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Q2 2015 ING Groep NV Earnings Call

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08/05/2015 09:00 AM GMT, Q2 2015 ING Groep NV Earnings Call

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PRESENTATION

Operator

Good morning. This is Cecelia welcoming you to ING's 2 quarter 2015 conference call. Before handing this conference call over to Ralph Hamers, Chief Executive Officer of ING Group, let me first say that today's comments may include forward-looking statements; such statements regarding future development in our business, expectations for a future financial performance and any statement not involving a historical fact. Actual results may differ materially from those projected in any forward-looking statement.

A discussion of factors that may cause actual results to differ from those in any forward-looking statement is contained in our public filings, including our most recent annual report on Form 20F filed with the United States Securities and Exchange Commission and our earnings press release as posted on our web site today.

Furthermore, nothing in today's comments constitutes an offer to sell or a solicitation of an offer to buy any securities.

Good morning, Ralph. Over to you.

Ralph Hamers ***ING Groep NV - CEO & Chairman of the Executive Board***

Good morning. Thank you. Welcome everyone to ING's second-quarter 2015 results. I will take you through the presentation first. For questions I have Patrick Flynn, our CFO; Wilfred Nagel, our CRO, here with me from the Executive Board.

Turning to the key points, slide 2, ING posted a strong set of results in the second quarter of 2015, supported by strong volume growth and lower risk cost.

Our underlying return on equity rose to 11.8% in the first half of 2015 and that's exactly in line with our Ambition 2017, as you may recall.

The Bank capital generation remained also strong at 30 basis points, but that's offset by 40 basis points upstream to the Group.

The fully loaded Group Core Tier 1 ratio increased 70 basis points to 12.3% but that's principally on the back of the NN deconsolidation, which, from a restructuring perspective, is certainly another milestone.

And I think, specifically for our shareholders, pleased to announce an interim cash dividend of EUR0.24 per ordinary share, which is equivalent to EUR922 million or, as we had indicated before, 40% of the underlying net profit for the first half of 2015.

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Now before we go into the quarterly figures I just want to recap a picture on the first half of the year, starting with the progress we're making on strategic initiatives.

In March 2014 we launched our Think Forward strategy with one clear purpose and that's to empower people to stay a step ahead in life and in business. Now the core of our strategy is to create a differentiating customer experience. It's truly all about the customer.

In the second quarter 2015 we continued to expand our digital offerings for our customers and we also identified new ways to facilitate the financing needs of small companies.

If you look at the progress we're making again in the first half-year, I'm very happy to say that we welcomed another 600,000 new customers in the first half and established approximately 250,000 new primary banking relationships. We see particularly strong growth in the challengers and growth countries in line with our strategy.

Another part of the strategy that we had indicated is how can we build more sustainable balance sheets going forward. And the next slide, slide 4, you actually see that we have also made steady progress on building more sustainable balance sheets in our challengers and growth markets.

You will remember that diversification of our assets across different segments was part in order to improve the concentration risk but also in order to improve our return. And now you see that the lending book is more diversified with the proportion of mortgages declining and the proportion of commercial banking, consumer lending and SME and mid-corporate lending increasing.

And now moving to the P&L, we posted strong results in the first half of 2015. The underlying net result banking increased 31.4% from the first half in 2014 and the return on equity was 11.8%.

If we exclude CVA/DVA, which was positive for the first half, the underlying result increased by 17% on a like-for-like basis due to continued volume growth and lower risk costs.

These results were supported by higher income, strong lending growth and improved cost-income ratio and lower risk costs. Basically, we have the trend moving in the right direction in all of our key metrics. That's what you can see on slide 6.

Now, on top of a very strong profit contribution from the Bank in the first half and the net gain resulting from the merger between Vysya and Kotak Bank, we've also booked contributions from both NN Group and Voya in the first half of this year, which have taken us to a net result of around EUR3.1 billion for the Group.

And, with that, we're pleased to announce an interim cash dividend of EUR0.24 per ordinary share, which is equivalent to EUR922 million or, as indicated before, 40% of the underlying net profit for the first half 2014.

And we remain committed to returning value to shareholders and reiterate our intention to pay a full-year dividend of at least 40% of ING Group's total net annual profits. And we will evaluate the potential for any supplement returns dependent on financial and strategic considerations and regulatory developments.

If we then look at the capital position, slide 8, we see that the Bank capital generation remains strong at 30 basis points. But that was offset by 40 basis points capital upstream to the Group. We're paying dividends from the Bank to the Group. And, as we have indicated before, we decided to manage surplus capital at ING Group and that's why we up streamed that dividend.

The Core Tier 1 ratio of the Bank with that is 11.3%, which is slightly down due to this upstream, but still comfortably above 11%. And the Core Tier 1 ratio of the Group increased 70 basis points to 12.3%. And that's principally as a result of the deconsolidation of NN.

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I want to emphasize here that we have not included any of the second-quarter profits in capital. The reason for this is that this actually will give us increased flexibility to decide on our dividend payout ratios for 2015 without requiring regulatory approval. We believe this is more important than showing slightly higher Group Core Tier 1 ratio for the quarter.

The buffer/surplus, including the EUR2.1 billion not allocated to the Group capital, the Group now amounts to EUR7.9 billion at the end of the second quarter of 2015.

Now if you then sum this up in a comparison between the ambitions that we had indicated 18 months ago when we launched the strategy and where we are right now, I'm now on slide 9, then you see then the first half 2015 we already reached most of our Ambition 2017 targets. And I'm very pleased with the progress that we're making on all of these metrics.

So far basically the focus on the first half year and our strategic progress. Let's now zoom into the second-quarter results.

ING's second quarter underlying pre-tax result was strong at EUR1.6 billion. And that was positively impacted by CVA/DVA, which was partly offset by the negative impact from mortgage refinancings.

Excluding the volatile items, as shown in the table in this graph, the pre-tax result increased by 19.2% from the second quarter 2014. It was stable if you compare it to the first quarter of 2015. And that, in itself, reflects a positive momentum in our business.

So if you correct for all the volatile items and then you look through what is really happening operationally, you see that we have real momentum in the business, with an increased pre-tax result of 19.2%.

I just mentioned that our results have been negatively impacted by mortgage refinancings. That's because our customers have moved to lock in low rates. And I want to give you a little bit more information on this development. Slide 12 I'm now on.

The prepayment risk and the subsequent impact on our results basically varies from one country to the other, because it's really linked to whether we can actually charge early repayment fees at the point of refinancings.

With the increased rate of mortgage refinancings that we have experienced, we needed to take a closer look at our policies and our hedging models. And this has given rise to two changes that we have reported in this quarter.

One affects the other income, specifically in Italy and Belgium. And that's in the amount of a negative EUR127 million of non-recurring charges. And that mainly has to do with the adjustment of the underlying hedges.

The second impact is the one on net interest income. And that's basically a change in the recognition of early prepayment fees in the Netherlands, which resulted in a EUR19 million reversal of net interest income this quarter. But that actually will be spread out over the future. So that is a correction on income but that is something we will then see coming in in the future as part of our net interest income line.

Looking at the net interest income line, turning to slide 13, the result rose 4% from the second quarter 2014. It was slightly down from the previous quarter but that was principally due to a lower interest result for financial markets and the one-off adjustment that I just mentioned in the booking of prepayment fees in the Netherlands.

So if you correct for the two, the financial markets and the impact from mortgage refinancings, we actually see that the net interest income has increased 5.8% from the second quarter 2014 and was flat from the previous quarter, with retail Germany and industry lending particularly strong in this quarter.

And zooming in to the financial market side, maybe, for a second. So where we see a 2 basis points drop in NIM from financial markets, or lower interest income on the financial markets side, we actually see there's still a good performance on the financial markets. It's just a difference in composition in income and the division between the other income within financial markets and the interest income.

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So income is good. Net interest income, if you correct it for both, is stable quarter on quarter. And it's 5.8% up if you compare it to the same quarter last year, so good development.

If we then zoom in to the NIM, the NIM, as said, decreased by 4 basis points to 143 basis points. But, as I indicated already, it's 2 basis points on the account of how we recognize income in financial markets. So there is a different division between other income and interest income. So the income line still good, but a different division between interest income and other income. And the other 2 basis points caused by the different recognition in prepayment fees of the Netherlands.

So if you correct for those two, which are not really negative, you actually see a stable NIM for the quarter.

The underlying there, what is causing this stable NIM for the quarter, we actually see that savings margins are a little bit up in the quarter and that's because of the adjustments of the savings rates to where the market is going. And the lending margins, if we correct for this impact in the Netherlands on prepayment fees, were flat. And we expect that the commercial margins will be roughly stable.

If we then look at the underlying growth of the core lending franchise, turning to slide 15, you can see on this slide that our core lending business increased by EUR8.7 billion, with a healthy growth across all different franchises in both retail and commercial banking. And that basically shows that we maintain the momentum that we have built across the network.

Retail banking increased EUR4.3 billion, driven by growth in Belgium, Germany, the other challengers and growth market. The Netherlands remains a bit weak on this.

Commercial banking rose EUR4.7 billion and that's driven by industry lending and, in particular, within industry lending, structured finance loans with a longer tenor. So a positive development there as well and this basically shows you how you can reconcile it in the balance sheet as well.

It's also notable that we're booking more and more of our commercial banking assets in the challenger and growth markets, which is exactly in line with our strategy to develop sustainable balance sheets in each of these countries.

Specifically, also, if you look at Germany, Germany has demonstrated strong growth in its lending capabilities, with funded commercial banking assets hitting the EUR10 billion mark already.

But, also, if you look at the underlying development of the consumer lending franchise in Germany, it continues to grow at more than 10% per annum and now exceeding the EUR5 billion threshold. So also a checkmark on where we are in delivering on our strategy.

Moving to expenses, our expense base is more and more impacted by regulatory costs. We had already indicated that the regulatory costs were going to increase. We see it happening every quarter. It is a very volatile component of the cost side because we book them at different moments in time.

But if you correct for the regulatory costs and if you correct for the foreign exchange influence on our cost base with the weaker euro and the stronger dollar, then expenses increased by 3.6% from the second quarter of last year and 4% from the first quarter.

If you really dive into this, then you see that the expenses in retail Netherlands and retail Belgium, excluding the regulatory costs, have remained flat but that we continue to invest in business growth in industry lending and retail Germany and other retail challengers and growth markets, as we have indicated.

And we don't mind that because, if you now turn to slide 18, we show that in retail Germany, where we do see cost growth, and industry lending, where we see the cost growth, that these are two examples of areas where basically we see the cost-income ratio itself either already at best in class, industry lending, and further decreasing, for example, in retail Germany.

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So cost growth in an area where income growth is higher and, as a result, you actually improved the cost-income ratio and your efficiency, or you actually continue at a best-in-class level in industry lending, I think that is nothing to worry about.

Also, as I indicated before, the customer base in Germany and the number of primary accounts is continuing to increase. We see the improvement of the cost-income ratio on the industry lending side. The cost increase is mainly driven by the number of FTEs that has increased 6% from a year ago. But that's because you need the professionals to actually work with your clients to do the business.

The lending book is increasing quickly in that area without changing our risk appetite.

So these are positive developments and, as said before, we don't mind seeing cost increases in these areas where we see either an improvement on efficiency, income growth or already franchises that are already at best in class in the market in terms of efficiency.

Turning to risk cost, risk costs were EUR353 million in the second quarter; down from the second quarter last year, down from the first quarter this year, reflecting lower risk cost in both retail banking and commercial banking. The total risk costs were 46 basis points of the average risk-weighted assets.

Most of the businesses are now close to the longer term average where we expect them to be across the cycle, except for the Netherlands. If we take a closer look at the Netherlands, which is then the final page for my introductory presentation before we get to the Q&A, we see that the risk costs in the Netherlands are decreasing but still relatively high.

On the mortgage side we see it stabilizing from one quarter to the other quarter. On the business lending side we see it decreasing. But, specifically on the business lending side, we feel that this is still an elevated level and we expect this to continue around this elevated level for the foreseeable quarters.

Clearly, risk costs in the Netherlands are still higher than we would like them to be but we feel comfortable that the worst is behind us. We see that in economic growth in the Netherlands and the improvement on the mortgage side, in the housing market, the domestic demand. So the worst is behind us from that perspective.

Risk costs overall show a downward trend but they're still at an elevated level.

Okay, to sum up. I think we have another quarter of strong results. EUR1.1 billion for the Bank; up 21.1% from the same quarter last year.

Our strategy implementation is on track. We can see it in different areas. We can see it with different drivers. It's on track across the whole network to the benefit of all of our customers with a customer growth of 600,000 this half-year and 250,000 primary relationships. It's to the benefit of our shareholders, for which we declare an interim dividend.

And that basically sums up the presentation. I'd like to open the call for questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions). Andrew Coombs, Citi.

Andrew Coombs ***Citi - Analyst***

My first question would be on slide 8 and the second question on slide 14.

Firstly, with respect to slide 8, you specified in your Group Core Tier 1 ratio you've elected not to include retained earnings in order to maintain flexibility on the dividend payout ratio. Could you please just explain the rationale behind that?

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And secondly, could you confirm that the Group Core Tier 1 ratio would actually have been about 50 basis points higher, so, i.e., 12.8%, if you had included the retained earnings? I just wanted to check my understanding was right there.

And then secondly, on slide 14, I noted that the interest margin in the commercial bank, excluding financial markets, has actually moved positively. That's slightly surprising, given the competitive pressures you've flagged there previously. So perhaps you could elaborate on what's driving the NIM improvement within the commercial bank? Thank you.

Patrick Flynn ***ING Groep NV - CFO***

In respect of dividend and the reserving process, what we have seen is that the regulator allows you to pay a dividend out of your accounting profits without recourse to specific approval, provided your fully loaded ratios are in the top book, which they set out in early January and where we are.

Therefore, to avoid the scenario where we need to ask the regulator for regulatory approval, we need to reserve each quarter -- and that's the new bit; initially we thought this was over the full course of the year, but in discussion with the ECB it seems to be a quarterly process -- we need to reserve from our accounting payout profits an estimate of what we want to pay out or have available to have to pay out in dividends.

If we were not to do this, not to reserve profits quarterly and not include them in capital but reserve them for dividends, because you can't, basically, do both, I think it's pretty logical. If they think you're going to pay it out in dividend then you can't include it in your capital. Can't fault the logic in that.

So to give us flexibility to pay out above 40% we decided not to reserve profits in our capital but keep them to one side and earmark them for potential dividends at the yearend. And we more than likely will do something similar in subsequent quarters.

This is designed to give us complete flexibility, or as much flexibility as we can, in terms of deciding how much dividend we're going to pay and avoid any scenario where we would need to revert to the regulator for permission.

And you're right that, had we included those profits in our Core Tier 1 ratio, we're actually closer to 13%.

Andrew Coombs ***Citi - Analyst***

Right. Thanks.

Operator

David Lock, Deutsche Bank.

David Lock ***Deutsche Bank Research - Analyst***

So I've got two questions. The first one's on the loan growth. It looks like you had a real strong performance, really, in your core lending businesses in the second quarter. I just wondered if this is a trend that you're seeing going forward, whether we should expect the 4% ambition to actually be a little bit higher over the rest of this year as some of your lending platforms come online. We've seen a steady step-up, I think, in a number of quarters over the last 18 months.

And then the second question is on net interest margin. I'm just trying to understand the outlook, really, for the rest of this year in terms of what you're seeing around deposit repricing potential or loan pricing potential going forward. Do you think the margin can still expand over the quarter this year from the new lower base? Or do you think it's really more of a stable outlook? Thank you.

Ralph Hamers ***ING Groep NV - CEO & Chairman of the Executive Board***

I will take the first question on loan growth. Patrick will then come back to your NIM question but also come back to the NIM question that Andrew asked.

So loan growth, a strong performance. Clearly, certainly in the commercial banking area, the loan growth is related also to the fact that you build up the number of professionals who know the business, who develop the relationships and get the business in.

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It's a good quarter also on the consumer lending side and the mortgage lending side and the SME lending side and some of the challenger and growth markets. We see good loan growth.

Clearly, some quarters were not on the 3% to 4% per annum. Some quarters were above, like this one.

I think if you look at the model that we're running, the way we reserve capital in order to support loan growth that works with the 4% ambition. So, as we have indicated in previous quarters, when we were a little bit short of it, we said, well you have to look at it from a year-on-year basis.

Also on this one I think let's not draw a conclusion on the quarter. We see strong growth this quarter. We have the people. We have the capital. We have the capacity and the resources. We see the demand out there. We're gaining market share in all of these fields. So we're very positive on it, but we would like to stick around the 4% ambition for the moment.

Then on NIM, I'll give the word to Patrick.

Patrick Flynn ***ING Groep NV - CFO***

Sorry, we cut Andrew off there a bit too quick. So the improvement in commercial banking is due to mix. So a lot of the commercial banking lending is in structured finance, which has got good margins, as we've said before. And that mix change from more structured finance as opposed to general lending is positive for the CB margin excluding FM.

And then in terms of NIM, if you look at both NIM and interest income, and I think Ralph's slide 13 pointed it out, over the past 12 months, past year, we've increased interest income by nearly 6%, 5.8%. That's due to the mix change and growth, lending growth, where the NIM in basis points has been flat.

So we do have the negative impact of low rates, which we can mitigate by trimming deposit rates and also improving the asset mix.

That's the strategy we've been following. It has been successful in that we've had, as I say, increased interest income, close to 6%, just under, but held NIM stable.

And looking forward, I suspect something similar, a similar pattern, provided we're able to continue the lending growth that Ralph just alluded to and we'll likely see that pattern continue.

Operator

Martin Leitgeb, Goldman Sachs.

Martin Leitgeb ***Goldman Sachs - Analyst***

My first question is on risk costs and on your comments made earlier that risk costs have now approached their over-the-cycle average you have been guiding for some time.

I was just wondering whether you could provide us with some guidance in -- obviously your guidance is implying that risk costs are likely to undershoot over the next couple of years, given they have overshot over the last couple of years. And I was just wondering if you can provide us any guidance what level of risk costs we should be looking at in terms of 2016 and 2017, being if that is not too far out?

And the second question is on excess capital. You state that the pro-forma for NN Group, the number is now EUR7.9 billion. And I was just wondering if you could give us an update in how you're thinking of potential regulatory headwinds, RWA inflation here. And also how you think on with regards to potential acquisitions, whether you would use part of that capital for potential acquisitions and whether such acquisitions would be predominantly within the euro area or they could be elsewhere? Thank you.

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Ralph Hamers *ING Groep NV - CEO & Chairman of the Executive Board*

Okay. Risk costs, Wilfred?

Wilfred Nagel *ING Groep NV - Chief Risk Officer*

Perceptually, of course, you're right. If we're now coming close to the average through-the-cycle risk cost, then, to maintain that average there will have to be periods where we're going to be below. The question is when will that happen?

Our guidance for the remainder of the year is unchanged. We still think we're going to end up around the 2014 level. There's a bit of potential, I think, for it coming in slightly below that, but what we're looking at right now is a slow, gradual recovery in most of the core markets.

We do see a general, as you've also seen this quarter, trend in quite a few of the markets for a declining risk cost.

The two things that I think for the remainder of this year will impact that positive trend negatively is first of all the fact that the Netherlands, as Ralph already pointed out, is still very sluggish in terms of recovery. And the second one is that there are significant uncertainties out there, which you're all aware of, around Russia, Ukraine, China; a lot of macro developments that will have an impact.

At the same time, we do see in a number of portfolios where we have taken significant provisions during and after the crisis, we're now seeing significant releases and that is obviously what's going to be driving the further reduction in net risk costs that we, indeed, reasonably should expect going deeper into that part of the cycle. And that is hopefully going to materialize in 2016 and 2017.

Ralph Hamers *ING Groep NV - CEO & Chairman of the Executive Board*

And then capital regulatory headwinds.

Wilfred Nagel *ING Groep NV - Chief Risk Officer*

Well, there's a number of developments on that front. The ones that probably everybody is aware of are the major ones.

There are four from our perspective. One is the revised standardized approach plus floors. Then there is the interest rate risk in the banking books. There is the revised SREP methodology. And there is TLAC.

Now on all of those we have a rough idea of what the framework is, what the methodology is, but we don't really have the actual numbers.

So if you take the revised standardized approach, it really depends in terms of its impact on where the floors are going to come in and we don't know that yet.

If you look at interest rate risk in the banking book, we have an idea of the scenarios that are going to be applied but we don't know exactly what the actual numbers are going to be in those scenarios. It's quite hard to quantify that.

The same with the SREP methodology. We know roughly what the new components are but, again, we don't know exactly where they're going to land.

And on TLAC, partly because TLAC itself is still a discussion, partly because the level is, to some extent, dependent on Core Tier 1, which, again, we don't know exactly what it's going to be, it's hard to quantify.

Clearly, individually each of them could have a significant impact and collectively they certainly could.

All we can say at this point is we participate in all the QIS and consultation processes. We're in constant dialog with the regulators. It's clear that all European banks will be impacted and, depending on which floors and which methodologies land where, it could be some more than others.

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We've talked in the previous quarterly call a bit about the Dutch mortgage book. That might, in some scenarios, be impacted more than others. But, equally, there are scenarios in which portfolios that do not directly affect us so much would be more impacted.

And then there is, last but not least, all of this analysis would be based on as-is balance sheet.

Obviously, we have various management actions available to us to mitigate the impact of each of these and that means that some of this might translate not into capital but into P&L impact and some of it would simply be capital. But, again, too early to tell.

Ralph Hamers ***ING Groep NV - CEO & Chairman of the Executive Board***

And the second part to that second question on acquisitions, I just go back to the Think Forward strategy.

You know that our strategy is based on organic growth. The organic growth is actually happening. We see it in the number of clients. We have real momentum in gaining new clients. We have real momentum in the businesses that we had indicated in which we wanted to grow.

And so, from that perspective, growth really needs to come from an inorganic way. And that's why we're principally not really looking at acquisitions from that perspective.

So if we were to think about acquisitions, as I have indicated before, we'll have to be very disciplined around it. But it will be if it is a team, or skill set, or assets for balance sheet management, or skills, those are things that may be interesting. But, again, we feel that that we can do also from the Bank's capital generation.

Martin Leitgeb ***Goldman Sachs - Analyst***

Thank you very much.

Operator

Benoit Petrarque, Kepler.

Benoit Petrarque ***Kepler Cheuvreux - Analyst***

Two questions on my side. The first one will be on the mortgage refinancing trend, which seems to accelerate. So could you tell us a bit what do you see in your book, so what type of actual refinancing trend you see?

And usually there's also some -- so next to non-recurring impact, there could be some more recurring negative on NI. We've seen one peer in Belgium, which have been mentioning negative impacts on recurring NI. So do you expect some negative on NI going forward and maybe net interest margin as well?

Second question will be on the cost side. I think if you look at H1 less regulatory costs you probably are around EUR4.2 billion. You mentioned EUR640 million of regulatory costs in H2. So it looks like you are heading for EUR9 billion plus on the cost side for full-year 2015. Is that something you have also in mind? Or you still think you will be lower than that?

And just maybe last one, could you update us on your oil and gas/commodity exposure going into Q3? Obviously prices are going down there, so are you more worried on that? Is that part of your more cautious guidance on risk cost? Could you explain a bit there what you see? Thanks.

Ralph Hamers ***ING Groep NV - CEO & Chairman of the Executive Board***

Patrick?

Patrick Flynn ***ING Groep NV - CFO***

So your question was specifically on the trend, I think, on refinancing. Refinancing, I think, as Ralph mentioned, happens most where the charges are the lowest, which is in Belgium and, to a lesser extent, Italy.

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Italy is a very small book. So it's not that relevant, particularly for the second part of your question, in terms of NIM impact in terms of the Group. It's just too small.

In terms of Belgium, we watch this very closely and we've seen a significant trail off of mortgage refinancings. It's dropping and has been most quarters now for some time. So it's clearly trailing off. Close to half the book has refinanced, so it's virtually done, I think. Not everybody will be able to refinance. As I say, it's trailing off significantly.

In terms of NIM impact, the non-recurring charges are into other income. The NIM impacts that could be prospective and continue, well, we do include, as you see in slide 20, EUR25 million of the charges that we can charge in Belgium. That will drop off, obviously, but you can see it's a relatively small number.

There is maybe a little bit lower margin as compared to the hedges on the new refinanced mortgages, but it's a small number. It's less than 1 basis point impact for the overall Group.

So the impact on NIM going forward, there is a little bit, as you can see, but it's not something that would derail us or not derail our views in terms of growing interest income or maintaining NIM. Some of these headwinds you just get that we have to compensate for, and we have.

The Belgian team have looked at this, are working hard to mitigate it and we also cut deposit rates. So this year we don't expect to see any net impact at all by virtue of cutting deposit rates in Belgium to offset it.

And on costs, yes, we had an ambition to try and keep costs flat. It's increasingly difficult with EUR230 million, EUR240 million of regulatory costs. We also -- FX is going to hit us for maybe another EUR100 million.

That said, that's positive for the cost-income ratio, given a lot of this comes in markets like structured finance, where we have an excellent cost-income ratio. So you get the benefit of that in the overall cost-income ratio.

And also there's EUR100 million adverse from the costs we announced in respect of the Dutch forward NL project, omni-channel project, last quarter. But we're working very hard to mitigate these cost increases and we're also trying to keep a very strong eye on the cost-income, which you see is at the 53% level.

Ralph Hamers *ING Groep NV - CEO & Chairman of the Executive Board*

Oil and gas, Wilfred?

Wilfred Nagel *ING Groep NV - Chief Risk Officer*

I would refer to page 32 of Ralph's presentation where we showed a breakdown of our oil and gas related exposure, as we did last quarter, and it hasn't changed. The exposure is about flat at EUR30 billion.

A couple of characteristics beyond what you see here on the page. Three-quarters of this book is very short. It's shorter than a year. So we can manage this quite easily if and when required in terms of overall quantum.

Secondly, what I would point out before diving in a little bit deeper is that -- so we've got, as you see on this chart, about EUR5 billion of exposure that would be negatively impacted by a further decline or prolonged low oil prices. Against that we have about EUR550 billion in lending that benefits from low oil prices. And, indeed, part of what we see in terms of economic recovery and write backs of provisions is indirectly related to that.

So I wouldn't necessarily call it all bad news that oil prices are low.

What are we seeing in this portfolio? The watch list is up a bit. Obviously, we have a number of names that we're watching more closely than we were doing a while ago. NPLs are stable, though. We're not seeing an increase in defaults or anything near that. And, obviously, you can't

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rule out that that would start happening at some point.

The question is what is the longer term oil price scenario? And, obviously, a lot of people have views on that. Our house view is that, at the moment, the actually quite strong underlying demand for oil is overshadowed by quite a significant oversupply.

We've seen a pretty strong cutback in investments in the oil industry over the past -- well, particularly the past nine to 12 months. It started a bit earlier than that. And that will, at some point, impact the supply and cut back on the oversupply.

Currently our view is that we expect a stabilization towards the first half of next year and probably a gradual increase in oil prices later next year, which would mitigate some of the things that we're looking at at the moment.

So, obviously, we're watching this space very closely but, given the type of portfolio we have, the tenors in there and the overall macro impact of lower oil prices, we're not quite as concerned as you might think.

Benoit Petrarque ***Kepler Cheuvreux - Analyst***

Thank you.

Operator

Ashik Musaddi, JPMorgan.

Ashik Musaddi ***JPMorgan - Analyst***

Just a couple of questions. First of all, just to get it correct, can you give us some thoughts on what are the hurdles for any M&A that you are planning in terms of ROE or any other metrics that you are looking for in M&A?

Secondly is, with respect to your NIM guidance, I remember your NIM guidance is around 150 basis points to 155 basis points for 2017. So are you still sticking with that? Do you still see the possibility of reaching towards that guidance, especially in the mid-range and not at the bottom end of the range?

And just a third question is just a clarification on your previous point on the why are you retaining the second quarter profits and not putting in the Group capital? So are you assuming 100% dividend payout ratio at the end of the year and that's why you're retaining the entire thing? Or is it just like creating buffers at the moment? Thank you.

Ralph Hamers ***ING Groep NV - CEO & Chairman of the Executive Board***

Well, on M&A and the hurdles, as I said already, we're not planning on M&A in the sense that you probably would think about M&A.

The Think Forward strategy is an organic growth strategy. We have gone through what we call a sustainable share framework. We have organic improvement plans for each and every franchise.

Clearly, if there were, what I indicated before, asset books or skills or if technology was available in the market, that sort of M&A is something that we would be looking at.

Yes, if, in a market in which we are active, in-country consolidation is happening, we'll have to take a look as to how that will influence our own position and how we feel it will affect our own strategy. But that would be then more reactive because there is something happening in that market.

Certainly we would not be thinking about new geographies from that perspective. So that's what I can say about that.

On the NIM guidance, so we have seen flat NIM over the last couple of quarters. But if you go back to when we started the strategy, the NIM was around 135-ish-basis points, mid-130s-basis points, and we have improved that to where we are right now, the 147-ish-basis points, if you corrected for the two factors that are indicated. So there is an improvement there.

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That improvement is on the back of a change in composition on the asset side. And what we've indicated that first it's a 2017 indication as to where we want to be in order to improve returns. It's not a target in itself. It's a means to see how we manage returns. We see that the actual asset diversification into areas in which we have higher NIMs is actually happening.

It is not 2017 yet so basically we feel still comfortable with the 151 basis points, 155 basis points by 2017.

Capital clarification I'll give to Patrick.

Patrick Flynn ***ING Groep NV - CFO***

Thank you for the question on the reserving. I should have mentioned it when I was asked initially.

Given that we reserved 40% in the first quarter and if we were to do 100% for the subsequent quarters, we come out probably somewhere near 80%, so less than 100%. And I think the 80% will give us ample flexibility in terms of what we're thinking of now.

That said, the final dividend payout ratio is something we will determine at the yearend. And, okay, repeat again, the way we're looking at it, we look at the profits we've made, what we think we'll make in the future and also where the regulatory world is looking like as well.

Ashik Musaddi ***JPMorgan - Analyst***

Yes. That's very clear. Thanks a lot for this.

Operator

Guillaume Tiberghien, Exane.

Guillaume Tiberghien ***Exane BNP Paribas - Analyst***

I've got two questions. The first one is on the cost base. I think someone asked earlier whether you think you can reach a target of EUR9 billion for this year or whether you will go above that level.

And the second question is again on the dividend. Obviously payout by consensus has now, I think, increased to about 80%, which is well above your minimum guidance.

Presumably regulatory constraints won't be known fully as we enter 2016. So is there a possibility that you might change the guidance to a more realistic level, even if regulatory uncertainties are not fully clarified, so that consensus can have a better feel as to where your dividends are going? Thank you.

Patrick Flynn ***ING Groep NV - CFO***

Well, in terms of costs, as I said already, we're going to work very hard to try and mitigate the impact. And they are very big, the three things that I mentioned: EUR400 million in aggregate. That said, there's some uncertainty around them.

So we never give up on this. This is something we will strive to achieve but, as I said, it's not easy. But we'll see at the end of the year where we end up on costs. Plenty of work to do in the interim.

On dividend, we have to -- just read your question again to make sure I hear it.

In terms of guidance, yes. We're reserving -- what we're doing now will give us capacity without the necessity to refer to the regulator in the region of somewhere around 80%, mechanically.

That doesn't imply that that's the payout ratio we're intending. It simply provides us flexibility up to that level without recourse to the regulator and we're not, at this juncture, disposed to want to go to the regulator.

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And we will assess what the appropriate number is. The minimum is 40%. So it's somewhere above that, provided we are comfortable with how the market -- how our profits have developed and how we see them developing and the regulatory environment.

I'm afraid that's not something that we will decide on or give a more precise view on probably until the fourth quarter.

Guillaume Tiberghien ***Exane BNP Paribas - Analyst***

Okay.

Operator

Bruce Hamilton, Morgan Stanley.

Bruce Hamilton ***Morgan Stanley - Analyst***

Just a couple of follow-up questions. Firstly, again looking at NIM and your ability to further manage down the deposit side of the equation, how much room do you have there? And which markets, in particular, do you have the biggest gap, relative to peers? Just to give us a sense.

And then secondly, just on the regulatory front. Clearly, depending on outcome, mitigating action will be taken. But can we explore that a little bit? So if we think about the floors being introduced and impacts on mortgage books, what mitigating action outside of simply deleveraging the balance sheet or changing your growth dynamics? How should we think about what's within your control to manage for those potential regulatory changes?

Ralph Hamers ***ING Groep NV - CEO & Chairman of the Executive Board***

I will take the question on the repricing of the liabilities. I refer to slide 28 where you basically see where we are on our savings rates in the different markets in which we're active.

Clearly, there's difference per market, per client category. And, in the end, if it is about savings rates, just like mortgage rates, it's a combination of where the market is and how you run your relationship with your client and the client interest here as well that you have to take into account. But this gives you a little bit of an idea where we are in the different markets.

Our position towards peers, in comparison to peers, is if we get EUR9 billion of savings in in a quarter, actually it's probably interesting and competitive in itself. So I think at this rate we're quite happy on one side to get the funding in, build the number of clients -- if you gain 600,000 clients in half a year, you must be doing something well -- and building client relationships going forward.

Then on the regulatory impact, I will give that to Wilfred.

Wilfred Nagel ***ING Groep NV - Chief Risk Officer***

In terms of mitigating actions it really, of course, depends on the product and the client group. Your question, I think, was targeting Dutch mortgages. Number of things to be said there.

First of all, again, it really depends on where these floors land and whether or not the ultimate capital impact really makes the product unattractive from an ROE perspective. It's a bit early to tell.

But, just hypothetically, obviously the treatment of that particular product in the balance sheet of various financial institutions and, in particular, insurance companies and non-regulated investors, is obviously very different from what it is for us.

So you already see a lot of appetite from institutional investors for mortgages also in the Dutch market. And I think, potentially, one of the mitigating actions could be that we strengthen the ties that we already have with a number of these investors on that particular product in order to move more to an originate-to-distribute model for this particular product. But, again, it's quite early to speculate.

Bruce Hamilton ***Morgan Stanley - Analyst***

Okay. Thanks.

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Operator

Anton Kryachok, UBS.

Anton Kryachok ***UBS - Analyst***

Just two follow ups, please. Firstly, on net interest margin. Earlier in the call, you have mentioned that you expect net interest margin to broadly stay at similar levels for the rest of the year. I just wanted to make sure which level were you referring to. Is it 143 basis points that you have reported on a stated basis? Or should we look at the underlying picture, which is closer to 147 bps?

And then the second question, please, on Dutch asset quality. The improvement in the NPL ratio in the quarter was quite strong. I think you've reported a fall in NPLs to 3.4%.

Can you please give us a little bit more color on whether such a strong improvement in the underlying asset quality can actually warrant some writebacks of your existing provisions? Or is it just you working through the files and taking down the provisions accumulated and writing down exposures which were impaired? Thank you.

Ralph Hamers ***ING Groep NV - CEO & Chairman of the Executive Board***

Patrick will give an answer on the NIM and Wilfred on the NPLs.

Patrick Flynn ***ING Groep NV - CFO***

I think it's really important again to go back to slide 13 that showed the EUR5.8 billion (sic - see slide 13, "5.8%") growth.

This isolates the movement in financial markets and it's really important to understand that. If you go back to, say, is it Q2, Q3 last quarter where we were in the 150 range, we had a very strong contribution to the financial markets. It has dropped significantly, the contribution of financial markets this year, but financial markets' revenues have increased. Both Q1 and Q2 were sequentially higher.

So we're very happy with the contribution of financial markets in total.

But the proportion of financial markets' revenues that are attributable to NII or other income is arbitrary. So, if you isolate the financial markets impact, we're broadly at the same level. Income is up and commercial results, excluding financial markets' NIM, is holding up well and is comparable to the same quarter of last year.

Also, we've had a little bit of negative headwind from the increase in the balance sheet with low rates that inflates the derivative holdings that we have to gross up on both sides of the balance sheet. And, if interest rates increase, that could also come down and we would hope that would happen before 2017.

So if you take into account what's happened in the financial markets, there is not that significant a change in NIM. And, hence, we believe that continuing to pursue our strategy of changing the mix means, and with some help from interest rates, by 2017 you could well see us in the target range, our ambition range, again.

Ralph Hamers ***ING Groep NV - CEO & Chairman of the Executive Board***

Wilfred?

Wilfred Nagel ***ING Groep NV - Chief Risk Officer***

A bit more color on the Dutch NPL situation. If we look at overall lending for the whole of the country, all the business lines' NPLs were down to 3.6% from 4.1%. The 3.4% that you were mentioning is on the retail banking side, all the lending there; so mortgages, business lending.

The only area where we see a slight uptick is in business lending in the Netherlands from 8.1% to 8.3%. But I would point out that that is not because the NPL stock is rising but rather because the total book there is dropping faster than the NPL stock. And that is a trend that I don't think will continue for long.

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We do see demand now beginning to pick up in the Netherlands. Also loan demand is beginning to stabilize. So I wouldn't expect this to be a permanent feature and we will see the NPLs also on that book coming down.

By extension, then, what's going to happen in the next two or three years in all likelihood is that we will begin to see some writebacks of earlier provisions in that book as well, leading to the below the average-of-the-cycle numbers that we were talking about earlier on.

But I would reiterate, if you look at the book overall in the Netherlands, the NPLs are down across the board and that does reflect a real underlying trend because, also, when we look at the shorter arrears before NPL, those numbers are also coming down in all segments.

Anton Kryachok ***UBS - Analyst***

That's very clear. Thank you very much.

Operator

Kirishanthan Vijayarajah, Barclays.

Kirishanthan Vijayarajah ***Barclays - Analyst***

A couple of questions; one on costs, one on the leverage ratio. Your regulatory cost slide, EUR640 million for this year. Do you think of that as steady state and a sensible number to think about for 2016/2017? Or is there potentially a bit more inflation to come there?

And on your leverage ratio you show 3.8% and a target of 4% but we're also seeing other eurozone banks now targeting 4% to 4.5%. So how are you thinking about leverage ratio right now? Is it becoming maybe a bit more of a constraint? And, I guess, related to that, are there any easier levers you can pull to maybe improve that ratio closer to the 4% in the shorter term? Thanks.

Patrick Flynn ***ING Groep NV - CFO***

In terms of leverage ratio, we set the target and when we did it it was based on IFRS and we're comfortably above the 4% on the IFRS basis.

The Delegated Act approach is still being finalized. There's quite a bit of detail in how it's computed that is important to work our way through. And I think I said on the last call, I believe we'll be able to -- whichever the metric is, I think the IFRS number is a good estimation of where we'll end up.

So we have capacity to manage our leverage and I think the IFRS number is a good indication of where we'll end up, whatever the basis of computation is.

What was the other question? Yes, regulatory costs. I hate to say it. It's hard to say that I wish EUR650 million was the max, because it's a very big number. But we think it actually could be a little bit over EUR700 million in the following year. That's due to the full impact of the Dutch DGS coming in, because as of -- we expect it to be enacted in July. It hasn't yet been, but it could well be done in legislation retrospectively. So our estimate of EUR640 million includes a half-year for the Dutch DGS and a full year next year, hence the increase.

Kirishanthan Vijayarajah ***Barclays - Analyst***

Okay, great. Thank you.

Operator

(Operator Instructions). Anke Reingen, Royal Bank of Canada.

Anke Reingen ***RBC Capital Markets - Analyst***

I just had two follow-up questions, please. Firstly on the dividend. I was just wondering was it accrued at an underlying level or on the first half. And then you talk about as a percentage of stated profit. And how far is dividend growth in absolute terms important for you? Or is it more you focus on the payout ratio? But obviously there will be different results depending on underlying or stated profit.

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And then secondly, just on potential regulatory changes. Are you aware of any change in how AFS gains are treated in your capital ratio? Thank you.

Patrick Flynn ***ING Groep NV - CFO***

In terms of dividend, our ambition is -- maybe just to clarify. With the half-year we said what we're paying is 40% of the underlying net of the Bank but the dividend for the full year will be based on the net profits. That's what the regulatory -- that's what you include in your profit. It's net-net-net. And after NN being deconsolidated, Voya gone, the Vysya's one time, we would expect the underlying and the net to be very, very close. Hence it is on net.

In terms of dividend, the minimum is 40% and I just said already we'll have to see at the yearend if we can pay more than 40%. And, as I said earlier, that we'll evaluate the full-year results and look at economic, commercial and regulatory developments.

In terms of AFS, it's included in the numbers. It's come down a little bit. We don't think it's particularly -- particularly worried about it in terms of a number, given the strength of our capital ratio. One-half of it's attributed to the Bank of Beijing, where you have a mitigating effect as it's an equity and then you have to hold an RWA against it.

Anke Reingen ***RBC Capital Markets - Analyst***

And as also you're not concerned that there might be a change in regulation under which you can't include all the unrealized gains.

Patrick Flynn ***ING Groep NV - CFO***

Yes, we can add that to the list of the regulatory things but, frankly, it's probably one of the smaller ones.

Anke Reingen ***RBC Capital Markets - Analyst***

Okay.

Operator

Matthew Clark, Nomura.

Matthew Clark ***Nomura - Analyst***

Two questions. One on the costs side. Are there any positive items we should think of going into the second half that might offset the negative regulatory costs and the seasonality, etc., that would present a headwind? So any reason why we shouldn't expect the second-half costs to be higher than the first half?

And then the second question is on the dividend accrual and the decision not to recognize the second-quarter profits. Was that a management decision or was that a Board decision? Thank you.

Patrick Flynn ***ING Groep NV - CFO***

I think a lot is one and the same because we sit on the Board and so that was our decision. I proposed it and the other members agreed with me. So it's simply to create flexibility.

These rules on what you include in regulatory capital and what you intend to pay out or what you want to keep as a flexibility to pay out apply to ING and they apply to all other European banks. It's an ECB framework and it's been evolved over the second half in that they want to apply it on a quarterly basis. So we proposed it.

The ECB don't enforce it. They tell you, okay, if you want to include regulatory profits in your regulatory capital, you have to jump through a whole load of hoops and fill in a whole load of forms and lots of people sign bits of paper. So it's quite burdensome and they have to approve that.

If you choose not to, then the administrative purpose is a lot easier. Their only challenge to this is, guys, we hear you talking externally about paying more than 40%. Please be realistic on the amount you want to include in capital.

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So we've decided ourselves to reserve that profit, earmark it for dividends to give us flexibility at the yearend to meet what we said is an ambition, which is to pay more than 40%.

And I repeat, again, that ambition, we will have to evaluate in the context of the environment that pertains at the yearend, include regulatory developments. But we are doing our bit. We don't control those regulatory developments. We don't have a [land out], but we're doing our bit in putting the profit aside so that we have the flexibility to pay more than 40%.

Ralph Hamers *ING Groep NV - CEO & Chairman of the Executive Board*

On the costs side, clearly, as we have indicated, the regulatory costs are coming in at EUR240 million the second half. The Dutch DGS will come in at a certain moment in time. That is part of that EUR240 million.

It's the EUR100 million that was coming in as part of the Dutch restructuring program, the actual investment in the omni-channel, but that's basically spread out over the year as well.

And then, depending on where the euro goes, some of the cost increases that we see are basically as a consequence of the weaker euro. It's good for our cost-income ratio on the dollar side of the business, but it's bad for the cost line itself.

So, for us, on the cost side, clearly, it's important to manage our costs. We are very disciplined about it but we're investing in franchises that are actually growing. So the cost-income is a much better indication for us.

Now in the second half, specifically, we will see more benefits of the restructuring programs that we're working on in the Netherlands and Belgium and the commercial bank still coming in. So that will continue as well.

So, as Patrick has said, will the second half be higher or lower? We're working very hard on it, very disciplined. We will only allow cost growth where we feel it in the end will improve the cost-income and that's basically the way we go about it.

Matthew Clark *Nomura - Analyst*

Okay. Thank you.

Operator

Farquhar Murray, Autonomous.

Farquhar Murray *Autonomous Research - Analyst*

Just one question, if I may. Really, just coming back on the comment you made on China and the potential possibly for loan losses coming through from there at all. Can you just recap the exposure to China that you have? I think it's in the region of about EUR15 billion.

And, within this, I presume, you have very limited direct exposure to the recent turbulence that we've seen. So I presume what you're thinking about is possible indirect consequences. Thanks.

Ralph Hamers *ING Groep NV - CEO & Chairman of the Executive Board*

Wilfred?

Wilfred Nagel *ING Groep NV - Chief Risk Officer*

So the exposure is a little over EUR13 billion, indeed. Out of that, EUR2.7 billion is the Bank of Beijing's stake and around EUR10 billion is lending. Plus there is, obviously, a little bit of pre-settlement exposure.

Out of the EUR10 billion, EUR5 billion is short-term trade finance and the rest is multinationals, major state-owned companies and some banks. We don't do midmarket or retail lending in China.

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If you look at the tenors, then 70% of this book is shorter than one year. Currently, the NPLs, and they have been doing that for a number of years, stand at 0%.

It doesn't mean we're not watching this. What we've seen is the State taking a number of measures to stabilize the equity markets, blocking shareholders with more than 5% of any company from selling at all. Interestingly, also telling margin-finance houses not to liquidate anything before the index hits 4,500 in Shanghai.

A lot of stocks were suspended. We've seen the PBOC pumping a lot of funding into brokers to buy shares. And, of course, out there, there is still $3.7 trillion in ForEx reserves that the Government has at its disposal to do things.

So we're watching this. I'm sure we're going to see volatility. I'm sure we're going to see some pain at some point. We're not, given the quality and the type of our portfolio, overly concerned at this point. We don't think that this is something that will lead to a full-blown crisis.

But, clearly, you will see contagion and we're already seeing that from a macro perspective, particularly in the rest of Asia and Australia, but potentially also in the rest of the world. And the commodity markets are a clear indicator of that.

Farquhar Murray ***Autonomous Research - Analyst***

And, just as a follow on, where then do you think you might get the knock-on through? Is it just literally just general economic conditions? Or is there any kind of marginal exposure to the margin houses that you mention?

Wilfred Nagel ***ING Groep NV - Chief Risk Officer***

Sorry, I didn't quite understand your question. Could you repeat it?

Farquhar Murray ***Autonomous Research - Analyst***

I think the question in brief is just trying to ask where do you have any exposure or indirect exposure to those margin-financing houses, just in terms of where perhaps your expected losses possibly to come through. I imagine it's literally just general economic difficulty.

Wilfred Nagel ***ING Groep NV - Chief Risk Officer***

No. We don't have any margin financing based on assets that are directly related to this.

I think what we're going to see is simply the macro fallout in terms of weaker demand for a lot of services and goods going into China. We are seeing currency volatility in Asia stemming from this. It is more that macro pattern than anything specific to our portfolio that we worry about.

Farquhar Murray ***Autonomous Research - Analyst***

Okay, great. Thanks very much.

Operator

Tarik El Mejjad, Bank of America.

Tarik El Mejjad ***BofA Merrill Lynch - Analyst***

Just to come back on the NIMs, please. You reiterated your guidance of 150 basis points to 155 basis points, but the asset side -- sorry, the balance sheet growth has been higher than what you targeted in your Investor Day. So does that mean you are scaling back your balance sheet in the next few years or you're expecting better shifts in your business mix towards higher margin products?

And my second question is on your loan growth and industry lending. Can you please give us more detail on what sectors are working well and how you manage still to grow, although oil and gas is not doing well? I know that you are diversified but if you can explain us what other factors are.

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And last question, very quickly, on Russia. It looks like it's not a concern any more but what's your strategy in there? Are you keen to start to grow your balance sheet again there or you are leaving it under control at this level? Thank you very much.

Ralph Hamers ***ING Groep NV - CEO & Chairman of the Executive Board***

On NIM, no. Whenever the assets -- the lending growth comes in, the lending growth comes in for us. Lending growth, the way it happens here is that we are very prudent. We're not changing our risk appetite to get lending growth in. That's not the way we work. We have the same risk appetite. The machine is running. We go after the categories that we like and the clients that we understand and the business that we understand. So there is no change there.

And when the growth comes in, the growth comes in and we're not necessarily working on scaling it back from that perspective.

Clearly, as we've indicated in the launch of the strategy, a move from the mid-130s-basis points to the 150s-basis points in NIM was generally because of a change in the asset composition. That's what we exactly see happening at this moment in time.

We have seen the NIM increase on that back. It may increase further but, in the end, we're managing client relationships and when we can do deals, we will do so.

On the structured finance side more, in particular, we actually see growth across the board in all the different industries and different sectors. Basically, it's a global business for us. We work from Latin America all the way to Asia in it because these are sector specialists that we work with. And where we can support our clients, we do so.

So it's really across the board geographically and it's across the board in terms of sectors.

Now on Russia, I'll give that to Wilfred.

Wilfred Nagel ***ING Groep NV - Chief Risk Officer***

If you look at page 30 of Ralph's presentation you'll see the current breakdown of the Russia exposure and also the delta compared to last quarter, which shows you that we're, again, down a few hundred million in total exposure.

The strategy is unchanged. What we did in 2014 was focus on the quantum, the total outstandings, and we did that by taking out all the exposures that were not core to our core clients and taking out all the clients that were not core to our franchise.

Once we had that done, as we said before, we started focusing on the quality of the exposure and managing the event risk that really Russia represents.

And what we're doing there is shifting, as much as we can, to ECA business, to pre-export facilities, to offshore collateralized business, shorter tenors where we can -- funding for our clients, where that works for them, their non-Russian activities. And, also, shifting as much of the onshore exposure really to our own onshore entity and funding it locally as much as we can, which we've been quite successful at.

Are we growing the balance sheet? No, that is not the plan. We think that the current exposure levels represent a core of our franchise and what our clients need from us to support them. And we intend, barring any unforeseen new developments, to keep it roughly where it is.

Tarik El Mejjad ***BofA Merrill Lynch - Analyst***

Thank you.

Operator

JP Lambert, KBW.

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Jean-Pierre Lambert ***Keefe, Bruyette & Woods - Analyst***

I would like to come back, it's a single question but various elements, on the calculations of the buffer you will build up at the end of the year.

The first question is, are you going to take into account the profit generation you may have next year?

The second question is, I would like to understand a bit better the mechanics how you will build the buffer for and how you will calculate it?

If we take a practical example, you have specialized lendings, which are EUR81 billion. It's currently risk weighted at 37%. The proposal under BIS is 120%, so you have a gap. How you will consider this in practice to build up your buffer? This is a simple example but can be expanded to the various business lines. Thank you.

Patrick Flynn ***ING Groep NV - CFO***

Sorry, which buffer are you referring to?

Jean-Pierre Lambert ***Keefe, Bruyette & Woods - Analyst***

I am referring to the portfolio of specialized lending, which is structured finance and others, which are going to be weighted, based on the proposal, at 120%. And my impression from the disclosure under EBA is it's risk weighted, I think, at 37% in your book.

Patrick Flynn ***ING Groep NV - CFO***

Maybe I'll start and Wilfred -- if you're talking about how much profit we will earmark that was available for potential dividend, that's simply the accounting results we have each quarter. If you're asking prospective regulatory changes [Basel IV], we have to assess that at the end of the year what they actually are.

Wilfred alluded to that there's quite a lot of uncertainty. It makes it very difficult to compute precisely what the impact may arise from them. And we'd hope at the yearend we will have more clarity on that so we can actually compute what you're asking.

Ralph Hamers ***ING Groep NV - CEO & Chairman of the Executive Board***

Maybe to come back, if you come back to how we generally go about capital distribution between three components. So we've indicated that 30% of the capital generation of the Bank is there to support growth. 30% is there to support improvement in Core Tier 1 or any other risk-weighted changes that you may see. And it was the minimum 40% that was earmarked to be paid out as a dividend.

Now, in the end, it's about managing that. So if the regulatory changes come towards us, and whether it is this one on structured finance or whether it is floors or whether it is anything else that comes from the regulators, in the end, from a bank's perspective, this is the way we manage it. If we have to dedicate more to capital it may impact growth. So that's the way we will go about it.

Clearly, we have a surplus at Group as well. And that's why we've indicated that if we go about thinking about being more than 40%, in the end that is dependent on strategic considerations, financial considerations and also regulatory changes that at that moment we expect or not. And that's the way we will go about managing it going forward.

Jean-Pierre Lambert ***Keefe, Bruyette & Woods - Analyst***

To come back maybe to understand better. Assume that you need a buffer of 100 at the end of the year, 100 whatever unit, and you have a net profit generation of X next year, will you deduct some of the buffer you build up, taking the net profit generation of next year into account?

And the second point is, when you look at the regulatory environment, will you take a conservative view or you will take a view on the trajectory of the regulation?

Ralph Hamers ***ING Groep NV - CEO & Chairman of the Executive Board***

I'm happy to go into more details on this in a separate call but not for this call.

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Jean-Pierre Lambert ***Keefe, Bruyette & Woods - Analyst***

Thanks very much.

Ralph Hamers ***ING Groep NV - CEO & Chairman of the Executive Board***

Operator, I thought this was the final question. So, with that, I'm very grateful that you took the time to call in and discuss the results with us.

Just recapping. Second quarter, strong results. The Bank net underlying at EUR1.1 billion; up 21% from the same quarter last year. Underlying developments; strong lending growth, strong savings growth. Over the last half-year 600,000 new clients coming in. So, basically, if you look at the strategy and the way are implementing it, you see that on all counts we are progressing and doing well.

The results are good. So, basically, we're rounding off a good quarter. Thanks very much and stay in touch.

Operator

Thank you. That will conclude today's conference call. Thank you for your participation, ladies and gentlemen. You may now disconnect.

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