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NN Group N.V.

Primary Credit Analyst:
Simon Ashworth, London (44) 20-7176-7243; simon.ashworth@standardandpoors.com

Secondary Contact:
Mark Button, London (44) 20-7176-7045; mark.button@standardandpoors.com

Table Of Contents

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NN Group N.V.

Rationale

Business Risk Profile: Strong
• NN Group has a strong market position in the Benelux region, supported by its new brand NN. • The group has strength and diversity in its distribution and operates across a number of markets in Europe and also in Japan, although the Dutch business dominates. • NN Group's current focus on expense efficiencies should position the operations well for ongoing competitive pressures in the Dutch life market.

Financial Risk Profile: Very Strong
• We now assess capital and earnings as very strong and we expect this to be maintained over the period of divestment by ING Group. • This recent upward revision is due to improved capital levels over 2013 and 2014 to date following capital injections from ING that have provided more certainty around the capitalization levels over the divestment period. • The strong financial flexibility assessment is based on our expectation of access to substantial sources of capital and liquidity and conservative leverage post-divestment by ING.

Other Factors
• Out of a possible anchor of 'a+' or 'a' we choose the lower anchor of 'a', as we continue to expect some pressure on earnings levels and we require more of a track record of capital adequacy at very strong levels. • We modify the anchor of 'a' upward by one notch to obtain the group credit profile (GCP) of 'a+' due to the combination of strong enterprise risk management (ERM) and satisfactory management and governance. • The ratings are currently constrained by one notch owing to ownership by ING; this is the difference between the GCP of 'a+' and the final rating of A. • Under our group rating methodology, we consider that NN Group's operations are "not strategically important" to ING given the pending base-case Initial Public Offering (IPO) of NN Group.

Factors Specific to the Holding Company
• The long-term counterparty credit rating on NN Group N.V. is lower than the long-term counterparty credit ratings on its operating subsidiaries to reflect the structural subordination of holding company creditors to operating company policyholders.

Outlook: Developing

The developing outlook indicates that we could take either a positive or a negative ratings action within our rating horizon. We could lower the ratings if we lower the ratings on ING before it has started to divest NN Group and prior to greater independence in the subgroup's funding profile. We could raise the ratings during the next 12-24 months if we see divestment progress by ING of NN Group and NN Group taking even more control of its own financing cash-flows and strategy, subject to its group credit profile (GCP) remaining at 'a+'.

Downside scenario

We may take a negative rating action on NN Group if:

- There is a negative rating action on ING before NN Group gains further insulation from ING – the negative outlook on ING indicates that we may lower the rating by one-notch by year-end 2015 if we believe there is a greater likelihood of losses on senior unsecured liabilities if the bank fails; or
- NN Group's GCP deteriorates by at least two notches from the current 'a+' level. We currently consider this to be unlikely, but it could occur if both the business and financial risk profiles deteriorate or if either one weakens and our ERM assessment weakens.

Upside scenario

We would consider that ING had made significant progress in divesting NN Group, for example, if it were to become a minority shareholder and we considered NN Group's funding to be largely independent of ING. We could raise the rating if NN Group gains more independence from ING while its GCP remains at 'a+'. This would require:

- Capital and earnings remaining resilient at least at strong levels;
- The insurance operations' access to sources of capital and liquidity remaining substantial and overall financial flexibility remaining strong;
- Our assessment of ERM remaining strong; and
- That we do not revise down to moderate our overall assessment of insurance industry and country risk in the Dutch life sector based on industrywide profitability concerns.

Base-Case Scenario

Macroeconomic Assumptions

- We expect the Dutch economy to return to GDP growth in 2014, we forecast 0.8% real growth.
- We expect long-term interest rates to increase slightly in The Netherlands over the next two years.
- We anticipate that Dutch unemployment levels will remain relatively high over the rating horizon, at 7.5% in 2014.

Company-Specific Assumptions

- The to be IPO'd entity, NN Group N.V., comprises the European insurance and investment management operations and the Japanese insurance operations.
- The initial IPO will occur in 2014, subject to market conditions, with ING disposing of more than 50% of its shareholding in NN Group before year-end 2015, in line with its European Commission (EC) commitments.
- Capital and earnings remain very strong and resilient prior to and throughout the divestment by ING, despite economic pressures.
- NN Group will continue to successfully externalize its debt, demonstrating its strong access to funding, independent of ING.
- Selected investment portfolio re-risking does not affect our assessment of risk position or capital adequacy.

Key Metrics

	--Year ended Dec. 31--				
	2015*	**2014***	**2013**	**2012**	**2011**
Standard & Poor's capital adequacy/redundancy (mil. €)	Very strong	Very strong	Strong	Strong	Strong
Net income from ordinary Activities§ (mil. €)	>1,000	>900	883	833	N.M
Gross premiums written (mil. €)	>9,000	>9,000	9,530	10,705	11,292

*Forecast data reflect Standard & Poor's base-case assumptions. §Represents operating results from ongoing business N.M is not meaningful for comparison purposes given changes in the group's operations.

Company Description

NN Group N.V. is the holding company of ING's insurance and investment management activities in the Benelux region, Central and Eastern Europe, and Japan. We expect NN Group N.V. to be the IPO entity for the planned divestment by ING commencing in 2014, depending on market conditions.

NN Group is primarily focused on long-term savings and life insurance products, although non-life products are underwritten (mainly in The Netherlands). Retirement products are a particular strength of the group. At the end of March 2014, NN Group had €148 billion of total assets.

Business Risk Profile: Strong

Our view of NN Group's business risk profile is anchored by the strength of its market position in the Benelux region, supported by its new brand NN.

Insurance industry and country risk: Intermediate risk predominantly given our assessment of the Dutch life sector

Overall, we consider that NN Group faces intermediate industry and country risk. This assessment is largely driven by our assessment of the Dutch life industry risk as intermediate. The relatively high operational barriers to entry required by the advisor-focused distribution channels are positive for our assessment of industry risk for the Dutch life sector. That said, we consider the market's growth prospects to be relatively limited. In our view, pressures on the Dutch life insurance sector have contributed to the industry's 30% decline in premium volume between 2008 and 2012. These pressures include negative consumer sentiment, partly as a result of the issues with unit-linked business, low interest rates, which make it hard for companies to offer attractive guaranteed returns, and increasing competition from the banking sector. Returns in the sector are relatively low--we estimate that the marketwide return on equity will grow to exceed 4% over the coming years. The historical asset-liability mismatch (ALM) heightens our assessment of product risk. However, in our view both Dutch life and non-life benefit from a moderately strong (3) institutional framework.

We consider that the balance of industry and country risks is unlikely to change during 2014–2016 based on our assumption that the composition of NN Group's current operations will remain intact through the base-case IPO. The focus on growth areas within Central and Eastern Europe (CEE) will mean that, over time, we expect this will account for a larger proportion of the group as a whole.

The following country and sector level exposures given the components of the industry and country risk assessment for NN Group based on 2013 gross premiums as one measure of industry and country risk exposures.

Table 1

Industry And Country Risk

Insurance sector	IICRA	Business mix (%) (gross premiums)
Netherlands life	Intermediate risk	34
Japan life	Intermediate risk	24
Netherlands non-life	Low risk	16
Belgium life	Intermediate risk	5
Poland life	Moderate risk	5
Spain life	Moderate risk	5
Czech Republic life	Intermediate risk	2

*2013 data.

Competitive position Strong mainly due to market position in the Benelux region

We assess NN Group's competitive position as strong based on the strength of the group's market position in the Benelux region, supported by its brand, NN. We expect the strength of the brand to support the franchise in the Benelux region following the separation of NN Group from ING's banking businesses. NN will become the single brand across the European and Japanese insurance operations.

In our view, NN Group exhibits strength and diversity in its distribution supported by the long-term ties with ING Bank that are expected to persist post-divestment. NN Group also operates across a number of markets in Europe, providing an element of geographic diversity to its profile. We base our overall business profile assessment for NN Group on its strengths within different regions: 1) The Netherlands, Belgium, and Luxembourg (Benelux) and 2) Central Europe and the rest of Europe (CEE) and 3) Japan. The group's vision is to create a leading, predominantly European, wealth management and protection company, which applies the strengths of the existing competitive advantages within The Netherlands and increasingly across CEE, offering a variety of life insurance, non-life insurance, pensions, and investment management products.

NN Group's competitive advantages across a number of important markets and our expectation of growing demand for private pensions over the long term are likely to support its strong competitive position. In particular, we expect the current transformation program in The Netherlands to reduce the pressure on operating performance through ongoing expense reduction programs, management actions to improve non-life claims experience, and other measures to capitalize on the competitive advantages in the group pensions market. In our view, this should position the operations well for prospective competitive pressures and prospectively allow an improvement in absolute profitability and a reduction in its volatility. A substantial part of this volatility has historically been from charges linked to restructuring and divestment activities.

NN Group is one of the largest international insurers operating in CEE, spanning seven countries with top-five market positions in a number of these. Regulatory changes prompted NN to shift its strategic focus to life insurance and voluntary pensions and away from mandatory pensions in many CEE countries. The regulatory changes affecting contribution rates and charges in certain key markets are likely to weigh on return prospects from this region, although we continue to consider that CEE provides valuable long-term growth prospects. This geographic diversity supports NN Group's strong business risk profile.

In our view, ING Life Japan has an adequate competitive position based on its good niche market position in Corporate Owned Life Insurance (COLI) for small and midsize enterprises (SMEs) in Japan. Although the COLI market is competitive, in our view the company will be able to maintain its leadership in this niche market through ample market experience and product innovation.

Table 2

Competitive Position			
	--Year ended Dec. 31--		
(Mil. €)	**2013**	**2012**	**2011**
Gross premiums written	9,530	10,705	11,292
Change in gross premiums written (%)	(11%)	(5.2%)	
Total assets as reported	145,758	N.M.	N.M.
Reinsurance utilization (%)	1.5	1.31	1.26
Business Segment (% of GPW)			
Life	82.35	83.81	84.99
P/C	17.65	16.19	15.01

N.M. Not meaningful for comparison purposes particularly given the divestment activity across the group

Financial Risk Profile: Very Strong

ING's decision to include ING Life Japan in the base-case IPO of NN Group, announced on Nov. 6, 2013, signalled a major step in the divestment journey; the scope of the IPO entity is finalized.

The €1 billion debt to equity conversion between ING and NN Group at year-end 2013, the external debt raise of €1 billion in April 2014 by NN Group (used to repay internal debt with ING) and the de-risking and removal of the cross guarantees between ING Bank and NN Group for the pension scheme, means that the base-case IPO appears to be on track. Our expectation is that the IPO will start in 2014, subject to market conditions. ING has committed to the EC to divest more than 50% of NN Group by year-end 2015.

Capital and earnings: Very Strong

We now assess capital and earnings as very strong. This predominantly reflects more certainty around capitalization levels at NN Group over the divestment period from actions to date (such as the material equity capital injections from ING and a track record of how sale proceeds have been used), improving our view of capital adequacy to very strong from strong. In particular, ING has confirmed it will make a further €850 million equity capital injection into NN prior to the IPO, following a €1 billion debt to equity conversion at year-end 2013 and the April 2014 issue of €1 billion in subordinated bonds used to repay internal debt. Importantly, the regulator has confirmed that NN Group can proceed with the IPO following the strengthening of the balance sheet. We expect that NN Group will, as a minimum, maintain robust levels of capital adequacy during and beyond the base-case IPO. The overall regulatory capital coverage position of NN Group was 277% as of March 2014 on a pro-forma basis.

NN Group has taken a number of actions over recent years to replenish capital and reduce risk to mitigate the adverse impact on capital adequacy of turmoil in the financial market. These initiatives, combined with the difficult operating environment, have reduced NN Group's capacity to generate earnings. However, we believe the continued focus on controlling risk exposures, despite modest potential investment portfolio re-risking, will ensure earnings are sufficient to support very strong capital adequacy. We anticipate pre-tax operating earnings from ordinary activities to be close to €1 billion per year over the rating horizon.

Table 3

Capital			
	--Year ended Dec. 31--		
(Mil. €)	**2013**	**2012***	**2011***
Common equity	14,295	26,640	23,474
Change in common equity (%)	(46.3%)	13.5%	
Total capital (reported)	22,004	38,939	38,584
Change in total capital (reported) (%)	(43.5%)	0.9%	

* The historic data does not reflect the current profile of the group given the recent divestment activity. 2013 should be reflective of the future profile

Table 4

Earnings			
	--Year ended Dec. 31--		
(Mil. €)	**2013**	**2012**	**2011**
Net income	18	1,065	1,246
Return on equity	0.1%	4.3%	5.6%
Operating result pre-tax	883	833	N.M.

N.M. Not meaningful for comparison purposes particularly given the divestment activity across the group

Risk position: Intermediate risk

We assess the group's risk position as intermediate. In our opinion, de-risking activity on certain asset classes has mitigated pressures on portfolio credit quality. Single-issuer concentrations primarily relate to highly rated eurozone (European Economic and Monetary Union) governments, in part reflecting the group's strategy to hold assets that match liability discount rates. We do not expect the modest investment portfolio re-risking to affect our overall assessment of the quality of the investment portfolio or markedly increase the volatility of capital or earnings but this remains the largest risk in terms of future revisions of risk position. We also note that the recent pension scheme de-risking, despite having a negative impact on capital, means that the group is not exposed to future funding requirements across this company's defined benefit scheme.

There are also risks to our intermediate assessment from the Japanese closed-block single-premium variable annuity (SPVA) business – however significant reserve strengthening at year-end 2013 has improved reserve adequacy to above best estimate, which combined with a more effective hedging program, we expect to reduce the risk of material capital volatility. An increase in the equity and interest rate risk that we perceive in the Dutch business could however lead us to conclude that NN Group's capital adequacy has a somewhat above-average volatility risk.

Table 5

Risk Position

	--Year ended Dec. 31--		
(Mil. €)	**2013**	**2012**	**2011**
Total invested assets	136,087	254,025	300,177
Net investment yield (%)	2.76	2.11	2.21
Investment portfolio composition (%)			
Cash and short-term investments	7.41	3.47	6.30
Bonds	57.46	74.29	69.65
Equity investments	7.02	3.64	4.00
Real estate	0.79	0.52	0.52
Mortgages & loans	26.24	16.64	17.92
Investments in affiliates	1.07	0.87	0.83
Other investments	0.01	0.58	0.78

Financial flexibility: Anticipated to have substantial sources on a stand-alone basis

We consider that NN Group has strong financial flexibility to manage its capital and liquidity, on a standalone basis. Our expectation is that NN Group would have access to substantial sources of capital and liquidity independent of ING following its planned IPO and we assume that NN Group will maintain conservative leverage post-divestment. The recent hybrid debt issue has also supported our assumption that NN Group will maintain strong levels of financial flexibility given proven access to the debt market.

Fixed charge cover ratios could be a potential pressure point given earning pressures and as the internal debt is externalized; this could pressure financial flexibility metrics absent operating earnings improvements and depending on ultimate leverage tolerances.

Table 6

Financial Flexibility

	--Year ended Dec. 31 2013--
Fixed-charge coverage (x)*	4.0
Financial leverage (%)§	24.5%

*Based on results before tax. §proforma Q1 2014

Debt maturity profile

The first call date on the external debt issued by NN Group N.V. (total of €1.5 billion proforma as at first quarter 2014) is not until 2024 from the recent €1 billion issue.

Our expectation is that the internal ING debt (total of €2.2 billion proforma as at first quarter 2014) will be repaid/externalized over the divestment period.

Other Assessments: Combination Of ERM And Management And Governance Improves The Anchor By One Notch

We modify the anchor of 'a' upward by one notch to 'a+' due to the combination of strong ERM and satisfactory management and governance. We assess the importance of ERM to the ratings as high. Throughout the period of the base-case IPO we expect to see continued evidence that capital allocation decisions at NN Group are consistent with its strategic goals.

Enterprise risk management:

Standard & Poor's considers NN Group's ERM program to be strong. The factors supporting the assessment of ERM include positive strategic risk management; a positive assessment of risk management culture; positive assessments of risk controls for credit, market, ALM, and insurance; and new product risks. The neutral controls of operational and emerging risks offset these factors. The importance of ERM to the rating on the group is high.

Strategic risk management is strong. Value-based management and comprehensive stress analyses remain the bedrock of the decision-making activities and tools for monitoring the group's corporate performance and strategy. This is offset by the fact that NN capital management is focused on managing capital on International Financial Reporting Standards (IFRS) and on a local regulatory basis, while capital adequacy on an economic basis is used as a guide and not as a trigger. A particular difficulty in some country units remains mismatches in achieving optimal hedging programs to protect capital on a market-consistent basis and the associated accounting impact.

We assess risk controls for ALM, credit, and market risk as strong. The main causes of potential volatility remain the Japanese closed-block variable annuity (VA) business and guarantees in separate account business in the Benelux region. The risk attribution of the VA business is actively monitored daily.

Management and governance: Satisfactory, new management team established

In our opinion, NN Group's management and governance is satisfactory. The operations have a stand-alone management team with significant insurance expertise, and NN Group is focusing on its vision to become a leading European wealth management and protection company including its pending base-case IPO from ING. The operational separation from ING Bank was completed by the end of 2010. During 2012 and 2013, the divestment preparations focused on operational improvements, including strengthening and de-risking the stand-alone capital positions of the different business units, and reducing financial interdependencies between NN Group and ING.

The revisions to the EC restructuring agreement continue to constrain some elements of the execution of management and corporate strategy, in particular acquisition and price leadership restrictions. However, we note that, for instance, the price leadership restrictions will be amended to reflect specific conditions in local markets and will no longer apply to The Netherlands. Despite these restrictions, there has been an acceleration in the group's vision to create a leading European wealth management and protection company.

Capital management continues to be informed by NN Group's economic capital model (ECAPS), although regulatory and accounting-based measures increased in importance post the financial crisis. NN Group has moved away from its historical leverage tolerances and it provides increasing clarity on the appropriate capital structure post-IPO. The strengthening of NN Group's balance sheet has included removing all borrowings by the holding company from its subsidiaries, building the cash position at the parent and holding higher levels of regulatory capital in key operating units.

Liquidity: Strong and well managed

Available liquidity includes significant holdings of high-quality government and corporate bonds, and cash. The sale of businesses, for example certain Asian insurance operations in 2012 and 2013, have provided substantial liquidity to meet NN Group's needs. We note that some of the recent divestment proceeds were used to reduce debt, in particular hybrid debt issued by ING to NN Group. In addition to liquid assets held at NN Group (€900 million on a pro-forma basis as of March 31, 2014), liquidity is supported by €5 billion in combined euro and U.S. dollar commercial paper (CP) programs.

Support

Group support

The ratings on NN Group are constrained by one notch owing to its ownership by ING. We consider the insurance operations as non-strategic to ING under our group rating methodology. We could lower the ratings on NN Group if we lower the ratings on ING prior to more progress with divestment from ING. ING currently has a negative outlook.

Accounting Considerations

NN Group reports under IFRS. This has introduced additional volatility to the (market-related) balance sheet and led to some accounting asymmetries. The recent restructuring of ING's insurance operations results in material disconnects in historical data trends and has introduced significantly volatility in results from restructuring and divestment related charges. For instance the scope of the IPO only became clear in 2013, so all information prior to this date does not represent the ongoing business. The 2013 data is representative of the group going forward.

Ratings Score Snapshot

Table 7

Ratings Score Snapshot	
Counterparty credit rating on core operating entities	A
Final rating	A/Developing
Anchor	a
Business risk	Strong
Financial risk	Very Strong

Table 7

Ratings Score Snapshot (cont.)	
Modifiers	+1
ERM and Management	+1
Holistic	0
GCP	a+
Liquidity	0
Sovereign risk	0
Support	
Group Support	-1
Government Support	0
Outlook/CreditWatch	Developing

IICRA--Insurance Industry And Country Risk Assessment.

Related Criteria And Research

Related Criteria

- Insurers: Rating Methodology, May 7, 2013
- Group Rating Methodology, May 7, 2013
- Enterprise Risk Management, May 7, 2013
- Management And Governance Credit Factors For Corporate Entities And Insurers, Nov. 13, 2012
- Principles Of Credit Ratings, Feb. 16, 2011
- Refined Methodology And Assumptions For Analyzing Insurer Capital Adequacy Using The Risk-Based Insurance Capital Model, June 7, 2010
- Hybrid Capital Handbook: September 2008 Edition, Sept. 15, 2008

Ratings Detail (As Of June 2, 2014)	
NN Group N.V.	
Counterparty Credit Rating	BBB+/Developing/A-2
Commercial Paper	A-2
Junior Subordinated	BBB-
Senior Unsecured	A-2
Senior Unsecured	BBB+
Subordinated	BBB-
Counterparty Credit Ratings History	
30-Apr-2014	BBB+/Developing/A-2
02-Dec-2013	BBB+/Stable/A-2
07-Dec-2010	A-/Negative/A-2
10-Nov-2010	A-/Watch Neg/A-2
26-Oct-2009	A-/Negative/A-2
03-Sep-2009	A/Stable/A-1

Ratings Detail (As Of June 2, 2014) (cont.)	
Related Entities	
ING Re (Netherlands) N.V.	
Financial Strength Rating	
Local Currency	A/Developing/--
Issuer Credit Rating	
Local Currency	A/Developing/--
Nationale-Nederlanden Levensverzekeringen Maatschappij N.V	
Financial Strength Rating	
Local Currency	A/Developing/--
Issuer Credit Rating	
Local Currency	A/Developing/--

*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.

Additional Contact:
Insurance Ratings Europe; InsuranceInteractive_Europe@standardandpoors.com