ING Groep N.V.
Group Public and Government Affairs
Léon Boogerd
T +31 20 541 5408
E leon.boogerd@ing.com

ING POSITION PAPER ON CAPITAL & LIQUIDITY REFORM PROPOSALS

ING[1] generally supports the Basel Committee and European Commission banking reform programmes to strengthen the global capital and liquidity regulations. The proposals contribute to a more equal international level playing field, a more resilient banking sector and promote a more harmonised approach to both capital and liquidity management.

While supporting the general thrust of the proposals of the Basel Committee and the European Commission, ING has specific comments that mostly concern the implications of a number of proposals on the business model of more traditional retail-oriented banks. We would support more clarity in the interpretation of some proposals in order to ensure full consistency, not only amongst different proposals, but also with regard to applying IFRS as the standard and ensuring global implementation. We would like to stress that the proposals should not unnecessarily hamper retail banks in their intermediary function and that banks should be able to continue to play their important role in the European economy. Rightfully so, capital ratios have already been raised significantly in reaction to the crisis; raising them unreasonably much further would seriously impact the availability and pricing of banking products. The main comments from ING concern the following:

1. ING feels that traditional retail banks could be disproportionally hit by:
   - The narrow definition of liquid assets in the proposed calibration of the Liquidity Coverage Ratio ('LCR');
   - The asymmetrical treatment of assets and liabilities under the proposed stress scenarios in the calibration of the Net Stable Funding Ratio ('NSFR').

   Whereas we support the concepts of both ratios, in their proposed form, these ratios could seriously hamper the liquidity transformation function of banks. Furthermore, ING is against the public disclosure of the ratios as this could entail an increased risk to banks with substantial savings (publication could initiate a self-fulfilling mechanism).
2. ING understands the desire to introduce a simple non-risk based leverage ratio. The calibration of this ratio should take a broad asset base and match this against the going-concern equity base. It should be noted, however, that this would lead to significantly higher leverage ratios, which demonstrates that such ratios cannot be assessed in isolation of risk-based ratios. ING would not support the migration of the ratio to Pillar 1 given the nature of the leverage ratio as a non-risked based metric; the leverage ratio is best placed in Pillar 2.
3. ING sees an increased interconnectedness and cross-reference between new regulatory initiatives and accounting initiatives. Although the awareness that both cannot be seen in isolation is very much welcomed, ING is concerned that developments may not be synchronised. Overall, ING stresses that IFRS should be leading in the recognition of assets. If and when other accounting standards significantly differ, corrections should be allowed as for instance with prudential filters. Furthermore, ING considers the consequent deductions following from regulatory adjustments overly strict.

[1] ING is a global financial institution of Dutch origin offering banking, investments, life insurance and retirement services to over 85 million private, corporate and institutional clients in more than 40 countries.

4. ING supports the increased focus on Core Tier 1 capital, and that hybrid Tier 1 capital instruments should become more loss-absorbing. However, market appetite for new instruments should carefully be taken into account, and the tax treatment of such instruments should be consistent in order to ensure a level playing field.
5. There are still serious questions about the impact of the proposed rules on the real economy and the costs of financial products. In addition, the new proposals might lead to an unintended increase in procyclicality, whereas at the same time other proposals are aimed to reduce procyclicality in the system, but these are still very unclear. All in all, this stresses the importance of extensive impact studies, as currently undertaken. ING is not fully convinced that new rules on capital and liquidity will be implemented in all jurisdictions, most notably outside the EU. If so, this would lead to undesirable level playing field consequences.

A further elaboration on these 5 points is given below.

1. Liquidity Standards

ING supports the concept of the Liquidity Coverage Ratio ('LCR'). To a large extent it matches with the existing framework that ING has been using for over 10 years. However, ING is of the opinion that the proposed, narrow definition of 'liquid assets' in the LCR calibration does not properly reflect reality in such severe stress scenarios as proposed. We therefore stress the need for inclusion of a wide variety of assets, including central bank eligible collateral and marketable securities. In case of overconcentration, measures can be taken in terms of haircuts and pricing of central bank facilities. The collateral value on all assets should be aligned with the concept of the central bank being the lender of last resort.

Restricting the liquid asset buffer to 'government bonds only' will have a spill-over effect on e.g. repo-markets, thereby effectively reducing the available liquidity in the professional market. It would also have an immediate effect on the availability and pricing of credit as especially traditional retails banks will be less able to assume the liquidity risks inherited in their product offering.

ING also supports the concept of the Net Stable Funding Ratio (NSFR). Its proposed calibration, however, prescribes a going-concern scenario on the asset side, and a severe stress scenario on the liabilities side. This results in an unrealistic, asymmetric weighting of assets and liabilities which makes it very hard for traditional retail banks to meet the 100% limit. For example, with a loan-to-deposit ratio of 1, NSFR would only amount to 85%. During the crisis ING was able to adapt its own asset generation to the stress experienced on the liability side. We would therefore favour a more realistic scenario planning that provides a more representative picture of the effect of a crisis on the balance sheet. This should ultimately result in a more symmetrical treatment of assets and liabilities.

National discretion on the determination of outflow percentages, the definition of stable versus unstable customer deposits, and eligibility of assets could seriously hamper a centralised and efficient approach to liquidity management, and also lead to increasing tendencies for ring-fencing of assets and trapped pools of liquidity. This particularly applies to host supervision on branches and subsidiaries. In our view, a uniform risk profile should imply the same liquidity requirements in every country of operation.

Finally, ING has concerns about the public disclosure requirement. This could set in motion an unintended self-fulfilling development. In case of a decreasing, still sufficiently high ratio could wrongfully be interpreted by depositors as a signal of funding problems. Depositors could subsequently withdraw their funds. ING would rather propose a pass/fail type of communication: this would discipline banks to have adequate liquidity ratios in place without creating the nervousness in the market that would be the result of mis-interpreted movements in published ratios.

2. Leverage Ratio

ING understands the desire to introduce a simple non-risk based leverage ratio to capture excessive leveraging and to safeguard against too much reliance on internal models and ratings. The interpretation of the development of the ratio over time requires careful judgement as it fundamentally depends on the business model, the composition of the assets (preferably on an IFRS basis), the type of off-balance sheet exposures and the going-concern Tier 1 capital base. In ING's view, this judgement can be best exercised by regulators in the already existing Pillar 2 capital adequacy assessment. A Pillar 1 approach would leave no room for judgement and too constraining a leverage ratio entails the risk to effectively switch-off the risk based Basel II framework. This may rather increase the risk of excessive risk taking, instead of reducing this.

ING welcomes the proposal on the leverage ratio to maintain a level playing field. To this end, ING would like to stress that equal treatment of how derivatives are recorded on balance sheets among differing accounting jurisdictions is paramount to achieve this. It should be noted that at the same time, a broad asset base would lead to significantly higher reported leverage ratios, which demonstrates that such ratios cannot be assessed in isolation of risk-based ratios. This is especially true for retail banks with low-risk high-volume balance sheets. By definition, under the calculation bases proposed, a leverage ratio will be more punitive for these types of business models, without correctly recognising the lower risk profile of such banks.

Finally, ING stresses that the concept of the leverage ratio is inherently inconsistent with the liquidity proposals; namely, a narrow buffer for eligible assets would require banks to buy eligible securities, thereby automatically increasing their leverage. Also in this respect, it is essential that supervisors and regulators cooperate and work together in analysing the impact of the leverage ratio. This should be a recurring item on the agenda of international supervisory meetings (i.e. European Supervisory Agencies, European Systemic Risk Board).

3. Alignment with IFRS developments and deduction of regulatory filters

The proposals frequently refer to the accounting treatment of various assets, while these, at the same time, are reviewed by accounting standard setters. The impact from both regulatory and accounting developments can therefore not be assessed in isolation as certain forthcoming accounting rules and choices therein will fundamentally influence the impact on the regulatory proposals and vice versa. ING strongly advocates full harmonisation of these approaches both in terms of content, as well as in terms of timing and targeted implementation. Furthermore, we stress that the IFRS should be leading in the recognition of assets. This is especially true for the proposed differing treatment of deferred tax assets (where strict recoverability tests are already required), pension fund assets and the possible introduction of different forms of provisioning. If and when other accounting standards significantly differ, corrections should be allowed for.

ING does not support the removal of the current prudential filter for unrealised revaluations, as long as IFRS 9 has not been adopted and huge differences with US GAAP are still in place. We believe that unrealised gains and losses on available-for-sale ('AFS') assets that are held in a long term business model are not relevant to the capital position. Next to impairment tests to write down in case of expected losses, these assets will automatically mature over time and relate only to assets. Recognising unrealised losses in regulatory capital will, like with the removal of other prudential filters, significantly increase volatility and procyclicality of the capital base and in light of the revision of IFRS 9, these filters should exist at least until its adoption.

As to the non-IFRS related regulatory adjustments and consequent deduction of minority interests and participations in financial institutions, ING would favour a more symmetrical approach to these balance sheet items. We stress that a proportional consolidation of RWA needs to be considered. Full deduction of third part capital is too punitive and any capital arbitrage that takes place today should be dealt with in a different way.

ING considers the consequent deductions following from regulatory adjustments overly strict. Correctly applying the principles of going- and gone-concern should lead to more realistic approach, using a limitation of certain components in common equity, like deferred tax assets to a certain percentage of common equity, or a combination of deductions from Tier 1 and Tier 2 capital not just from Core Tier 1.

4. Capital Base

ING considers the proposal to increase the focus on common equity and to have stricter limits on additional forms of capital reasonable. However, the main criteria for additional forms of capital could have considerable implications on the investor appetite for such instruments going forward. A decrease of the investor base could have an upward effect on the costs of such instruments that would make it unattractive for the bank to issue them. The success of these instruments is therefore equally determined by the market.

Realising that the discussions on the appropriate trigger levels is difficult, ING also agrees that all newly issued Non-Core Tier 1 instruments should have a mandatory principal write-down or conversion feature, but this should not lead to a more punitive impact than for common equity holders. However, we consider it even more important that an equal level playing field is achieved with regard to the tax treatment of such instruments. In light of the attractiveness of the instrument, we stress that there is sufficient flexibility that such instruments can be treated as debt for tax purposes consistently in all jurisdictions, as long as the new requirements are met in substance.

Furthermore, grandfathering should be allowed as many current outstanding hybrids do not fulfil the new requirements. ING would suggest applying a reasonable, but not too long grandfathering period in which hybrids are accounted for in full for 5 years after implementation, and amortising thereafter.

5. Implementation

The impact of the new rules could be very substantial. Not only in terms of capital, liquidity and profitability, but also in terms of systems, processes, implementation and associated costs. Especially given the ambitious time schedule, to have the final proposals available end-2010, and implementation by end-2012. Therefore, we would support a gradual implementation of the new rules in order to ensure an orderly adjustment.

We very much welcome the efforts to assess the impact of the proposals on the real economy and the costs of financial products. We expect the effects to be quite significant. Lending will become more expensive as more capital is required. Moreover, the proposals will increase funding cost, leading to increased competition for savings, and thus to more price sensitive behaviour and less stable funding sources for the economy as a whole.

Finally, it is far from certain that countries outside the European Union (e.g. US, China) will implement the proposals in the same manner as in Europe. We would seriously regret such a development, as this will lead to a significant further distortion in the level playing field for internationally operating banks.

DETAILED ING RESPONSE TO THE BASEL COMMITTEE

Liquidity standards

Liquidity Coverage Ratio
ING is in favour of an international introduction of the Liquidity Coverage Ratio / Requirement ('LCR') within the Pillar 1 framework. A similar concept is already part of ING's existing supervisory reporting tools and both ING and the Dutch Central Bank consider it as a useful measure to monitor liquidity risk.

However, ING sees significant risks in defining the profile of eligible liquid assets for the buffer too narrow. While such a buffer would successfully contribute to the institutions' resilience to liquidity risk, it would have a detrimental effect on the traditional role of especially retail banks to provide credit to the economy as the product offering, by definition, contains illiquid forms of financing. In this sense, a too narrowly defined buffer would effectively transfer the liquidity risk from banks towards customers, as these would need to find financing via higher interest rates or alternatively, possibly less regulated sources, taking away the role of banks for self-originated asset production.

Acknowledging the outset of authorities not to make banks reliant on central banks facilities during the 30-day stress scenario, ING strongly pleads allowing for different forms of 1) marketable securities and 2) central banks eligible collateral, taking due account of appropriate haircuts and pricing of central bank facilities. Especially central banks eligible collateral is needed to allow, for example, internally securitised mortgages to be part of this buffer. Not allowing for such securities would have a direct effect on the availability and pricing of mortgages. Disallowing marketable securities would have a damaging effect on the liquidity in e.g. repo and covered bond markets.

As to the national discretion offered in the consultation, ING favours an approach whereby the calibration of the ratio is harmonised at the highest level possible. This is vital for banks to effectively manage their liquidity positions and to maintain the level playing field.

Being one of Europe's largest savings banks, ING sees a risk in publicly disclosing this ratio. Whilst market discipline serves as a good basis for proper liquidity management, there is an inherent risk that this information could be misinterpreted which may damage market confidence and trigger outflows. In this vein, ING advocates full disclosure towards the home regulator, as well as frequent and more detailed disclosure towards host regulators, but is not supportive to the public disclosure of the LCR.

Clearly, the global crisis had its impact on possibilities to fund for longer term in the market, as well as on the required quality of collateral. This was alleviated by central banks offering their support on a larger than normal scale. Nevertheless, central banks kept high standards for eligible collateral. Again from that viewpoint the proposed narrow definition of liquid assets is too strict and does not properly reflect reality in severe stress scenarios as proposed. In Annex 1, only government bonds are 100% eligible whilst corporate/covered bonds already receive large haircuts. All other forms of collateral are ruled out; whilst ING believes these do contain good value and should therefore be included in the buffer.

Also, a too narrowly defined liquid asset buffer may have unintended consequences in government bond markets, and induce banks to take more risk in other asset classes to compensate for the expensive liquidity buffer.

Net Stable Funding Ratio
ING is in favour of an international introduction of the Net Stable Funding Ratio / Requirement ('NSFR') in a Pillar 2 framework. However, as with the LCR, ING feels that the proposed calibration of the NSFR would be too restrictive to traditional retail banking institutions that collect savings and invest these in the economy. This is demonstrated by the asymmetry in the stress scenario between the weightings of loans (100% - going concern) on the one side, and weightings of deposits (85% - severe stress) on the other side.

ING stresses that, during the crisis, it had continuously been able to adapt its own asset origination in line with the stress experienced on the liability side. Also, the crisis showed that once clarity was reached on a uniform approach across the EU on deposit guarantee schemes, stability and confidence in customer deposits returned. The current weightings in the NSFR therefore do not properly reflect the stress experienced on both sides of the balance sheet as well as the differences between business models, predominantly retail versus investment banking. ING therefore proposes to adjust the stress scenarios to reflect crisis situations more realistically.

As with the LCR, ING is also concerned about the public disclosure of this ratio, and the room for discretion for national supervisors. Requirements should be harmonised at the maximum level for banks to effectively manage their liquidity positions.

Completeness of legislative approach
ING suggests that the various parameters are set at a European level to maintain a level playing field and avoid too much national discretions. Key elements such as outflow percentages, stable versus unstable customer deposits and eligibility of assets should, however, be determined based on historical observed outflows for an institution in stress events. Some degree of national discretion for home supervisors should therefore be given to ensure that such parameters properly reflect the specific nature of a banks business model. However, a very granular approach on the behaviour of deposits introduces additional model risk. It therefore makes sense to make certain, high-level distinctions but these should be limited, allowing for institutions to apply their own behavioural models where applicable.

Scope of application
Reporting should take place on consolidated level. Solo reporting leads to costly exercises and possible wrong interpretations by local supervisors that do not reflect the complete picture of the company. As already outlined in Questions 1, ING advocates full disclosure towards the home regulator, as well as frequent and more detailed disclosure towards host regulator.

Treatment of intra-group transactions and commitments
ING advocates managing the liquidity position from a central point. This is inherent in global markets and also non-financial corporates manage their liquidity positions centralised. Because liquidity risks span over short periods of time, a decentralised position could leave parts of a bank illiquid, while sufficient funds are available in other parts of the company. A centralised managed position provides most flexibility to ensure that all parts of the company remain liquid. Not having centralised liquidity management can lead to trapped liquidity pools and suboptimal balance sheet management for the institution as a whole, which could induce unnecessary risk taking and balance sheet lengthening that could otherwise have been avoided.

In this sense, ING favours a symmetrical treatment of intragroup loans and deposits, whereby it is assumed that even under severe stress, group entities would roll over their loans and deposits and entities that have received a legally binding commitment from another group entity could assume that they are always able to draw upon it.

Supervisory responsibility for branch liquidity
ING would fully support an approach by which for credit institutions with significant branches or cross-border services in another countries, the liquidity supervision would become the responsibility of the home supervisor, in close collaboration with host supervisors, in order to lift or waive separate requirements at national levels. Trapped pools of liquidity are contrary to client behaviour where deposits can be spread across borders. A trapped pool as such does not provide certainty at all and ING therefore very much supports the proposal to lift or waive separate liquidity standards at the level of branches and subsidiaries, based on a harmonised standard and uniform reorganisation and winding-up procedures.

These reorganisation and winding-up procedures should, however, follow the concept of an advanced contingency plan. Another good solution that would fit into this framework and also address the concerns of supervisors could be the intra-group transferability of assets. ING is in favour of intra-group asset transfers as it could assist groups in managing liquidity and capital positions and could help stabilise entities. However there are many existing barriers to prevent this instrument from functioning effectively, in particular large exposure rules for intra-group transactions and ring-fencing activities of local supervisors (partially because of non-harmonised liquidity rules).

Monitoring tools
ING already use a large number of metrics to grasp liquidity risk. Harmonisation of practises among different supervisors is very much supported.

Monitoring intraday liquidity risk will be more important going forward, mainly because banks will be forced to charge additional costs for intraday usage of liquidity facilities and regulators need create more insights in the intraday cash & collateral positions, controlled by limits. There is a risk that the newly proposed regulations that increase capital and liquidity requirements for banks negatively influence the smooth running of the payments system in the sense that the new guidelines would lead to banks maintaining more liquidity/collateral, therewith effectively becoming more sensitive to the timing of cash flows.

While banks are already more reluctant to provide their customers with easy access to intraday credit, banks are now under pressure to consider liquidity pricing as intraday liquidity is a service that is not for free any more. As the development of the intraday liquidity position largely depends on externalities outside of the control of banks, the best approach from a regulatory perspective would be to force banks to monitor this intraday liquidity position and mandate banks that run large intraday liquidity gaps to hold more available unencumbered collateral during the day. This would unquestionably affect the availability and pricing of these facilities.

Definition of capital

Revision of the regulatory capital structure
ING considers the proposal to increase the focus on common equity and to have stricter limits on additional forms of capital reasonable. However, the main criteria for additional forms of capital could have considerable implications on the investor appetite for such instruments going forward. A decrease of the investor base could have an upward effect on the costs of such instruments that would make it unattractive for the bank to issue them. The success of these instruments is therefore equally determined by the market.

Realising that the discussions on the appropriate trigger levels is challenging, ING also agrees that all newly issued Non-Core Tier 1 instruments should have a mandatory principal write-down or conversion feature. However, we consider it even more important that an equal level playing field is achieved with regard to the tax treatment of such instruments. In light of the attractiveness of the instrument, we stress that there should be sufficient flexibility that such instruments can be treated as debt for tax purposes consistently in all jurisdictions, as long as the new requirements are met in substance.

Furthermore, the proposals frequently refer to the accounting treatment of various assets, while these, at the same time, are reviewed by accounting standard setters. The impact from both regulatory and accounting developments can therefore not be assessed in isolation as certain forthcoming accounting rules and choices therein will fundamentally influence the impact on the regulatory proposals and vice versa. ING strongly advocates full harmonisation of these approaches both in terms of content, as well as in terms of timing and targeted implementation. Furthermore, we stress that the IFRS should be leading in the recognition of assets. This is especially true for the proposed differing treatment of deferred tax assets (where strict recoverability tests are already required), pension fund assets and the possible introduction of different forms of provisioning. If and when other accounting standards significantly differ, corrections should be allowed for.

ING does not support the removal of the current prudential filter for unrealised revaluations. We believe that unrealised gains and losses on available-for-sale ('AFS') assets that are held in a long term business model are not relevant to the capital position. These assets will automatically mature over time and only relate to assets. Recognising unrealised losses in regulatory capital will, like with the removal of other prudential filters, significantly increase volatility and procyclicality of the capital base and in light of the revision of IFRS 9, these filters should exist at least until its adoption.

As to the non-IFRS related regulatory adjustments and consequent deduction of minority interests and participations in financial institutions, ING would favour a more symmetrical approach to these balance sheet items. We stress that a proportional consolidation of RWA needs to be considered. Full deduction of third part capital is too punitive and any capital arbitrage that takes place today should be dealt with in a different way.

ING considers the consequent deductions following from regulatory adjustments overly strict. Correctly applying the principles of going- and gone-concern should lead to more realistic approach, using a combination of deductions from Tier 1 and Tier 2 capital, not just from Core Tier 1.

ING considers it appropriate under certain circumstance to require the write down of the principle amount of an instrument or its conversion to a Core Tier 1 instrument. However, an objective trigger bears the risk that, once an institution is close to the trigger point, speculators will take large positions and push an institution over the trigger point. If an objective trigger point is set by the supervisors, we think supervisors should first use it for some time in a discretionary way, thus gaining experience with its advantages and disadvantages. Key then is that supervisors share their experiences amongst each other. If and only if this experience over several years would show that the disadvantages are negligible the trigger could become a hard trigger.

With regard to the prudential adjustments, ING has to following specific comments:

Minority interest
The existing capital rules relating to minority interest are not always correctly reflecting the true economic Group position. Therefore, ING believes that the proposal to remove minority interest as eligible capital is a step in the right direction. However, ING believes that that there should be symmetry between equity and assets "owned" by minority shareholders. Therefore ING believes that the proposal should also allow a pro rata relief of the RWA's with respect to minority interest. For minorities in which non-consolidated stakes are hold, ING is not in favour of the full deductibility from Core Tier 1 capital.

Investments in the capital of certain banking, financial and insurance entities which are outside the regulatory scope of consolidation
These components are similar to the existing rules although the deduction will be allocated to common equity in full instead of the old 50/50 rule. We believe that the proposed allocation of the deduction will have a significant impact on the growth strategy of a company as partial acquisitions will have a significant negative impact on common equity whilst the available capital of the acquired company is likely to increase under the current proposals.

Pensions
The objectives of the proposed capital treatment of pensions are (1) to remove any filter allowed by national supervisors and (2) to deduct any surplus relating to defined pension benefits ("pension assets"). The filter is not relevant for ING as no pension filter is allowed by DNB currently. Other jurisdiction may allow a filter re the IFRS transition in 2005 (amortisation of transitions corridor) and/or a filter if the corridor is already taken to equity.

A more conceptual issue is why any pension asset should be deducted from capital. This moves away from the going concern assumption and is more a liquidation approach. ING does not support this development as it believes that IFRS should be leading in the recognition of assets. As such IFRS already contains a recoverability test on pension assets, which requires "proof" of recoverability in a going concern scenario. The capital framework should be restricted to setting risk weightings in order to address the uncertainty/quality of the assets recognised under IFRS. Furthermore, IAS 19 is likely to be revised in the short term and it is unclear how the pending changes in IAS 19 should be fully reflected in the proposals.

Deferred tax
The proposals would not allow recognition in capital of deferred tax assets which rely on future profitability of the bank. It is unclear what is exactly meant, especially because the examples in the proposals of deferred tax assets that may be recognised for capital purposes are in fact current tax assets, not deferred tax assets. Many deferred tax assets simply result

from timing differences between IFRS and tax accounting and it is unclear how the proposals impact these deferred tax assets. Furthermore, the proposals are unclear on netting deferred tax assets and deferred tax liabilities.

A more conceptual issue is why deferred tax assets should be deducted from regulatory capital. This moves away from the going concern assumption and is more a liquidation approach. ING does not support this development as it believes that IFRS should be leading in the recognition of assets. As such IFRS already contains stringent criteria for recognition of deferred tax assets which requires "proof" of recoverability in a going concern scenario. Finally, not recognizing deferred tax assets would make the capital requirements more (rather than the intended less) procyclical.

Cumulative gains and losses due to changes in own credit risk on fair valued financial liabilities
The existing filter only applies to gains and losses on liabilities which are fair valued as a result of the application of the fair value option. The proposal extends this filter to cover gains and losses due to changes in own credit risk on all liabilities which are fair valued.

The result of this proposal will be the extension of the filter to all trading liabilities and non-trading derivatives. It is expected that the impact is limited as the counterparty normally requires sufficient collateral and as such changes in own credit risk does not impact the fair value. Unclear is how this will be aligned with the upcoming standard re own credit.

Unrealised gains/losses
ING believes that the unrealized gains/losses recognized under IFRS should not be included in capital and therefore supports the continuation of the current prudential filter. The rational for this is that the available-for-sale assets are held in a long term business model. The unrealized gains/losses will automatically revert over time and are therefore not relevant to the capital position. Real losses will impact capital as and when they occur as actual impairments are not subject to a filter. ING believes that recognising unrealised gains and losses in regulatory capital will significantly increase volatility and procyclicality.

Finally, we do not see the rationale of amending the capital definitions based on IAS 39 principles. The new classification and measurement standard (IFRS 9) does not include the AFS category and is expected to be effective around the same time as the new Basel requirements. The accounting treatment under IFRS 9 will make the current prudential filter irrelevant.

The proposed requirements in respect of calls for non-Core Tier 1 and Tier 2 are sufficiently robust. A buy back of a hybrid instrument should in our view not be treated the same as a call feature because a buy back will only be executed in exceptional circumstances that are not foreseen at the date of issuance.

ING also notes that even more junior ranked ordinary shares also have the ability to be bought back. Therefore it should be possible to buy back hybrid instruments at any time without any restriction, subject to approval from the regulator. This approval is in compliance with the existing rules on early redemption of hybrid instruments.

It should be possible to buy back the hybrid instruments before five years after the issuance date provided that the financial institution replaces the hybrid instrument with capital of at least the same or better quality that has already been issued or will be issued in due course e.g. in case of an exchange offer. Regulatory approval will be needed in any case.

Contingent capital, grandfathering and disclosure

The development of contingent capital instruments in still in its early stages. The unknown nature and characteristics of such instruments should therefore provide that regulators and the industry should prudently evaluate such instruments prior to introduction. ING views contingent capital instruments as a meaningful option to explore, allowing banks to develop a form of capital that can be used to counter financial distress at a time that other forms of capital are not (readily) available. A debt instrument that converts into common equity during a period of financial strain can effectively improve a bank's capital position.

ING thinks that grandfathering should be allowed as many current outstanding hybrids do not fulfil the new requirements. As markets will quickly focus on the new situation and to avoid regulatory arbitrage, we therefore suggest applying a reasonable, but not too long grandfathering period in which hybrids are accounted for in full for 5 years after implementation, and amortising thereafter.

Leverage ratio

ING understands the desire to introduce a simple non-risk based leverage ratio to capture excessive leveraging and to safeguard against too much reliance on internal models and ratings. The interpretation of the development of the ratio over time requires careful judgement as it fundamentally depends on the business model, the composition of the assets (preferably on an IFRS basis), the type of off-balance sheet exposures and the going-concern Tier 1 capital base. In ING's view, this judgement can be best exercised by regulators in the already existing Pillar 2 capital adequacy assessment. A Pillar 1 approach would leave no room for judgement and too constraining a leverage ratio entails the risk to effectively switch-off the risk based Basel II framework. This may rather increase the risk of excessive risk taking, instead of reducing this.

It should be noted that at the same time, a broad asset base would lead to significantly higher leverage ratios, which demonstrates that such ratios cannot be assessed in isolation of risk-based ratios. This is especially true for retail banks with low-risk high-volume balance sheets. By definition, a leverage ratio will be more punitive for these types of business models, without correctly accounting for the lower risk profile of such banks.

Finally, ING stresses that the concept of the leverage ratio is inherent inconsistent with the liquidity proposals; namely, a narrow buffer for eligible assets would require banks to buy eligible securities, thereby automatically increasing their leverage. Also in this respect, it is essential that supervisors and regulators cooperate and work together in analysing the impact of the leverage ratio. This should be a recurring item on the agenda of international supervisory meetings (i.e. European Supervisory Agencies, European Systemic Risk Board).

Counterparty credit risk

Improved measurement/revised metric to better address counterparty credit risk
The suggested approach seems to oversimplify the current use of CVA in the financial industry, which could lead to a disproportional capital increase which would be an incorrect representation of CVA risk. In general, ING understands the need to capitalise for CVA risk given the increased importance of counterparty risk on derivatives valuation. However, a more consistent approach would be preferable, where CVA risks and hedges are treated as an integral part of the trading book. Using VaR models the different sensitivities of CVA to interest rate and credit spread curves could be better incorporated than by using a bond-equivalent approach. Also, a broader scope of hedging instruments could be used to offset CVA exposure, if CVA is combined with all other positions in the trading book.

Conceptually, the proposal does not differentiate between different accounting regimes banks use to account for CVA (based on a market implied measure of CVA or based on a through-the-cycle reserve using historical PDs and LGDs). The proposal also solely allows for single name CDS hedges. In practice, CVA exposure is often hedged using index or proxy hedges. This could leave a substantial part of CVA exposure relates to (mid-) corporate counterparties on which no CDS hedges are available. Although index and proxy hedges might not be perfect, not including them at all would be too conservative, and not giving any capital incentive to hedge CVA exposure using these instruments.

Collateralised counterparties and margin period of risk
The proposal has a concept where extra capital would be required for collateral arrangements where disputes are too high. While the concept makes sense, ING stresses that it needs to be ensured that no overly administrative burden is created in the measurement of collateral management as this is still a highly customized process. It should also be noted that valuation methodologies used by banks and CCPs can differ. Transparency in this respect is important to increase market confidence.

Furthermore, ING would like to stress that haircuts should be aligned with the ECBs list of collateral to prevent confusion and apply a uniform set of standards throughout Europe.

Central counterparties
ING agrees to the enhanced standards to qualify for a zero percent risk weight to prevent systemic risk from being build up by the increased usage of CCPs. Depending on the size of guarantee fund contribution.

In this respect, ING deems it extremely important that Recommendation 14 (BIS/IOSCO) and respectively Recommendation 17 (CESR) are not materially altered and that next to the disclosure of “extreme but plausible” scenarios it is further specified that also the model parameters (such as curves) for the initial and variation margin calculations are disclose in line with Recommendation 14/17.

Regulators should continue to apply zero risk weightings to banks “exposure” resulting from collateral, market and guarantee fund contribution given the unique support mechanisms of CCPs (on the assumption that the CCP is run to defined strict standards).This is inter alia motivated as follows: The CESR and BIS/IOSCO standards require a robust legal framework for the CCP to operate in. Consequently, any excess collateral (such as Initial Margin) or any unused Default Fund contribution should be sufficiently legally ring-fenced in case of a

potential CCP default. The only remaining exposure is the variation margin, which however is offset with the market exposure (again under a legally robust framework). Consequently, bank’s exposure in case of a CCP default is extremely limited. Not applying the 0% risk weight for these exposures would take away a significant part of the benefit for banks using CCPs.

Enhanced counterparty credit risk management requirements

The proposed changes do very well address the observed weaknesses. Issue is however that by far not all firms apply IMM and given the much more stringent rules are not encouraged to do so. This should be taken into account to manage expectations of the impact of the new rules to manage counterparty credit risk exposures.

Countercyclical measures

Provisioning
ING would like to reiterate its position that IFRS should be the leading standard for elements related to accounting. As provisioning fits into this framework, we consider it of utmost importance that prior to revision of IFRS 9, no further actions should be taken before the final standards has been set and implemented. Furthermore, ING is concerned about the unclear direction of the proposals at this stage, as well as the risk of the European Union moving ahead of international developments. This could potentially create serious level playing field issues.

Capital buffers and cyclicality of the minimum requirement
Although ING understand the reasoning for conservation and procyclical buffers from a political viewpoint, the crisis has shown that while one would have expected banks to utilise the buffers created, capital requirements only went up. It is to this end that ING would therefore propose to only add a conservation buffer, of which the limit is to be set based on macroeconomic and certain business models specific parameters. The European Systemic Risk Board and European Banking Authority should play a key role in setting the standards for these parameters in Europe.

Systemically important financial institutions

First, a definition of the "system" is needed. Ideally, the system would encompass the entire financial sector. This includes banks, insurers, pension funds, mutual funds, etc. It also includes non-regulated entities such as broker-dealers and finance companies. Systemic importance means: playing a vital role in the financial system. Put in another way: when a systemically important part of the system ceases to function, this jeopardises the continuity of the system.

The financial crisis has shown that a great diversity of institutions and markets were deemed 'systemically important' (judged from the fact that they received government support). This includes e.g. banks, insurers, specialised insurers, GSE's, security broker-dealers. The diversity of this list shows that it is not straightforward to come up with criteria for systemic relevance. The list does show that focusing on size alone is besides the point: 1) it wrongly includes big institutions that are not systemically relevant, and 2) it wrongly excludes small institutions that are systemically relevant. Thus, systemic importance is not related to size only. Diversification, kind and size of exposures, risk management, internal controls, interconnectedness, contingency planning etc. are all part of the game.