Research Update:

Aegon Group's Core Subsidiaries Downgraded To 'A+'; Aegon N.V. Ratings Affirmed; Outlooks Stable

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Overview

- In the past two years, Aegon group's (Aegon's) profitability has declined more than that of peers as a result lower sales growth, high ongoing restructuring costs and hedging effects, and intensifying competition.
- Extraordinary gains raised net income to €1.5 billion in 2019, but we forecast profitability will decline in 2020-2021 and that Aegon will underperform against peers.
- At the same time, Aegon N.V. has gradually reduced its financial leverage and diversified its dividend streams thanks to the successful transformation of Aegon U.K. and profitable growth in Spain and Asia.
- We are therefore lowering our rating on Aegon group's core operating subsidiaries to 'A+' from 'AA-'. At the same time, we are revising our outlooks on Aegon N.V. and Scottish Equitable PLC to stable from negative and affirming the respective 'A-' and 'A+' ratings on these entities.
- The stable outlook reflects our view that Aegon retains wide geographic diversification and significant competitive advantages in the U.S. and the Netherlands, and has a strong financial risk profile sustained by a high level of capital adequacy.

Rating Action

On Feb. 21, 2020, S&P Global Ratings lowered its long-term insurer financial strength and issuer credit ratings on the core subsidiaries of Aegon group (Aegon; the group) domiciled in the U.S. and the Netherlands to 'A+' from 'AA-', and affirmed our short-term ratings on the companies at 'A-1+' (see Ratings List below). We also lowered the long- and short-term ratings on highly strategic subsidiary AEGON Bank N.V. to 'A/A-1' from 'A+/A-1+'. The outlooks on all long-term ratings are stable.

At the same time, we have revised our outlook on holding company Aegon N.V. to stable from negative, and affirmed our 'A-/A-2' ratings on the company. We have also affirmed our ratings on the company's debt (see list).

We have also revised the outlook to stable from negative on Aegon's insurance unit Scottish

Equitable PLC (SE Plc) and affirmed our rating on the company at 'A+'. This follows a revision of our assessment of SE Plc's group status to core from strategically important.

Outlook

The stable outlooks reflect our expectation that the group will continue to benefit from a strong market share in the U.S. and Dutch pension and life insurance and services market. It further reflects the group's profitable operations growth in the U.K., Spain, and Asia, and robust capital and earnings, supported by a regulatory Solvency II ratio remaining at about 200%.

Upside scenario

Although unlikely at this stage, we could raise the rating over the next 12-24 months if we consider the group is likely to materially and consistently improve its profitability, matching the performance of its peer group, through positive trends in sales volumes and margins and declining operating expenses and restructuring costs. At the same time, the group would have to maintain the current level of capital adequacy and continue to expand its international operations while maintaining relevant market positons in the U.S. and the Netherlands.

Downside scenario

We currently view a downgrade as unlikely over the next two years, because we believe actions taken by Aegon's management would support the group's very strong capital adequacy in the case of unexpected shocks. However, we would consider lowering the ratings if Aegon significantly reduces the diversity and scope of its operations through material divestments, impairing its competitive position.

Rationale

In the past two years, Aegon has been unable to convert its widely diversified market position into consistently strong earnings commensurate with its ostensible market strength. We believe Aegon's profitability has declined more than that of peers in the past two years due to stagnant business volumes, high ongoing restructuring costs and hedging effects, and intensifying competition from larger competitors.

In 2019, Aegon's net income of €1.5 billion was in line with our forecasts, but the group's underlying earnings failed to exceed €2.0 billion, contrary to our expectations. The gap between underlying earnings and net income reduced in 2019 compared with the previous year, but this was mainly the result of one-off realized gains in the U.S. and Netherlands, a release of a pension provision, and a lower impairment level thanks to good market conditions.

In our view, these positive items will not recur again on the same scale. We believe continuing record-low interest rates will dampen profitability by lowering investment yields and increasing the costs of guarantees, and could also lead Aegon to revise downward its assumptions regarding 10-year interest rates in the U.S., which it currently expects will rise to 4.25% over 10 years. We also believe it is likely that ongoing costs associated with the group's hedging program and restructuring expenses will continue to weigh negatively on profitability. As such, we have revised downward our 2020 net income forecast to about €1.2 billion from €1.5 billion previously.

Overall, we expect the group will maintain very strong capital adequacy under our model and a

Solvency 2 ratio of about 200%, also supported by a longevity reinsurance contract signed at end 2019. Aegon's capitalization remained very strong as of end-2019--under our model it stood well above the 'AA' level, and the consolidated Solvency II ratio exceeded 200%. However, we believe Aegon's high proportion of softer capital forms such as the value-in-force (VIF) of its life portfolio and its hybrid debt, weaken the quality of its capital.

Our decision to affirm our rating on holding company Aegon N.V. reflects our opinion that Aegon N.V. has a diverse dividend stream coming from different and uncorrelated markets and regulatory jurisdictions, in particular U.S., Dutch, U.K, and Asian markets. While the U.S. provides about 60% of Aegon N.V's total dividend remittances, we believe the holding company could largely cover all its fixed charges, even without contribution from the U.S., thanks to its gradually declining financial leverage and significant excess cash at the holding level of €1.2 billion at end-2019. In addition, the Solvency 2 framework does not allow for double leverage, unlike for holding companies of U.S. life insurance peers. We note Aegon N.V.'s track record in gradually reducing financial leverage, which we estimate stood at no more than 26% at end-2019, and its debt issuance capacity, as demonstrated by the issuance of restricted Tier 1 and a long-dated Tier 2 hybrid instruments in 2019.

In the past few years, Aegon has made significant investments to transform it market position in the U.K. to that of a digital solutions provider, including the acquisition of Cofunds Ltd. and BlackRock Inc's U.K. digital platform. We believe the bulk of the restructuring costs have been covered and that Aegon U.K.'s digital solutions' profit generation will gradually increase in the coming years, also benefitting from SE Plc's capacity to sell investment products with an insurance wrapper. In addition, we note that Aegon U.K. has become a consistent earnings and dividend provider for the group. We therefore consider Aegon U.K. and its intrinsic part SE Plc as core to Aegon and highly unlikely to be sold.

Ratings Score Snapshot

Aegon NV - Ratings Score Snapshot

	To	From
Business Risk Profile	Very Strong	Very Strong
Competitive position	Very Strong	Very Strong
IICRA	Low Risk	Low Risk
Financial Risk Profile	Strong	Strong
Capital and earnings	Strong	Strong
Risk exposure	Moderately Low	Moderately Low
Funding structure	Neutral	Neutral
Anchor	a+*	aa-
Modifiers		
Governance	Neutral	Neutral
Liquidity	Exceptional	Exceptional
Comparable ratings analysis	0	0
Financial Strength Rating	A+	AA-

*This reflects our view that Aegon displays ongoing weaker financial performance compared to 'AA-' rated insurers.

Related Criteria

- Criteria | Insurance | General: Insurers Rating Methodology, July 1, 2019
- General Criteria: Group Rating Methodology, July 1, 2019
- General Criteria: Hybrid Capital: Methodology And Assumptions, July 1, 2019
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings, April 7, 2017
- General Criteria: Guarantee Criteria, Oct. 21, 2016
- General Criteria: Principles For Rating Debt Issues Based On Imputed Promises, Dec. 19, 2014
- Criteria | Insurance | General: Refined Methodology And Assumptions For Analyzing Insurer Capital Adequacy Using The Risk-Based Insurance Capital Model, June 7, 2010
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

Ratings List

Downgraded		
	To	**From**
AEGON Bank N.V.		
Issuer Credit Rating	A/Stable/A-1	A+/Negative/A-1+
Senior Subordinated	A-	A
AEGON Levensverzekering N.V.		
Transamerica Life (Bermuda) Ltd.		
Blue Square Re N.V.		
Issuer Credit Rating	A+/Stable/--	AA-/Negative/--
Financial Strength Rating	A+/Stable/--	AA-/Negative/--
Transamerica Financial Life Insurance Co.		
Issuer Credit Rating	A+/Stable/--	AA-/Negative/--
Transamerica Financial Life Insurance Co.		
Transamerica Premier Life Insurance Co		
Transamerica Life Insurance Co.		
Financial Strength Rating	A+/Stable/--	AA-/Negative/--
Downgraded; Short-Term Rating Affirmed		
Transamerica Life Insurance Co.		
Transamerica Premier Life Insurance Co		
Issuer Credit Rating	A+/Stable/A-1+	AA-/Negative/A-1+
Ratings Affirmed		
AEGON Funding Company LLC		
Senior Unsecured	A-	
Subordinated	BBB	

Commercial Paper	A-2	

Outlook Action; Ratings Affirmed

	To	From
AEGON N.V.		
Issuer Credit Rating	A-/Stable/A-2	A-/Negative/A-2
Senior Unsecured	A-	A-
Subordinated	BBB	BBB
Junior Subordinated	BBB	BBB
Junior Subordinated	BBB-	BBB-
Commercial Paper	A-2	A-2
Scottish Equitable PLC		
Issuer Credit Rating	A+/Stable/--	A+/Negative/--
Financial Strength Rating	A+/Stable/--	A+/Negative/--

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. A description of each of S&P Global Ratings' rating categories is contained in "S&P Global Ratings Definitions" at https://www.standardandpoors.com/en_US/web/guest/article/-/view/sourceId/504352 Complete ratings information is available to subscribers of RatingsDirect at www.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column. Alternatively, call one of the following S&P Global Ratings numbers: Client Support Europe (44) 20-7176-7176; London Press Office (44) 20-7176-3605; Paris (33) 1-4420-6708; Frankfurt (49) 69-33-999-225; Stockholm (46) 8-440-5914; or Moscow 7 (495) 783-4009.