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Credit Opinion: NN Group N.V.

Global Credit Research - 13 Nov 2014

Netherlands

Ratings

Category	Moody's Rating
Rating Outlook	NEG
LT Issuer Rating	Baa2
Subordinate	Baa3 (hyb)
ING Groep N.V.	
Rating Outlook	NEG
Senior Unsecured	A3
Senior Unsecured MTN	(P)A3
Junior Subordinate-Dom-Curr	Ba1 (hyb)
Junior Subordinate-Fgn-Curr	Baa3 (hyb)
Pref. Stock	Ba1 (hyb)
ING Verzekeringen N.V.	
Rating Outlook	NOO
BACKED Subordinate	Baa3 (hyb)

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Key Indicators

NN Group N.V.[1][2]

	2013	2012	2011	2010	2009
As Reported (Euro Millions)					
Total Assets	145,758	338,753	335,608	325,659	290,409
Shareholders' Equity	14,295	26,640	23,474	20,270	15,967
Net Income (Loss) Attributable to Common Shareholders	10	1,038	1,226	(1,574)	(621)
Moody's Adjusted Ratios					
Goodwill & Intangibles % Shareholders' Equity	11.8%	20.6%	50.6%	66.5%	91.2%
Financial Leverage	32.5%	30.2%	37.6%	44.2%	48.8%
Total Leverage	35.3%	31.8%	39.3%	45.6%	51.4%
Earnings Coverage (1 yr)	0.9x	4.1x	4.3x	-3.0x	0.3x

[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

NN Group N.V.'s Baa2 issuer rating (negative outlook) reflects the credit fundamentals of the insurance operations that it owns and the structural subordination of the holding company's obligations to the obligations of the

insurance operating entities. NN Group is the result of the merger between ING Verzekeringen N.V. and ING Insurance TopHolding N.V. on 1 March 2014, and owns European and Japanese insurance operations as well as worldwide asset management operations.

NN Group's operations benefit from a leading franchise in the Netherlands, a strong presence in some European markets and in Japan, namely in the Benelux, relatively limited exposure to high risk assets, and recently strengthened capitalisation. These strengths are partly offset by historical weak and volatile profitability, the risks attached to the Japanese closed book of Variable Annuity business, which, notwithstanding the hedging programme in place, represents a source of potential losses in periods of distress in financial markets and notably in periods of high volatility, and a high level of guarantees on the Dutch life book of business. Moody's notes however that NN Group has been able to reduce its sensitivity to interest rate risk by maintaining a low duration gap between its assets and its liabilities.

Formerly 100% owned by ING Groep N.V., the holding company of the ING group (ING), NN Group listed on 2 July 2014 on Euronext Amsterdam. As of 30 September 2014, ING owned a stake of 68.1% in NN Group, but it is required to reduce its shareholding to below 50% before 31 December 2015 and divest the remaining stake before 31 December 2016, according to a restructuring plan agreed with the European Commission. Therefore, Moody's assesses the financial strength of the insurance group on a stand-alone basis. Nonetheless, some linkages subsist between NN Group and ING and these links are expected to be reduced progressively.

The dated and undated subordinated bonds issued by NN Group with optional deferral coupon mechanism are rated Baa3(hyb) (negative outlook). This rating is in line with Moody's standard notching guidelines for this type of instruments and reflects the subordination of the notes, the cumulative nature of the coupon deferral mechanism and the financial strength of the issuer.

Credit Profile of Significant Subsidiaries

Headquartered in Amsterdam, the Netherlands, NN Group is the holding company for ING group's European and Japanese insurance activities. The main subsidiaries of NN Group are operating in the Benelux (with a dominant insurance franchise in the Netherlands, ranking number one in life insurance and three in non-life), and in Japan where it is the leader in Corporate Owned Life Insurance business sold through independent agencies and bankinsurers partners. The Japanese business also includes a closed book of Variable Annuities (VA), of which around 90% is expected to run-off within the next five years.

NN Group holds subsidiaries in other European countries (mainly in Spain and in Central and Eastern Europe) and asset management operations worldwide. Although it holds some non-life insurance operations (primarily in the Benelux), NN Group is primarily focusing on life insurance and pensions.

Credit Strengths

- Dominant franchise in the Netherlands, ranking #1 in life insurance and #3 in non-life

- Good asset quality and liquidity of the operating companies

Credit Challenges

- Continue to improve the insurance operations' profitability and the group's net income

- Continue to manage the financial and operational risks attached to the Japanese closed book of VA business

- Continue to protect the balance sheet of insurance operations from a relatively high exposure to low interest rate and to volatility in financial market by maintaining ALM and hedging discipline

- Achieve the financial disentanglement with ING Groep N.V., which for example continues to hold EUR1.2 billion of debts issued by NN Group (as of 30 September 2014)

Rating Outlook

The outlook of NN Group is negative. The negative outlook mainly reflects the pressures on earnings coverage resulting from a weak profitability.

What to watch for:

- Impact of management actions on group's profitability

- Evolution of asset quality

What Could Change the Rating - Up

There is limited upwards pressure on the NN Group's ratings given the negative outlook. However, sustained improvements in profitability could contribute to a change in outlook to stable.

What Could Change the Rating - Down

NN Group's ratings could be downgraded in the event of:

- Inability to sustainably improve profitability

- Deterioration in the group's leverage position or capital position

- Increased losses on the Japanese closed VA book, for example as a result of deterioration in financial markets

Capital Structure and Liquidity

The ING group has historically had an integrated treasury and capital management strategy, whereby perpetual hybrid securities were always raised via direct issuance of the parent company, ING Groep N.V. which were then on-lent to the banking or insurance operations. Conversely, lower Tier-2 capital or subordinated debt was raised directly from the main banking or insurance operations according to their needs. Since 2014, NN Group N.V. is the only issuer of hybrid debts for the entire NN Group.

As of 30 September 2014, NN Group's debts were comprised of EUR0.4 billion of senior debts issued to ING Groep N.V., EUR0.8 billion of perpetual subordinated debts issued to ING Groep N.V. and EUR2.5 billion of subordinated debts (of which EUR2.0 billion issued in 2014). NN Group also reports EUR4.4 billion of other borrowed funds, mainly including collateral related to hedging instruments.

NN Group's financial leverage has improved since 2011, to reach 32.5% at year-end 2013, driven by the improvement in shareholders' equity but also by the reduction in debt, consequent to liability exchanges, call of securities and the conversion of EUR1 billion of senior debt issued to ING Groep N.V. into equity in Q4 2013.

NN Group's recent issuances (EUR1 billion of perpetual subordinated debt in July 2014 and EUR1 billion of dated subordinated debt in April 2014) have been used to replace debt issued to ING Groep N.V. and have therefore not negatively affected NN Group's leverage ratios. At the same time, the group's shareholders' equity improved in the first half of 2014, so that financial leverage continued to improve in 2014. We now consider NN Group's financial leverage metrics to be fully consistent with its rating level.

However, fixed charge coverage at NN Group has historically been weak, with the 5-year average at 1.3x (and 0.9x in 2013), which is below Moody's expectations for NN Group's current rating level. Although this number includes exceptional and non-recurring charges, Moody's believes that the level of earnings for the various insurance operations constrains NN Group's earnings coverage and financial flexibility. NN Group's profitability remains one of the main weaknesses of NN Groups' credit profile and is the main driver of our negative outlook on NN Group's rating. Nonetheless, we note that operating earnings improved in 2014 (with a growth in operating earnings of 21% in the first nine months of 2014 compared to 2013) and if NN Group achieved its target of growth in operating profits of 5 to 7% in the medium-term, this would bring earnings coverage metrics more in line with NN Group's current rating level.

Liquidity

The holding company's current cash buffer position is at around EUR1.2 billion. This cash position increased from EUR0.8 billion at year-end 2013, following an injection of capital from ING Group (EUR850 million) prior to the IPO and dividends from subsidiaries (EUR431 million) partly offset by repayment of senior debt (EUR200 million) and capital injections into subsidiaries (EUR517 million).

In the meantime, the refinancing risk is limited. Although most of the borrowed funds have short-term maturities, we note that most of these operations are linked to the collateral received for the derivatives used by NN Group or represent internal transactions (with other entities of the ING group) which are expected to be restructured overtime as part of NN Group becoming a stand-alone company.

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