S1 2021 Earnings Call

Company Participants

- Duncan Russell, Chief Transformation Officer
- Jan Willem Weidema, Head of Investor Relations
- Lard Friese, Chief Executive Officer
- Matt Rider, Chief Financial Officer

Other Participants

- Andrew Baker
- Ashik Musaddi
- David Barma
- Farquhar Murray, Analyst
- Fulin Liang, Analyst
- Michael Hunter

Presentation

Operator

Good day and welcome to the Aegon Second Quarter 2021 results conference call for analysts and investors. Today's conference is being recorded. At this time, I would like to turn the conference over to Jan Willem Weidema, our Head of Investor Relations. Please go ahead, sir.

Jan Willem Weidema {BIO 15133400 <GO>}

Thank you, sir. Good morning everyone and thank you for joining this conference call on Aegon's Second Quarter 2021 results. We would appreciate it if you could take a moment to review our disclaimer, our forward looking statements which you can find at the back of the presentation. With me today are Aegon CEO Lard Friese, Chief Transformation Officer Duncan Russell and CFO Matt Rider. Let me now hand over to Lard.

Lard Friese {BIO 17008174 <GO>}

Thanks Jan Willem and good morning everyone. We appreciate that you are joining us on today's call and look forward to updating you on our second quarter results. In my part of the presentation, I will take you through the strategic highlights and through the progress we have made on our strategic assets. Our Chief Transformation Officer, Duncan Russell, will take you through the actions we are taking on our US variable annuity business. And Matt Rider will then go through the details of the results and our capital position. Finally, I will conclude the presentation with a wrap up, after which we will open the call for a Q&A session.

So let's move to slide number 2. We have made steady progress on our strategic priorities and financial targets and I'm encouraged to see this reflected in our second quarter results. Economic recovery aided by increased vaccination rates supported our results. The second quarter of 2021 saw an increase in the operating result across all segments driven by expense savings, increased fees due to higher equity markets and a normalization of claims experience in the United States. We have made good progress on the implementation of our expense savings program and have seen EUR220 million reduction in annual addressable expenses through the second quarter. This strengthens our confidence in our ability to deliver on the three-year target of EUR40 million expense savings. Our balance sheet remains strong with the capital ratios of all three main units firmly above their respective operating levels. We have made steady progress in managing our financial assets during the second quarter. We launched a program that offers certain variable annuity customers with a lump sum payment in return for surrendering their policies.

Furthermore, we plan to dynamically hedge two remaining legacy variable annuity portfolio for equity and interest rate risks. These two initiatives will create value by releasing capital at terms we believe our favorable compared to other alternatives and increases the predictability of the capital that the business generates. By introducing new innovative products, expanding distribution and enhancing customer service, we are driving growth in our strategic asset category. We achieved double-digit sales growth in US life, delivered another quarter of strong sales in US middle market Retirement Plans and almost doubled the net deposits in our UK workplace business. We continued our strong growth momentum in the Netherlands with record high levels of both mortgages and administration and assets under administration in new style defined contribution pensions.

AEGON Asset Management also continued its growth track record of positive third-party net deposits as strong demand for our solutions both in our wholly-owned business and in our Chinese joint venture continues. In our ASG portfolio, Aegon Asset Management and its partners, have helped to fund investments in affordable and workforce housing units in the United States to better serve our local communities. We also continue to improve our risk profile, having already executed around two-thirds of our plant management actions to reduce interest rate risk in the United States. The progress we are making on our strategic priorities and financial targets provides us with the confidence to accelerate the increase in dividends on our path to pay around EUR0.25 per common share by 2023.

Therefore, we are announcing today an increase on our interim dividend by EUR0.02 to EUR0.08 per common share. Furthermore, the strength of our balance sheet allows us to take another step towards achieving our deleveraging target. We are therefore announcing the redemption of $250 million professional Capital Securities in the third quarter. Let me now give you an overview of where we stand with the execution of our operating plan on slide number 3. Our ambitious plan comprises more than 1100 detailed initiatives designed to improve our operating performance by reducing costs, expanding margins, and growing profitably.

We have continued the rapid pace and execution rhythm throughout the second quarter. We've been successful in doing that as we have completed another 110 initiatives in the second quarter bringing the total to over 500, this means that 45% of all initiatives have now been fully implemented and they will contribute to the operating results over time. Expense savings initiatives have already delivered EUR220 million of savings which this is more than half of our EUR400 million expense reduction target, that strengthens our confidence in our ability to deliver on the target for 2023.

Initiatives aimed at improving customer service enhancing user experience in launching new innovative products are also well underway. These growth initiatives contributed EUR26 million to the operating result in the second quarter of 2021. We intend to continue the rapid pace and intense organizational rhythm throughout the remainder of the year and beyond. Let's turn to slide 4 to discuss the progress we have made with respect to our strategic assets. Our priority here is to grow the customer base and expand our margins. In US Individual Solutions, we have the ambition to regain a top 5 position in selected life products over the coming years. In the second quarter, improving commercial momentum resulted in a 24% increase in new life sales. World Financial Group increase the number of licensed agents by 13% compared with the second quarter of last year. We also expanded our market share in this distribution channel through the addition of a new funeral planning benefit.

Furthermore Whole Life Final Expense sales increased by 39% following enhancements made to both product and the application process. Volume growth, more favorable product mix and lower expenses resulted in a 40% increase in the value of new business. The US retirement business Transamerica aims to compete as a top 5 player in the new middle market sales. This business continued to build momentum with the fourth consecutive quarter of written sales of over $1 billion in the second quarter of positive net deposits.

Written sales were supported by pool plan arrangement contract wins, which are a strategic growth driver. Sales from these types of arrangements more than doubled and now represent more than 1/3 of this quarter's middle market sales. So let's turn to Dutch Strategic assets on slide 5. We are market leader in both mortgage origination and new style defined contribution pensions and we continued our momentum in the second quarter. We originated EUR2.9 billion mortgages in the second quarter benefiting from a strong housing market. Mortgages under administration reached a record high of EUR58 billion. In our workplace business, we saw a 20% increase in net deposits for new style defined contribution products. Assets under management for this business surpassing the EUR5 billion mark for the first time and the scoring Aegon's leading position in this market.

We want to develop the online bank Knab into a digital gateway for Individual Retirement Solutions. Knab continued its growth trajectory and added more than 5,000 customers in this quarter. In the United Kingdom, assets under administration reached GBP200 billion for the first time driven by net deposits and favorable market movements. Our aim is to grow the Retail and Workplace channels of our platform business. In these channels, we doubled the net deposits to GBP1 billion which included a significant massive trust contract win. This underscores that we are well positioned in this fast-growing market of multi-employer pension schemes, market movements and expense savings had helped to further improve the efficiency of the platform. By growing the platform business and taking out expenses, we aim to mitigate the impact from the gradual run-off of the traditional portfolio which is the driver behind the annualized revenues lost from net deposits for the quarter.

So let me turn to our global asset manager and our growth markets in slide number 6. In our Asset Management business, we aim to significantly increase the operating margin of the Global Platforms business by improving efficiency and driving growth. Third party net deposits in the global Platforms were EUR2.1 billion driven by significant net deposits in various investment strategies and the Fixed Income Platform. The operating margin of the global Platforms business increased by nearly 2 percentage points. This resulted from higher revenues from net deposits, favorable market developments and higher origination fees in Aegon's real assets business. These origination fees were driven by responsible investing mandates in workforce and affordable housing.

Net deposits and strategic partnerships, were EUR815 million for the quarter driven by our joint venture in China. Increased performance fees and management fees from growth of the business led to a significant increase in the operating results for strategic partnerships to EUR56 million. In Aegon's growth markets, we continue to invest in profitable growth. The value of new business from new life sales increased by 6%, mainly driven by higher sales in Brazil, Spain and Portugal. New premium production for property and casualty and accident and health insurance increased to EUR28 million as a result of new product launched in Spain and Portugal. Here, sales through our Spanish bancassurance partners are benefiting from the redesign of the digital sales channels to accelerate the digital transformation and insurance distribution. These actions supported the doubling of sales through digital channels to over 15% of the total production in June.

In summary, on slide number 7, we are making steady progress in growing our strategic sssets. 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 it over to Duncan who will talk about the actions we've taken regarding our US variable annuity business. So Duncan, over to you.

Duncan Russell {BIO 21983913 <GO>}

Thank you, Lard. At our Capital Markets Day, we laid out our intentions to maximize the value from our financial outlook by accelerating, increasing or derisking the cash flows of these blocks of businesses. To date, we have focused our resources on identifying and implementing unilateral action that we can take ourselves and bilateral actions that we can take in conjunction with our stakeholders. I would now like to highlight two recent actions that we have taken on the variable annuity business which in total have $85 billion account value. These actions demonstrate our approach to managing our financial assets.

The two assets that we are announcing today are aimed at reducing our risk exposure to the legacy blocks of the business with income and death benefit riders.The first action is targeted at the GMIB block of business. This is a mature block of business with an account value of $6.5 billion and mainly consists of policies sold by Transamerica from the '90s until 2003. Associated guarantees were not originally priced nor subsequently managed on a risk-neutral basis. And therefore, despite being less than 10% of our variable annuity assets, the GMIB riders alone consume about 40% of the required capital the variable annuity book.

In mid-July, we launched our buyout program for the GMIB customer base whereby we offered customers a lump sum payment in return to surrendering their policies. This may be an attractive choice to some customers given that their needs may have change since they originally purchased their policies about 20 years ago. On our side. we compare the costs and benefits of this program with our alternatives including, running the block off over time or transacting with a third party. And we see the buyout program as an attractive way to reduce our financial market risks and create value by releasing capital at a reasonable price as we buyout the policies below the economic value of the liability.

This initiative aimed at reducing our GMIB exposure achieving a 15% take-up rate once it is fully completed would be a good outcome. There is uncertainty around that and we will not have a better sense of the actual take-up rate until the fourth quarter of this year. As we get more insight, we will update you on the program's progress. Second, we have decided to expand our dynamic hedge program to cover the GMIB DB block of business, meaning that going forward, all of our variable annuity liabilities will be dynamically hedged for equity and interest rate risk.The expanded hedge will build on a dynamic hedging program we have already in place for the GMWB book, that program has been running since the mid-2000 with a good track record and achieving hedge effectiveness for the targeted risks of about 95%.

We will introduce expansion as of the fourth quarter when we have more clarity on the outcome of the buyout program and that will drive the amount of hedging we will need to do. During the third quarter, we are adjusting the existing macro hedges to smoothen the transition to full dynamic hedging. The negative financial impact of these two actions, expanding the dynamic hedge and the lumpsum buyout program is expected to be less than 5 percentage points on the RBC ratio assuming the market stay around the current levels and we do not see extreme market movements on implementation. The impact on the RBC ratio consists of a higher level of statutory reserves as we will include the hedge costs now in our reserves, but a lower level of required capital as our risk has reduced. The lower level of required capital means that operating capital generation from the VA block will also be slightly lower than otherwise as less capital will be released over time as the block runs off. And because we no longer have an open equity exposure associated with the GMDB Rider. We expect annual operating capital generation to be around $50 million lower than otherwise would have been the case.

Looking forward, we will be left with a large mature block of variable annuity business that is hedged and consumes relatively low level of required capital. We will continue to explore ways to improve the net present value of the business. On an IFRS basis, these actions are expected to result in a one-time pre-tax other charge of approximately $500 million to $700 million in the third quarter of 2021 mostly driven by a non-cash write-off or deferred acquisition costs.

On slide 10, I want to touch upon what we mean by dynamic hedging. Put simply, interest rate and equity risk embedded in the guarantees will be immunized on an economic basis. Therefore, the financial position of Aegon will not, over time, be subject to changes in the value of the legacy guarantees that we have provided deposit holders on this product. One implication of our statutory reserves will effectively move to a fair value basis and move away from a regulatory prescribed grading to 3% long-term interest rate assumption. By dynamically hedging the interest rate risk embedded in the guarantees, we will mitigate the interest rate sensitivity of the reserves. Aligning our capital position and economic view of the liabilities simplifies our management and decision-making around this block of business going forward.

I also want to be clear on the two exposures that will remain for our shareholders and why we have decided not to hedge these. First, while we hedge the equity risk embedded in the guarantees which we have not to hedge changes in the present value fee income from the base mutual fund contract. We see these as an asset management type exposure on which we will earn a return over time. This base fee sensitivity is the main driver of our residual equity market sensitivity in the US of 34 percentage points on the RBC ratio for a 25% drop in equity market. Second, we will remain exposed to risks from changes in realized and implied volatility. We considered hedging this, but concluded that the cost of doing so was onerous relative to the benefits that we bring to our shareholders. The level of implied volatility is an input into the valuation of our variable annuity guarantees. Implied volatility tends to be higher than actual realized volatility, which makes it expensive to hedge. And scopes and spikes in implied volatility tend to mean reverting. Our exposure to realized volatilities caused by the convexity of our liabilities and -- and our delta hedge program given the nature of the guarantees to our customers. It is costly to fully hedge the impact of realized volatility in the convex instruments like options or variant slots. Therefore, we have decided to only partially hedge this risk to protect ourselves against the tail risk of extreme market movements. We will explore ways to further reduce our sensitivity to movements in equity implied volatility. In the meantime, this means that a period of higher implied volatility, all else being equal, will lead to a lower RBC ratio and vice versa.

Let me wrap up my part of the presentation to slide 11. Our aim with the finance assets is to proactively manage our risks, exposures and profitability in order to improve the net present value of these businesses. We have allocated resources to finance assets in order to drive this and we feel that we are making good progress. The actions that I have described today are significant examples of the measures we are taking. The buyout program the GMIB block will reduce our exposures and risks on terms we believe are favorable compared to the alternatives. The remaining exposure will be more tightly managed on a risk-neutral basis, thus to ensure that shareholder outcomes are more predictable. We will continue to seek additional ways to create value from our financial assets. This can include additional unilateral or bilateral actions as those are more in our control and we can more easily quantify and understand the financial impact of this. So we will now allocate internal resources to investigate our options around potential third party solutions. We aim to be transparent in our considerations on this and how we intend to maximize the value of the variable annuity business. So, we will provide an update on our progress sometime in the first half of 2022. With that, I will hand over to Matt.

Matt Rider {BIO 20002664 <GO>}

Thanks Duncan. And good morning everyone. On the next several pages, I will take you through the highlights of our second quarter 2021 results, our capital position. Let me start with the financials on slide 13. Expense savings increased fees from higher equity markets and a normalization of claims experience in the US drove the increase of our operating results by 62% from the year ago quarter to EUR562 million. Our balance sheet remains strong with the capital positions of all our three main units firmly above their respective operating levels and the Group Solvency II ratio at 208%. Cash Capital at the holding is in the upper half of the operating range at EUR1.4 million. This allows us the flexibility to continue to execute on our transformation. As well as to further reduce our gross financial leverage which stood at EUR6.1 billion at the end of the second quarter. One of our priorities is the reduction of economic interest rate exposure in our US business. Thanks to the actions discussed by Duncan, we have executed on about two-thirds of our interest rate reduction plan.

This primarily involved lengthening the duration of our asset portfolio and extending our forward starting swap program. Another priority is proactively managing our long-term care portfolio. In the second quarter, we obtained approval for additional rate increases worth $64 million. This brings the total to $176 million and means that we have already achieved over 50% of our $300 million target. Let me turn to slide 14 to go into more detail on the expense savings. On 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 EUR245 million compared with 2019. EUR220 million of these savings are driven by the expense initiatives as part of our operational improvement plan.

We are continuing to execute on this plan and are satisfied to have already delivered half of the expense reduction target. Expenses in this quarter again benefited from lower travel and marketing activities due to the impact of the COVID-19 pandemic. We expect these benefits to reverse over time. Furthermore, we aim to profitably grow our business by improving customer service, enhancing user experience, and launching innovative new products. While these growth initiatives resulted in EUR28 million of expenses in the last 4 quarters, they contributed EUR26 million to the operating result in the second quarter of 2021.

Let me turn to slide 15 to share with you the most important drivers behind the increase in our operating results. In the second quarter of 2021 our operating result amounted to EUR562 million, an increase of 62% compared to the same period last year. In fact, the apples-to-apples increase is 74% at constant currencies and when adjusting for the reclassification of the operating result of Central and Eastern Europe to other income. The operating result not only benefited from lower expenses, but also from higher equity markets. We saw significant revenue growth mainly in asset management and our fee-based businesses in the US. Improved investment margins in the Netherlands supported by increased allocations of corporate bonds also contributed to higher earnings. In US life business, mortality claims experience was EUR27 million adverse relative to our long-term expectations, which is a significant improvement compared with the second quarter of last year. The adverse mortality experience was largely attributable to COVID 19 as the cause of death. This was offset by EUR55 million favorable morbidity claims experience in the long-term care book which included a one-time reserve release. Correcting for this one-time reserve release, the actual to expected claims ratio was 81% driven by elevated claims terminations as a result of higher mortality. In the UK, the operating result increased by 19% to EUR44 million driven by lower expenses and higher fee revenues from growth of the platform business. The operating result from International increased by EUR1 million to EUR34 million. However, on an apples-to-apples basis and at constant currencies, the operating result increased by 60% reflecting significantly better results in TLB and Spain and Portugal. Finally, the operating result from Asset Management nearly doubled to EUR71 million mostly driven by our Chinese asset management joint venture. The operating result of the global Platforms increased as well because of higher revenues from net deposits and favorable markets.

Let's turn from operating results to net results on the next slide. As you can see on slide 16, the net result amounted to EUR845 million for the second quarter of 2021. Non-operating items contributed a gain of EUR644 million before tax. Fair value gains amounted to EUR468 million and were largely driven by private equity and real estate revaluations in the Americas and the Netherlands. In addition, the macro hedge program in the Americas delivered a gain as a result of the macro interest rate hedge paying off as interest rates decline. We realized gains on investments of EUR162 million mainly due to gains on debt securities in the US which were sold to fund investments in long duration assets as part of the interest rate risk management plan. Once again, we benefited from a benign credit environment with net recoveries of EUR15 million. Other charges amounted EUR153 million and mainly resulted from more conservative assumptions for variable annuity surrender rates to reflect portfolio and industry experience. One-time investments related to the operational improvement plan along with the charge related to settlements of litigation in the Americas we're almost fully offset by the release of a provision in the Netherlands following a settlement related to a co-insurance contract.

Now turning to slide 17 to go through the capital positions of our main units. The capital ratios of our three main units ended the quarter above their respective operating levels. The US RBC ratio increased by 16% during the quarter to 444%. The RBC ratio was positively impacted by higher equity markets and by positive private equity and real estate revaluations. The RBC ratio benefited from management actions including the sale of an alternative asset portfolio. In the Netherlands, the Solvency II ratio of the Dutch Life unit increased by 23 percentage points to 172%. This increase reflects benefits from management actions, model updates and favorable market movements. The main management action in the Netherlands was a settlement related to a co-insurance contract. This led to a release of a technical provision and a reduction in required Capital. Model updates related to refinements of asset -- of an asset and expense modeling, real estate revaluations and favorable interest rate movements also contributed to the increase of the ratio. Operating capital generation had a positive impact and more than offset EUR25 million remittance to the group in the second quarter. Scottish Equitable, our main legal entity in the UK, increased its Solvency ratio to 163%. This increase was primarily driven by a forthcoming increase in the corporate income tax rate which led to a reduction in required cuts.

Let us now turn to the development of cash capital at the holding on the next slide. Cash Capital at the holding increased during the quarter driven by remittances from our units. Some units paid their half yearly remittance during the second quarter, including the US. In addition, we received the regular quarterly remittance from the Dutch Life unit. After deducting funding and operating expenses of the holding, this results in free cash flows of EUR175 million for the quarter. Proceeds from the divestment of Transamerica's portfolio of Fintech and Insurtech companies was partly offset by minor capital injections into some country units. Cash Capital at the Holding closed the quarter at EUR1.4 billion which is in the upper half of the operating range and provides the group sufficient financial flexibility to both execute on the transformation program and to continue efforts to reduce financial leverage. Furthermore, we expect to inject capital into one of our growth markets, Brazil. We will contribute approximately EUR40 million to enable the business to absorb adverse claims experienced from COVID-19 while maintaining a strong balance sheet to support its current growth trajectory.

This brings me to my final slide regarding our delivery on capital deployment commitments. On our Capital Markets Day, we guided for a muted near term dividend growth. Since then, we have made steady progress on our strategic priorities and financial targets. This supports an increase of the interim dividend by EUR0.02 compared with last year to EUR0.08 per share. Finally, we continue to reduce the gross financial leverage as we have announced today our intention to redeem $250 million in perpetual capital securities. After the redemption, we will have reduced our gross financial leverage by approximately EUR700 million since the second quarter of 2020 to EUR5.9 billion. This puts us on track to achieve our target to reduce gross financial leverage to between EUR5 billion and EUR5.5 billion by 2023. With that I pass it back to you Lard for the wrap-up.

Lard Friese {BIO 17008174 <GO>}

Thanks Matt and thank you also Duncan. I would like you all to take away from today's presentation that we are making steady progress on our strategic priorities and our financial targets. We have increased our operating results supported by all segments. We are implementing our operational improvement plan initiative by initiative and are maintaining an intense organizational rhythm. We have achieved more than half of our EUR400 million expense savings target for 2023. We are increasing the value of our variable annuities portfolio to a lumpsum buyout program and by extending the dynamic hedging program. This also allows us to allocate internal resources to investigate our options around potential third party solutions and we are maintaining our commercial momentum in our Strategic Assets.

Lastly, we continue to work together with the Vienna Insurance Group to close the divestment of our businesses in Central and Eastern Europe. VIG is in constructive talks with new Hungarian states and has indicated that they are confident that the matter will be resolved in the near term. In summary, I am pleased with the results we announced today and how we are progressing -- how we are progressing steadily on our strategic commitments and financial targets. I would now like to open the call to your questions. And in the interest of time I kindly request you to limit yourself to two questions. Operator, please open for the Q&A.

Questions And Answers

Operator

Thank you, sir. (Operator Instructions). Our first question comes from the line of Andrew Baker from Citi. Please go ahead.

Q - Andrew Baker {BIO 20402705 <GO>}

Hi everyone and thanks for taking my questions. So the first on the US risk management actions. Wondering if you could give us a sense of the capital that you expect to be released from the expansion of the dynamically hedged and also lumpsum buyout program? And then secondly on this, statutory target. So obviously, it looks like you're on track to well exceed the guidance that you had on OCD for both 2021 and potentially 2023 as well as maybe free cash flow? So just wondering if you could just give an update on what your expectations on those metrics are? Thank you.

A - Lard Friese {BIO 17008174 <GO>}

Thank you very much, Andrew, for your questions and the first one will be taken by Duncan. The second one by Matt. So on US risk management actions, Duncan.

A - Duncan Russell {BIO 21983913 <GO>}

Thank you, Andrew. As indicated, we think the net impact of the two will be a no worse than a 5 percentage points hit to the RBC ratio and within that we expect a small positive from the buyout program, a small negative from the implementation of the dynamic hedge. And the capital back in the VA block, the statutory capital back in the VA block today is around $2 billion. Once we implement the dynamic hedge, we think that will drop to around about $1.4 billion.

A - Lard Friese {BIO 17008174 <GO>}

Okay. Matt, the operating capital.

A - Matt Rider {BIO 20002664 <GO>}

Yeah on a year-on-operating capital generation and let's say the remittance outlook. So just a reminder, at the Capital Markets Day we had guided for EUR1.1 billion operate cash gen from the business units and in the first quarter call, I guided more to the EUR1.4 billion. Given the progress that we have made on the operational improvement plan and other tailwinds that we have received through the -- through the second quarter, including the COVID mortality experience has been more benign, especially on the morbidity side, we're guiding now to something between EUR1.1 billion and EUR1.5 billion for operating capital generation. Now in terms of the -- the remittance guidance, we had been guiding toward something like EUR1.4 billion to EUR1.6 billion cumulatively through 2023 at the Capital Markets Day. At this moment in time, we're not changing the guidance on remittances, We're more saying that it looks like it more is in the top end of that range more than the -- more than the bottom of that also. I think that's --

Q - Andrew Baker {BIO 20402705 <GO>}

Thank you.

Operator

Thank you. We'll now move to our next question from David Barma from Paribas. Please go ahead.

Q - David Barma {BIO 19957338 <GO>}

Good morning and thank you for taking my questions. The first one is to come back on the -- on the measures on the VA block. So I think that they won investors quite -- quite clear. But you also mentioned the objective around the predictability of the business line and obviously it's quite difficult to look at the capital generation developments of the variable annuity block. Can you talk a little bit about how we should think about the volatility of the metrics and that block post the actions that you've announced today? And then the second question is on the Dutch Solvency ratio. Could you just help us break down the -- the moving parts in the second quarter? Thank you.

A - Lard Friese {BIO 17008174 <GO>}

Thanks David. So on the VA question Duncan. And then the Dutch ratio, Matt. So Duncan, please, over to you.

A - Duncan Russell {BIO 21983913 <GO>}

So you're right, David. That one of the drivers -- one of our philosophies has been to reduce the volatility around our capital base and capital generation and for the financial assets, that's an important consideration. If you look at the variable annuity block of business post the implementation of the dynamic hedge, capital generation will be lower. We've guided for operating capital generation to be around $50 million lower and to be in the range of $250 million to $300 million going forward once that's implemented.

Backup generation, there will be a higher quality because we would have immunized the risks around the guarantees in the block of business and we'll be left with volatility coming from the base contracts which we think is more like an asset management type of fee income, because that's the fee we earn on the underlying mutual funds. And then the half the capital generation will be coming from that source and the rest of the capital generation will be coming from the recent required capital spread and on reserves, et cetera, which also we think is a high quality source of capital generation. Hopefully that answers your question.

A - Lard Friese {BIO 17008174 <GO>}

So Matt, please.

A - Matt Rider {BIO 20002664 <GO>}

Yeah. For the, for the Dutch solvency ratio. I can -- I think breakt it to you pretty easily. So we started out the quarter at 149% solvency ratio. We had some operating capital generation there. So you kind of add 2% to that. And then we had some market variances mostly related to interest rate movements. So interest rates declined and also the yield curve flattened and real estate revaluations which I think I mentioned in the opening.

Those added about 2 percentage points to the solvency ratio. So between those two things markets added about 6 percentage points. And then there were some management actions that took place. You may recall from my opening remarks, we did settle a litigation basically that arose from a co-insurance contract in the Netherlands. That added 5 percentage points to the ratio and there were some changes to the fixed income portfolio which added 2 percentage points basically, it was a reduction of structured credit exposure. And then there were 10 percentage points worth of various model and assumption updates. I'm not going to get into the detail of that, but I think that should get you to around 1.72 that we ended the quarter at.

Q - David Barma {BIO 19957338 <GO>}

Thank you very much.

Operator

We'll now take our next question from Ashik Musaddi from JP Morgan. Please go ahead. Ashik. Please go ahead, your line is open.

Q - Ashik Musaddi {BIO 15847584 <GO>}

Sorry I was mute, sorry. So good morning Duncan, Lard and Matt, Just a couple of questions I have. I mean how do we think I mean the two actions we are taking, ultimately it is negative for RBC ratio, it is negative for operating capital generation, it is negative for financial numbers like IFRS numbers, so it's like negative from all lower numbers perspective. I understand it reduces the risk. So that's a good thing. I mean, at least, it will help your cost of equity. But does it help you to exit that business as well at some point? I.e., the moment you have -- you have like done all the hard work, heavy lifting of hedging, etcetera, then does it become very easy for you to exit that financial asset or it doesn't change anything from that perspective? So, any thoughts on that would be very interesting. And would you be interested in exiting that once you have done all those heavy lifting or would you want, okay, I've done all the heavy lifting, why now sell it rather than this just run it for cash? So that's the first one. And second thing is to to Matt, this thing about the capital generation, you mentioned EUR1.4 billion to EUR1.5 billion is what you're thinking about at the moment. I mean, clearly, interest rates have dropped from when we discussed about EUR1.4 billion in first quarter. So clearly if you are trying to still say that EUR1.4 billion has actually gone up, I am a bit surprised and would be good to know what are the drivers of those jump given that interest rates have dropped in second quarter? So that would be very helpful. And like, is that a good run rate going forward or is it just for including one-off, etc, something like that? Thank you.

A - Lard Friese {BIO 17008174 <GO>}

Yeah, thanks Ashik and so Duncan on the VA, please. And then Matt will indeed take the capital generation question.

A - Duncan Russell {BIO 21983913 <GO>}

Good morning Ashik. I'll try and break down my answer to this. Firstly, I think the two initiatives we've announced they are meaningful and do create meaningful value for our shareholders. And part of the reason we focused on them was because in a relatively short period of time, we've been able to identify ways to create value and also execute upon it. And and that was part of the consideration of the focus at this point in time on bilateral and unilateral actions. And as you point out, there is a small negative impact on the RBC at no more than 5 percentage points negative, only a small reduction and operating capital generation going forward as there is less capital to be released going forward. But they're outweighed, in our view, by the benefits to predictability certainty and just general risk management and also the fact that we've now aligned our statutory reserves and statutory capital to a risk-neutral or economic view of the liabilities. Just makes our decision-making going forward easier as our ECOM views align with our capital capital view.

I think you're right to say that the two actions are helpful as we move now into exploring third party transactions. As we've got now, as I said, the statutory capital base results in more economic base and we think that parties will look at it on that way also. And we are at the same time reducing the size of the GMIB block of business through a buyout program and basically acquiring licensees back to the side with economic value. And so we are going to move into the phase now exploring the implications of third party possibilities to us and we will be rational in our approach there as one of our themes indeed is to improve the predictability and quality of our cash flow and risk manager. However, and there are other considerations, will have to weigh up. For example, there could be capital implications, capital dysynergies from taking out the VA block that can be counterparty at exposures we'd need to understand and mitigate. There is a large exposure at the end of the day. And the structure, the VA block is in a legal entity -- is seen as a legal entity and how exactly we have extract that is something we'd have to work through. We obviously have a view on value in which we would be rational around that.

And then finally, as I pointed out to an earlier question, it is an overall -- it is -- the VA block is still a meaningful contributor to the overall Group financial setup. It's going to contribute still on an operating capital generation base, it's roughly $250 million to $300 million per annum. And consumed roughly $1.4 billion of capital post the implementation of the hedge. So we'd have to weigh up all those things and that's part of the work we're going to do in the coming months and quarters, I would look with to come back to you at some point in first half of 2022 on our considerations around that.

Q - Ashik Musaddi {BIO 15847584 <GO>}

So. Okay, thank you.

A - Matt Rider {BIO 20002664 <GO>}

So I can pick up the operating capital generation. So yes, guiding towards EUR1.4 billion to EUR1.5 billion for the full year. One thing I would mention is that we have seen interest rates come down a little bit from the first quarter. So they were down about 30 basis points as of the second quarter and as of today, maybe another 10 basis points. But it's just good to remind everybody that the -- we're not so sensitive to interest rate movements on operating capital generation in the US especially. Where we are sensitive is on equity markets and those things have continued to perform strongly and that is driving some of the, let's say, the expected increase in the operating cap gen for the remainder of the year. Now having said that, you asked like what's a decent run rate. So -- so second quarter is a pretty good base from which to start, so just kind of walk it forward, we had EUR376 million of operating cap gen after holding and funding expenses sort of add that back, you get to EUR435 million. And then there were some positive one-offs. We had the combination of mortality and morbidity good Guys (technical difficulty). And there were a couple of other tailwinds from from other items within the -- in Europe. They come down to like let's let's say a clean quarter would be about EUR380 million for the -- just for clean quarter operating cap gen within the business. The first half of the year, we did EUR723 million. Add two times the EUR380 milloin and then you get to something in EUR1.4 billion -- something in that EUR1.4 billion to EUR1.5 billion space depending on what you think COVID is going to do in the last half of the year. We factored in the 50,000 US population deaths call it a little less than half of let's say EUR20 million for extra COVID claims. You could pencil your own number in there. We could be in the middle of the second wave. We didn't take anything into account for positive morbidity experience. So the EUR1.4 billion to EUR1.5 billion seems to be conceivable number.

Q - Ashik Musaddi {BIO 15847584 <GO>}

Very clear and very detailed. Thank you, Matt.

Operator

Fulin Liang from Morgan Stanley. Please go ahead.

Q - Fulin Liang {BIO 21126177 <GO>}

Hello. Thank you. Very good. Good set of results. I got two questions. So the first one, the VA the -- the kind of your -- approaching your current existing customers to buyout the policies, I assume that has been, you need -- have gained regulatory approval and I'm just wondering how you -- and because, as Duncan said, you actually buyout these policies under below the economic value of the policies. Will -- have you -- how do you assess kind of the litigation risk will in the future? That's the first one. And then secondly is you haven't mentioned about your plan on the fixed annuity book in U.S. which, because that is also kind of your financial asset, Is the -- for you. Is the fixed annuity solution will come together with variable annuity book solution or is it a separate consideration? Thank you.

A - Lard Friese {BIO 17008174 <GO>}

Thanks Fulin. So Duncan, over to you.

A - Duncan Russell {BIO 21983913 <GO>}

Sure. I think in terms on the buyout program is we are offering our customers an opportunity to surrender their policies in exchange for cash Fulin. As I pointed out, these products were sold a long time ago, in some cases 20 years ago and the circumstances of our customers could have changed over that period. So they have the ability to exchange or surrender their policy in exchange for cash payment, which is north of account value and could be attractive to them, but it's obviously at their discretion on that choice and they'll engage with their advisers on that. We did pre-engage with their advisors before launching the program to get feedback and we've had feedback, constructive feedback, since launch. It's still very early and want to see how that progresses over the coming weeks and months. And also, as you pointed out, the buyout offer is slightly lower than the economic value of the guarantees to us and so we also think it's beneficial for our shareholders.

And the second question was on the annuities, yeah, and whether that will come together with the VA, it could do and we'll, as I said, we've just started exploring transaction considerations and considerations in general around third party solutions for the variable annuity block. The fixed annuity block is also a financial asset. It could contribute to any liquidity considerations we may have around the variable annuity block. So that's something we'll take into account as we -- as it progresses in the coming months and quarters.

Operator

Thank you, We'll now move to our next question from Michael Hunter from Berenberg. Please go ahead.

Q - Michael Hunter {BIO 1957201 <GO>}

Thank you. I had only two questions. But I think -- so the -- can you -- can you say the various measures in the US and the updated guidance on operating capital generation, what does it do to the US cash remittance which I think was $209 million first half? What stays -- when can we see a meaningful rise in this figure? What I'm trying to say is could we see it already in the first half of 2022 or the second half of 2023? And the second question is on the the buyout program. So the figures you have given are based on the 15% assumption? Can you give a little bit of a sensitivity around that figure. You know what if it were 20%? What would be the -- the benefits? That's my two questions. Thank you.

A - Lard Friese {BIO 17008174 <GO>}

Yes, thank you very much. Michael. Let's start with the US cash remittance question, Matt Rider. And then -- then followed by your question on the program by Duncan. So, Matt, over to you.

A - Matt Rider {BIO 20002664 <GO>}

Yeah. What I can say there is that just maybe the facts first. So in the second quarter the US did remit $209 million. That's their normal-- their normal remittance. They did EUR18 million in the first quarter as well. We haven't changed our outlook for the remittances from the US, but I think it's important to reflect the fact that we are increasing the dividend by $0.02 a share a year for a reason here. So we're not getting into the detailed remittance guidance within the US. But I think that the EUR0.02 share increase is telling you something about that. And that is driven by operating capital generation that looks to be in that $900 million and $950 million range in the US.

A - Lard Friese {BIO 17008174 <GO>}

Yeah, thank you. Duncan.

A - Duncan Russell {BIO 21983913 <GO>}

Yeah, on the second question, Michael. The dynamic here is that we will be paying out cash if and when that will develop through our option and releasing associated guaranteed reserves and required capital and we think about that dynamic is a cycle for the RBC ratio is indicated. We're not giving a sensitivity as it's very early in that program and in truth, it depends on which policyholders accept, that specific characteristics, that specific circumstances and also how markets develop between now and the uptake of the offer. So, if it is okay with you, we will look to come back in 3Q or 4Q with further details.

Q - Michael Hunter {BIO 1957201 <GO>}

And just to follow-up, you said you'd spoken to advisors and clearly, the program was launched about a month ago. Can you say a little bit more about the progress?

A - Lard Friese {BIO 17008174 <GO>}

Duncan?

A - Duncan Russell {BIO 21983913 <GO>}

No, in short, so you're right, we did -- obviously we've been working on this for several months and we, as you launch it, a lot of execution, which goes around it. One part of that is making sure that we have feedback prior to the launch and we've obviously had feedback since that which havebeen constructive. But it's really early to be honest with you Michael, as of summer holidays, very early. Customers have to engage with their advisers. So we're not expecting to get more information really a couple of months now.

Operator

Thank you. I will now take our and our last question from the queue from Farquhar Murray from Autonomous. Please go ahead.

Q - Farquhar Murray {BIO 15345435 <GO>}

Good morning, all. Just two questions if I may, firstly, on capital generation and remittances, you seem to have increased the capital generation target for year 2021 by about EUR0.6 billion versus where we were in December. And on the kind of cash flows remittances that just seems to be basically talking towards the upper end of the cumulative range that I think adds about EUR0.3 billion. Can you possibly just explain whether there is something to that gap between the two or is this kind of a bit more of a conversation at the end of the year? And then secondly, turning to the variable annuity actions and in particularly RBC and capital generation impact, can you just clarify that those are based on end of June market circumstances and might you just be able to outline the sensitivities around those impacts, just so we understand how they could vary between here and the closing at the end of the year? Thanks.

A - Lard Friese {BIO 17008174 <GO>}

Okay. So let me -- thank you very much Farquhar. So let's start with Matt on the cap gen question and then Duncan at the VA question.

A - Matt Rider {BIO 20002664 <GO>}

Yeah, so on the operating capital generation. you said, is it -- is it more of a conversation for the end of the year, we'll see how that -- we'll see how the year turns out. I would just say that so far the progress has been actually quite good both in terms of implementing the operational improvement plan, but also the macroeconomics have been favorable for us. So those are -- those are just tailwinds. So the way that we kind of think about it is that we've kind of drastically reduced the downside risk in the overall targets put out at the Capital Markets Day. So all that all that is kind of the encouraging. But to be clear, we are still early in the transformation and we do have a lot of work to do. So you could say that were perhaps late in the economic cycle and we do want to be cautious about the outlook for credit markets for example, but also COVID claims if we get into a second wave in the US, as we come out of the COVID-19 pandemic. So we're not changing our guidance at this part point in terms of remittances. Only to say that we are now guiding towards the top end of that gross remittances guidance for the 2021 to 2023 guidance that we've done at the Capital Markets Day. So we had that at EUR1.4 billion to EUR1.6 billion. So now we're thinking more like EUR1.6 billion, but clearly the progress that we've made in the capital markets helped us along here. We are guiding more towards the top.

Q - Michael Hunter {BIO 1957201 <GO>}

Thank you very much Matt. So, Duncan.

A - Duncan Russell {BIO 21983913 <GO>}

Hi Farquhar. No. They're not -- they're not based on 2Q, they are based on current circumstances. And with respect to additional guidance is a bit tricky and the reason for that is obviously quite a few variables here in terms of take out rates from the buyout program which will in itself may be influenced by equity markets and interest rates and then also the implementation of the dynamic hedge which also impact of that could be influenced by equity market and interest rate. Plus the fact that we put in a partial hedge several months ago as well which is them on rates issue for some mitigation. However, we feel fairly confident that the -- as I have indicated in my presentation that the net of that is going to be no worst than 5 percentage point from RBC ratio barring really extreme market movements. So we think we feel pretty comfortable with that guidance.

Q - Farquhar Murray {BIO 15345435 <GO>}

Just a follow-on, does that -- does that kind of extreme circumstances carry through to the capital generation indication as well?

A - Duncan Russell {BIO 21983913 <GO>}

The capital generation, the $50 million adjustment to the capital generation is mostly driven by -- was driven by two things. One is the lower level of required capital being released because we're effectively transferring capital into reserves here and so that may get slightly impacted by rates and equity markets that depends on implementation, because that will impact how much required capital is being impacted. But as I said, the 5 percentage points, that should be fairly range bound. The second impact is the impact of the dynamic -- of the hedge on the equity market in the DB book of business where the operating capital generation we assume some equity market return and we all no longer capture that. And so I don't think it's meaningfully -- meaningfully impacted by market circumstances.

Q - Michael Hunter {BIO 1957201 <GO>}

Okay, perfect. Thanks so much.

Operator

Thank you. With this I would like to hand the call back over to Lard Friese, Chief Executive Officer for any additional or closing remarks.

A - Jan Willem Weidema {BIO 15133400 <GO>}

Thank you operator. This is Jan Williem Weidema. This concludes today's call. Thanks again for your continued interest in Aegon.