Qualitative and Quantitative Information on Capital Adequacy of ING Bank Śląski SA Group

for 2007

ING BANK ŚLĄSKI

Introduction

In keeping with Article 111 a) of the Banking Law Act dated 29 August 1997 (Journal of Law of 2002 No. 72, item 665 as amended) (hereafter: the Banking Law), ING Bank Śląski S.A., (hereafter: the Bank) shall put into the public domain the qualitative and quantitative information on capital adequacy, save for insignificant information, and also the information whose disclosure could diminish the Bank's position on the relevant market under the Consumer Protection and Competition Act and the information protected under law.

Pursuant to Resolution 11/II/2008 by the Bank Supervisory Board dated 27 March 2008, the information on capital adequacy of ING Bank Śląski S.A. Group is hereby disclosed.

In keeping with §14 of Resolution 1/2008 by the Banking Supervision Commission, in 2007, the Bank took advantage of the interim period in order to estimate the capital charge and equity. In practice, application of the interim period signifies computation of the discussed values based on the regulations to-date (the so-called Basle I). The information shown in the annual consolidated report of the Bank was prepared in line with Basle I, both in terms of capital charge and calculation of equity. In this publication, the data are presented in accordance with the document published earlier, extended with the calculation of equity and capital adequacy consistent with Basle II.

I. Equity

1.1 Equity and Short-term Capital

Equity is composed of: share capital, reserve capital from sale of shares above the face value, revaluation allowance and retained profit. All amounts of capitals and equity are shown at face value.

Share capital is shown at face value, in accordance with the Charter and entry into the commercial register.

Reserve capital from sale of shares above the face value is formed from the issue premium earned from the issue of shares, less direct costs incurred in that connection.

Revaluation allowance is formed as a result of:

- measurement of financial instruments classified as available-for-sale
- measurement of financial instruments backing cash flows
- measurement of non-current assets measured at fair value.

the deferred tax write-offs connected with the above measurements are recognised in the revaluation allowance. Revaluation allowance is not distributable.

Retained profit is the profit earned by the Bank throughout the previous period less the dividend paid out. Retained profit is composed of:

- other reserve capital
- other reserves
- general risk fund
- retained profit of previous years
- net financial result attributable to the dominant entity.

Other reserve capital, other reserves and general risk fund are formed from the profit contribution and are used for the purposes defined in the Charter and other regulations.

The banking general risk fund is formed from the profit after tax, in keeping with the Banking Law Act dated 29 August 1997 as amended.

Short-term capital is calculated under the Ordinance Fin/31/08 by the President of the Management Board dated 17 January 2008, which reflects the current regulations in that area. Since the volume of the Bank’s trading operations is significant, short-term capital is used to determine the capital adequacy norm. To estimate capital adequacy, short-term capital is recognised only to the level of the total capital charge for market risk.

Short-term capital is built of:

- market profit including the daily market result on operations in the trading portfolio and the daily market result due to foreign currency change and prices of commodities for the operations in the banking portfolio; it is calculated year-to-date up to the reporting date, less the charges recognised,
- losses (negative value) on all operations in the banking portfolio, calculated year-to-date up to the reporting date, exclusive of the exchange rate and commodity price changes.

1.2 Equity Calculation under Basle I

The information on equity according to Basle I was presented in line with Article 127 of the Banking Law Act and Resolution 4/2008 by the Banking Supervision Commission dated 8 September 2004 on the scope and detailed principles of capital charge determination for individual types of risk and the scope of application of statistical methods and conditions whose fulfilment makes it possible to obtain the consent to their application, the mode and detailed principles of the bank's solvency ratio calculation, the scope and manner of bank's operations within holdings in capital charge and solvency ratio calculation as well as determination of additional bank's balance positions recognised together with equity in the capital adequacy calculation, and the scope, manner and conditions of their determination.

Table 1: Equity and short-term capital in line with Basle I in PLN 000

I	**BASIC CAPITAL**	**2 890 953**
1.	Core capital	1 160 175
	- In-paid capital	*130 100*
	- Issue premium	*993 750*
	- Other elements of reserve capital	*36 325*
2.	Reserve capital	1 519 424
	- Other reserves together with retained profit of previous years	*1 609 298*
	- Minority capital	*1 720*
	- Net profit of the current period and profit under approval (verified by the chartered auditor)	*0*
	- Revalued basic equity	*-91 594*
3.	General risk fund for unidentified banking risk	530 179
4.	Basic capital decreases	-318 825
	- Intangible assets at balance value	*-318 825*
IV	**BANK EQUITY**	**2 890 953**
V	**SHORT-TERM CAPITAL**	**91 761**
VI	**EQUITY FOR CAPITAL ADEQUACY**	**2 982 714**

Short-term capital is calculated in accordance with §5 of the Resolution 4/2004 by the Banking Supervision Commission.

1.3 Equity Calculation under Basle II

The information on equity according to Basle II was presented in line with Article 127 of the Banking Law Act dated 29 August 1997 and Resolution 2/2007 by the Banking Supervision Commission dated 13 March 2007 on other decreases of basic capital, its volume, the scope and conditions of decrease of the bank's basic capital therewith, other bank's balance positions recognised as supplementary capital, their amount, the scope and conditions of their recognition as bank's supplementary capital, reductions of supplementary capital, their amount, the scope and conditions of decrease of bank's supplementary capital therewith; and also the scope and manner of recognition of banks' operation within holdings in calculation of equity.

Table 2: Equity and short-term capital in line with Basle II in PLN 000

I	**BASIC CAPITAL**	**3 101 097**
1.	Core capital	1 160 175
	- In-paid capital	*130 100*
	- Issue premium	*993 750*
	- Other elements of reserve capital	*36 325*
2.	Reserve capital	1 729 568
	- Other reserves together with retained profit of previous years	*1 609 298*
	- Minority capital	*1 720*
	- Net profit of the current period and profit under approval (verified by the chartered auditor)	*359 622*
	- Revalued basic equity	*-241 072*
3.	General risk fund for unidentified banking risk	530 179
4.	Basic capital decreases	-318 825
	- Intangible assets at balance value	*-318 825*
II	**SUPPLEMENTARY CAPITAL**	**10 275**
1.	Adjusted revalued basic equity moved to supplementary capital	10 275
	- unrealised profit on AFS debt instruments	*0*
	- unrealised profit on AFS equity instruments	*10 275*
III	**DECREASES**	**40 000**
1.	Decreases in basic capital	*29 725*
2.	Decreases in supplementary capital	*10 275*
IV	**BANK EQUITY**	**3 071 372**
V	**SHORT-TERM CAPITAL**	**66 674**
VI	**EQUITY FOR CAPITAL ADEQUACY**	**3 138 046**

In the calculation of equity for Basle II purposes, revaluation allowance is also considered; it is formed as a result of:
- measurement of equity instruments in the AFS portfolio
- measurement of debt instruments in the AFS portfolio
- measurement of cash flow hedge for assets other than in the AFS portfolio
- measurement of own real property.

In line with the principles of capital calculation for COREP capital adequacy reporting the revaluation allowance position also includes measurement of Fair Value Option (FVO) financial instruments and measurement of investment properties.
In the revaluation allowance the deferred tax write-offs due to above measurement recognition are included. Revaluation allowance is not distributable.

In supplementary capital the profit under approval and the net profit of the current reporting period less the foreseeable charges and dividend in the amount below the profit verified by the chartered auditor are also recognised.

Supplementary capital includes the adjusted revalued basic equity moved to supplementary capital for unrealised profit on equity and debt instruments available for sale.

In accordance with Resolution 2/2007 by the Banking Supervision Commission (§4), the Bank decreases the basic capital and the supplementary capital with the value of capital exposures in PTE ING. First, the supplementary capital and then the basic capital is decreased.

Short-term capital is calculated under §5 of Resolution 01/2007 by the Banking Supervision Commission.

II. Capital Charge

2.1 Capital Charge Calculation for Basle I

In the 2007annual consolidated report of the Bank, the capital charge was shown in accordance with Resolution 4/2004 by the Banking Supervision Commission.

Table 3: Aggregate capital charge per individual types of risk in line with Basle I in PLN 000

I	**CREDIT RISK**	**1 727 660**
II	**MARKET RISK, including:**	**91 761**
	- FX risk	5 269
	- risk of prices of equities	786
	- special risk of prices of debt instruments	40 804
	- general risk of interest rates	17 219
	- risk of supply and counterparty settlement	27 683
III	**TOTAL CAPITAL CHARGE**	**1 819 421**

2.2 Capital Charge Calculation for Basle II

In keeping with §14 of Resolution 1/2008 by the Banking Supervision Commission, in 2007 the Bank took advantage of the interim period in order to estimate the capital charge for credit and operational risk.

The capital charge due to credit risk was calculated using the Basle I methods. In accordance with the new regulations, the charge due to counterparty risk was moved to the aggregate charge due to credit risk. Standard methods, compliant with Basle II, were employed to calculate the charge for market risk. On the other hand, the capital charge for operational risk was estimated using the Basic Indicator Approach (BIA).

Under the circumstances of the overall reduction of the charge for operational risk, the capital charge due to credit risk accounts for 96% of the Bank's capital charge total and has the most influence on the capital adequacy calculation.

Table 4: Aggregate capital charge per individual types of risk in PLN 000

I	**CREDIT RISK, including:**	**1 755 343**
	- counterparty credit risk	27 683
II	**MARKET RISK, including:**	**66 674**
	- FX risk	5 309
	- risk of prices of equities	752
	- special risk of prices of debt instruments	43 394
	- general risk of interest rates	17 219
III	**OPERATIONAL RISK**	**259 636**
IV	**CAPITAL CHARGE FOR OPERATIONAL RISK ADJUSTED DUE TO INTERIM PERIOD**	**-259 636**
V	**TOTAL CAPITAL CHARGE**	**1 822 017**

Credit exposure structure and amount of exposures by risk weights are shown in table 5.

Table 5: Capital charge for credit risk in PLN 000

Risk weight	Exposure value before off-balance sheet exposure conversion ratios	Exposures by off-balance sheet exposure conversion ratios				Exposure value	Risk-weighted exposure value	Total capital charge for 4 credit risk
		0%	20%	50%	100%			
0%	25 440 401	118 682	710 478	0	6 707 618	24 753 337	0	0
20%	16 062 047	0	0	0	0	16 062 047	3 212 409	277 396
50%	2 579 365	242	83 235	0	1 926 004	2 512 535	1 256 268	107 782
100%	18 718 386	134	1 988 978	0	1 998 969	17 127 070	17 127 070	1 370 166
Total	**62 800 199**	**119 058**	**2 782 691**	**0**	**10 632 591**	**60 454 988**	**21 595 747**	**1 755 343**

III. Capital Adequacy Ratio

The capital adequacy ratio is calculated and shown as a percentage value - a fraction multiplied by 100, where:
- the numerator is the value of equity increased with short-term capital (whose value does not exceed the capital charge for market risk)
- the denominator is the total capital charge multiplied by 12.5.

As at 31 December 2007, the consolidated solvency ratio of the Bank was 13.12% (Basle I) and 13.78% (Basle II). The differential results from the changes in the equity calculation methodology and implementation of Basle I resolutions to calculate the capital charge for market risk

IV. Internal Capital

In calculation of the internal capital the Bank employs the methodology developed by ING Group. Economic capital is the term ING Group uses for internal capital. Economic capital at the portfolio level is the estimation of maximum credit losses (beyond the expected loss), which the Bank may incur on this portfolio over a specific period of time and with the assumed confidence level (brackets).

Economic capital is required so as to protect the Bank against unforeseeable (credit- and transfer-related) losses beyond the expected loss. Adequate capital provides for loss absorption without exposing the Bank to the risk of bankruptcy. From the portfolio level economic capital is allocated to a single transaction level, depending on the transaction and client risk parameters (PD, LGD and EAD) as well as the correlation between a given transaction and the entire portfolio of the Bank.

In other words, economic capital is used to protect the Bank against loss deviations beyond the expected loss (a certain average after economic cycle), which is understood as the normal cost of banking operations. By contrast, deviations beyond the average value form the so-called unexpected loss.

The confidence level is the probability that the amount of economic capital will prove sufficient to absorb credit losses over a given time horizon, usually within 1 year.

Probability of the bank's insolvency (the loss tolerance level) is the opposite of the confidence level. The losses which exceed the tolerance level are extraordinary losses; they are not covered with economic capital and they lead to the Bank's bankruptcy.

ING Group determined its planned rating as AA-, and the corresponding PD is 0.05%. Confidence brackets may be defined by applying probability of default for that rating as the loss tolerance level. The confidence bucket corresponding to the tolerance level of 0.05% is 99.95% (i.e. 100% - 0.05%).

According to the ING Group methodology, the total economic capital is the total of capitals used to cover 5 types of risk; i.e.:

1. credit risk for which the economic capital is calculated based on the expected loss and unexpected loss with the assumed period and defined confidence brackets,
2. market risk for which the economic capital is calculated using the Value at Risk method or statistical estimation of potential loss over the assumed period,
3. operational risk for which the economic capital is calculated using the Advanced Measurement Approach (AMA),
4. business risk for which the economic capital is measured by analysing volatility trends over time for income statement values,
5. transfer risk for which the economic capital is calculated based on the expected and unexpected losses in the manner similar to the one applied for credit risk.

The calculated amounts of economic capital are reduced with the diversification effect-based adjustment. The diversification ratio is calculated based on the correlation among various types of risk.

There are also additional correlations and diversification effects present for credit risk as well; they result from the fact that a single client and transaction belong to a definite portfolio in terms of territorial designation, sector, client type and exposure amount.

Correlation ratios and diversification effects are estimated at the level of ING Group and updated at least once a year.