

## CREDIT OPINION

5 July 2017

Update

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### RATINGS

#### ING DiBa AG

Domicile	Frankfurt am Main, Germany
Long Term Debt	Not Assigned
Type	Not Assigned
Outlook	Not Assigned
Long Term Deposit	A2
Type	LT Bank Deposits - Fgn Curr
Outlook	Stable

Please see the [ratings section](#) at the end of this report for more information. The ratings and outlook shown reflect information as of the publication date.

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## ING DiBa AG

### Semiannual update

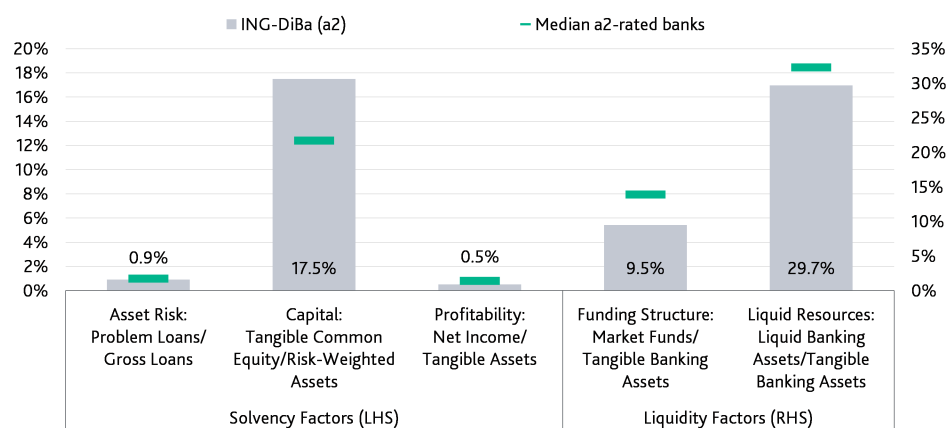
#### Summary Rating Rationale

We assign A2/P-1 deposit ratings and an Aa3(cr)/P-1(cr) Counterparty Risk Assessment to ING DiBa AG (ING-DiBa). We further assign an a2 Baseline Credit Assessment (BCA) and Adjusted BCA to the bank.

ING-DiBa's A2 ratings reflect (1) the bank's a2 BCA and Adjusted BCA; and (2) our Advanced Loss Given Failure (LGF) analysis, which takes into account the severity of loss faced by the different liability classes in resolution and does not result in rating uplift for ING DiBa's deposit ratings.

The a2 BCA reflects ING-DiBa's low asset risk, solid capitalisation, stable profitability and solid funding structure. At the same time, the BCA takes into account (1) ING-DiBa's gradual repositioning towards a universal banking franchise; as well as (2) the challenges that the bank faces to generate assets quickly enough to invest excess cash from its growing deposit base without compromising its currently healthy asset risk profile. The BCA is capped at two notches above the BCA of its Dutch parent bank, ING Bank N.V. (ING Bank, A1 positive, A1 positive, baa1<sup>1</sup>). This reflects that the weaker credit strength of the parent bank, coupled with ING-DiBa's brand identity and resulting risk correlation with ING Group, limits the German subsidiary's credit strength.

Exhibit 1  
Rating Scorecard - Key Financial Ratios



Source: Moody's Financial Metrics

## Credit Strengths

- » Solid regulatory capitalisation
- » Profitability remains sound despite pressure from low interest rates
- » The funding profile benefits from a large deposit base; no dependence on market funds

## Credit Challenges

- » Maintain a modest level of problem loans in retail lending over the cycle
- » Manage asset risk and sustain strong loan quality in the bank's rapidly expanding wholesale lending businesses, despite pressure to invest excess liquidity in a low interest-rate environment

## Rating Outlook

- » The outlook on ING-DiBa's long-term deposit ratings is stable, reflecting our expectation that (1) the ratings of its parent ING Bank will remain stable; and (2) ING DiBa will maintain its sound asset quality and defend its comfortable capital levels.

## Factors that Could Lead to an Upgrade

- » An upgrade of ING DiBa's deposit ratings could be prompted by (1) a higher BCA; and/or (2) an increase in rating uplift resulting from our Advanced LGF analysis.
- » Upward pressure on ING DiBa's a2 BCA remains subject to an improvement of ING Bank's baa1 BCA, because we currently cap ING-DiBa's BCA at two notches above its parent's BCA. If ING DiBa's BCA were less constrained by the BCA of its parent, upward pressure on ING DiBa's BCA could be exerted if the bank were to (1) at least maintain its currently sound capitalisation; (2) manage to successfully diversify its loan book without compromising on its asset quality; and (3) further improve its financial performance whilst maintaining a very low market funding dependence.
- » Upwards pressure on the deposit ratings could further develop if ING-DiBa were to issue meaningful amounts of debt to provide an additional buffer for deposit holders.

## Factors that Could Lead to a Downgrade

- » A downgrade of ING DiBa's deposit ratings could be triggered as a result of (1) a downgrade of the bank's BCA; and/or (2) a lower relative deposit volume in our Advanced LGF analysis.
- » ING DiBa's BCA could be downgraded in the event of (1) a weakening of the parent bank's credit profile, constraining its BCA further; (2) an unexpected and more significant reduction of ING DiBa's regulatory capital ratios, as a result of its diversification strategy into wholesale lending assets, or through the parent bank reallocating capital within ING Group N.V. (ING Group, Baa1 stable<sup>2</sup>); (3) a significantly higher dependence on confidence-sensitive market funding sources, especially if conducted in foreign currency; and/or (4) increasing interdependencies between ING-DiBa and ING Group.
- » Negative pressure on the deposit ratings could also arise from a lower relative deposit volume in favour of an increase of other instruments (e.g. covered bonds or money market instruments) located above deposits in our Advanced LGF analysis.

This publication does not announce a credit rating action. For any credit ratings referenced in this publication, please see the ratings tab on the issuer/entity page on [www.moody's.com](http://www.moody's.com) for the most updated credit rating action information and rating history.

## Key Indicators

Exhibit 2

### ING DiBa AG (Consolidated Financials) [1]

	12-15 <sup>2</sup>	12-14 <sup>2</sup>	12-13 <sup>3</sup>	12-12 <sup>3</sup>	12-11 <sup>3</sup>	CAGR/Avg. <sup>4</sup>
Total Assets (EUR billion)	144	137	127	120	110	71 <sup>5</sup>
Total Assets (USD billion)	156	165	176	158	142	2.4 <sup>5</sup>
Tangible Common Equity (EUR billion)	6.5	6.0	5.7	5.4	5.2	5.4 <sup>5</sup>
Tangible Common Equity (USD billion)	7.0	7.3	7.9	7.1	6.8	0.8 <sup>5</sup>
Problem Loans / Gross Loans (%)	0.8	1.1	0.9	0.9	1.0	0.9 <sup>6</sup>
Tangible Common Equity / Risk Weighted Assets (%)	17.5	18.3	19.5	20.6	23.7	17.9 <sup>7</sup>
Problem Loans / (Tangible Common Equity + Loan Loss Reserve) (%)	11.5	14.6	12.7	12.6	12.9	12.9 <sup>6</sup>
Net Interest Margin (%)	1.3	1.2	1.1	1.0	1.3	1.2 <sup>7</sup>
PPI / Average RWA (%)	3.4	2.9	2.9	2.4	3.6	3.2 <sup>7</sup>
Net Income / Tangible Assets (%)	0.5	0.4	0.4	0.3	0.4	0.4 <sup>6</sup>
Cost / Income Ratio (%)	39.6	42.8	45.2	51.8	44.9	44.8 <sup>6</sup>
Market Funds / Tangible Banking Assets (%)	9.5	9.0	9.4	11.0	10.2	9.8 <sup>6</sup>
Liquid Banking Assets / Tangible Banking Assets (%)	29.7	32.2	30.8	28.1	23.0	28.8 <sup>6</sup>
Gross Loans / Due to Customers (%)	81.3	78.8	80.1	83.8	82.8	81.3 <sup>6</sup>

[1] All figures and ratios are adjusted using Moody's standard adjustments [2] Basel III - fully-loaded or transitional phase-in; IFRS [3] Basel II; IFRS [4] May include rounding differences due to scale of reported amounts [5] Compound Annual Growth Rate (%) based on time period presented for the latest accounting regime [6] Simple average of periods presented for the latest accounting regime. [7] Simple average of Basel III periods presented

Source: Moody's Financial Metrics

## Detailed Rating Considerations

### Solid regulatory capitalisation

ING-DiBa reported a solid Common Equity Tier 1 (CET1) capital ratio of 14.9% as of December 2015 under the Capital Requirements Regulation and Directive (CRR/CRD IV), down from 15.8% as of December 2014 (the delta between our 2015 IFRS-based TCE ratio of 17.5% and the CET1 ratio of 14.9% mainly stems from the bank's 340f German GAAP reserve and its 2015 after-tax retained earnings not yet included in regulatory capital as of 31 December 2015). The CET1 ratio declined as the bank continued to rapidly expand its wholesale banking business in order to achieve a better, more remunerative investment of its ample excess liquidity generated by its strong retail deposit franchise. Given plans to further grow the bank's commercial lending book, the CET1 ratio will likely soften more in the coming years, driven by the additional risk weighted assets. Overall, though, we expect ING-DiBa to remain comfortably capitalized, as we assume that the bank will maintain sufficient flexibility to retain a portion of its annual profits, notwithstanding the automatic transfer of profits under a profit and loss transfer agreement with its holding company, ING Deutschland GmbH (unrated). There exists a potential risk that the parent bank, in the interest of optimising the group's capital allocation, may require ING-DiBa to upstream capital through dividends, which could also be supported by changes in regulation under the single supervisory mechanism that took effect in November 2014. However, we currently deem such a scenario unlikely.

The bank's leverage ratio (tangible common equity, TCE, relative to total assets) of 4.5% as of 31 December 2015 remained below our 5% baseline requirement and is reflected in a one-notch negative adjustment in our assigned Capital score of aa3. We have not factored in a substantial weakening in capitalisation levels that might result from investments into additional wholesale portfolios, as we expect this to be managed carefully by the bank. However, the development of capital ratios warrants close monitoring, in our view.

### Low level of problem loans, but wholesale lending ramp-up leads to increased risk profile

ING-DiBa grew total loans and advances by 9% year-over-year to €97.9 billion as of 31 December 2015. The loan book's concentration of residential mortgages remained at a high level, although the mortgage-loan book only grew 3% year-over-year to €64.7 billion as of end-2015 (2014: €63.2 billion). ING DiBa's total lending growth - and thus its asset risk - was driven by a steep 64% year-over-year growth of the bank's Corporate Banking division, to €17.1 billion. ING-DiBa manages high cash-inflows from unabated deposit growth

and aims to diversify away from German mortgage lending. As such, we expect that the bank will continue its focus on corporate and trade finance, as well as consumer and other non-mortgage lending, thereby elevating the risk profile of the bank.

Despite these pressure points, credit conditions in Germany will likely remain benign in the medium-term future and we therefore anticipate a broadly stable operating environment for retail mortgage loans and consumer credit. This, along with the bank's prudent underwriting practices and a rigid termination process for non-performing loans, will likely support the stability of the bank's problem loan metrics going forward. However, ING-DiBa's asset quality is becoming increasingly dependent on the performance of its newly acquired wholesale assets. We have therefore captured the bank's considerable loan growth in its commercial lending book, which results in partly unseasoned portfolios, as well as its sector concentration in retail mortgages in our assigned Asset Risk score of aa2 (three notches below the macro adjusted score).

The impaired loan ratio for ING-DiBa's residential mortgage portfolio was a low 0.9%, and for the riskier, but much smaller €5.7 billion consumer loans portfolio a modest 2.8% as of yearend 2015. The impaired loan ratio on the growing €17.1 billion commercial banking portfolio was also low at 0.4%, whereby most of the impaired loans were fully collateralised or guaranteed. ING-DiBa's intra-group exposures are contained within regulatory limits and are, to a large extent, collateralised.

### **Profitability remains sound despite pressure from low interest rates**

Despite the challenges of the low interest-rate environment, we expect that ING-DiBa's risk-adjusted profitability has remained largely stable during 2016. Owing to the strong competitive edge afforded by its lean, low-cost business model, ING-DiBa has more leeway than other banks to manage its product pricing, in particular its funding costs. For instance, in June 2016, the bank reduced its interest rate on current accounts from 0.5% to 0.35% for existing customers with less than €100,000 in deposits. A reduction from 0.6% to 0.5% was enacted in December 2015. Despite this move, ING-DiBa's interest offerings on deposits remain at the upper end of market rates and imply that it can still adjust deposit pricing further downwards, whereas other banks pay minimal or no interest and would need to move into negative territory to protect their margins. The rising economies of scale of the growing franchise and its focus on technology leadership confer additional benefits, as ING-DiBa displays some of the strongest efficiency metrics in the German retail banking market.

ING-DiBa's risk charges could rise, partly because the low charges in recent quarters on its mortgage-loan book benefitted from an exceptionally benign credit environment, and because its growing consumer loans and commercial lending activities will gradually drive the average cost of risk up. However, we consider the risk to profits so far to be manageable and note that the bank can absorb a high multiple of recent years' risk provisions in its income statement. The baa3 Profitability score reflects positively our assessment of the relative resilience of the bank's profits to the adverse operating environment, as well as the high risk-charge coverage by pre-provision income.

ING-DiBa's record pre-tax profit of €1,115 million for 2015 (an increase of 26% year-on-year) was driven by a steep 11% rise in net interest income, reflecting continued margin recovery on the back of lower interest expenses, as well as income from higher-yielding assets, and very low risk charges.

### **The funding profile benefits from a large deposit base; no dependence on market funds**

As a primarily retail-funded institution, ING-DiBa's strong liquidity profile is a key credit strength. Given our forecast of growing retail savings in Germany and gradually rising demand for direct banking, we expect that ING-DiBa's comfortable funding profile and liquidity situation will remain robust throughout 2017 and beyond. The bank's Funding Structure score of aa2 reflects the fact that its modest amount of market funds largely consists of funds from development banks and covered bonds. The score also captures the high granularity of the majority of ING-DiBa's retail deposits, which we consider to be generally more stable than those of large, institutional deposits.

ING-DiBa comfortably meets the new CRR-based liquidity and funding requirements, as illustrated by its strong liquidity coverage and net stable funding ratios (LCR/NSFR). Also, the bank could use its largely unencumbered mortgage-loan book in order to raise major (secured) funds at attractive rates.

## Notching Considerations

### AFFILIATE SUPPORT

We believe that the parent bank, ING Bank N.V., would likely support its German subsidiary in case of need. Therefore, we assume very high affiliate support for ING-DiBa in the event of need. However, this does not result in any rating uplift because ING-DiBa's BCA is higher than that of its parent bank.

We allow for a two-notch flexibility above the parent bank's BCA because, under the EU's Bank Recovery and Resolution Directive (BRRD), Europe's resolution regime may allow for the ring-fencing of strong and viable subsidiaries in the event of a resolution prompted by distress at the parent level.

### LOSS GIVEN FAILURE

ING-DiBa is subject to the EU BRRD, which we consider to be an Operational Resolution Regime. We therefore apply our Advanced LGF analysis, considering the risks faced by the different debt and deposit classes across the liability structure should the bank enter resolution.

In this analysis, we assume residual tangible common equity of 3% and losses post-failure of 8% of tangible banking assets, a 25% runoff in "junior" wholesale deposits, a 5% run-off in preferred deposits. These ratios are in line with our standard assumptions.

For ING-DiBa's deposits, our LGF analysis indicates a moderate loss-given-failure, leading us to position the deposit rating in line with the bank's a2 Adjusted BCA. This is in part attributable to our assumption that only a very small percentage (10%) of ING-DiBa's deposit base can actually be considered junior and qualify as bail-in-able under the BRRD.

### GOVERNMENT SUPPORT

German banks operate in an environment of materially weakened prospects for financial assistance from the government. We do not consider ING-DiBa to be of high domestic systemic relevance given the bank's low complexity and modest interconnectedness with the financial sector. Therefore, we do not include any rating uplift for government support in our deposit ratings for ING-DiBa.

## About Moody's Bank Scorecard

Our Scorecard is designed to capture, express and explain in summary form our Rating Committee's judgment. When read in conjunction with our research, a fulsome presentation of our judgment is expressed. As a result, the output of our Scorecard may materially differ from that suggested by raw data alone (though it has been calibrated to avoid the frequent need for strong divergence). The Scorecard output and the individual scores are discussed in rating committees and may be adjusted up or down to reflect conditions specific to each rated entity.

## Rating Methodology and Scorecard Factors

Exhibit 3

ING DiBa AG

### Macro Factors

**Weighted Macro Profile**                      **Very Strong -**                      **100%**

Factor	Historic Ratio	Macro Adjusted Score	Credit Trend	Assigned Score	Key driver #1	Key driver #2
Solvency						
Asset Risk						
Problem Loans / Gross Loans	0.9%	aa2	← →	a2	Unseasoned risk	Loan growth
Capital						
TCE / RWA	17.5%	aa2	← →	aa3	Nominal leverage	
Profitability						
Net Income / Tangible Assets	0.5%	baa3	← →	baa3	Earnings quality	
Combined Solvency Score		a1		a2		
Liquidity						
Funding Structure						
Market Funds / Tangible Banking Assets	9.5%	aa3	← →	aa2	Deposit quality	Market access
Liquid Resources						
Liquid Banking Assets / Tangible Banking Assets	29.7%	a2	← →	a2	Asset encumbrance	
Combined Liquidity Score		a1		aa3		
Financial Profile				a1		
Business Diversification				0		
Opacity and Complexity				0		
Corporate Behavior				0		
Total Qualitative Adjustments				0		
Sovereign or Affiliate constraint:				A2		
Scorecard Calculated BCA range				a1-a3		
Assigned BCA				a2		
Affiliate Support notching				0		
Adjusted BCA				a2		
<b>Balance Sheet</b>		<b>in-scope (EUR million)</b>	<b>% in-scope</b>	<b>at-failure (EUR million)</b>	<b>% at-failure</b>	
Other liabilities		18,521	12.9%	27,000	18.8%	
Deposits		121,126	84.1%	112,647	78.2%	
Preferred deposits		109,013	75.7%	103,563	71.9%	
Junior Deposits		12,113	8.4%	9,085	6.3%	
Equity		4,319	3.0%	4,319	3.0%	
Total Tangible Banking Assets		143,966	100%	143,966	100%	

Debt class	De jure waterfall		De facto waterfall		Notching		LGF notching guidance versus BCA	Assigned LGF notching	Additional notching	Preliminary Rating Assessment
	Instrument volume + Subordination	Sub-ordination	Instrument volume + Subordination	Sub-ordination	De jure	De facto				
Counterparty Risk Assessment	9.3%	9.3%	9.3%	9.3%	1	1	1	2	0	aa3 (cr)
Deposits	9.3%	3.0%	9.3%	3.0%	0	0	0	0	0	a2

Instrument class	Loss Given Failure notching	Additional Notching	Preliminary Rating Assessment	Government Support notching	Local Currency Rating	Foreign Currency Rating
Deposits	0	0	a2	0	A2	A2

Source: Moody's Financial Metrics

## Ratings

Exhibit 4

Category	Moody's Rating
<b>ING DIBA AG</b>	
Outlook	Stable
Bank Deposits	A2/P-1
Baseline Credit Assessment	a2
Adjusted Baseline Credit Assessment	a2
Counterparty Risk Assessment	Aa3(cr)/P-1(cr)

Source: Moody's Investors Service

## Endnotes

- 1 The ratings shown are ING Bank's deposit rating and outlook, its senior unsecured rating and outlook, and its BCA
- 2 The ratings shown for ING Group represent the bank's senior unsecured rating and outlook

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