

Effectively managing liquidity risk in a complex international bank and insurance group

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Agenda

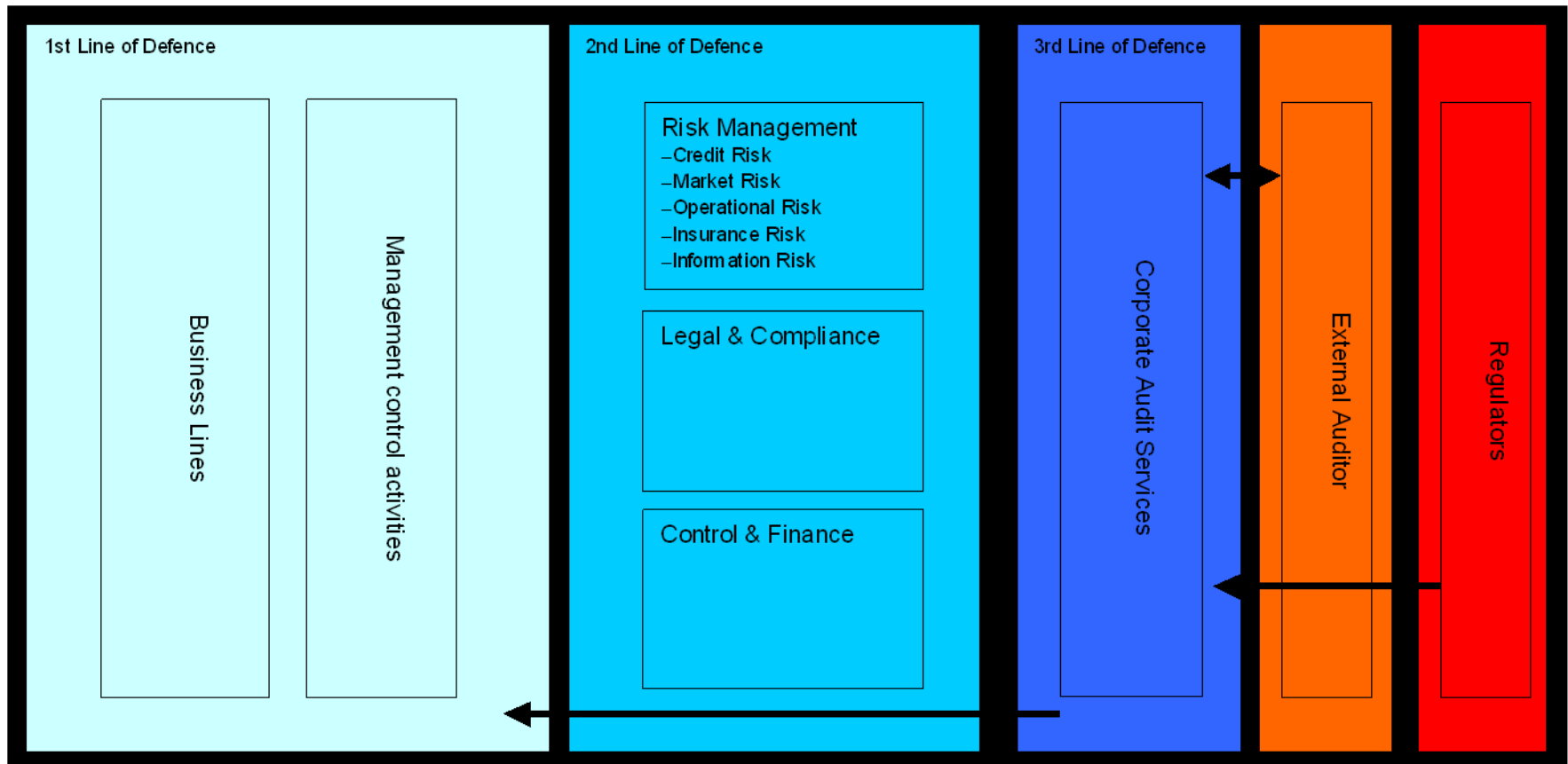
- Introduction
- Risk Management Organisation
- Liquidity Risk within ING Bank and Insurance
- Structural, tactical and contingency liquidity risk
- Testing of the Contingency Funding Plan
- Regulatory, legal and governmental issues
- Points for discussion

Introduction

Profile:

- ING is one of the 20 largest financial institutions worldwide.
- In the retail and wholesale banking activities ING operates worldwide with a primary focus on the Benelux home market.
- ING Direct is a leading direct bank with over 17.7 million customers in nine large countries.
- ING operates in worldwide insurance activities with a focus on the homemarket. ING is a large provider of life insurance in the US and a top property and casualty insurer in Canada.
- ING is also a large asset manager with assets under management up to EUR 600 billion per year-end 2006.

Risk Management Organisation: 3 lines of defence



Liquidity risk in ING Bank's balance sheet

Liabilities => Potential outflow

- Counterparty
- Withdrawal features
- Short- or long-term
- Deposit insurance

Assets => Potential inflow

- Counterparty
- Marketable/secondary markets
- Eligible for Central Bank
- Short- or long-term

Off-balance => Potential in- and outflow

- Given or received credit facilities

Customer loans		Core capital	22
		Issued debt (incl. sub)	102
		Customer deposits	
	451		488
Investments		Banker deposits	
	180		189
Banker loans		Trading	21
	139		73
Trading	75	Other	
			51
Other	51		
Total	895		

Liquidity risk in ING Insurance's balance sheet

Liabilities => Potential outflow

- Counterparty
- Surrender features
- Short- or long-term

Assets => Potential inflow

- Counterparty
- Marketable/secondary markets
- Eligible for Central Bank
- Short- or long-term

Off-balance => Potential in- and outflow

- Given or received credit facilities

Investments for risk of policyholders	113	Core capital	24
Loans and advances to customers	38	Issued debt	9
Reinsurance contracts	6	Insurance and investments contracts	269
Cash	3	Other borrowed funds	16
Investments	140	Other	16
Other	34		
Total	334		

Structural, tactical and contingency liquidity risk

In general 3 types of liquidity risk are recognized:

- **Structural liquidity risk:**

Long-term liquidity risk resulting from the total on- and off-balance sheet positions

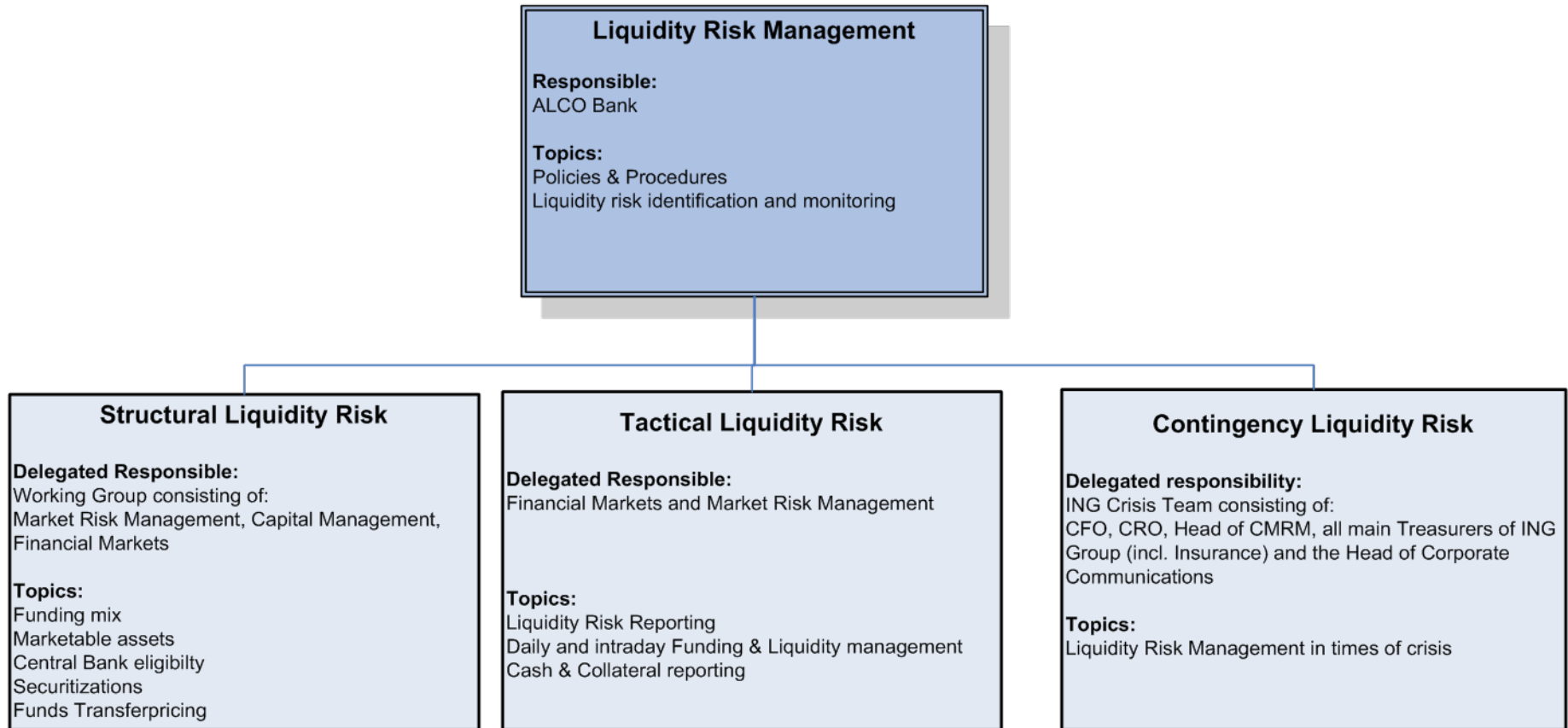
- **Tactical liquidity risk:**

Short-term liquidity risk resulting from the short-term on- and off-balance sheet positions

- **Contingency liquidity risk:**

Liquidity risk under stress scenarios

Structural, tactical and contingency liquidity risk



Structural Liquidity Risk

- Within ING structural liquidity risk is addressed within the Asset & Liability Management of the Group
- For this purpose a Working Group made up of the Capital Management, Market Risk Management and Financial Markets departments focuses on:
 - Balance sheet projections
 - Funding mix
 - Marketable Assets
 - Funds Transfer Pricing
 - Securitizations

Tactical Liquidity Risk (1)

- **ING Bank's Liquidity Risk Reporting:**
 - ING Bank uses the **Dutch Central Bank report** as its **internal Liquidity Risk Report**.
 - The report covers **entire ING Bank**.
 - The report is based on a scenario analysis that represents a **mix between a severe market and ING-specific event**
 - The focus of the report is on the **weekly** and **monthly** liquidity positions
 - The relevant positions are all **on- or off-balance sheet positions and cash flows** due within the relevant period.
 - The liquidity value of positions is calculated by multiplying the on- or off-balance sheet position or the cash flows with the appropriate **liquidity weighting**.
 - The liquidity weightings depend on factors as the type of liquidity crisis, the counterparty, the existence of secondary markets, client behaviour and product type.
 - **Convertibility** and **transferability** issues are considered.

Tactical Liquidity Risk (2)

- Simplified example ING Bank Liquidity Risk Reporting:

Balance sheet			
Government bonds	100	Equity	100
Mortgages	100	Issued debt	100
Demand deposits	100	Savings	100
	<u>300</u>		<u>300</u>

Liquidity Risk Report	Balance	Week liquidity	Month liquidity	<1W	<1M	>1M
ECB eligible assets	105	100	100			
Amount receivable	100	10	15	10	15	85
Demand deposits (credit institutions)	50	25	50			
Demand deposits (non-professional)	50	0	0			
Equity	-100	0	0			
Issued debt securities	-100	-8	-10	-8	-10	-90
Savings	-100	-2.5	-10			
Irrevocable credit facility given	(-100)	-2.5	-10			
Total	5*	122	135			

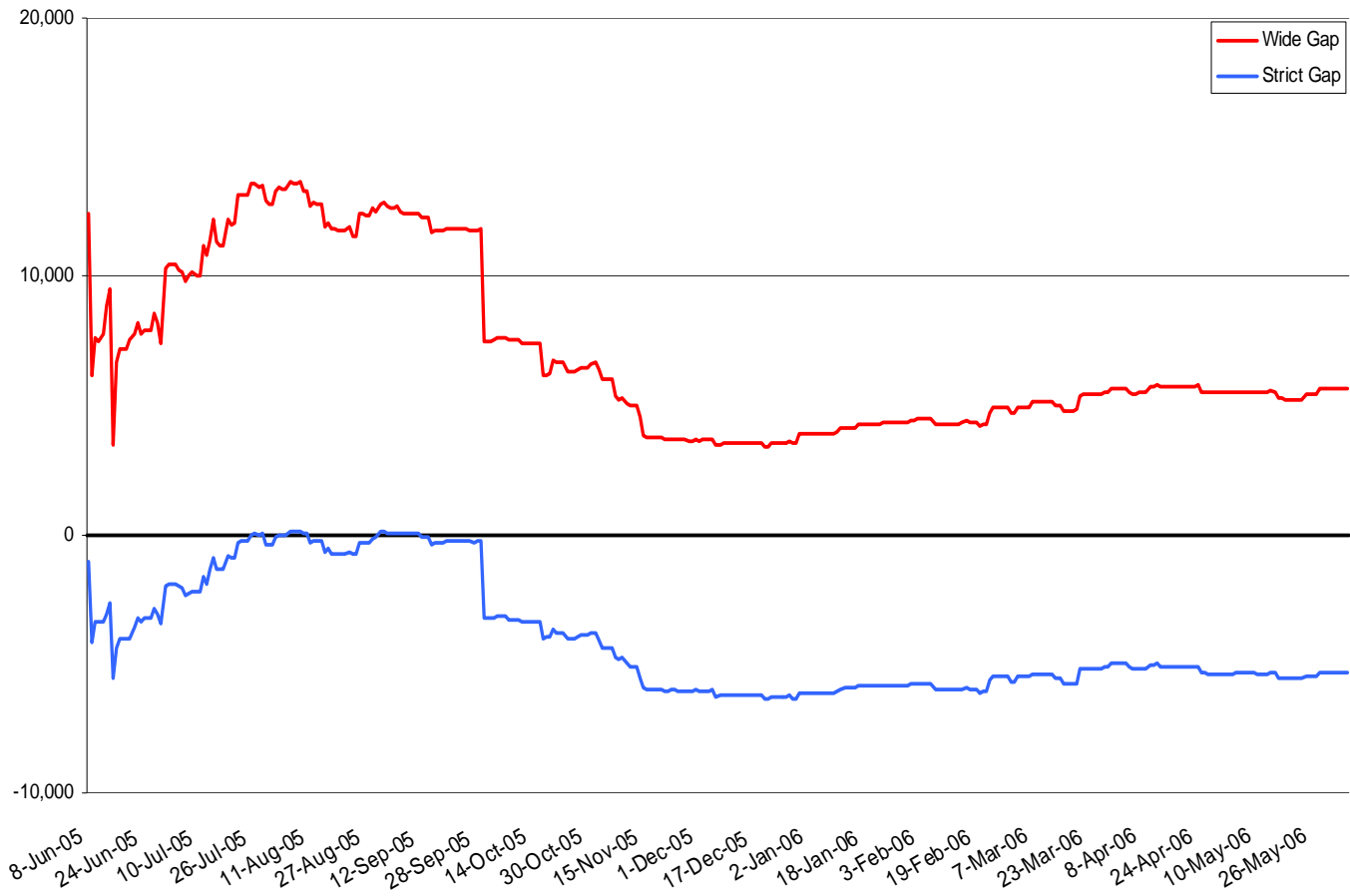
* Difference caused by market value of Government bonds

Tactical Liquidity Risk (3)

- **ING Bank's Liquidity Risk Framework:**
 - **Risk appetite:** Within ING Bank it is policy to maintain an **adequate buffer of liquidity** above the regulatory zero-limit.
 - This buffer must ensure that even under a severe liquidity crisis, ING is still capable of meeting its obligations in due time for at least **one month**.
 - Within ING Bank a framework is implemented on the level of the ALCO's that sets **limits** on the weekly and monthly liquidity risk positions.

Tactical Liquidity Risk (4)

- **Daily and interday Funding & Liquidity Risk Management:**
Strict (cash) and wide (cash + available collateral) liquidity gaps over time



Contingency liquidity risk

- **Contingency Funding Plans are in place on all relevant levels describing:**
 - Roles & responsibilities
 - Actions
 - Communication
 - Management information
- Within ING a special **crisis team** is responsible for Liquidity Risk Management in times of crisis.
- This Crisis Team consists of:
 - The CFO and the CRO
 - All the main Treasurers of ING Group
 - The head of Market Risk Management
 - The head of Corporate Communications

Testing of the Contingency Funding Plan (1)

Goals

- Test the ability to generate sufficient liquidity (efficiently and effectively).
- Test the internal and external communication lines within ING Bank.
- Determine the required management information and the ability to provide these reports in time.
- Determine possible points for improvement for the current liquidity management practise within ING Bank.

Test

During two successive business days the members of the ING Contingency Crisis Team have been confronted with a scenario in which:

- the bank suffered large outflows of funding due to rumours in the market and negative press
- its funding possibilities in the professional markets have largely disappeared
- continuous requests for information are done by regulators, rating agencies and the media.

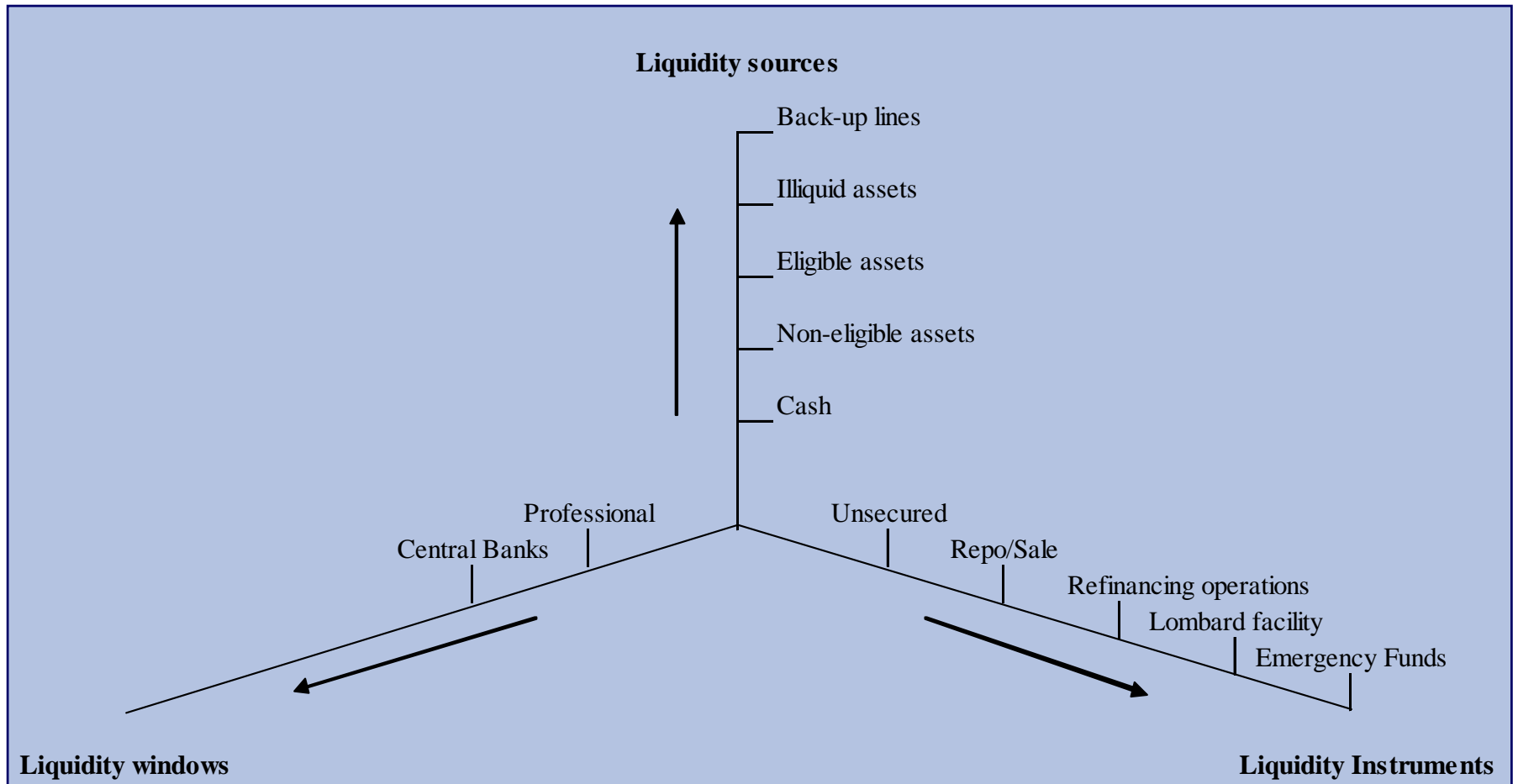
Testing of the Contingency Funding Plan (2)

Main findings

The crisis team was able to solve the immediate liquidity problems as described in the scenario, the following aspects turned out to be of key importance:

- adequate and timely management information
- communication with central bank/regulator is essential
- the role of Corporate Communications and Affairs is essential for the communication in times of crisis
- preferred order of generating liquidity

Testing of the Contingency Funding Plan (3)



Preferred order in generating liquidity

Regulatory, legal and governmental issues

- **ING Group is supervised by multiple supervisors across the globe:**
 - Liquidity risk is an exception to the home supervision principle
 - Inconsistent across countries
 - Additional reporting workload
- **Transferability issues**
 - Liquidity surpluses can't be transferred freely **from** certain countries
 - Liquidity can't be transferred freely **in** certain countries
- **Convertibility issues**
 - Due to market and/or regulatory restrictions some currencies can't be easily converted to EURO

Points for discussion

- Centralization?
- Horizon?
- Creating awareness for liquidity risk throughout the organization is of the utmost importance. This awareness must lead to the fact that all existing activities and new activities are evaluated against the risk appetite of the bank.