Q1 2021 Earnings Call

Company Participants

- Jan Willem Weidema, Head of Investor Relations
- Lard Friese, Chairman and CEO
- Matt Rider, CFO

Other Participants

- Andrew Baker, Analyst
- Ashik Musaddi, Analyst
- Colm Kelly, Analyst
- Fulin Liang, Analyst
- Michael Huttner, Analyst

Presentation

Operator

Good day, and welcome to the Aegon First Quarter 2021 results conference call. Today's conference is being recorded. At this time, I would like to turn the conference over to Jan Willem Weidema. Please go ahead, sir.

Jan Willem Weidema {BIO 15133400 <GO>}

Thank you, operator. Good morning, everyone, and thank you for joining this conference call on Aegon's first quarter 2021 results. We would appreciate it if you could take a moment to review our disclaimer on forward-looking statements, which you can find at the back of the presentation.

With me today are Aegon's CEO, Lard Friese; and CFO, Matt Rider. Let me now hand over to Lard.

Lard Friese {BIO 17008174 <GO>}

Thank you, Jan Willem, and good morning everyone. We really appreciate that you are joining us on today's call as it is a busy day with many companies reporting results. So, thank you very much for being here.

In my part of the presentation, I will take you through the strategic highlights for the first quarter and through the progress we have made in our Strategic Assets. Matt Rider will then go through the details of the results and our capital position, and present the progress we have made in our Financial Assets. I will conclude the presentation with a wrap up, after which we will open the call for the Q&A session.

Let's turn to slide number two. We have made early progress towards delivering on our strategic priorities and I'm encouraged to see this reflected in our first quarter results. Despite the pandemic, our employees remain committed to support our customers and business partners, and I continue to be deeply impressed by the energy that they bring to transform Aegon into a more focused, high-performance company.

The first quarter of 2021 saw a 20% increase in the operating result to EUR431 million, driven by improvements in the United States, the Netherlands and Asset Management. So far, we have reduced the addressable expense base across the Group by EUR136 million and are on track to deliver half of our 2023 target of EUR400 million expense savings by the end of 2021. Our balance sheet remains strong with the capital ratios of all three main units and the holding around or above their operating levels.

We have made steady progress managing our financial assets during the first quarter. In our US business we reduce the sensitivity of our Variable Annuities business to interest rates, and so far have achieved one-third of the targeted long-term care rate increases. In our Strategic Assets, we continue to invest in new products, product distribution and customer service.

In the first quarter, we gained momentum from improved sales performance in each of our core markets. A good example is in the US Individual Solutions business where we grew the number of licensed agents in our main distribution channel by 18% and saw increases in our market share there as a consequence of new product introductions.

We've also taken concrete actions to improve our risk profile, already executing more than half of our plan to reduce interest rate risk in the United States. Furthermore, we took advantage of higher interest rates by implementing a new macro interest rate hedge. This is an important step towards expanding the dynamic hedge to our legacy variable annuity block in the United States. We have also further increased our strategic focus by divesting Transamerica's venture fund and closing the sale of Stonebridge.

We are working together with the Vienna Insurance Group to close the divestment of our businesses in Central and Eastern Europe. As disclosed earlier, the Hungarian Ministry of the Interior denied the intended acquisition by VIG as a foreign investor of the Aegon companies in Hungary on April 6 of this year. Based on the VIG's statements, we remain confident that the current situation will be resolved positively in the near future.

Let me now give you an overview of where we stand with the execution of our operating plan on slide 3. Our ambitious plan comprises over 1,100 detailed initiatives designed to improve our operating performance by reducing cost, expanding margins and growing profitability. I personally chair weekly meetings with my management team to track the progress on these initiatives to ensure that we keep a good pace and to remove any potential impediments to achieving our targets.

In the first quarter of 2021, we completed another 160 initiatives, bringing the total to over 400. This means that 35% of all initiatives have now been fully implemented. That gives us confidence in the contribution from these expense savings and growth initiatives to our results in the coming months. Expense initiatives helped to drive down expenses by EURO136 million, which is already about a third of the 2023 expense target. The contribution from growth initiatives is still relatively small but we expect this to build up over time. We will continue to rapid pace an intense organizational rhythm throughout the year, building on these first successes.

Let's now turn to slide number four to discuss the progress we've made in respect of our Strategic Assets. Our priority here is to grow the customer base and expand our margins. In the US Individual Solutions business, we have the ambition to regain the top 5 position in selective life products over the coming years. In the first quarter, we saw good momentum resulting in a 27% increase in new life sales. Our market share in Transamerica's main distribution channel, World Financial Group or WFG, increased significantly following the addition of a new funeral planning benefit. In addition, the number of WFG licensed agents grew by 18%. Volume growth, more favorable product mix and lower expenses resulted in an 88% increase in the value of new business.

In the US Retirement Business, Transamerica aims to compete as a top 5 player in the new middle-market sales. Transamerica is leveraging its strength in Pooled Plan Arrangements as attractive propositions for the middle market, and we see the momentum is building here with written sales increasing by 27% compared to the same quarter last year. Net deposits also turned positive in this market segment following targeted campaigns with our existing advisor network.

Our Dutch Strategic Assets performed well, as you can see on slide number five. We are market leaders in both mortgage origination and defined contribution pensions, and we gained momentum in the first quarter. We originated EUR3 billion mortgages, benefiting from a strong housing market and increased demand for mortgage refinancing in the current interest rate environment.

In our defined contribution pension business, we grew net deposits by 14%. We have a competitive offering in this space, thanks to the scale of our administration subsidiary, TKP, and our leading asset management solutions. And lastly, our online bank, Knab, that we want to develop into a digital gateway for individual retirement solutions, added another 11,000 customers.

In the United Kingdom, our aim is to grow in the Retail and Workplace channels. In both channels, we had a number of notable proposition enhancements in recent months that have supported the positive development in net deposits. Market movements and expense savings have helped to further improve the efficiency of the platform. By growing the platform business and taking out expenses, we aim to mitigate the topline impact from the gradual run-off of the traditional portfolio, which is the driver behind the revenues lost from net deposits for the quarter.

Let me now turn to our global asset manager in our growth markets on slide number six. In our Asset Management business, we have a longstanding track record of third-party net deposits from our strategic partnerships and global platforms. Net deposits in Strategic Partnerships were again strongly positive at EUR3 billion for the quarter, driven by our joint venture in China. Increased performance fees and management fees from growth of the business led to a doubling of the operating results for the quarter to EUR62 million.

In our Global Platforms, third-party net flows were also positive, driven by strong deposits on the fixed income platform. The operating margin for our Global Platforms increased by 4 percentage points, which was not only supported by net deposits but also by expense savings initiatives. For instance, we migrated the administration of our fiduciary business from a dedicated platform to existing systems used in other parts of our business.

We continue to invest in profitable growth in our growth markets, Spain and Portugal, Brazil and China. The new business value from new life sales increased by 23% despite lower sales in the bank channel. This was driven by a more favorable business mix in China. New non-life premium production in our businesses in Spain and Portugal increased as a result of new product launched.

So in summary, we've made early progress in improving our performance and growth across our Strategic Assets. We will continue to drive efficiencies while at the same time investing in products and services to our customers in the various core businesses.

And with this, I would like to hand over to Matt Rider. Matt, over to you.

Matt Rider {BIO 20002664 <GO>}

Thank you, Lard, and good morning everyone. On the next several pages, I will take you through the highlights of our first quarter 2021 results, our capital position and the recent progress we have made in managing our financial assets. Let me start with the financials.

Expense initiatives have so far delivered EUR136 million of savings. Together with higher equity markets, this drove the increase of our operating result by 20% to EUR431 million. Our balance sheet remains strong with the capital positions of all three of our main units and for the Group around or above their operating levels.

Our gross financial leverage stood at EUR6.1 billion at the end of the quarter, and we remain on track to achieve our 2023 deleveraging target. This capital position provides us with financial flexibility to execute on our transformation and navigate through the COVID-19 pandemic. One of our priorities is to reduce the economic interest rate exposure of our US business by one-third to one-half. We have now executed more than half of the actions of the interest rate risk management plan that we announced at the Capital Markets Day, primarily by lengthening the duration of our asset portfolio.

Furthermore, we took advantage of higher interest rates by implementing a new macro interest rate hedge. This is an important step toward expanding the dynamic hedge to our legacy variable annuity block in the United States. During the remainder of this year, we plan to take additional actions to reduce our exposure to interest rates. I will come back on this in more detail later in this presentation.

Let me turn to slide nine to go into more detail on the expense savings. At our Capital Markets Day, we announced our plan to reduce addressable expenses by EUR400 million. In the last four quarters, we reduced addressable expenses by EUR203 million compared with 2019. EUR136 million of these savings are driven by the expense initiatives as part of our operational improvement plan. We will continue to execute on this plan and are confident that we will achieve half of the targeted savings by the end of this year. Expenses in the quarter again benefited from lower travel and marketing activities due to the impact of the COVID-19 pandemic. We expect these expense reductions to reverse as vaccines are being rolled out and restrictions are gradually lifted in the countries in which we operate.

Turning to slide 10, you will see that these expense savings together with favorable equity markets were an important driver behind the increase in our operating result. In the first quarter of 2021, our operating result amounted to EUR431 million, an increase of 20% compared to the same period last year. In fact, the apples-to-apples increase is 32% at constant currencies and when adjusting for the reclassification of the result for Central and Eastern Europe from operating results to other income.

As I indicated, the operating result benefited from lower expenses and higher equity markets. These led to growth of fee revenue, mainly in Variable Annuities and in the Retirement Plans businesses in the United States. Improved investment margins in the Netherlands also contributed to higher earnings. This reflects an increased allocation to corporate bonds and lower interest revenue.

In the United States, COVID-19 obviously had an impact on our claims experience. In the Life business, we experienced EUR138 million of adverse mortality relative to our long-term expectations. Two-thirds of this was directly attributable to COVID-19 as the cause of death. We believe that the remaining adverse mortality experience is also mostly related to the pandemic. This was partly offset by EUR65 million, better than expected morbidity experience in the long-term care book this. This net of additions to the IBNR reserves. We have established these as we expect claims to be reported once the concerns of our policyholders with respect to assisted living facility subside.

In the UK the operating result declined by 11% to EUR39 million, driven by a lower result from our protection and distribution businesses. Fee revenues were broadly stable as the favorable impact from higher equity markets was offset by net outflows in recent quarters. The decrease of the operating result in International of EUR21 million is mainly caused by the reclassification of the result from our operations in Central and Eastern Europe to other income. On an apples-to-apples basis and at constant currencies, the operating result decreased by 6%.

Business growth and improved claims experienced in Spain and Portugal and China were more than offset by a lower result from businesses that are not part of our core perimeter, including TLB.

Finally, the operating result from Asset Management nearly doubled to EUR5 million. This was mostly driven by the strong performance of Aegon's Chinese Asset Management joint venture where performance fees net of performance-based compensation contributed EUR32 million. The operating result of the Global Platforms increased as well, mainly because of higher revenues from net deposits and favorable market movements.

Let us turn from operating result to net result on the next slide. As you can see on slide 11, Aegon reported a net result of EUR386 million for the first quarter of 2021, a result broadly in line with the operating result after tax. Non-operating items contributed a gain of EUR50 million. Fair value gains amounted to EUR3 million, as losses on hedge programs due to higher equity markets and interest rates were offset by a reduction in the Liability Adequacy Test deficit in the Netherlands.

In the current low interest rate environment, we realized EUR31 million of gains on investments from normal trading activity. Once again, impairments on our bond portfolio remained very low and recoveries on investments, including the unsecured loan portfolio in the Netherlands and corporate credits in the Americas, led to net recoveries of EUR16 million (Technical Difficulty). However, we remain cautious on the outlook for credit markets, given the uncertainty around the potential short-term effects from reduced government support for the economy as well as on the potential long-term impacts from the pandemic.

Other income amounted to EUR1 million, largely driven by favorable impacts from an update of inflation assumptions in the Netherlands and a one-time gain in the Americas related to the sale of an individual retirement account portfolio, offset by one-time investments related to the operational improvement plan and IFRS 9 and IFRS 17 project costs.

I'm now turning to slide 12 to go through the capital position of our (Technical Difficulty). The capital ratios of our three main units are around or above their operating levels. The US RBC ratio decreased by 4 percentage points since the end of last year. Market impacts had a slight negative impact on the RBC ratio. Higher equity markets and significantly higher interest rates, both of which are economically good for us, led the flooring on part of our variable annuity reserves. Flooring prevents reserves from going below zero in case of favorable market conditions. The way to think about this is that reserve flooring leads to an additional buffer. This either serves to absorb future shocks or it gets released over time as capital generation.

In addition, dividend payments to the intermediate holding company used for tax payments reduced the RBC ratio by 8 percentage points. We expect the remittance from the US to the Group in the second quarter. Operating capital generation had a positive impact despite being impacted by adverse mortality.

In the Netherlands, the Solvency II ratio of the Dutch Life unit decreased by 10 percentage points to 149%, which is around the operating level of 150%. The decline resulted mainly from the reduction of the ultimate forward rate by 15 basis points as well as by rising interest rates, and in particular a steepening of the yield curve. This is a reflection of the fact that Aegon hedges on an economic basis. We expect to earn this reduction in the ratio back within 6 years through higher capital generation as a result of lower UFR drag.

Operating capital generation was offset by a EUR25 million remittance to the Group in the first quarter. In the UK, our main legal entity, Scottish Equitable, increased its capital ratio to 158%. The increase was primarily driven by both operating capital generation and by management actions to reduce financial market risk. These positive impacts more than offset the impact of remittances to the intermediate holding company, which will be used in part to fund one time investments as part of the operational improvement plan.

Let's now turn to the development of cash capital at Holding on the next slide. Cash Capital at Holding increased during the quarter, driven by remittances from our units. Next to the regular quarterly remittances from the Dutch Life unit, we received remittances from Aegon International and our businesses in the United States and in the UK.

Total remittances in the first and third quarters of the year tend to be somewhat lower than other quarters, as Transamerica pays the bulk of its remittances to the Group in 2Q and 4Q. After holding and funding and operating expenses, this results in free cash flows of EUR75 million. Proceeds from the divestment of Stonebridge were more than offset by capital injections of EUR50 million, mainly to fund one-time investments related to our operational improvement plan.

Cash Capital at Holding closed the quarter at EUR1.2 billion, which is in the upper half of the operating range and provides the Group sufficient financial flexibility. We expect to manage Cash Capital at the Holding to the top half of the operating range in the near term considering the current risks in the macro environment, the ongoing restructuring of our business and in recognition of our target (Technical Difficulty).

Let me now turn to our Financial Assets, starting with the US Variable Annuities business n slide 14. As at the end of March, we have stopped selling variable annuities with significant interest rate, sensitive living and death benefit riders. Transamerica will continue to serve the retirement needs of individuals with products like accumulation variable annuities that have limited interest rate sensitivity.

To this end, the Company recently launched a new product that offers customers protection of their principal investment with upside potential of investment growth. Additionally, we have taken advantage of the higher interest rates in the first quarter and have put in place a macro interest rate hedge as a transition measure toward potential full dynamic hedge of the legacy variable annuity book. This hedge covers part of Aegon's remaining economic interest rate exposure, representing approximately one-third of the interest rate exposure associated with the legacy variable annuity block with income and death benefit riders.

This measure will mitigate the potential capital impact from the expansion of Aegon's dynamic hedge to the legacy variable annuity block, if interest rates were to decline from the levels at the end of March. We are making good progress on the expansion of the dynamic hedge and we'll provide an update on the planned implementation of the second quarter 2021 results.

We also progressed well on our long-term care book, which has now closed for new individual standalone policies. To date, we have received approval for rate increases with net present value of $112 million or 37% of the targeted amount of $300 million. The rate increase program is a multi-year program and we expect a more moderate speed on obtaining approvals from here. Long-term care claims for the first quarter came in at an actual to expected ratio of 43% as a result of higher mortality and discharges from long-term care facilities. Given the successful rollout of the vaccine program in the US, we expect new long-term care claims to reverse to normal levels over time.

Let me now turn to slide 16. Our aim for the Dutch Life business is to turn it into a low-risk cash generating generator paying predictable, regular dividends. A newly established team is actively managing capital and risk exposures to achieve this.

Our Dutch Life business remitted EUR25 million to the Group for the second quarter in a row. This remittance is in line with its quarterly operating capital generation. The Solvency II capital ratio of the Dutch Life business has decreased by 10 percentage points this quarter, largely the result of the annual reduction of the ultimate forward rate by 15 basis points and from the impact of increasing interest rates, and in particular curve steepening. These movements were in line with sensitivities and will lead to higher capital generation in the future.

To summarize, we are progressing to maximize the value of our financial assets. Next to getting further approvals for long-term care rate increases and the -- expansion of our dynamic hedging program for the legacy variable annuity block will be central in the coming months. Throughout our transformation, we will maintain a strong capital position in our main units and at the holding. Furthermore, we expect to deliver on our commitment to reduce financial leverage by another EUR200 million before the end of 2021.

With that, I pass it back to you, Lard, for the wrap-up.

Lard Friese {BIO 17008174 <GO>}

Thank you, Matt. I would like to -- you to take away from today's presentation that we have made early progress on our plans to transform Aegon. We have increased our operating result by 20% to EUR431 million. We are executing on our operational improvement plan and are intensifying the organizational rhythm. We are on track to deliver on our expense savings target. We have significantly reduced our interest rate risk and we'll take more steps later this year.

We have made steady progress on optimizing our financial assets, including achieving rate increases in long-term care. We continue to invest in new products, product distribution and customer service in our Strategic Assets, and we have further increased our strategic focus through the divestment of non-core businesses. Lastly, we are working together with the Vienna Insurance Group to close the divestment of our businesses in Central and Eastern Europe.

In summary, I'm pleased with the results we announced today and how well we are progressing on our strategic commitments and financial targets. But the journey has only just begun. We will continue to drive our transformation and increase our speed of execution, and we will do that in a rational and disciplined way. Looking to the future, I'm confident in the strength of our business, our strategy and the unwavering commitment of our employees to continue delivering on our plans.

I would now like to open the call for your questions and in the interest of time, I kindly request you to limit yourself to two questions. So operator, please open the Q&A.

Questions And Answers

Operator

Thank you, sir. (Operator Instructions) Thank you. And we will take our first question from Andrew Baker with Citi. Please go ahead sir, your line is open.

Q - Andrew Baker {BIO 20402705 <GO>}

Hi, thank you for taking my questions. Sorry, I've got two from me. Are you just able to provide a quick update on the outlook for both mortality and morbidity for the rest of the year? And then just on the CEE disposal, if it is a drawn-out [ph] close process, does this have any implications on any of your usage of cash in your plans around that and more specifically your debt reduction plans or even your 2023 dividend step change? Thank you.

A - Lard Friese {BIO 17008174 <GO>}

So, Matt, you -- can you take the update on mortality and morbidity? And on VIG, yeah, as you know, VIG is in the lead to obtain the required regulatory approvals to close the transaction in CEE and obviously we're supporting them with their efforts. They have run into an issue in Hungary and they have -- they've told us that. They are in discussions with the Hungarian Government and they hope to resolve the situation positively -- expect actually to resolve the situation positively in the near future.

A - Matt Rider {BIO 20002664 <GO>}

On new mortality and morbidity, just to give us a little bit of a baseline, so for the first quarter we had about EUR138 million of adverse mortality and that was offset by approximately 50%. We had 65 million better morbidity in the long-term care book. What we're seeing is -- I think we had given some guidance before that we would expect to see about a $50 million per year impact for 100,000 additional COVID deaths. What we're forecasting now -- so we think that, that sensitivity still holds, the $50 million for 100,000 deaths. So we're -- right now we're expecting in the second quarter about 75,000 US population deaths declining to about 25,000 population deaths in the third quarter.

Operator

Thank you. And we take our next question from Michael Huttner with Berenberg. Please go ahead sir, your line is open.

Q - Michael Huttner {BIO 21454754 <GO>}

Hello, can you hear me? Good morning. I had two questions, one is the IBNR-and long-term care. I didn't understand -- it sounded like extra reserving but I'm not sure. And then the other thing, you said remittances from the US in Q2, and I just wondered if you could give us a figure. Thank you.

A - Lard Friese {BIO 17008174 <GO>}

Matt, can you take both of them please?

A - Matt Rider {BIO 20002664 <GO>}

Sure. On the IBNR, what we're seeing is that people are not going into long-term care facilities. So, they are afraid of contracting COVID. So, there is probably a kind of a pent-up demand for this. So, we are establishing an IBNR because at some moment in time we are going to see an acceleration of people going into long-term care facilities. So, it is a bit. It is a bit additional reserving. The current reserve stands at $59 million, but we would expect that to be released as people go into the long-term care facilities.

For the US remittances, we don't specifically say anything about the individual countries. But what we are guiding for, for 2021 is the same thing that we had talked about at the Capital Markets Day, which is somewhere between EUR600 million and EUR700 million for the full year.

Q - Michael Huttner {BIO 21454754 <GO>}

Thank you very much.

Operator

Thank you. And we take our next question from Colm Kelly with UBS. Please go ahead, your line is open.

Q - Colm Kelly {BIO 19140684 <GO>}

Yeah, and thanks very much. And just question on the capital generation, it was in line with expectations today and on track versus the 2021 guidance. But I suppose, given the strength of the progress on the operating plan, given higher reinvestment yield in 1Q, you know that there is some thought that, that should have been maybe a bit better -- a bit higher in a similar way that the earnings was better than expected. So, can you just take me through why we haven't seen maybe a better uplift in terms of capital generation in 1Q in that context?

The second question, can you just update on US reinvestment yields for 1Q, how that compares with the (inaudible) in the CMD plan? And if it remains at the current levels, what impact are you expecting it would have for 2021 capital generation? Those are the two questions. Thank you.

A - Matt Rider {BIO 20002664 <GO>}

So on the first point on the capital generation, I would just remind you that capital generation is typically a little bit lower in the first quarter due to seasonality than it is in the rest of the year. But what we had seen was -- so we don't normalized for everything. So, you do see the impact of adverse mortality coming through the normalized capital generation -- or the operating capital generation in the first quarter. But the other one is a problem that we actually like to have, which is higher new business strain coming out of the US, which is going to result in higher capital generation in the future. For the -- let's say -- let's stick to the US in terms of investment yields. For the first quarter, new money yields were at 2.9% and the back book yield was at 4.21%. So we had seen a modest uptick in the new money yield from the fourth quarter given the rise in interest rates. But as we'll see, we are going to see capital generation go up as a consequence of the rising rates and that comes through I think in the presentation quite well. Thank you.

Q - Colm Kelly {BIO 19140684 <GO>}

Okay, thanks. And maybe just one follow-up. I mean you've a very useful slide indicating 35% of the initiatives in the operating plan has been executed. In terms of the financial impact within capital generation, do you have an estimate of what proportion you think has flowed through or has been already realized within capital generation?

A - Matt Rider {BIO 20002664 <GO>}

Yes, I would say so. It was total addressable expenses down EUR203 million for the whole thing, that's on the fourth-quarter rolling average, I would say, perhaps 25% (inaudible).

Q - Colm Kelly {BIO 19140684 <GO>}

Okay, perfect. Thanks Matt.

Operator

Thank you. (Operator Instructions) We take our next question from Ashik Musaddi with J.P. Morgan. Please go ahead, your line (Technical Difficulty).

Q - Ashik Musaddi {BIO 15847584 <GO>}

Thank you, Matt, and good morning Matt. Good morning, Lard. Just couple of questions; actually going back to the previous question again, when we think about capital generation for the year, I mean your guidance was EUR800 to EUR900 million, if I remember correctly. But on top of that, the way I think you -- I mean credit losses are more on less zero. So, that should have added reasonably plus the investment income would be higher as well based on your expectation plus the -- you're running ahead in terms of your cost saving as well. So EUR800 to EUR900 million could go up a bit stronger than expectations.

You mentioned that first quarter was impacted by mortality losses and typically there is a bit of seasonality. So, is there any possibility you can give some color about seasonality and the excess mortality in the capital valuation numbers so that we can think about what the normal run rate for the quarter could be and how we need to think about the full year? So that's one.

And secondly, in terms of the interest rate hedges that you have done, I mean what is the economics of that? What is the drag in terms of capital -- or capital generation? I mean are all those embedded in the numbers in your planning or is there any additional positive or negative that we should be thinking in the future? Thank you.

A - Matt Rider {BIO 20002664 <GO>}

So I can take the first one on the, let's say, a normal run rate for the operational cash or capital generation. If you look at the quarter, we did about EUR220 million of capital generation after holding and funding expenses. So if you add back the holding and funding expenses, that puts you at about EUR290 million before holding funding expenses.

Now if you add back the poor claims experience in the first quarter, that gets you to about EUR360 million of, let's say, a run rate clean quarter capital generation. And I think from that you can deduce the fact that we are having -- you can work through the numbers yourself, but it implies for the full year something like EUR1.4 billion of operating cash flow generation for the year.

Now I would remind you that operating cash flow generation is not equal to free cash flow. So importantly, we do have to be -- so we are running ahead of our expectations on operating capital generation but we do still see some risk in terms of the credit markets and we still do see some risk in terms of the COVID-19 developments on mortality.

So we still want to be, let's say, cautious with respect to our guidance on this and I would just remind you at the Capital Markets Day we guided for EUR1.1 billion on a similar basis. So, I think -- again we're running ahead of our expectations, which is good, but we also going to be a bit cautious given the uncertainty in the financial markets with respect to COVID-19.

Now on the interest rate hedges maybe -- let's divide it into two pieces. So the first piece is, you will remember on the Capital Markets Day that we had a -- that we had an ambition to reduce our interest rate exposure in the US one-third to one-half. And at this point in time, we have delivered approximately 50% of those actions. Those were largely in the general account.

Now in addition to that, we have the -- we've introduced a new interest rate hedge in the US that relates to the variable annuity book of business. This is where we have taken approximately one-third of the interest rate risk, were that be [ph] business off the table. This is in -- let's say, in preparation for implementing a full dynamic hedge.

The cost of that -- the cost -- because we're using linear instruments, basically the cost of the interest -- the additional interest rate hedge is zero, but we do see the volatility of that number that will come through our capital. So it's not so much a capital generation thing, you see it more reflected in the sensitivities of the RBC ratio to equity markets and interest rates. Let me leave it [ph].

Q - Ashik Musaddi {BIO 15847584 <GO>}

I mean, just a quick follow-up on that. Actually it's a request. I mean it would be great if we can cover the interest rate risk in future in a session or something so that we understand where are the risks, what you are doing and what are their interest rate risks remaining in the balance sheet, because clearly -- I mean you are progressing but the problem is we are not able to see that in terms of number because sensitivity may not be the right way of looking at economics. So, any help in the future on interest rate related exposure, risks, hedges et cetera, would help a lot. Just a good [ph] thought. Thank you.

A - Matt Rider {BIO 20002664 <GO>}

That's an entirely fair request and we will come back when we do the second quarter results on our progress on implementing the dynamic program in the US and that will be part of it.

Q - Ashik Musaddi {BIO 15847584 <GO>}

Thank you.

Operator

Thank you. And we take our next question from Fulin Liang with Morgan Stanley. Please go ahead, your line (Technical Difficulty).

Q - Fulin Liang {BIO 21126177 <GO>}

Okay, thank you. Good morning, and I've two questions. So first one is, actually coming back to that interest rate hedge, so you to the macro interest rate hedge. I think the -- when you put on the hedge, the US 10-year was 1.5 roughly. And does that mean that -- I understand that as you essentially locked in that 1.65 for one-third of your VA book, but if I look at your ultimate like so called US 10-year assumption, at the end of the pack you say you have ultimate US 10-year assumption of 2.75 in 10 years' time. Does that mean actually when you lock in a rate which is actually lower than this 2.75, it will be reflected in your Q3 actuarial assumption review somehow and somehow flow reduce some of the economics? Is that right way to understand this or -- the dynamics of these new assumptions?

And then secondly is just one small confirmation. So you set of the IBNR for LTC and of the benefit we reported this quarter plus the previous quarter as well, that is already net of the so-called IBNR reserves, right. So we shouldn't -- so basically you already baked in the pent-up amounts on the LTC in the number in the benefit to reported. So we shouldn't expect some reversal of this benefit to reverse going forward, is that right? Thank you.

A - Matt Rider {BIO 20002664 <GO>}

So on the first point, there is a difference between the -- let's say, the statutory treatment of that interest rate macro hedge from that long-term rate assumption. That long-term rate assumption that we have, Fulin, is strictly related to IFRS. So the interest rate macro hedge doesn't -- it's sort of an apples-to-oranges comparison. The only place that you're going to be seeing the results of that in macro hedge is going to be in market volatility. So you have it exactly right.

We executed the trades at approximately with a EUR10 of 1.65% and to the extent that markets move around there, then we're either going to be reporting IFRS gains if interest rates decline or IFRS losses if they increase. But the main reason for this of course is that we do it in the -- that we do it for capital management purposes.

Now on the IBNR point, yes indeed, so we have a low actual to expected ratio now for long-term care morbidity and really this is relating mostly to the mortality side, not so much in terms of people entering long-term care facilities. So I would expect that -- so that amount that we have now on the balance sheet, the $59 million IBNR, we would expect to release that to the extent that we see additional entries into long-term care facilities that are running above our long-term expectations. So, we would expect to release that as we come out of the P&L.

Q - Fulin Liang {BIO 21126177 <GO>}

Okay, thank you. (Ends Abruptly)