

CREDIT OPINION

21 December 2017

Update

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RATINGS

ING DiBa AG

Domicile	Frankfurt am Main, Germany
Long Term Debt	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

Update to credit analysis

Summary

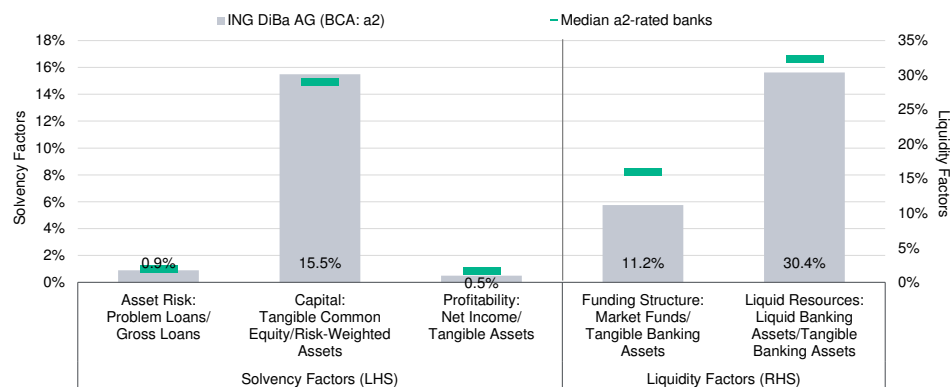
We assign A2/P-1 deposit ratings and an Aa3(cr)/P-1(cr) Counterparty Risk Assessment to [ING-DiBa AG](#) (ING-DiBa). We further assign an a2 Baseline Credit Assessment (BCA) and an a2 Adjusted BCA to the bank.

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 more 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, Aa3 stable, Aa3 stable, baa¹). 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

- » The funding profile benefits from a large deposit base; de minimis dependence on market funds
- » Profitability remains sound despite pressure from low interest rates
- » Solid regulatory capitalisation

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 deposit ratings is stable, reflecting our expectation that (1) the BCA 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 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 further diversify its loan book without compromising on its asset quality; and (3) 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 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) a multi-notch downgrade of ING-DiBa's Financial Profile due to 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 stable²); (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 for the most updated credit rating action information and rating history.

Key indicators

Exhibit 2

ING DiBa AG (Consolidated Financials) [1]

	12-16 ²	12-15 ²	12-14 ²	12-13 ³	12-12 ³	CAGR/Avg ⁴
Total Assets (EUR billion)	158	144	137	127	120	71 ⁵
Total Assets (USD billion)	166	156	165	175	158	1.3 ⁵
Tangible Common Equity (EUR billion)	6.9	6.5	6	5.7	5.4	6.6 ⁵
Tangible Common Equity (USD billion)	7.3	7	7.3	7.9	7.1	0.8 ⁵
Problem Loans / Gross Loans (%)	0.7	0.8	1.1	0.9	0.9	0.9 ⁶
Tangible Common Equity / Risk Weighted Assets (%)	15.5	17.5	18.3	19.5	20.6	17.1 ⁷
Problem Loans / (Tangible Common Equity + Loan Loss Reserve) (%)	10.2	11.5	14.6	12.7	12.6	12.3 ⁶
Net Interest Margin (%)	1.3	1.3	1.2	1.1	1.0	1.2 ⁷
PPI / Average RWA (%)	3.1	3.4	2.9	2.9	2.4	3.2 ⁷
Net Income / Tangible Assets (%)	0.5	0.5	0.4	0.4	0.3	0.4 ⁶
Cost / Income Ratio (%)	39.8	39.7	42.8	45.2	51.8	43.9 ⁶
Market Funds / Tangible Banking Assets (%)	11.2	9.5	9.0	9.4	11.0	10.0 ⁶
Liquid Banking Assets / Tangible Banking Assets (%)	30.4	29.7	32.2	30.8	28.1	30.2 ⁶
Gross Loans / Due to Customers (%)	82.2	81.3	78.8	80.1	83.8	81.2 ⁶

[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

Profile

ING-DiBa is the third-largest retail bank in [Germany](#), with 8.8 million customers. In addition, the bank has built up a growing presence in commercial banking in recent years, with operations being closely integrated into the global wholesale banking network of ING Group. As of 31 December 2016, ING-DiBa reported total consolidated assets of €158 billion and net customer loans of €106 billion, of which €68 billion were residential mortgages and €26 billion wholesale banking loans. The bank's asset base, which also included a €39 billion investment portfolio, was funded to a large part by €130 billion in customer deposits.

On the retail side, ING-DiBa is a pure direct bank, mainly providing banking services in Germany, with a smaller presence in Austria. The bank focuses on residential mortgage lending and savings and current accounts, but its range of retail products and services also includes consumer loans, direct securities accounts, and brokerage services.

In wholesale banking, ING-DiBa provides corporate lending and transaction services, structured finance and real estate finance, and financial markets products, such as hedges for currency, commodity, and interest rate risk. The bank's wholesale customer base mostly comprises large German and Austrian corporates with revenue in excess of €250 million, as well as international investors, such as pension funds. In addition, certain lending portfolios originated by ING Group are transferred to and booked within the wholesale banking segment of ING-DiBa.

ING-DiBa was established in October 1965. As of 31 December 2016, the bank was wholly owned by the Netherlands-based ING Group, through ING Deutschland GmbH.

Detailed credit considerations

Solid regulatory capitalisation

ING-DiBa reported a solid Common Equity Tier 1 (CET1) capital ratio of 13.2% as of December 2016 under the Capital Requirements Regulation and Directive (CRR/CRD IV), down from 14.9% as of December 2015 (the delta between our 2016 IFRS-based tangible common equity, TCE, ratio of 15.5% and the German GAAP-based CET1 ratio of 13.2% mainly stems from the bank's 340f reserve under German GAAP, which is included in TCE, but excluded from CET1, as well as its 2016 after-tax retained earnings not yet included in regulatory capital as of 31 December 2016).

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.

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 (TCE relative to total assets) of 4.4% as of 31 December 2016 remained below our 5% baseline requirement and is reflected in a one-notch negative adjustment for our Capital score. We have also factored in a further weakening in capitalisation levels that will likely result from investments into additional wholesale portfolios, leading us to an assigned Capital score of a1, two notches below the macro adjusted score.

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

ING-DiBa grew total gross loans and advances by 9% year-over-year to €107 billion as of 31 December 2016. The loan book's concentration of residential mortgages remained at a high level, although the mortgage-loan book grew a somewhat lower 5% year-on-year to €68 billion as of end-2016 (2015: €65 billion). ING-DiBa's total lending growth - and thus its asset risk - was driven by a steep 69% year-on-year growth of the bank's wholesale banking division, to €29 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 a2 (three notches below the macro adjusted score).

The impaired loan ratio for ING-DiBa's residential mortgage portfolio was a low 0.7%, and for the riskier, but much smaller €6.5 billion consumer loan portfolio a modest 2.9% as of year-end 2016. The impaired loan ratio on the growing €29 billion commercial banking portfolio was also low at 0.2%, 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, ING-DiBa posted record pre-tax profit of €1,234 million for 2016 (an increase of 11% year-on-year), which was driven by a steep 9% rise in net interest income, reflecting continued margin recovery on the back of lower interest expenses, as well as income from higher-yielding assets. In addition, risk charges remained very low, which helped to offset a 7% rise in operating expenses.

Interest expenses declined by a substantial 17% in 2016, reflecting a further reduction in the interest offering on deposits during the period. While at the start of 2015, ING-DiBa still paid 0.80% interest on current accounts for existing customers with less than €100,000 in deposits, the bank successively lowered this rate to 0.60% in March 2015, 0.50% in December 2015, and 0.35% in June 2016. During 2017, the interest rate was further reduced to 0.20% in March 2017 and to 0.10% in August 2017, but now only applies only to the first €50,000 in deposits, with balances above that level being remunerated at 0.05%.

While ING-DiBa has now also almost reached the zero interest rate floor for deposits and margins in the retail business are expected to contract in 2018 and beyond, the bank should be able to protect its topline through further volume growth and the further build-

out of its wholesale banking segment. In addition, the rising economies of scale of the growing franchise and its focus on technology leadership should enable the bank to continue to display 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 baa2 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.

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 2018 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.

ING-DiBa's BCA is supported by Germany's Very Strong- Weighted Macro Profile

ING-DiBa's Weighted Macro Profile is Very Strong-, at the same level as [Germany's Macro Profile](#). Germany accounted for 61.6% of total loans at the end of 2016, 27.1% were related to other EU countries (16.2% stemmed from the Netherlands), and the remaining 11.3% were sourced in other international markets. Because the Macro Profile of Germany being among the highest globally, any further internationalisation of the asset base is likely to weaken the Weighted Macro Profile of ING-DiBa. This in turn could result in pressure on the bank's standalone financial strength.

Support and structural considerations

Affiliate support

We believe that the parent bank, ING Bank, 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 analysis

ING-DiBa is subject to the EU BRRD, which we consider to be an Operational Resolution Regime. We therefore apply our Advanced LGF analysis, where we consider 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 its Provisional Rating Assessment at a2, in line with the 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 support from the [Government of Germany](#) (Aaa stable³) in our deposit ratings for ING-DiBa.

Counterparty Risk Assessment (CR Assessment)

The CR Assessment is an opinion of how counterparty obligations are likely to be treated if a bank fails, and is distinct from debt and deposit ratings in that it (1) considers only the risk of default rather than both the likelihood of default and the expected financial loss suffered in the event of default; and (2) applies to counterparty obligations and contractual commitments rather than debt or deposit instruments. The CR Assessment is an opinion of the counterparty risk related to a bank's covered bonds, contractual performance obligations (servicing), derivatives (e.g. swaps), letters of credit, guarantees and liquidity facilities.

ING-DiBa's CR Assessment is positioned at Aa3(cr)/P-1(cr).

The bank's CR Assessment is positioned two notches above the a2 Adjusted BCA, based on the buffer against default provided to the senior obligations represented by the CR Assessment by more subordinated instruments, primarily junior deposits. To determine the CR Assessment, we focus purely on subordination, taking no account of the volume of the instrument class.

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	15.5%	aa2	↓	a1	Nominal leverage	Expected trend
Profitability						
Net Income / Tangible Assets	0.5%	baa2	← →	baa2	Earnings quality	
Combined Solvency Score		aa3		a2		
Liquidity						
Funding Structure						
Market Funds / Tangible Banking Assets	11.2%	a1	← →	aa2	Deposit quality	Market access
Liquid Resources						
Liquid Banking Assets / Tangible Banking Assets	30.4%	a1	← →	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:				--		
Scorecard Calculated BCA range				a1-a3		
Assigned BCA				a2		
Affiliate Support notching				0		
Adjusted BCA				a2		
Balance Sheet		in-scope (EUR million)	% in-scope	at-failure (EUR million)	% at-failure	
Other liabilities		22,653	14.4%	31,764	20.2%	
Deposits		130,151	82.6%	121,040	76.8%	
Preferred deposits		117,136	74.4%	111,279	70.6%	
Junior Deposits		13,015	8.3%	9,761	6.2%	
Equity		4,726	3.0%	4,726	3.0%	
Total Tangible Banking Assets		157,530	100%	157,530	100%	

Debt class	De Jure waterfall		De Facto waterfall		Notching		LGF Notching Guidance vs. Adjusted 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	9.2%	9.2%	9.2%	9.2%	2	2	2	2	0	aa3 (cr)
Deposits	9.2%	3.0%	9.2%	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
ING DIBA AG	
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
- [3](#) The rating shown is the Government of Germany's long-term issuer rating and outlook

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