

## Aegon Group

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# Aegon Group

| SACP* Assessments  |     |   |                    | SACP* |   | Support        |   | Ratings       |   |
|--|-----|---|--------------------|-------|---|----------------|---|---------------|---|
| Anchor   | aa- | + | Modifiers          | 0     | = | aa-            | + | 0             | = |
| Business Risk  |     |   | ERM and Management | 0     |   | Liquidity      | 0 | Group Support | 0 |
| Very Strong  |     |   | Holistic Analysis  | 0     |   | Sovereign Risk | 0 | Gov't Support | 0 |
| Financial Risk   |     |   |                    |       |   |                |   |               |   |
| Strong   |     |   |                    |       |   |                |   |               |   |
|  |     |   |                    |       |   |                |   |               |   |
| *Stand-alone credit profile.<br>See Ratings Detail for a complete list of rated entities and ratings covered by this report. |     |   |                    |       |   |                |   |               |   |

## Major Rating Factors

### Strengths:

- A globally diversified insurance group operating across the U.S. and international markets.
- Highly recognized brands: Transamerica in the U.S., and Aegon globally.
- Line-of-business diversification via individual life and annuities, pension, retirement solutions, and asset-management segment.

### Weaknesses:

- Material difference between net underlying earnings and bottom line profitability, due to restructuring expenses and one-time items.
- Operating performance is a relative weakness compared with global peers.
- High reliance on softer forms of capital such as future profits and hybrid debt within S&P Global Ratings' capital model.

## Rationale

The ratings on Aegon group and its operating subsidiaries reflect the group's geographic and product diversity with widely recognized brands: Transamerica in the U.S., and Aegon globally. However, we consider operating performance a relative weakness compared with peers because of volatile earnings and an ongoing wide difference between underlying earnings and net earnings. The rating also reflects our view that the group will remain well capitalized, even considering its volatile earnings and higher reliance on softer forms of capital such as future profits and hybrid debt.

Aegon is primarily a life insurance and pension business focused on the U.S. market and the Netherlands. Given that a material part of its activity is in the form of general account business, it is particularly sensitive to changes in long-term

interest rates, credit spreads, and trends in mortality and longevity.

### Outlook: Negative

The negative outlook stems from the wide gap between Aegon's net profits and its underlying adjusted operating earnings. Moreover, net profits remain volatile and relatively modest for a group of its size and business position.

#### Downside scenario

We could lower our ratings within the next 12 months if:

- Further material "below-the-line" items erode net profitability or keep it at current levels; or
- We observe that the group's capital adequacy has weakened substantially.

#### Upside scenario

Conversely, we could revise our outlook to stable if Aegon's underlying earnings remain above €2 billion, and the gap between underlying earnings and net profit narrows significantly, while capitalization remains at least very strong and the quality of capital improves. More specifically, the latter would be demonstrated by a shift of the capital structure toward harder sources. If Aegon continues to develop and expand its lower-risk, fee-based product mix, resulting in higher-quality less volatile earnings, it would support an outlook revision to stable.

## Base-Case Scenario

### Macroeconomic Assumptions

- 10-year treasury yields in the U.S. rising to 3.4% in 2019 and 3.6% by year-end 2020.
- U.S. GDP growth of 2.3% in 2019 and 1.8% in 2020.
- Netherlands' GDP increasing by 1.9% in 2019 and 2020.
- U.K. GDP increasing by 1.3% in 2019 and 1.5% in 2020.

## Key Metrics

|   | 2020F  | 2019F  | 2018  | 2017  | 2016  | 2015  |
|---|--------|--------|-------|-------|-------|-------|
| Underlying earnings (before tax) (mil. €) | >2,000 | >2,000 | 2,074 | 2,103 | 1,913 | 1,939 |
| Net income (mil. €)                       | 1,500  | 1,400  | 744   | 2,361 | 586   | 619   |
| Return on equity (%)                      | 6.0    | 5.0    | 3.6   | 8.9   | 8.0   | 8.3   |
| Financial leverage (%)                    | 25.9   | 29.5   | 29.1  | 32.0  | 33.2  | 29.7  |
| Fixed charge coverage (x)                 | 6.4    | 6.0    | 4.0   | 8.0   | 7.0   | 6.7   |

F--Forecast.

## Business Risk Profile: Very Strong

In our opinion, Aegon benefits from its widely known brand in the U.S. and internationally. Its large geographical footprint for distribution of its life and pension products is also an advantage. Aegon is focusing more on less capital-intensive products, by shifting its business mix to fee-based and technical earnings. It has doubled its contribution from fee-based income over the past couple of years.

Netherlands-based Aegon is one of the world's largest insurance companies, writing gross premiums of €19.3 billion in 2018. Transamerica, the U.S. arm, maintains a top-10 position in variable annuities, universal life, and term life products. It generates more than two-thirds of the group's total underlying earnings. The Netherlands is the second-largest earnings generator for Aegon. The group is among the top-five distributors of life and pension and saving business in the country and also has a top 5 position as a pension distributor and mortgage originator.

We see volatile operating performance as a relative weakness for the group's competitive position. Over the past three to four years, macroeconomic factors and one-time items have hurt the group's operating performance and we see a wide difference between net underlying earnings and net income. The group has taken strategic actions to overcome weak and volatile earnings, such as outsourcing administration of U.S. life and annuity business and the divestment of noncore operations, in both the U.S. and Europe. It has also recapitalized its Dutch operations via a capital infusion. We still believe Aegon's earnings remain highly sensitive to macroeconomic factors, affected by one-time items, restructuring, and disposal of business and new acquisitions.

## Financial Risk Profile: Strong

Aegon strengthened its capital adequacy in 2018, which supports the group's financial risk profile. Its revised focus on fee-based and protection business, disposal of noncore activities, business restructuring, and product re-design are likely to reduce the volatility in capital adequacy and profitability. However, high reliance on softer forms of capital such as future profits and hybrid debt typically increases capital volatility.

Aegon's earnings have long lagged our expectations and did so again in 2018: Net income of €744 million was below

our expectation of €1,500 million. While Aegon's underlying earnings were in excess of €2 billion in 2018, meeting our expectations, below-the-line items continued to impair net income in 2018 and we expect them to continue to do so in 2019-2021. These below-the-line items have included some one-offs such as losses on the disposal of noncore operations and settlements of legal claims, but also some ongoing costs such as those associated with the group hedging program. Moreover, the consistency of the adjusting items of all kinds in 2016-2018 leads us to think it likely that they will continue to impair profitability.

Aegon has managed its investment portfolio conservatively. Sector concentration is balanced and exposures to individual counterparties are based on the rating on the counterparty. We assess the weighted average quality of the fixed income portfolio in the 'A' range. However, Aegon's material obligations under its staff pension scheme create the potential for capital volatility. Interest rate risk is also present in the remaining general account book. Outside this exposure, Aegon has extensive interest rate and equity hedge programs to mitigate risk in its variable annuities products in the U.S., and guaranteed products in its Dutch business. We also consider the foreign exchange risk as low and limited primarily to translation risk in the income statement and balance sheet.

We anticipate that the group will sustain its strong financial flexibility through the forecast period, with financial leverage of less than 30%. Aegon's financial leverage ratio stood at 29.1% as of year-end 2018, compared with 32% in 2017. This is still higher than the average for global multiline insurers. Fixed-charge coverage based on net income was a relatively thin at 4x in 2018, although we expect this to increase to 6.4x by 2020.

## Other Assessments

We consider Aegon's enterprise risk management (ERM) to be strong. Aegon is a well-diversified business with widespread geographic coverage and we consider the importance of ERM to our rating as high. The group's transparent and disciplined compensation structure tied to risk profile, its program to reduce financial market risks, and its strong strategic risk management support our view of ERM.

We view Aegon's management and governance as satisfactory. This largely reflects Aegon's well-constructed financial policies and clear strategic priorities. Aegon has comprehensive financial standards and a broad-ranging, sophisticated set of risk-appetite statements. We consider Aegon to have a low appetite for financial market risk, as its low direct exposure to unhedged equities suggests. That said, the company retains material exposure to credit risk and interest rate risk.

We consider liquidity to be well-managed at Aegon. We continue to view the liquidity position at the holding company as robust. Aegon manages its liquidity position by applying very severe stress tests. Aegon continues to operate with a large cash balance and highly liquid treasuries/agencies securities in the U.S. to meet its liability requirements.

## Factors Specific To The Holding Company

The 'A-' long-term issuer credit rating on the holding company Aegon N.V. reflects its position as the holding company of the Aegon insurance group. The rating is three notches below the ratings on the core operating entities, which are

rated 'AA-'. This reflects that the majority of the holding company's cash flows and earnings come from the U.S., and under our criteria holding companies of U.S. insurance businesses tend to be rated three notches below the operating entities, not two notches, as would typically be the case for other European holding companies.

The holding company's liquidity is adequate, in our view. We expect a steady stream of cash flows from the operating units, especially in the U.S., which should be sufficient to enable the holding company to meet its obligations.

## Accounting Considerations

Our analysis is based primarily on audited financial data prepared in accordance with International Financial Reporting Standards (IFRS) as well as the Netherlands civil code. Aegon has opted for temporary exemption for IFRS 9 implementation until such time as IFRS 17 is implemented, currently expected for January 2022. Although the full impact of IFRS 17 is not yet clear, we expect it will have a significant impact on shareholders' equity, income, and other comprehensive income and disclosures.

## Related Criteria

- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings, April 7, 2017
- General Criteria: Guarantee Criteria, Oct. 21, 2016
- Criteria - Insurance - Life: Methodology: Treatment Of U.S. Life Insurance Reserves And Reserve Financing Transactions, March 12, 2015
- General Criteria: Principles For Rating Debt Issues Based On Imputed Promises, Dec. 19, 2014
- Criteria - Insurance - General: Methodology For Assessing Capital Charges For U.S. RMBS And CMBS Securities Held By Insurance Companies, Aug. 29, 2014
- Criteria - Insurance - General: Insurer Hybrid Capital Instruments With Nonviability Contingent Capital (NVCC) Features, July 24, 2014
- General Criteria: Group Rating Methodology, Nov. 19, 2013
- Criteria - Insurance - General: Enterprise Risk Management, May 7, 2013
- Criteria - Insurance - General: Insurers: Rating Methodology, May 7, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities And Insurers, Nov. 13, 2012
- General Criteria: Criteria Clarification On Hybrid Capital Step-Ups, Call Options, And Replacement Provisions, Oct. 22, 2012
- Criteria - Insurance - General: Methodology For Assessing Capital Charges For Commercial Mortgage Loans Held By U.S. Insurance Companies, May 31, 2012
- Criteria - Insurance - General: Methodology For Calculating The Convexity Risk In U.S. Insurance Risk-Based Capital Model, April 27, 2011
- Criteria - Insurance - General: Refined Methodology And Assumptions For Analyzing Insurer Capital Adequacy

Using The Risk-Based Insurance Capital Model, June 7, 2010

- General Criteria: Methodology: Credit Stability Criteria, May 3, 2010
- Criteria - Financial Institutions - General: Methodology: Hybrid Capital Issue Features: Update On Dividend Stoppers, Look-Backs, And Pushers, Feb. 10, 2010
- Criteria - Financial Institutions - Banks: Assumptions: Clarification Of The Equity Content Categories Used For Bank And Insurance Hybrid Instruments With Restricted Ability To Defer Payments, Feb. 9, 2010
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009
- Criteria - Insurance - General: Hybrid Capital Handbook: September 2008 Edition, Sept. 15, 2008

## Related Research

- With European Insurers Well Positioned For Economic Uncertainty, Focus Shifts To Future, Feb. 12, 2019

### Ratings Detail (As Of April 25, 2019)\*

#### **Holding Company: AEGON N.V.**

|                         |                 |
|-------------------------|-----------------|
| Issuer Credit Rating    | A-/Negative/A-2 |
| Commercial Paper        |                 |
| <i>Foreign Currency</i> | A-2             |
| Junior Subordinated     | BBB             |
| Junior Subordinated     | BBB-            |
| Senior Unsecured        | A-              |
| Subordinated            | BBB             |
| Subordinated            | BBB-            |

#### **Operating Companies Covered By This Report**

##### **AEGON Levensverzekering N.V.**

|                           |                 |
|---------------------------|-----------------|
| Financial Strength Rating |                 |
| <i>Local Currency</i>     | AA-/Negative/-- |
| Issuer Credit Rating      |                 |
| <i>Local Currency</i>     | AA-/Negative/-- |

##### **Transamerica Advisors Life Insurance Co.**

|                           |                 |
|---------------------------|-----------------|
| Financial Strength Rating |                 |
| <i>Local Currency</i>     | AA-/Negative/-- |
| Issuer Credit Rating      |                 |
| <i>Local Currency</i>     | AA-/Negative/-- |
| Senior Unsecured          | AA-             |

##### **Transamerica Financial Life Insurance Co.**

|                           |                 |
|---------------------------|-----------------|
| Financial Strength Rating |                 |
| <i>Local Currency</i>     | AA-/Negative/NR |
| Issuer Credit Rating      |                 |
| <i>Local Currency</i>     | AA-/Negative/NR |

## Ratings Detail (As Of April 25, 2019)\*(cont.)

**Transamerica Life (Bermuda) Ltd.**

Financial Strength Rating

*Local Currency*

AA-/Negative/--

Issuer Credit Rating

*Local Currency*

AA-/Negative/--

**Transamerica Life Insurance Co.**

Financial Strength Rating

*Local Currency*

AA-/Negative/NR

Issuer Credit Rating

*Local Currency*

AA-/Negative/A-1+

**Transamerica Premier Life Insurance Co**

Financial Strength Rating

*Local Currency*

AA-/Negative/NR

Issuer Credit Rating

*Local Currency*

AA-/Negative/A-1+

**Related Entities****AEGON Bank N.V.**

Issuer Credit Rating

A+/Negative/A-1+

**Blue Square Re N.V.**

Financial Strength Rating

*Local Currency*

AA-/Negative/--

Issuer Credit Rating

*Local Currency*

AA-/Negative/--

**Scottish Equitable PLC**

Financial Strength Rating

*Local Currency*

A+/Negative/--

Issuer Credit Rating

*Local Currency*

A+/Negative/--

**Domicile**

Netherlands

\*Unless otherwise noted, all ratings in this report are global scale ratings. S&P Global Ratings' credit ratings on the global scale are comparable across countries. S&P Global Ratings' credit ratings on a national scale are relative to obligors or obligations within that specific country. Issue and debt ratings could include debt guaranteed by another entity, and rated debt that an entity guarantees.

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