

Measures to manage capital

ING increasingly looks at available financial resources and economic capital employed when managing capital. These concepts come from our internal risk management models. Economic capital (EC) is a measure for the totality of risks run in the company over a one-year time horizon and with a AA confidence interval of 99.95%. Available financial resources (AFR) equal market value of assets minus market value of liabilities, excluding hybrids issued by ING Group which is counted as capital.

At ING Bank the proxy for AFR is Tier-1 capital, in the absence of a full market value balance sheet for ING Bank plus the revaluation reserve equities. AFR should exceed EC for both ING Bank and ING Insurance. EC for ING Group is defined as EC ING Bank plus EC ING Insurance minus the diversification benefit (10% in the past and 15% going forward) plus any EC specifically allocated to ING Group. AFR Group equals AFR ING Bank plus AFR ING Insurance minus core debt ING Group. The target is that ING Group AFR should be at least 120% of ING Group EC. It is policy that any buffer should be able to be deployed with maximum flexibility and therefore be kept centrally.

During 2007 ING Bank submitted to the Dutch bank regulator, de Nederlandsche Bank (DNB) the pillar 2 internal capital adequacy assessment process filing, which contains an overview of the most important capital management policies, procedures and reports. This filing is the basis for the supervisory review of the capital adequacy of ING Bank.

The new Financial Supervision Law also defines the necessary supervision on financial conglomerates. Here also ING Bank has worked with the regulator to make sure ING meets all regulations.

THE CAPITAL LETTER

The cornerstone of the capital adequacy assessment process at ING is the yearly Capital Letter, which contains an analysis of the capital position of ING, a review of the justification for the target capital ratios and an economic and business development forecast. It also assesses the capital needed to support the business going forward versus the expected availability of capital given profitability and the financial instruments at the disposal of capital management. The capital position of ING Group, ING Bank and ING Insurance is discussed according to the viewpoint of the various stakeholders: regulators, shareholders, rating agencies and according to the internal risk assessment. The Capital Letter also includes the results of recent stress tests and a contingency plan (for both good and bad developments). It gives an overview of the available 'toolkit' to manage capital at ING. The Capital Letter is produced annually in June to coincide with the start of the planning cycle for subsequent years. The document is not public information, but is approved by the Executive Board and shared subsequently with the Supervisory Board and the regulators.

CAPITAL ADEQUACY

The main task of the Group capital management function is to monitor, manage and plan the capital adequacy of ING Group, ING Bank and ING Insurance and to execute all related capital markets transactions. The benefits of a centralised capital management function are that maximum financial flexibility is created to pursue strategic objectives and to withstand financial stress and that the different requirements of shareholders, regulators, rating agencies and internal economic capital models

can be properly balanced.

At the beginning of each year, a funding plan and a securitisation plan are prepared describing all intended financings and other capital market transactions.

ING endeavours to employ its capital in the most optimal way. It is therefore important that business units receive the right incentives to only hold capital necessary to support the risks in their business and to upstream the remainder to ING Group. In turn they should be able to count on a capital injection if their business can grow profitably.

Free surplus is that part of available financial resources (capital) that exceeds economic capital employed. Many ING Insurance business entities need to hold more capital than economic capital due to regulatory and/or rating agency constraints. However, to the extent free surplus is not constrained, it is free to be employed elsewhere in the interest of furthering profitable growth. During 2007 in total EUR 5.8 billion of dividends were paid by ING Insurance Netherlands to the holding company of ING Insurance. As of 31 December, there remained tied-free surplus of EUR 3.5 billion and EU Solvency at 150% in ING Insurance Netherlands.

Significant work was put into the management of the corporate line Insurance during 2007. The corporate line contains capital management and general management items that are beyond the management control of the business units, such as capital funding, top-down hedges and special expenses not directly related to the business. A new foreign exchange translation risk policy was approved and also the new interest rate risk management policy was implemented. Capital Management executed in total EUR 6 billion of equity index option transactions during 2007 to protect the value of the ING Insurance equity stakes (also some of the equity positions of ING Bank were hedged on the corporate line of ING Bank).

In the course of selling life insurance policies ING Insurance Netherlands also sells mortgages. At the beginning of 2007 approximately EUR 17 billion of mortgages had accumulated within ING Insurance Netherlands, mostly at a mortgage subsidiary. This entity was transferred to ING Bank, where the assets can be funded more cheaply and the systems are in place to actively manage the prepayment risk. This transfer reduced the operating leverage of ING Insurance significantly. Subsequently, more mortgages were transferred directly from ING Insurance Netherlands to ING Bank, creating liquidity and thereby facilitating the implementation of the new asset allocation. In total EUR 12 billion of mortgages were transferred.

SHARE TRANSACTIONS

It was foreseen that during 2007 significant excess capital would continue to build without further intervention. Therefore it was decided to proceed with a EUR 5 billion share buy-back to be spread out over a full year from June 2007 onwards. By the end of 2007, 90.7 million shares had been repurchased for a total consideration of EUR 2.8 billion. The full impact of the share buy-back, once it has fully run its course, will be to improve EPS by approximately 7%.

Also, after the repurchase of ING preference shares from Aegon during 2006, the ING preference shares of both Fortis and ABN AMRO were repurchased during 2007. With these transactions, all three major holders have now sold their ING preference shares back to ING Group.