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## SNS REAAL Insurance Operations

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# SNS REAAL Insurance Operations

SACP* Assessments				SACP*		Support		Ratings		
Anchor	bbb+	+	Modifiers	0	=	bbb+	+	0	=	Financial Strength Rating
Business Risk			ERM and Management	0		Liquidity	0	Group Support	0	BBB+/Stable/--
Strong			Holistic Analysis	0		Sovereign Risk	0	Gov't Support	0	
Financial Risk										
Lower Adequate										

\*Stand-alone credit profile.  
See Ratings Detail for a complete list of rated entities and ratings covered by this report.

## Rationale

### Business Risk Profile: Strong

- Established market share retained, despite nationalization.
- Market premium volumes shrinking.
- Second-largest Dutch life provider and sixth-largest non-life player.

### Financial Risk Profile: Lower Adequate

- Losses have eroded capital, although it remains moderately strong.
- Write-off of intangibles makes shareholders' funds prospectively more volatile.
- Coupon payments set to resume in 2015, but interest coverage multiple will remain depressed.

**Outlook: Stable**

The outlook is stable and incorporates our expectation of modest underlying earnings over 2015-2016.

We could take a positive ratings action if:

- SRIO is returned smoothly to the private sector in 2015;
- SRIO's new owner injected fresh capital to improve statutory solvency and keep capitalization on our model at least as the strong level;
- We gained comfort over SRIO's long-term operational strategy, investment strategy and capitalization; and
- SRIO produces a bottom-line profit of €150 million or more in 2015 and beyond, inclusive of any further "one-off" losses, to sustainably and securely ensure its ability to pay interest on outstanding financing instruments.

Conversely, we could take a further negative action if:

- SRIO continues to see material bottom-line losses through 2015-2016; or
- Capital adequacy on our model falls to the upper adequate level or below.

**Base-Case Scenario****Macroeconomic Assumptions**

- We expect that The Netherlands will see a period of weak growth as domestic demand contracts. We forecast real GDP growth of 0.5% in 2014 and 1.43% in 2015.
- The Dutch life sector is closely linked to the property market. Insurers are significant mortgage issuers and investors and some life products are linked to house sales. House prices fell sharply in 2012 (by 7.3%) and 2013 (4.5%). Although residential property prices have stabilized in 2014, we do not expect significant increases until 2015.

**Company-Specific Assumptions**

- Life premiums to shrink by 10% to €2.1 billion in 2014 and to decline further in 2015.
- Non-life premiums to fall by 3% over 2014 to €760 million and not to stabilize until 2016.
- The group will report a loss of €450 million in 2014 and produce only modest profits in 2015-2016.
- The Dutch state will return the group to the private sector in 2015.

## Key Metrics

(Mil. €)	2015F	2014F	2013	2012	2011
Gross premium written	2,810	2,926	3,190	3,455	3,696
Combined ratio (%)	100	102	105	104	100
Net income	50	(450)	(623)	(147)	166
Capital adequacy	Very Strong				

## Company Description

SRIO comprises the life and non-life insurance and pension operations of the SNS Reaal bancassurance group. The chief operating entities are life insurer SRLEV N.V. (including pension provider Zwitterleven) and non-life insurer Reaal Schadeverzekeringen. Since July 2014, the insurance group has traded under the name Vivat Verzekeringen. In 2013, 76% of premiums came from life and pensions. The group operates a multibrand and multichannel strategy within the Dutch market.

SRIO has been owned by the Dutch state since the SNS Reaal bancassurance group was nationalized in 2013. The group is in the process of being divested from SNS Bank and returned to the private sector. We expect that the sale will be agreed in the first quarter of 2015 and concluded later in the year.

The European Commission has given permission for SRIO to be nationalized as long as it does not use this backing to undercut competitors by writing business uneconomically. It has, however, required coupon payments on SRLEV's two hybrid debt issues to be deferred until SRIO is returned to the private sector and no longer benefits from state support. Under our Imputed Promises criteria, we lowered the ratings on both issues to 'D' because interest payments had been deferred. These issue ratings are unlikely to change until coupon payments resume.

## Business Risk Profile: Strong

### Insurance industry and country risk: Relatively low by Western European standards

The group operates in the Dutch life and non-life markets. As such, we assess it as facing intermediate industry and country risk. We consider the Dutch life industry carries intermediate risk and the Dutch non-life market carries low risk. The group's chief market is the Dutch life sector, from which it derives 76% of its premiums. The advisor-focused distribution channels imply relatively high operational barriers to entry, which we assess as reducing risk for incumbents. The Dutch life insurance market is mature and well-developed, meaning that its growth prospects are relatively limited, in our view, especially given competition from bank-style savings products. In addition, regulatory restrictions on commissions paid to brokers could depress this sales channel. Returns in the sector are relatively low and were further damaged in 2013 by fines for mis-selling and changes to longevity assumptions. We expect profitability to recover modestly in 2014-2015, to an average return on equity of more than 4%, as the sector reaps the benefits of cost-cutting and as bond yields improve. Our assessment of the sector will continue to benefit from a strong institutional and legal framework in the Netherlands.

**Table 1**

Industry And Country Risk		
Insurance sector	IICRA	Business mix (%)
Netherlands Life	Intermediate Risk	76
Netherlands Non-Life	Low Risk	24

### Competitive position: Franchise maintained through nationalization

SRIO is a significant player in the Dutch life and non-life markets. Although its operations are geographically confined to a market that has faced profitability challenges in recent years, SRIO enjoys good diversification between its lines of business and the six brands under which it operates. Only 6% of its premiums are sourced through SNS Bank, and this income stream will continue, even when the bancassurance group is broken up in 2015.

Although SRIO has maintained its positions in the Dutch life and non-life markets (where it has market shares of 13% and 5%, respectively) through its period of state ownership, those markets have been contracting. We expect that SRIO's life premiums will fall by 10% to €2.15 billion in 2014, and that non-life premiums will fall by 3% to €760 million. We expect to see premiums in both sectors fall further in 2015, albeit more slowly.

**Table 2**

SNS REAAL Insurance Operations Competitive Position					
	--Year ended Dec. 31--				
(Mil. €)	2013	2012	2011	2010	2009
Gross premiums written (GPW)	3,190	3,455	3,696	3,728	4,362
Change in GPW (%)	(7.67)	(6.52)	(0.86)	(14.53)	(0.50)
Total assets under management	47,907	50,001	47,225	49,298	49,721
Growth in assets under management (%)	(4.19)	5.88	(4.21)	(0.85)	1.90
P/C: reinsurance utilization - premiums written (%)	7.53	8.06	6.37	8.28	8.23
Life: reinsurance utilization - reserves (%)	12.82	10.09	7.93	0.60	0.65
Business segment (% of GPW)					
Life	75.42	76.30	77.06	78.30	81.34
P/C	24.58	23.70	22.94	21.70	18.66

## Financial Risk Profile: Lower Adequate

### Capital and earnings: Key outlook driver

Shareholders' funds have fallen significantly from €4.4 billion in December 2011 to €2.3 billion in December 2013. Despite this, our assessment of capitalization remains moderately strong, largely because investment risk has been significantly reduced, chiefly by managing down credit risk in the bond portfolio. Stabilization of the capital position and how SRIO's bottom-line profitability develops over 2015-2016 remains key to our forecast for our rating.

SRIO made a loss of €623 million in 2013, although €745 million of this consisted of "one-off" losses, chiefly the write-off of intangibles such as goodwill within Zwitserleven and the value of business acquired within the life and pensions book. Life and pensions solvency was hit by the lowering of the rating on France, which increased the

discount rate, and also by higher cost allocations from the group. The non-life book was affected by the bad weather in the fourth quarter, which caused the combined ratio to rise to 107%. (Lower combined ratios indicate better profitability. A combined ratio of greater than 100% signifies an underwriting loss.)

Further one-off losses in the first nine months of 2014, this time originating from the higher fixed-cost allocation to a smaller premium base and updated reserve reviews contributed to a loss for the period of €377 million. The underlying result was close to break-even. In the light of this result, we consider that the group is likely to realize a significant loss of €450 million for 2014.

We consider that the group will struggle to restore former levels of underlying profitability over 2015-2016. Moreover, SRIO's statutory solvency remains relatively low for the market at 163% of the required minimum.

Our base-case scenario forecasts a break-even result in the second half of 2014, in line with the underlying profit in the first half. Even in the absence of further one-off losses in 2015-2016, we envisage that investment returns that are low relative to guarantees, combined with difficult life and non-life markets, will limit ultimate profit to around €60 million for 2015 and a break-even position in 2016, as better-yielding investments mature. Moreover, future profitability is likely to remain sensitive to fluctuations in life liabilities, as measured by the quarterly liability adequacy test.

**Table 3**

<b>SNS REAAL Insurance Operations Capitalization Statistics</b>					
<b>--Year ended Dec. 31--</b>					
<b>(Mil. €)</b>	<b>2013</b>	<b>2012</b>	<b>2011</b>	<b>2010</b>	<b>2009</b>
Common shareholders' equity	2,610	2,958	4,380	3,630	3,300
Change in common shareholders' equity (%)	(10.98)	(33.06)	20.66	10.00	4.56

### **Risk position: Impairment of value of business acquired enhances potential volatility**

SRIO has reduced and diversified its investment risk exposure significantly over 2011-2013. The portfolio is now concentrated on fixed-interest investments (87% rated 'AAA' or 'AA'), and mortgages, which predominantly have low loan-to-value ratios or are backed by the Dutch state. Nonetheless, we regard the group's risk position as moderately high. This is chiefly a function of the erosion of the buffer offered by the value of business acquired within the life book. Now that this has been entirely written off, future fluctuations in discount rates will affect shareholders' funds directly. A further factor in our assessment is uncertainty over the new owner from 2015 and its plans for the group.

**Table 4**

<b>SNS REAAL Insurance Operations Risk Position</b>					
<b>--Year ended Dec. 31--</b>					
<b>(Mil. €)</b>	<b>2013</b>	<b>2012</b>	<b>2011</b>	<b>2010</b>	<b>2009</b>
Total invested assets	47,907	50,001	47,225	49,298	49,721
Net investment income	1,437	1,601	1,437	1,501	3,059
Net investment yield (%)	4.04	4.47	4.02	4.07	8.15
Net investment yield including realized capital gains/(losses) (%)	4.21	4.51	4.54	4.33	8.11
Portfolio composition (% of general account invested assets)					
Cash and short term investments	3.21	4.25	3.42	5.60	4.64
Bonds	64.21	64.48	85.56	80.01	55.94

**Table 4**

<b>SNS REAAL Insurance Operations Risk Position (cont.)</b>					
Equity investments	3.37	3.39	N/A	N/A	4.53
Real Estate	0.97	0.98	0.73	0.69	0.70
Mortgages	8.25	8.36	8.75	12.58	7.02
Loans	19.96	18.41	1.43	0.97	25.03
Investments in affiliates	0.02	0.12	0.11	0.15	0.17
Investments in partnerships, joint venture and other alternatives investments	0.00	0.00	0.00	0.00	0.52
Other investments	0.00	0.00	0.00	0.00	1.45

N/A--Not available.

### Financial flexibility: Coupon ban limits

The nonpayment of coupons on capital securities, as required by the European Commission, has impaired our assessment of financial flexibility. We consider it likely to preclude the group raising further capital through the debt markets. Furthermore, our forecast that profitability will be thin in future implies low interest coverage ratios when coupon payments resume. Consequently, we regard financial flexibility as less than adequate.

**Table 5**

<b>SNS REAAL Insurance Operations Earnings Statistics</b>					
<b>--Year ended Dec. 31--</b>					
<b>(Mil. €)</b>	<b>2013</b>	<b>2012</b>	<b>2011</b>	<b>2010</b>	<b>2009</b>
Total revenue	4,476	4,913	4,977	5,188	7,424
EBIT adjusted	(1,015)	(1,029)	430	(397)	809
Net income (attributable to all shareholders)	(623)	(147)	166	243	200
P/C: net expense ratio (%)	43.2	40.9	38.2	38.4	40.6
P/C: net loss ratio (%)	72.0	62.8	61.7	64.2	58.4
P/C: net combined ratio (%)	105.2	103.7	99.9	102.6	99.0

## Other Assessments

The group has established strong and responsive controls over market, interest rate, and operational risk in particular. The integration of these controls has enabled capital measures to remain strong, despite the decline in shareholders' funds. The group's enterprise risk management (ERM) framework continues to develop, but we consider the limited use of risk appraisal and management in the strategic running of the business as weighing on our strategic risk management assessment. As a result, we consider the group's ERM capabilities to be adequate, with strong risk controls.

Although senior members of group management resigned on nationalization and the CEO of Zwitterleven has subsequently resigned, their replacements have extensive executive experience in the insurance sector and, in our view, there is a good depth of experience and expertise within the group. We expect the insurer's operational strategy to remain unchanged, despite the strategic uncertainty surrounding the group. Risk tolerances, especially in investments, have been effectively managed down during the group's difficulties. Overall, we consider management and governance to be fair.

We regard SRIO's liquidity profile as exceptional, an assessment enhanced by the liquidity profile of the group's asset base and the consistency of its premium inflows. We do not consider liquidity to be a constraint on the rating.

## Related Criteria And Research

### Related Criteria

- Group Rating Methodology, Nov. 19, 2013
- Methodology: Use Of 'C' And 'D' Issue Credit Ratings For Hybrid Capital And Payment-In-Kind Instruments, Oct. 24, 2013
- Insurers: Rating Methodology, May 7, 2013
- Enterprise Risk Management, May 7, 2013
- Refined Methodology And Assumptions For Analyzing Insurer Capital Adequacy Using The Risk-Based Insurance Capital Model, June 7, 2010
- Use Of CreditWatch And Outlooks, Sept. 14, 2009
- Hybrid Capital Handbook: September 2008 Edition, Sept. 15, 2008

### Related Research

- SNS REAAL Insurance Operations Downgraded To 'BBB+'; Outlook Stable, Oct. 23, 2014

### Ratings Detail (As Of November 18, 2014)

#### Operating Companies Covered By This Report

##### SRLEV N.V.

Financial Strength Rating

*Local Currency*

BBB+/Stable/--

Counterparty Credit Rating

*Local Currency*

BBB+/Stable/--

##### REAAL Schadeverzekeringen N.V.

Financial Strength Rating

*Local Currency*

BBB+/Stable/--

Issuer Credit Rating

*Local Currency*

BBB+/Stable/--

##### Domicile

Netherlands

\*Unless otherwise noted, all ratings in this report are global scale ratings. Standard & Poor's credit ratings on the global scale are comparable across countries. Standard & Poor's credit ratings on a national scale are relative to obligors or obligations within that specific country.

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