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Credit Opinion: REAAL Verzekeringen

Global Credit Research - 22 Jul 2015

Netherlands

Ratings

Category	Moody's Rating
SNS Reaal N.V.	
Rating Outlook	STA
Senior Unsecured MTN	(P)Ba2
Commercial Paper	NP
SRLEV NV	
Rating Outlook	POS
Insurance Financial Strength	Baa3
BACKED Junior Subordinate	Ba3 (hyb)
REAAL Schadeverzekeringen NV	
Rating Outlook	POS
Insurance Financial Strength	Baa3

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Key Indicators

REAAL Verzekeringen[1][2]	2014	2013	2012	2011	2010
As Reported (Euro Millions)					
Total Assets	60,525	55,475	56,464	53,990	53,044
Total Shareholders' Equity	2,015	2,589	2,932	4,020	3,630
Net income (loss) attributable to common shareholders'	(612)	(625)	(149)	192	242
Gross Premiums Written	3,105	3,190	3,455	3,696	3,728
Life Insurance Gross Premiums Written	2,346	2,406	2,636	2,848	2,919
Property & Casualty Insurance Gross Premiums Written	759	784	819	848	809
Net Premiums Written	2,898	2,967	3,232	3,450	3,574
Moody's Adjusted Ratios					
High Risk Assets % Shareholders' Equity	153.8%	126.0%	128.4%	91.3%	122.5%
Reinsurance Recoverable % Shareholders' Equity	173.9%	147.6%	100.4%	83.4%	10.0%
Goodwill & Intangibles % Shareholders' Equity	3.5%	2.4%	27.9%	37.9%	63.5%
Shareholders' Equity % Total Assets	3%	4%	5%	7%	6%
Return on avg. Capital (1 yr. avg ROC)	-13.9%	-12.0%	-2.6%	2.8%	3.4%
Sharpe Ratio of ROC (5 yr. avg)	NM	NM	NM	16.9%	NA
Adv./(Fav.) Loss Dev. % Beg. Reserves (1 yr. avg)	-1.8%	-0.7%	-5.2%	-4.4%	-5.0%
Financial Leverage	49.8%	44.5%	45.5%	33.8%	47.8%
Total Leverage	52.6%	46.9%	49.7%	42.6%	64.6%
Earnings Coverage (1 yr.)	-4.1x	-5.1x	-0.2x	2.5x	4.2x

[1] Information based on IFRS financial statements as of Fiscal YE December 31 [2] Certain items may have been relabeled and/or reclassified for global consistency

Opinion

SUMMARY RATING RATIONALE

The following credit opinion presents the rating rationale of the financial strength ratings of SRLEV N.V. and REAAL Schadeverzekeringen N.V.. Moody's currently considers the combined operations of all the insurance companies of SNS REAAL Group (mainly SRLEV N.V., REAAL Schadeverzekeringen N.V. and Proteq Levensverzekeringen N.V.) as one analytic unit. Therefore, the following credit opinion refers to the financial strength of the combination of these companies (called REAAL in this document).

Moody's Baa3 insurance financial strength ratings (positive outlook) on REAAL's main legal entities (SRLEV N.V., a life insurance company, and REAAL Schadeverzekeringen N.V., a non-life insurance company) reflect their focus on retail and SMEs businesses and low asset risk. The ratings also factor in (i) Spread deficiency challenges with a sizeable portfolio of life insurance products offering relatively high guarantees and large duration mismatch, (ii) volatile capitalisation and weak quality of capital given high leverage ratios; and (iii) weak operating profitability in both life and non-life.

On 17 July 2015, Moody's upgraded the backed subordinated and junior subordinate debt ratings of SRLEV N.V. to Baa3(hyb) from B3(hyb). The Baa3 insurance financial strength rating of REAAL's main legal entities was confirmed. The rating action reflects Moody's expectation that the sale of REAAL to Anbang Insurance Group Co. Ltd. (Anbang) is more likely to complete following the approval from the Dutch Insurance Regulator (DNB) and the completion of the sales agreement with Anbang. The only pending hurdle is the approval from the Chinese regulator following which Anbang will inject 1.35 billion in REAAL to strengthen REAAL's Solvency II position,

The confirmation of the Baa3 IFSR reflects the likely stabilisation in REAAL's credit fundamentals as a result of the strengthening in the insurer's solvency position. The upgrade on the hybrid debt ratings reflects the (i) reduced risk of not payment of principal based on our expectation that the deal will be completed and thereby REAAL's solvency position will be significantly strengthened after Anbang's EUR1.35bn capital injection (ii) Moody's expectation that REAAL will likely resume the payment of coupons on the subordinated debt following Anbang's capital injection, which will have to be made within 90 days of the completion of the deal.

The business mix of REAAL consists of life insurance (76% of gross premiums written in 2014) and non-life insurance, including disability (24%).

Credit Strengths

The main credit strengths of REAAL are as follows:

- Conservative investment policy
- Moderate risk profile thanks to a focus on retail and SMEs businesses

Credit Challenges

The key credit challenges of REAAL are as follows:

- Pressure on market position due to challenges faced by insurer and difficult conditions in the Dutch market
- Managing spread deficiency and high duration mismatch in a sustained low interest rate environment
- Improving the operating profitability of the company, and adapting itself to the contraction of the individual life insurance market and maintaining reasonable levels of profitability in a context of low interest rates, bearing in mind the relatively high level of guarantees of the traditional savings products
- Manage volatility in the capitalisation given substantial ALM mismatches

Rating Outlook

SRLEV N.V. and REAAL Schadeverzekeringen N.V. insurance financial strength ratings carry a positive outlook, reflecting the potential improvement in REAAL's financial profile following the future capital injection once the deal completes. We will also assess the strategy that Anbang intends to pursue in REAAL as part of the positive

outlook.

SRLEV N.V.'s EUR400 million Tier 2 Notes due 2041 and CHF105 million perpetual subordinated securities' ratings are also on positive outlook, reflecting our expectation of a likely upgrade in the debt ratings once REAAL resume the coupon payments on the hybrid debt. REAAL indicated that the ban on coupon payments imposed by the European Commission was lifted following the agreement reached with Anbang, but the group decided to continue not to pay coupons on SRLEV's hybrids while the transaction completes, in accordance with the fully optional coupon skip mechanism included in these securities.

Our current Ba3(hyb) ratings on these hybrid debts are three notches below SRLEV's insurance financial strength rating, which is wider than Moody's standard notching practices for debts issued by operating insurance companies, incorporating the still remaining risk of not resumption of the coupon payments.

What to watch for:

- Evolution of REAAL's insurance operations' market shares and profitability
- Volatility of economic capitalisation
- Duration mismatch and spread deficiency
- Resumption of payment in hybrid coupons

What Could Change the Rating - Up

The following factors could exert upward pressure on the ratings:

- A substantial improvement in REAAL's financial profile by reducing the volatility in economic capitalisation to interest rate movements and remediating the large duration mismatch and spread deficiency problems
- A meaningful improvement in REAAL's operating profitability
- An improvement in market position in life and non-life, both of which have been under pressure as a result of problems faced by the insurer

What Could Change the Rating - Down

Downward pressure is unlikely given the positive outlook. However, the ratings could be stabilised following:

- A substantial deterioration in REAAL's long-term economic capitalisation either from a sustained material reduction in Solvency II position, increased volatility or material reduction in the quality of capital
- Financial or total leverage exceeding 50%
- Continuing pressures on market position in the Dutch insurance market

DETAILED RATING CONSIDERATIONS

Moody's rates REAAL Verzekeringen's main legal entities Baa3 for insurance financial strength, which is in line with the rating indicated by Moody's insurance financial strength rating scorecard.

Insurance Financial Strength Rating

The key factors currently influencing the rating and outlook are:

MARKET POSITION AND BRAND: Baa - MARKET SHARE UNDER PRESSURE IN A DIFFICULT DUTCH INSURANCE MARKET

REAAL was the fourth-largest player in the highly concentrated Dutch market with a market share at 13.1% in life and 5.2% in non-life in 2013. The Group has maintained a top rank in the individual life segment (with a 16.8% market share in new production) but has lost market share notably in the group life business (7.4% in 2014 compared to 14.6% in 2013). Competition is high in the Dutch insurance market as the group is competing with large players such as NN Group and AEGON, and also with banks, as Dutch banking and insurance products carry the same fiscal advantages since 2008.

We believe the period preceding the nationalisation had a negative impact on REAAL's franchise and raised uncertainty regarding REAAL's ability to maintain its historically strong market positions, especially in the rapidly evolving Dutch life insurance market, where insurance savings are falling and competition in the pensions segment is growing.

DISTRIBUTION: Baa - PREDOMINANTLY THROUGH INDEPENDENT CHANNELS

REAAL's insurance premiums predominantly come from the brokerage channel. Nonetheless, REAAL has maintained a stable and diversified intermediary base and Zwitserleven has enjoyed a preferred position with IFAs. The network of SNS Bank is also used to sell insurance products, but this channel currently contributes to less than 10% of the insurance revenues. The acquisition of Axa's operations in the Netherlands and Zwitserleven, provided further diversification in the distribution strategy thanks to a developed agents' network, and the use of the direct channel is also growing rapidly in the Netherlands. Therefore, we believe that distribution control and diversification of REAAL is in line with a Baa-rating.

PRODUCT FOCUS AND DIVERSIFICATION: Baa - LIFE PRODUCT RISK IS ELEVATED GIVEN THE HIGH GUARANTEES AND UL MISSELLING ISSUES

REAAL is adequately diversified between life and non-life, although the latest acquisitions have more significantly benefited the life segment (representing 76% of the 2014 premiums). Most of the Group's products are also distributed within the retail and SME segments.

In the non-life segment, Motor accounted for 33% of the 2014 gross premiums, Fire for 28% and A&H for 17%, which confers a moderate business risk profile in P&C, although Moody's considers Disability (which accounts for the majority of A&H gross premiums) as a long-tailed line given the importance of benefits paid by annuities.

In the life segment, 14% of the 2014 technical provisions were related to traditional individual savings contracts, which carry high guarantees on average between 3%-4%, while 14% of liabilities were savings mortgages products. The annuities' liabilities were also significant (9%). This is offset by a large portfolio of unit-linked (UL) contracts (36% of the 2014 liabilities), although these products also offer guarantees at maturity. Furthermore, the mis-selling issues that the Dutch market faced in the UL segment have caused a sharp decline in the production of UL products, which contributes to deteriorate the risk profile of the life industry in the Netherlands.

Moreover, unlike most of its competitors, the insurance group has no geographic diversification.

ASSET QUALITY: A - CONSERVATIVE INVESTMENT PORTFOLIO

The Group has historically carried a significant amount of goodwill, yielded by the acquisitions of AXA, Winterthur and DBV. Goodwill and intangibles sharply declined to 3.5% of shareholders' equity at year-end 2014 from historical levels following an impairment incurred in 2012.

Reinsurance recoverables were at 174% of shareholders' equity in 2014, as the Group entered several traditional life reinsurance transactions as part of its capital release programme.

REAAL's investment risk is low with a conservative fixed income portfolio. Fixed-income securities and cash are predominant in the investment portfolio, and most of the credit exposures are in the investment grade category. High risk assets as a percentage of equity were adequate, mostly compiled of equities, loans or not rated debt and real estate. Therefore, overall, Moody's continues to consider asset quality of REAAL is in line with an A rating.

CAPITAL ADEQUACY: Baa - CAPITALISATION WILL LIKELY IMPROVE AFTER CAPITAL INJECTION, BUT CHALLENGES REMAIN DUE TO LOW INTEREST RATE ENVIRONMENT

The insurer's capitalisation under Solvency I also deteriorated in 2014 to 136% from 172% at YE13, mainly due to the negative impact of model and cost parameter changes as well as of unfavourable movements in yield curves and credit spreads. Moody's views the capitalisation of the company to be weak in absolute terms and when compared with the rest of the large Dutch insurance players (with on average Solvency I ratios above 200%).

We expect capitalisation to improve, following the completion of the sale, when Anbang will inject EUR1.35 billion to strengthen REAAL's Solvency II capital cover to 140%-150%. Nevertheless, REAAL's solvency has proven to be highly volatile and the quality of capital will remain low (albeit improved) given the high reliance on subordinated debt.

In addition, we believe that execution risks to strengthen REAAL's credit fundamentals will likely remain given the

headwinds the group faces in a context of a persistently low interest rate environment and the challenging outlook for the Dutch insurance market.

PROFITABILITY: Ba - UNDER PRESSURE AS A RESULT OF LOW INTEREST ENVIRONMENT AND A SHRINKING MARKET

In 2014, REAAL reported a net loss of EUR612 million (YE13: net loss of EUR625 million). This loss was predominantly driven by a total charge of EUR648 million due to weak operating performance in non-life and life, with life profitability impacted by the decline in long term interest rates which exacerbated the spread deficiency given the duration mismatch between investments and liabilities.

Following the future likely capital injection, REAAL may be able to remediate some of the pressures on the group's operating performance. However, the sustained low interest rate environment and difficult and very competitive Dutch insurance market will likely remain a challenge to restore operating performance in the short to medium term.

LIQUIDITY AND ALM: A - REINVESTMENT RISK IS ELEVATED

At SRLEV N.V., liquid assets adequately cover net policyholder reserves, and Moody's calculated ratio of liquid assets / liquid liabilities is good. Asset/liability risks are managed by using derivatives to reduce interest rate or equity risks. Nonetheless, the duration gap (between the assets and the liabilities of the insurance activities) is relatively large, leaving the insurance company with a significant reinvestment risk, especially given the relatively high guarantees embedded in the life products.

RESERVE ADEQUACY: A - RISK IN THE DISABILITY PORTFOLIO

The company's disclosure of prior year non-life reserve shows favourable development. However, Disability liabilities have an average duration of more than five years, and Moody's considers that this segment carries a higher risk of reserve underestimation than short-tailed liabilities. Therefore, we view that the Group's reserve adequacy is consistent with a A-rating.

FINANCIAL FLEXIBILITY: Ba - VERY HIGH LEVERAGE, EARNINGS COVERAGE REMAINS UNDER PRESSURE

The financial flexibility of REAAL remains under pressure given the low interest coverage. Fixed charge coverage has been negative since 2012 because of the constrained profitability and one-off items such as impairments and provisions related to LAT shortfall . We expect earnings coverage to remain under pressure, in line with our expectations of constrained profitability at the insurance operations.

The insurance financial leverage was 50% at year-end 2014. Financial debts at year-end 2014 consisted of EUR0.9 billion subordinated debts - of which EUR400 million and CHF 105 million issued by SRLEV in 2011 - and EUR0.7 billion of amounts due to banks (excluding the repo agreements and the loans related to securitised mortgages that we do not consider as financial debt). The high financial leverage reflects the financing of the acquisitions of AXA operations and of Zwitserleven, which was realised to a large extent through debts issuance. Total leverage for REAAL was 53% in 2014. Furthermore, the coupon deferrals on existing hybrid securities further constrain the financial flexibility of REAAL.

Following the future capital injection, we expect leverage to decline to a pro-forma 38% at year-end 2014.

Rating Factors

REAAL Verzekeringen[1][2]

Financial Strength Rating Scorecard	Aaa	Aa	A	Baa	Ba	B	Caa	Score	Adjusted Score
Business Profile								A	Baa
Market Position and Brand (20%)								A	Baa
- Relative Market Share Ratio			X						
Distribution (5%)								Ba	Baa

- Distribution Control				X					
- Diversity of Distribution					X				
Product Focus and Diversification (10%)								A	Baa
- Product Risk - P&C			X						
- Product Risk - Life			X						
- Product Diversification		X							
- Geographic Diversification					X				
Financial Profile									
Asset Quality (10%)								Ba	Baa
- High Risk Assets % Shareholders' Equity				153.8%				A	A
- Reinsurance Recoverable % Shareholders' Equity					173.9%				
- Goodwill & Intangibles % Shareholders' Equity	3.5%								
Capital Adequacy (15%)								Ba	Baa
- Shareholders' Equity % Total Assets					3%				
Profitability (15%)								B	Ba
- Return on Capital (5 yr. avg)						-4.5%			
- Sharpe Ratio of ROC (5 yr. avg)							NM		
Liquidity and Asset/Liability Management (5%)								Aa	A
- Liquid Assets % Liquid Liabilities		X							
Reserve Adequacy (5%)								Aa	A
- Adv./(Fav.) Loss Dev. % Beg. Reserves (5 yr. wtd avg)		-3%							
Financial Flexibility (15%)								Ba	Ba
- Financial Leverage				49.8%					
- Total Leverage					52.6%				
- Earnings Coverage (5 yr. avg)						-0.5x			
Operating Environment								Aaa - A	Aaa - A
Aggregate Profile								Baa2	Baa3

[1] Information based on IFRS financial statements as of Fiscal YE December 31 [2] The Scorecard rating is an important component of the company's published rating, reflecting the stand-alone financial strength before other considerations (discussed above) are incorporated into the analysis

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