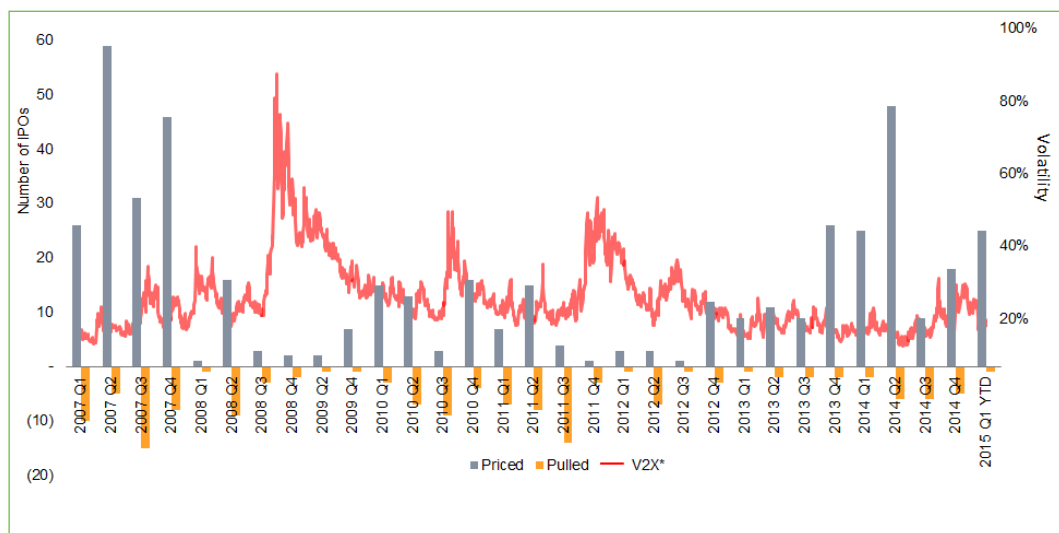
several large European IPOs, including AA Plc. (2014), Euronext (2014) and Nationale Nederlanden (2014).

NLFI recommends to further explore the possibilities for the IPO of ABN AMRO to make use of one or more 'leading' potential investors as pre-IPO investors. They would only have to be used if their inclusion has a beneficial effect on the sale of the first tranche. NLFI is not in favour of granting a discount on the share price to any cornerstone investors, as this would have a detrimental effect on proceeds to the State, nor is NLFI in favour of granting additional control to cornerstone investors.

## 4.1 Absorptive capacity of the market

For sufficient investors to buy ABN AMRO shares at a good price, sufficient absorptive capacity of the market is needed. The actual, concrete interest from investors will only become clear during the marketing process of the IPO and during and after the management roadshow presentations to potential investors. They will take place in the weeks prior to IPO pricing. There are some indicators through which an estimate can be made in advance of whether there is interest in the shares or whether investors are interested specifically in alternative investment opportunities (such as bonds). These will be explained in more detail below.

The following graph shows how many IPOs worth more than € 100 million have taken place since 2007 ('priced') and how many have been cancelled ('pulled') or delayed. One can clearly see that more IPOs were cancelled in the crisis years. Since late 2013, the number of completed IPOs has increased and has returned to the level before the crisis.

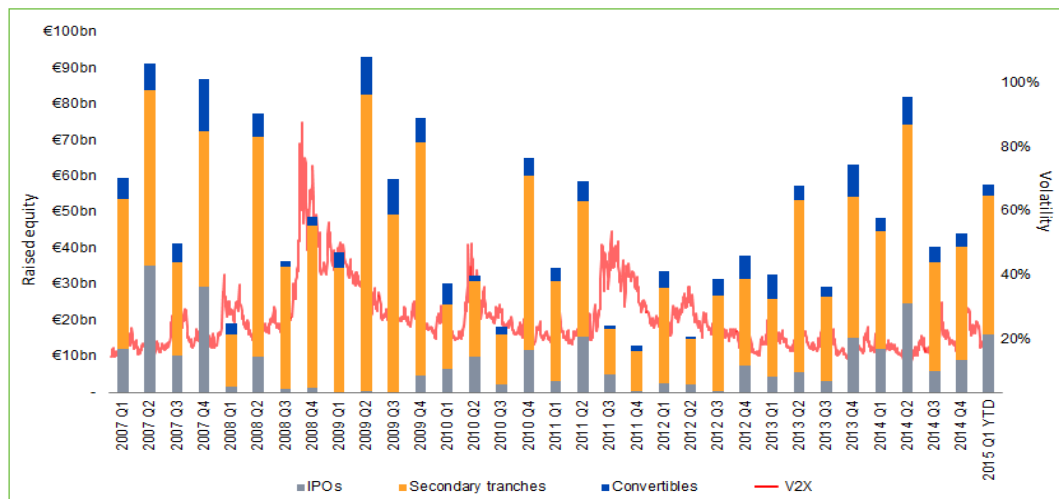


\*V2X is a measure of the stock market volatility

Examining the capital market as a means of attracting equity capital (shares and hybrid capital that is loss absorbing), the following can be noted:

1. Total collected equity capital is fluctuating and demand has been increasing since mid 2013;
2. The composition of the instruments issued (IPOs, follow-up tranches and convertible capital instruments) is different; in the crisis years, relatively numerous subsequent transactions were issued by, for example, companies that needed extra capital. The number of IPOs has been increasing for several years, during which Q2 and Q4 of each have been traditionally busier than Q1 and Q3;
3. In times of low volatility, capital market instruments can be issued relatively easily. When volatility is high, investors are less willing to invest in capital market instruments. Volatility has been declining since 2013, a circumstance that is favourable to IPOs.

This is reflected in the graph below.



It can be concluded that, since 2013, investors have become more interested in investing in shares, including the shares of financial institutions. Investor interest in IPOs of Nationale Nederlanden and Voya (both sold by ING Group as part of the agreements with the European Commission) are good examples of this trend. Several investment banks have also indicated that investors would like to invest in a bank such as ABN AMRO.

## 4.2 IPO costs

This chapter explains which advisors of a selling party are involved in an IPO and what costs are involved. We then look at ways to reduce costs as much as possible.

It is the desire of you, the House of Representatives and NLF I to keep the costs associated with an IPO as low as possible. NLF I considers it important to note that this emphasis on cost reduction does not affect the quality of advisors and the syndicate banks. Quality is the first requirement; costs play a major, but secondary

role. If an IPO occurs, there are various advisors who are hired by various parties. NLFI considers it an important task to keep the costs of the advisors hired by NLFI to a minimum.

Part of the costs are included in the NLFI budget. Costs incurred by NLFI while managing ABN AMRO are included in the budget and the annual accounts of NLFI. The Minister of Finance shall reimburse these costs to NLFI and pass them on to ABN AMRO.<sup>24</sup>

The cost of the parties that assists NLFI in a possible IPO of ABN AMRO are not included in NLFI's budget. The basic principle is that such costs of sale will be deducted from the sale proceeds of shares. These costs are then withheld from the sale proceeds, and net income is accounted for in the budget and financial statements of the central government (budget IXB).

#### 4.2.1 *Advisors to the selling shareholder*

With regard to costs, it is important to distinguish between costs borne by the selling shareholder (NLFI / State) and costs borne by the company (ABN AMRO). Before discussing the possibilities of reducing costs as much as possible, we will first look at the different advisors used by the selling shareholder in an IPO. Other stakeholders, such as the management board, the supervisory board and the works council of ABN AMRO may hire advisors for their own account.

Financial advisor to NLFI: After a competitive procurement process, NLFI hired Rothschild to advise and assist in relation to the exit of ABN AMRO and its preparation. Rothschild will provide advice on all relevant aspects related to the exit and will also assist in appointing the investment banks who will provide support for the IPO. Furthermore, Rothschild will provide additional capacity to NLFI in times of pressure. This does not mean that NLFI will no longer be able to form its own opinion. As a rule, a financial advisor receives a monthly (retainer) fee and a fee on completion of the transaction (a fixed amount or a percentage of the proceeds). A relatively low monthly fee has been agreed with Rothschild, one that is related to the work performed, along with a fee on completion of the exit that is independent of the size of the transaction and is partly based on the opinion of NLFI on the quality of the services provided by Rothschild.

Legal advisor for NLFI: following a competitive procurement process, NLFI hired Allen & Overy to advise NLFI on relevant legal issues relating to the exit of ABN AMRO. Legal advisors usually receive compensation for hours worked. In exceptional cases, a maximum amount may be agreed (within certain parameters). Such an agreement was arranged in this case.

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<sup>24</sup> In accordance with Article 7 of the Trust Office Foundation Management Financial Institutions Act (NLFI Act) Also see the Decree of 29 August 2011, containing rules on cost allocation of the Trust Office Foundation for the Management of Financial Institutions (NLFI).

Syndicate investment banks: these are contracted in connection with the IPO. The tasks of these banks include the following matters:

- a. Managing the IPO process;
- b. Liaising with potential investors and assisting management in talks with potential investors;
- c. Advising in the preparation of the so-called 'equity story' (summary of strategy, demonstrating why investors should buy the shares of ABN AMRO);
- d. Conducting due diligence (financial investigation) for the syndicate;
- e. Assisting in the preparation of the prospectus;
- f. Assisting in the preparation of analyst presentations and roadshows;
- g. Collecting and analysing feedback from potential investors and the orders they place;
- h. Advising on the distribution of shares to potential investors and advising about the exact price at which the shares should be offered.

The fee for the investment banks is often a percentage of the proceeds of an IPO. Sometimes a fixed amount is (partly) agreed. The advantage of a fee expressed as a percentage of the proceeds is that banks then have an additional incentive to achieve as high a price as possible. One risk is that there is more pressure from the syndicate of investment banks to place a larger first tranche, which can increase the proceeds and thus the compensation. In the case of an IPO of ABN AMRO, this risk is limited if the first tranche remains relatively small by determining in advance that it will not exceed 30% (see section 4.2).

NLFI has analysed the fees that investment banks have been paid in European privatisations (by means of an IPO) since 2006 where the size of the offering exceeds € 100 million. The average fee for the first tranche was 1.7% and the median 1.3% of sale proceeds. In recent privatisations, the average fee was approximately 1%. NLFI will try to ensure that the fee for the first tranche will be less than 1%. This includes a small percentage that investment banks often take into account as compensation for the so-called 'underwriting commitment'. This is a commitment with which investment banks actually guarantee that investors who are allocated shares will also pay for the shares.

The tranches that are floated in subsequent years will be associated with lower costs because there is no need for the laborious IPO process. Investors are already familiar with the stock. There is usually no need to draw up a prospectus (depending on the precise transaction structure) and there is less need for assistance with roadshows. Moreover, no IPO discount is applied.

NLFI has held a tender procedure for the construction of a generic NLFI-wide panel of investment banks. NLFI can ask the respective banks for advice on a range of topics related to equity capital markets. NLFI's need for advice may, in principle, cover all NLFI holdings. All interested market parties were informed and treated equally during the procurement (non-discrimination). A description of the procurement and evaluation process was included in the tender documents in order to promote transparency. Objective criteria were used for the assessment of the suitability of the

parties and the substantive assessment of tenders (to promote objectivity in the selection process). In principle, any party may participate, subject to compliance with the criteria set by NLFI.

In order to finally arrive at a syndicate of investment banks that can supervise the IPO of ABN AMRO, a so-called 'mini-competition' or 'auction' will principally be organised based on quantitative and qualitative criteria within the generic NLFI panel of investment banks.

The advantage of a generic NLFI-wide panel is that the preparatory work for an IPO of ABN AMRO can be started quickly after approval by the House of Representatives.

In order not to weaken the negotiating position of NLFI with respect to investment banks, this opinion does not contain a detailed negotiating strategy and position. NLFI will inform you of this confidentially.

Legal advisor to the investment banks (Underwriters' Counsel): the group of investment banks hire legal counsel in order to ensure compliance with all laws and regulations and to conduct due diligence. This is also important for NLFI and ABN AMRO. Normally, legal advisors are reimbursed based on hours worked. In exceptional cases, a fixed amount cap may be agreed (within certain parameters).

We may also incur costs for a communications advisor. This advisor shall ensure that all communications regarding the timing of the IPO, for instance, and all communications in other countries are guided along the right channels. A fixed amount is usually agreed on for this.

#### 4.2.2 *Cost minimisation*

NLFI considers it important to keep the costs of the advisors appointed by NLFI, to a minimum. Examples include various fee structures and the establishment of a competitive process for the auctioning of the various roles. With the advisors hired to date (an independent financial advisor and a legal advisor), NLFI obtained good negotiated results and fixed compensation or maximum payments within an agreed set range. This is also the ambition when recruiting other advisors: good quality at the lowest possible price. NLFI assessed whether a non-traditional IPO process can be used from some elements in order to save costs. We looked at options that are possible and acceptable for an IPO of a company such as ABN AMRO, a large systemically important financial institution. The nature and size of ABN AMRO provide additional responsibilities with regard to the exit process. The process must be controllable, and the probability of an unsuccessful exit should be minimised. When replying to Parliamentary questions on this topic, you indicated<sup>25</sup> that the alternatives that would be presented during the round table of 30 October 2013, would result in significantly lower proceeds for the State and limited access to capital

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<sup>25</sup> Dated 25 November 2013, reference FIN/2013/U1101.



markets for ABN AMRO. This would be undesirable. For this reason, the alternatives in question are not discussed in this report.

NLFI investigated the following alternatives:

1. Agreement on a fixed fee for investment banks rather than a percentage of the proceeds;
2. Limitation of the supervision by investment banks by having certain activities carried out by the Agency or ABN AMRO independently;
3. An auction of the shares, also called a 'Dutch Auction', as in the case of Google.
4. Introduction of a volksaandeel (people's share); providing a portion of the shares to individuals at a fixed price based on registration.

The feasibility, advantages and disadvantages of these alternatives are discussed below.

1. *Agreement on a fixed fee for investment banks in the syndicate rather than a percentage of the proceeds.*

The advantage of a fixed fee is that it gives clarity in advance about the amount of costs. This means that, if there is a smaller initial tranche than initially planned, the fixed fee may be high if recalculated as a percentage.

The advantage of a percentage is that the amount changes along with the size and price of each tranche; if the tranche is relatively small and the price is low, the cost will be relatively low.<sup>26</sup> Another advantage is that compensation in the form of a percentage serves as additional motivation for the banks to achieve a good price; after all, a better price results in higher compensation.

In negotiations with the investment banks, NLFI will assess which form of compensation, or a combination of both forms, will ultimately lead to the lowest cost.

2. *Limitation of the supervision by investment banks by having certain activities carried out by the Agency or ABN AMRO independently.*

The Ministry of Finance has examined the extent to which the Agency may play a role in an IPO.

ABN AMRO has been conducting many preparations independently, since it is the 'object of sale'. This is also the case with other IPOs; a company that goes public requires a lot of preparatory work. With regard to the execution by ABN AMRO of activities that are usually conducted by investment banks in the syndicate, a balance must be found between the various interests. Should ABN AMRO be asked to perform work at a reduced rate, it is then not acting 'at

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<sup>26</sup> Calculation example: if a first tranche consists of 50 million shares yielding € 10 each and the investment banks charge a fee of 1%, then the cost will be € 5 million. If the shares only yield € 8 each, then the cost will only be € 4 million.

arm's length'.<sup>27</sup> Moreover, it may be at the expense of time that the bank can spend on customers who generate income. NLFİ therefore advises that ABN AMRO be given the opportunity to play a role in the IPO under normal market conditions as well as the opportunity, just as the other (Dutch) investment banks, to compete for a role in the syndicate.

3. *An auction of the shares, also called a 'Dutch Auction', such as in the case of Google.*

A Dutch Auction can work well with a brand that is as well-known and unique as Google (there are few listed companies that have similar activities, market share and brand awareness in which investors can invest). Investment banks spend less time trying to attract investors, since the share is already very familiar. At the time of the Google IPO, Google was known as a brand, but at least equally important was the fact that it was also known as a company with (exceptional) growth potential. Consequently, the shares practically sold themselves and investors lined up to invest in them. In Europe there are over 250 listed banks, and investors choose to invest in only a few of them. NLFİ believes that a Dutch Auction is not suitable for a company like ABN AMRO.

A Dutch Auction of an unknown brand is possible, but it does require extensive marketing. This requires hiring investment banks, for which costs are incurred. Therefore, there is no cost advantage compared to an IPO.

4. *Introduction of a volksaandeel (retail offering)*

A volksaandeel (actively offering shares specifically to private investors during the IPO, also known as a 'retail offering') does not necessarily lead to lower costs. In fact, a traditional retail offering is usually accompanied by a wide-ranging marketing campaign specifically aimed at the target group of private investors. For example, a separate website where individuals can find relevant information is often also developed. It is also customary to set up a call centre to answer questions from individuals and to print additional copies of the prospectus. Section 5.4 contains further explanation of the considerations for providing private investors with the opportunity to buy shares during the IPO of ABN AMRO.

More generally, it can be stated that all selling shareholders would benefit from achieving an IPO on the best possible terms and lowest possible cost. Professional shareholders regularly sell participating interests and make use of an IPO. To date, no alternatives have been developed that substantially reduce the cost of an IPO.

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<sup>27</sup> At arm's length means that a transaction must be conducted according to commercial (market) conditions.



## 5 Governance after initiating exit by means of an IPO

### 5.1 Introduction

In the general meeting of 27 November 2013, considerable attention was paid to the future of ABN AMRO in view of the exit of the State. This was mainly due to the large public interest that comes with a systemically important bank such as ABN AMRO and the concern of the House of Representatives that history (the nationalisation of ABN AMRO and SNS REAAL) will repeat itself.

The question of whether ABN AMRO's continuity is sufficiently secured after the commencement of an exit was discussed at length against this background. Also discussed was whether the measures recommended by NLFI in the Exit Advice of August 2013 with regard to governance were sufficiently effective and adequate. Both topics are discussed in this chapter. This also applies to the other topics which you have promised the House of Representatives to investigate further. This includes the commitment to 're-explore whether offering loyalty dividends will generate sufficient interest to achieve good returns and whether this could possibly harm investor interest'.

### 5.2 Public interest

Following the discussion at the general meeting of 27 November 2013 to assess if the public interest in ABN AMRO is sufficiently safeguarded, the House of Representatives adopted the Nijboer motion. It requests you 'to substantiate how the public interests associated with the stability and continuity of the services provided by ABN AMRO, can be embedded in the articles of association of ABN AMRO or can be associated with the invocation of the right of preference shares by the ABN AMRO Continuity Foundation'.<sup>28</sup>

In the House of Representatives debate on ABN AMRO, you stressed that the public interests associated with financial institutions are secured in laws and regulations. This also applies to (systemically important) banks. In your letter of 23 August 2013, you stated that the Cabinet considers it important to maintain ABN AMRO in the Dutch banking landscape for the sake of diversity and competition in the market. The

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<sup>28</sup> Motion 32013, no. 46.

bank must not be allowed to lose its function for the Netherlands as a result of an acquisition and subsequent dismantling.<sup>29</sup> This applies for all (systemically important) banks. Since this public interest has already been adequately secured - as evidenced by the legislation on financial supervision and the ensuing supervision that has resulted - it was your opinion that there was no reason to take additional measures specifically for ABN AMRO.

In addition to the embedding of public interest in the financial regulatory legislation, the Dutch company law also provides a certain degree of assurance. Case law and jurisprudence suggests that a shareholder of a listed company that has operations in a sector identified by the government as 'vital<sup>30</sup> to the preservation of social life' (such as in the case of a system bank like ABN AMRO<sup>31</sup>) is always obliged to weigh public interest against other interests. For such companies of public interest, corporate interest is partly determined by public interest.<sup>32</sup>

This means that, if a private sale of ABN AMRO to a party is considered or if a public offer is made for the shares of ABN AMRO, NLFI is also obliged, as a shareholder, to take account of public interest in its recommendations to the Minister on the possible decision to proceed or not to proceed with the sale. Under the NLFI Act, NLFI should also take into account the sustainability of the future situation, the continuity of the company, the stability of the financial system and fair competition in the financial markets. Any protection foundation able to acquire voting rights in ABN AMRO in certain situations will also have to include public interest in its deliberations when making decisions.

### 5.3 Further details on governance

If the sale of ABN AMRO is initiated via IPO, the company will have new shareholders from that moment on. This means that the interest of the State and the control of NLFI in ABN AMRO will decrease in favour of the new shareholders. In the Exit Advice of 23 August 2013, NLFI recommended that several measures should be taken in order to protect the remaining financial interest of the State and of the company against hostile takeovers or the undesirable influence of activist shareholders.

These measures include:

1. the introduction of a statutory qualified majority for important decisions in the shareholders meetings; and
2. the establishment of a protection foundation to which a call-option is granted for the acquisition of protective preference shares.

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<sup>29</sup> This has no effect on an acquisition where the function of the bank is maintained for the Dutch market.

<sup>30</sup> These vital sectors are mentioned, among others, in the report 'Tussen naïviteit en paranoia: Nationale veiligheidsbelangen bij buitenlandse investeringen in vitale sectoren' ((Between naïveté and paranoia: National security interests in foreign investment in vital sectors) by the Working Group on Economic Security (Attached to Kamerstukken (Parliamentary Papers) II 2013/14, 30 821, no. 22).

<sup>31</sup> Enterprise Section of the Amsterdam Court, 5 April 2012, JOR 2013/14.

<sup>32</sup> Public interest from the perspective of the shareholder, R. Abma, WPNR, No. 7048, 31 January 2015.

Over the last few months, NLFI has been working with ABN AMRO on additional preparations. On various (sub-)topics, NLFI has enlisted the help of investment bankers, lawyers and a variety of trade unions. In preparing the new articles of association, the usual corporate relationships and best practices for good governance<sup>33</sup> were adopted as the starting point. This section deals with the parts of the recommended future governance of ABN AMRO that constitute an elaboration of the aforementioned measures.

*a. Qualified majority (protecting remaining interest of State)*

Previously, NLFI advised you to protect the remaining financial interest of the State in ABN AMRO, by stating in the articles of association that a qualified majority is required in the shareholder meeting before decisions can be reached on a number of important issues. This is an acceptable measure for investors and avoids the impact that other protective structures<sup>34</sup> can have on the valuation of a company. NLFI recommends adopting a qualified majority known to the market<sup>35</sup> that also appears in the law as a permitted majority.<sup>36</sup> This is a two-thirds majority of the votes cast representing more than half of the issued capital. As a result, NLFI's control with regard to stipulated important subjects remains effective as long as NLFI maintains a holding in ABN AMRO that is greater than one third of the issued capital. As long as NLFI holds at least one third of the shares in ABN AMRO, the required qualified majority acts as a de facto veto for NLFI. NLFI could make use of this if, for example activist shareholders were successful in a campaign against ABN AMRO to move the headquarters of the bank abroad or to bring about a de-merger.

NLFI recommends that there is as little deviation as possible from the usual corporate relationships when dealing with a qualified majority in the shareholder meeting. For this reason, NLFI advises that qualified majority voting should be only introduced for subjects that are most essential for the company and that may have the greatest impact on the residual financial interest of the State; these include important changes in name, registered office, purpose and other important changes in the identity or nature as defined in Article 2:107a of the Netherlands Civil Code, amendment of the articles of association and dissolution of the company. In addition to article 2:107a Civil Code and the limit specified therein for approval by shareholders of (dis) investments with a value greater than one-third of the total assets, NLFI suggests that, given the relatively large size of ABN AMRO's assets, use is made of the significantly lower boundary of one-third of the equity of the bank.

NLFI believes that this measure will sufficiently protect the remaining financial interest of the State, while the negative impact on the value of the remaining interest of the State remains as limited as possible. The measure suggested here falls within the boundaries established by Dutch company law and complies with European legal regulations.

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<sup>33</sup> Netherlands Corporate Governance Code.

<sup>34</sup> Such as priority shares. These are ordinary shares to which additional control can be assigned.

<sup>35</sup> For example, ING Group NV...

<sup>36</sup> Articles 2:133, paragraph 2 and 134, paragraph 2 of the Netherlands Civil Code (Burgerlijk Wetboek).

### *b. Embedding the social role*

With regard to embedding the social role of ABN AMRO in the bank's articles of association, NLFİ has already indicated in the Exit Advice of August 2013 that this would be a desirable addition to the governance of the bank. ABN AMRO supports this position. NLFİ recommends that, in the new articles of association of the bank, the interests of the company are explicitly stipulated to include the interests of customers, savers and depositors,<sup>37</sup> and ABN AMRO is overtly designated a systemically important bank and, as such, should also give consideration to society as a whole. It is advisable to embed these statements in the articles of association, because they form the foundation of a company.<sup>38</sup> They guarantee that the management and supervisory boards of ABN AMRO act in the interests of the company when executing their corporate duties, which shall also include associated partial interests, such as the interests of customers and society as a whole. This further connects to relevant case law<sup>39</sup> and the general duty of care for financial institutions as specified in the Financial Supervision Act (Wet op het Financieel Toezicht Wft).

### *c. Protecting the continuity of the company*

At present, the less stringent form of the rules for two-tier entities (Article 2:155a Civil Code) apply to ABN AMRO. If the sale of ABN AMRO is initiated through an IPO, the full set of rules applying to two-tier entities will take effect. This means that the authority required for appointing and dismissing members of the management board shifts from the general meeting of shareholders to the supervisory board. As such, the rules applying to two-tier entities indirectly offer a de facto form of protection against shareholders with 'hostile' intentions because these shareholders are unable to appoint members of the management board. This protection is not complete because the shareholder meeting can terminate the confidence in the entire supervisory board.

An IPO will introduce new shareholders to ABN AMRO. From that point on, the bank can no longer avoid having to face undesirable shareholder activism that could harm the continuity of the bank or a takeover bid on which no agreement has been reached with the company. As long as NLFİ has an interest in ABN AMRO that is greater than one-third of the issued capital, NLFİ is in a position, as a shareholder, to protect the company from activist shareholders who, for instance, start a campaign against the bank in order to implement certain undesirable changes in the strategy or structure, or to defend the bank against a party considering an undesirable takeover bid for ABN AMRO. Once NLFİ's interest is reduced to below one third, NLFİ will no longer be in this position.

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<sup>37</sup> The relevant provision in the articles of Association are: 'The interest of the company includes the interests of its affiliated company, including but not limited to the legitimate interests of customers, savers and depositors, shareholders, employees and the community in which the company carries out its activities.'

<sup>38</sup> This is in line with the recommendations of the Commission on the Structure of Dutch Banks, in the report 'Naar een dienstbaar en stabiel bankwezen' (On the road to a subservient and stable banking sector) of June 2013 with the recommendation that banks explicitly record their vision of the role they want to play in society in a social provision in the articles of association.

<sup>39</sup> NJ 2014/167, with annotation by P. van Schilfgaarde and Article 4:24a Wft.

ABN AMRO has stated the desire to be adequately protected during an IPO. Various protective measures are possible for this purpose, including certification of shares and the previously discussed foundation, which is then granted a call option to acquire protective preference shares.

In the case of certification, the shares are transferred to a trust, usually in the form of a foundation. This foundation subsequently issues share certificates to investors. Investors then acquire the beneficial ownership of the shares (and, for example the associated right to any dividend paid on the shares), while legal ownership remains with the trust office. The certificates are traded on the stock exchange. In general, the result of certification is that the trust office basically retains the voting rights of shares, while the certificate holders have the right to ask the trust office for a voting proxy. If certificate holders request a voting proxy in this way, the trust office may no longer exercise the voting rights on the shares in question. The law<sup>40</sup> provides the opportunity, in certain cases (often referred to as situations of 'war'),<sup>41</sup> to withdraw the proxies so that the trust office can exercise the voting rights on the shares and thus provide protection to the company. A prerequisite is that the trust office is independent from the company.<sup>42</sup>

In the case of preference shares for a foundation, this foundation acquires a call option to acquire preference shares with voting rights. By invoking the call option, the foundation may, in situations that threaten the continuity of a company, acquire control of the company in order to (temporarily) fend off unwanted activist shareholders or an undesirable takeover.

In the Exit Advice of August 2013, NLF I recommended, after consultation with ABN AMRO, that preference shares be established for a foundation. In the subsequent debate in the House of Representatives, the sufficient effectiveness and adequacy of this protective measure was discussed at length, partly because of the required permission (DNO) from the Supervisor. In the event that protective preference shares are issued, the necessary permission can only be requested from the Supervisor at the time that the foundation actually wishes to exercise the call-option (thus in a real threat of a war situation). Due to the processing period utilised by the Supervisor for a DNO provision, there would be some uncertainty about the timely availability of the instrument and hence its effectiveness. Against this background and your commitment to the House of Representatives to further examine and, if necessary, resolve this point, NLF I once again collaborated with ABN AMRO during the ensuing period to explore and elaborate the various options for effective and adequate protection. It is extremely important for ABN AMRO to have sufficient clarity about the effectiveness and adequacy of the chosen protection measure and therefore the answer to the question whether a DNO will be obtained, as quickly as possible in the process and preferably prior to the IPO. NLF I understands this

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<sup>40</sup> Article 2: 118a, paragraph 2, Civil Code.

<sup>41</sup> The terms 'war time' and 'peace time' are common terms in published studies on the protective measures of listed companies.

<sup>42</sup> Article 2: 118a, paragraph 3, Civil Code.



position and the concern that the House of Representatives has expressed about this point. A protection structure has recently been elaborated in which the advantages of both certification and protective preference shares are combined in such a way that, in the opinion of NLFi and ABN AMRO, sufficient assurance can be obtained on the effectiveness and adequacy of the protection, early enough in the process. NLFi recommends formally submitting this protection structure, which is further elaborated below, for approval by the Supervisor in the near future.

*Trust Office Foundation for the Continuity of ABN AMRO – further elaboration*

NLFi recommends, prior to ABN AMRO's IPO, setting up a trust office in the form of a foundation intended to protect the continuity of ABN AMRO (hereinafter: ABN AMRO Continuity Foundation). The ABN AMRO Continuity Foundation will not be granted a call-option to acquire protective preference shares, but the foundation will receive, at the time of the IPO, the shares which the State then wishes to sell on the market. This also applies to later sell-downs on the stock exchange. The ABN AMRO Continuity Foundation will not be granted a call-option to acquire protective preference shares, but the foundation will receive the shares which the State wishes to sell on the market, at the time of the IPO. The proceeds from the sale of the certificates in the IPO, as with a sale of shares, will go to the State. With certification, it is not the shares but the certificates that are traded on the exchange. The legal ownership of the shares remains with the ABN AMRO Continuity Foundation.

In general, certification is designed in effect to enable the trust office to retain the voting rights of shares and to grant certificate holders the right to ask the trust office for a voting proxy.<sup>43</sup> The trust office may consequently exercise the voting rights associated with the shares for which certificate holders have not requested any proxies.

For the ABN AMRO Continuity Foundation, NLFi recommends deviating from this practice by stipulating that the foundation always automatically grants the certificate holders a proxy to vote for each shareholder meeting in times of 'peace'. The certificate holders can then choose to 1) use the proxy vote by voting personally in the ABN AMRO shareholder meeting or, 2) return the voting proxy with or without a voting instruction to the ABN AMRO Continuity Foundation, so that the foundation can vote or 3) to do nothing, vote personally or return the vote to the ABN AMRO Continuity Foundation (in which case the vote is then lost). The ABN AMRO Continuity Foundation could encourage certificate holders to return their proxy vote by issuing voting recommendations. In this way, the ABN AMRO Continuity Foundation can also try to address any shareholder absenteeism. Proxies can be returned by certificate holders for each shareholder meeting. As an important exception to the principle that the ABN AMRO Continuity Foundation automatically grants voting proxies to

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<sup>43</sup> unless there is a war situation as described in Article 2:118a, paragraph 2 of the Civic Code.

certificate holders,<sup>44</sup> NLFI recommends that the ABN AMRO Continuity Foundation should, in some cases of undesirable shareholder activism and a takeover bid on which no agreement has been reached with ABN AMRO, be able to temporarily restrict, exclude or revoke the proxies, and, in this way, may temporarily assume the voting rights on certified shares. With regard to the temporariness of such a measure, NLFI recommends that the period of the measure be limited to the maximum period in which protective preference shares have to be withdrawn, which is within two years. By restricting, excluding or revoking voting proxies in 'times of war', the ABN AMRO Continuity Foundation may exercise the voting rights of all the shares that the State has already renounced and thus provide temporary protection for the continuity of ABN AMRO. The board of ABN AMRO can use this period of up to two years for further consideration and possible consultation with the relevant activist shareholder(s) or bidder(s) behind the (unwanted) bid. As long as the interest of the State is greater than one-third of the issued capital and NLFI is able to provide protection through its legally required qualified majority for important changes to the identity or character of the bank, NLFI recommends organising the certification at ABN AMRO so that the foundation can only restrict, exclude or revoke voting proxies after prior approval from the Minister and NLFI.

Designing the foundation in such a manner ensures, on the one hand, that it is able to adequately and proportionately protect ABN AMRO in times of war without unduly disrupting voting at shareholder meetings in times of peace and, on the other hand, that a DNO can be requested from the Supervisor for the ABN AMRO Continuity Foundation at an early stage in the preparatory process of the IPO. After all, the ABN AMRO Continuity Foundation will be able to exercise voting rights at the shareholder meeting once the IPO occurs, in peacetime, the foundation can vote on the shares for which certificate holders have returned their voting proxy with or without specific instructions, and in wartime the foundation can (temporarily) exercise the voting rights of all shares which the State has divested during the IPO. In composing the board of the ABN AMRO Continuity Foundation, the requirements of independence contained in the law will be strictly and carefully applied.

If and insofar as the certification of shares is ultimately chosen as the manner of protecting the continuity of ABN AMRO, the listed ABN AMRO shares mentioned in this Exit Advice are in fact listed ABN AMRO certificates.

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<sup>44</sup> Article 2:118a, paragraph 2, Civil Code provides this possibility by determining that the voter (in the case of ABN AMRO, the ABN AMRO Continuity Foundation), can only restrict, exclude or revoke a given voting proxy if:

- a. a takeover bid has been announced or made on shares in the capital of the company or the share certificates, or there is a reasonable expectation that such will occur, without the company having agreed to such a transaction;
- b. a holder of certificates or several holders of certificates and shares, according to a mutual agreement to cooperate and this with or without the involvement of subsidiaries, provide or arrange for at least 25% of the company's issued capital, or;
- c. the exercising of voting rights by a holder of certificates is, in the opinion of the voter, fundamentally in conflict with the interests of the company and the related company.

### *Response time and rights of the works council*

In addition to the established ABN AMRO Continuity Foundation, Dutch corporate law also provides other instruments that ABN AMRO could use to exert some influence if the bank is faced with unwanted shareholder activism.

When activist shareholders wish to discuss the strategy or management of the company with ABN AMRO, for instance, they are free to ask the company to place the subject on the agenda for discussion at a shareholder meeting.<sup>45</sup> In that case the management of the company can call upon the period of 60 days prior to the general meeting stipulated in the articles of association,<sup>46</sup> which must be observed for the submission of a request for inclusion of an agenda item. If it is a subject that can lead to a change in the strategy of the company, for example, by withdrawing confidence in the supervisory board, the management board may also invoke the so-called 'response time' of the Dutch Corporate Governance Code, which must be respected by Dutch listed companies. Best practice provision IV.4.4 in conjunction with II.1.9 of the Dutch Corporate Governance Code provides that shareholders should take into account a response time of 180 days when scheduling such strategic subjects. Invoking this period gives the management of the company the time and opportunity to consider a possible response. The board should use the response time for further deliberation and constructive consultation, at least with these shareholders, and should explore the alternatives.<sup>47</sup>

If a takeover bid is made for ABN AMRO for which no agreement has been reached with the management and supervisory boards, it is considered a hostile takeover bid. The decision not to support a bid is not a decision for which the works council has a duty to provide advice, because it is a decision not to do something. This is different than when ABN AMRO would explicitly grant the works council (WC)<sup>48</sup> such advisory powers. In that case, the works council could possibly increase its involvement in the acquisition process by exercising its advisory power.

A strategic change, such as a merger or division can also be brought to a vote by the management board under pressure from an activist shareholder.<sup>49</sup> Such decisions usually fall under the advisory remit of the works council, on account of which the works council can increase its involvement.

The works council has no independent legal right to submit a request for inquiry to the Enterprise Chamber. It may do so, but only in accordance with the articles of association or by agreement with the company. The inquiry procedure basically focuses on the behaviour of the management board or the supervisory board, but

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<sup>45</sup> Shareholders cannot force such subjects to a vote at a shareholder meeting. Only the executive board of a company possesses such a right of initiative.

<sup>46</sup> Article 2:114a Civil Code.

<sup>47</sup> The Cryo-Save ruling of the Amsterdam Court of Appeal ('Enterprise Chamber') in September 2013 has ascribed this provision a high status, making it more or less a legal rule.

<sup>48</sup> The works council of ABN AMRO is called the Raad van Medewerkers (Council of Employees) (RVM).

<sup>49</sup> Shareholders cannot force such subjects to a vote at a shareholder meeting. Only the executive board of a company possesses such a right of initiative.

can also relate to a shareholder meeting. In general, a (hostile) bidder has already built up a shareholding in the company before making a public offer. With such a right of investigation, the works council could possibly attempt to influence the behaviour of the bidder and thus the process of an unwanted takeover bid.

ABN AMRO is aware of these possibilities and NLFi trusts that the bank will deal with them in a sensible way.

In the opinion of NLFi, the established ABN AMRO Continuity Foundation can offer good (temporary) protection for the continuity of ABN AMRO. Additionally, NLFi itself can provide the necessary protection for ABN AMRO, partly through the use of the qualified majority. NLFi recommends that there be no additional protective measures for ABN AMRO. This could negatively affect the valuation of ABN AMRO and may deter potential investors.

## 5.4 Stable shareholder base

### *Introduction*

During the general meeting of 27 November 2013, you agreed to 're-explore the question whether offering loyalty dividends would lead to sufficient interest in order to achieve good yields and whether this could possibly harm investor interest'. This is due to the desire expressed in the House of Representatives to attract long-term shareholders to obtain a stake in ABN AMRO. In general, it is consequently expected that these long-term shareholders will actively endeavour to promote the creation of long-term value. Long-term shareholders could also serve as a counterweight to shareholders who are focused on short-term interests. Rewarding long-term shareholders with additional dividends (loyalty dividends) could assist in attracting them. By binding shareholders longer to a company, they should begin to feel more responsible for policy and provide more of a counterweight to shareholders mainly guided by short-term interests. The following is a more detailed analysis.

A loyalty dividend is an extra dividend that shareholders are paid on shares that they retain for a predetermined period. To demonstrate that the shares are actually held for the agreed period, shareholders' shares in the company must be registered.. 'Ordinary' shares will be converted into 'registered' shares. Registration of the shares removes them from the book-entry system. Registered shares can no longer be traded on the exchange. Should shareholders wish to sell their registered shares, the shares must first be reconverted. The shareholders are then no longer eligible for the loyalty dividend.

### *Legal framework*

The Netherlands has no legal basis for granting loyalty dividends. In the DSM ruling,<sup>50</sup> the Supreme Court held that shareholders may be given additional rewards under

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<sup>50</sup> HR 14 December 2007 ('DSM ruling').

certain conditions, as long as such practices do not violate the principle of equality among shareholders.<sup>51</sup> Due to the limited review by the Supreme Court, jurisprudence has established no consensus on how a loyalty scheme must be designed in a legally viable manner. It is clear that introducing a loyalty dividend makes a distinction among shareholders, as loyalty shareholders are favoured over ordinary shareholders. It is ultimately up to the European Court of Justice to evaluate if the necessary objective justification exists for the practice (testing it against requirements of legitimacy, effectiveness, subsidiarity and proportionality). Despite the green light from the Supreme Court, DSM decided at the time not to proceed with the introduction of a loyalty dividend. There are no other Dutch companies with loyalty schemes. There are, indeed, two Dutch companies with a loyalty scheme for *voting rights*. These schemes were recently established in the context of a merger (not an IPO).<sup>52</sup> In both cases, the schemes ensured that a long-term existing major shareholder obtained, in any event, additional voting rights, so that it remained in control.

#### *Is a loyal shareholder involved?*

A discussion that has been going on in the Netherlands for some time concerns the question of whether a loyal shareholder is more involved. A shareholder that retains their interest in a company for a long, ongoing period, is not necessarily an involved shareholder. Involved shareholders are regarded as shareholders that exercise their shareholder rights (e.g. votes at the AGM) and inform the management board about their views on long-term value. Several authors have pointed out that there is no empirical evidence justifying the expectation that long-term shareholders will also actively take positions to promote long-term value.<sup>53</sup> Organisations such as Eumedion and VEB stress the fact that shareholders that hold their shares for a long time are not, for certain, more involved or more likely to contribute to the creation of long-term shareholder value. Active involvement makes demands on the shareholders' time and money. This does not always coincide well with the objective of many investors to achieve the highest possible return for a given risk profile.<sup>54</sup>

A debate has also been going on in scholarship and jurisprudence concerning the desirability of focusing on long-term shareholders. These discussions indicate that it is not certain if listed companies are definitely worse off with short-term shareholders. It was also revealed that long-term shareholders are not necessarily more concerned with the long-term interests of a company. Too many long-term shareholders may lead to reduced liquidity. This could have a negative effect on shareholder value creation.<sup>55</sup> Investors with a short-term focus may in turn contribute to good pricing.

<sup>51</sup> Art. 2:92 para. 2 Civil Code.

<sup>52</sup> CNH Industrial N.V. (created from a merger between Fiat Industrial S.p.a. and CNH Global N.V.) and Fiat Chrysler Automobiles N.V. Both companies are only listed on foreign stock exchanges.

<sup>53</sup> For example A. Doorman, 'Annotatie Hoge Raad 's-Gravenhage, JOR 2008, 11, B. Bier 'Betekent winstrecht ook recht op winst?' Handboek Onderneming en aandeelhouder 2012, p. 163-208 en M. Koelemeijer en R.W.F. Hendriks 'Loyaliteitsdividend: naar loyale aandeelhouders?' Tijdschrift voor vennootschaps- en rechtspersonenrecht, 2012, 5, p.144-148.

<sup>54</sup> Loyalty dividend with listed companies: justified?, Mr. S.F. de Beurs, Corporate Law and Finance, 2011, p. 6/7 and Introducing loyalty shares terrible plan, Eumedion, 24 May 2013 and Study of short-term behaviour of Dutch institutional investors, W. Kuipers, Corporate Law 2013/106.

<sup>55</sup> Note, reward loyal shareholders, attachment to 31083, no. 26.

Listed companies place great importance on the adequate liquidity and marketability of their shares. For the stock market, this is also an important criterion for admitting a company to an index that shareholders can follow. In practice, therefore, listed companies strive to maintain a certain balance between long-term and short-term shareholders.

#### *Negative effects of loyalty dividends*

Loyalty dividends are only for shareholders who are actually involved in the listed company, both legally and economically. This is not the case if shareholders do not hold shares for their own account and at their own risk, for example because they have hedged the underlying economic risk. For example, a shareholder can set up a holding in between himself and the company that does issue marketable shares. Or a specialised loyalty fund is set up that does issue marketable participations. A check on such forms of abuse is very difficult and results in high administrative costs for the company.

Additionally, loyalty dividends may have a potential impact on the disciplinary function of shareholders with regard to the company's management. Shareholders would normally prevent the board members from using its power, position and the money contributed by shareholders to allow their own interests to prevail over those of the shareholders. Therefore, the shareholders' meeting also has the responsibility of monitoring the board and possibly disciplining it (the agency function). Disgruntled shareholders may exercise their rights to force the board to implement a different policy or to sell their shares (voting with their feet). When the latter results in loss of the loyalty dividend, it is likely that a shareholder will be slower to resort to it. Knowing this, the management board can more easily disregard any criticism, which means that it will be even less attractive for shareholders to make their views known to the board. The consequence may be that shareholders are passive in exercising their shareholder rights and become less involved in the company (which is precisely the purpose of a loyalty dividend). Published discussion suggests that the precise effect remains unclear. Further investigation is therefore required.

As mentioned above, registered shares may no longer be freely traded on the exchange. Published research indicates that, when a large number of shares are converted into loyalty shares, share liquidity on the stock exchange decreases. The number of shares available for unrestricted trading ('free float') is reduced. This can lead to a share price that is more susceptible to volatility. Shareholders are therefore exposed to greater price risk. The reduced liquidity may cause the company's costs of attracting capital to increase, which can have a detrimental impact on the effectiveness of the capital market. A smaller 'free float' can lead to a lower weighting of the share on indices. For funds and institutional investors that track these indices, this could mean that the relevant shares need to be sold, resulting in a lower share price. The actual occurrence of such risks ultimately depends on the number of shares left for free trading on the stock exchange. One solution could be to limit the number of shares per shareholder that could qualify for a loyalty dividend. Under French legislation, a shareholder may, for example, be eligible for the additional dividend on shares representing no more than 0.5 per cent of the issued capital of

the company. The risk incurred by such a restriction is that the scheme becomes less or no longer effective and meaningful.

It is also important to take into consideration that shareholders who do not register will receive a lower dividend once the loyalty dividend is introduced. As relatively more 'loyal' shareholders are established, it becomes less attractive to become either a 'loyal' shareholder or an ordinary shareholder. This effect increases as the bonus dividend is set higher. The greater the success, the less it yields for loyalty shareholders and ordinary shareholders. This is an important consideration when determining the amount of the loyalty dividend.<sup>56</sup> No practical experience regarding this issue is available.

Supporters of loyalty shares suggest that the formation of a core group of shareholders could act as a deterrent to hostile buyers. The question, however, is whether 'loyal' shareholders who are offered a takeover premium,<sup>57</sup> will also actually remain loyal to the company and not sell their shares for this reason. As yet no research is available to demonstrate such loyal behaviour among investors.<sup>58</sup>

#### *Investor input*

NLFI has asked a number of investors about their interest in loyalty shares during an ABN AMRO IPO. The result indicates that such interest is small.<sup>59</sup> The (legal) inequality that such an instrument could create has been indicated.<sup>60</sup> Mention must also be made of the risk of reduced liquidity and a fall in price. Another identified negative effect concerns the potential for abuse and the administrative burden associated with monitoring any abuse. In addition, various parties<sup>61</sup> have indicated that it is not certain if loyalty shareholders are also involved shareholders. Because the shareholders in a loyalty scheme automatically receive additional dividends or voting rights after a certain period, it is referred to as paid love.

#### *Conclusion*

It is clear that a great deal of uncertainty continues to exist. Further investigation must be made into the consequences of introducing a loyalty dividend in order to decide on the advisability and the manner in which a loyalty program can best be realised. Given all these uncertainties, the lack of interest among investors and the major (financial) interests associated with a successful IPO of ABN AMRO, NLFI believes that a loyalty dividend should not be introduced as part of an IPO of ABN AMRO.

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<sup>56</sup> Belonen van royale aandeelhouders?, V. Dank, August 2013, p.53.

<sup>57</sup> Rate increase as a result of a potential acquisition which can, in practice, reach up to 30%.

<sup>58</sup> One of the recommendations in the report *IPOs and Bookbuilding in Future HM Government Primary Share Disposals* dated 16 December 2014 which came into being under the leadership of Lord Myners following the privatisation of Royal Mail, is to focus on index investors as the most reliable long-term investors.

<sup>59</sup> Below is the finding of the EC during the consultation for the draft Committed shareholdership directive.

<sup>60</sup> 'Rather a sharper dividend payout ratio for each shareholder than a visually lower dividend payout with a loyalty dividend construction.' 'We don't all get the same as the other'

<sup>61</sup> Introduction of loyalty shares terrible plan, Eumedion, 24 May 2013.



#### *c. Alternative binding of shareholders?*

Jurisprudence describes several other possibilities for a company that might help bind a group of shareholders for a longer term and create a stable shareholder base. It is important that the company defines a clear course for the long-term and conducts a clear dividend policy. This can lead to shareholders also considering the sustainability of the shareholder value to be objects of the company.<sup>62</sup> It is also important that a constructive dialogue is established between the company and its shareholders, which shall be accounted for in a transparent manner on current and future policy. The proper use of investor relations can help ensure that shareholders continue to have confidence in the company. At least, more involvement can be created and short term orientation is prevented.<sup>63</sup> NLFI trusts that ABN AMRO will optimally use these opportunities.

#### *d. Employee participation plan*

During the general meeting of 27 November 2013, the House of Representatives asked about the feasibility of an employee participation plan. Such a plan, in particular where long-term ownership among employees is stimulated by giving discounts or assigning shares with a certain priority, may contribute to the creation of a stable shareholder base. In answering you indicated that the topic will be discussed between ABN AMRO and the works council of the bank and that, should it come to a proposal, the necessary wage moderation will be an important consideration in the assessment. Meanwhile, ABN AMRO has explored the possibilities. The management board of ABN AMRO has now concluded that it is not in favour of granting discounts to employees on the purchase of shares in an IPO or giving them priority treatment or any other benefit, at least not for the first tranche. This conclusion also applies to members of the management board. Although employee participation is a customary manner in the market to create a stable shareholder base and emphasise internal commitment, the management board has attached great weight in its deliberations to the existing concerns in society around remuneration. As a result, none of the scenarios examined are felt to be appropriate in the current social context. If, during an ABN AMRO IPO, private investors are offered the opportunity to buy shares as part of a general placement, then the persons concerned will naturally also be free to register to buy shares (where applicable).

#### *e. Tranche for private investors*

An important part of formulating an allocation policy for the shares ('allocation policy') involves whether or not to actively offer private investors the opportunity to buy shares in ABN AMRO. As one option in this regard, consideration could be given to limiting the accessibility of the public to the ABN AMRO shares and to creating, in that sense, a 'pricing tension' and 'level playing field' with professional investors. To achieve this effect, it would usually be necessary to launch a wide-ranging marketing

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<sup>62</sup> Loyalty dividend with listed companies: justified?, Mr. S.F. de Beurs, Corporate Law and Finance, 2011, p. 9.

<sup>63</sup> Note reward loyal shareholders, attachment to 31083, no. 26 and Rewarding loyal shareholders?, V. Dank. 2013, Tilburg, p. 127.



campaign specifically aimed at the target group of private investors. Such an active approach of enticing private investors to buy shares is called a 'retail tranche'. Apart from the costs that may be associated with such a tranche, other features play a role in this issue. For instance, the report by Lord Myners in response to the privatisation of Royal Mail ('IPOs and Future Bookbuilding in HM Government Primary Share Disposals' dated 16 December 2014) stated that a retail tranche could make an exchange transaction considerably more complex and inflexible. It was also noted that not all enterprises to be privatised lend themselves to a retail offering due to, for example, company risk profiles or the expectation that the returns of a given company might display a fluctuating pattern. Against this background, consideration might better be given to a more passive approach to retail investors in which these investors are given the opportunity to buy ABN AMRO shares via the general placement of shares (with or without the right of guaranteed allocation), but without any implementation of an explicit marketing campaign or other (financial) incentives that might encourage the purchase of shares.



## 6 Conclusion

In the previous chapters we described how the exit of ABN AMRO can be shaped. In the opinion of NLFI, an IPO is still the optimal exit option for ABN AMRO. ABN AMRO is ready for an IPO, the financial sector is sufficiently stable, there is currently sufficient interest in the market and an acceptable valuation seems feasible. NLFI recommends that the external preparations for an exit of ABN AMRO by means of an IPO are initiated. The above does not, of course, constitute investment advice. The final decision to sell the shares through an IPO will have to be made partly on the basis of the valuations to be obtained at that time and subject to the other considerations set out in this report.

The IPO is expected to occur from the fourth quarter of 2015, assuming that it will comply with all preconditions and that the Supervisor has issued a DNO statement for an IPO and for the ABN AMRO Continuity Foundation. NLFI recommends you reduce the size of the first tranche to 20-30% at IPO (including any possible greenshoe) in order to find a good balance between sufficient liquidity and to still be able to sufficiently benefit from a rising share price.

After the IPO, it is important to reduce the remaining interest in a controlled manner. This can be achieved through issuing secondary tranches. NLFI considers the placement of a continued tranche as a fundamental and weighty decision, for which prior consent from the Minister of Finance is required. A new DNO must be requested from the Supervisor for any continued tranche.



## Attachment: IPO process outline

In an Initial Public Offering (IPO), shares of a company are sold to investors. The shares are bearer shares and freely traded. After the IPO, the shares are listed on a stock exchange (in the Netherlands this is the Euronext in Amsterdam). In an IPO, shares may be offered by the existing shareholder (proceeds go to the shareholder, a so-called 'secondary offering'), or by the company through the issuance and sale of new shares (in which case the proceeds go to the company; a so-called 'primary offering').

The process of an IPO can be simply divided into the key stages described below:

### *1. Preparation of an IPO*

Making the company 'exchange ready' requires a thorough preparation in the field of internal organisation, reporting procedures, increasing load of certain functions, corporate governance, etc.

### *2. Mandate to the syndicate banks*

The next step in the process is to provide a mandate to the banks that will accompany the IPO. The syndicate banks are often referred to as the (joint) global co-ordinators'. The mandate and price agreements are recorded in a so-called engagement letter between the syndicate banks and the company.

### *3. Prospectus (in the Netherlands)*

The prospectus is prepared by the company and its advisors. In the prospectus, that has to be approved by the AFM the company provides all relevant information to potential investors to enable them to make an informed assessment of the offered shares and the company. The preparation of the prospectus is inextricably linked to the due diligence (see 5). The findings from the due diligence process are used in to determine what is relevant for the prospectus and also to verify the contents of the prospectus. Before the prospectus is published to potential investors, it must be approved by the AFM.

### *4. Underwriting agreement*

An important next step is to enter into an underwriting agreement between the company, the selling shareholder and the full syndicate of banks. In addition to the global co-ordinators, this syndicate also comprises banks that have been assigned a different role in the process (such as the bookrunners, see below). Usually the syndicate guarantees the placement of shares in an underwriting agreement. Furthermore, the underwriting agreement often contains guarantees and indemnifications from the company to the syndicate banks and suspensive conditions such as a material adverse change, legal opinions and comfort letters. The

underwriting agreement generally contains a lock-up arrangement with the aim of creating a stable market price and investor confidence.

#### *5. Due diligence*

Due diligence is carried out by the syndicate banks and their advisors and advisors of the company. The study focuses on the main financial, fiscal, legal and commercial aspects of the company. The study includes interviews with the management board, supervisory board, management and management presentations.

#### *6. Bookbuilding and roadshow*

Bookbuilding is the most common method of determining the initial share price. First the syndicate establishes a price range in which the price is expected to be offered at and which is included in the prospectus. During bookbuilding, investors are invited to subscribe by specifying the desired number of shares and price. The 'book' is then built based on this. The banks that keep / update books are called 'bookrunners'.

During the formal marketing period, the syndicate organises a roadshow with presentations by the company to analysts and then potential institutional investors. Any communication during the roadshow and elsewhere must be in accordance with the prospectus.

#### *7. Determining introductory price and number of shares*

The IPO offer price and the number of offer shares shall be determined based on marketing feedback. This is disclosed in a press release ('pricing statement') as a supplement to the prospectus.

#### *8. Allocation, listing, trading and settlement*

After establishing the price, the allocation of the shares among the bidders will be determined. After the allocation, the actual IPO occurs: the shares will be listed and the conditional trading will start (on a so-called 'as if and when delivered basis'). The trade is conditional because the payment and delivery of the shares have not yet occurred, so all transactions can be voided. After the divestment, the trading of the shares is unconditional.

#### *9. Stabilisation post IPO*

To keep the exchange rate stable and to increase confidence in the market, the syndicate usually has the option of carrying out stabilisation transactions after the IPO (via the greenshoe). Stabilisation is only allowed under strict conditions and within a certain period.