ING Bank NV
Issuer Rating Report

SCOPE

STABLE OUTLOOK

AA-

On March 31, 2017 Scope Ratings upgraded ING Bank's Issuer Credit-Strength Rating (ICSR) to AA-, senior unsecured debt ratings to A+, Tier 2 instrument to A- and Additional Tier 1 instruments issued by ING Group to BBB. All long-term ratings carry a stable outlook. ING successfully transitioned to a streamlined and simplified bank business model, while strengthening its financial profile and preserving the value of its core franchise. The short-term rating is S-1, with a stable outlook.

The ratings were not solicited by the issuer. Both the ratings and the analysis are based solely on publicly available information. The issuer has not participated in the process. For the full list of ratings see the **Ratings** section at the end of this report.

Highlights

The ratings of ING Bank NV are driven by its strong and resilient retail and commercial banking franchise in the Benelux region. As well, ING continues to be at the forefront of direct retail banking operations in several important markets, including Germany. The bank has remained profitable despite restructuring, impairments on financial assets and elevated credit costs. At the same time, both the bank's funding profile and capital position have strengthened. Management's success in restructuring, both in terms of the plan agreed with the European Commission for the "Think Forward" strategic delivery and the normalisation of earnings, remains a key driver for the rating. Meanwhile, with management now focused on executing the second phase of their strategic plan, we remain cautious in regards to potential risks of the group's growth strategies in its non-core geographies.

As the disposal of investment management and insurance businesses is complete, the balance sheets of ING Bank and ING Group have converged. We note that the ratings are not applicable to unguaranteed debt issued by subsidiaries of ING Bank NV.

Rating drivers (Summary)

The rating drivers, in decreasing order of importance in the rating assignment, are:
1. Strong banking franchise in the Benelux region and established retail player in Germany.
2. Funding and capital have improved to reassuring levels.
3. Management has consistently delivered on its targets.
4. Potential risks of the group's growth strategies in certain geographies

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Bloomberg: SCOP

Rating change drivers

Additional capital measures from Basel III (commonly referred to as Basel IV), if implemented in full, might pressure ING's ability to maintain its solvency ratios. The proposed measures include revised risk weights under the standardised approach, restrictions in the application of the internal-rating-based models, and a re-introduction of a capital floor. Given ING's extensive use of internal-rating-based models, and its sizeable exposures to real estate in a country with historically high loan-to-value ratios, such measures, if fully implemented, would materially increase the bank's credit risk weights.

Meaningful deterioration in asset quality. The bank's credit exposures mostly comprise Dutch mortgages and industry lending within the areas of structured finance and real estate finance. The residential mortgage portfolio exhibits a low-risk profile, whereas the credit quality of the wholesale one has been steadily improving. We see potential risk in moving the focus to riskier assets, with higher margins to offset the low-rate environment, by relaxing its generally conservative underwriting standards. Moreover, ING has some more-problematic portfolios – like Russia/Ukraine (EUR 6.3bn) and shipping/ports (EUR 14.7bn) – that are monitored closely by the bank, and on which regular updates are provided.

Evidence that ING competitive advantage will lead to a significant improvement of its business position in Challengers and Growth Markets. The strong digital footprint characterising ING has so far proved instrumental in acquiring market share in Germany, where the bank is now within the top retail players. The bank's competitive advantage, identified in the early adoption of the direct banking model but also in the Bank's flexibility in adapting its distribution model to customers' behaviour, could, in the medium to long-term, allow the bank to increase its market share in non-core geographies. We would regard positively such a development.

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Rating drivers (Details)

Strong banking franchise in the Benelux region and established retail player in Germany

ING's global operations comprise retail banking and wholesale banking, which respectively account for approximately 60% and 40% of underlying net result.

ING operates as a universal bank in the Netherlands and Belgium, where it respectively ranks first and third in terms of number of customers. In the Benelux region, ING has built a low-risk franchise, which has been a steady contributor to the bank's earnings. In Germany, the bank has become the third-largest private retail bank in terms of number of retail customers, after Deutsche Bank/Postbank and Commerzbank. ING's German subsidiary has been acquiring new customers at a high pace, while simultaneously increasing and diversifying its product offering, and moving from a pure retail bank to a quasi-universal bank: from 2013, when wholesale banking accounted for 7% of the German underlying pre-tax result, to 23% in 2016. Moreover, in the last three years, ING doubled its pre-tax result in the country.

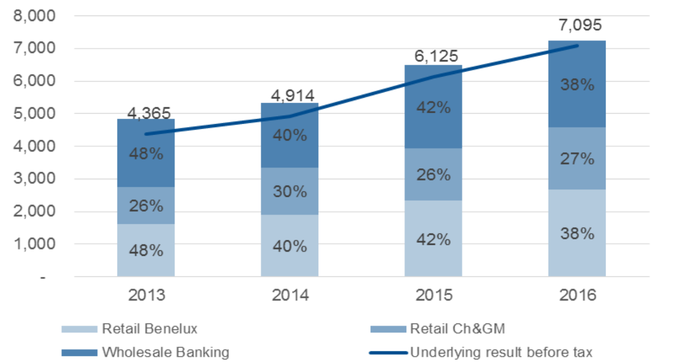
In 2016, wholesale and retail activities in the Netherlands collectively accounted for 32% of pre-tax result; followed by Germany, the second-largest contributor at 19%, and Belgium at 17%.

Retail operations in 'Other Challengers' and 'Growth Markets' (which comprise Australia, Czech Republic, France, Italy, Spain, Poland, Romania and Turkey, as well as the UK legacy run-off portfolio and Asian stakes) have allowed the bank, more markedly in the last two years, to offset the effect of the low-interest-margin environment in western Europe. In Belgium, the compression of margin has been more pronounced, since the bank has reached the legal floor on saving rates. Consequently, the retail strategy in the Benelux is and will be more oriented towards keeping control of margins and costs, meanwhile the paramount goal for operations in the rest of the world is income growth.

Within Wholesale Banking, Industry Lending, which comprises structured finance and real estate finance, is the largest contributor to income. ING Bank is among the top ten players in structured finance globally, with a particular focus on industries such as oil and gas, metals and mining, power and infrastructure and transportation. The segment 'Financial Markets' comprises trading and sales businesses.

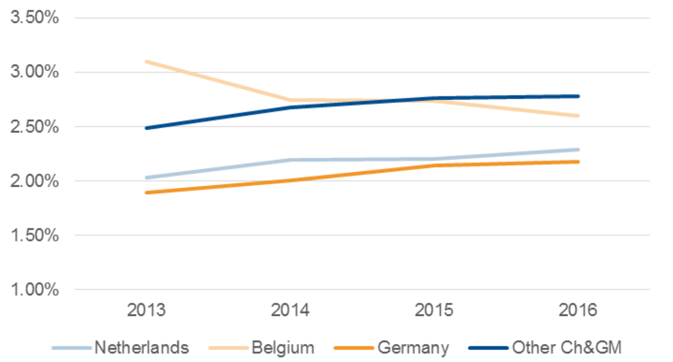
ING Bank has been consistently profitable – even in 2008 and 2009, when its net profits were EUR 0.8bn and EUR 0.7bn, respectively. In 2016, ING Bank reported a net profit of EUR 4.2bn.

Figure 1: Underlying result before tax by business (EUR m)



Source: Company data, Scope Ratings

Figure 2: Net interest margin on retail lending



Source: Company data, Scope Ratings

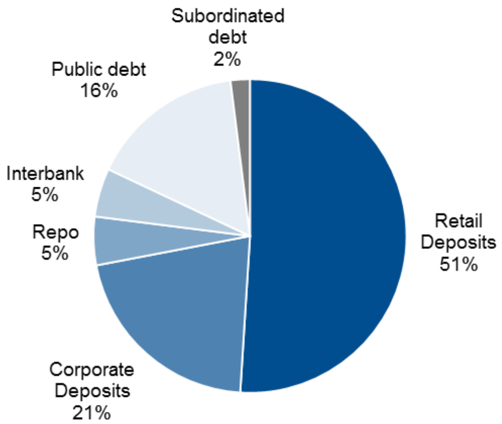
Funding and capital have improved to reassuring levels

Over the last few years, ING Bank has worked to reduce risks and optimise its balance sheet. Customer deposits make up the largest component of funding, representing 63% of liabilities, an increase supported by continued deposit gathering, especially through the digital banking channel. The reported loan-to-deposit ratio, after peaking in 2011 at 120%, has been declining steadily and, as of YE 2016, stood at 106%. The funding mix has also improved, with a significant increase in the retail deposit base and a reduced reliance on wholesale funds. At the same time the maturity ladder has been extended and funding sources diversified.

As of 2016, ING Group reported a fully loaded CET1 ratio of 14.2%, a 520bps buffer over its 2017 SREP requirement including buffers, and a total capital ratio of 19.7%. Organic capital generation and early issuance of capital securities have allowed the bank, as of YE 2016, to fall short by just EUR 10bn to EUR 12bn (for 2019 and 2022 respectively) of its more stringent TLAC requirement.

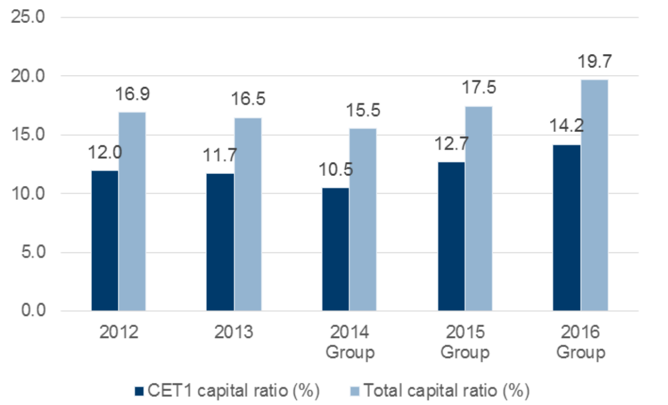
ING maintained a holding company structure providing a comparatively high degree of flexibility regarding its funding strategy. In January 2017 the Single Resolution Board confirmed ING designation of ING Group as the single point of entry for the resolution strategy. In 2016, ING issued a Tier 2 with an issuer-substitution clause; the Bank can be replaced by the Group. In March 2017, ING Group issued its first contractually defined TLAC-eligible senior unsecured instrument. This debt will gradually replace the 41% or EUR 19bn of ING Bank’s senior unsecured debt maturing between 2017 and 2018. Given this plan to replace maturities, which we deem feasible, and the already strong solvency ratios, the only uncertainty regarding future compliance to requirements is linked to the finalisation of Basel III risk-weights.

Figure 3: Funding mix as of year-end 2016



Source: Company data, Scope Ratings

Figure 4: Improved capital position



Note: From 2014 figures are on CRD IV fully loaded basis
Source: Company data, Scope Ratings

Management has consistently delivered on its targets

Between 2014 and 2016, with the repayment of state aid and the disposal of most of its insurance and investment management activities, ING completed, ahead of time, the plan agreed with the European Commission. With the sale of the remaining 14.1% stake in the insurance company NN Group, in April 2016, ING marked the final step of its divestment plan and transition phase to a pure bank: the balance sheets of the bank and the group have converged. ING Group’s profitability, as well as its capital position (as previously noticed), has weathered the charges and impairments related to these disposals relatively well.

In 2014, the bank launched an initial three-year plan oriented towards completing the restructuring measures, normalising cost of risk, and resuming dividends. ING has made good progress on its strategy and financial roadmap, meeting most of its initial objectives as of YE 2016. Risk costs have been declining, both in absolute terms and in percentage of RWAs, while the bank continues to increase outreach and expand lending. The new phase introduces, in our opinion, not excessively demanding targets for the group. Management has retained some flexibility in regards to returns, in light of the continued uncertainty characterising the finalisation of Basel III capital rules.

Recently, the bank announced changes in its management team: the CFO, Patrick Flynn, will leave the bank to be replaced by Koos Timmermans, currently responsible for the Benelux operations; while the current CRO, Wilfred Nagel, who will retire, will be replaced by Steven van Rijswijk. We don't regard this news as a change of direction for the bank, since both Timmermans and van Rijswijk have been at ING for many years, and Ralph Hamers will most likely be re-appointed CEO for a second four-year term.

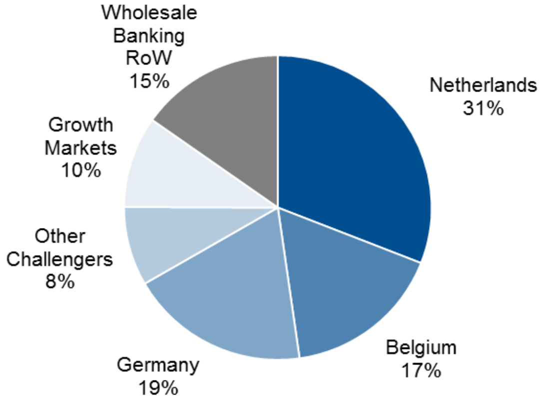
Potential risks related to the group's growth strategies in certain geographies

In 2016, the bank made good progress in achieving its financial targets: lending grew by 5.2%; underlying return on equity was 10.1%; and the CET1 ratio increased to 14.2%. In addition, dividends, which were resumed in 2014, exhibited a pay-out ratio above 55% in 2016.

However, we have less clarity on how the bank intends to develop its various businesses in Asia and in 'Growth Markets' such as Turkey, Romania and Poland. These markets represent, as of YE 2016, 26% of individual customers, 6% of customer lending and deposits combined, and 30% of ING global employees. Indeed, ING offers branch-based retail and wholesale services in these countries. With regard to the Asian stakes (Bank of Beijing, Kotak Mahindra in India, TMB in Thailand), management has indicated that these may develop into direct banks.

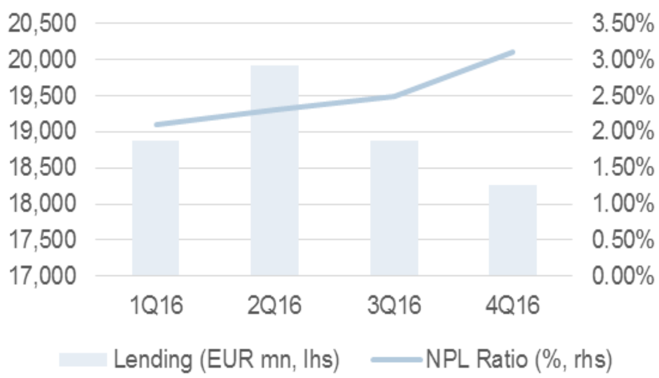
We deem these markets instrumental in boosting ING revenues, we also warn of intrinsic risks linked to developing economies. We notice that the quality of some portfolios, like the Turkish one, while representing only 3.5% of total outstanding continues to deteriorate. Management appears keen on maintaining a portfolio of mature, challenger and growth businesses. However, the geographic breadth of the bank's operations (30 countries when including both wholesale and retail) may bring challenges, as the current regulatory environment appears more favourable for simpler and less geographically widespread business models.

Figure 5: Underlying result before tax by geography, YE 2016



Source: Company data, Scope Ratings

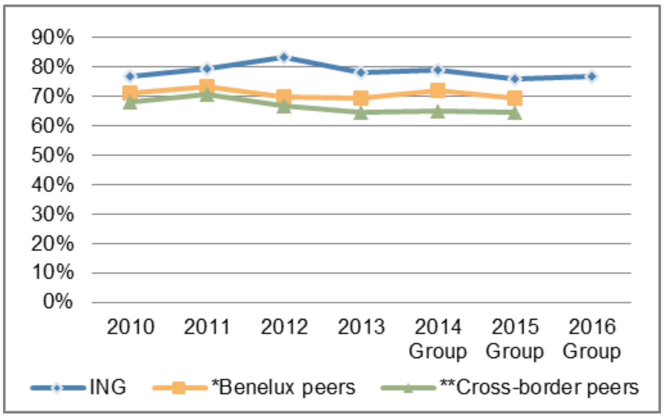
Figure 6: Turkey, credit outstanding and NPL ratio



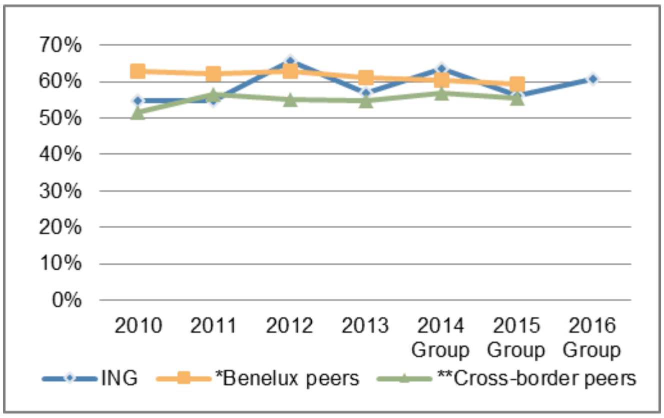
Source: Company data, Scope Ratings

Appendix A: Peer comparison

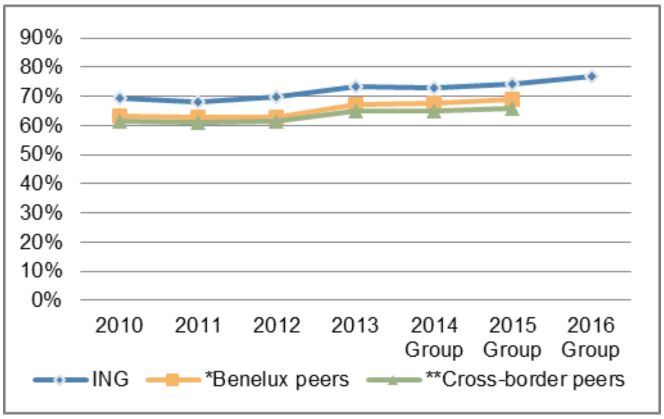
Net interest income % revenues



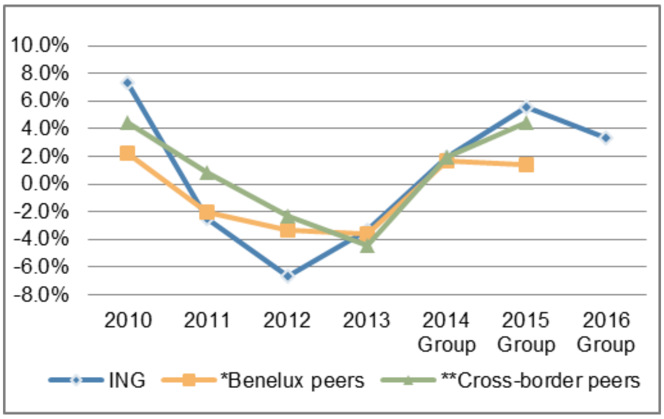
Cost to income (%)



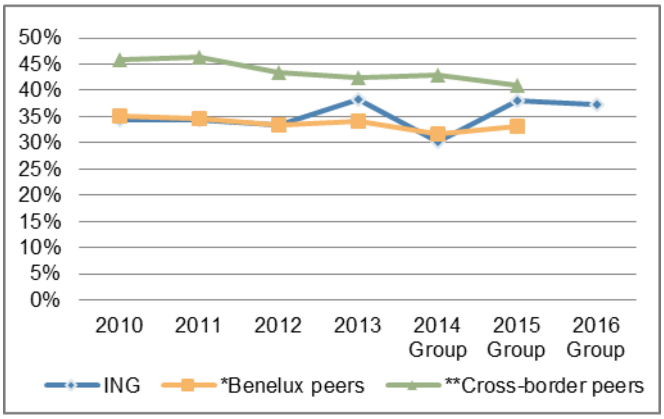
Total deposits/total funds (%)



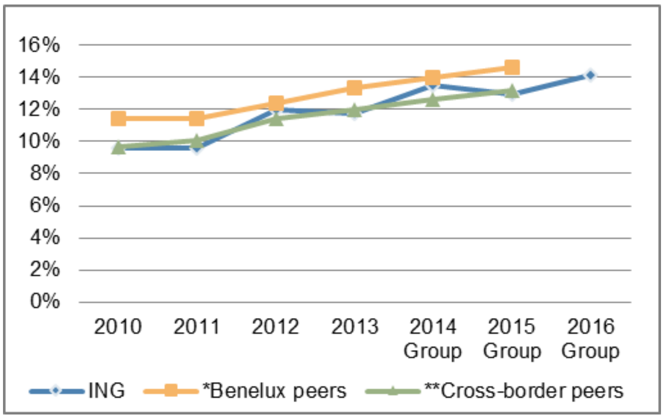
Total gross loan growth (%)



Asset risk intensity



CET1 ratio transitional (%)



Source: SNL, Scope Ratings
*Benelux peers: KBC, ABN Amro, Rabobank, ING
**Cross-border peers: Santander, BBVA, Unicredit, Erste Bank, Nordea, KBC, ING.

Appendix B: Selected financial information – ING Bank NV (2012-2014) / ING Group (2014 onwards)

	2012	2013	2014	2014 Group	2015 Group	2016 Group
Balance sheet summary (EUR bn)						
Assets						
Cash and interbank assets	54.5	54.9	49.3	49.4	51.4	47.0
Total securities	104.6	113.0	137.6	137.6	125.0	112.7
Derivatives	64.2	37.2	50.9	51.0	42.4	40.7
Net loans to customers	579.7	559.7	571.3	570.7	602.8	624.0
Other assets	33.0	22.8	19.5	184.3	20.1	20.7
Total assets	**836.1**	**787.6**	**828.6**	**992.9**	**841.8**	**845.1**
Liabilities						
Interbank liabilities	38.7	27.3	30.0	30.0	33.8	32.0
Senior debt	154.1	142.1	140.0	145.4	138.3	118.1
Derivatives	68.1	39.2	54.4	54.1	45.2	42.8
Deposits from customers	481.5	508.2	527.4	522.0	540.0	561.7
Subordinated debt + non-equity hybrids	17.5	15.7	17.3	18.9	17.0	17.8
Other liabilities	38.7	21.5	20.7	164.0	19.1	22.3
Total liabilities	**798.6**	**753.9**	**789.9**	**934.4**	**793.3**	**794.7**
Ordinary equity	36.7	32.8	38.1	50.4	47.8	49.8
Equity hybrids	0.0	0.0	0.0	0.0	0.0	0.0
Minority interests	0.8	1.0	0.6	8.1	0.6	0.6
Total liabilities and equity	**836.1**	**787.6**	**828.6**	**992.9**	**841.8**	**845.1**
Common equity tier 1 capital	33.4	30.1	33.7	31.5	41.6	44.5
Income statement summary (EUR bn)						
Net interest income	12.2	12.0	12.6	12.3	12.6	13.2
Net fee & commission income	2.1	2.2	2.3	2.3	2.3	2.4
Net trading income	0.7	1.0	0.4	0.5	1.5	1.3
Other income	-0.4	0.1	0.4	0.5	0.3	0.3
Operating income	**14.7**	**15.3**	**15.7**	**15.6**	**16.6**	**17.3**
Operating expense	9.7	8.7	9.8	9.9	9.3	10.5
Pre-provision income	**5.1**	**6.6**	**5.8**	**5.7**	**7.3**	**6.8**
Loan-loss provision charges	2.2	2.3	1.6	1.6	1.5	1.0
Other impairments	0.2	0.1	0.1	0.1	0.0	0.1
Non-recurring items	1.6	0.0	-0.3	-0.3	0.4	0.2
Pre-tax profit	**4.3**	**4.2**	**3.9**	**3.7**	**6.2**	**5.9**
Discontinued operations	0.0	0.0	0.0	-1.3	-0.1	0.4
Income tax expense	1.1	1.1	1.0	1.0	1.6	1.6
Net profit attributable to minority interests	0.1	0.1	0.1	0.2	0.4	0.1
Net profit attributable to parent	**3.1**	**3.1**	**2.7**	**1.3**	**4.0**	**4.7**

Source: SNL, Scope Ratings

Appendix C: Ratios – ING Bank NV (2012-2014) / ING Group (2014 onwards)

	2012	2013	2014	2014 Group	2015 Group	2016 Group
Funding/Liquidity						
Gross loans % total deposits	121.5%	111.3%	109.5%	110.5%	112.7%	112.0%
Total deposits % total funds	69.6%	73.3%	73.8%	72.9%	74.1%	77.0%
Wholesale funds % total funds	30.4%	26.7%	26.2%	27.1%	25.9%	23.0%
Liquidity coverage ratio (%)			>100%	>100%*	>100%*	
Asset mix, quality and growth						
Gross loans % funded assets	76.2%	75.6%	74.6%	61.4%	76.4%	78.4%
Impaired loans % gross loans	2.6%	2.8%	2.9%	n.a.	2.5%	2.2%
Loan-loss reserves % impaired loans	36.9%	38.6%	35.5%	n.a.	37.7%	38.1%
Gross loan growth (%)	-6.6%	-3.3%	2.0%	-1.1%	5.5%	3.4%
Impaired loan growth (%)	11.6%	6.7%	6.1%	n.a.	-9.3%	-11.3%
Funded assets growth (%)	-13.4%	-2.5%	3.4%	-9.4%	-15.1%	0.7%
Earnings						
Net interest income % revenues	83.1%	78.2%	80.4%	79.0%	75.6%	76.6%
Fees & commissions % revenues	14.5%	14.6%	14.6%	14.7%	14.0%	14.1%
Trading income % revenues	4.9%	6.2%	2.4%	3.2%	8.9%	7.6%
Other income % revenues	-2.5%	0.9%	2.7%	3.1%	1.5%	1.8%
Net interest margin (%)	1.6%	1.7%	1.7%	1.7%	1.7%	1.7%
Pre-provision income % risk-weighted assets (RWAs)	1.7%	2.3%	2.0%	1.9%	2.4%	2.1%
Loan-loss provision charges % pre-provision income	42.7%	34.7%	27.5%	28.2%	20.3%	14.5%
Loan-loss provision charges % gross loans (cost of risk)	0.4%	0.4%	0.3%	0.3%	0.2%	0.2%
Cost income ratio (%)	65.6%	56.8%	62.8%	63.4%	56.0%	60.8%
Net interest income / loan-loss charges (x)	5.7	5.2	7.8	7.7	8.5	13.4
Return on average equity (ROAE) (%)	8.8%	8.8%	7.7%	2.8%	8.2%	9.5%
Return on average funded assets (%)	0.4%	0.4%	0.4%	0.1%	0.5%	0.6%
Retained earnings % prior year's book equity	2.9%	0.3%	4.6%	0.1%	2.7%	4.1%
Pre-tax return on common equity tier 1 capital	13.3%	12.7%	11.6%	10.0%	15.0%	13.7%
Capital and risk protection						
Common equity tier 1 ratio (%, fully loaded)	n.a.	10.0%	11.4%	10.5%	12.7%	14.2%
Common equity tier 1 ratio (%, transitional)	12.0%	11.7%	11.2%	13.5%	12.9%	14.1%
Tier 1 capital ratio (%, transitional)	14.3%	13.5%	12.5%	13.5%	14.5%	16.3%
Total capital ratio (%, transitional)	14.4%	13.5%	16.5%	14.6%	16.9%	19.3%
Tier 1 leverage ratio (%, fully loaded)	n.a.	n.a.	n.a.	n.a.	4.4%	4.8%
Total loss coverage (CET1 + loan-loss provisions) % RWAs	13.9%	13.0%	13.2%	15.5%	14.7%	15.8%
Asset risk intensity (RWAs % total assets)	33.3%	38.2%	35.8%	30.3%	38.2%	37.2%

*For ING Bank
Source: SNL, Scope Ratings

ING Bank NV
Issuer Rating Report

Ratings	
Issuer Credit-Strength Rating	**AA-**
Outlook	Stable
Senior unsecured debt	A+
Tier 2	A-
Additional Tier 1 instruments	BBB
Short-term debt rating	S-1

* The ratings are not applicable to debt issued by unguaranteed subsidiaries of the rated parent.

Regulatory Disclosures

Information pursuant to Regulation (EC) No 1060/2009 on credit rating agencies, as amended by Regulations (EU) No. 513/2011 and (EU) No. 462/2013

Responsibility

The party responsible for the dissemination of the financial analysis is Scope Ratings AG, Berlin, District Court for Berlin (Charlottenburg) HRB 161306 B, Executive Board: Torsten Hinrichs (CEO), Dr. Stefan Bund and Dr. Sven Janssen.

The rating analysis has been prepared by Chiara Romano, Analyst.

Responsible for approving the rating: Sam Theodore, Managing Director

Rating history for ICSR:

Date	Rating action	Rating
02.04.2014	First assignment	A
05.10.2015	Outlook Change	A
02.02.2017	Upgrade	A+
31.03.2017	Upgrade	AA-

The rating outlook indicates the most likely direction of the rating if the rating were to change within the next 12 to 18 months. A rating change is, however, not automatically ensured.

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The rating was prepared independently by Scope Ratings and without a mandate (unsolicited rating) and without participation of the issuer.

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Website of the rated entity/issuer, Annual reports/quarterly reports of the rated entity/issuer, Current performance record, Detailed information provided on request, Data provided by external data providers, Interview with the rated entity, External market reports, Press reports / other public information, Scope Ratings considers the quality of the available information on the evaluated company to be satisfactory. Scope ensured as far as possible that the sources are reliable before drawing upon them, but did not verify each item of information specified in the sources independently.

Examination of the rating by the rated entity prior to publication

Prior to publication, the rated entity was given the opportunity to examine the rating and the rating drivers, including the principal grounds on which the credit rating or rating outlook is based. The rated entity was subsequently provided with at least one full working day, to point out any factual errors, or to appeal the rating decision and deliver additional material information. Following that examination, the rating was not modified.

Methodology

The methodologies applicable for this rating “Bank Rating Methodology” (May 2016) & “Bank Capital Instruments Rating Methodology” (May 2016) are available on www.scoperatings.com. The historical default rates of Scope Ratings can be viewed on the central platform (CEREP) of the European Securities and Markets Authority (ESMA): http://cerep.esma.europa.eu/cerep-web/statistics/defaults.xhtml. A comprehensive clarification of Scope’s credit rating, definitions of rating symbols and further information on the analysis components of a rating can be found in the documents on methodologies on the rating agency’s website.

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