Moody's Investors Service

Global Credit Research
Credit Opinion
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Credit Opinion: REAAL Verzekeringen

REAAL Verzekeringen

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	RUR
Insurance Financial Strength	Baa3
BACKED Junior Subordinate	B3 (hyb)
REAAL Schadeverzekeringen NV	
Rating Outlook	RUR
Insurance Financial Strength	Baa3

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Key Indicators

REAAL Verzekeringen[1][2]

	2013	2012	2011	2010	2009
As Reported (Euro Millions)					
Total Assets	54,114	56,464	53,990	53,044	53,062
Shareholders' Equity	2,589	2,932	4,020	3,630	3,300
Net Income (Loss) Attributable to Common Shareholders	(625)	(149)	192	242	196
Gross Premiums Written	3,190	3,455	3,696	3,728	4,362
Life Insurance Gross Premiums Written	2,406	2,636	2,848	2,919	3,548
Property & Casualty Insurance Gross Premiums Written	784	819	848	809	814
Net Premiums Written	2,967	3,232	3,450	3,574	4,254
Moody's Adjusted Ratios					
High Risk Assets % Shareholders' Equity	126.0%	128.4%	91.3%	122.5%	396.4%
Reinsurance Recoverable % Shareholders' Equity	147.6%	100.4%	83.4%	10.0%	11.3%
Goodwill & Intangibles % Shareholders' Equity	2.4%	27.9%	37.9%	63.5%	75.4%
Shareholders' Equity % Total Assets	4%	5%	7%	6%	4%
Return on Capital (1 yr)	-12.1%	-2.8%	2.6%	3.3%	3.0%
Sharpe Ratio of ROC (5 yr avg)	NM	NM	16.0%	NA	NA
Adv (Fav) Loss Dev % Beginning Reserves (1 yr)	-0.7%	-5.2%	-4.4%	-5.0%	-6.5%
Financial Leverage	44.8%	45.8%	34.2%	48.1%	51.8%
Total Leverage	47.2%	49.9%	42.9%	64.8%	69.3%
Earnings Coverage (1 yr)	-4.8x	-0.2x	2.4x	4.1x	7.4x

[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 SNS REAAL Insurance activities in this document).

Moody's Baa3 insurance financial strength ratings (under review with direction uncertain) on SNS REAAL Insurance activities' 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. More negatively, the ratings also factor in (i) a deteriorating capitalisation, which Moody's views currently as weak in absolute terms and when compared with other large Dutch insurers, (ii) low operating margins in the non-life and life businesses as a result of a very competitive market exacerbated by the current low interest rate environment, and (iii) ALM challenges with a sizeable portfolio of life insurance products offering relatively high guarantees.

The ratings of SNS REAAL Insurance activities also reflect the uncertainties on the franchise of the insurance group as part of the sale process.

On 19 February 2015, the ratings of SNS REAAL's insurance operations were placed on review with direction uncertain following the announcement that SNS REAAL has signed an agreement with Anbang Group Holdings Co. Ltd., a Chinese insurance company, to sell REAAL N.V., the holding company of SNS REAAL's insurance operations. Under the agreement, Anbang will pay a cash consideration of EUR150 million. The buyer also commits to (1) strengthen the capitalisation of the Dutch insurer to a Solvency II level of between 140-150%, resulting in an additional capital injection between EUR770 million and EUR1.0 billion (2) repay EUR552 million of internal loan, including EUR250 million of intercompany loan to SNS Bank and EUR302 million of T2 hybrid loans to SNS REAAL N.V.. The anticipated effective date of sale is 30 June 2015 with an expected close in 3Q15, subject to regulatory approval.

The business mix of SNS REAAL Insurance activities consists of life insurance (75% of gross premiums written in 2013) and non-life insurance, including disability (25%). SNS REAAL Insurance activities represented 42% of total assets of SNS REAAL group and 50% of its shareholders' equity at year-end 2013.

Credit Strengths

The main credit strengths of SNS REAAL Insurance activities are as follows:

- Moderate risk profile thanks to a focus on retail and SMEs businesses;

- Conservative investment policy.

Credit Challenges

The key credit challenges of SNS REAAL Insurance activities are as follows:

- Maintaining a good franchise and market position, in a period of uncertainties regarding the future of the insurance operations;

- Improving the efficiency and operating performance 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.

- Weak capitalisation, both in absolute terms and when compared with other large Dutch insurers

Rating Outlook

SRLEV N.V. and REAAL Schadeverzekeringen N.V. insurance financial strength ratings are on review with direction uncertain, reflecting a variety of positive and negative scenarios. Positive pressures could arise if Anbang transaction is completed resulting in capital injection of between EUR770 million to EUR1.0 billion. Conversely, negative pressures could arise if the transaction does not materialise; this scenario will likely weaken the stand-alone credit profile of the insurer, in the absence of external support.

SRLEV N.V.'s EUR400 million Tier 2 Notes due 2041 and CHF105 million perpetual subordinated securities' ratings are also on review with direction uncertain, reflecting the possibility of a multi-notch upgrade if SNS REAAL is able to complete the aforementioned transaction and if Anbang recapitalises the insurance operations as planned, most likely leading to a resumption of coupon payments. SNS REAAL has 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, in accordance with the fully optional coupon skip mechanism included in these securities. Conversely, the ratings could be downgraded if we believe that the sale of the insurance operations could be cancelled, or the entity would be sold to a counterparty which will not resume coupon payments or decide not to pay part of the principal.

Our current B3(hyb) ratings on these hybrid debts are six 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 an expectation of several years of deferred coupons on these securities.

What to watch for:

- Evolution of SNS REAAL's insurance operations' market shares and profitability

- Sale process of the insurance operations

What Could Change the Rating - Up

The following factors could exert upward pressure on the ratings:

- A significant improvement of the fundamentals of the insurance operations such as restoring good levels of capitalisation and profitability, while maintaining strong market positions.

- Potential acquisition by Anbang which commits to strengthen the capital of SNS REAAL's insurance operations and repay internal loans

What Could Change the Rating - Down

The following factors could exert downward pressure on the ratings:

- No completion of the transaction with Anbang, resulting in a sustained deterioration of capitalisation of the insurer

- Risk of longer coupons deferral on the hybrids and /or not payment of the principal

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 - GOOD MARKET POSITIONS, OFFSET BY SOME UNCERTAINTIES ON THE FRANCHISE

Following the acquisition of the Dutch operations of Axa in 2007 and Zwitserleven in 2008, SNS REAAL Insurance activities have become 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 18.4% market share in new production) but has lost market share in the group life business (8.9% in 1H14 compared to 19.2% in 1H13). 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 SNS REAAL's insurance operations franchise and raised uncertainty regarding SNS 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

SNS REAAL's insurance premiums predominantly come from the brokerage channel. Nonetheless, SNS REAAL Insurance activities have 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 SNS REAAL Insurance activities 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

SNS REAAL Insurance activities are adequately diversified between life and non-life, although the latest acquisitions have more significantly benefited the life segment (representing 75% of the 2013 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 2013 gross premiums, Fire for 27% 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, 16% of the 2013 technical provisions were related to traditional individual savings contracts, most of them bearing guarantees at 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 2013 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. However, goodwill and other intangibles improved significantly to 3% of reported shareholders' equity at year-end 2013, as a result of impairments of goodwill and VOBA.

Reinsurance recoverables represented 153% of shareholders' equity in 2013, as the Group entered several traditional life reinsurance transactions as part of its capital release programme.

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 SNS REAAL Insurance activities is in line with an A rating.

CAPITAL ADEQUACY: Ba - WEAKENING REGULATORY SOLVENCY, PARTLY SUPPORTED BY LIFE REINSURANCE

The insurer's capitalisation under Solvency I also deteriorated in 2014 to an estimated 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%) and expects capitalisation to remain under pressure as a result of the weak profitability.

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

In the first nine months of 2014, SNS Reaal's insurance operations reported a net loss of EUR337 million. This loss was driven by (1) a charge of EUR266 million in 1H14 related to a Liability Adequacy Test (LAT) shortfall, mainly due to cost dissynergies from disentanglement from SNS Bank NV (Baa2) as well as shrinking premiums volumes and (2) an additional EUR144 million LAT shortfall in 3Q14, driven primarily by the decline in long term interest rates. Even when excluding these items and the impact of the investment portfolio and hedges, the underlying results of the insurance activities have been weak, reducing to a profit of EUR 1 million in 1H14 from EUR 29m in 1H13, reflecting the pressure arising from the low interest environment and shrinking premiums. We expect this trend to continue into 2015.

We also anticipate that the spread between SRLEV's asset yield and its average credited rate will continue to deteriorate as a result of reducing asset returns (the yield on 10-year Dutch sovereign bonds reduced to 0.8% as at 28 November 2014 from 2.2% as at YE13) and the insurer's ALM mismatch, with a 4.4 years gap between the duration of its fixed income investments and the duration of its provision for insurance contracts as at YE13.

Looking forwards, we believe REAAL Verzekeringen's results will remain under pressure from the continuous low interest rate environment and intense competition. More specifically, the competition is particularly high in the segment of individual savings products, where banks are likely to continue to gain market shares, and in the pension segment, two areas in which SNS REAAL has significant operations.

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 AND

UNCERTAINTIES ON POTENTIAL REMEDIES IMPACTING SRLEV'S DEBTS

The financial flexibility of SNS REAAL Insurance activities remains under pressure given the low interest coverage. Fixed charge coverage was negative in 2012 and 2013 because of the constrained profitability and one-off items such as impairments. 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 45% at year-end 2013. Financial debts at year-end 2013 consisted of EUR0.9 billion subordinated debts - of which EUR400 million and CHF 105 million issued by SRLEV in 2011 - and EUR2.2 billion of amounts due to banks (including some repo agreements). 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 SNS REAAL Insurance activities was 47% in 2013. Furthermore, restrictions imposed to SNS REAAL regarding the payment of the coupons on existing hybrid securities further constrain the financial flexibility of SNS REAAL's insurance activities.

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								Baa	Baa
Asset Quality (10%)								A	A
- High Risk Assets % Shareholders' Equity				126.0%					
- Reinsurance Recoverable % Shareholders' Equity				147.6%					
- Goodwill & Intangibles % Shareholders' Equity	2.4%								
Capital Adequacy (15%)								Baa	Ba
- Shareholders' Equity % Total Assets				4%					
Profitability (15%)								Ba	Ba
- Return on Capital (5 yr avg)					-1.2%				
- Sharpe Ratio of ROC (5 yr avg)							NM		
Liquidity and Asset/Liability Management (5%)								Aa	A
- Liquid Assets % Liquid Liabilities		X							
Reserve Adequacy (5%) - Adv (Fav) Loss Dev % Beginning Reserves (5 yr. wtd avg)		-4%						Aa	A
Financial Flexibility (15%)								Baa	Ba
- Financial Leverage				44.8%					
- Total Leverage				47.2%					
- Earnings Coverage (5 yr avg)					1.8x				
Operating Envrionment								Aaa - A	Aaa - A

Aggregate Profile								Baa1	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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