Capital management

Objectives

ING Group Capital Management (Capital Management) is responsible for the adequate capitalisation of ING Group and ING Bank entities at all times in order to manage the risk associated with ING's business activities. This involves not only the management, planning and allocation of capital within ING Group and ING Bank, but also the necessary capital market transactions, term (capital) funding and risk management transactions. ING takes an integrated approach to assess the adequacy of its capital position in relation to its risk profile and its operating environment. This implies taking into account the interests of its various stakeholders. Capital Management takes into account the metrics and requirements of regulators, rating agencies and internal risk based metrics such as the Risk Appetite Framework.

ING applies the following main capital definitions:

- Common equity Tier 1 capital, Tier 1 capital and Total capital – Tier 1 capital is defined as shareholders' equity plus Additional Tier 1 (hybrid) capital less regulatory adjustments. Common equity Tier 1, Tier 1 and Total capital divided by risk-weighted assets equal the Common equity Tier 1, Tier 1 and Total capital ratios respectively. Common equity Tier 1 capital is equal to Tier 1 capital excluding Additional Tier 1 (hybrid) capital;
- Common equity Tier 1 Risk Appetite – the solvency risk appetite statement is not only compared to the actual reported level, but also includes the potential impact of a standardised and pre-determined 1-in-10-year stress event (i.e. at a 90% confidence level with a 1-year horizon) as described in the Risk Management section;
- Overall Capital Requirement (OCR). The OCR means that ING's own funds exceeds the sum of the total SREP capital requirement (wherein per risk type the maximum is taken of Regulatory and Economic Capital requirements), capital buffer requirements and macro-prudential requirements.

Developments

2016 was an important year for ING Group, as it further strengthened its capitalisation. The further regulatory capital strengthening reflects strong profitability as well as the sale of the remaining stake in NN Group. Although the regulatory environment remains uncertain, our capital position ensures we can continue to support our customers to realise their financial future.

In January 2016, ING sold 33 million ordinary shares of NN Group and subsequently exchanged the final tranche of EUR 337.5 million mandatory exchangeable subordinated notes in February 2016, which were issued in 2014 as part of the anchor investment in NN Group. These transactions reduced ING's remaining stake in NN Group from 25.8% to 14.1%. In April 2016, ING sold its remaining 14.1% stake in NN Group. The divestment of NN Group is the final step of ING´s programme to divest all of its insurance and investment management businesses as part of the restructuring agreement with the European Commission. As a result of the sale of NN Group shares, NN Group is no longer an investment, and available Tier 1 instruments on-lent to NN Group no longer need to be deducted from available Tier 1 capital. This had a positive impact on available Tier 1 capital of EUR 0.8 billion.

All net capital flows in 2016 related to the sale of insurance related activities are disclosed in Note 51 'Other events'.

In March 2016 a GBP 66 million grandfathered additional Tier 1 security, which was fully on-lent to ING Bank, was redeemed by ING Group on its first call date. In April 2016, ING Bank NV issued EUR 1 billion CRD IV-eligible Tier 2 instruments. The transaction had an issuer substitution option which gives ING the right to exchange these for subordinated Tier 2 notes issued by ING Groep NV.

In September 2016, ING Group redeemed USD 800 million 7.05% grandfathered Perpetual Debt Securities which were on-lent to ING Bank NV.

In November 2016, ING Group issued USD 1,000 million contingent convertible Securities which qualify as Additional Tier 1 capital under CRD IV/CRR to strengthen ING's capital base. The perpetual bond, which will be on-lent to ING Bank can be called by ING Group five years after issuance, has a coupon of 6.875%.

The transitional (phased-in) common equity Tier 1 requirement that ING Group had to meet on a consolidated basis in 2016 was set at 10.25%. This requirement is the sum of (i) 9.5% being the ECB's decision on the 2015 Supervisory Review and Evaluation Process (SREP), including the capital conservation buffer, and (ii) 0.75% for the Systemic Risk Buffer (SRB) which has been set separately for Dutch systemic banks by the Dutch Central Bank. The fully-loaded SRB requirement is currently set at 3% for ING Group and phases in over four years, with a final implementation date of 1 January 2019. The impact from countercyclical buffer requirements was insignificant at the start of 2016.

At year-end 2016, ING Group received the ECBs decision on the 2016 SREP. The common equity Tier 1 requirement for ING Group was set at 9.0% in 2017. This requirement consists of a 4.5% Pillar 1 requirement, a 1.75% Pillar 2 requirement, a 1.25% Capital Conservation Buffer (CCB) and the 1.50% Systemic Risk Buffer (SRB) which has been set separately for Dutch systemic banks by the Dutch Central Bank (De Nederlandsche Bank). This excludes Pillar 2 guidance, which is not disclosed. The CCB and the SRB are scheduled to phase-in over the coming years to 2.5% and 3.0% respectively by 1 January 2019. Consequently, the fully-loaded Maximum Distributable Amount (MDA) trigger level is expected to rise from 9.0% in 2017 to 11.75% in 2019 and assumes a stable Pillar 2 requirement. In the event that ING Group breaches the MDA level it may face restrictions to pay dividends, coupons on AT1 instruments and bonuses. The impact from the Countercyclical Buffer (CCyB) is negligible at this stage.

With a 14.2% fully-loaded Group common equity Tier 1 ratio as at 31 December 2016, ING is in compliance with the current fully-loaded requirement of 11.75%. ING Group's fully-loaded Tier 1 ratio (including grandfathered securities) was 16.6% at the end of 2016, while the total capital ratio (including grandfathered securities) increased to 19.7%.

To support orderly resolution, the BRRD requires banks to meet minimum requirements for own funds and eligible liabilities (MREL). In addition, ING as a Global Systemically Important Bank (G-SIB) needs to comply with the total loss absorption capacity (TLAC) proposal published by the Financial Stability Board (FSB) in November 2015.

Since 2012, ING has worked with the different resolution authorities to determine a resolution strategy and to identify potential impediments to resolution. Following an discussion throughout 2016, with the Single Resolution Board (SRB) and the national resolution authority, De Nederlandsche Bank (DNB), we concluded that ING Group should be our designated resolution entity. At the end of January 2017, the Single Resolution Board (SRB) has informed us that it supports the designation of ING Group as the point of entry. Henceforth, ING Group will be the issuing entity for all TLAC/ MREL eligible debt consisting of Additional Tier 1, Tier 2 and senior unsecured debt.

G-SIBs will be required to meet the TLAC requirement alongside the minimum regulatory requirements set out in the Basel III framework. Specifically, they will be required to meet a Minimum TLAC requirement of at least 16% of the resolution group's risk-weighted assets (TLAC RWA Minimum) as from 1 January 2019 and at least 18% as from 1 January 2022. Minimum TLAC must also be at least 6% of the Basel III leverage ratio denominator (TLAC Leverage Ratio Exposure (LRE) Minimum) as from 1 January 2019, and at least 6.75% as from 1 January 2022. Buffer requirements will come on top of the RWA requirement but not on top of the leverage requirement. In addition, the Single Resolution Board has assumed full power as per 1 January 2016. The work plan for the SRB in 2016 focused on determining the preferred resolution strategy, the resolution entity and the required amount of Minimum Required Eligble Liabilities (MREL).

ING Bank continues to maintain a strong and high quality capital level, with a fully-loaded common equity Tier 1 ratio and a phased-in common equity Tier 1 ratio of 12.6%, thereby complying with CRR/CRD IV solvency requirements. Dividend from ING Bank to ING Group of EUR 1.3 billion was paid in November 2016. The fourth quarter 2016 profit of EUR 0.6 billion is not included in the regulatory capital per December 2016 as this was upstreamed as dividend to ING Group in February 2017. The sale of 2.5% of Kotak Mahindra Bank shares, which was settled in October 2016, had no material impact on ING's capital ratios. The fully loaded and phased in Tier 1 ratios respectively increased from 13.9% to 14.7% and 13.4% to 14.4%, primarily reflecting developments in ING Bank's common equity Tier 1 ratio. This was partly offset by the redemption of the USD 800 million 7.05% grandfathered Perpetual Debt Securities in September. In April 2016, ING Bank had issued EUR 1 billion of Tier 2 bonds with an issuer substitution option through exchange. Now that clarity has been provided on the preferred resolution strategy, ING intends to use the option to replace these ING Bank Tier 2 notes with ING Group Tier 2 notes at similar terms through exchange. The noteholders have agreed upfront to the terms and conditions to exchange their ING Bank Tier 2 notes for ING Group Tier 2. ING Bank's fully-loaded Tier 1 ratio (including grandfathered securities) was 14.7% at the end of 2016, while the total capital ratio (including grandfathered securities) increased to 17.8%.

Dividend

ING Group's dividend policy aims to pay a progressive dividend over time which will reflect considerations including expected future capital requirements, growth opportunities available to the Group, net earnings, and regulatory developments. The Executive Board proposes to pay a total cash dividend of EUR 2,560 million, or EUR 0.66 per ordinary share, over the financial year 2016. This is subject to the approval of shareholders at the Annual General Meeting in May 2017. Taking into account the interim dividend of EUR 0.24 per ordinary share paid in August 2016, the final dividend will amount to EUR 0.42 per ordinary share and will be paid fully in cash. The total amount of EUR 1,629 million is fully covered by the remaining balance of 'interim profits not included in CET1 capital' at year-end 2016.

Policies

The activities of Capital Management are executed on the basis of established policies, guidelines and procedures. For the Capital Treasury there are additional policies and limits that guide the management of the balance sheets and the execution of capital market transactions.

Processes for managing capital

In addition to measure capital adequacy, Capital Management also ensures that sufficient capital is available through setting targets and limits relevant to the above mentioned metrics for ING Group and ING Bank and ensuring adherence to the set limits and targets through planning and executing capital management transactions. The ongoing assessment and monitoring of capital adequacy is embedded in Capital Management's capital planning process. Following the annual budgeting process, each year a capital plan is prepared for the Group as a whole and each of its material businesses. This plan is updated on a quarterly basis and it is assessed to what extent additional management actions are required. At all times maintaining sufficient financial flexibility should be preserved to meet important financial objectives. At the foundation of the capital plan are ING's risk appetite statements that determine target setting. These constraints are being cascaded to the different businesses in line with our risk management strategy.

Important inputs to the capital planning and management process are provided by stress testing that is performed on a regular basis. These stress tests focus on topical issues and the sensitivity of the Group's capital position to certain risks. These analyses provide input that help to steer strategic direction. Setting policies for recovery planning and resolution are a natural extension of ING's capital management policies and follow ING's risk management framework seamlessly.

Capital adequacy assessment

As at 1 January 2014, the CRR/CRD IV capital rules entered into force. The capital position table reflects own funds according to the Basel III rules as specified in the CRR/CRD IV. As CRD IV will be phased-in gradually until 2019, the table shows the CRD IV positions according to the 2019 end-state rules and the 2016 rules. ING reports these metrics for ING Group and ING Bank. During 2016, ING Group and ING Bank were adequately capitalised.

ING Group capital position

	(fully-loaded)		(phased-in)	
	2016	2015	2016	2015
Shareholders' equity	49,793	47,832	49,793	47,832
– Deductions of significant investments in financial institutions	0	–1,389	0	–558
– Interim profit not included in CET1 capital[1]	–1,629	–1,586	–1,629	–1,586
– Other adjustments	–3,596	–4,069	–3,698	–4,134
Regulatory adjustments	–5,225	–7,044	–5,327	–6,278
Available common equity Tier 1 capital	**44,568**	**40,788**	**44,466**	**41,554**
Additional Tier 1 securities[2]	7,706	6,574	7,706	6,574
Regulatory adjustments additional Tier 1	0	0	–809	–1,716
Available Tier 1 capital	**52,274**	**47,362**	**51,364**	**46,412**
Supplementary capital Tier 2 bonds[3]	9,488	8,570	9,488	8,570
Regulatory adjustments Tier 2	109	102	–86	–657
Available Total capital	**61,871**	**56,034**	**60,765**	**54,325**
Risk weighted assets[4]	314,325	321,151	314,325	321,135
Common equity Tier 1 ratio	14.18%	12.70%	14.15%	12.94%
Tier 1 ratio	16.63%	14.75%	16.34%	14.45%
Total capital ratio	**19.68%**	**17.45%**	**19.33%**	**16.92%**

1 The interim profit not included in CET1 is the proposed final dividend of EUR 1,629 million, subject to approval of the shareholders at the Annual General Meeting in May 2017.
2 Including EUR 3,052 million (2015: EUR 2,061 million) is CRR/CRD IV compliant and EUR 4,654 million (2015: EUR 5,187 million) to be replaced as capital recognition is subject to CRR/CRD IV grandfathering rules. For 2015 this amount is presented net of positions on lent to insurance.
3 Including EUR 7,347 million (2015: EUR 6,229 million) is CRR/CRD IV-compliant and EUR 2,141 million (2015: EUR 2,341 million) to be replaced as capital recognition is subject to CRR/CRD IV grandfathering rules.
4 The 2015 fully-loaded RWA deviated from the phased-in RWA as a result of a slightly higher threshold to which the significant Financial Institutions were risk weighted.

As per 31 December 2016 the total amount of available distributable items following the CRD IV definition is EUR 37,959 million, slightly higher compared with EUR 36,284 million in 2015.

ING Group available distributable items according to the CRR/CRD IV

	2016	2015
Share premium	16,950	16,054
Other reserve	22,372	21,131
Share of associate reserve	5,781	5,715
Non distributable	–7,379	–6,832
Total	**37,724**	**36,068**
Accrued interest expenses on own fund instruments at year-end	235	216
Distributable items	**37,959**	**36,284**

ING Bank NV capital position according to CRR/CRD IV

	(fully-loaded)		(phased-in)	
	2016	2015	2016	2015
Shareholders' equity	43,540	40,857	43,540	40,857
Interim profit not included in CET1 capital[1]	–617	0	–617	0
Other adjustments	–3,548	–4,022	–3,661	–4,103
Regulatory adjustments	–4,165	–4,022	–4,278	–4,103
Available common equity Tier 1 capital	**39,375**	**36,834**	**39,262**	**36,753**
Additional Tier 1 securities[2]	6,496	7,248	6,496	7,248
Regulatory adjustments additional Tier 1	0	0	–798	–1,281
Available Tier 1 capital	**45,871**	**44,083**	**44,960**	**42,721**
Supplementary capital Tier 2 bonds[3]	9,488	8,570	9,488	8,570
Regulatory adjustments Tier 2	109	102	-86	-239
Available Total capital	**55,467**	**52,754**	**54,362**	**51,052**
Risk weighted assets	312,086	318,202	312,086	318,202
Common equity Tier 1 ratio	12.62%	11.58%	12.58%	11.55%
Tier 1 ratio	14.70%	13.85%	14.41%	13.43%
Total capital ratio	17.77%	16.58%	17.42%	16.04%

1 The interim profit of the fourth quarter 2016 has not been included in CET1 capital as of 31 December 2016.
2 Of which EUR 3,542 million (2015: EUR 3,531 million) is CRR/CRD IV compliant and EUR 2,954 million (2015: EUR 3,718 million) to be replaced as capital recognition subject to CRR/CRDIV grandfathering rules.
3 Of which EUR 7,347 million (2015: EUR 6,229 million) is CRR/CRD IV-compliant and EUR 2,141 million (2015: EUR 2,341 million) to be replaced as capital recognition is subject to CRR/CRD IV grandfathering rules.

Regulatory requirements

Capital adequacy and the use of regulatory required capital are based on the guidelines developed by the Basel Committee on Banking Supervision (The Basel Committee) and the European Union Directives, as implemented by the Dutch Central Bank (Dutch Central Bank until 3 November 2014, the ECB thereafter) for supervisory purposes. In 2010 the Basel Committee on Banking Supervision issued new solvency and liquidity requirements, which superseded Basel II. The minimum requirements, excluding buffers, for the common equity Tier 1 ratio is 4.5%, the minimum Tier 1 requirement is 6% and the total capital ratio is 8% of all risk-weighted assets. Basel III requires Banks to hold a capital of at least 80% of the old Basel I requirements, which was 8% of the RWAs as calculated with the Basel I methodology. This Basel I floor has been extended until the end of 2017.

ICAAP/SREP process

On a yearly basis ING submits extensive documentation on the Internal Capital Adequacy Assessment Process (ICAAP) to its regulator as prescribed in the CRD IV frameworks. This documentation includes a description of ING's internal capital models, its risk appetite framework, an asset quality analysis and a capital planning, both under normal circumstances and in certain stressed scenarios. This documentation is an important input for the regulator's Supervisory Review and Evaluation Process (SREP) resulting in a letter to ING Management. The SREP is conducted by the ECB and examines on a regular basis ING's internal models and processes. The regulatory 2016 guidance indicated that the minimum capital ratios ECB considers adequate for ING Group and ING Bank sufficiently covered by ING's own capital standards.

Ratings

Main credit ratings of ING at 31 December 2016

	Standard & Poor's		Moody's		Fitch	
	Rating	Outlook	Rating	Outlook	Rating	Outlook
ING Groep N.V.						
– long-term	A-	Stable	Baa1	Stable	A+	Stable
ING Bank N.V.						
– long-term	A	Stable	A1	Stable	A+	Stable
– short-term	A-1		P-1		F1	

ING's key credit ratings and outlook are shown in the table above. Each of these ratings reflects only the view of the applicable rating agency at the time the rating was issued, and any explanation of the significance of a rating may be obtained only from the rating agency.

A security rating is not a recommendation to buy, sell or hold securities and each rating should be evaluated independently of any other rating. There is no assurance that any credit rating will remain in effect for any given period of time or that a rating will not be lowered, suspended or withdrawn entirely by the rating agency if, in the rating agency's judgment, circumstances so warrant. ING accepts no responsibility for the accuracy or reliability of the ratings.

Authorisation of Consolidated Annual Accounts

Amsterdam, 13 March 2017

The Supervisory Board

J. (Jeroen) van der Veer, *chairman*
H.J.M. (Hermann-Josef) Lamberti, *vice-chairman*
E.F.C.B. (Eric) Boyer de la Giroday
H.W. (Henk) Breukink
I. (Isabel) Martín Castellá
M. (Mariana) Gheorghe
R.W.P. (Robert) Reibestein
A.C. (Ann) Sherry

The Executive Board

R.A.J.G. (Ralph) Hamers, *CEO and chairman*
P.G. (Patrick) Flynn, *CFO*
W.F. (Wilfred) Nagel, *CRO*