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Research Update:

Netherlands-Based ING Bank Outlook Revised To Stable On Strengthening Capital; 'A/A-1' Ratings Affirmed

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Overview

- We believe that Netherlands-based ING Bank's improving earnings capacity and capitalization could lead to a strengthening of our main measure of projected capital adequacy in the near term.
- In addition to its improving internal capital generation capacity, we take into account ING Groep's recent Tier 1 capital notes issue to support ING Bank's capital position.
- We are revising our outlook on ING Bank to stable from negative and affirming our 'A/A-1' ratings, while assigning a 'BB-' rating to ING Groep's notes.
- The outlook reflects our belief that the bank's capital strengthening will likely compensate for the probable removal before end-2015 of the notch of uplift for government support we factor into our rating if we consider that extraordinary government support is less predictable under the EU Bank Recovery and Resolution Directive.

Rating Action

On June 8, 2015, Standard & Poor's Ratings Services revised its outlook to stable from negative on Netherlands-based ING Bank N.V., ING Bank's banking subsidiaries ING Belgium SA/NV and ING Financial Markets LLC, and ING Bank's Dublin branch. At the same time, we affirmed our 'A/A-1' long- and short-term counterparty credit ratings on all four entities.

Similarly, we affirmed our 'A-/A-2' ratings on ING Bank's holding company, ING Groep N.V. and revised the outlook to stable from negative.

We also assigned our 'BB-' long-term issue rating to the fixed-rate reset perpetual additional Tier 1 (AT1) capital notes issued by ING Groep, which will qualify for intermediate equity content under our methodology.

Rationale

The outlook revision to stable and affirmation of our 'A/A-1' ratings on ING Bank reflect our view that positive trends in ING Bank's earnings capacity and capitalization will likely offset the potential reduction in extraordinary government support.

We currently view ING Bank's capital and earnings as adequate, as our criteria define this term. This is based primarily on our assumption that the bank's projected risk-adjusted capital (RAC) ratio before diversification adjustments will likely stand at 9.75%-10.25% within the next 18 months, compared with 9.1% as of Dec. 31, 2014, and 8.9% as of Dec. 31, 2013. Although our expected RAC ratio of 9.75%-10.25% is not materially above 10%, we expect that a combination of improving operating profitability, absence of material one-time charges in 2015-2016, and management guidance on regulatory capital targets will likely give us increasing confidence on the group's steady capital position. As a result, we could revise our assessment of capital and earnings upward over the next six to 12 months.

We view ING Bank's profitability as adequate compared with that of peers, with our calculation of core earnings to adjusted assets at 0.47% in 2014, which compares a little more favorably against other large Dutch peers and other large European banks. Net results were hit in 2014 by a large amount of nonrecurring items, including €303 million for the one-time levy for the rescue of SNS Reaal by the Dutch state imposed on all Dutch banks in 2014, and €653 million for making the Dutch Defined Benefit pension fund financially independent. Excluding these negative effects, the bank's 2014 core earnings remained stable compared with 2013, even after the deconsolidation of ING Vysya Bank. The bank managed to maintain a resilient net interest margin, despite the persistent low-interest-rate environment. Loan impairment charges decreased in 2014 by 30%, benefiting notably from a gradual improvement in the real estate market in The Netherlands. ING Bank's cost efficiency remains broadly in line with its peers, with a cost-to-income ratio, by our measures, at 56% in 2014.

Our revised forecast of a RAC ratio improving gradually to 9.75%-10.25% in the next 18 months primarily factors in ING Groep's issuance in April 2015 of US$2.25 billion of fixed-rate reset perpetual AT1 capital notes. The US$2.25 billion AT1 issue contributed to a 50 basis point (bps) increase of our pro forma RAC ratio at year-end 2014. Other key assumptions are:

- 3%-5% annual growth in lending and credit risk-weighted assets in 2015-2016;
- A 1%-3% increase in upfront costs as a result of information technology projects being implemented;
- A small additional improvement in the net interest margin over time;
- Further gradual decrease in loan impairment charges in 2015 and 2016;
- 10% annual phasing out of the "old style" Tier 1 hybrids currently included in total adjusted capital, with no replacement hybrids assumed at this stage; and
- A 40% pay-out ratio at the group level, effective from 2015.

The group made further progress in implementing its repositioning strategy. It fully repaid Dutch State Aid during the last quarter of 2014 and completed the sale of Voya Financial Inc. during the first quarter of 2015.

The ING group is actively engaged in the full divestment of its remaining stake in the insurance company NN Group. On May 28, 2015, the group announced that it had reduced its stake in NN Group's outstanding capital to 42.4% from 54.8%. Recent divestments have led to the elimination of double leverage at the holding company level. The group intends to complete its divestment in NN Group, in an orderly manner, ultimately by the end of 2016. Thereafter, we understand that ING Group will consist of banking operations only.

The group estimates that, adjusted for full divestment of NN Group shares, the ING Group's pro forma fully loaded common equity Tier 1 (CET1) ratio would have been 13.5% on March 31, 2015, which represents a capital surplus in excess of €6.6 billion over the bank's CET1. Indeed, at end-March 2015, the bank estimated its Basel III fully loaded core Tier 1 ratio at 11.4%, compared with a minimum internal target of 10%. This ratio remained stable compared with that at year-end 2014 because of the decision to upstream €1 billion to the group while reporting an underlying quarterly net profit of €1.137 billion. We assume that the bank will maintain at least an equivalent buffer over time.

The group intends to manage its capital surplus at the holding company level. At this stage, we do not incorporate this amount in our RAC ratio calculation. We recognize that this amount enhances the group's overall financial flexibility, but its permanence cannot be ascertained, given that the group's policy is to use this surplus for evolving regulatory requirements but also to return capital through an attractive dividend. As already stated, the group announced its intention to pay a dividend of 40% of ING Group's annual net profits.

The US$2.25 billion perpetual notes represent ING Groep's first additional AT1 issuance. We understand that the notes will rank senior to ordinary shares, pari passu with already issued perpetual hybrid capital and debt securities, and subordinated to more senior debt. We assigned a 'BB-' issue rating to these notes in accordance with our criteria for hybrid capital instruments (see "Bank Hybrid Capital And Nondeferrable Subordinated Debt Methodology And Assumptions," published Jan. 29, 2015). The 'BB-' issue rating reflects our assessment of ING Groep's unsupported group credit profile of 'a-' and our approach, which involves deducting:

- One notch because the notes are contractually subordinated;
- Two notches because the notes have Tier 1 regulatory capital status;
- One notch because the notes contain a contractual conversion clause;
- One notch because the instrument contains a going-concern conversion trigger (defined as the CET1 ratio falling below 7%), and we expect that the distance to the trigger will remain within a range of 301 bps-700 bps; and
- One notch because the notes are issued by a nonoperating holding company, where we see potential structural subordination and we consider it unclear whether ING Groep would avoid defaulting on this instrument if ING Bank was to default on an equivalent hybrid instrument. For more information on the use of this notch, see "Credit FAQ: The Rating Implications Of The Emerging Bank Resolution Frameworks In The U.K., Germany, Austria, And Switzerland," published on Feb. 3, 2015.

The notes are part of ING Groep's Tier 1 capital base. Consequently, we also assigned intermediate equity content to them under our criteria. This reflects our view that they can absorb going-concern losses through discretionary coupon cancellation, they are perpetual, and there is no coupon step-up.

Outlook

The stable outlook on ING Bank indicates our view that the gradual strengthening of the bank's capital and earnings position will likely lead to a one-notch uplift of the bank's stand-alone credit profile (SACP), which will compensate for the probable removal of the notch of uplift above the bank's SACP that reflects our expectation of extraordinary government support. We would remove this notch if we consider that, by year-end 2015, extraordinary government support is less predictable under the new EU Bank Recovery and Resolution Directive. We would consequently affirm our long-term counterparty credit rating on the bank.

Our view on the strengthening of the bank's capital position relies on the following expectations:
- A continuing improvement of preprovision operating income to average assets, getting closer to 1.00%;
- A further gradual decrease in loan impairment charges in 2015 and 2016;
- A controlled 3%-5% annual growth in lending and credit risk-weighted assets;
- A 40% pay-out ratio at the group level, effective from 2015; and
- The bank's maintenance of a buffer above its stated CET1 minimum internal target of 10%, equivalent to its current level, while part of the multibillion euro capital surplus managed at the holding company level is preserved.

We could lower our rating on ING Bank before year-end 2015 if we were to consider that the bank's projected RAC ratio would remain weaker than we currently expect and stay below or just around 10% during the next two years, while our expectation of extraordinary government support fades.

We could raise our rating on ING Bank if we consider that potential extraordinary government support for ING Bank's senior unsecured creditors is unchanged in practice, despite the introduction of bail-in powers and international efforts to increase the banks' resolvability, and if concomitantly we see a strong likelihood of our RAC ratio for the bank improving sustainably to more than 10%.

Ratings Score Snapshot

ING Bank N.V.

Issuer Credit Rating	A/Stable/A-1

SACP	a-
Anchor	bbb+
Business Position	Strong (+1)
Capital and Earnings	Adequate (0)
Risk Position	Adequate (0)
Funding and Liquidity	Average and Adequate (0)
Support	+1
GRE Support	0
Group Support	0
Government Support	+1
Additional Factors	0

Related Criteria And Research

Related Criteria

- Bank Hybrid Capital And Nondeferrable Subordinated Debt Methodology And Assumptions, Sept. 18, 2014
- Group Rating Methodology, Nov. 19, 2013
- Banks: Rating Methodology And Assumptions, Nov. 9, 2011
- Banking Industry Country Risk Assessment Methodology And Assumptions, Nov. 9, 2011
- Bank Capital Methodology And Assumptions, Dec. 6, 2010

Related Research

- Dutch ING Bank 'A/A-1' Ratings Affirmed On Stabilizing Economic Risks In The Netherlands; Outlook Remains Negative, Nov. 4, 2014
- Various Rating Actions Taken On Dutch Banks On Stabilizing Economic Risks, Nov. 4, 2014
- Banking Industry Country Risk Assessment: The Netherlands, Nov. 4, 2014
- Dutch ING Bank And Groep Outlook Revised To Negative On Potential Government Support Reduction; Ratings Affirmed, April 30, 2014

Ratings List

Outlook Action; Ratings Affirmed

	To	From
ING Bank N.V.		
ING Financial Markets, LLC		
ING Belgium S.A./N.V.		
ING Bank N.V. (Dublin Branch)		
Counterparty Credit Rating	A/Stable/A-1	A/Negative/A-1
ING Groep N.V.		
Counterparty Credit Rating	A-/Stable/A-2	A-/Negative/A-2

Ratings Affirmed

ING Bank N.V.	
Senior Unsecured	A
Subordinated	BBB
Certificate Of Deposit	A-1
Commercial Paper	A-1
ING (US) Funding LLC	
Commercial Paper[1]	A-1
ING (US) Issuance LLC	
Senior Unsecured[1]	A
ING Capital Funding Trust III	
Preferred Stock[2]	BB
ING Groep N.V.	
Senior Unsecured	A-
Junior Subordinated	BB

New Rating

ING Groep N.V.	
Junior Subordinated	BB-

[1]Guaranteed by ING Bank B.V.
[2]Guaranteed by ING Groep N.V.

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