Risk and capital management

Risk and capital management play a key role in supporting our senior leaders as they implement the Think Forward strategy. Financial and non-financial risk management support our leaders in setting our commercial direction and are key tools for sustainable decision-making. Capital management promotes the success and growth of our business by ensuring that we deploy capital efficiently at all levels of the bank.

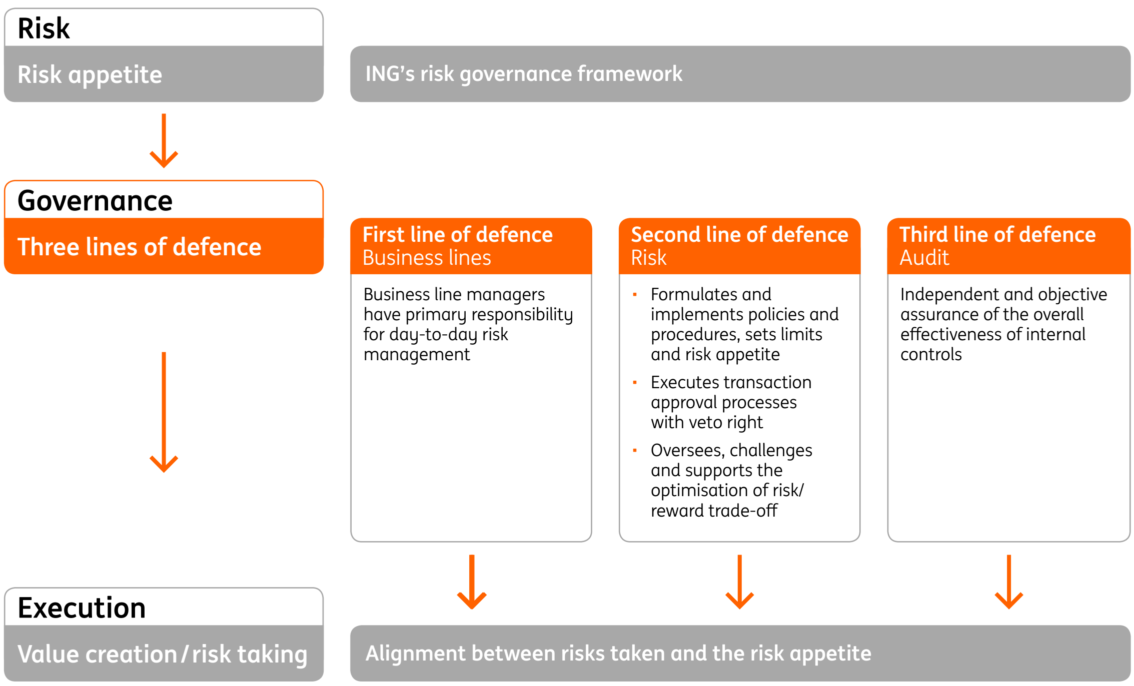
Managing risks

Taking risks is an integral part of doing business. ING faces both financial and non-financial risks. Financial risks arise when we extend loans to customers, take their deposits, provide them with hedging solutions and when we play our role as intermediary in financial markets. Non-financial risks are those associated with failures in our processes, and with failure to comply with rules, regulations, laws, and the ethical norms that are generally considered to apply to our people and activities.

The mission of risk management is to properly identify, measure and manage these risks so that they are aligned with both our strategy and our appetite for risk. ING puts a lot of effort into understanding, measuring and managing risks. We believe that we have set up an effective risk management framework and a strong risk management culture.

ING's overall capacity to take risks is set out in the Risk Appetite Framework. Within the framework, we monitor a range of risk metrics to make sure that our risk profile is in line with our appetite for risk. ING also conducts bank-wide and portfolio-specific stress tests to assess resilience in specific market conditions. Underlying assumptions and metrics are regularly reviewed to ensure they stay relevant in a constantly changing environment. ING's most important risks and control measures are regularly reported to and discussed by the Risk Committee of the Supervisory Board. Both the financial and non-financial risk reports are reviewed in detail, including the status of ING's metrics with regard to solvency, liquidity, funding, credit and market risk.

For more information on risk appetite and risk metrics, please refer to the risk appetite framework section of the "Risk Management" chapter, part of the consolidated annual accounts of this Annual Report.



Three lines of defence

ING's governance framework establishes three lines of defence to manage risk effectively.

The commercial departments, which have the primary responsibility for day-to-day risk management, form the first line of defence. They are accountable for identifying and addressing the risks that occur in conducting their activities, including originating loans and taking deposits, within applicable frameworks and the institution's limits. They know our customers well and are best placed to act in both customers' and ING's best interests.

The independent risk management departments, headed by the Chief Risk Officer (CRO), act as a second line of defence. Their role is to make sure risk is properly identified, measured, managed and reported. In order to achieve that, they set policies, implement and operate control frameworks, and have a deciding influence on risk acceptance. They also ensure compliance with internal and external requirements on an individual and consolidated basis. Further, they support the commercial departments and act where necessary to keep the risk profile within the defined risk appetite. The CRO sits on the Executive Board and the Management Board Banking, ensuring risk remains a continuing topic for the leadership team.

Corporate Audit is the bank's third line of defence. It tests and evaluates the risk governance and management, as well as its internal control processes. It provides an independent and objective assessment to improve the functional effectiveness of the first two lines.

Taken together, we believe these three layers make for a strong risk and control environment.

For more information on key risks, please refer to the risk profile section of the "Risk Management" chapter, part of the consolidated annual accounts of this Annual Report.

Impact of changing customer expectations

ING operates in a rapidly changing world. To remain relevant, we need to look closely at the quality of the services we provide to our customers. Customer expectations are changing drastically. Most retail customers prefer to use digital channels; this is the main interface for ING's communication. Although we face competition from other banks, fintechs are challenging the entire banking sector. These new entrants rely on technology to deliver innovative financial services.

ING is responding to these changes with a strategy that focuses on differentiating through leadership in digital banking and increasing the digital interactions that we have with our customers. Digitalisation is our strongest asset and most effective barrier for new entrants, as well as our best opportunity for increasing revenue and efficiency in our distribution model.

Although these aspects are commercial in nature, there is a major impact on the risk management function. As distribution and communication channels become more direct and are available 24/7, customers expect instant and continuous access to their funds and our services. Our risk management function must evolve accordingly. Therefore, ING has introduced a number of initiatives to further improve the customer experience and to simplify, standardise and automate our core risk processes. This resulted in a new risk organisation starting on 1 March 2017. Risk management helps ensure that we provide this convenience without compromising on our risk standards.

Key developments

Uncertainty in the macroeconomic environment persisted throughout 2016. Political and economic instability in Turkey, the outcome of the Brexit referendum in the United Kingdom, uncertainty about US economic policy, a slowing Chinese economy, the simmering conflict between Russia and Ukraine, as well as volatility in commodity prices (including oil prices) further impacted markets worldwide. At the same time, ING faced a further decline in interest rates, putting pressure on its net interest margin.

Against this backdrop, ING's balance sheet demonstrated its resilience. We experienced healthy lending growth and declining risk costs resulting from active management of non-performing loans. ING Bank's non-performing loans (NPLs) expressed as a percentage of lending credit outstandings further improved. The NPL ratio decreased at the end of 2016 to 2.1% from 2.5% at the end of 2015. This decrease was caused by a EUR 1.7 billion reduction in NPLs, mainly in residential mortgages in the Netherlands and Real Estate Finance, combined with an increase in total credit outstandings. For the oil and gas portfolio, the NPL ratio increased to 2.1% from 1.8% at the end of 2015, mainly caused by higher NPL amounts, as market conditions remained challenging.

In 2016, ING Bank maintained its liquidity position on a consolidated level above minimum requirements. ING Bank issued EUR 9.5 billion long-term debt, including EUR 7.5 billion of long-term senior unsecured debt and EUR 1.0 billion of CRD IV eligible Tier 2 securities. ING Bank's loan-to-deposit ratio, excluding securities that are recorded at amortised costs, rose to 1.05 compared to 1.04 at the end of 2015, mostly due to growth of the loan book.

Compliance with applicable laws and regulations is resource-intensive and costly. Banks continue to be faced with new and increasingly onerous regulatory requirements, and we expect the scope and extent of regulations in the jurisdictions in which we operate to generally increase further. ING is concerned that the lack of coordination among policymakers and the lack of clarity on future regulatory requirements is making it increasingly difficult to actively support the economies where we operate.

Regulation is becoming increasingly more extensive and complex. A recent example is the implementation of the Common Reporting Standard (CRS) in 2016, which like FATCA requires financial institutions to report detailed client-related information to the competent authorities. Customer due diligence (CDD) and transaction monitoring impose obligations on financial institutions to maintain appropriate policies, procedures and controls to detect, prevent and report money laundering (AML), terrorist financing, and fraud.

Despite our efforts to comply with applicable laws and regulations, there are a number of risks in areas where applicable regulations are unclear, subject to multiple interpretations or under development, are in conflict with each other, or where regulators revise their guidance or courts overturn previous rulings. Meeting all these requirements within the strict timelines that have been set poses a significant operational challenge for banks. Implementing the necessary processes and procedures to effectively comply has significant implications for IT systems and data, while people who have the necessary knowledge and skills are scarce.

User Access Management (UAM) is an important element of our control framework to mitigate unauthorised and/or inappropriate access to our data and information. The standards of controls on UAM are high and best practices illustrate that the trends are towards further increasing requirements. We have identified control deficiencies related to UAM and a central task force was formed to coordinate, assess, monitor and track remediation efforts that resulted in increased focus by the Executive Board, senior management and ING staff. In 2017, management will continue to enhance the internal controls, mitigation and monitoring the progress of mitigation and remediation.

Cybercrime is a continuous threat to companies in general and to financial institutions specifically. Both the frequency and the intensity of attacks increase on a global scale. Threats from Distributed Denial of Service (DDoS), targeted attacks (also called Advanced Persistent Threats) and Ransomware intensify worldwide. ING Bank builds on its cybercrime resilience, further enhancing the control environment to protect, detect and respond to e-banking fraud, DDoS and targeted attacks. Additional controls continue to be embedded in the organisation as part of the overall internal control framework and are continuously re-assessed against existing and new threats. During 2016 ING did not experience any cyber incident that can be classified as material. ING provides continuous reporting on cyber incidents to the ECB.

ING Bank also works on strengthening its global cybercrime resilience including strong collaboration against cybercrime with the financial industry, law enforcement authorities, government (e.g. National Cyber Security Center) and Internet Service Providers (ISPs).

To address non-financial risk, global education and awareness in the form of e-learning modules, awareness sessions and other materials were provided on topics such as fraud and security, conflicts of interest, financial economic crime (FEC) and an onboarding e-learning for staff new to Operational Risk Management (ORM) worldwide. We continue to develop e-learning modules and campaigns to increase knowledge and awareness around topics like market abuse, anti-bribery, corruption and other financial/economic crimes. ING addresses personal conduct-related integrity risks by committing to conduct business in an honest and ethical manner and taking a zero tolerance approach to bribery and corruption in all of its relationships and business dealings, wherever it operates.

A comprehensive chapter on ING's risk management practices is part of the consolidated annual accounts of this Annual Report.

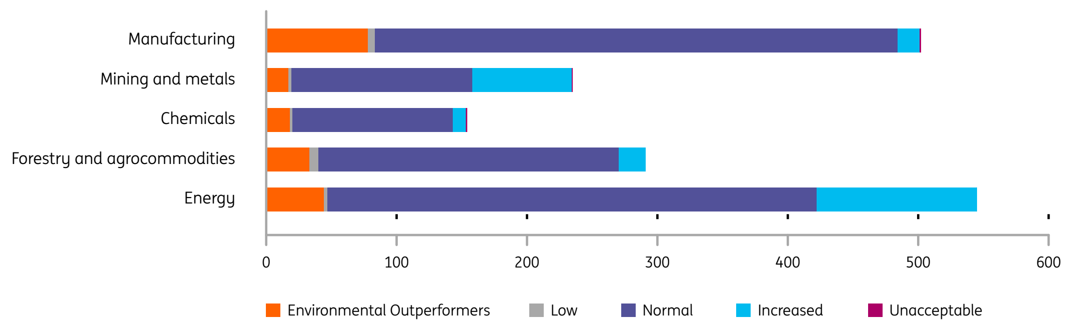
Environmental and Social Risk Management

ING Bank makes a positive contribution to global economic growth by promoting responsible lending and investment practices. Transparency, openness and regaining trust are material topics, both for ourselves and our stakeholders. ING's Environmental and Social Risk (ESR) policy framework underpins the choices we make in a consistent and transparent manner on how, where and with whom we do business.

The ESR policy framework gives ING Bank a competitive advantage by helping us to stay a step ahead as new environmental, social and human rights regulations are implemented globally. It is regularly updated to help ING and our clients enhance gradually the implementation of key standards of the UN Guiding Principles on Human Rights and the OECD Guidelines for Multinational Enterprises. Hence, the ESR policy framework also provides guidance for compliance with new directives and government decisions to combat climate change.

The ESR policy framework applies to all business conduct globally. It is on the Wholesale segment (34.6 percent of ING Bank's assets) that we focus our assessments and promote active ESR dialogue, as Wholesale clients run a more substantial risk of being involved with environmental and social issues. We have been working with Wholesale clients for more than 15 years to support them in understanding and managing their environmental and social impacts. The ESR policy framework also applies to ING's retail activities for mid-corporates and SMEs. This follows the framework's rationale and principles, but usually employs a simplified version of the approach used for Wholesale clients.

ESR client assessment outcome per sector policy



The ESR policy framework in action

We screen all ING clients across the entirety of our relationship. The ESR policy framework incorporates assessment tools that are used in ING's mainstream processes and systems. It is therefore fully integrated into regular client and transaction reviews. The ESR policy framework covers ESR-sensitive sectors and also includes explicit restrictions for activities not in line with ING Values (for example, companies involved in manufacturing cluster munitions), which we will not finance.

The graph above reflects portfolio figures per sector for ESR client assessment outcomes relating to Wholesale clients.

A client's ESR risk profile is just the starting point when assessing how the ESR policy framework will apply in each specific business engagement. One of the most important determinants of ING's ability to assess and manage environmental, social and human rights-related risks with a client is our proximity to the potential impact. The type of financial product or service offered to the client determines this proximity upfront and thus the appropriate level of due diligence and mitigation measures. The sector, operating context and geography will also provide an initial indication of the degree of ESR due diligence that is needed.

For example, the graph above highlights the risk profile of ING's mining and metals portfolio. One of the clients identified as high risk is Endeavour Mining, whose relationship is managed by ING's Mining & Metals (M&M) Structured Finance Team. The risk profile is high as Endeavour's gold mines and projects are located in high-risk countries including Mali, Burkina Faso, and Ivory Coast. As part of ING's site visits in 2013, 2015 and 2016 the M&M Team discussed with Endeavour's senior management the effective implementation of their Health, Safety and Environment policies across all their operations. The client provided information to ING on local employment, sanitation, clean drinking water, and the client's contribution to local development. As part of monitoring, the client provides regular reports on compliance with international standards and best practices. This example illustrates how ING focuses on and establishes meaningful and informed client engagements that better support our clients in managing environmental, social and human rights impacts.

In 2016, 4,433 wholesale lending engagements were assessed under the ESR policy framework. Engagements categorised as ESR low (86%) and medium risk (8%) were managed by local and regional risk management, whereas engagements categorised as ESR high risk (5%) required specialised advice by the ESR Department headquartered in Amsterdam. In 2016, this Department issued 214 advices which followed a deeper ESR assessment. Out of 214 cases related to high-risk engagement 47% received ESR positive advice, 26% negative and 27% were granted positive advice subject to conditions. These improvements play an important role in the transition towards an improved environmental and social performance on the ground.

The ESR policy framework follows mainstream approval processes and it is applied by well-trained and empowered people. In 2016, 545 risk, front office and compliance colleagues participated in ESR-dedicated training globally via webinars. Training also included classroom sessions in ING Amsterdam, Bratislava, Brussels, Paris, Frankfurt, Luxembourg, Geneva, Moscow and Istanbul.

Training

	2016	2015	2014
Number of employees	545	479	375

The ESR policy framework contributed to ING being ranked the most sustainable bank out of 395 banks in 2016 by Sustainalytics, a global provider of environmental, social and governance (ESG) research and ratings. And we were again included in the DJSI World Index and the Europe Index in the category "banks".

Our commitment to sustainability and a positive ESR profile has also contributed to ING becoming the Environmental Agent Bank to two large and complex project financings where we take responsibility for coordinating the environmental, social and human rights information for the other lenders in the syndication.

Developing best practice

Beyond stimulating higher environmental and social performance in our portfolio, ING actively collaborates with other institutions and regulators to address environmental challenges that are sector- not just client-specific.

- **ING and climate change:** In 2015, ING decided to cease financing new coal-fired power plants and coal mines and to continue to reduce our coal portfolio. ING declined approximately 10 coal-related projects or transactions in 2016 as a result of this policy.

- We recognise that regulators are increasingly concerned with climate change risk as more countries ratify the Paris Agreement. We participate in a number of climate change initiatives, including round tables. And ING has been engaging with the Financial Stability Board Task Force on Climate-related Financial Disclosures, which is developing voluntary, consistent climate-related financial risk disclosures for use by companies in providing information to stakeholders.

- **ING and Human rights:** In October 2016, ING became an adhering bank to the Dutch banking sector agreement on international responsible business conduct regarding human rights. The Agreement aims to set the standard on how Dutch banks should organise themselves in order to address human rights impacts through the businesses they finance. One of the challenges pointed out by ING during our human rights presentation in the UN Forum on Business and Human Rights was the need for alignment and policy coherence on state and industry level in order to ensure that those seeking to do “the right thing” are not pushed out of competitive markets. ING is increasing its efforts to engage with other financial institutions in the Netherlands and globally to promote a common level playing field in business and human rights. This is done through our ongoing participation in the Thun Group of banks, which promote dialogue on human rights among banks, and through our formal advisory role to the OECD on responsible business conduct in the financial sector.

- **ING and Biodiversity:** As a member of the Round Table for Sustainable Palm Oil (RSPO), we participate in the RSPO Financial Institutions Task Force, which discusses issues linked to deforestation in the palm oil supply chain. In 2016, we supported the disclosure of concession maps of palm oil suppliers’ plantations in Southeast Asia. This improves transparency and addresses illegal deforestation and fire monitoring by attributing land to the owners.

- During 2016, we actively supported the Cross-Sector Biodiversity Initiative (CSBI), a partnership between the oil & gas industry (IPIECA), mining and metals (ICMM) and the Equator Principles Association to develop and share good practices related to biodiversity and ecosystem services.

By participating in the above initiatives, we aim to contribute positively to a level playing field that provides feasible and pragmatic feedback reflecting the views of our clients, shareholders, employees, regulators and other stakeholders.

Regulatory developments

Banks must contend with new fundamental reform initiatives for some aspects of Basel III that are evolving into a so-called “Basel 3.5” capital regime. We are disappointed by the continuing lack of clarity around these reforms to capital rules to be set by the Basel Committee. This uncertainty makes it increasingly difficult for banks to actively support the economies where they operate, particularly in financing areas such as mortgages, SMEs and areas that structurally support economic recovery, including utilities, renewables and infrastructure.

One element of Basel III is the possible restriction on distributable items (established in the EU in article 141 of the Capital Requirements Regulation). This limits the ability of the bank to pay dividends, hybrid coupons and/or management remuneration if its capital drops below the sum of its Pillar 1 and Pillar 2 requirements and combined buffer requirements, often referred to as the Maximum Distributable Amount (MDA) trigger. As part of the 2016 Supervisory Review and Evaluation Process (see more on SREP below), the ECB decided to split the Pillar 2 requirement into:

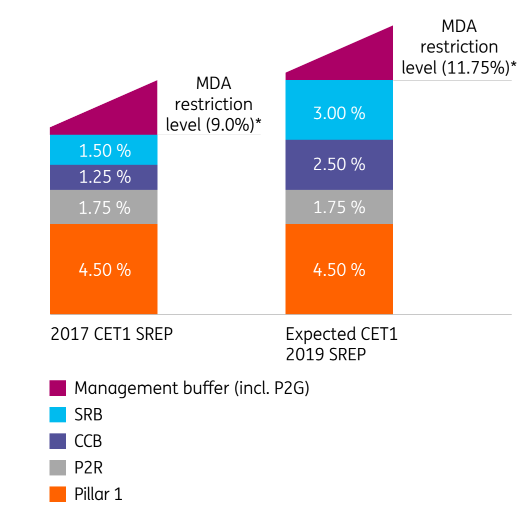
- Pillar 2 requirements (P2R), which are binding and thus breaches have direct legal consequences.
- Pillar 2 guidance (P2G), which is not directly binding, so a failure to meet P2G does not automatically trigger legal action. Nonetheless, the ECB expects banks to meet P2G and a breach of the P2G will lead to the ECB taking fine-tuned measures based on the individual situation of the bank.

Requirement and Guidance for ING Group in 2017

ING Group has been notified of the European Central Bank (ECB) decision on the 2016 Supervisory Review and Evaluation Process (SREP), which sets the capital requirements for 2017. 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) that 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. ING Group’s fully-loaded common equity Tier 1 ratio of 14.2% at 31 December 2016 is well in excess of this requirement.

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 on paying dividends, coupons on AT1 instruments and bonuses. We believe that the impact from the Countercyclical Buffer (CCyB) is negligible at this stage. With a 14.2% fully-loaded Group CET1 ratio as at 31 December 2016, ING is already in compliance with the expected fully-loaded requirement of 11.75% as of 2019 .

ING Group SREP



* Excluding CCyB which is negligible at this stage.

Bank Recovery and Resolution Directive

Since its adoption by the European Parliament in 2014, the Bank Recovery and Resolution Directive (BRRD) has come into effect in most EU countries after transposition into national law, including in the Netherlands. The BRRD aims to safeguard financial stability and minimise the use of public funds in cases where banks face financial distress or fail. To comply with the new rules, banks across the EU need to have recovery plans in place and to cooperate with resolution authorities to determine and make feasible the preferred resolution strategy.

ING has set up a very comprehensive recovery plan to ensure the bank's readiness and support decisive action to tackle financial crises on its own. Effective since 2012, the plan is updated annually to make sure it stays fit for purpose and to ensure ING's ability to act decisively. In 2016, the plan was extensively updated to bring it in accordance with the BRRD. The completeness, quality and credibility of the updated plan is assessed annually by ING's regulators.

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 diligently with the different resolution authorities to determine a resolution strategy and to identify potential impediments to resolution. Following an intensive 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. In November 2016, we concluded that ING Group should be our designated resolution entity. At the end of January 2017, the Single Resolution Board (SRB) 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 entity'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 Eligible Liabilities (MREL).

On 6 April 2016, ING Bank 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 notes.

A consistent approach to capital management

ING Group's overall approach to capital management is to make sure capital is adequate to cover the economic risk at all levels and to ensure compliance with regulations. ING Group reassesses these levels constantly to ensure optimal capital use. The continued strength of ING's capital position, the adequacy of our financial position and our risk management effectiveness allow us to empower people and businesses to realise their goals. They make it possible to increase our lending capabilities, pay dividend on common shares to shareholders and invest in new technologies and best practices. In this way, ING delivers shareholder returns while at the same time investing in further innovation of products and services.

ING's Capital Management strategy is driven by its strategic aims and its risk appetite. Our policy is to retain sufficient financial flexibility to implement ING's strategy in all market conditions. ING's risk appetite statements form the basis of the capital plan. The capital plan sets targets above the minimum regulatory requirements. The risk appetite statements and targets are developed and communicated to the different businesses in line with capital allocation. Policies for recovery planning and resolution are a natural extension of ING's capital management policies and are fully aligned with ING's risk management framework.

Capital distribution

ING Group manages capital at Group as well as Bank level and allocates capital within its different entities to meet local capital requirements. ING's subsidiaries are well capitalised. ING sets targets for individual businesses above the minimum local capital requirements and aims for an efficient distribution of capital. The capital provides room for loan growth and supports the acceleration of our Think Forward strategy to achieve continued commercial growth, an improved customer experience and quicker delivery of new products.

Stress testing

Stress testing is an integral component of our risk and capital management framework. It allows us to (i) assess potential vulnerabilities in our businesses, business model or portfolios; (ii) understand the sensitivities of the core assumptions in our strategic and capital plans; and (iii) improve decision-making through balancing risk and return.

In addition to internal stress test scenarios reflecting the outcomes of the annual risk assessment, ING also participates in regulatory stress test exercises. ING was subject to the 2016 EU-wide stress test conducted by the European Banking Authority (EBA) in cooperation with the European Central Bank (ECB), De Nederlandsche Bank (DNB), the European Commission and the European Systemic Risk Board (ESRB). The adverse stress-test scenario was set by the ECB/ESRB and covers a three-year time horizon (2016-2018). The stress test was carried out applying a static balance sheet assumption as at December 2015, and therefore does not take into account current or future business strategies and management actions.

The results of the EBA stress test reaffirmed the resilience of our business model and the strength of ING's capital base. Our commitment to maintain a robust, fully-loaded Group CET1 ratio in excess of prevailing requirements remains. Under the hypothetical baseline scenario and EBA's methodological instructions, ING Group would have a fully loaded common equity Tier 1 capital ratio (CET1) of 12.5% in 2018. Whereas, under the hypothetical adverse scenario and EBA's methodological instructions, ING Group would have a fully loaded CET1 ratio of 9.0% in 2018.

Capital developments at ING Group

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 strong capital position ensures we can continue to support our customers to realise their financial futures.

In January 2016, ING successfully sold 33 million ordinary shares of NN Group, and in February 2016 it exchanged the final tranche of EUR 337.5 million mandatory exchangeable subordinated notes, which had been 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 the NN shares, Tier 1 instruments 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.

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 successfully issued EUR 1.0 billion of 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 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, that can be called by ING Group five years after issuance, has a coupon of 6.875%.

ING Group's fully-loaded common equity Tier 1 ratio was 14.2% at the end of 2016. The proposed dividend, to be paid in May 2017, has already been excluded from ING Group's capital base, in line with regulatory requirements. The Group's phased-in common equity Tier 1 ratio at the end of the year increased by 1.2%-point from the previous year to 14.1%, largely due to higher capital and lower RWA. The fully loaded CET1 ratio showed a slightly more positive development compared to the phased-in ratio which is largely explained by the larger reduction of the deduction of significant investments in financial institutions due to the sale of the NN Group shares. ING Group's phased-in (transitional) common equity Tier 1 ratio of 14.1% is well in excess of the 10.25 % common equity Tier 1 2016 requirement and the 9.0% common equity Tier

1 2017 requirement. 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%.

Dividend

ING'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.

Capital development at ING Bank

ING Bank's capital position is primarily managed through its published common equity Tier 1 ratio and leverage ratio. These elements are the most widely used variables for assessing bank capitalisation. ING Bank also takes other constraints into account, including:

- Additional regulatory capital requirements, including the amount of Tier 1 capital, total capital and the Basel I floor.
- Economic capital. Although it is currently not a constraining factor, economic capital is used to manage the bank's risk profile and to set limits.
- Rating agency considerations. Each rating agency provides a different analysis and specific topics may need to be addressed.

A strong capital base

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. A 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. The total capital ratio (including grandfathered securities) increased to 17.8%.

In April 2016, ING Bank 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 notes.

ING also demonstrated in 2016 the ability to generate capital consistently through strong profitability. ING currently has a strong capital position, meeting all regulatory requirements and capable of withstanding market challenges and new regulations. The strength of the balance sheet provides a firm base to execute further lending capabilities, serving customer needs, as well as paying dividends.

Read more in the "Capital management"chapter, part of the Consolidated annual accounts in this Annual Report.