Moody's
INVESTORS SERVICE

Credit Opinion: ING Bank N.V.

Global Credit Research - 30 May 2014

Amsterdam, Netherlands

Ratings

Category	Moody's Rating
Outlook	Negative
Bank Deposits	A2/P-1
Bank Financial Strength	C-
Baseline Credit Assessment	baa1
Adjusted Baseline Credit Assessment	baa1
Senior Unsecured -Fgn Curr	(P)A2
Senior Unsecured -Dom Curr	A2
Subordinate	Baa2
Commercial Paper	P-1
Other Short Term -Fgn Curr	(P)P-1
Other Short Term -Dom Curr	(P)P-1
ING Bank A.S. (Turkey)	
Outlook	Negative(m)
Bank Deposits	Baa3/P-3
NSR Bank Deposits -Dom Curr	A1.tr/TR-1
Bank Financial Strength	D-
Baseline Credit Assessment	ba3
Adjusted Baseline Credit Assessment	baa3
ING Bank N.V. - Sao Paulo	
Outlook	Negative(m)
Bank Deposits -Fgn Curr	Baa2/P-2
Bank Deposits -Dom Curr	A2/P-1
NSR Bank Deposits -Dom Curr	Aaa.br/BR-1

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Key Indicators

ING Bank N.V. (Consolidated Financials)[1]

	[2]6-13	Avg.
Total Assets (EUR million)	829,555.0	--
Total Assets (USD million)	1,078,296.4	--
Tangible Common Equity (EUR million)	35,082.6	--
Tangible Common Equity (USD million)	45,602.1	--
Net Interest Margin (%)	1.5	[3]1.5
(Market Funds - Liquid Assets) / Total Assets (%)	3.0	[3]3.0
Core Deposits / Average Gross Loans (%)	87.9	[3]87.9
Cost / Income Ratio (%)	54.3	[3]54.3

Source: Moody's

[1] All figures and ratios are adjusted using Moody's standard adjustments [2] Basel II; IFRS [3] IFRS reporting periods have been used for average calculation

Opinion

SUMMARY RATING RATIONALE

ING Bank's A2 long-term debt and deposit ratings, with a negative outlook, incorporate two notches of systemic support, reflecting the fact that ING group, and particularly ING Bank, are 1) systemically important institutions in two European markets, the Netherlands and Belgium, and 2) maintain significant retail presence throughout Europe and Australia via ING Direct.

ING Bank N.V. (ING Bank) is the second largest bank in the Netherlands and one of the largest financial institutions both in Europe and globally. The current C- bank financial strength rating (BFSR), which is equivalent to a baseline credit assessment (BCA) of baa1, reflects the bank's 1) strong franchise in the Benelux region, which is rooted in a robust retail presence; 2) the international scope provided by ING Direct; 3) sound profitability, despite increased loan losses; 4) adequate capital position; and 5) improved liquidity. These strengths are partly offset by the downside risk on asset quality due to the challenging operating environment in the Netherlands.

Rating Drivers

- Leading franchises in key markets

- Sound profits despite increased credit costs

- High reliance on wholesale funding mitigated by ongoing efforts to lengthen debt maturities and deploy balance sheet integration strategy

- Capital provides satisfactory loss absorption capacity

- Deteriorating operating environment in the Netherlands weighs on asset quality

Rating Outlook

Both the standalone BFSR of C-/baa1 and the long-term debt and deposit ratings of A2 have a negative outlook. The negative outlook of the BFSR reflects our view that the economic trends in the Netherlands remain challenging, which implies greater downside risk in asset quality in areas where the Dutch banks have large concentrations. Such downside potential could go beyond the expected impact of normal cyclical changes.

The negative outlook of the long-term ratings is driven by the outlook of the BFSR.The negative outlook also takes into account the recent adoption of the Bank Recovery and Resolution Directive (BRRD) and the Single Resolution Mechanism (SRM) regulation in the EU. In particular, this reflects that, with the legislation underlying the new resolution framework now in place and the explicit inclusion of burden-sharing with unsecured creditors as a means of reducing the public cost of bank resolutions, the balance of risk for banks' senior unsecured creditors has shifted to the downside. Although our support assumptions are unchanged for now, the probability has risen that they will be revised downwards to reflect the new framework. For further details, please refer to our Special Comment entitled "Reassessing Systemic Support for EU Banks," published on 29 May 2014.

What Could Change the Rating - Up

Upgrades are unlikely in the near term. In the medium term, upward pressure on the BFSR could arise as a combined effect of 1) a material decrease in risk in the Dutch and European operating environments; and 2) the completion of the targeted restructuring measures at the level of ING Groep, including the repayment of state aid and the sale of insurance operations. A strengthening of the bank's standalone credit profile is unlikely to result in upwards rating pressure on ING Bank's long-term debt and deposit ratings, given the high support assumptions currently factored into the ratings and more generally against the background of a longer-term uncertain support environment for European banks.

What Could Change the Rating - Down

The main factors that would lead us to downgrade ING Bank's standalone BFSR include 1) a significant deterioration in the macroeconomic environment beyond our current expectations, leading to higher credit losses,

2) further pressure on margins; 3) a reappraisal of ING Bank's reliance on wholesale funding in the context of an increasingly fragile funding environment; and 4) if the current restructuring of the ING Group resulted in weaker-than-expected franchise value or capital.

The bank's senior ratings could be downgraded following 1) a downgrade of its standalone BFSR; or 2) a re-assessment of systemic support currently factored into the ratings.

DETAILED RATING CONSIDERATIONS

LEADING FRANCHISES IN KEY MARKETS

ING Bank's franchise is robust in the core retail and corporate businesses in the regions in which it operates. Either as a leading player in large markets (retail Benelux), or as a second-league player with strong expertise in niche areas (ING Direct or commercial banking), the bank has preserved good pricing power and steady earnings generation capacity.

ING Bank has a strong position in the Netherlands in commercial as well as retail banking where it operates as a universal bank and ranks second for local operations. The bank holds a 20% market share in the Dutch retail space and 20%-30% in the small and medium-sized enterprise (SME) and mid-corporate segments.

ING Bank also has a solid universal banking franchise in Belgium through ING Belgium (A2 negative, C-/baa1 negative), formerly Banque Bruxelles Lambert, which ranks fourth in the local market with market shares in excess of 15%. ING Belgium also consolidates the activities of ING Luxembourg (unrated), a 100% subsidiary involved in the local retail, corporate and private banking businesses.

ING Bank has significant presence through direct banking in Australia, France, Germany, Italy and Spain. In these markets, the bank does not rank among the top retail institutions but it is always among the leaders - if not the leader - in internet banking. ING Bank's position is particularly strong in Germany where it operates through ING DiBa (A2 negative, C/a3 negative), which accounts for more than half of total funds entrusted in ING Direct. ING DiBa was also one the first ING Direct subsidiaries/branches to have achieved its transformation into a full bank as well as its integration in ING Bank's term-funding strategy, whereby ING Direct's excess funding could be used to finance part of the group's long-term assets. Along the same line, ING Direct's branch in France also merged with ING Bank N.V.'s French commercial banking branch.

The other foreign franchises include retail activities in emerging markets in Central and Eastern Europe and Asia. Some of them are positioned as savings banks such as the 75% owned ING Bank Slaski (Baa1 negative, D+/baa3 stable), the fifth-largest player in Poland, and ING's operations in Turkey, which rank twelfth locally. Activities in Asia are essentially strategic positions held through the 44% owned Vysya Bank in India, the 30% owned TMB (Baa3 stable, D-/ba3 stable) in Thailand and the 14% equity stake in Bank of Beijing.

While ING Direct and, to a lesser extent, emerging market operations bring geographical diversification to ING Bank's retail activities, commercial banking's contribution to the bank's results is around 45%. ING Bank's commercial banking business encompasses financial markets, structured finance (i.e., professional credit including energy, transport and infrastructure, specialised financing, trade and export finance), general lending, payment and cash management, leasing and factoring, and real estate. Without being a first league player, ING Bank has maintained a leadership position in this area in both Benelux and Central and Eastern Europe.

SOUND PROFITS DESPITE INCREASED CREDIT COSTS

We believe that ING Bank's recurring profitability has remained robust. The recurring earnings base has proved resilient and operating efficiency is good, based on a cost-to-income ratio of around 57% on a consolidated basis. Nevertheless, we continue to expect that pressure on earnings will continue to come from elevated cost of risk as a result of the difficult macroeconomic environment.

Recurring earnings have remained relatively steady over the past three years. Interest income, which accounts for 75%-85% of the bank's total underlying income, has remained globally stable. Margin pressure on savings, the lengthening of the duration of wholesale funding, lower returns from the investment portfolio following de-risking operations in 2012 and the low interest rate environment exerted negative pressure on interest margins during 2012 (2012: 1.35%; 2011: 1.42%). However, we positively note the bank has managed to pass on higher cost of funds to borrowers through repricing. The consolidated interest margins recorded in 2013 have recovered to the levels of 2011. Higher margins over 2012 have offset the negative effects of slightly lower client volumes on the results of 2013.

The higher level of credit costs observed since mid-2011 weighs on the bank's recurring profit. Driven by the deterioration in the domestic operating environment, the commercial banking book, including the real estate finance portfolio, the Dutch SME and business portfolio, and to a lesser extent the Dutch mortgage portfolio, are the main contributors to the increase in credit costs over the past quarters. At approximately 43 basis points (bps) of average customer lending, loan loss provisions account for approximately one third of ING Bank's pre-provision profit in 2013, which still leaves room to generate profit. We nevertheless expect credit costs to remain high over the coming quarters.

HIGH RELIANCE ON WHOLESALE FUNDING, MITIGATED BY ONGOING EFFORTS TO LENGTHEN DEBT MATURITIES AND DEPLOY BALANCE SHEET INTEGRATION STRATEGY

Despite large deposits on a group-wide basis, ING Bank's reliance on wholesale funding remains high, reflecting the structural features of the Dutch banking system. However, the ongoing efforts deployed by the bank over the past few years to mitigate this weakness have been successful. These measures included 1) the lengthening in the duration of wholesale debt to reduce funding gaps; 2) the use of the excess funding available at foreign cash-rich subsidiaries to finance cash-poor entities through an active group-wide balance sheet management strategy; and 3) the increase in deposits in the Netherlands. ING Bank has achieved sizeable progress in 2012 in all these areas.

Combined with the effects of sluggish loan growth, the improved funding profile of the bank has contributed to a better liquidity position. At year-end 2013, the Basel 3 Liquidity Coverage Ratio (LCR) is above 100%, based on the LCR rules prevailing as of that time. We also positively note that the bank significantly improved the liquidity at ING Bank N.V., the Dutch parent company, which, on a standalone basis, used to have the largest customer funding gap within the group. Another positive feature is the bank's relatively low asset encumbrance , which leaves sufficient amount of loans available to be packaged into central bank eligible securitisations in case of need.

CAPITAL PROVIDES SATISFACTORY LOSS ABSORPTION CAPACITY

At year-end 2013, ING Bank's Core Tier 1 ratio was 11.7% compared to 11.9% at year-end 2012. Overall, we consider the bank's capital base, together with its earnings power, provides it with a satisfactory loss absorption capacity.

The revised agreement with the European Commission (EC) announced on 19 November 2012, which set the repayment schedule for the remaining state aid (in four equal tranches of EUR1.125 billion until May 2015, including the 50% associated premium), provides the bank with sufficient time to repay, without jeopardising its capital base. The first three tranches were repaid on 26 November 2012, 6 November 2013 and 31 March 2014 respectively. The residual amount (EUR1.025 billion) is expected to be fully up-streamed from ING Bank. We believe the phased repayment will give ING Bank sufficient time to retain earnings and consolidate its capital, while continuing to comply with Basel III.

The bank currently discloses a pro forma fully loaded Basel III Core Tier 1 ratio of 10%. The bank indicates that the transfer of all future funding and indexation obligations under its current Defined Benefit Pension Plan in the Netherlands to the ING Pension Fund announced on 9 January 2014 is expected to have a negative impact of 20bps on its pro forma fully loaded Core Tier 1 ratio.

DETERIORATING OPERATING ENVIRONMENT IN THE NETHERLANDS WEIGHS ON ASSET QUALITY

Deterioration in asset quality driven by the weaker domestic operating environment has continued into 2013, as reflected in the higher non-performing loan (NPL) ratio of 2.8% at year-end 2013 (year-end 2012: 2.5%; year-end 2011: 2%). The Real Estate Finance, the domestic business lending and the Dutch mortgage portfolios have been the main contributors to the recent increase in the bank's credit costs. We believe these will remain the main drivers of loan losses over the coming quarters and expect the overall cost of risk to remain elevated until the domestic economy recovers.

The Real Estate Finance portfolio represents around 65% of the bank's Tier 1 capital. 59% is located in the Netherlands, followed by 9% in Spain and 6% in Italy. Credit costs were around 135 bps in 2013 versus 125 bps for full-year 2012 while the NPL ratio increased to 10.7% at year-end 2013 from 7.6% at year-end 2012 (partly due to the decrease in the outstanding balance following disposals of assets in 2013). We however note that the costs have slightly reduced over the past two quarters. The limited exposure to construction finance and real estate development is a positive feature. However, given the rising vacancy rates and falling prices in the Dutch and some other European real estate, and the lag between the deterioration of an economy and the emergence of difficulties in the sector, we expect this portfolio to continue to generate elevated losses. We note that DNB recently concluded (as reflected in the ING Bank's public disclosures) that ING Bank's CRE exposures were adequately covered by provisions (referred to as Pillar 1 impact by the European Central bank). We also note that this assessment has been undertaken ahead of the ECB's Asset Quality Review. Further comments on the Dutch banks' exposures to the commercial real estate sector can be found in Moody's Credit Focus entitled "ABN AMRO Bank, NIBC Bank, Rabobank Nederland, ING Bank: Answers to Frequently Asked Questions" dated 13 March 2013.

The Dutch residential mortgage book has seen credit costs increasing to 23 bps in 2013 from 11 bps in full-year 2012. Starting from very low historical levels, the current credit costs are still low compared to those observed in some other European mortgage markets. However, some specificities of the Dutch market, including very high loan-to-values and the high proportion of bullet loans (a historically tax-driven feature) make it vulnerable in a scenario of a strong deterioration in the macroeconomic environment. This risk is common to all Dutch retail banks.

The bank's aggregate exposure to the GIIPS countries is EUR57 billion at year-end 2013, or 148% of its Tier 1 capital, including EUR21 billion to Italy and EUR30 billion to Spain. The latter currently represents 79% of ING Bank's Tier 1 capital. The elevated amount of the exposure is mitigated by the fact that the vast majority of the exposure consists of self-originated mortgages that continue to perform well and corporate lending. It also includes EUR9 billion covered bonds. Regarding exposures to peripheral sovereign debt, the bank reported exposures of EUR0.5 billion to Portuguese government bonds, EUR0.3 billion to Spanish government bonds and EUR1.3 billion to Italian government bonds.

Global Local Currency Deposit Rating (Joint Default Analysis)

ING Bank's GLC deposit rating is supported by the bank's standalone credit assessment of baa1 and our assessment of a high probability of systemic support from the Netherlands (Aaa negative) given its large domestic market shares. In accordance with our joint default analysis (JDA) methodology, ING Bank's ratings receive a two-notch uplift from its standalone credit assessment, bringing the GLC rating to A2, with a negative outlook.

Notching Considerations

ING Bank's dated subordinated debt is rated Baa2, i.e., one notch below the bank's standalone credit assessment.

Foreign Currency Deposit Rating

Our foreign currency deposit ratings for ING Bank are A2 /Prime-1 with a negative outlook.

Foreign Currency Debt Rating

Our foreign currency debt ratings for ING Bank are A2 /Prime-1 with a negative outlook.

ABOUT MOODY'S BANK RATINGS

Bank Financial Strength Rating

Moody's Bank Financial Strength Ratings (BFSRs) represent Moody's opinion of a bank's intrinsic safety and soundness and, as such, exclude certain external credit risks and credit support elements that are addressed by Moody's Bank Deposit Ratings. Bank Financial Strength Ratings do not take into account the probability that the bank will receive such external support, nor do they address risks arising from sovereign actions that may interfere with a bank's ability to honor its domestic or foreign currency obligations. Factors considered in the assignment of Bank Financial Strength Ratings include bank-specific elements such as financial fundamentals, franchise value, and business and asset diversification. Although Bank Financial Strength Ratings exclude the external factors specified above, they do take into account other risk factors in the bank's operating environment, including the strength and prospective performance of the economy, as well as the structure and relative fragility of the financial system, and the quality of banking regulation and supervision.

Moody's uses the Baseline Credit Assessment (BCA) to map BFSRs onto the 21-point Aaa-C rating scale and like the BFSR, it reflects a bank stand- alone default risk. Each point on the Aaa-C scale represents a specific probability of default and therefore allows Moody's to use the BCA as an input to Moody's Joint Default Analysis (JDA), described below. The baseline credit assessment reflects what the local currency deposit rating of the bank with the given BFSR would be without any assumed external support from a government or third party

Global Local Currency Deposit Rating

A deposit rating, as an opinion of relative credit risk, incorporates the Bank Financial Strength Rating as well as Moody's opinion of any external support. Specifically, Moody's Bank Deposit Ratings are opinions of a bank's ability to repay punctually its deposit obligations. As such, Moody's Bank Deposit Ratings are intended to incorporate those aspects of credit risk relevant to the prospective payment performance of rated banks with respect to deposit obligations, and includes: intrinsic financial strength, sovereign transfer risk (in the case of foreign currency deposit ratings), and both implicit and explicit external support elements. Moody's Bank Deposit Ratings do not take into account the benefit of deposit insurance schemes which make payments to depositors, but they do recognize the potential support from schemes that may provide assistance to banks directly.

According to Moody's joint default analysis (JDA) methodology, the global local currency deposit rating of a bank is determined by the incorporation of any external elements of support into the bank's Baseline Credit Assessment. In assigning the local currency deposit rating to a bank, the JDA methodology also factors in the rating of the various potential support providers (parent company, cooperative group, regional or national governments), as well as the degree of dependence that may exist between each one of them and the bank. Moody's assessment of the probability of systemic support (by a national government) is derived from the analysis of the capacity of a government and its central bank to provide support on a system-wide basis. The systemic support indicator is determined for a particular country and serves as an input for all bank ratings in that country. The support indicator can be set at, above or, in rare cases, below the government's local currency bond rating for that country.

National Rating Scale

National scale ratings are intended primarily for use by domestic investors and are not comparable to Moody's globally applicable ratings; rather they address relative credit risk within a given country. A Aaa rating on Moody's National Scale indicates an issuer or issue with the strongest creditworthiness and the lowest likelihood of credit loss relative to other domestic issuers. National Scale Ratings, therefore, rank domestic issuers relative to each other and not relative to absolute default risks. National ratings isolate systemic risks; they do not address loss expectation associated with systemic events that could affect all issuers, even those that receive the highest ratings on the National Scale.

Foreign Currency Deposit Rating

Moody's ratings on foreign currency bank obligations derive from the bank's local currency rating for the same class of obligation. The implementation of JDA for banks can lead to high local currency ratings for certain banks, which could also produce high foreign currency ratings. Nevertheless, it should be noted that foreign currency deposit ratings are in all cases constrained by the country ceiling for foreign currency bank deposits. This may result in the assignment of a different, and typically lower, rating for the foreign currency deposits relative to the bank's rating for local currency obligations.

Foreign Currency Debt Rating

Foreign currency debt ratings are derived from the bank's local currency debt rating. In a similar way to foreign currency deposit ratings, foreign currency debt ratings may also be constrained by the country ceiling for foreign currency bonds and notes; however, in some cases the ratings on foreign currency debt obligations may be allowed to pierce the foreign currency ceiling. A particular mix of rating factors are taken into consideration in order to assess whether a foreign currency bond rating pierces the country ceiling. They include the issuer's global local currency rating, the foreign currency government bond rating, the country ceiling for bonds and the debt's eligibility to pierce that ceiling.

About Moody's bank financial strength scorecard

Moody's bank financial strength model (see scorecard below) is a strategic input in the assessment of the financial strength of a bank, used as a key tool by Moody's analysts to ensure consistency of approach across banks and regions. The model output and the individual scores are discussed in rating committees and may be adjusted up or down to reflect conditions specific to each rated entity.

Rating Factors

ING Bank N.V.

Rating Factors [1]	A	B	C	D	E	Total Score	Trend
Qualitative Factors (50%)						B-	
Factor: Franchise Value						C+	Neutral
Market share and sustainability			x				
Geographical diversification		x					
Earnings stability			x				
Earnings Diversification [2]							
Factor: Risk Positioning						C+	Neutral
Corporate Governance [2]							
- Ownership and Organizational Complexity							
- Key Man Risk							
- Insider and Related-Party Risks							
Controls and Risk Management			x				
- Risk Management			x				
- Controls		x					
Financial Reporting Transparency		x					
- Global Comparability	x						
- Frequency and Timeliness	x						
- Quality of Financial Information		x					
Credit Risk Concentration			x				
- Borrower Concentration			x				
- Industry Concentration			x				
Liquidity Management				x			
Market Risk Appetite		x					
Factor: Operating Environment						B+	Weakening
Economic Stability			x				
Integrity and Corruption	x						
Legal System	x						
Financial Factors (50%)						C	
Factor: Profitability						C	Weakening
PPI % Average RWA (Basel II)			2.12%				
Net Income % Average RWA (Basel II)			1.52%				
Factor: Liquidity						D+	Neutral
(Market Funds - Liquid Assets) % Total Assets			6.64%				
Liquidity Management				x			
Factor: Capital Adequacy						A	Neutral
Tier 1 Ratio (%) (Basel II)	12.76%						
Tangible Common Equity % RWA (Basel II)	10.97%						
Factor: Efficiency						C	Neutral
Cost / Income Ratio			59.56%				
Factor: Asset Quality						D+	Weakening
Problem Loans % Gross Loans			2.45%				
Problem Loans % (Equity + LLR)				33.10%			
Lowest Combined Financial Factor Score (15%)						D+	
Economic Insolvency Override						Neutral	
Aggregate BFSR Score						C+	
Aggregate BCA Score						a2	
Assigned BFSR						C-	
Assigned BCA						baa1	

[1] - Where dashes are shown for a particular factor (or sub-factor), the score is based on non-public information.
[2] - A blank score under Earnings Diversification or Corporate Governance indicates the risk is neutral.