Q4 2016 Earnings Call

Company Participants

- Alexander Rijn Wynaendts, Chief Executive Officer, Chairman-Executive & Management Board
- Willem van den Berg, Head-Investor Relations

Other Participants

- Albert Ploegh, Analyst
- Andy Hughes, Analyst
- Arjan van Veen, Analyst
- Ashik Musaddi, Analyst
- Bart Horsten, Analyst
- Darshan Mistry, Analyst
- Farooq Hanif, Analyst
- Farquhar C. Murray, Analyst
- Gordon Aitken, Analyst
- Nadine van der Meulen, Analyst
- Nick Holmes, Analyst
- Steven Haywood, Analyst

MANAGEMENT DISCUSSION SECTION

Operator

Good day and welcome to the AEGON Q4 Results Analyst and Investor Conference Call. Today's conference is being recorded. At this time, I would like to turn the conference over to Willem. Please go ahead, sir.

Willem van den Berg {BIO 15203834 <GO>}

Thank you. Good morning, everyone, and thank you for joining this conference call on AEGON's fourth quarter 2016 results. We would appreciate it if you take a moment to review our disclaimer on forward-looking statements, which is at the back of this presentation.

After the prepared remarks, our CEO, Alex Wynaendts, will answer your questions. Matt Rider is joining us today. However, as he has not been formally appointed yet as our CFO, he will not be taking questions at this time.

I will now hand it over to Alex.

Alexander Rijn Wynaendts {BIO 1821092 <GO>}

Thank you, Willem, and good morning, everyone. As always, thank you for your interest in our company and also for joining us for our fourth quarter 2016 earnings call.

I would like to begin by providing you with a brief overview of the key developments this quarter. We reported strong underlying earnings which were supported by successful expense savings program, favorable markets and improved claims experience in the U.S.

As a result of favorable markets, our Solvency II position increased to 159% which is in the upper half of our target range. Now furthermore, I'm also pleased to announce a final 2016 dividend of $0.13 per share bringing our full-year dividend to $0.26 per share.

Let's now move to the next slide and take a closer look at our underlying earnings for the quarter in more detail. Underlying earnings before tax increased by 27% to €554 million. This was mainly due to strong results in the Americas as we are seeing the benefits of our five-part plan to improve returns in the U.S. that we announced in the second quarter 2016.

As we indicated at the Investor Day in December, we continue to make significant progress towards our expense savings target. These cost reductions resulted in an uplift in underlying earnings year-on-year and I will provide you more details on the program shortly.

Earnings were also positively impacted by favorable markets as higher interest rates resulted in a favorable €25 million tangible - intangible adjustment in the U.S. and Asia. In addition, rising equity markets increased account balances, resulting in increased earnings from our fee-based business. We also saw improved claims experience in the U.S. during the quarter, driven by favorable mobility in long-term care and in supplemental health, while mortality experienced in our life business was in line with our long-term expectations.

Let's now zoom in on our expense savings program on slide 4. I'm pleased to share with you that we are successfully executing on our program to reduce expenses. And as announced in December, we have increased our 2018 expense savings target by €150 million to a total of €350 million. I would like to emphasize here that these expense reductions will enable us to improve returns and at the same time fund the necessary investments that we continue to make in technology in order to fully digitize customer experience.

In 2016, we achieved run rate expense savings of €110 million, double our original full-year target of €56 million. This has allowed us to double our U.S. expense savings target to $300 million and we expect to reach our original target of $150 million one year ahead of schedule.

To support this target, we've taken significant management actions in the fourth quarter. They include the planned closure of three locations, a further net reduction of more than 500 roles and the strategic decision to close our Affinity, Direct TV and Direct Mail channels. In the Netherlands and at the holding, we're also well on track to achieve the planned expense reductions and are continuing to make good progress towards our 2018 target.

Let's now turn to slide 5 and how net income developed over the quarter. Our net income of €470 million is a significant improvement, both in comparison with recent quarters and with the fourth quarter of 2015. As I highlighted a few moments ago, we reported underlying earnings of €554 million or from a non-underlying earnings perspective, it was a balanced, a very benign quarter.

Fair value items, which amounted to a €13 million loss, were mainly impacted in the Americas by market performance volatility following the U.S. elections. These losses were offset by positive real estate revaluations and the impact of favorable market movements on the guarantee portfolio in the Netherlands. Realized gains totaled €36 million and were mostly a result of private equity divestments, while other charges amounted to €38 million.

We continued to see a favorable effective tax rate primarily due to tax rates in the U.S. and in the UK. And as a result, the effective tax rate this quarter on underlying earnings was 15%, which is below our blended statutory tax rate of 32%.

I would now like to highlight our record gross deposits for the year on the next slide. The record of €100 billion of gross deposits in 2016 was mainly driven by retirement plans in the U.S. and our global asset management business and clearly demonstrates the success we've had with shifting our business towards fee-based products.

In terms of asset management, gross inflows were mainly the result of higher inflows in our Chinese joint venture. The U.S. retirement plan gross deposits increased mainly due to the acquisition of Mercer's retirement business, which now allows us to compete in the jumbo segment as well as higher recurring deposits.

As I indicated at the third quarter, we anticipated higher outflows after the Mercer acquisition and expect elevated outflows to continue until early 2018 as the portfolio business is being migrated onto our platform. Despite these outflows, full-year net deposits were positive and totaled €2.7 billion in 2016.

In the UK, AEGON's platform showed record net inflows of €2.2 billion for the quarter, of which €600 million were from new customer inflows. The platform now is over €16 billion of assets and over 440,000 customers, confirming it as one of the fastest growing in the market. Indeed, including Cofunds and BlackRock's defined contribution business, we will manage well over €100 billion in assets. These inflows in combination with favorable market movements contributed to an increase in revenue generating investments of 5% year-on-year.

Let me now move from deposits to our insurance business. I'm turning to slide 7. New life sales were down by 12%, a reflection of lower agent recruiting at our World Financial Group distribution channel in the U.S.

In the Netherlands, we continued to see a shift towards fee-based solutions, which led to lower life sales. As a result of our decision to exit certain products in the Americas in the first half of 2016, accident and health new premium production declined to €224 million.

The same time, we've also made the decision to run down our existing business in the Affinity, Direct TV and Mail channels with immediate effect as these businesses do not meet our strategic objectives. From a top-line perspective, sales will mainly be impacted by a loss of travel insurance sales, while underlying earnings impact is expected to be modest and offset by the additional expense savings announced at the Investor Day. As a result of our decision, $100 million of capital will be released over the next years.

Finally on sales, I'm pleased that we've extended our successful partnership with Banco Santander to include health insurance in Spain and expanded distribution in Portugal. This will support the further growth of our joint venture business in Spain and Portugal.

Turning to slide 8 which shows the development of our Solvency II ratio during the fourth quarter. As you can see, our Solvency II ratio increased to 59%, as capital generation and favorable market impacts were partially offset by one-time items. In the Netherlands, the Solvency II ratio decreased to 141%, as the volatility adjuster did not show a material recovery after the steep decrease in the third quarter. The benefit from higher interest rates and higher credit spreads was partly offset by adverse effect of increased inflation expectations and in addition, required capital increase in the fourth quarter, driven by the repositioning of the Dutch investment portfolio, together with the additional interest rate hedges we put in place in December to reduce our interest rate sensitivities.

You will be aware that our regulator, the Dutch Central Bank, recently issued new guidance on the calculation of the Loss Absorbing Capacity of Deferred Taxes, LAC-DT, which took place in early February. Our current assumptions for LAC-DT is 75%. A reduction of the LAC-DT assumption by 25 percentage points would reduce our Dutch Solvency II ratio by 8 points and would reduce the group ratio by 3 points.

I'm turning to the U.S., where U.S. RBC ratio amounted to 440%, as capital generation was more than offset by dividend payments to the holding. And in the UK, our Solvency II ratio was up to 156%. As you're aware, we are working on the completion of the Part VII transfers, which we expect to complete this summer. This is expected to free up additional capital, which we intend to upstream to the group.

I will now turn to slide 9 to our holding excess capital position which amounted to €1.5 billion at the end of 2016. Remittances from the Americas, asset management, Central and Eastern Europe and Spain and Portugal well exceeded the dividends paid to shareholders and holding expenses in the year. We expect remittance to remain strong, and this will enable us to continue returning capital to shareholders through growing dividends. Our holding excess capital of €1.5 billion is at the top end of our target zone despite one-time items in 2016 such as the share buyback and capital injections to fund growth, particularly in Asia.

In December, we issued €500 million of senior notes with a coupon of only 1% taking advantage of market circumstances. The proceeds of this issuance are earmarked for the redemption of a 3% senior note due July of this year. As we have shared with you last year, the holding had planned to receive a dividend from our Dutch business over 2016.

In the meantime, we have upstreamed €100 million from our operating entities to the Dutch Holding Company. And a decision to upstream this dividend from AEGON, the Netherlands to the group has been postponed, until we have finalized our review on the new guidance from DNB on LAC-DT. And this is expected to take place in the second quarter of 2017.

Let me now turn to dividends on the next page in slide 10. It's one of our priorities to return an attractive level of capital to shareholders. In 2016, we made significant progress with a commitment of returning capital to shareholders by completing the €400 million share buyback in the first half of the year and by announcing a final dividend of €0.13 bringing the total dividend payment for the full year to €0.26 which is an increase of 4% compared with last year. The full-year dividend marks the fifth consecutive year that we have increased our dividend returned to shareholders. Indeed, since 2011, we have increased our dividend by nearly 25%.

Now, let me turn to slide 11 where you can see an overview of the progress we've made executing our strategy in 2016, and then look ahead to our main priorities in 2017 and 2018. In the U.S., we continue to execute towards achieving One Transamerica by aligning the organization by function. This has allowed us to accelerate our expense savings program and to execute successfully on the 5-part plan.

In the UK, we successfully completed the transformation of our business from a largely traditional pension business to the leading platform business in the UK market. And we achieved this by divesting in two steps; our capital intensive and sizeable £9 billion UK annuity book, and by freeing up approximately £500 million of capital. With the Cofunds and BlackRock acquisitions, the platform will have over £100 billion of assets on administration, making it the largest platform in the market.

Looking ahead, we expect to realize significant revenue synergies through cross-border collaboration in Continental Europe. Meanwhile, in Asia, we've been focusing on supporting the growth of our businesses, while improving capital efficiency significantly. As announced earlier, one of the measures we've taken to improve returns and cash flow generation in Asia is to restructure the Affinity business. We are exiting non-profitable businesses and investing in digitally-enabled new businesses.

Finally, we continue to explore ways to reduce the IFRS capital allocated to run-off businesses in the U.S., particularly related to payout annuities and BOLI/COLI. As you're aware, the prospect for a potential transaction has improved with higher interest rates.

So, to close, I would like to give you an update on the progress we are making towards our 2018 financial targets. So far, we have achieved run rate expense savings of €110 million, which is significantly ahead of our initial 2016 target. This has allowed us to increase our expense savings target and gives me every confidence that we will reach our increased target of €350 million by the end of 2018.

I'm pleased with our solid Solvency II capital ratio of 159% for the group, which as I mentioned before, is in the upper half of our target range. Our ratio remains stable throughout 2016, despite the volatile markets we experienced, supported by strong local capital ratios in our operating units.

Furthermore, we've also been able to maintain a stable holding excess capital position, while returning €930 million to shareholders for 2016, including a final 2016 dividend of €0.13 per share. I remain confident that we will take necessary measures so we can make significant progress towards our 2018 targets.

I'm now ready to take your questions. Thank you very much.

Q&A

Operator

Thank you. Thank you. So, now, we'll take our first question from Ashik Musaddi from JPMorgan. Please go ahead. Your line is now open.

Q - Ashik Musaddi {BIO 15847584 <GO>}

Hi. Good morning, Alex. I have three questions. First of all, can you give us some clarity about your interest rate sensitivity, especially in the U.S. Somehow, it shows that rising interest rate is negative and falling interest rate is negative as well. So, what are we missing here? Because, if I think about economically, a rising interest rate is a fascinating news for the Life business in U.S. So, what are we missing here? Any thoughts on more economic basis rather than just headline solvency basis.

Second thing is, can you give us a bit more clarity on Dutch capital position because it looked like there has been a drop over first half numbers, and there is still uncertainty around LAC-DT. And how should we think about the dividend upstreaming from Netherland? You flagged about €100 million. But how should we get comfortable with that?

And thirdly is - are you continuing to remain confident that even if you don't get any dividend from Netherlands and from UK, your dividend is still covered going forward as well, dividend and HoldCo cost. That would be great if you can give clarity on these three ones. Thank you.

A - Alexander Rijn Wynaendts {BIO 1821092 <GO>}

Thanks, Ashik for your questions, and let me try to answer them, all three. First, on the interest rate sensitivity, indeed, we have shown you the sensitivities on slide 27, but I'd like to make a couple of comments, which hopefully will help you understand what the dynamics are. First of all, the interest rate sensitivities are mostly impacted by our VA business in the U.S. And as you know, we hedge our interest rates, our equity exposure, also volatility amongst others, and it's quite a complex – how should I say – there's a very complex hedging we're putting in place. And the sensitivities that you see here effectively, they're shown at a point in time, and they're also shown in isolation on the basis that the shocks happen instantly.

What it doesn't show here and what is not reflected is that we constantly rebalance our positions as part of a dynamic hedging program. So, your point of saying that higher rates is good for our business is absolutely true, and is still true. And that is not reflected properly in sensitivities because these sensitivities, they show you at a certain point in time, but do not show the rebalancing and also, do not show the positive impact of higher spread because you get more interest rate, which is a plus doesn't show you the positive of higher fees when equity markets goes up because it only shows at a certain point in time. So, I hope that helps you and I can confirm to you that higher interest rates is good for our business, is good for our customers and is good for all of us.

In terms of the capital position of the Netherlands, what I'd like to say is that in the Netherlands, the ratio actually was affected quite significantly by the EIOPA, volatility adjuster which dropped in Q2 from 18% to 10%, 10 points in the Q3 and then rebounded a little bit in Q4 but stayed quite low at 13 basis points. And at Q3, you'll remember, we did flag that this EIOPA VA had quite a negative impact on our ratio. Now, we've seen, indeed, some interest rate increases which is positive, but these were offset by an adjustment we had to make, in relation to our inflation expectations. And as you know, inflation expectations in Europe have actually – over the last couple of months have gone up. So, we had to make a one-time adjustment for inflation.

And, in addition to that, I flagged two items. One of them was that we're repositioning our portfolio to try to take advantage of investment opportunities in the liquid investments that requires a higher SCR and finally, equally important, is that we have further reduced our sensitivity to interest rates by putting up more hedges and when you do so, you also effectively reduce your level of capital but what you do is reducing the sensitivities even more.

I hope that explains the Dutch position, so I can talk about our dividend. If you look at remittances, last year, we have had cash flow generation of, let's say, around €1.2 billion which is the €300 million I mentioned times 4, but we also had dividends upstreamed from all our businesses of €1.1 billion, which I think confirms that our dividend is pretty well covered even on the basis of 2016 where we did not get a dividend neither from the Netherlands and for the UK. So, our dividend is well covered.

I did mention our situation in the UK where we expect to have completed our Part VII in the summer and that for sure will lead to a release of excess capital, which we intend to upstream. So, all this combined should give you, in my view, absolute comfort that our dividend to shareholders is well covered.

Q - Ashik Musaddi {BIO 15847584 <GO>}

Okay, that's very clear. Thank you. Thanks, Alex.

A - Alexander Rijn Wynaendts {BIO 1821092 <GO>}

Thanks.

Operator

Thank you. And now we'll take our next question from Albert Ploegh from ING. Please go ahead. Your line is now open.

Q - Albert Ploegh {BIO 3151309 <GO>}

Yes. Good morning, all. Two questions from my side. Would like to go a little bit into the U.S. earnings and especially what has been flagged as the one-time items. I mean, this quarter, clearly, there was a quite positive experience in the long-term care, which, of course, was an issue last year and the review took place in Q3.

You do flagged the word seasonal in there. So, how should we consider this €34 million positive in Q4 and how to look at that in terms of, let's say, the run rate going forward on that specific business line? At the same time, you mentioned also the, let's say, the adverse persistency on the universal life policies, give a little bit color there and how comfortable are you with that experience going into 2017? Thank you.

A - Alexander Rijn Wynaendts {BIO 1821092 <GO>}

So, Albert, thanks for your question. Yeah. In terms of the claims experience, yes, we are pleased to see positive claims experience in long-term care and in our health business – in both businesses. Now, the seasonality of it is the following. As you say, a lot of the business we do in supplemental health is effectively ensuring or covering the deductibility.

And that means that we have more claims in the beginning of the year because that's when the people are using up their deductibility. In the second half of the year, in most cases, deductibility has already been used and that means they can't claim with us, and that explains that seasonality. I think it's very difficult to say what part is seasonality, but I would say we've had just good performance and good experience and some seasonality.

Now, in terms of persistency, the adverse persistency is specifically into one area and that's been universal life policies. But, what I would like to say is that they have remained with what is the expected volatility range. I don't believe that – we don't believe that the most – the recent experience we've seen here is something that we naturally will see continuing going forward. Thank you.

Q - Albert Ploegh {BIO 3151309 <GO>}

And maybe one small follow-up more from a cash flow perspective. You mentioned the UK Part VII transfers. What can we expect a little bit in terms of timing? Will it be then more, let's say, a Q2 event so more news in August or is it more in, let's say, end of year kind of event? And what's the – let's say, can you give a little bit feeling on the kind of sizing and how we should link that to the regulator in terms of approvals of that. Thank you.

A - Alexander Rijn Wynaendts {BIO 1821092 <GO>}

Yeah. Albert, as we mentioned, Part VII, we have two Part VIIs. The one was with the first deal, with the Rothesay deal, and the second Part VII was with the – second deal with Legal & General, and we were planning for the summer. Now, that means that this – the dividend or the upstreaming is clearly a second half of 2017 event. As you know, we have now a very different business in the UK, very much derisked, much more a fee business, and that makes it also more predictable for us to be able to become comfortable about upstreaming their dividend to the holding.

Q - Albert Ploegh {BIO 3151309 <GO>}

Okay. Thank you.

Operator

Thank you. And now, we'll take our next question from Darshan Mistry from Citi. Please go ahead. Your line is now open.

Q - Darshan Mistry {BIO 19807857 <GO>}

Morning. Two questions please. Firstly, on the Solvency II sensitivities within the UK. Could you provide some color as to why the sensitivities for the UK business have increased significantly versus 2Q? And could it be that once your Part VIIs are in fact, completed in the UK, could the sensitivities normalize or drop again, that's with reference to interest rate sensitivity and credit spread sensitivity?

Secondly, on the Dutch Solvency II ratio, you seem to have taken quite a big hit versus kind of where you would have been on a rolling forward basis, but your interest rate sensitivities don't seem to have decreased materially. So, could you please again provide a bit more color as to what's going on within the Netherlands? Thank you.

A - Alexander Rijn Wynaendts {BIO 1821092 <GO>}

Thanks, Darshan. In the UK, the way you need to look at is that effectively by executing on the sale of our annuity book, we are reducing our SCR. And that means that interest rate sensitivity that we have remaining in the UK is related to our employee pension funds. So, it's a smaller amount that is related to a smaller SCR. And that's why in percentage points, you see that the sensitivity is what you see happening there. So, unless you have to relate it as a smaller movements on smaller SCR but in terms of percentage, it's not necessarily smaller. Hope that answers your first question.

Yes, and on the Netherlands, what I can do is repeat and hopefully give you a bit more color. What I said earlier and I announced to Ashik's question is that there's a couple of important drivers in Netherlands. That VA adjuster, the decline from 18 basis points to 10 basis points with a small rebound to 13 basis points, has been quite significant.

And yes, interest rates have increased, but as I explained, the inflation expectations also, going forward have increased. And that means we had to take a one-off impact for higher inflation expectations. And other items like repositioning the portfolio, as I mentioned and also putting in place more hedges just requiring more capital. Now, I think that the sensitivity in the Netherlands on interest rates now is lower than it was and that also is to give our sales and our regulator more comfort that we are less dependent on fluctuations of the market.

What I'd like to add on the Netherlands is that we, of course will engage and are starting to engage with the regulator on the review of our LAC-DT, which is now subject to the guidance which has come out I think exactly 2 weeks ago, not even 2 weeks ago. As you know that's a very - it's very complex. The guidance is very clear on a number of points. But we need also to get interpretation on others and see how it gets applied to us specifically with the DNB.

We've also mentioned earlier to you that we are looking at management actions we've taken in relation to positioning our portfolio. We also have mentioned earlier that we are putting forward - have put forward request for some model changes.

So, there's a lot of pieces that are moving parts and a lot of actions that is taking place and that's also the complexity I think is well highlighted by the fact that the Dutch regulator has actually given us 6 months to come up with this clarification. And we would like to use 6 months to address all the other items I just mentioned to you before. So, that's what I would like to add on the Dutch Solvency II ratio. Thank you.

Q - Darshan Mistry {BIO 19807857 <GO>}

Perfect. Thank you.

Operator

Thank you. And now, we'll take our next question from Farooq Hanif from Credit Suisse. Please go ahead. Your line is now open.

Q - Farooq Hanif {BIO 4780978 <GO>}

Thank you. Hi, everybody. I just want to come back on this inflation expectation. Is this related to wage increases on the defined benefit book? Just wondering if you could clarify that. And secondly, in the U.S., if we do get a delay to the DOL regulatory changes, I mean, I'm interested in your view on that anyway, but if we do get a delay, isn't there an issue that you've updated your product suite and actually you might have to sort of revert to some previous product suites or change the way that you price your VAs or deliver them to adapt? I mean, so how ready are you for the two potential outcomes of DOL or no DOL? If you could answer that, that will be really helpful. Thanks.

A - Alexander Rijn Wynaendts {BIO 1821092 <GO>}

Farooq, good to hear you're back. On inflation, I would say, it's really general inflation, so it's not so much the wage increases that is in our defined benefit plans. It's just the fact that we need for our cost going forward, long-term business, we need to make assumptions on inflation, that's wages and any type of costs. And as you know, in the Eurozone, inflation is now starting to creep up and we see now some headline inflation numbers and that we need to reflect that in our Solvency II and that has affected our owned (33:05) funds, but it's a one-off. So, I think the inflation expectation, it's a step up and hopefully from here, we would not need to adjust it much more.

Now, in the U.S. relation – Department of Labor regulation, yeah, as you know, now it's been clear that the implementation will be postponed. Having said that, we continue to take all the steps and make sure that we can implement the rules including – no changes as was originally planned for April of this year. We still want to see what the review will lead to; we've taken the steps, we want to be prepared, and we'll be prepared. Now, what impact it will have on product mixes? Yeah, certainly there will be products with commissions, and product with fees, that is clear that will be a change. We, by the way, have already started launching a new product that address that new environment.

But what is more important I would say is that also the distribution feels comfortable in selling the product because we can adjust ourselves and be well-prepared, but distribution needs to be comfortable that they are in line with the changes and that is something we still have to see.

Q - Farooq Hanif {BIO 4780978 <GO>}

So, in terms of just – if I may just follow-up on that, sales have been weak in the market. Do you think there's still going to be a period of uncertainty on sales? When do you think it can rebound and what part do high yields play? I know that these products have been derisked, but what part does that play on demand and ability to be a more attractive guarantee?

A - Alexander Rijn Wynaendts {BIO 1821092 <GO>}

Well, Farooq, I think it's difficult to share what sales will do in the future. But what I can say is that with interest rates now clearly higher than what they were, the good thing is that the cost of guarantees is down for customers, so they will begin using them better to buy these products. And at the same time, it also enhances the profitability of the sales which we're taking.

I do think that the market will want to see clarity on where this is all going because we're talking about a delay, so we want to get clarity. And that's the reason also we are now assuming, as if the Department of Labor rules would be applicable, so that at least we should know for sure that whatever comes out of Department of Labor is something which we already implemented and have implemented, and that should be positive for our sales.

Q - Farooq Hanif {BIO 4780978 <GO>}

Thank you very much.

Operator

Thank you. And now, we'll take our next question from Arjan van Veen from UBS. Please go ahead. Your line is now open.

Q - Arjan van Veen {BIO 5197778 <GO>}

Thank you. I have a couple of questions on just dividend upstreaming and the cash position at the HoldCo. Firstly, on Netherlands, the solvency ratio is 141%. You kindly gave us sensitivities to (36:11) LAC-DT changes. One of your peers yesterday said that their solvency position today is down from year-end, due mainly to sovereign spreads changes and obviously, the sensitivity for them is quite high. You don't specifically disclose it. So, the question really is you have a target of €225 million from Netherlands.

You didn't upstream that in 2016. I note the €100 million you put in the HoldCo. But, given where we are at this point now, could you give some view as to whether you think Netherlands upstreaming in 2017 is likely? And I'm kind of a bit – personally, I would think it's better to rebuild the solvency and then pay out dividend. So, actually, I would suggest actually not paying dividends for a while until we get to a very comfortable situation.

And then the second question is more than when we look at the whole capital upstreaming from the company as a whole. So, U.S., your target is €900 million, which is paying out based on incentives (37:14) you gave at the solvency – sorry at your Investor Day in December in the U.S., is paying out effectively 100%. Your dividend currently is €530 million plus €300 million corporate cost. So, you're basically, U.S. upstreaming is covering your dividend and corporate cost.

So, the question really is then, when we look at the cash at corporate office is (37:35) €1.5 billion, but you raised €500 million of debt on December 9 and that rolls away again in the middle of the year because it's been issued to replace some debt that you already have, so that draws back down €1 billion. So, really just curious around – your target is €1 billion to €1.5 billion.

You're at the bottom of that if you take out that debt and I know the comments you made around the UK. So, really just curious as to what you see the dividend upstreaming capacity is or upside to what you said previously around some of the other divisions like asset management in Europe and whether Asia is still going to be a negative drag as per your guidance. Thank you.

A - Alexander Rijn Wynaendts {BIO 1821092 <GO>}

Right. Yeah. On the Netherlands, there's not so much more I can say than we have said already. So, I think that's being clear. I would just add one point in relation to the comment on the government spreads. I think you know that the positioning of our portfolio effectively means that we have very limited exposure to government spreads. I'll just give you a number, is that if government spreads would widen by 25 basis points it would have a 3% negative impact on the Solvency II ratio of AEGON, the Netherlands.

So, as you can see that is very limited. The reason is also that most of our investments in Netherlands are in Dutch and German government bonds and in Dutch mortgages which as you know have been a very good - a very well performing asset.

Now, in terms of upstreaming, I think you made the points yourself on the U.S. and what I said on the Netherlands. I think in my introductory remarks was clear, we need clarity on where LAC-DT before I'm going to make more comments about likelihood or not likelihood of what we will do with the dividend. And, I would agree with you that we do need to have a good starting point, have a good capital position before you start paying out dividends, we will all agree with that.

Now, as you mentioned yourself, our dividend actually is pretty well covered. Our dividend plus holding expenses is very well covered, if you only look at the dividend of the U.S. So, I mentioned a couple of things. The UK. The Part VII will be executed in the summer, that will lead to the release of excess capital and that will be part of that or will be upstreamed to the holding, and that's a second half of the year event. CEE asset management, Spain, continue to provide dividends to the holding.

And finally, I'd like to make a remark on Asia. I did say in my introductory remarks that we are working on capital efficiency in Asia on a number of fronts. And, I do expect actually that our Asian business has - will be in an excess capital position going forward and that should also give us some room there. In addition to the announced - measure we announced already which is the exiting of our Affinity business, which is effectively also generating cash flow and, as such, dividends.

Q - Arjan van Veen {BIO 5197778 <GO>}

Thanks, Alex. That's very helpful.

Operator

Thank you. And now, we'll take our next question from Farquhar Murray from Autonomous. Please go ahead. Your line is now open.

Q - Farquhar C. Murray {BIO 15345435 <GO>}

Good morning, gentlemen. Just two questions, if I may, all focused on the LAC-DT guidance discussion. Firstly, please, could you just work through which elements of the guidance you regard as new and what will be the process to reaching certainty around the implications of this? As you'd say, we seem to be giving them out 6 months to do this.

And then, secondly, AEGON seems to be making much more cautious comments on this LAC-DT guidance and updated yesterday. Does that reflect indications from the DNB on your approach, or is it just a more prudent approach to what's presumably a relatively complicated kind of calculation and process? Thanks.

A - Alexander Rijn Wynaendts {BIO 1821092 <GO>}

Farquhar, on the LAC-DT, what you're seeing is a guidance that is covering a number of points. It's not addressing all the aspects of LAC-DT. This is a guidance. It's more like a Q&A I think that's been talked about that's addressing a number of specific points. Now, I'm not going and I'm not in a position today to say which one is new and not new. It's also about the interpretation and how you applied it to your business. So, you will really have to wait, I'm sorry, for the next six months for us to work this out through in a thorough way, ourselves together with our regulator.

So the remarks we're making on the LAC-DT is just to say this is very complex. It is not for nothing, by the way, that the regulator has given the industry six months to clarify this. And as I mentioned, we also want to take advantage of this six-month period to address a number of other issues and the number of management actions we can take for the Solvency II ratio. We've told you already that we have submitted a request for some model changes and they need also regulatory approval. So what we are trying to achieve is to get all these things together. And that will be done by the end of the second quarter.

Q - Farquhar C. Murray {BIO 15345435 <GO>}

Okay, thanks.

A - Alexander Rijn Wynaendts {BIO 1821092 <GO>}

Thanks.

Operator

Thank you. And we'll take our next question from Nadine van der Meulen from Morgan Stanley. Please go ahead. Your line is now open.

Q - Nadine van der Meulen {BIO 15200446 <GO>}

Yes. Good morning. Thanks for taking my questions. Sorry, another question on LAC-DT. You mentioned if the sector drops from 75% to 25%, that it would have an impact, I think, on the Netherlands solvency ratio of 8 percentage points. So that would, on the current basis, bring the solvency down to around 133%. I was wondering if you could remind us of the capital generation in the Netherlands. Previously, you've guided on that. I'm not sure if that has changed. So we can have an idea of how long potentially it would take to get to a certain level comfortable enough to upstream again. And previously, when you didn't upstream cash from the Netherlands and the moment you started doing that again was when the Solvency II level was above 150%. Just wondering if you can comment on that, whether that is sort of the level that you would need or between 140%, 150% for you to be comfortable. That's the first question.

The second question is with regard to the net dividends received from the units. At the nine-month level, you had received from the unit €700 million and that has now jumped up to €1.1 billion. That jump up, so in Q4, is bigger than what I expected, especially because the Netherlands is zero. Would you mind giving the splits for the regions and comment on the sustainability of each of the regions? That would be super helpful. Yeah, I suppose lastly on the yields. So if you look at the reinvestment yields versus the back book yields, could you give us an update on where you are there? Because in the past, you've guided that if yields would remain where they were; in year one, there would be a negative €40 million impact; year two, €60 million; and year three, €100 million. Perhaps you can update us on that guidance. Thank you very much.

A - Alexander Rijn Wynaendts {BIO 1821092 <GO>}

Nadine, thanks for your question. I think on the LAC-DT, there really is not much more than what I can say - what I've said earlier. We just wanted to give you some sensitivity. But you need to keep on mind that the sensitivities - I said that earlier in the context of the VA sensitivities, that's, at the point in time, in isolation. And that's not the reality. The fact is that we have a lot of moving parts in that Solvency II calculation. And therefore, we'd want to give you the sensitivity also to give you more the direction and some idea of materiality. But the pieces usually work in different ways together. So that what, I think, you need to keep in mind. And I'm not repeating what I said earlier about all the other things which we're working on in Q2. Now, in terms of -

Q - Nadine van der Meulen {BIO 15200446 <GO>}

No, I completely appreciate - yeah, sorry, I completely appreciate that. And sorry to push you on this one. But would you mind giving at least an indication of what the solvency range would be in the Netherlands that you would be comfortable with to upstream?

A - Alexander Rijn Wynaendts {BIO 1821092 <GO>}

I just want to make first - I was just going to get there, Nadine, to make a comment that's -

Q - Nadine van der Meulen {BIO 15200446 <GO>}

Sorry.

A - Alexander Rijn Wynaendts {BIO 1821092 <GO>}

No, don't worry. No problem. The last time that we did upstream dividends, I need to remind you we were not yet in the Solvency II world. So there was no 160% because the last time we upstreamed dividends, it was in the Solvency I world. And so we've given you a range, a target capital range. And for the time being, we have no reasons to change that target capital range. What you also need to take into account is that a target capital range has to be seen in conjunction with sensitivities. It's a combination of two.

And clearly, with the process around LAC-DT, with the process that I mentioned, with other things that we addressed and discussing with the DNB; we will take again that opportunity to have a review of our capital ranges and ensure that both us and the regulator are comfortable going forward. But I cannot say this at this point in time because the review, all the work needs to be done. The sensitivities, being a very important part of that, will all take place in the next six months. Now you'll have noticed that we have reduced and I mentioned that by additional hedging, we put in the Netherlands, we have reduced further our sensitivities in the Netherlands.

So in terms of your second question on the upstreaming of dividends, I cannot give you an answer exactly what was paid at Q2-Q3. And I can ask Willem van den Berg to come back to you to give you the exact dates. What I know is that over the year 2016 – and you're right, the fourth quarter usually is the quarter we get dividends – we received €1.1 billion. And your third question on yields. Let me give you the yields. On new money in the fourth quarter, that was 3.8% while the current new money yield is 4.2%. And the back book yield actually hasn't changed and remained at 4.7%. So what you see is the gap is closing. I think that was your question really, you wanted to find out the gap closing.

Q - Nadine van der Meulen {BIO 15200446 <GO>}

Yeah.

A - Alexander Rijn Wynaendts {BIO 1821092 <GO>}

New money at 4.2% versus 4.7%. That's only 50 basis points gap. And that means, therefore, that the earnings drag from rates staying at this level is they would not move up is also reduced. Yeah -

Q - Nadine van der Meulen {BIO 15200446 <GO>}

Yeah, okay. Thank you.

A - Alexander Rijn Wynaendts {BIO 1821092 <GO>}

Was that your question, Nadine?

Q - Nadine van der Meulen {BIO 15200446 <GO>}

Yeah. Even on the €1.1 billion cash upstream for the full year, could you give a split of that, of the different regions?

A - Alexander Rijn Wynaendts {BIO 1821092 <GO>}

Well, the largest part, obviously, as we discussed earlier, is coming from the U.S.

Q - Nadine van der Meulen {BIO 15200446 <GO>}

Yeah, of course.

A - Alexander Rijn Wynaendts {BIO 1821092 <GO>}

And we have received a dividend from – in Central and Eastern Europe, we received a dividend. We received a dividend from asset management and we received a dividend from our business in Spain. These are the big chunks.

Q - Nadine van der Meulen {BIO 15200446 <GO>}

All right, thanks.

A - Alexander Rijn Wynaendts {BIO 1821092 <GO>}

Thank you.

Operator

Thank you. And we'll now take our next question from Nick Holmes from Société Générale. Please go ahead. Your line is now open.

Q - Nick Holmes {BIO 3387435 <GO>}

Hi, there. Thank you. Two quick questions. The first is, Alex, can you give us a bit more color on your plans for the U.S. run-off book? I think you said you're looking at payout annuities, BOLI/COLI. Just wonders what the latest was there. Then secondly, coming back on the DOL. I remember at the Investor Day, you were talking about fixed index annuities and the opportunities for you with that product. Wonders is that something you're getting into at the moment? Thank you very much.

A - Alexander Rijn Wynaendts {BIO 1821092 <GO>}

So, Nick, yeah, on our run-off business, we've been saying already for some time that we would like to get our payout annuities in BOLI/COLI businesses sold together. With interest rates rising, clearly, the valuation for us gets more attractive and there's been more appetite in the market. I did also mention that these businesses are not in a separate legal entity. And that means that the contracts that we need to put in place is not about selling a company. It's about effectively re-ensuring our BOLI/COLI and payout annuity business.

And that means that you introduce a counterparty risk because the buyer, the one that takes over this business effectively becomes a counterparty risk for us. And that's why we need to make sure that not only we attract and we get a good price. But we also have the right counterparty because it would not make a lot of sense to free up capital and then to allocate capital to a counterparty risk. So it's a combination of the two. I did mention it in my introductory remarks. And this is based on the fact that we have actually seen significantly more interest recently in these businesses. And yeah, it's too early to say what will happen. But I would not have mentioned it in my remarks if we would not have seen additional interest coming in.

Now, on the Department of Labor. Yeah, to come back to what we said earlier, a postponement also means some uncertainty. So that's the reason why we're assuming effectively our work – our base case is that these rules will be implemented. And if there's a delay or relaxation and particularly in the number of modalities around litigation and I think I've mentioned that to you earlier, that would be positive. And we talked about the fixed index annuity. I want to say we've introduced that product also. But it's now too early to talk about a really sizeable amount of sales. But now we have that product also and then introduced it. And just on the...

Q - Nick Holmes {BIO 3387435 <GO>}

That's great.

A - Alexander Rijn Wynaendts {BIO 1821092 <GO>}

...Department of Labor, so it's about implementing. But the pieces that we felt were the most difficult for us is, in particular, when we have difference with customers. In the past, any differences or disagreements would be dealt within the arbitration court, which means that you would have more professional amongst each other. Now, in the proposals that were submitted by the previous government or the previous administration, actually litigation was in a very different way because it was through, I would say, the classical jury trials. And you can imagine that creates a whole different dynamic, in particular, also for distributors and providers of the product because in jury trial, it's not always obvious what the outcomes are especially when you are facing a jury that is more sympathetic to customers than it is going to be to distributors or to the company. So these are a lot of the modalities which are being worked on because if these issues are not being addressed, it's going to be quite risky for providers and distributors to get engaged in selling these products. So it's not only about the product in itself, but it's also about all the modalities around it. I hope that gives you a bit more color.

Q - Nick Holmes {BIO 3387435 <GO>}

Yeah. That's great, Alex. Thank you very much. Very interesting and very clear. Thank you.

A - Alexander Rijn Wynaendts {BIO 1821092 <GO>}

Thank you.

Operator

Thank you. And now we'll take our next question from Bart Horsten from Kempen & Co. Please go ahead. Your line is now open.

Q - Bart Horsten {BIO 2390919 <GO>}

Yes, good morning. I will try to ask a few questions also on LAC-DT which have not been asked so far. First of all, you said that you upstreamed €100 million from your operating entities to the HoldCo in the Netherlands. Does that mean that these entities are well-capitalized enough or don't you need approval for that from the DNB? And secondly, just to understand you made more or less the upstream of dividends to the holding conditional on the review. Does that mean that if the 75% stays intact, that you will upstream the €100 million or are there still other conditions? And even if it would be lower to below 75%, would you still be able to upstream dividends?

My second question relates to the margin development in the U.S. I see quarter-on-quarter an improvement of your margins in retirement plans, variable annuities and mutual funds. Is it fair to assume that these improvements or these relatively higher levels will continue into full year 2017 and beyond? And my final question, if I may, relates to the question earlier asked by Nadine on the reinvestment yield. Could you indicate at what level of U.S. Treasury yields you would be breakeven on the reinvestment yield versus your back book yields? Thank you.

A - Alexander Rijn Wynaendts {BIO 1821092 <GO>}

Yeah, Bart. On your first question, it's, I think, quite obvious that if we would effectively upstream a dividend from operating companies in the Netherlands to the holding of the Netherlands, that you can assume that these operating companies are well-capitalized. Otherwise, we'd not have done that. On the second question, again, I'm going to repeat what I said. We want to do the review first. We want to have a comprehensive review. It includes a number of other factors. So I'm not going to make any speculation or any further comments on what level of LAC-DT we will or we will not pay a dividend. I'm not in a position to do so.

And in terms of margin development, yes, you're right and I'm pleased you're noting that, that effectively you see an improvement in the margins. And that is a result of really two things. First of all, it's our focus on profitability. As you know, we have always insisted on a disciplined approach on profitability. We do not want to sell products if they don't make sense for our customers and don't make sense for us. And secondly, of course, what is now coming through is the, I would say, the expense reduction program, the hard work on expense reductions, which is effectively now also improving the margin. So we have a 60 basis points margin on variable annuity that has improved from the previous quarter and we believe that it's a reasonable base case to assume going forward. In terms of reinvestment yield, I mentioned that earlier, I think, to Nadine. Our current new money investment yield is 4.2% while our book is 4.7%. So there's a 50 basis points difference.

Q - Bart Horsten {BIO 2390919 <GO>}

Yes, I know that. But could you flag what do you need in terms of rate movements in the U.S. to get to that same level? Would that be a 50 basis points increase in the Treasury yield or -

A - Alexander Rijn Wynaendts {BIO 1821092 <GO>}

Yeah. Well, as you know, we invest in a book which has a lot of different categories. So assuming the spread doesn't change, you would need 50 basis points in Treasuries. But this could be lower if the spread increases or higher. So you need to look at the combination, the spread plus Treasury. But I think the point is we're pretty close now. And we've never been so close to it for a long time.

Q - Bart Horsten {BIO 2390919 <GO>}

Okay, good to hear. Thank you.

A - Alexander Rijn Wynaendts {BIO 1821092 <GO>}

Thank you.

Operator

Thank you. And now we'll take our next question from Andy Hughes from Macquarie. Please go ahead. Your line is now open.

Q - Andy Hughes {BIO 15036395 <GO>}

Hi. Thanks so much. A couple of questions on the Netherlands, if I could, and one on the group cash flow. So on the Netherlands, the inflation assumption has changed. Could you just clarify what it's gone from to? And I'm just looking at the January movement in the EIOPA yield curve and it's moved quite a lot. It's gone up by sort of 23 basis points over January. I'm just wondering how does that change things because presumably if you don't own much Dutch government bonds, then actually it should be reasonably positive given what's happened to the spreads on Dutch mortgages relative to the EIOPA yield curve.

And sort of an extreme example. If the LAC-DT credit was zero, now you'd obviously drop below the 130 (58:21) you've guided to for the Netherlands. But is that the end of the world? You've got a big solvency buffer at the holding company. You're raising senior debt at 1%. It doesn't sound like even if it drops to zero, you would take any action on the group dividend. So maybe you could just clarify that point based on where we are today. And the final question is on the cash flow bit. So everything sounds better. Cash flow and cost savings coming through, fee income better, expense savings and even a sort of small profit on the long-term care morbidity assumptions. And obviously, the cash flow guidance is staying the same. But surely, all these items are positive and should come through in the cash flow over the year. So are you kind of ahead of plan based on this quarter's results on your cash flow guidance, please? Thank you.

A - Alexander Rijn Wynaendts {BIO 1821092 <GO>}

Yeah, Andy, there's not much more I can say really on the Netherlands. You've seen the sensitivities. As I said, there's many moving parts. The EIOPA curve clearly also has quite an impact as one of many other items. So moving to your second question, yes, we're seeing improved morbidity. As I said to it, some of it is seasonal. I explained that earlier. We're seeing also improved margins. Yeah, over time, that is going to be positive on cash flows. That is (59:52).

Q - Andy Hughes {BIO 15036395 <GO>}

Okay. And just clarify, what is the inflation assumption the Netherlands is coming from to? Are you able to say what you're assuming now in inflation in the Netherlands?

A - Alexander Rijn Wynaendts {BIO 1821092 <GO>}

I'll defer to Willem. He'll come back to you. But it is the public inflation. And as you know, that has been something which had been tracked. I'm sorry I don't know the exact number. But it has increased actually recently. And that's why we had a step-change in our Solvency II.

Q - Andy Hughes {BIO 15036395 <GO>}

And it's an active assumption. So if the Dutch implied inflation rate changes, then that automatically changes in your assumptions or is it something you set periodically?

A - Alexander Rijn Wynaendts {BIO 1821092 <GO>}

No. We just have to reflect the updated assumptions once every so many – yeah, whatever time. But Willem will come back to the exact number on the inflation.

Q - Andy Hughes {BIO 15036395 <GO>}

Great. Thank you very much.

Operator

Thank you. And now we'll take our next question from Gordon Aitken from RBC. Please go ahead. Your line is now open.

Q - Gordon Aitken {BIO 3846728 <GO>}

Hey, good morning. Thanks. A couple of questions, please. One on UK and Cofunds. You closed this acquisition just on 1 January, but you announced it sometime ago back in August. Just wondering what your experience has been since you bought it or since you announced it in terms of flows. You bought that DC book from Mercer in the U.S. I know that Mercer was an institutional book and this is retail. But should we expect a period of sort of transition where some business does leave?

And just related to that, you talked about a technology upgrade here. And your advisers have been quite vocal about the fact they hope that you spend more money on the platform compared to the previous owner. Just wondering what the cost of any upgrade would be. And the second question is on the U.S. business and variable annuities and the impact of DOL. You've talked about the impact on the gross flow. But if we look at the movement in the net or the net-net outflow and compare that to the movement in the gross flow, it's clear that the level of gross outflows have also increased. Is DOL having an impact on the in-force book as well as having an impact on sales? Thank you.

A - Alexander Rijn Wynaendts {BIO 1821092 <GO>}

Hi, Gordon. Yeah, now on Cofunds, actually, it's of course early because we have only got the keys since I think January 1 early in the morning. But what we're pleased to see is a number of things. First of all, we're seeing good flows coming and good retention. Actually, good retention is what you were referring to in relation to Mercer, what we are seeing some anticipated outflows. This is retail, as you point, and we've adviser panels that are positive.

So we've had a very positive asset environment and reception by the advisory community, which, as you know, is the biggest provider of business to Cofunds, that we came as the owner of Cofunds with our commitment, of course, to put our technology which is well-recognized at work here. You're probably also aware that we have this agreement with Nationwide. That's another positive because it also brings in inflows. So we've had good experience. But again, I have to say, well, we are only halfway in February. So it's too early to come to a final conclusion. But it's going well. Also, the teams are working well together. I think, as I said to you, they see this as really a new start and there's a lot of excitement there. Now on Department of Labor impact on in-force and sales, I think what we mostly see is the impact on sales. So when sales come down and you have outflows anyway, then of course it's impacting the in-force on the longer run. But we do not see a direct impact on the in-force. Yeah, I hope that -

A - Operator

...your question.

Q - Gordon Aitken {BIO 3846728 <GO>}

Yeah, thanks.

A - Alexander Rijn Wynaendts {BIO 1821092 <GO>}

Yeah, thank you.

Operator

So we'll take our last question from Steven Haywood from HSBC. Please go ahead. Your line is now open.

Q - Steven Haywood {BIO 15743259 <GO>}

Good morning. Thank you, Alex. You mentioned the €500 million of capital that's freed up in the UK. Could you say to us sort of what proportion or what is available to shareholders to be upstreamed from the UK business here? And then on the implementation of the fiduciary rules. Have they actually been delayed or are they still being part implemented from April 2017 and obviously on 1 January? Or is the review going alongside the implementation stage? Any update there will be quite helpful. Thanks.

A - Alexander Rijn Wynaendts {BIO 1821092 <GO>}

Yeah. No, what I did mention is the freeing up of capital for the transaction. By the way, that doesn't mean that that whole amount is available because you need to look at your starting point. I'm not going to give you a number now about the amount of capital that is available. As I said, we will see what the overall capital position of UK is after we've completed the Part VII and then obviously upstream excess capital that is available for upstreaming. And on the DOL, yes, we are - our base case is still implementation in April. So we're working towards it and are prepared for implementation in April. And if rules or things have changed, yes, then we'll have to see. But our base case is still we need to get ready for implementation in April.

Q - Steven Haywood {BIO 15743259 <GO>}

Okay, that's very helpful. Thank you.

A - Willem van den Berg {BIO 15203834 <GO>}

Thanks, Steve.

Operator

Thank you. And as there are no further questions at this time, I would like to turn the call back to Mr. Alex Wynaendts for any additional or closing remarks.

A - Alexander Rijn Wynaendts {BIO 1821092 <GO>}

I would like to thank you all for participating and for the great questions. And have a great day and have a good weekend later today. Bye-bye.

Operator

Thank you, ladies and gentlemen. That will conclude today's AEGON Q4 results analyst and investor conference call. Thank you for your participation. You may now disconnect.