

## Q2 2015 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

- Archie van Riemsdijk, Reporter
- Ashik Musaddi, Analyst
- David T. Andrich, Analyst
- Farooq Hanif, Analyst
- Gordon Aitken, Analyst
- Mark David Cathcart, Analyst
- Matthias de Wit, Analyst
- Nick Holmes, Analyst
- Steven A. Haywood, Analyst
- William H. Elderkin, Analyst

## MANAGEMENT DISCUSSION SECTION

### Operator

Good day and welcome to the Aegon Quarter Two Results Conference Call. Today's conference is being recorded.

At this time, I would like to turn the conference over to Willem. Please go ahead.

### Willem van den Berg {BIO 15203834 <GO>}

Thank you, Lisa. Good morning and thanks to everyone for joining this conference call on Aegon's second quarter 2015 results. Our CEO, Alex Wynaendts, will provide you with an update of this quarter's performance before then taking questions alongside our CFO, Darryl Button. 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.

I'll now hand it over to Alex.

### Alexander Rijn Wynaendts {BIO 1821092 <GO>}

Good morning. And, as always, thank you for joining us. I'm happy to present today a solid set of results with increased earnings, increased sales and cash flows, all of which I'll address in more detail in the next couple of slides. Return on equity came in at 8.2% for the quarter or 8.9%, excluding our run-off businesses.

Let's turn to slide three, which gives an overview of the most important elements of this quarter's underlying earnings and net income. Underlying earnings before tax were up by 7% to €549 million. This increase was the result of growth in our fee business and favorable currency movement, which more than compensated for the divestment of our activities in Canada and France and for lower earnings from Life & Protection and fixed annuities in the U.S.

Mortality results in our U.S. life insurance business much improved from the first quarter, but still came in €17 million below expectations. Experience is unfavorable, particularly in the block of universal life products sold more than a decade ago. Fair value items had a significant impact on our net income. And this is due to volatile financial markets. And I will take you through this in more detail on the next slide.

We break out fair value items down in four categories. And, as you will see, unfortunately, almost everything went against us this quarter. Firstly, the loss on fair value investments. This was mainly driven by lower-than-expected returns on hedge funds and oil and gas related investments following the drop in oil prices. This was partly compensated by positive revaluations on our Dutch real estate portfolio as the housing market continues to recover.

Secondly, as a result of the increase in interest rates, both in U.S. and Europe, the value of our liabilities decreased substantially. However, hedges declined more resulting in a loss of €186 million on fair value hedging with an accounting match. Specifically in the Netherlands, volatile market circumstances in the second quarter led to historically high swings in our guarantee provisions and related hedges.

Thirdly, fair value hedging, without an accounting match, had a loss of €73 million, mainly due to the macro hedge on the closed book of variable annuities in the U.S. This was caused by an increase in interest rates impacting the hedges, timing of adjustments of the equity hedge program, and losses related to successful uptake of the enhanced lump-sum offering for our legacy variable annuity book. Fourth and finally, other fair value items largely offset each other.

I'll now move to slide five, which shows how our fee-based business are continuing to performing well. Our focus on growing our variable annuities, our retirement plans and asset management business once again led to strong inflows.

Gross deposits showed double-digit growth for the fourth consecutive quarter and were up 29%. Aegon Asset Management contributed strongly to this development as third-party deposits were again strong. In the U.S., we continue to see a sustained demand for our retirement plans and variable annuity products.

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Two other noteworthy developments in the U.S. this quarter were the announcement of a new retirement plan, a long-term care distribution partnership with Edward Jones, and the launch of a new retirement plan with Merrill Lynch tailored for not-for-profit organizations. Edward Jones alone has a network of over 14,000 financial advisors worldwide. And by partnering with these household names, we will help many new customers across the United States secure a financial future.

We're also pleased that we've been able to maintain a high level of sales in what remains a low-rate environment. This required us to take actions to maintain profitability for our new business. In addition, pension volumes in Netherlands were impacted by reduced buyout activity. Our focus on profitable sales resulted in €183 million market consistent value of new business for the quarter. And please note that this is over and above our internal profitability hurdle of 1,000 basis points over swaps.

Slide six highlights key steps we have taken in terms of executing on our strategy. Let me share three examples. First, the sale of our Canadian business and Clark Consulting which generated €600 million and will increase return on equity by more than 40 basis points. This demonstrates our continued commitment to optimizing our portfolio and deploying our capital in businesses that offer strong growth and high returns.

Second, efficiently managing the capital in our businesses. We have, for instance, recently completed a third longevity transaction in the Netherlands. This longevity hedge, covering close to €6 million of underlying reserves, provides downside protection for a period of six years against longevity improvements.

While we have now covered longevity risk of the majority of our pension book in the Netherlands, we will continue to explore further opportunities to optimize our Dutch longevity profile. In the U.S., we've also expanded the lump-sum offering of our legacy variable annuity product. And we are pleased that we exceeded expectations with a reduction of US\$1 billion in account balances in the first six months of the year.

And, third, the continued investments we're making in improving efficiency through the digitization of our core businesses. In the UK, for instance, we're upgrading 2,000 customers every day from our back book onto our digital platform without requiring any manual action. This is a great example of the type of innovation we need to remain competitive in the future. The benefits of Aegon and Aegon's customers are clear. It just leads to higher customer satisfaction, which is driving higher retention rates and lower operating expenses, which are allowing us to offer competitive fees.

Another good example of successful digitization is Knab in the Netherlands. Its sustained customer growth is supported by very high customer satisfaction scores and has recently surpassed €2 billion of savings as more and more clients recognize the benefits of our unique offering. Our efforts to grow fee-based earnings and manage our capital efficiently are translating into high operational free cash flow, as you can see on slide seven.

Normalized operational free cash flows were €727 million in the first half this year, a growth of 17% compared with last year. Holding excess capital increased to €1.5 billion, as

dividends upstreamed by our business units were partly offset by the payment of the final dividend, the asset management partnership with La Banque Postale and holding expenses. Based on these strong, normalized cash flows and our solid capital position, I am pleased to announce that we have increased our interim dividends to €0.12 per share.

These cash flows are still on a Solvency I basis, which brings me to our update on Solvency II on the next slide. First, however, I would like to briefly touch on another regulatory development, the proposed judiciary rule by the U.S. Department of Labor, DOL. If unchanged, this rule will have a meaningful impact on how products are sold and built, especially for higher risk and variable annuities.

We strongly agree that advisors providing sales and products should act in the best interest of their clients. And we also broadly agree with spirit of what the DOL is trying to achieve, the best customer interest standard. However, we believe the proposed initial rule in its current form is not workable.

Our main concern is that the proposed rule could have the unintended consequence of actually limiting lower and middle income earners access to the advice they need. We and others in the sector have actively engaged with the Department of Labor and remain confident that policymakers will come to a solution that enables those preparing for retirement to achieve their goals.

Let's now turn to slide eight for an update on Solvency II. This quarter, we achieved several important milestones: finding our internal models with the Dutch Central Bank and the PRA in the UK, as well as reaching an agreement on the calibration of our U.S. business. This means that we will use a conversion factor for the U.S. RBC ratio of 250% where we previously had assumed 200%. This high conversion factor, however, has also covered the issue of transferability.

For the Dutch business, we are allowed to make use of the volatility adjuster both in our own funds and the SCR calculation. In reaching the agreement with the Dutch Central Bank, we have also agreed to increase the capital we will hold for investment-related spread risk and in particular mortgages which had an impact of 15 points on the Dutch ratio.

In the UK, regulators provided new guidance on not only the level of fundamental spreads to be used in the matching adjustments but also the requirements to hold risk-based capital for the potential change in fundamental spreads in a stress scenario. And this negatively impacted the UK ratio by 30 points.

Having obtained clarity on these key items enables us to tighten our previously guided Solvency II range for the group to 140% to 170%, giving us a strong capital position. Let me reiterate that local capital position also continue to be important as it is these that will ultimately drive cash flows to the holding.

As we have committed, we, today, provide you with more insight on where we believe our units will be. It's important to realize, however, that there still remain a number of

uncertainties. And we expect to be able to provide further clarity at our next Analyst Investor Conference in January.

In summary, so this quarter was marked by an increase in earnings, sales and cash flows. Our capital position remains solid, while we continue to make progress on the implementation of Solvency II. By managing our capital efficiently, by digitizing our business and by optimizing our portfolio, we're making significant progress on execution of our strategy. And this gives us every confidence as we look to the future.

Darryl and I are now happy to take your questions. Thank you.

## Q&A

### Operator

Thank you. We will now take the first question from Farooq Hanif from Citi. Please go ahead.

#### Q - Farooq Hanif {BIO 4780978 <GO>}

Hi. Thanks very much. I hope you don't mind me asking three questions. Firstly, I'm interested in the range of your Solvency II, the 140% to 170% and, in particular, why there's such a large range for the Americas and other business units. So, if you could explain qualitatively what's going on there.

Secondly, what further capital management plans do you have to improve your position within that range? Or if you're not willing to answer that, at least, do you think there is material stuff you can do in the near-term to game this thing in the right way? Maybe that's a wrong phrase, but just to improve your probability of getting to the upper end.

And, lastly, what does not paying a dividend from the Dutch business do to your capital in the Dutch business every year? Thanks.

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

Hey, Farooq. It's Darryl. Let me try and address those three questions in order. Wide range, still what causes the size of the range? Well, we still - overarching, we still have some built-in for we don't know what we don't know. And I would just kind of leave that across all of the units. We still have to complete a number of conversations between now and the end of the year. However, we thought it was important to at least give you a feel of where we think these ranges are.

The Netherlands range is admittedly wider than the other because that's probably where we have still the most uncertainties on the feedback from our internal model application. In particular, I think, it's well-known that we're using the matching adjustment mechanism in the UK. And there was a deterioration on the UK ratios from the fundamental spreads that surprised us and the industry a few weeks ago or a couple months ago now. And that

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is why the UK has gotten moved to the left, but also gotten smaller as we've gotten that clarity.

We did get clarity from the Dutch Central Bank on the ability to use the volatility adjuster mechanism. And that has been factored in here. However, we did have to make some adjustments to our spread risk capital on the asset side, in particular, the mortgages. And that was also a negative impact. However, that being said, the overall model application still is in their hands for review. And we're still awaiting feedback on the overall package. And given the relative lateness of both of those items, the volatility adjuster and the mortgage spread risk, that still needs a deeper review from the Dutch Central Bank. So, there's more uncertainty there.

On the Americas, admittedly, it's much more of a mechanical answer. And it is a lower answer than what we had been expecting because of the 250% conversion ratio. There are still some open items, although, admittedly, they are smaller in the Americas and getting smaller. We do have some open items on tiering of the U.S. capital base and how things like deferred taxes factor in to the group ratio. We have to work through those conversations. And then, of course, there are the natural things that might move the RBC ratio itself on the U.S. side which provides some uncertainty in here. But, admittedly, the uncertainties on the Americas are certainly getting smaller.

On your second question, capital management actions, there are quite a number of actions that we're still - and will be executing on between now and the end of the year to make sure that we have optimized - I'll use the word optimized - we are particularly in Europe, between the UK and the Netherlands, adjusting our hedge programs to make sure that they are optimized to the Solvency II framework. And that's in our sight line and we're in full control of that process and executing on that.

Third question, I think, if I wrote it down correctly, was the Netherlands. What if the Netherlands is unable to pay a dividend and how does that impact your capital? All I can reiterate there, again, is the majority of the cash flow does come from the U.S. And the U.S. is not impacted at all by the Solvency II standards. So, that's the good news. We just don't know where we sit with the Netherlands. It will very much depend if we're in the upper end or the lower end of that range that we've shown here today. So, that's still very much an open conversation between us and the Dutch Central Bank between now and December.

**Q - Farooq Hanif** {BIO 4780978 <GO>}

Just wanted to come back to the Netherlands. I think my question was more is it material to the Dutch solvency ratio you not paying a dividend every year? So the operator capital generation and the growth in that capital ratio, is that quite a big positive every year because you decide not to pay a dividend?

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

Yeah. Well, so, a couple things. I mean, in terms of size, we have been upstreaming on average around a €250 million dividend from the Dutch operation. So, that's in absolute

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terms the size that we're talking about. And you can do the math in terms of what €250 million does to our holding capital position and our cash flow position. We still have to do the analysis of what the Solvency II operating cash flow generation looks like. And part of that is still hung up in this conversation. It still needs to happen in terms of a final calculation.

So, it's difficult to unwind the framework going forward till we complete that. I would say that cash is cash over time. So, valuation frameworks can move that any one single point in time, but then over time, cash is cash. So, you think you will get back to somewhere in that same zone over the long-term. In the near-term, though, our recent capital planning and expectations from the Netherlands has been around that €250 million mark.

**Q - Farooq Hanif** {BIO 4780978 <GO>}

Okay. Thank you very much.

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

Yeah.

## Operator

Thank you. We will now take the next question from Ashik Musaddi from JPMorgan. Please go ahead.

**Q - Ashik Musaddi** {BIO 15847584 <GO>}

Hi. Good morning, Alex. Good morning, Darryl. A couple of questions. I mean, you keep on flagging this fundamental spread thing in the UK, whereas not even a single UK company is kind of flagging that. I mean, what is the problem there? And why did it look like 30 percentage point hit on that? And just on that same thing is what is the impact of that on the group ratio? That's the first one.

Secondly is if you think about – I mean, just going back to the question asked by Farooq. I mean, are you really comfortable with your Dutch and UK capital position here or will you be looking to address specifically these two geographies? And thirdly is what are your discussions with the regulator with respect to your group dividend? I.e., a weak Solvency ratio in Netherlands and UK. Will that impact your group dividends to shareholders? Thank you.

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

Yeah. Let me give a shot on that. So, on the fundamental spread issue in the UK, actually, I think, very much the rest of the UK industry has been talking about this issue, although, they may be in different form. But this is really what led to the movement over to the transitionals that came out of nowhere last quarter. Really there was just a start change in the treatment of the size of the fundamental spreads that are shaved off the matching adjustment and then the treatment of that in the capital calculations. And a lot of the UK industry is now talking about using transitionals for exactly this reason and this is why. So, I

don't believe we're unique in this. And I think maybe others have talked about it in a different form, but that's what's in behind the movement to transitionals.

**Q - Ashik Musaddi** {BIO 15847584 <GO>}

I mean - sorry, just to interrupt you on that one. I mean, UK companies are talking about the longevity being the biggest pain for them which I don't think - I mean, I don't think fundamental spread has anything to do with the longevity. I think that is to do with the credit spread part, whereas UK companies are talking about risk margin which has to do with just longevity.

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

Yeah. Again, I guess, I can't comment on how others have been talking about the component pieces. What I can tell you is that there was a change in methodology on - well, there was a change in the fundamental spreads themselves. That's going back a while now. So, that's going back in the last quarter. And there was at least a change in view and our interpretation of how those fundamental spreads need to be built into the SCR calculations. And that was both. So, that created a numerator and a denominator impact. I believe that impacted anybody using the matching adjustment but it - again, all I can speak to is it certainly had an impact on our expectation.

**Q - Ashik Musaddi** {BIO 15847584 <GO>}

Okay.

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

On the - are we comfortable on the capital position on the Dutch and the UK business? I will start with the UK. As I think everyone is aware, our capital has been on the lower end of our tolerance level. And our Pillar I ratios currently sits at the 135% level. And that is below what we think is long-term capital aspirations for our business in the UK which is why we've not been paying a dividend from the UK and strengthening the capital base from the operational earnings.

I will say that our normalized operating cash flow out of the UK is tracking well for the £100 million per annum, £25 million per quarter that we signaled earlier. And so, that is tracking well and growing well, but we're definitely on the lower end and building capital in the UK and not in a dividend paying mode as of yet.

On the Dutch situation, it really depends, quite frankly, on where we are in that range. And I think that, unfortunately, the range is still pretty wide, but it depends if we're on the upper end or the lower end on our ability to upstream a dividend this year. And that's really going to take it into, unfortunately, a fourth quarter conversation.

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

Yeah. Let me take you to the third question which is your question on the Dutch regulator relation to the dividend payment of the group. As Darryl said earlier, the biggest part of our cash flows are coming from our U.S. business and our U.S. business is not impacted by



Solvency II. So, our cash flow stream to the holding continue to be strong. Our overall capital position remains strong. And that's why we have announced also an increase in our interim dividend. I think it's important that you recognize that. And, secondly, I'd like to reiterate here that we have expressed our intention of doing a share buyback once we have clarity and after we have clarity around Solvency II. And that commitment remains very firm.

**Q - Ashik Musaddi** {BIO 15847584 <GO>}

All right. That's very clear. Thank you.

**Operator**

Thank you. We will now take the next question from William Elderkin from Goldman Sachs. Please go ahead.

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

Hi. Good morning, everyone. Alex, I mean, you've actually just answered the question I was about to ask. But, I mean, I was slightly struggling to reconcile the declaration you made in terms of the interim dividends, your competence in the future. But coupled it what Standard Life said, the cautious commentary certainly to me in terms of the UK capital position, and uncertainty in terms of the Dutch capital position, I mean, if you can shed any more lights on that. Though I think you've probably addressed most of that with your comments just now.

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

Yeah. No, I think we would not add anything than reiterate what I just said earlier.

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

Yeah. Okay. All right. Thank you.

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

Thank you.

**Operator**

Thank you. We will now take the next question from Mark Cathcart from Jefferies. Please go ahead.

**Q - Mark David Cathcart** {BIO 19783252 <GO>}

Yeah. Hi. In relation to the €300 million derivative loss in the second quarter, you said everything seems to go against you. I think you sort of had some sort of hedge rebalancing the time when you had quite a lot of interest rate volatility. So, I'm just wondering, if it was bad luck or if there is sort of some kind of risk control issue that needs to be looked at here? And also, are you doing anything, so that we can have these blow-

ups in future quarters? Are you likely to change anything on the back of what's happened this quarter?

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

Yeah. Hey, Mark. It's Darryl. Let me take that one. So, a couple of things in the fair value. In the Netherlands, we did have €140 million, as you can see on the slides, loss from the fair value hedging program. That's in the category where we do have a match between the assets and liabilities. So we do expect a fairly tight number there.

Just to put some context around that, that was in a quarter where our underlying liabilities and our overall hedges move by €3 billion in the Netherlands. And what fell out of that was €140 million net loss. So on one hand, the hedges were, I think you could say, fairly successful and did their job in covering a €3 billion change in the liabilities. On the other hand, the residual that fell out was €140 million. And that's still €140 million.

We have identified - because the movements were so extreme -- we have identified where actually our hedge could have been even more effective than it was. So, as much as we're pleased with the fact that we got the vast majority of the risk change with the rates moving as severe as they did, it did show some weakness in our hedge program. And we've actually stepped in now and actually made some changes there to fix that. So, that's the context around the €140 million from the Netherlands.

In the U.S., we do have a number of interest rate hedge programs where we get no accounting match whatsoever. So, when we have a sharp rise in interest rates or fall in a quarter like we had in Q2, then we will bear some losses. And they are really more accounting losses and not economic losses. And that was part of the underperformance in the U.S. There was also \$30 million in the U.S. related to the acceleration of our ALSO program, our Alternative Lump Sum Offer program, for the old GMIB. And that was in there. And we're getting some successful take-up rates on that, but that came at a cost as well.

So, those three, combined with what Alex mentioned earlier in his opening remarks on the fair value investments, which do fluctuate plus or minus any one quarter, but also going against this, really explains the bulk of the miss in the fair value line.

**Q - Mark David Cathcart** {BIO 19783252 <GO>}

Okay. Thanks.

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

Yes.

**Operator**

Thank you. And the next question is from David Andrich from Morgan Stanley. Please go ahead.

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

Hi. Good morning. Thank you for taking my questions. I just had a question about your Solvency II ranges, particularly for the Netherlands and the UK. I was wondering -- the bottom end of the ranges for these two countries and maybe particularly in others, but it's probably typical of the UK too. I was just wondering -- is this essentially a convergence with your standard formula Solvency II number or is there still kind of a gap there between where your standard formula number would be and where the bottom end of your partial internal model would be?

And then second, I mean, it's likely you probably are not able to answer this given discussions are still ongoing. But can you give any indication of what kind of minimum Solvency II level the Dutch or UK regulators are looking for? Any indication at all?

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

Yeah. David; it's Darryl. Let me take those. The first question, the answer is yes. Actually, it is a convergence with our standard formula numbers. We're finding actually a very small difference now between our internal model and our standard formula numbers. Of course, you never really know on standard formula because in the standard formula framework, you have the ability for capital add-on that could be added later. So, you don't ever have definitive knowledge of what your standard formula is. But on the calculated standard formula numbers and our internal model, the gap is actually quite small now.

And then do I have some insight on the minimum standards? Not really. Those are the conversations that we're going to have in the second half of the year around what ranges that we want to run to. The only thing I would maybe add there is that we've always said from the beginning our Solvency II is a different framework from the old Solvency I and especially in that all the risks are covered in the denominator. So, unlike the Solvency I framework where it was a little more high level and factor-based but known to be gaps in risk coverage and, therefore, you held higher multiples to make up for those gaps, Solvency II works in a different way. You identify all of the risk coverages. You quantify them. You calculate them. You build models. And you put them into the denominator.

So, as a result, we have always expected lower ratios. And that's kind of what we're seeing. And we'll carry that into the conversation in terms of what the expected ranges and coverages are for us to be able to continue to pay dividends. And that'll be a big part of our second half discussions and, certainly, what we'll be discussing with you in January.

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

Great. Thank you very much.

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

Yes.

**Operator**

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Thank you. And the next question is from Gordon Aitken from RBC. Please go ahead.

**Q - Gordon Aitken** {BIO 3846728 <GO>}

Yeah. Morning and three quick questions, please. You mentioned in the Dutch market that you have undertaken a third longevity hedging. Just wondering – you said there are further options there -- I just wonder if you could give us more details on those further options on the Dutch liabilities. And also, could you hedge the longevity risk you have in the UK and – or could you even sell that UK annuity block? That's the first question.

Secondly, on operational risk, are you calculating capital for operational risk on an internal model or the standard formula? And if it's the internal model, is there a risk here that the regulator says you should use a standard formula?

And just finally on fungibility. I mean, we've had equivalents clarified for the U.S. at 250%, but the U.S. regulators would not practically allow RBCs to drop below, let's say, 400%. Are you concerned about how fungible the capital in the group is? Thank you.

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

Yeah. Let me take that. On the NL longevity, is there opportunity to do more? Yes, absolutely. And, in fact, actually, the deal that we just announced back in July was 40% of actually larger package deal that we put together. So, we've executed on 40% of a €15 billion reserve coverage deal. And we're currently out shopping and negotiating on the remaining 60% of that deal. So, there's €6 billion done and another €9 billion to still go from that same deal. So, we are still seeing appetite and demand in the market for longevity risk. And we're still going to be actively looking to delay longevity risk off in the Netherlands.

Yes, there's also an opportunity to do something similar in the UK. And, actually, we're looking at that as well. And so we're looking at some longevity hedging for the annuity book in the UK. And that's actively ongoing. I should have mentioned that earlier on the capital management initiatives question that came up. On the operating risk question, the answer is we're actually on a standard formula already. So these numbers are on a standard formula operating risk calculation there for operating risk capital.

And then on the U.S. fungibility, actually, the bigger issue has really been transferability. And I think that's the heart of the question you asked. And that is the good news of the calibration decision and conclusion we've reached with the Dutch Central Bank is that although it's the 250% factor and it's higher than we were expected which gives us a lower ratio, it does also include the transferability issue. So, there's no further discussion on hair cutting the U.S. numbers for transferability which is basically, I think, it's what you meant by fungibility. It's the ability to transfer the excess capital over and above the 250% RBC ratio and count that in the group ratio. So, that's been settled.

**Q - Gordon Aitken** {BIO 3846728 <GO>}

Thanks very much.

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## Operator

Thank you. We will now take the next question from Nick Holmes from Société Générale. Please go ahead.

### Q - Nick Holmes {BIO 3387435 <GO>}

Oh, hi there. Thank you very much. Two questions, please. First, coming back to Solvency II, you've got quite a wide range at the group, 140% to 170%. I wanted to ask, what is your target level? And then looking at – Alex, you mentioned the share buyback. You're still very much on your agenda when you conclude the Solvency II. Can you give us some sort of sensitivity for the share buyback? I mean, if you were at 140%, would you still do the buyback?

And then second question is on something completely different, which is the DOL proposal. I wonder if you could give us a little bit more color on this. I mean, I know that you and the industry are obviously discussing it and you're not happy with the proposal as it stands. But I wondered if you could just give us a bit more color about the products that you see affected. Is it your retirement services products as well as your variable annuities that could be affected? And what sort of proposals are you making to the DOL to ensure that there is not an adverse effect on your business? Thank you very much?

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

Thank you, Nick. Sure. On the Solvency II ranges, as I think Darryl very clearly indicated, it is too early at this point in time to give you any further indication as where we feel the range should be. And, again, I will reiterate here that the biggest part of our business is in the U.S. The biggest part of our capital is in the U.S. That is driven by different rules in Solvency II. That also has different rules in terms of cash flow and fungibility.

So, we will provide you that clarity hopefully at the end of the year and certainly in January when we have our A&I Conference. But as such, you need to look at these different pieces and there's still quite a number of facts and issues, which we want and have to discuss with our regulator. I think it's important to note here that the capital position we have today and the cash flows we have, have allowed us to increase our interim dividends to €0.12. And, as we've shared with you earlier, these discussions around dividends, about capital are all discussions we're also having with our regulator.

Now, on the share buyback, I'm afraid I will have to give you the same answer. What I did say is we remain committed on executing on the share buyback. This commitment we've made, we will remain committed to it. At exactly what level and when and how is something I cannot be clear today. Repeat it, at the end of the year, when we have clarity, when we have resolved all outstanding discussions, we will give you that clarity, the one you're looking for.

Now, on the Department of Labor, the DOL. Yes, indeed, this, obviously, in its present form, as I said in my introductory remark, is we believe not really workable. And the reason it's not really workable is that we see that the unintended consequences are such that it is going to limit middle income in its access to advice and advice they really need.

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We've seen quite similar trends in other markets in the UK in particular. It is important that people, while they're looking at how they retire, what products and solutions they need, they will need advice and that advice needs to be paid for.

Now, the question is more, how does advice needs to be paid for? Is it a commission? Is it a fee? And I think that is really at the heart of the discussion. What form, under what form and what type of products will we make available, so that we can continue to address its very significant needs? The need for people to ensuring that they have an income over the remaining part of their life. Now, in its current form, yes, it will have, in my view and the view of the industry, in general, potentially an impact on what I would call the qualified sales, VA sales. As for Aegon, that is - represents 58% of our sales. That part is potentially impacted if the rules are not changed from where we are right now today.

What we also see is that it's likely that assets will be retained actually longer in our pension plans. To what extent that is going to be an offset at this point in time, clearly is very difficult to say. We are engaged in discussions, as you are aware, as an industry, very actively engaged. At this point in time, today is the last day of the hearing which has not shed - as you know, the last four days of hearings have not shed enormous amount of new information. I think all parties will have to take their back.

We do hope to get more clarity within two months to three months. But what we understand is that there is an understanding that a number of rules have to be adjusted in order to make sure that it does not have the unintended consequences which we're being flagged very clearly. I hope this helps, Nick.

**Q - Nick Holmes** {BIO 3387435 <GO>}

Yeah. No, that certainly does. Thank you very much. Just a very quick follow-up on the DOL proposal. A lot of people have focused on the negatives - the unintended negative consequences, as you described, of less advice, less sales. Do you think there is a potential for a positive in the sense that more constraint on things like advisor commission remuneration? It might actually be positive for profit margin. There could be a more disciplined approach to distribution.

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

Well, again, that is very early to say that at this point in time. I think we've been very clear that we very much agree that we should act in the best interest of all our customers. We should do that with the right product. We should do that in the right way of selling it, which I think is really important. And the compensation element is important because, without a compensation element, there is not sufficient incentive from anybody, really, to take the steps they need to take in order to prepare for retirement.

So what we see - and that is clear in markets where similar rules have been applied and you're well-placed in the UK, see what RDR has done. It does have an unintended consequence. And you see whole parts of the population effectively not being served anymore just because the system does not allow the proper remuneration for the advice which is really needed.

**Q - Nick Holmes** {BIO 3387435 <GO>}

Okay. Thank you very much.

## Operator

Thank you. We will now take the next question from Steven Haywood from HSBC. Please go ahead.

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

Hi. Good morning, everybody. With regards to the U.S. mortality adverse impact you saw this quarter, I know the absolute size of it is lower than in the first quarter, but is this – do you reckon a continuation of the trends seen in the first quarter or more of a one-off related item? And do you think this will come under particular scrutiny at your yearly review in the third quarter?

Also, I just wanted to question on the ALSO program. You said there was a \$30 million loss in the second quarter. Is this dollars loss? And also, do you expect any further losses going forwards? And then, just a small question on the non-life business and how is the review of this business going and how is the run-off of the proxy channels going as well? Thank you very much.

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

Yeah. Steven, it's Darryl. Let me take the first two on U.S. mortality and also on the U.S. mortality. I'm looking at it as a one-off definitely. We are pleased that it's come back significantly from Q1. We knew that – we were pretty sure that Q1 was a seasonal aberration but, admittedly, still US\$19 million behind our expectation.

As I said in the past, any one quarter fluctuation, we have a large block of mortality in the U.S. So we will have fluctuations around the mean. Any one quarter in of itself is not enough to cause us to change our trend line and our assumptions, but that's obviously something that we will look at for the third quarter.

But I'm considering – and, as we've analyzed it, again, it continues to be fairly dispersed across our book, although it does seem to be concentrated more on our universal life products than our term products. But we really haven't been able to pinpoint any one associated factor with that. So I'm treating it as a one-off.

On the ALSO, yeah, I quoted \$30 million. I think the actual number was US\$32 million – was the impact from ALSO. Do we expect more of that going forward? There will be some. We had a lot of momentum on the second launch of the ALSO program, \$600 million take-up in the second quarter alone, \$1 billion year-to-date. Those numbers have started to already taper off going forward. So like always when we release these programs, we get a lot of initial take-up and then they start to drift down. So, there will be some more in Q3 and maybe further into Q4, but the numbers will be smaller. On the third question, I'm sorry, I didn't –

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

That's all right. I'll take the third question. On the life - non-life business in the Netherlands, the question you asked is about where are we standing in our strategic review. Yes, we have said that certain parts of our non-life business are subject to strategic review. At this point in time, there's not more that I am able to share with you. But this fits very well into the strategy - a very clearly stated strategy of focusing and putting our capital in our businesses that we believe are long-term attractive for Aegon, businesses where we can make the right returns with the right risk profile.

And this is, in this context, we have been reviewing, as you know, Canada, which has now been closed. We're pleased it's been closed. We have sold our French business, Clark Consulting, recently announced. And we also reviewing our business, our run-off business in the U.S. which is our BOLI/COLIs, the in-force business, as well as our structured annuities in the U.S. So, this is very well a strategy of focusing on those businesses which we want to maintain and executing on those business we see are not fitting the long-term profile of Aegon.

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

Okay. Thanks very much.

**Operator**

Thank you. We will now take the next question from William Elderkin from Goldman Sachs. Please go ahead.

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

Thank you for taking the follow-up question. Two ones. Is the dividend trajectory you seem to be indicating, which is upward and also just thinking about the comments you've made on the buyback, is that sustainable from your U.S. and other operations if the Solvency II ratios from the Dutch and UK operations are at the low end of the range, and, hence, judging by what Darryl says, won't be upstreaming? That's question one.

And then, in terms of the UK life Solvency II coverage ratio, you've provided - guidance range you've provided, are you making use of transitional relief when you're calibrating that number and that range?

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

Yeah. Well, I just want to remind you that we have increased our interim dividend. I also said that we would be committing to doing the share back as soon as we have the clarity. And that is certainly sustainable based on our U.S. cash flows.

On our UK life, you might want to add something?

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

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Yeah. On the UK, the numbers we've shown you are actually Solvency II without transitionals. However, with the transitionals due, we will apply for transitionals as part of our package. Although what transitionals do is provide some floor and some stability to the ratio in the near-term, while you convert from the old framework to the new. But, as you know, our Pillar I ratio is 135%. So the Solvency II and the Pillar I ratio are coming in around the same level, ironically. So, we will have transitionals as part of our application but the information we're showing you is Solvency II, excluding transitionals.

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

Okay. So just perhaps to - I heard that correctly. So you'd be - the dividend trajectory and the buyback aspiration is sustainable, even if the Solvency II ratios of the Dutch and UK entity are at the low end of the range and are not upstreaming for some time? I just (46:46) correctly.

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

Yeah. I can just repeat what I just repeated. We had strong cash flows coming from our business. We have a U.S. position which is not affected by Solvency II. We have to obviously get a total picture around Solvency II at which time, again, we will confirm what our position will be. But based on where we are today, the information we have and the cash flows from the U.S. that is sustainable.

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

Okay. Very clear. Thank you.

**Operator**

Thank you. We will now take the next question from Matthias de Wit from KBC. Please go ahead.

**Q - Matthias de Wit** {BIO 15856815 <GO>}

Yes. Good morning. I had a few questions left. First of all is on the market impacts on your operating cash flow which were €677 million negative. I wonder whether you could break this down between the different components. And it would also be helpful if you could provide an indication on why these losses are larger than the IFRS losses linked to these non-recurring or market impacts.

Second question I had is on the Solvency II treatment of your U.S. captives. Could you provide some indication on how you've dealt with them currently and whether there's any remaining uncertainty in this respect? Thank you.

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

Yeah. On the operating free cash flow, the sizable impact to the markets, the €677 million, that breaks down a little over €400 million coming from the U.S. A lot of that has to do with the impact of rising interest rates. This is the reverse effect of what we've seen in the last couple of quarters, which is why I've been a little cautious on the excess capital position in

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the U.S. We do see some perverse movements in our capital ratios in the U.S. So, when interest rates are going up, we're having losses on some of our interest rate hedges that aren't fully reflected on the liabilities. And that actually costs us capital, even though we're -- have economic hedges to hedge the risk long-term. So we've seen some gains as rates were coming down, which were a little counterintuitive, admittedly, over the last two quarters or three quarters, generating capital in the U.S. and now we're seeing the reversal of that when rates are going up.

In the Netherlands, it goes back to a little bit to the -- there was about €200 million or so due to the Netherlands related to market rates and spreads. But one of the impacts is the question I answered earlier, which was the ineffectiveness of the hedge program this quarter with the sharp rise in interest rates. Although the underlying hedges performed well, protecting a €3 billion movement in the liabilities, there were still that residual €140 million that came off those guarantee hedges. And so, that was -

**Q - Matthias de Wit** {BIO 15856815 <GO>}

Are you in this respect talking about a change in the IFRS liability or is it -- is this also relevant to the statutory accounts?

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

It is. The same issue crosses over into the statutory. It's a different mechanism that picks it up, but over in the TRT mechanism on the statutory side had the same ineffectiveness of the hedging come through and impact it. And that's a large part related to. We always see some volatility in basis risk come through every quarter because of the mismatch between curves and spreads that are used between the hedges and the liabilities. But in this quarter, it was larger than usual and a lot of it had to do with the same IFRS mismatch carried over onto the statutory side.

**Q - Matthias de Wit** {BIO 15856815 <GO>}

And I guess a part of that's reversed since the start of the third quarter or is that the wrong assumption?

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

Are you talking about in the Netherlands? Sorry.

**Q - Matthias de Wit** {BIO 15856815 <GO>}

Yes.

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

Since the third quarter of 2014? Yeah.

**Q - Matthias de Wit** {BIO 15856815 <GO>}

No. No. No. No. Since start of this quarter.

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

Oh, the start of this quarter. Oh, sorry. I thought you were going back to last year. The start of this quarter, well, again, I'll take you back to what I said before. The movements in the second quarter were extreme. It did show some weaknesses in our hedge program. We've stepped into actually tighten the hedge down. So, what we would like to do is have tighter hedge results and try and keep this number. And really that's a statement across that would apply to the U.S. as well.

So, we're working on both hedge programs to try and tighten down the volatility that comes off of these. And that's ongoing work. And we actually have quite a bit of work we're doing in that area. Now, the only caveat I would add to that is we have some additional work to do now in the Netherlands and the UK in particular. As we have the final Solvency II rules, we do have to also change our hedge programs over to give us the optimal coverage under Solvency II. So, there's a lot of work going on right now to tighten those hedges down.

**Q - Matthias de Wit** {BIO 15856815 <GO>}

Okay. And on the captives side side, please?

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

The captives, yeah. That's all encompassed inside of the figures that I gave you before. So, there aren't really any - what I would say, any material open issues on the captives. We did recapture one of our largest offshore captives in Bermuda. We did re-domicile that to be an onshore captive inside the U.S. And so, that really does move most of the offshore activity back onshore and that all of the captives are encapsulated in the ratios and numbers that I've given you here today.

**Q - Matthias de Wit** {BIO 15856815 <GO>}

Got it. Thank you.

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

Yeah.

**Operator**

Thank you. We will now take questions from the media. We will now take the next question from Archie van Riemsdijk from Dow Jones. Please go ahead.

**Q - Archie van Riemsdijk**

Yes. Hello. This is maybe a bit off-topic. But I was wondering - I recently read a note on - yeah what - possible future plans for Aegon and it said that it has a closed management culture. And that it has to do with the Stichting or the foundation. And that would have a negative impact on the shareholder value. What is your idea on that? And is that an issue that is considered by Aegon?

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

Well, let me just put into context what the association is. The association is a shareholder of Aegon like any other shareholder. The association comes from the time that the company was formed in 1983. It was between a mutual company and a life company. When the two merged together, the interest of the mutual company were actually transferred into - they came into the association that it has right now. The association has been very supportive of Aegon along all the years. The association has provided the support at the times of acquisitions in the past. And association remains a very solid and a very good shareholder like any other shareholder.

**Q - Archie van Riemsdijk**

Okay. So, no worries on that front?

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

I'm only pleased to have a stable, long-term shareholder, a shareholder that is looking after the interest, as you can see right away. It's all public on the website. It's looking after the interest of all stakeholders. It starts by customers, shareholders, employees and any other stakeholders that are around the association.

**Q - Archie van Riemsdijk**

Okay. Thanks very much.

**Operator**

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

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

Well, I'd like to thank you, all, for your continued interest. And look forwarding to catching up with you at any time. Bye-bye.

**Operator**

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

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