

# Risk management

## Containing risk and adding value to the business

2007 was characterised by a great deal of turbulence in the financial markets, beginning with concerns over US subprime mortgages in early 2007 and then widening into a general banking liquidity crisis. The turmoil put a spotlight on risk management across the financial sector. The crisis had only limited impact on the profit and loss account through ING's investments in pressurised assets classes.

### Pre-tax P&L impact directly related to credit and liquidity crisis

in EUR million	3Q	4Q	3Q+4Q
US subprime RMBS	-17	-47	<b>-64</b>
Alt-A RMBS	0	0	<b>0</b>
CDOs/CLOs	-15	-36	<b>-51</b>
Monolines	0	-66	<b>-66</b>
Investments in SIVs, ABCP	0	-45	<b>-45</b>
Leveraged Finance	-29	0	<b>-29</b>
<b>Total</b>	<b>-61</b>	<b>-194</b>	<b>-255</b>

### US subprime RMBS, Alt-A RMBS and CDO/CLO exposures and revaluations at year-end 2007

	Amortised cost* EUR billion	Market value EUR billion	Fair value in %	Pre-tax revaluation via equity EUR million
US Subprime RMBS	3.1	2.8	90.1%	-307
Alt-A RMBS	28.4	27.5	96.7%	-936
CDO/CLO	2.0	1.9	93.4%	-134
<b>Total</b>				<b>-1,377</b>

\* Purchase price +/- amortisations – cumulative impairments.

### Economic Capital break-down by risk category ING Bank

in EUR billions	2007	2006
Credit risk (including Transfer risk)	<b>7,503</b>	7,557
Market risk	<b>7,407</b>	4,816
Non-financial risk*	<b>3,017</b>	3,503
<b>Total Banking operations</b>	<b>17,927</b>	15,876

\* Non-financial risk includes operational risk as well as business risk.

### Economic Capital break-down by risk category ING Insurance

in EUR billions	2007	2006
Credit risk (including Transfer risk)	<b>1,021</b>	1,411
Market risk	<b>15,258</b>	14,555
Insurance risk	<b>3,293</b>	3,110
Non-financial risk*	<b>3,627</b>	3,334
<b>Total Insurance operations</b>	<b>23,199</b>	22,410

\* Non-financial risk includes operational risk as well as business risk.

### MANAGING THE MARKET TURMOIL

ING has integrated risk management in ING's daily business activities and strategic planning. ING has systematically invested in its risk management capabilities over recent years. ING's risk approach is reflected in the diversified business mix and the composition of the balance sheet.

A robust risk management organisation and a strong liquidity position helped ING manage the problems that occurred in the credit and other financial markets in 2007. It has been ING's policy to maintain a high quality and well diversified portfolio. To that effect ING has strict limits and investment policies in place which are defined in mandates for every portfolio. Investment and trading decisions are based on extensive internal research, and not only on published ratings. Some limits were at more stringent levels since early 2007, anticipating a potential downturn of the market.

ING applies conservative standards in mortgage underwriting and has not originated US subprime mortgages. Moreover, ING is not in the business of manufacturing subprime Residential Mortgage Backed Securities (RMBS) or Collateralized Debt Obligations (CDOs) nor has it purchased a material amount of US subprime backed CDOs/ Collateralized Loan Obligations (CLOs). ING's exposure to the US housing market is predominantly via highly rated RMBS investments.

As a result, ING's exposure to pressurised asset classes, e.g. subprime and Alt-A (RMBS) (those with a risk profile between prime and subprime), CDOs and CLOs, is of high quality and has not led to material impairments.

The total direct pre-tax negative impact on ING's 2007 profit and loss account was EUR 255 million (EUR 61 million in the third quarter and EUR 194 million in the fourth quarter). The direct impact is a result from exposures to these pressurised asset classes and leveraged finance in the third quarter, as well as monoline insurers, Structured Investments Vehicles (SIVs) and Asset-Backed Commercial Paper (ABCP) in the fourth quarter. Pre-tax revaluation for the pressurised asset classes (US subprime RMBS, Alt-A RMBS and CDOs/CLOs) at year-end 2007 was EUR -1,377 million. On an after-tax basis this runs through shareholders' equity in the balance sheet.

### ING has a high quality ABS portfolio

The US subprime RMBS, US Alt-A RMBS, CDO and CLO portfolios are part of ING's Asset Backed Security (ABS) portfolio, which is of high quality and well diversified due to strict limits and investment policies defined in mandates for every portfolio. The investments ABS portfolio, almost entirely available for sale, was EUR 84 billion at year-end.

The ABS portfolio comprises mainly AAA rated securities (89%) and AA rated securities (10%). Unrealised gains/(losses) relating to available for sale (fixed income) securities, including Mortgage Backed Securities (MBS), are taken to the revaluation reserve in shareholders' equity, unless there is evidence of impairment, in which case the negative revaluation reserve is recognised in profit or loss account. In addition, Loans and advances to customers, valued at amortised costs, contained EUR 13 billion European asset-backed products with market value around 100% and an average credit rating of AAA.

## 1.2 Report of the Executive Board

### Risk management (continued)

#### Limited exposure to US subprime mortgages

The US subprime RMBS exposure is of relatively high quality. ING has a very limited exposure to US subprime RMBS and does not originate subprime mortgages. Investment decisions have been based on extensive internal research. Exposure to US subprime RMBS amounted to EUR 2.8 billion at 31 December, 2007, representing 0.2% of total assets and was fair valued at 90.1% of its cost. The negative pre-tax revaluation on US subprime RMBS at 31 December, 2007 was EUR 307 million. Net impairments and trading losses combined amounted to EUR 64 million (EUR 17 million in the third quarter and EUR 47 million in the fourth quarter). At year end, 96.0% of the portfolio was rated AA or higher, and in the fourth quarter only EUR 31 million was downgraded by ratings agencies.

#### High quality Alt-A portfolio

Alt-A mortgage loans are regular residential mortgage loans in the US market which are frequently packaged into RMBS. Notwithstanding the widespread existence of Alt-A RMBS a single standardised definition does not exist.

At times, ING has generally applied a 'broad' definition to Alt-A RMBS. Under the broad definition of Alt-A RMBS, the applicable RMBS contains at least one of the following three characteristics: on average a Loan-to-Value ratio between 70%-100%, a FICO credit score between 640-730, and 'low documentation' (referring to reduced requirements regarding personal income and/or asset verification) of 50% of the debt holders in the portfolio or more.

ING's exposure under the broad definition amounted to EUR 27.5 billion at 31 December 2007, representing 2.1% of total assets. ING Direct's share of this exposure was EUR 23.6 billion. Note that ING Direct reports Alt-A RMBS under a so-called 'narrow definition'. In this instance a security qualifies as Alt-A RMBS if it meets all three criteria simultaneously. Hence, average FICO scores higher than 730, LTVs of less than 70% and 'low documentation' less than 50% are excluded from Alt-A. In accordance with the narrow definition, ING Direct's exposure amounted to EUR 9.7 billion at 31 December 2007.

On average, the ING Direct Alt-A RMBS portfolio is near prime and of high-quality with a loan-to-value ratio of 71%, an average FICO score of 723 and more than 99% of the portfolio is rated AAA. S&P's estimates average AAA Alt-A RMBS credit enhancement at approximately 7.5%, whereas ING Direct's Alt-A RMBS portfolio has a 12% average credit enhancement. ING Direct's average credit enhancement can absorb eight times the current pipeline losses in the underlying Alt-A mortgages.

The portfolio had a negative pre-tax revaluation of EUR 936 million at 31 December 2007. The rating agencies downgraded EUR 10 million of ING's Alt-A RMBS portfolio in the fourth quarter of 2007. There were no impairments or trading losses taken in respect of the Alt-A RMBS portfolio. ING continues to review its RMBS portfolio very closely, and performs structural monitoring activities at the level of the individual security.

#### CDOs and CLOs

At the year end, the Group's net exposure to CDOs and CLOs was EUR 1.9 billion, or 0.1% of assets. Net impairments and trading losses combined taken on CDOs/CLOs totalled EUR 51 million (EUR 15 million in the third quarter and EUR 36 million in the fourth quarter). At the end of the year, the portfolio was valued at 93.4% of cost, with a negative pre-tax revaluation of EUR 134 million. The revaluation reflects limited investments in CDOs backed by US subprime mortgages (EUR 15 million at year-end).

#### Leveraged Finance

ING's leveraged finance pipeline is limited and transactions are in various stages of syndication and negotiation. At the end of the year ING had a leveraged finance pipeline of EUR 2.3 billion or 0.2% of total assets, over 13 deals. Existing underwriting standards, which were tightened from the first quarter 2007 onwards, and leverage limits have resulted in negligible mezzanine and covenant-lite lending.

A small markdown of EUR 29 million was taken at the Wholesale Bank in the third quarter to reflect the decrease in fair value during the underwriting period.

#### Monoline insurers

ING Group has a limited exposure to monoline insurers. ING's direct exposure to monoline insurers is negligible. However, ING has some indirect exposure to monoline insurers as it has insured EUR 3.5 billion, or 0.3%, of assets with several monoline insurers, either through embedded guarantees ('wrapped bonds') or through credit derivatives. Changes in the monoline insurer's rating (and as a result the asset's fair value) impact the equity (unrealised losses) for wrapped bonds. Underlying wrapped bonds in the available for sale securities portfolio are monitored through the regular credit review process and were not impaired as of 31 December 2007. The rating of the monoline insurers impacted ING's profit and loss account in the fourth quarter by EUR 66 million, due to the downgrading of a monoline insurer, which resulted in EUR 630 million of underlying assets on the trading book of Wholesale Banking no longer being protected.

#### Negligible liquidity impact

ING has a strong balance sheet and a sound capital position. ING enjoys a favourable funding base with customer deposits providing 61% of total funding. Retail (36%) and corporate (25%) deposits are relatively stable sources of funding. Our funding costs remain low. The fixed income market recognises our sound balance sheet and favourable risk profile.

ING's approach to liquidity management requires a significant surplus of liquid assets, rigorously tested contingency plans and close monitoring of market conditions. A number of liquidity problems have appeared in the market due to the US subprime concerns, including challenges rolling over short-term Asset-Backed Commercial Paper (ABCP) in the secondary market, increased credit spreads and shorter terms.

Since the start of the market turmoil in August 2007, ING's Liquidity Crisis Committee has met on a regular basis in line with ING's liquidity policy. The Committee discusses ING's liquidity and funding profile and is chaired by the chief risk officer (CRO). Other members include the chief financial officer (CFO), all the main treasurers of ING Group, the head of Market Risk Management and the head of Corporate Communications and Affairs. The liquidity strategy and market conditions are monitored on a daily basis. Large buffers of liquidity were retained throughout 2007, and as a result, contingency funding plans, in place at all levels, were not required to be executed as ING's liquidity position remained sound during the year.

### Ongoing volatility in the financial markets

As a result of ongoing and unprecedented volatility in the global financial markets in recent quarters, we have incurred negative revaluations on our investment portfolio, which have impacted our shareholders' equity. Furthermore, we have incurred certain impairments and other losses, which have impacted our profit and loss accounts. Such impacts have arisen primarily as a result of valuation issues arising in connection with our exposures to US mortgage-related structured investment products, including sub-prime and Alt-A Residential Mortgage-Backed Securities (RMBS), Collateralized Debt Obligations (CDOs) and Collateralized Loan Obligations (CLOs), monoline insurer guarantees, Structured Investment Vehicles (SIVs) and other investments. In many cases, the markets for such instruments have become highly illiquid, and issues relating to counterparty credit ratings and other factors have exacerbated pricing and valuation uncertainties. Valuation of such instruments is a complex process involving the consideration of market transactions, pricing models, management judgment and other factors, and is also impacted by external factors such as underlying mortgage default rates, interest rates, rating agency actions and property valuations. While we continue to monitor our exposures in this area, in light of the ongoing market environment and the resulting uncertainties concerning valuations, there can be no assurances that we will not experience further negative impacts to our shareholders' equity or profit and loss accounts from such assets in future periods.

### BUILDING A COMPETITIVE ADVANTAGE

The purpose of ING Risk Management is to build a sustainable competitive advantage by fully integrating risk management in ING's daily business activities and strategic planning. Assuring maintenance of solvency, credit ratings and liquidity implies that products and portfolios are structured, underwritten, priced, approved and managed appropriately and that internal and external rules and guidelines are complied with.

Fully integrating risk management in ING's daily business activities and strategic planning is further achieved through a transparent disclosure of ING's risks and a risk strategy that is consistent with the overall Group strategy and the risk appetite.

In recent years ING has systematically invested to improve its risk management capabilities. This has become necessary as investor demands have increased, regulation has become more sophisticated, technology has grown more complex and as secondary markets have continued to evolve. After years of targeted investments in people and technology, ING ended 2007 with around 4,500 employees dedicated to risk management.

In April 2007, ING made a strong commitment to risk management by appointing Koos Timmermans to the Executive Board as chief risk officer. It was decided to separate this function from the role of the chief financial officer because of the increasing complexity and importance of both the risk and finance functions in ING. Having Risk Management separately represented in the Executive Board ensures that risk is a key component of management decisions.

The risk appetite, or the willingness of the Group to take risks, is defined by the Executive Board and measured through three key measures: Earnings at Risk and Capital at Risk, which are measured in the 'Risk Dashboard', and Economic Capital. Business line managers try to maximise value relative to these measures, while Risk Management monitors and controls the actual risk profile against the Group's risk appetite.

ING has a risk governance framework in place to ensure its risk appetite is communicated and enforced throughout the Group. The framework contains three lines of defence: the business lines themselves, which have the primary responsibility for day-to-day management; Risk Management, which provides high-level policies, limits and risk oversight; and Corporate Audit Services, the internal audit department within ING Group, which provides an independent assessment of the design and effectiveness of internal controls over the risks to ING's business performance.

### The Risk Dashboard

The Risk Dashboard, disclosed for the first time in September 2007, is a tool that enables the Executive Board to identify risk concentrations and potential risk mitigating actions. This tool gives an overview of risks inherent in all the banking and insurance businesses and facilitates monitoring the adherence of risk-taking with respect to the Groups' risk appetite. It thereby allows ING to take strategic decisions using comparable risk measures and to maximise efficient capital allocation. The tool is unique to ING and will be reported annually. A full disclosure of the Risk Dashboard is included in the Risk section of the Annual Accounts.

### Risk appetite measures

ING defines its risk appetite through three different measures: Earnings at Risk, Capital at Risk and Economic Capital.

Earnings at Risk (EaR) is a measure of the potential reduction in IFRS earnings from expectations, assuming no mitigating management actions, during a moderate (i.e. '1 in 10') stress scenario. Internally this is compared to the next year's forecast IFRS earnings and as such provides an indication of the quality of earnings. The overall risk appetite level for ING, decreased to 31% (from 32% in 2006). This is due to the earnings increasing stronger than EaR. ING Bank's EaR dominates the overall ING Group EaR mainly due to credit and transfer risk. For further details on Earnings at Risk see the Risk section of the Annual Accounts.

Capital at Risk (CaR) is the potential reduction of the current net asset value (based on fair values) of the balance sheet over the next year relative to the expected value during a moderate (i.e. '1 in 10') stress scenario, and assuming no mitigating management action. The Capital at Risk figure tends to be dominated by ING Insurance and is mainly interest rate risk related to long-term client guarantees and equity risk. The overall risk appetite level for ING Group in 2007, measured as Capital at Risk/Available Financial Resources (AFR),