Q3 2014 Earnings Call

Company Participants

- Alexander Rijn Wynaendts, CEO, Chairman-Executive & Management Board
- Darryl D. Button, Chief Financial Officer
- Willem van den Berg, Head-Investor Relations

Other Participants

- Albert Ploegh, Analyst
- Archie van Riemsdijk, Reporter
- Ashik Musaddi, Analyst
- David T. Andrich, Analyst
- Farooq Hanif, Analyst
- François Boissin, Analyst
- Gordon Aitken, Analyst
- Jan Willem Knoll, Analyst
- Maud van Gaal, Finance Reporter
- Nick Holmes, Analyst
- Steven A. Haywood, Analyst
- William H. Elderkin, Analyst

MANAGEMENT DISCUSSION SECTION

Operator

Good day, and welcome to the Aegon Q3 Results Conference Call. Today's conference is being recorded. At this time, I would like to turn the conference over to Willem van den Berg. Please go ahead, sir.

Willem van den Berg {BIO 15203834 <GO>}

Thank you, operator. Good morning and thank you for joining us for this conference call on Aegon's third quarter 2014 results. As always, we will keep today's presentation short, leaving plenty of time to address your questions. 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.

Our CEO, Alex Wynaendts, will provide an overview of this quarter's performance and will then be joined by our CFO, Darryl Button, to answer your questions.

I'll now hand it over to Alex.

Alexander Rijn Wynaendts {BIO 1821092 <GO>}

Good morning, everyone. Let me begin by saying that this was clearly a quarter of mixed results. Earnings this quarter have been impacted significantly by the changes we have made to our assumptions and the enhancements to our models, something I will address in more detail very shortly.

Excluding these onetime items, underlying earnings were €512 million, which is in line with what we would normally expect. And at the same time, we are pleased with the strong profitable sales performance over the quarter and the continued execution of our strategy, including the recently announced sale of our business in Canada.

Cash flows were robust, taking into account a higher new business trend related to the exceptionally large pension contract win in the Netherlands. There was also a onetime impact on our capital position in the Netherlands, following evaluation methodology change for our Dutch mortgage portfolio. I will also return to this in a moment.

Let's turn to slide 3, where we have provided you with a comprehensive overview of the outcome of our assumption review and model updates.

I am clearly disappointed by the outcome of our annual assumption review. But on that note, let me say that this is a core part of what we do. We make assumptions, we validate it through our experience, and adjust them when necessary. And that is exactly what we have done this quarter.

As we flagged earlier, we have updated our mortality assumptions and strengthened reserves in the U.S. This was a result of emerging experience, supplemented by industry studies and relates mostly to the older age segment, ages of 85 and above. And this is a group for which the industry has limited experience.

On the contrary, our assumptions related to policy behavior for variable annuity book have been too conservative and these were also updated to better reflect actual experience. The combined impact of assumption changes on underlying earnings was €138 million, as you can see in the table.

Also included this quarter is the result of several model enhancements. Over the past year, we have intensified our efforts to review and enhance our models. We've made many different products, and therefore, models. So, this is a very significant undertaking. More than 60 high-priority models have now been validated and were necessarily adjusted. The impact here was €82 million on underlying earnings and €151 million on income before tax.

We have also improved our processes and governance related to the ongoing maintenance of our models.

In addition to the onetime impact shown in the table, the assumption changes and model updates will have a recurring negative impact on underlying earnings before tax in our U.S. Life & Protection business of approximately €20 million per quarter. This is significant, but I can assure you that we will be looking at all options available to mitigate the impact as much as possible.

Let me now turn to capital on slide 4. We have adjusted the level 3 fair valuation methodology for our mortgage portfolio in the Netherlands to use more market observable data. As a result, our IGD ratio in the Netherlands stands at 220% and the group IGD ratio now stands at 202%. This is a valuation methodology change only and does not change our view of this asset class or of our Dutch mortgage business. Therefore, we expect the immediate capital impact to be recovered through cash flows over the lifetime of the mortgage portfolio.

UK Pillar I ratio was stable and remains at the target level. Here, though, I would like to point out that uncertainties will remain until the recently announced DWP regulatory changes are fully implemented in the coming years. And finally, in the U.S., our capital position is healthy at $1.1 billion over the S&P AA level.

Total sales were up 38% this quarter, which is a reflection of the continued strength of our franchise across our markets. Slide 5 shows the strong growth of our life and accident and health sales. Life sales were higher across all markets, and the highlights this quarter was securing the largest ever pension buyout deal in the Netherlands.

In the U.S., we continue to see higher demand for our universal life products, in particular indexed universal life. Growth in accident and health sales has been driven by the addition of new distribution partners, successful worksite marketing, and additional amount for our products created by the introduction of the Affordable Care Act in the U.S.

Now turning to slide 6. Strong momentum in deposits growth continued this quarter, with record gross deposits of over €15 billion. Aegon Asset Management had a very strong quarter with new mandate wins in each of its markets. Third-party inflows more than tripled to €7 billion, driven in part by growing demand for Dutch mortgage funds, which has now assets of over €2 billion.

U.S. variable annuities had record deposits both on a gross and a net basis. Deposits remained strong in our U.S. pensions business despite fewer takeovers, as we continued to see higher recurring deposits.

Other parts of our business are also contributing to deposit growth. Assets on our UK platform increased 20% to £2.4 billion and the platform continues to be one of the fastest growing in the market.

In the Netherlands, our online bank, Knab, is also growing. This is a great example of how we are using technology to get closer to our customers and provide the products and services they look for. It took some time to generate momentum. However, since we have repositioned the business earlier this year, the numbers of customers has more than doubled with assets now stand at over €800 million.

So in summary, while I'm not pleased with the negative impacts on this quarter's earnings, I'm proud of the many ways in which we are successfully executing on our strategy. Sales are higher across almost every part of our business, underlining the successful expansion of our franchise.

We announced the sale of our business in Canada, and we continued to work hard towards repositioning our company successfully in the digital world. And therefore, I am confident that Aegon is well positioned to not only manage future challenges but also to take advantage of the many opportunities we see across our businesses.

Darryl and I are now happy to take your questions, and I'm sure you'll have a few. Thank you.

Q&A

Operator

Thank you. And we will take our first question from David Andrich from Morgan Stanley. Please go ahead, sir.

Q - David T. Andrich {BIO 15414075 <GO>}

Hi. Good morning. Thank you for taking my questions. My first question is just around the model - assumption changes. And I was just wondering, going forward now, what kind of I guess stricter controls have you put in place and how much more consistent are the assumptions across the different business units?

And then second of all, I was just wondering in terms of the UK business, you cite that the cash flow generation is challenged due to ongoing regulatory changes. I was just wondering, has something changed since Q2 or is this more just along the lines of the continued transition of the business in the UK? Thank you.

A - Darryl D. Button {BIO 7089946 <GO>}

Hi, David. It's Darryl. I'm going to take your first question. Just on a model updates and assumption changes. First of all, on the assumption changes, the biggest change we did have is the one we flagged back in the second quarter on the mortality. This is really an area where industry data has been limited in this ultra-older-age category, our own data as well. But we've seen enough combination of our data and industry data that suggested that we need to make this change. And so, we've done that.

I don't think that we're going to be needing to change the mortality assumptions again anytime soon. So, I think we've dealt with that. Not all the assumption changes were negative. We had a significant positive on the variable annuity on the lapsation as well. So, that's part of our annual update.

On the model updates, I would say that we have had an intensified effort over the last year to really go through and scrub all of our high-priority models, and Alex mentioned that earlier. So, I certainly hope that this lends itself to fewer adjustments going forward.

As part of that process, I can also say that we've also strengthened our own internal governance for ongoing review and maintenance of these models, going forward. So, I hope that also contributes to a much lower likelihood of these assumption updates in the future.

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

David, on the UK, this is a continuation of the transition in which we are in. It's a transition, as you know, from a business model, but it's also the changes, the regulatory changes, which are affecting our business and which still have to be implemented. I can just name a few of them. The implementation of DWP, as you know, it's not only a price gap, which is being included, but probably a more important impact would be the elimination of the difference between what we charge active members, members that contribute to pension plan and members that don't.

So, all of that has to be worked out. That also requires we engage with each of our customers individually because these are large customers for which we have a contract with their participants. You're well aware of the annuity changes. There's been recently another change in taxes for individuals.

So, all these changes all create uncertainty and I just wanted to make sure we understand that we are working hard towards repositioning our business; that we are executing on what we committed to execute on. But we are in an environment that has a lot of changes, which also means that it requires a lot of attention for people to address those change and implement all these regulatory changes, which some are still not even clear how they need to be implemented. So, it's a continuation of this transition phase.

Q - David T. Andrich {BIO 15414075 <GO>}

Okay. So, no change in terms of the expected cash flow from the UK business going forward then?

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

Well, we have given you a range which we see as a target for the UK. I've been very clear that we are looking at the lower end of the range. And I believe that these changes will make it probably even more challenging than it was before these regulatory changes were in place to achieve that target.

Q - David T. Andrich {BIO 15414075 <GO>}

Okay. Thank you very much.

Operator

And we will now take our next question from Ashik Musaddi from JPMorgan. Please go ahead.

Q - Ashik Musaddi {BIO 15847584 <GO>}

Yeah. Hi. Good morning, everyone. So, three questions, first of all, can you give a bit more color on what this €20 million per quarter is and how do you arrive at this number? Secondly, I mean, it looks like these – all these assumption changes and model updates has no impact on your cash flows, i.e., is it fair to say that this is purely an IFRS accounting thing and has no impact on the capital position on a local basis, i.e., you don't have any concerns from the upstreaming dividend from U.S. or Netherlands because of all these accounting assumption changes and model updates?

And thirdly, basically, can you give us a bit more color about this model changes? How much of that is driven by low interest rate? How much of that is driven by underwriting? Still a bit more thought on that would be really appreciated. Thank you.

A - Darryl D. Button {BIO 7089946 <GO>}

Hi, Ashik. It's Darryl. I'm going to try and hit those questions, all three of them. On the €20 million per quarter, how was that arrived at? Basically, when you're strengthening the assumptions, it's really strengthening the assumptions that goes to both the reserves and the DAC in combination. Effectively, in this particular case, it was strengthening reserves.

What it does is it changes the trajectory of the reserve build over time. So, there's a onetime catch-up on the reserves and that's what you've seen through the P&L period going forward. There's also additional premium that has to now be set aside to increase the reserves further, so the trajectory of the reserve build is increased. And that's what drives the €20 million a quarter going into the future.

It's actually – it is not an IFRS-only. There'll also be a regulatory cash flow impact out of the U.S. as well. I expect that to be in the neighborhood of maybe even slightly larger than this €20 million on regulatory earnings in the U.S. So, that will impact their operational free cash flow going forward.

The third question, I must admit, I didn't...

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

Can we give some color on the model changes?

A - Darryl D. Button {BIO 7089946 <GO>}

Yeah, the model changes themselves.

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

Interest rates (15:11)

A - Darryl D. Button {BIO 7089946 <GO>}

Yes. So, you can see that there were a collection of different model changes. And you can see that on the slide in the presentation. Generally, it falls in the category of using - really upgrading and making our models more sophisticated on the life side, increasing the model points that we now model. So a lot of the life assumption changes was getting better premium persistency assumptions down to the lower cohorts, which means basically getting more granular data points down into the models, which would have been difficult in the past due to technology restrictions.

But as we continue to upgrade technology and we're able to basically get that finer granularity down into the model points, same thing goes on the variable annuity side as well, an update to the withdrawal assumptions enable to take that down into a finer cohort of individuals and data points. Those are really the nature of the changes, the one on the fair value side related to getting a better projection of our future hedging cost down into the model. So, they all fall in that generic camp of more sophisticated, newer technology model enhancements.

Q - Ashik Musaddi {BIO 15847584 <GO>}

But that's really very clear. But like just one follow-up on that, the €300 million of the total impact you flagged in third quarter itself, how much of that is actually going to cash, i.e., how much of that will weaken your cash position? And just a follow-up on - from that simple question again is, how should we think about the trajectory of cash flows? Because if I remember correctly, you mentioned that from U.S., you should get roughly, give or take, €900 million dividend to holding company. From Netherlands, I think it's around €300 million. So, what changes today from the - on these two numbers, specifically?

A - Darryl D. Button {BIO 7089946 <GO>}

Yeah. Ashik, there's actually very limited impact to the capital position in the U.S. from this change today. I caveat that slightly and at the end of the year - we'll do our annual cash flow testing work at the end of the year and there may be some impact on that. But for the most part, there's really no cash or regulatory impact from these IFRS changes today. However, the lower mortality and the adverse part of the assumptions will obviously bear through regulatory earnings as that experience emerges into the future, which is why the regulatory earnings impact will be slightly higher than the IFRS earnings impact going forward.

Q - Ashik Musaddi {BIO 15847584 <GO>}

Yes. Okay. That's very clear. Thanks a lot.

Operator

And we will now take our next question from William Elderkin from Goldman Sachs. Please go ahead.

Q - William H. Elderkin {BIO 3349136 <GO>}

Hi. Good morning, everybody. I just got two questions left. One following up from the previous one, (18:00) if we are looking at U.S. underlying capital generation, we should be lowering that by – my expectations, by around $100 million a year, if I understood the answer to the previous question correctly.

And then, secondly, just on long-term care, a number of your competitors had a few problems there. I was just wondering if you could give us an update as to your position, and then whether is anything there we need to be worrying about from your side.

A - Darryl D. Button {BIO 7089946 <GO>}

Yes, William. This is Darryl. I'm going to take those questions. Yes, your math is right on the U.S. adjustment to the operating free cash flows. That's a pretty good estimate.

Long-term care, we had a small – so, as part of our assumption changes, there was a small hit. It was about €16 million, so that's a pretty small number in the grand scheme of things in terms of updating the assumptions.

I will say, as part of the actual quarter performance, we did flag that it was not a strong quarter from a mortality and morbidity perspective, and that was around €60 million total. But half of that was the morbidity expense of €30 million that was related to long-term care.

And we have seen some higher claims this quarter and we strengthened the – effectively, we strengthened the IBNR reserve which is setting aside what we think we need to set aside for future claims.

So, that is impacting the Q3 results by the €30 million plus the additional €16 million on the assumption change this quarter. Otherwise, we're comfortable with our reserves, and I don't foresee anything different than that.

I think we can take the next question, operator.

Operator

Thank you. We will now take our next question from Albert Ploegh from ING Bank. Please go ahead.

Q - Albert Ploegh {BIO 3151309 <GO>}

Yes. Good morning. All thanks for taking my questions. The first one is on the Dutch mortgage impact, so the change basically in the fair value accounting thereof. What are the implications for that also on the cash flows going forward? It seems actually that it probably will move up a little as a result. And will it also impact maybe your strategy to invest in Dutch mortgages going forward? And whether there's potentially any impact or any difference in the impact between Solvency I and Solvency II growth (20:39) on that?

Then the second question is on the business review of the low-performing assets, and in specific, France. Is there anything to mention on the progress on that specific file (20:55) (20:56-21:07) Is there anything that you can say on that? Thank you.

A - Darryl D. Button {BIO 7089946 <GO>}

Albert, I must admit the phone cut out after your second question. Could you repeat your third question?

Q - Albert Ploegh {BIO 3151309 <GO>}

Sorry. The third question is on interest in the Dutch consolidation to participate, and your local competitor made clear statements last week. So, any color from your end will be welcomed as well.

A - Darryl D. Button {BIO 7089946 <GO>}

Okay. I'll jump in with the first one. On the Dutch mortgages, yeah. So, we have updated our valuation. You're correct, actually, it will have a higher cash flow, going forward. So, it's really a point-in-time valuation change. We really feel very strongly about the ultimate performance of this asset class and the underlying asset cash flows. So, any valuation change that we make today will come back into capital and cash flows into the future. So, you're correct on that.

In terms of impacting our investment strategy into Dutch mortgages, we actually have gotten to the point where we are really from a concentration risk perspective, filling up on our capacity on our own balance sheet for Dutch mortgages. So, starting this quarter, in fact, we've started diverting more of our Dutch mortgage production into our fund, our fee business, so the asset management fund that we've opened up to sell to third party.

So, that's where I predict more of our Dutch mortgage production to go into the future. Obviously, that's a little more lower margin for us, going forward, but it comes back to the concentration that we have to manage on our own balance sheet.

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

Yeah, Darryl, I'll take the two other questions. In terms of the business reviews, I was obviously – we were pleased to announce the sale of Transamerica in Canada. As you have probably guessed, this has been quite a long process, a process where we have really looked at all the different options and try to ensure that we would get the best possible outcome for shareholders.

And the same applies to France. Again, here, we are reviewing options. We've committed to give you clarity by the end of the year. We're looking at the various options we have, all of it, with the same objective of optimizing the returns for our shareholders. And as you can imagine, if you're in a hurry, that's usually not the best way of optimizing returns. So, we will do what is right here.

Your last question was about the consolidation. I will repeat what I said all along. Aegon is focused on organic growth. In the Netherlands, we have a very strong position. And we've made that very clear. We've not participated in the process around real (23:43). And we are not intending to do anything different there. When you look at our organic growth in the Netherlands, you can see we're well positioned.

We're particularly well positioned in the pension business, where we're able to secure the largest-ever deal. Was not only gained – won on the fact that we have now good proposition, but also because here we were able to provide the participants of the plan the kinds of products and service they were looking for. And that has made the difference. So, that is really at the heart of our strategy growing organically. And that applies to our businesses across the world.

Q - Albert Ploegh {BIO 3151309 <GO>}

All right. Thank you very much for your answers.

Operator

And we will now take our next question from Nick Holmes from Société Générale. Please go ahead.

Q - Nick Holmes {BIO 3387435 <GO>}

Hi there. Thank you very much. Two more questions on the mortality review, please. The first one is, can you give us more color on the level of confidence that you have in your new assumptions? And I'm thinking things like, how do you compare with the industry and how much scope have you built into the assumptions for further deterioration in mortality?

And then secondly, you mentioned options to mitigate the €20 million recurring impact. I wondered what those might be. And in particular I wondered is some longevity something which might be a natural hedge to what you've got on the mortality? Thank you.

A - Darryl D. Button {BIO 7089946 <GO>}

Hey, Nick. It's Darryl. Yeah. So, on the mortality assumptions, I think now we compare very well and very conservatively I think on the older age mortality issue. This is something I've mentioned in the past. The industry data has been sparse, but it is now starting to emerge. I've seen enough benchmarking data to show me that this is not just a Transamerica issue, that this is an industry issue. So I think you're going to hear more on that as we go forward. But I feel very comfortable now that we've made the change. We've made a significant change, and to a point where we're very comfortable with our assumptions.

On your second part related to longevity, the only thing I would maybe mention there is that we have been I think very upfront that we have – with our hedging programs here in the Netherlands, the risk that really we're left with that dominates the balance sheet becomes longevity risk. And so, we're very actively looking to pursue longevity-hedged transactions and move those into the capital markets. And we've executed on a couple of those deals already, and we continue to work on that and you'll see more from us on that front.

Q - Nick Holmes {BIO 3387435 <GO>}

Great. Thank you very much. I just wanted to come back to the options to mitigate the €20 million. I think, Alex, you mentioned that. I just wondered what you're thinking of.

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

Yeah. Nick, obviously, we always look at our business ways of optimizing. And what we're saying here is we're going to have a look again as to where are the options to further improve efficiency. I'm looking at our big back book in terms of expenses and margins. So, it's not something specific that I can share with you at this point in time. This is at the end of the year. It's a process around the budget. And you can – I just want to make sure you understand that both Darryl and I are going to make sure that we do everything here to mitigate as much as possible that impact.

Q - Nick Holmes {BIO 3387435 <GO>}

So, sorry to labor this point, but just very finally, does that mean, might be scoped to offload some of this business that kind of thing that you're looking at?

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

Again, Nick, at this point in time, I can say we will be looking at all options to optimize our position here. And clearly, and I said that I am disappointed by the outcome. I'm disappointed by the onetime hit, but obviously, equally disappointed by the fact that it has an impact going forward. So, we'll be looking at always optimizing our position here.

Q - Nick Holmes {BIO 3387435 <GO>}

Okay. Thank you very much indeed.

Operator

And we will now take our next question from Farooq Hanif from Citi. Please go ahead.

Q - Farooq Hanif {BIO 4780978 <GO>}

Hi, everybody. I hope you can hear me. Thanks a lot. I want to just go over some topics again, if you don't mind. Firstly, on the RMBS assumption change, I would've thought that the reserve – I mean, the additional sort of the valuation hit that you've taken for that could come back quite quickly into capital given the duration of the book. So, could you give us an idea, quantitatively, of how much of the I think the €500 million or so is going to come back into cash every year as a result of that? That's question one.

Question two is on the upstream. I know it's early to comment on Q4 and next year, but it seems to me that you've got a very good surplus generation in the U.S., and obviously, a hit to IGD in the Netherlands. So, I'm just kind of wondering whether this is going to really change your policy on payout or level of upstream from these two businesses. Could it have an impact?

And lastly, you talked about there being no capital impacts from the assumption changes. But theoretically speaking, if we had a Solvency II number, which I know we don't have, but if we had one, would there be any impact on Solvency II from any of the changes you've made? Thank you.

A - Darryl D. Button {BIO 7089946 <GO>}

Hi, Farooq. It's Darryl. Let me try and address those questions. On the first one - on your first one, yeah, just basically divided by seven and gives you a rough feel for how much that cash flow will come back in. So, that gets you to about €70 million year going forward on a €500 million adjustment. So, I think that's a reasonable number there.

In terms of upstreaming, yeah, so we've talked about the U.S., and obviously, the excess capital position in the U.S. remains very robust. And the U.S. is a - we are in a fortunate position. The U.S. cash flow is not impacted in any way by new regulatory standards, i.e., Solvency II. So, I expect the U.S. cash flow will - as we've suggested throughout the year, will come in the second half of the year - sorry, in the fourth quarter.

And the Netherlands, I think it's very much a fourth quarter decision and we're having conversations obviously. And we'll be having conversations with the regulator in the fourth quarter. Obviously, the Solvency I IGD ratios are very strong, but we continue to prepare ourselves and implement and get ready for implementation on Solvency II. So, it's very much going to be a fourth quarter discussion and conversation in the Netherlands.

On the third question...

Q - Farooq Hanif {BIO 4780978 <GO>}

Solvency II impact of the assumption changes, yeah.

A - Darryl D. Button {BIO 7089946 <GO>}

Yeah. A very hypothetical question, I guess. So - but I think it's fair to say if you look at the upfront impact that we've had on the assumption changes this quarter and you combine it with the quarterly impact that we've talked about going forward, I think that gets maybe a little bit of a feel of what might be on more of an upfront basis within a Solvency II context. That's probably about the best I can do. We're obviously not running Solvency II numbers on our U.S. business. So...

Q - Farooq Hanif {BIO 4780978 <GO>}

Yes, of course. Yeah. So, it basically has no impact, does it - of course. I was (31:33) thinking...

A - Darryl D. Button {BIO 7089946 <GO>}

No, it has no mechanical (31:37)...

Q - Farooq Hanif {BIO 4780978 <GO>}

Mechanical impact, yeah.

A - Darryl D. Button {BIO 7089946 <GO>}

Again, our working assumptions for Solvency II on our U.S. business remains that we will get equivalency and use deduction and aggregation.

Q - Farooq Hanif {BIO 4780978 <GO>}

And just one – just to go back very quickly. So on the U.S. business, you're very careful, you didn't use any adjective when you were describing the fourth quarter cash flow, you just said it was going to come. But you weren't saying it's going to be better or worse because of the higher surplus?

A - Darryl D. Button {BIO 7089946 <GO>}

Yeah. Just because we've been running above our capital targets in the U.S. and we have obviously – the difference in the U.S. is we have much better clarity on the regulatory framework. And so, I think the excess capital we have in the U.S. combined with the clarity that we have on the U.S. statutory and regulatory framework gives us a lot more sidelines and visibility on the U.S. upstreaming. We continue to prepare ourselves for Solvency II here in Holland.

Q - Farooq Hanif {BIO 4780978 <GO>}

Okay. Thanks very much.

Operator

And we will now take our next question from Gordon Aitken from RBC. Please go ahead.

Q - Gordon Aitken {BIO 3846728 <GO>}

Good morning. Just back on to this U.S. mortality assumption change. Now, I understand it's sort of the 85- to 95-year-old male smokers are not living as long as you expected. I know you flagged this in Q2, but it's a surprising development, given that the general increase is in the life expectancy, especially we've seen those at older ages. So, firstly, why do you think you're seeing this in the U.S. and not see in your UK business or your Dutch business?

Second, I mean, to what extent is this a new development over the last 12 months or for several years, have you seen more people dying versus your expectations? And finally, in Q2, you mentioned that you're seeing lower-than-expected reinsurance recoveries on this? Why aren't the reinsurers paying that?

A - Darryl D. Button {BIO 7089946 <GO>}

Yeah. So, I mean, generally, what I would say on the U.S. mortality, it's – there is a general trend to increasing longevity that's still there. But what we've had to adjust back is that that increase in longevity is not as much as what we had predicted it would be.

You have to go back into – if I go back a little bit into why the data is just really starting to emerge, you really get back into older age state planning, second-to-die spouse products and things like that. These are the products that really extend out into these older ages and they were popular in the 1980s and 1990s as when those products started being sold to people in their 50s and 60s. So, that's the cohort of people that are now in the 85 to 95 area that are coming on line now that's giving us the data points that we're seeing.

So, we've had to pull back our assumption. And again, I will repeat what I've said before. I've seen pricing benchmark data from the U.S. that suggests this is not ours alone. But we see a trend and it's important. We still sell these products. And we're still very much committed to this part of the market. So, it's important that we acknowledge and address the trends when we see them, so we can get our pricing assumptions updated and make sure that we don't grow into this problem into the future. So, that's I think the importance for us to deal with this now.

I think you're going to see a good continued emerging experience as the data comes on line. There was a recent – going back a year or so, an old age mortality study performed in the industry that really did start to correlate with our own data, which is giving us the confidence to make this assumption change.

I'm not sure I can add a whole lot more. I really don't want to comment on competitors or other experience or how you've been hearing that from others. I don't think that's my place to do here.

Q - Gordon Aitken {BIO 3846728 <GO>}

Reinsurance?

A - Darryl D. Button {BIO 7089946 <GO>}

Yeah. So, reinsurance. They are in a position – they do have – they are in a position to see more cumulated data than any one of the individual companies. I think actually the experience there has been mixed. And that's a question you're going to have to ask them in terms of what they've seen in this part of the market in terms of this data trend.

Q - Gordon Aitken {BIO 3846728 <GO>}

It's just that Q2 seemed to imply that the reinsurance recoveries were down.

A - Darryl D. Button {BIO 7089946 <GO>}

Sorry. Sorry. Yeah. You'd asked specifically. Yeah. Well, that's part of a – to be honest with you, that's actually part of our assumption update as well in terms of – so, the largest number that I've been talking about is the older age mortality adjustment. We also had an impact for adjusting our own reinsurance recover assumptions in the model. And that's also impacting the Life & Protection numbers in the U.S. this quarter.

Q - Gordon Aitken {BIO 3846728 <GO>}

Thank you.

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

(36:30), strengthen those, yes.

Operator

And we will now take our next question from François Boissin from Exane BNP Paribas. Please go ahead.

Q - François Boissin

Yes. Good morning, everybody. I have two questions remaining, please. The first one on Dutch mortgages. Can you give a bit more detail on what drove the depreciation and value? And does this have an impact on your nominal value of mortgages? Or does this lead to a lower market value of mortgages only? That's my first question.

The second question is on the market value – sorry – market consistent value of new business, you had quite a decline in Q3, mainly in the U.S. and in the Netherlands. I wondered whether you could provide a bit more details on why that was and how you saw the outlook for that. Thank you.

A - Darryl D. Button {BIO 7089946 <GO>}

Sure. I'll take the first one – it's Darryl. On the Dutch mortgages, what drove the change? It was a change in our discounting methodology to come up with the fair value of the mortgages as we report under IFRS 13. It's a level 3 valuation, which means we can't go into the market and get an actual fair value on mortgages from transactions directly. So, we are obliged to come up with a fair value calculation.

We basically have gone back into the market and we've adjusted our methodology to incorporate more market observable information. We've taken a look at some of the RMBS transactions that have been done over the last year, as well as updated our methodology to include more of the junior tranches on these securitizations in the calculation.

Effectively what that means is we increased the discount rate, which lowered the fair value of the mortgages. And that's – fair value of those mortgages are included in the IGD calculations and will be included in the Solvency II calculations as well. So, it's strictly a market value adjustment. It does not impact the nominal value. It also does not impact the IFRS earnings, only the fair values, which do not come through the IFRS P&L statement.

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

In terms of your question of the value of new business, what we're seeing in this quarter is very strong sales. We see sales up 38% compared to last quarter. Sales are up in our key markets, and that has had a clearly positive impact on MCVNB. However, the positive impact was more than offset by two items. First of all, we've had lower interest rates, which means that the value of new business with lower interest rate is lower. And what we see also is, Darryl mentioned that earlier, we are generating a significant amount of mortgages now for our third-party asset management business. There's a lot of demand for it. And that part of the mortgage, obviously, does not come into the market-consistent value of new business. It does not come to our general account. And that explains why you have despite very strong sales and you would have there expected high MCVNB, slightly lower MCVNB this quarter compared to last year.

Q - François Boissin

Okay. That's quite clear. In terms of outlook, I mean, should I understand that basically now your ability to write new mortgages for your own account has been limited? So should we expect lower margins, or let's say, should we not expect margins to recover in the Netherlands going forward on the back of that?

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

Well, these mortgages have been put on the books, so these margins are there. These margins will be there for the maturity of the mortgages. And what we're doing right now effectively is using our franchise in the market. We have now 13% market share on mortgages, based on very strong origination capabilities to leverage that on behalf of our third party business. This is attractive business. It needs no capital. It's business where we get a fee. Fees are attractive, between 40 and 50 basis points. And they stay - they're very sticky because once you buy a mortgage and the institutional investor buys that mortgage, it will stay - it will have to hold on that mortgage until the customer, the one who bought - that issued the mortgage will redeem it or repay it.

Q - François Boissin

Yeah, I understand this. But this is more kind of - this is more fee business from third party, but how should I think of the general account business in the Netherlands?

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

As I was saying, these mortgages are - that are on the book, they will hold on these margins. The margins will stay there.

Q - François Boissin

Right. Thank you very much.

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

Thank you. Thank you.

Operator

And we will now take our next question from Jan Willem Knoll from ABN. Please go ahead.

Q - Jan Willem Knoll {BIO 18247722 <GO>}

Yes. Good morning, gentlemen. Thanks for taking my questions. Back on the model assumption review, you mentioned you reviewed 60 high-priority models. What percentage of your reserves has been covered by this review and what is the euro amount of reserves that will be covered by the ongoing review going forward?

And then, on Dutch non-life, you mentioned a negative impact of a number of large claims in general insurance. Maybe you can give a bit more color on the size and the nature of these claims. And then lastly, on the Dutch pension buyout market, maybe you can comment a bit on the pipeline you're seeing there and the impact of, say, of the low interest rate environment on the appetite of pension funds to move to a structural solution.

And also, the fact that your Dutch IGD ratio has been declining in the quarter quite significantly would have any impact on the short-term or the short- to medium-term on your appetite to grow in the Dutch pension buyout market. Thanks.

A - Darryl D. Button {BIO 7089946 <GO>}

Yeah. I'll try and cover the first one. I can't give you an exact reserve coverage number, but what I can tell you is we've – as I mentioned before, we really intensified our efforts over the last – really over the last year in terms of a comprehensive model review and update across the organization. We focused our efforts and segmented them into the high-priority models, which were a function basically of the bigger reserve coverage and the bigger numbers. And we've really gotten through all of those high-priority models.

And I mentioned earlier on the call that we've strengthened our governance program in terms of ongoing model validations and governance and control reviews. That now carries on, well, going forward obviously on these high-priority models, but also extending to all of the lower models. So while I can't give you a actual reserve number, what I can tell you is that we've covered all of the material and larger-ticket models with this update.

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

In terms of the general insurance in the Netherlands, as you know, they have two parts. One is, I will call it property and casualty. That's where we've seen a number of exceptional large claims. They relate to number of fires which we have had. You don't need many actually to kind of move the number from a profit to a loss here in this quarter. However, what we see is a further improvement in our disability segment. And it's the result of actions we've been taking in the last year to prove the quality of our portfolio, improve underwriting, but also to increase prices. So, we are here on the good trend, but have had a couple of exceptional items.

Your question on the Dutch pension markets, just to put it in perspective, the large buyout of the miners' pension had an impact of €70 million on our new business strain in Netherlands. And that obviously is exceptionally high and this was the largest ever contract. In general, we have seen in the past quarters new business strain has been closer to the level of €15 million to €20 million, and that is what we expect also to be going forward.

This business is lumpy, so you'll have big contracts and then you might have a couple of quarters much lower one. We are still very interested in this market. We believe we're well positioned. We want to make sure that any deal we do is a deal that also meets our requirements in terms of pricing. This deal, the (44:37) deal, the pensions for the mine workers, clearly is within our pricing discipline.

What's important is that it fits very much in our strategy because we're not only looking at the pension plan in itself but we're looking at the participants, and I've talked about that more often. These are customers, the participants in the pension plan, they need more products, more services. Governments are retiring here in the Netherlands as they do in many other parts of the world. The responsibility shift goes to the individual and this is at the heart of our strategy, but we will do that only if we're able to achieve our pricing requirements. Thank you.

Q - Jan Willem Knoll {BIO 18247722 <GO>}

Okay. Thanks.

Operator

We will now take our next question from Steven Haywood from HSBC. Please go ahead.

Q - Steven A. Haywood {BIO 15743259 <GO>}

Hi. Good morning. Thank you for taking the questions. I just wanted to clarify something. The model update for hedging costs on your GMWB VA book in the fair value items, this €46 million, what exactly does this relate to on this – on the change in the model update for the hedging costs? I thought Aegon had influenced (45:50) its dynamic hedging structure here fairly recently.

And second question, I see there's an adjustment for lower yields of about minus €8 million in the Americas line. Can you just clarify whether this is an addition to the $10 million per quarter charge that you disclosed or is this related to that?

A - Darryl D. Button {BIO 7089946 <GO>}

Yeah, Steven. It's Darryl. On the – I'll take both of those. On the first question, specifically, what we've done, you're right, we've made no change to our dynamic hedge program on the GMWB. That's fully intact. What this involves is projecting that program into the future. And where that's important is actually on the DAC calculations. So, it is a fair value product and a fair value hedge program, but we have to project those hedge costs forward and into the end of the life of the product, and then adjust our DAC models. So, this change that we made was actually a more enhanced way of projecting those future Greeks and hedge program through the life of the product. And that had a onetime impact on DAC. And that's what you see on the fair value line.

On the drop in yields, it actually is just a onetime adjustment as we reflected and updated the curve that we used at the Q3. So, it's – sort of I would say it's unrelated to the standing guidance, if you will. This is very much a onetime impact. And I wouldn't expect this to recur next quarter. The standing guidance on the impact in rates is just the ongoing investment yield drag that comes from persisting in the low interest rate environment.

Q - Steven A. Haywood {BIO 15743259 <GO>}

Thank you. And then just a follow-up on the last one, that standing guidance that's not changed either?

A - Darryl D. Button {BIO 7089946 <GO>}

No, it is not.

Q - Steven A. Haywood {BIO 15743259 <GO>}

Okay. Thank you.

Operator

Thank you. And we will now take our next question from Archie van Riemsdijk from Dow Jones. Please go ahead.

Q - Archie van Riemsdijk

Yes. Good morning. Thanks for taking my question. And maybe a reiteration of an earlier question. But could you maybe once more give some color on the change in valuation of the Dutch mortgages? And to what extent can this be described as accepting that the losses on the mortgages are higher than the model previously expected?

A - Darryl D. Button {BIO 7089946 <GO>}

Yeah. Archie, it's Darryl. First, let me deal with the last part of your question first. It actually has nothing to do with expected higher losses on the mortgage. Let me be perfectly clear on that. We still feel as good today as we did yesterday on the quality of the Dutch mortgage cash flow. So, it has nothing to do with that. It really is about a level 3 valuation under IFRS, which means we have to do a fair valuation. It requires expert judgment to do that, and there's some subjectivity in that because we cannot point directly into the market and find the fair value of the Dutch mortgage which means we have to come up with a discount rate to discount the cash flows. And there, we've used more recent market observable information to adjust our calculation, and that leaves to a valuation change day one. Obviously, whatever – because we still feel strongly about the cash flow development on the future, whatever we strengthened day one will come back to us over the next coming seven or so years as the mortgages mature.

Q - Archie van Riemsdijk

Okay. Thank you. And as an additional question, could you give the number of how much capital – well, it has increased, capital requirement for these mortgages by €0.5 billion, but what was the previous requirement and how much has it increased?

A - Darryl D. Button {BIO 7089946 <GO>}

Well, that goes into our actual overall IGD ratio. So, what you have to understand is that the fair value of the mortgage book is inside of the IGD calculation. So, we reduced the fair value of the mortgages by €500 million. And that's €500 million on a €26 billion, €27 billion mortgage-based, so to put that into some context, if you will.

Q - Archie van Riemsdijk

Okay. So, you have no number for the total capital requirements of this...

A - Darryl D. Button {BIO 7089946 <GO>}

I don't...

Q - Archie van Riemsdijk

Mortgage book?

A - Darryl D. Button {BIO 7089946 <GO>}

I think that's something you can follow up with Investor Relations or Robin actually would probably be your best contact...

Q - Archie van Riemsdijk

Okay.

A - Darryl D. Button {BIO 7089946 <GO>}

On that.

Q - Archie van Riemsdijk

Great. Thank you.

A - Darryl D. Button {BIO 7089946 <GO>}

Okay.

Operator

And we will now take our next question from Maud van Gaal from Bloomberg. Please go ahead.

Q - Maud van Gaal

Yes. Hi. I'm also looking for one further clarification and sorry if it's already been discussed. But regarding the assumption review on slide 3, it says that a review of the lower impact models will continue throughout 2015. Will that then lead to further adjustment to quarterly earnings? Will that have another impact?

A - Darryl D. Button {BIO 7089946 <GO>}

Maud, it's Darryl. I can't promise that it won't, but I don't expect it to. It's probably the best thing that I can say. And we've taken into this quarter everything that we can see or would expect. The other thing I would mention is that we've really dealt with the more material ones up through this quarter. So, it's part of our ongoing, and I really try to describe it, we really have strengthened the governance in terms of our ongoing model reviews going forward and this will be part of that. So, I'm not expecting. I think if there was something, it would have at this point an equal chance of being positive and negative.

Q - Maud van Gaal

Thank you (52:02).

A - Darryl D. Button {BIO 7089946 <GO>}

Okay

Operator

As there are no further questions in the queue, I would like to turn the call back to our host for any additional or closing remarks.

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

Yeah. I just would like to thank you for participating in this call and thank you for your continued interest in Aegon. And have a good day. Bye-bye.

Operator

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