ING Bank NV
Issuer Rating Report

SCOPE STABLE AA-

Overview

Scope Ratings has assigned a AA- issuer rating to ING Bank NV. ING Group rating is aligned with the one of ING Bank, at AA-. The bank's senior unsecured debt (non-TLAC/MREL-eligible) has been rated AA- and the Group's senior unsecured debt (TLAC/MREL-eligible) at A+. All ratings carry a Stable Outlook.

The ratings do not apply to unguaranteed subsidiaries of the rated parent.

The ratings were not solicited by the issuer. Both ratings and analysis are based solely on publicly available information. The issuer has not participated in the process.

Highlights

- The ratings of ING Bank are driven by the strong universal banking franchise in the Benelux region and the lean wholesale banking model, with the bank leveraging its industry lending expertise through an extensive worldwide network.
- ING's presence in less mature economies has supported continuous earning streams, cushioning the pressure of the low interest rate environment in western Europe.
- Equally central to the rating is the bank's competitive advantage: its early adoption of the direct banking model and ability to adapt its distribution model to customer behaviour. The bank has proved it can run a scalable business model within and across geographies, recognising early on the importance of the digital channel and automating back-end processes.
- After revelations of shortcomings in customer due diligence and anti-money laundering practices at ING Netherlands, the bank initiated a thorough review of its policies and procedures worldwide. Given management's sound track record on delivery, we deem the review to be adequate.
- The funding profile is sound. Deposit-taking, mostly in retail, is combined with continuous but diversified market issuance. Capital metrics have also improved and should weather the forthcoming effects from Basel IV.

Rating drivers (summary)

The rating drivers, in decreasing order of importance in the rating assignment, are:

- Assets of overall good quality; active management of isolated areas of risk
- A strategy centered on customers and digital banking; efficiency gains to materialise with some delay
- Lending growth, repricing efforts and focus on fee- and commission-generating products should sustain revenues going forward
- Strong funding profile supported by continuous deposit-gathering; ability to organically build up capital should weather forthcoming regulatory changes

Ratings & Outlook

Issuer Rating	AA-
Outlook	Stable
ING Bank - Senior unsecured debt	AA-
ING Group - Senior unsecured debt	A+
ING Group - Tier 2 instruments	A-
ING Group - AT1 instruments	BBB
Short-term debt rating	S-1+

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Bloomberg: SCOP

Rating change drivers

Meaningful deterioration in asset quality. The bank's credit exposure is tilted towards retail, with residential mortgages representing almost 70% of total retail credit oustandings. Commercial banking exposures are well diversified across sectors and geographies. There are, however, portfolios of more problematic countries and industries, but these are continuously monitored. The overall quality of the lending portfolio is sound due to the large share of secured loans, with a Stage 3 ratio of 1.5% as of YE 2018 and Stage 3 coverage at 30.6%. As the bank moves towards higher-margin lending such as unsecured consumer and SME finance, we would regard negatively any meaningful deterioration in asset quality.

Competitive advantage leading to a significant improvement in Challengers and Growth Markets[1]. ING's strong digital footprint has so far proved instrumental in Germany, where the bank is now a top retail player. We would regard positively an improved market position in non-core geographies resulting from ING's ability to adapt its distribution model to customer behaviour.

Worse-than-expected reputational damage from weak anti-money-laundering practices.

[1] Challengers markets are: Australia, France, Italy, Spain and Czech Republic. Growth markets are: Poland, Romania, Turkey and Asian bank stakes.

Rating drivers (details)

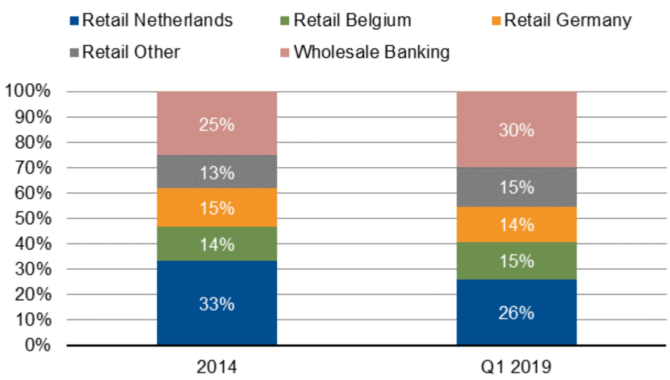
Assets of overall good quality; active management of isolated areas of risk

ING operates across several geographies, through retail banking franchises coupled with an extensive network supporting wholesale banking. As of Q1 2019, retail represented 65% of lending and wholesale banking, 35%[2].

Residential mortgages represent 67% of the retail lending portfolio: the indexed loan-to-value ratio (LTV) on Dutch mortgages averaged 65% at YE 2018, declining in past years due to rising property values, limitation of tax deductibility of interest payments and a cap on maximum LTV (at 100% from 2018).

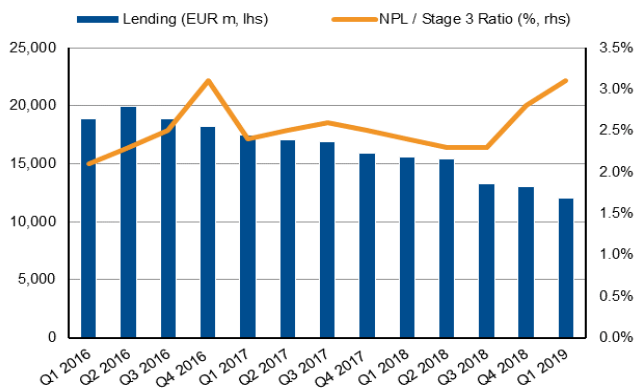
The bank has slightly reduced its mortgage portfolio in relative terms in recent years, instead growing wholesale and, to a lesser extent, SME lending. ING has also increased lending in general while diversifying geographically. Retail lending in Other Challengers and Growth Markets increased by ca. 26% in the past four years.

Figure 1: Lending breakdown



Source: Company data, Scope Ratings

Figure 2: Turkish exposure detail



Source: Company data, Scope Ratings

As for wholesale banking, ING has seen less activity aligning to its overall risk appetite, and given market conditions, has indicated a careful approach to new lending in the segment. Moreover, the bank has exited real estate development and imposed limits on more cyclical sectors such as real estate and leveraged finance. The significant degree of sector diversification in its commercial lending business, coupled with the high share of senior and covered lending, is reassuring.

Turkish exposures stood at EUR 12bn as of Q1 2019 (including retail banking activities at EUR 5.2bn), declining markedly in the past quarters both in real terms and as a result of the Turkish lira's depreciation. This portfolio is proactively managed and adequately provisioned for, with a Stage 3 ratio of 3.1% and a coverage ratio of 55%.

Serious shortcomings in 'know your client' (KYC) due-diligence at ING Netherlands led to customers being able to launder money through their accounts during 2010-16. In September 2018, ING agreed with the Dutch public prosecutor to pay a EUR 675m fine and EUR 100m disgorgement, the latter being the estimated sum that ING underspent on staff. Following the announcement, CFO Koos Timmermans, former member of ING's banking management board and responsible for Dutch operations for some of the years under scrutiny, resigned. In September, ING also announced that the SEC, following a

[2] Lending and money market credit outstanding, including guarantees and letters of credit but excluding undrawn committed exposures (off-balance-sheet positions)

request for information, concluded its investigation and recommended no enforcement action be taken.

Following the settlement, ING expanded on the bank-wide KYC enhancement programme initiated in 2017, beyond the KYC requirements initially envisaged by the fourth AML directive and the client activities control framework. We regard the review of policies and practices as thorough, especially given management's positive track record.

Moreover, bonuses for the 2018 year were reduced and both management and executive board members forfeited their entitlement to variable remuneration.

In March, the Bank of Italy found deficiencies in anti-money laundering processes in ING's Italian operations, which led ING to temporarily freeze new-customer onboarding. Further reputational challenges remain a possibility: ING's role as largest lender in the Netherlands might dent its ability to carry on business in the region, given the heightened public scrutiny.

A strategy centred on customers and digital banking; efficiency gains to materialise with some delay

Retail strategies for both the Benelux region and wholesale banking are oriented towards cost-control, while the goal for retail operations in the rest of the world is income growth.

In the Netherlands and Belgium, the lender is halfway through a transformation programme aimed at greater efficiency, through the creation of a single banking platform and the development of a single mobile app and a web app.

ING is reducing its physical presence in both Belgium and the Netherlands, with the increasing penetration of digital channels resulting in record numbers of mobile interactions. The process in Belgium has begun with the integration of Record Bank into ING Belgium, through client migration and the reduction or redeployment of resources. Underlying expenses have declined; however, we expect efficiency gains to become more pronounced from 2020.

In Germany, the bank has become the third largest in private retail by number of customers. In a country that has historically shied away from digital channels and where the brick-and-mortar strategy has long dominated, ING has built a significant market position without opening a single branch. ING has disrupted the market through digital customer onboarding and authentication, account opening and loan extensions. However, for the advisory phase, ING relies on Interhyp, a mortgage broker of which it has majority ownership.

In other European markets, ING is rolling out its Model Bank digital platform, which started with the Czech Republic in 2018 and will extend to France, Italy and Spain. Notwithstanding the aim for a platform that integrates products and services across geographies, ING continues to customise its approach based on customer behaviour.

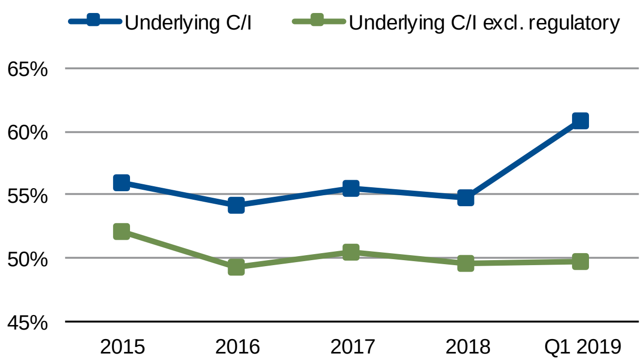
For example, it has retained a few branches in major Spanish and Italian cities, while reducing its physical presence in countries where digital channels are gaining strength, such as Poland. In the country, in the past two years, mobile and desktop interactions have quadrupled.

The bank is at the forefront in the adoption of distributed ledger technology for trade finance. In wholesale banking, it also intends to harmonise its products across geographies.

The IT cost base has been kept flat, moreover through a balance of transformation investment and the savings materializing from previous programmes, the overall underlying costs (excluding regulatory expenses) have also been kept almost flat in the past years.

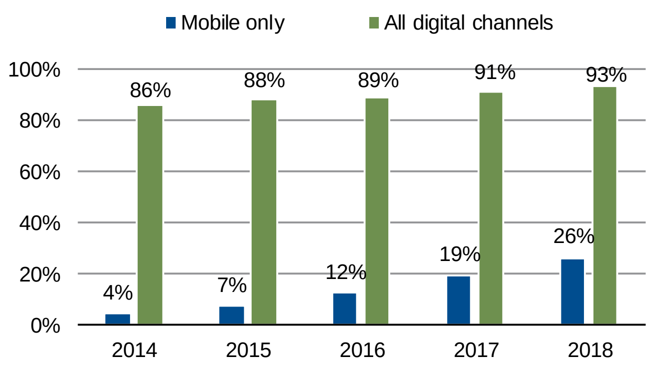
The bank is still aiming for a cost-to-income ratio of between 50% and 52%, but has dropped the previously announced 2020 timeframe. We expect the phase-out of digital investments, together with cost savings from staff reductions, to offset the increased regulatory and compliance costs amid the extended timeline, likely beyond 2022.

Figure 3: Cost-to-income ratio



Source: Company data, Scope Ratings

Figure 4: Digital channels penetration, retail banking



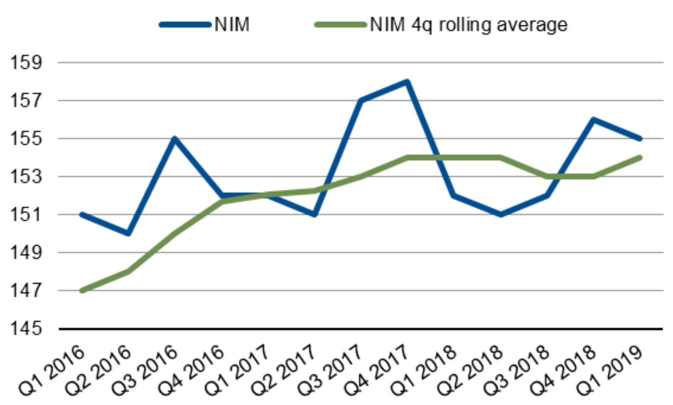
Note: % of active retail customers; Source: Company data, Scope Ratings

Lending growth, repricing efforts and focus on fee- and commission-generating products should sustain revenues going forward

ING has a history of strong operating performance, staying profitable despite higher impairments and the divestment of insurance and investment management activities as part of its restructuring.

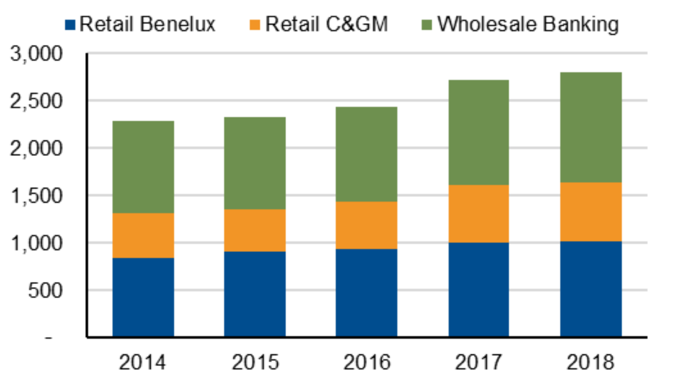
Volume growth and resilient margins, now at the top of management guidance, have provided for sustained net interest income in recent times.

Figure 5: Net interest margin development



Source: Company data, Scope Ratings

Figure 6: Fee income by segment, historical



Source: Company data, Scope Ratings

As of Q1 2019, customer lending has increased by over 5% YoY, positioning ING at the higher end of European peers. In retail, the number of primary customers – defined as active payment customers with recurring income and at least one extra active product – has increased by roughly 1m per year and now makes up 33% of the total customer base, generating 3.5 times the value of non-primary customers.

Compared to peers, ING derives a comparatively small portion of revenues from fees and commissions; although management is increasingly focused on cross-selling and ramping up fee-generating products. In this sense, the AXA partnership, announced in June 2018, will integrate bancassurance products in ING's digital front-end platform, providing protection to the consistent retail customer base in the Challengers markets.

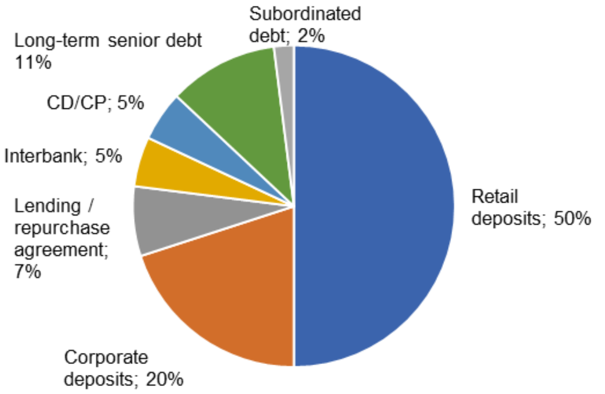
Strong funding profile supported by continuous deposit-gathering; ability to organically build up capital should weather forthcoming regulatory changes

Customer deposits represent the largest component of funding, at 70% of liabilities (excluding trading securities and IFRS equity) as of Q1 2019; continued deposit-gathering in retail represents 50%. The reported loan-to-deposit ratio, after peaking in 2011 at 120%, has been declining and stood at 108% as of Q1 2019.

The group's market funding strategy benefits from the comparatively high degree of flexibility provided by the holding company structure. In January 2017, the Single Resolution Board confirmed the designation of ING Group as the single point of entry for the resolution strategy. Since then, and following increased regulatory clarity on MREL/TLAC-eligible instruments, the lender has now built up a sizeable buffer of holding-company senior and subordinated debt to protect the operating company's creditors and build up its TLAC/MREL position.

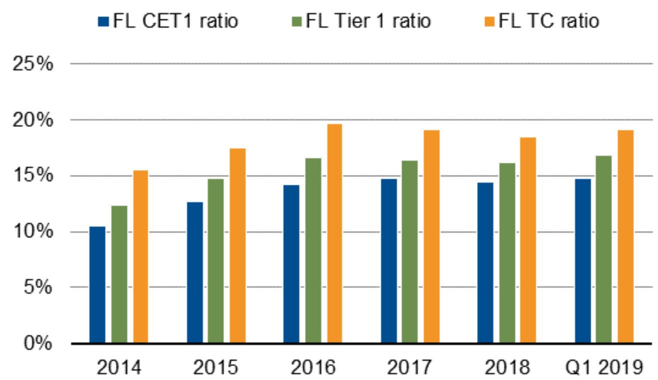
As of Q1 2019, ING Group reported a CET1 ratio of 14.7% and a total capital ratio of 19.1%. ING has proved it can sustainably grow lending while building up its solvency position.

Figure 7: Funding mix as of Q1 2019



Note: Liabilities excluding trading securities and IFRS equity.
Source: Company data, Scope Ratings

Figure 8: Improved capital position



Source: Company data, Scope Ratings

Going forward, the group will have to balance the impact of regulatory changes from Basel 4 and the targeted review of internal models on risk-weighted asset (RWA) density, which is estimated to inflate RWAs between 15% and 18%.

The measures proposed under Basel IV (or, more correctly, the finalisation of Basel III) include revised risk weights under the standardised approach, revisions on the application of the internal-rating-based models in 2022 (responsible for 80% of estimated RWA inflation for ING), and the introduction of an output floor (20% of the effect) to be phased in between 2022 and 2027.

On a pro-forma basis, the YE 2018 CET1 ratio would decline by 200bps, to 12.5%. According to ING, management action can mitigate a third of this effect, taking it close to its CET1 ratio target of around 13.5%. Given the group's profitability track record, but mostly because half of the loan book will mature or be refinanced before such changes are in force, we are moderately confident that ING's capital position can withstand the forthcoming regulatory changes.

ING's additional tier 1 instruments: key features and risks

We rate the AT1 securities issued by ING Group at BBB/Stable.

In accordance with our rating methodology for capital instruments, the starting point for the notching-down of ING's capital instruments is provided by its senior non-preferred rating of A+. The minimum four notches reflect the deeply subordinated status of AT1 capital instruments in the priority of claims, their going-concern loss-absorbing features and investors' exposure to coupon-cancellation risks. We believe no other factors warrant additional notching.

Table 1: CRD4 compliant AT1 instruments of ING Group rated by Scope

ISIN	Currency	Coupon %	Issue amount	Issue date	Next Call date	Scope Rating
US456837AE31	USD	6	1,000,000,000	16/04/2015	16/04/2020	BBB
US456837AF06	USD	6.5	1,250,000,000	16/04/2015	16/04/2025	BBB
XS1497755360	USD	6.875	1,000,000,000	21/11/2016	16/04/2022	BBB
XS1956051145	USD	6.75	1,250,000,000	26/02/2019	16/04/2024	BBB

Source: Santander, Scope Ratings

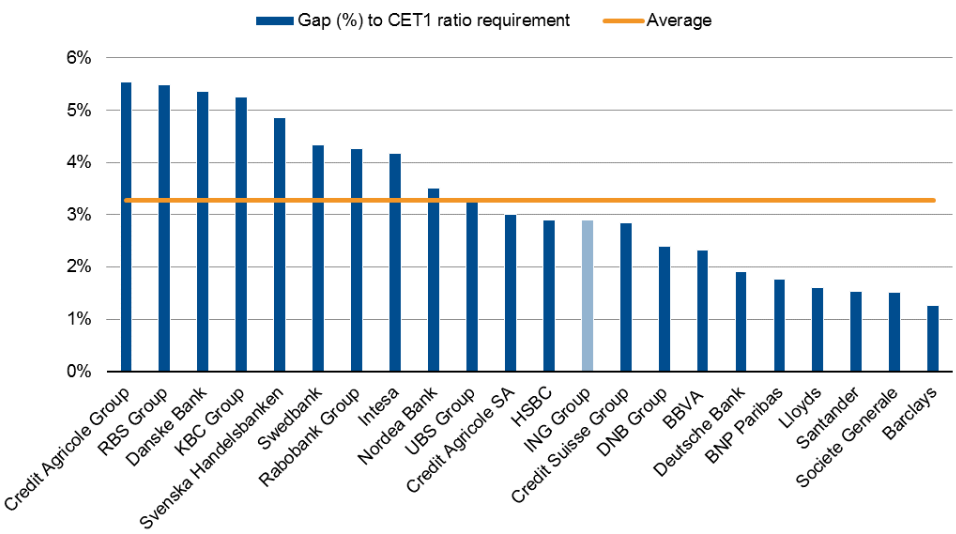
Coupon-cancellation risk

Coupons on these instruments are mandatorily cancelled if insufficient distributable items are available for distributions or if payments exceed the Maximum Distributable Amount (MDA).

As of YE 2018, ING's available distributable items stood at approximately EUR 43bn, more than sufficient to cover distributions.

The MDA is calculated upon a breach of the Combined Buffer Requirement. Following the conclusion of the 2018 SREP process, the group capital requirement was set at 11.81% at the beginning of 2019 and will marginally increase to 11.83% by Q4 2019 for the phase-in of countercyclical buffers. As of Q1 2019, ING Group holds a 2.9% or EUR 9bn buffer on the requirement, slightly below the average of banks whose AT1s instruments we rate.

Figure 9: Buffer to CBR, selected European banks

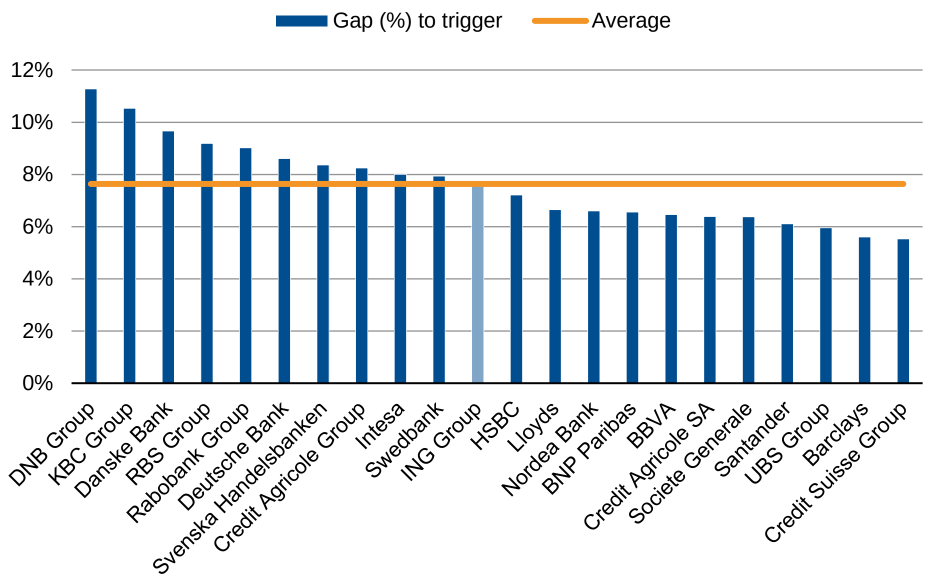


Source: ING Group, Scope Ratings

Principal-loss absorption risk

Pursuant to the terms and conditions of the notes, full conversion into shares will take place if the trigger level is breached, i.e. if the consolidated group's transitional CET1 ratio falls below the 7% threshold. As of Q1 2019, ING Group's buffer to the trigger stood at 7.7% or EUR 24bn.

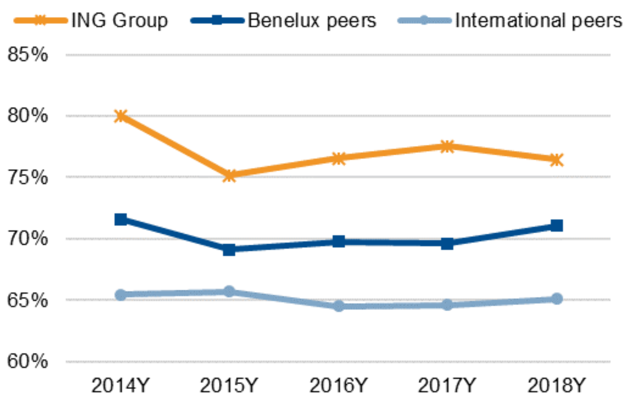
Figure 10: Buffer to trigger, selected European banks



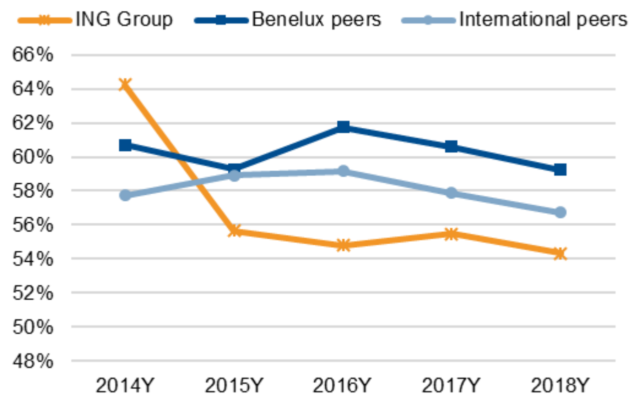
Source: ING Group, Scope Ratings

I. Appendix: Peer comparison

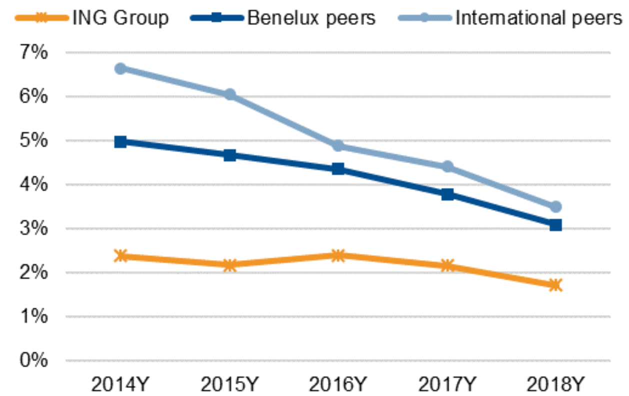
Net interest income/operating income (%)



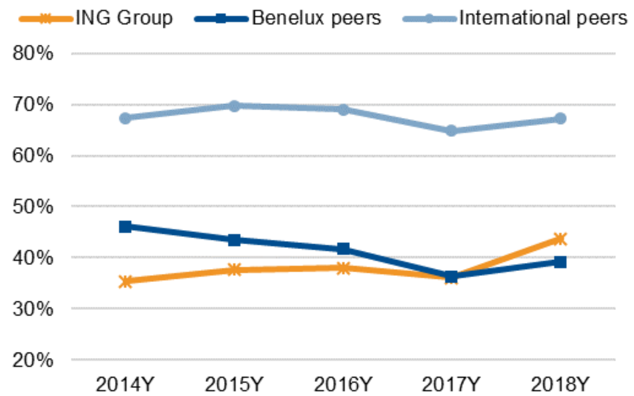
Cost to income (%)



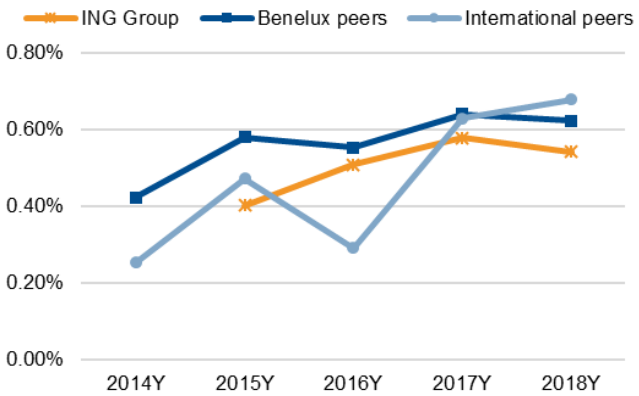
Problem loans/gross customer loans (%)



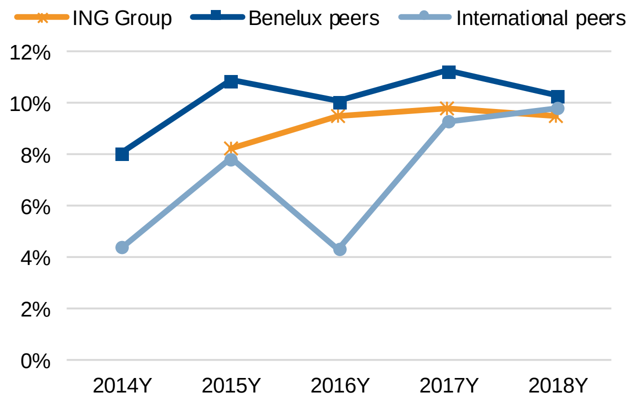
Loan loss reserves/problem loans (%)



Return on average assets (%)



Return on average equity (%)



Source: SNL

Benelux peers: KBC, ABN Amro, Rabobank, ING
**International peers: Santander, BBVA, Unicredit, Erste Bank, Nordea, ING

II. Appendix: Selected Financial Information – ING Group

	2014Y	2015Y	2016Y	2017Y	2018Y
Balance sheet summary (EUR m)					
Assets					
Cash and interbank assets	49,352	51,446	47,002	50,800	80,409
Total securities	188,543	167,387	153,432	131,634	118,434
of which, derivatives	50,992	42,359	40,721	29,675	24,774
Net loans to customers	756,476	766,294	623,984	645,195	672,747
Other assets	184,286	20,106	20,663	18,587	15,440
Total assets	**1,178,657**	**1,005,233**	**845,081**	**846,216**	**887,030**
Liabilities					
Interbank liabilities	29,999	33,813	31,964	36,821	37,330
Senior debt	145,430	138,254	118,116	110,197	133,330
Derivatives	54,059	45,160	42,834	28,244	23,827
Deposits from customers	707,834	703,437	561,664	583,446	610,430
Subordinated debt	18,883	16,997	17,784	16,507	14,037
Other liabilities	163,036	19,102	22,320	19,880	16,341
Total liabilities	**1,119,241**	**956,763**	**794,682**	**795,095**	**835,295**
Ordinary equity	51,344	47,832	49,793	50,406	50,932
Equity hybrids	0	0	0	0	0
Minority interests	8,072	638	606	715	803
Total liabilities and equity	**1,178,657**	**1,005,233**	**845,081**	**846,216**	**887,030**
Core tier 1/ common equity tier 1 capital	40,543	41,554	44,466	45,581	45,493
Income statement summary (EUR m)					
Net interest income	12,304	12,561	13,241	13,714	13,916
Net fee & commission income	2,293	2,318	2,433	2,710	2,798
Net trading income	501	1,473	1,314	740	1,201
Other income	280	355	302	514	283
Operating income	**15,378**	**16,707**	**17,290**	**17,678**	**18,198**
Operating expenses	9,880	9,299	9,475	9,811	9,888
Pre-provision income	**5,498**	**7,408**	**7,815**	**7,867**	**8,310**
Credit and other financial impairments	1,607	1,481	987	679	656
Other impairments	75	27	110	18	19
Non-recurring items	304	127	1,032	0	775
Pre-tax profit	**3,707**	**6,172**	**5,903**	**7,268**	**6,838**
Discontinued operations	-1,296	-122	441	0	0
Other after-tax Items	0	0	0	0	0
Income tax expense	971	1,637	1,618	2,281	2,027
Net profit attributable to minority interests	189	403	75	82	108
Net profit attributable to parent	**1,251**	**4,010**	**4,651**	**4,905**	**4,703**

Source: SNL

III. Appendix: Ratios – ING Group

	2014Y	2015Y	2016Y	2017Y	2018Y
Funding and liquidity					
Net loans/ deposits (%)	105.0%	105.5%	107.8%	106.4%	106.5%
Liquidity coverage ratio (%)	NA	NA	NA	114.5%	122.7%
Net stable funding ratio (%)	NA	NA	NA	NA	NA
Asset mix, quality and growth					
Net loans/ assets (%)	64.2%	76.2%	73.8%	76.2%	75.8%
Problem loans/ gross customer loans (%)	2.4%	2.2%	2.4%	2.2%	1.7%
Loan loss reserves/ problem loans (%)	35.5%	37.7%	38.1%	36.2%	43.8%
Net loan growth (%)	NA	1.3%	-18.6%	3.4%	4.3%
Problem loans/ tangible equity & reserves (%)	26.5%	29.1%	25.1%	23.0%	18.9%
Asset growth (%)	NA	-14.7%	-15.9%	0.1%	4.8%
Earnings and profitability					
Net interest margin (%)	NA	1.2%	1.5%	1.6%	1.6%
Net interest income/ average RWAs (%)	NA	4.0%	4.2%	4.4%	4.4%
Net interest income/ operating income (%)	80.0%	75.2%	76.6%	77.6%	76.5%
Net fees & commissions/ operating income (%)	14.9%	13.9%	14.1%	15.3%	15.4%
Cost/ income ratio (%)	64.2%	55.7%	54.8%	55.5%	54.3%
Operating expenses/ average RWAs (%)	NA	3.0%	3.0%	3.2%	3.1%
Pre-impairment operating profit/ average RWAs (%)	NA	2.4%	2.5%	2.5%	2.6%
Impairment on financial assets/ pre-impairment income (%)	29.2%	20.0%	12.6%	8.6%	7.9%
Loan loss provision/ average gross loans (%)	NA	0.2%	0.2%	0.1%	0.1%
Pre-tax profit/ average RWAs (%)	NA	2.0%	1.9%	2.3%	2.2%
Return on average assets (%)	NA	0.4%	0.5%	0.6%	0.5%
Return on average RWAs (%)	NA	1.4%	1.5%	1.6%	1.5%
Return on average equity (%)	NA	8.2%	9.5%	9.8%	9.5%
Capital and risk protection					
Common equity tier 1 ratio (%, fully loaded)	10.5%	12.7%	14.2%	14.7%	14.5%
Common equity tier 1 ratio (%, transitional)	13.5%	12.9%	14.1%	14.7%	14.5%
Tier 1 capital ratio (%, transitional)	13.5%	14.5%	16.3%	16.2%	16.2%
Total capital ratio (%, transitional)	14.6%	16.9%	19.3%	18.5%	18.4%
Leverage ratio (%)	3.4%	4.4%	4.8%	4.7%	4.4%
Asset risk intensity (RWAs/ total assets, %)	25.5%	31.9%	37.2%	36.6%	35.4%
Market indicators					
Price/ book (x)	0.8x	1.0x	1.0x	1.2x	0.7x
Price/ tangible book (x)	0.8x	1.0x	1.1x	1.2x	0.7x
Dividend payout ratio (%)	92.3%	62.5%	55.0%	53.2%	56.2%

Source: SNL

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