

Q4 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

- Ashik Musaddi, Analyst
- David T. Andrich, Analyst
- Farooq Hanif, Analyst
- Farquhar C. Murray, Analyst
- Gordon Aitken, Analyst
- Nick Holmes, Analyst
- Steven A. Haywood, Analyst
- William H. Elderkin, Analyst
- William Hawkins, Analyst

MANAGEMENT DISCUSSION SECTION

Operator

Good day and welcome to the Aegon Q4 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, sir.

Willem van den Berg {BIO 15203834 <GO>}

Thank you, Reese. Good morning. And thank you for joining this conference call on Aegon's fourth 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 our 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>}

Thank you, Willem, and good morning, everyone. And thank you for joining us today. I'm pleased to report that the fourth quarter was a strong close to a solid year for Aegon in what remains a challenging environment, in particular, with the persistently low interest rates and market volatility.

Last year, we've made significant progress with the execution of our strategy. So let me highlight a few of the steps we've taken before providing you with an overview of the Q4 numbers. In terms of optimizing our portfolio, we are pleased to have been able to announce the sale of operations in Canada and of our stake in La Mondiale Participations in France. At the same time, we continued to invest in our future growth, in particular, by expanding our distribution capabilities.

In Portugal, our new partnership with Banco Santander gives us access to over two million customers through 600 branches. And in France, our new asset management partnership with La Banque Postale will give us access to 11 million retail customers in addition to growing institutional client base. Finally, in Brazil, I can announce today that we have entered into a distribution agreement with BANCOOB, Brazilian Cooperative Bank. This will enable us to offer life and pension products to its 2.8 million customer throughout their 2,000 branches in Brazil.

While we are expanding distribution in all our markets, we also remain focused on improving our operational capabilities. In the U.S., for example, we successfully merged two divisions to create our new investments and retirement division. This will further improve efficiencies, and will also help us better serve our customers along their life cycle, including through retirement.

This brings me to customer loyalty. And I'm pleased with the programs that we have successfully implemented throughout the organizations to better connect with our customers in the way they choose. Examples include the Mijn Aegon portal in the Netherlands, our new online products in Spain, but also helping more than a million people in the U.S. with our retirement outlook, too.

I'm also proud that we have made significant progress towards becoming the preferred employer in our sector. And as you can well imagine, this is important to us as we need to be able to attract and retain talent throughout our organization. The results of our most recent global employee survey showed that our employee satisfaction scores are now above the high performing norm.

Let me now turn to our fourth quarter results. And as you can see, slide 3 provides a good overview of a strong performance. Underlying earnings before tax were up 19% to €562 million. And this increase is driven by growth of our business, a stronger U.S. dollar, and an employee benefit reserve release in the Netherlands of €45 million.

Sales growth continued. Return in equity increased to 9.7%. And cash flows were strong at €338 million for the quarter. I'm also pleased to announce that based on our solid capital position and cash flow generation, we will increase our final dividend to €0.12 per share.

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As you can see on slide 4, we continue to generate strong sales growth. This is a particularly good result given the challenging environment with regulation changing in almost all our markets, customer demand also changing and the low interest rate environment. Gross deposits were up 29% for the quarter and 25% for the year, showing clear evidence of the success of our strategy to move to a more fee-based business model.

Life sales also higher, although maintaining profitability is being challenged by the low interest rate environment. Earlier this year, we reintroduced our universal life secondary guarantee product in the U.S. with real-time pricing to enable us to maintain flexibility despite declining interest rates.

Earlier this month, however, due to the increased interest rate volatility, we took the decision to withdraw the product from the market, and this action is a clear reflection of a strict pricing discipline. We were also pleased to see our accident and health as well as general insurance sales pass the €1 billion mark in 2014 for the first time, again, an evidence of our success in expanding the distribution of our broad product offering. As I indicated earlier, we are seeing strong momentum in our fee-based business.

I'll now turn to slide 5. In the U.S., variable annuities, pensions, and mutual funds all recorded strong gross deposits. Variable annuities in particular continue to be a major driver of growth and expanding distribution has been key to our success. Also, here, as a result of the low interest rate environment, we've had to make adjustments to our variable annuity product. And in the Netherlands, Aegon's innovative online bank, Knab, is fast becoming a success, with one of the highest net promoter scores in the entire sector.

The last quarter, we had seen the number of customers grow significantly and the number now stands at over 50,000 customers with over €1 billion of assets. Our UK platform continues to be the fastest growing in the market while third-party deposits in our asset management business were up significantly compared to last year.

Now turning to slide six, I would like to make a few comments on our capital position and balance sheet. The capital position of the group as well as of our individual country units remain solid as our focus this year turns fully towards preparing for Solvency II. The group IGD ratio remains strong at 208%, holding excess capital stands at €1.2 billion, and net dividends received from our units were more than offset by the €500 million senior debt maturity, by holding expenses and by an investment into our joint venture with Santander in Portugal. There was also an adverse cash impact related to currency hedges due to the strengthening of the U.S. dollar.

In the United States, excess capital remained stable at \$1.1 billion as the impact of the dividend paid to the holding was offset by capital generation including the benefit of market impacts. In the Netherlands and the UK, we are actively preparing for Solvency II. We are repositioning our investment portfolio and working hard to submit our internal models for approval by our regulators. We expect this work to continue throughout the year. And we expect to get clarity on a number of important outstanding items related to Solvency II along the way.

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Given the size of our U.S. business, it will come as no surprise that third country equivalence is very important to Aegon, and we continue to work on the process of bringing our U.S. business under Solvency II using deduction and aggregation.

In the Netherlands and the UK, we are waiting for the clarification on several critical items including the use of the matching adjustments and the volatility adjustment. Because of the uncertainties that remain, we expect it will not be until the second half of 2015 before we're in a position to provide you with more guidance on Solvency II outcomes.

On slide seven, you will see that we ended the year with a gross financial leverage ratio of 28.7%, well within our target range of 26% to 30%. Fixed charge coverage has improved significantly to 6.5 times, also within our target range. And this improvement has been mostly driven by a reduction in outstanding debt of over €2 billion including €1 billion in 2014 alone. We've also taken advantage of current market conditions to refinance leverage at low interest rates going forward. The steps we have taken to reduce leverage and to increase our fixed charge coverage not only strengthened our balance sheet but also provide us with greater financial flexibility.

Turning now to slide eight, our solid capital position and strong cash flow generation over the second half 2014 supports the increase in the final dividends 2014 to €0.12 per share. This makes the full year 2014 dividend €0.23 per share, a 5% increase over the previous year. We will continue to offer our shareholders the option to take the dividend in cash or stock. And we will continue to neutralize the dilution and, therefore, effectively pay a full-cash dividend. As a result, our dividend payout ratio for 2014 as a percentage of free cash flows will be 53%.

Now, in summary, I'd like to say that we are pleased with the results we achieved in the fourth quarter. And we are seeing that more and more people are choosing Aegon and placing their trust in our products and services, which gives us every confidence in our future and in our ability to generate sustainable earnings growth going forward.

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

Q&A

Operator

To begin, we will take questions from investors and analysts only. This will be followed by an opportunity for the media to pose questions. We will now take our first question from David Andrich from Morgan Stanley. Please go ahead.

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

Hi. Good morning. Thank you for taking my questions. First of all, I was just wondering, in terms of the Netherlands. I understand that you didn't upstream any capital from the Netherlands in Q4 even though you're above your minimum IGD target of 200%. And I guess I was just wondering how much capital do you think you need to retain there, and

then how high do you think you need to build your IGD capital in preparation for Solvency II which I know the Dutch regulator is looking at more closely.

And then second of all, kind of similar question for the UK, I see that your Pillar 1 ratio at Q4 was 140%, and you have a minimum target of 145%. And I guess I was wondering how that would impact the free cash flow guidance we've been given in the past in terms of the step up in UK in 2015.

And then finally, I was just wondering on Solvency II, in terms of kind of the key debates, if there had been - I don't think you're giving updated guidance on the range that you gave in June, but I was just wondering if you have any kind of update on the key arguments behind your 150% to 200% range, if there had been kind of a shift one way or another for any of the big arguments there. Thank you.

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

Hey, David. It's Darryl. I'll jump in there. I think all three of your questions are quite interrelated. The reality is, in both the Netherlands and the UK, we really are transitioning into Solvency II this year. And as we look at the decision whether or not to pay a dividend out of the Dutch operations, the reality of the situation is that there's just so many uncertainties out there still remaining on our Solvency II numbers that we decided not to upstream a dividend at this point while we continue to work through those.

In the UK, it's a similar answer. You see the Pillar 1 ratios, but again, more and more of our emphasis is shifting over to the Solvency II. One of the things that we see specifically in the UK is that as we actually de-risk the portfolio and take risk out, removing some of the callable bonds to get ready for matching adjustment under Solvency II, that actually lowers our Pillar 1 ratio, but it obviously helps our Solvency II position. So, you see that dynamic happening.

In terms of the Solvency II specifically, we're really in the middle of our internal model approval process. We expect to file our application and submit that in the second quarter. That's why it's going to be really the second half of the year before we get the results back from that. So, that really is the Solvency II answer to all of your questions as it relates to the European business. The U.S., obviously, as Alex mentioned earlier in his notes, we'll continue to work through the deduction and aggregation process as it relates to the U.S.

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

Okay. So, it sounds like kind of a bit of a holding pattern then until you get the internal model approved in the second half of the year?

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

Yes. I think that's the right way to look at it. We really are in a holding pattern. We really are going through a lot of work on this end with the Dutch Central Bank to go through all the elements of Solvency II, and that's really where we're at.

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

Okay. Thank you very much.

Operator

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

Q - Ashik Musaddi {BIO 15847584 <GO>}

Yes. Hi. Good morning, Alex. Good morning, Darryl. Thanks a lot for your update. Just all the questions related to Solvency, so slide number 23. First of all, what happened in the U.S.? How come your capital stayed at €1.1 billion even though you streamed out \$600 million of capital? How much of that is driven by – so that means there's implied capital generation of around \$600 million. How much of that is markets and how much of that is earnings? And also, some clarity on what the sensitivities on U.S. capital on this particular basis with respect to market, any color there would be great.

Secondly, any thoughts on what happened with that cash flow testing that you flagged in past? Where are we on that now? Did anything new came up in fourth quarter or was it just as per plan? And thirdly is on the – again with the Dutch regulator, can you give us some color about what sort of dialogue you're having with the Dutch regulator, i.e. how are they looking at capital at the moment, i.e. are they looking at Solvency I, kind of Solvency II, how they decide whether you should pay a dividend or not or they just don't know as well? So, I mean, how should we think about it at least? It would be great to get some color on that. Thank you.

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

Hi, Ashik. It's Darryl. I'm going to take those as well. First of all, in the U.S., on the capital position in the U.S., it was a strong quarter for the U.S. We did see some market positives in the capital numbers in the U.S. Those are maybe a little bit counterintuitive with the interest rates dropping. But the reality is that our hedges produced cash earnings for us in the quarter related to interest rate hedging.

And on the liability side, it wasn't as sensitive as the hedges because we were basically using up past margin in the products. So, margins in the capital ratio on the liability side were used to dampen that effect, whereas the hedges produced real earnings in the quarter.

So, of that \$600 million, you're about right on that capital generation. I would say that about half of that was – maybe a little less than that, but a little less than half of that was related to really the market circumstances in the quarter. So, the actual cash generation for the U.S. was \$300 million to \$350 million.

The sensitivity, it does – on the sensitivity side, we do have to watch that if markets go back the other way, interest rates go up, which of course would be economically positive for the business. The hedges will perform the other way. So, some of this would reverse

on the other side. So, we're quite comfortable having the U.S. operating at a capital level, a little above the target range right now. I think that just - I think we're comfortable operating in that range given the sensitivities that we see.

The cash flow testing question you asked, yes, the good news is we got through the year-end cash flow testing within the provisions that we'd already set up earlier in the year. So, there was no additional impact related to that at the end of the year.

And the third question I think you had was how is the Dutch Central Bank looking at capital in Netherlands. They've actually been fairly explicit...

Q - Ashik Musaddi {BIO 15847584 <GO>}

Sorry. Not just Netherlands but the group overall as well because ultimately they will be the local regulator for you. So how are they looking at - I mean, when you upstream dividend from U.S., how do they look at whether you can pay it to shareholders or not, whether you can do a buy back or not? Any sort of color, I mean, how are they looking at it?

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

Sure. From a group perspective, that's actually the discussions that we're having with them right now on how to calibrate the U.S. system into Solvency II under deduction and aggregation. So, the good news is that the Solvency II regime allows for equivalence treatment in the U.S., and we've been operating with the Dutch Central Bank on that premise. And so we continue to further those discussions with them on how mechanically to do that.

So really what's - the conversations going on right now are the calibration, how we move from that system into Solvency II, as well as the fungibility and transferability rules within Solvency II, so are any there restrictions that we need to put on due to fungibility of capital. Those are the major conversations that we're having with them right now.

Q - Ashik Musaddi {BIO 15847584 <GO>}

And with respect to the Dutch business only?

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

The Dutch business only, they've been very clear with the Dutch industry that they want to look at and operate on a Solvency II basis in 2015. 2015 is the transition year, so we're still producing IGD I Solvency I capital ratios, but as we move into mid-2015, they really want to be talking to the Dutch industry on a Solvency II basis by this summer.

Q - Ashik Musaddi {BIO 15847584 <GO>}

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

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

Yes.

Operator

Thank you. We will now take our next question from Farooq Hanif from Citi. Please go ahead, sir.

Q - Farooq Hanif {BIO 4780978 <GO>}

Hi, everybody. Good morning. You won't be surprised, a quick question on – well, quick, sort of, two questions on Solvency II and a question on margins in the U.S. So, on Solvency II, can you just spell out for us what the deduction aggregation issue is? If you can just tell us in very simple terms what the kind of the bull case and bear case is.

Secondly, could you talk about your interest rate sensitivity in the Netherlands? So, my impression is that you're pretty solidly hedged and sort of matched with hedging in the Netherlands. But if you could just sort of confirm that for us.

And lastly, you had very strong profitability in Q4 in the VA business and in employer solutions and benefits. So, could you just talk about what's going there in terms of what kind of above-margin guidance, would that normalize? Thanks very much.

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

Yes, Farooq, let me take the first two. On Solvency II, the deduction and aggregation bull case versus bear case in the U.S. So, basically the essence of the conversation is how to use the U.S. regulatory framework and the U.S. regulatory capital ratios and use those inside of Solvency II, and that's what's referred to under Solvency II as deduction and aggregation. It means that we do not compute the U.S. business on Solvency II, Pillar 1 own funds, and SCR required capital basis.

We use U.S. regulatory available capital and required capital. And then we agreed to some conversion of that available and required capital into our group ratios. That's actually very similar to what we do today under our group IGD 1 ratios today. So we have to work through how that works, getting from legal entity, regulatory capital ratios in the U.S. and getting that converted across into Solvency II.

There is also fungibility and transferability regulation inside of Solvency II that we have to work through, and quite frankly, it's a little bit confusing, I think, for all of us in the industry right now exactly what that regulation calls for in terms of are there any restrictions you have to put on, on non-EA capital as it relates to the fungibility of that capital, so that's the activity that we're doing.

The second question you asked was on the Netherlands interest rate sensitivity. We really do have interest rate hedges in place across all of our major liabilities. So from an ALM perspective, all of the long pension liabilities in the Netherlands have been interest-rate hedged. Those hedges have performed, obviously, extremely well given what rates have done here.

And where we do see a pocket of residual interest rate exposure in the Netherlands is more related to the longevity part of the business. And at the end of the day, what happens is the risk-based capital we hold for longevity, the present value of that longevity capital gets higher as you get into a lower rate environment. So that's a second order impact that we see coming through. But by far, the vast majority of the interest rate exposure in the Netherlands has been hedged.

Q - Farooq Hanif {BIO 4780978 <GO>}

Can I just quickly come back on the deduction and aggregation? So is it as simple as saying there's a - for laypeople like us, say, is there a simple - simpler thing than the minimum RBC ratio of which you will bring into the group calculation your...

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

Yes, sure. So...

Q - Farooq Hanif {BIO 4780978 <GO>}

...and you don't know where that is. So currently, is it 175% that you see, more 250% in your (24:22)?

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

We have been using 200% RBC ratio as a conversion factor. We have highlighted that and noted that when we gave our original guidance that that is a subject of debate. I could see that that is a topic of discussion that we're having now. So, if that was a higher conversion rate, that would lead to a lower group ratio contribution. So, those are conversations that we're going through now. I think...

Q - Farooq Hanif {BIO 4780978 <GO>}

So, would it be correct to say that bear cases look - they will only look at what you can pay because that's your dividend and, say, anything below that is still minimum required capital? So that will be, well, more like, whatever, 400%?

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

Yes. I think if you took a very strict read on the fungibility regulations that are out there, you could restrict the capital down to simply what's fungible in terms of one year's dividend. I think that's a very strict and literal read. We don't think that's the proper application of it, but that's a possibility, in which case the conversion ratio doesn't matter. On a different read, then it's really about the conversion ratio and, obviously, the ratio would be different if we use 200% or if we use 300%, so as an example on how to convert those statutory numbers across.

Q - Farooq Hanif {BIO 4780978 <GO>}

And just very - sorry to take so much of your time. But on the interest rate hedging, so correct me if I'm wrong, but you're - are you hedging economically and, therefore,

ignoring the UFR? Or are you taking into account that you have the benefit of the UFR and, therefore, underhedging?

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

I think we have adjusted our hedge programs over time to the UFR. So, we look at the UFR as a long-term rate assumption. So, there would be some exposure if the UFR was dropped. That's possible, but our hedges are economically hedged to the liability flows assuming the UFR.

Q - Farooq Hanif {BIO 4780978 <GO>}

Thank you very much. Thank you.

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

Yes.

Operator

Thank you. We will take our next question from Farquhar Murray from Autonomous. Please go ahead.

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

Good morning, gentlemen. Just two questions, if I may. Firstly, just coming back on Solvency II. We've seen some peers becoming more definitive on their Solvency II positioning. And I'm just trying to understand why Aegon is somewhat less happy about that. I assume it's because the aggregation deduction method is more significant for you than for other peers. But I'm just trying to understand whether there's anything else that just seems to explain why you're taking a slightly different approach there.

And then just on the earnings impact from low interest rates on slide 33 of the presentation pack, can you just explain why the year-on-year guidance is essentially unchanged from the previous guidance you've given? I might have expected the kind of drag effect to have increased given the fall in interest rates and just want to understand what happened there.

And actually, just on a point of detail, is that guidance based on the year-end interest rate positioning or is it some kind of average of 4Q or the full year? Thanks.

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

Yes. Farquhar, hi. It's Darryl. Yes, your answer is right on the Solvency II question. I mean, given the size and dominance of the U.S. for Aegon, obviously, the deduction and aggregation and that whole calibration discussion I just had with Farooq is very material to what our end ratios are. So we're just less confident on zeroing in on a range right now for the group because of that. And I think that's a fair distinction between our position and perhaps a couple others here in the Netherlands.

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On the earnings guidance, yes. So we basically slid the earnings guidance forward, so it's the same \$10 million, \$15 million, \$25 million that we had before, but now that's relative to a 2014 base, before it was relative to a 2013 base. It is maybe a little smaller than what you were expecting. Some of that is helped by the fact that when we unlocked the rate assumptions back in 2013, we really lengthened out the time at which we expect to get to the 10-year assumption in the U.S.

So we grade there only over a 10-year period. So that helps smooth down some of the sensitivities. And it really should be read as a year-over-year basis. So if rates stay where they are basically today, flat for the next three years, then this is a year-over-year guidance relative to same quarter back in 2014.

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

All right. Just as a follow on the Solvency II aspect. I mean, has the range in any way particularly increased from what you indicated in June? And just directionally, where has the Solvency II ratio presumably developed since June?

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

Yes. Again, I'm not going to give an actual outcome number, but we gave a 50-point range, which is quite wide, back in June. And I still think that's a reasonable range given all the uncertainties. A lot of the uncertainties we highlighted in June are still uncertain for us. We still stand here today with not knowing what the volatility adjuster looks like. We still have to go through our approval process for matching adjustment, all of the IMAP internal approvals. Those are the same caveats that we had back in June.

I wish we had more progress on that, but we're still actually waiting for - we're still waiting on volatility adjuster detail from EIOPA. And then the deduction and aggregation issue is maybe more unique to Aegon, but it's a material issue for us, so we continue to work through that with the Dutch Central Bank.

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

Okay. Thanks so much indeed.

Operator

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

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

Thanks. Good morning, everybody. A couple of questions. First, a couple of follow ups. With the sort of the headline Solvency II debate, importance of equivalence, what is the sort of materiality of the group level Solvency II ratio to your ability to upstream capital, and I guess ultimately return of capital to shareholders, particularly if the sort of the underlying U.S. regulations aren't changing? I can see why Solvency II uncertainty in the

Netherlands is very important to that. But could you just spell it out again on why that headline group level ratio is – whether that impacts things?

And then secondly, I've got a couple of other questions. In terms of the UK business, you've had this £150 million to £200 million sterling capital generation target. I got a feeling last year that you'd indicated that was going to be a challenge. Could you just give us an update of where we've got to on that? Thirdly, in your press release, you referred to higher U.S. operating expenses expected in 2015. Could you just give us a little bit of some quantification there?

And then finally, in terms of the evolution of the variable annuity portfolio, I think in the past you've talked about sort of three buckets, I think, in terms of pre-2004, 2004 to 2007, or 2004 to 2008 and then versus the newer generation of products. And if we look at the overall portfolio you report, roughly how big are each of those elements?

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

Hi, William. Let me take the Solvency II question. I think it's very similar to what I answered with Ashik earlier, the relevance of the solvency of the U.S. cash position into dividends as per Aegon. I think, the first answer really is that the Solvency II doesn't change the U.S. regulatory environment, first and foremost. So our ability to pull dividends and upstream cash out of the U.S. is driven by the U.S. statutory environment and not impacted by Solvency II.

I think where the group ratio is relevant, we get into the issue of how to then convert that framework into the overall group ratio and the view that the Dutch Central Bank will have as our lead supervisor on that U.S. position. And that's the source of the conversations we're having right now on how to do that calibration. So, I think that's the important takeaway points on that.

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

Yes. On the UK, maybe I'll say something. William, we've stated clearly that we are restructuring our UK business. We are taking our costs down. We are investing in our platform capability, which I'm pleased to see is actually well recognized right now. We still remain the fastest growing platform. We've also said we need to achieve some certain financial objectives, and cash flow generation is a very important one from it.

I guided last quarter that the £150 million to £200 million level was a challenging level because all the additional uncertainties, DWP, and now we have this issue about pension that effectively can be taken in the form of cash. So there's a lot of uncertainty there, but we're still very focused on trying to achieve that objective. And management in the UK is very focused to do so. So, it's way too early today to say that it's challenging. We are continuing to focus with that objective.

In terms of expenses in the U.S., I should say we have – I don't like to speak about good expenses and not good expenses. But the expense growth in U.S. mainly is driven by the growth of our business. So, we're putting more business. We have more sales people. We

obviously have to spend more to effectively administer the increased volumes. But we are growing our business much faster than we're growing our expenses. So, what we're doing in the U.S. is still looking at ways of reducing our expenses.

As you know, we not only invest in growth but we also are spending a lot of effort, people, but also some expenses in further digitizing our business in the U.S. And then, I think it's extremely important to be well positioned for the future. And so these, I would consider, really as being good expenses because they are very clearly linked to the growth of our business.

In terms of variable annuities, in terms of the numbers, Darryl, you've got them in the meantime?

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

Yes. I'll probably have to get - I'll have to get the IR team to follow up with you on specifically. I know that on the GMIB products, the one we talked about a lot the pre-2002 on that IB product balances are around €5 billion on that product. We also have older era. We have death benefit only products. Those are somewhere around €18 billion, I think, if I remember correctly. That fits within total portfolios running around \$65 billion. So hopefully, that gives you some perspective. Obviously, the vast majority are the GMWB products that we've been selling since 2003 forward, and that's obviously the product that's been performing well.

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

Just one brief follow up. And as the proportion of those sort of new-generation GMWB rises, will that continue to support the overall margin we see coming through quarter-on-quarter?

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

Yes, definitely. That's where the earnings growth - I think that's one of the earnings growth drivers from the U.S. Obviously, the U.S. has been driven by pension mutual funds, VA, and as well as the life protection business going forward. On that VA product, that's where the margins have been quite strong. We have had to react as interest rates move up and down. We will actually have to make some smaller changes to the product given where rates have gone just in the last two or three months. And so we expect to do that here shortly. But for the most part, the margins have been held up pretty well, I would say.

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

Thank you very much.

Operator

Thank you. We will now take our next question from Gordon Aitken from RBC. Please go ahead.

Q - Gordon Aitken {BIO 3846728 <GO>}

Thank you. Just some questions on the Dutch pensions market, please. First of all, could you just update us on the persistency on your existing block of Dutch DB schemes? And second, are you seeing margins increase as these schemes really have nowhere else to go? I know competition is increasing, but you still got a very relatively small number of providers offering DB in the Dutch market? And third, may I see your comment on potentially contracting buyout market in 2015? I'm just wondering would you offer buy-ins as is done in the UK? Thanks.

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

Yes. Let me take his question on the Dutch pension market. As you know, we are leader in the market, with close to 25% market share. Persistency actually has been very good, but I also would say that we are not in a position to decide what schemes we want to keep on and at what price. So we've seen a couple of schemes that we have not renewed, but that was because we were not able to renew them at the price we think is the right price to renew them. So with this leadership position, obviously, it allows us also to make sure that we maintain the good pricing.

Are margins increasing? I don't think margins are really increasing. As you know, there's only a few providers. Aegon remains absolutely committed to a very strict policy in terms of pricing. And we will continue to remain committed to that pricing discipline.

What we do see is indeed effectively that, as a result of the low interest rate, which as you understand, is not going to be very supportive of a lot of conversion, what you see is that we are seeing customer now moving more and more to other type of products which are more modern products in the forms of PPIs and administration only. And Aegon is uniquely positioned with our buyout capability, with our PPI capability, which we have at Aegon and at TKP. As you know, with TKP, we are the largest administer of pension funds right now in the Netherlands. And we also provide asset management services.

So we have a full range of different products and services within the entire pension universe, which allows us actually to move on different places at the same time. And that is exactly what we are trying to do now and we're doing that very successfully.

Q - Gordon Aitken {BIO 3846728 <GO>}

And just the last question on buy-ins?

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

No. We don't see a lot of that happening in the Netherlands yet. Keep in mind, the Netherlands has been quite a traditional pension market wherem, in the past, many companies, corporates have their own pension. What they're more looking at is now how can they meet the liabilities for the future, how can they satisfy also an increased regulatory demand. That is where the focus is right now.

Q - Gordon Aitken {BIO 3846728 <GO>}

It's just interesting in that the average solvency in the Dutch market is actually in the pension schemes is materially better than in the UK. And in the UK, that doesn't seem to be a problem, schemes which are slightly underfunded, offering them buy-ins on parts of their liability. Just wondering, I mean, is that a development that will happen in the Dutch market, you think?

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

Well, as you say yourself, the coverage ratios, although they have come down, they're still comfortable compared to what we see in other places. So, therefore, as long as you remain on top of - ahead of 100%, and they could seem to be actually benefiting a little bit from very good performance on equity markets which obviously has offset some of the negative impact from lower interest rates, that's where we see the focus right now.

Q - Gordon Aitken {BIO 3846728 <GO>}

Great. Thank you.

Operator

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

Q - Nick Holmes {BIO 3387435 <GO>}

Oh. Hi there. Thank you very much for taking my questions. Two questions. First is, just wondered, are you still intending to neutralize the dilutive effect of the pref share transaction this year? I think you've indicated in the past that you would like to do it this year. I just wondered what sort of timing you might envisage if this year is still appropriate or whether you're thinking of putting it out further.

And then also wanted to come back on Solvency II. Apologies about this. But just wondered if you could remind us of the sensitivity to your 150% to 200% range, if for example you were to change the 200% company action limit that is the basis of your current calculation to, let's say, 250%, what sort of effect - I think you've given us this before, but I wonder if you could just remind us again. Thank you very much.

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

Yes. On the sensitivity, we'll come back in a second to make sure we have - because it's the same one we've given you earlier.

On the prefs, Nick, what I can say is what I've said last time. We are indeed committed to neutralize that effect on pref shares. But I also said clearly that we need clarity on Solvency II and Solvency II outcome, and I don't expect that we get much clarity about Solvency II before the second half of the year. So, only thereafter will we consider executing on our commitment to neutralize that effect.

Q - Nick Holmes {BIO 3387435 <GO>}

Okay. That seems very reasonable. Yes.

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

In terms of the Solvency II number, Darryl or Willem?

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

Nick, I might have to have the guys follow up with you specifically on what I said, so I'm going from memory on this.

Q - Nick Holmes {BIO 3387435 <GO>}

Yes, yes.

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

But I think it was 10 points to 20 points on the group ratio for a change from 200 to 250, if I remember.

Q - Nick Holmes {BIO 3387435 <GO>}

Okay, okay.

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

Willem has reminded me, it's 15 points, so I think my 10 points to 20 points was a pretty good guess.

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

Yes.

Q - Nick Holmes {BIO 3387435 <GO>}

Okay. That's great. Thank you very much.

Operator

Thank you. We will now take our next question from William Hawkins from KBW. Please go ahead.

Q - William Hawkins {BIO 1822411 <GO>}

Hello. Could you give us a bit more color on what you're thinking about the net inflows onto your UK platform, please? The figure has been quite stable over the past few quarters and we all know about the regulatory uncertainty. But when and at what rate do you expect that aggregate figure to start to pick up?

And then within that figure, I think, correct me if I'm wrong, you've been kind of disappointed this year. Though the good news is you've had a lot of money coming in

from new customers, but the conversion from the back book hasn't been as high as you've anticipated. Could you maybe give us a guide for where we were in the fourth quarter relative to the previous nine months? Has there been any improvement in that? And again, allowing for the regulatory uncertainty, how you think that mix may change this year? Thank you.

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

William, I'll take that question. On the platform, as you indeed point out, we were pleased to see that the biggest part of our customers are new customers. We've also said that we are looking ways of upgrading existing customers from our back book that would be much better served on a platform, and also it would allow these customers to consolidate assets.

As you know, really the game on the platform is not so much to move a customer from one platform to another one, but really the objective here is to move him from the old business and - well, we have not really given him a lot of attention to this platform knowing that that customer has assets in different places. And what the good news is that we see that significant part of customers that indeed go to the platform do consolidate the assets from different areas. In many cases, they bring up similar amount from different places.

Now, how that is going to continue this year and what the trend will be is difficult to say. As you know, we have a couple of issues on the whole pension area. You are well aware of it. But also on the individual pension area with the changes, the government now effectively allowing people that are age 55 or plus just to take their pension out, will bring in a new dynamic. So, I think it's too early now for us to say how we see the trend continuing.

But what I see is that our platform is not only recognized by our new customers but also more and more by existing customers who use it as a tool to consolidate assets. And, yes, margins are lower on the platform. But it is clearly our objective to more than offset that by increasing the volumes because of the consolidation of the customers. And we expect that in this quarter going forward to second quarter, we will be able to effectively upgrade a significant amount of targeted customers from the kind of back book environment to which we are in to this platform. But still, it's too early now to say how that trend will continue for the rest of the year. Hope this helps.

Q - William Hawkins {BIO 1822411 <GO>}

Thank you.

Operator

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

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

FINAL

Hello, guys. Good morning. Can you just sort of give us some indication in terms of the U.S. sales, in terms of the VA product changes you've made and in terms of the universal life secondary guarantee product that you've pulled. Can you indicate what kind of impression this has on future sales going forwards and what you're doing to offset this impact?

And also, following up from a previous question on the sensitivity to the reinvestment rate. I just wanted to clarify that the minus \$10 million per quarter that you had in the last results presentation threw an impact for 2014 versus 2013. Now that's been rolled forward to 2015 versus 2014. Does that mean it's a minus \$20-million impact on 2015 versus 2013? I hope that makes sense.

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

On the sales, as we said, we are really looking at our products, not only in terms of do they make sense for Aegon, do we meet our hurdle rate, but also if do they make sense for our customers. And where we have come to the conclusion with the universal life secondary guarantee is that this product at this rate with this volatility do not make any sense for customers anymore, neither do they make really sense for Aegon. That's the reason why we've decided to pull it.

Just to give you an indication, it was around €95 million, 15% of last year's sales. So what we expect is that we will see some of that sales effectively being redirected to other products, which we believe make more sense to our customers and should allow our customers to achieve very similar objective. A good example is the index-linked universal life product, which, as you know, we've been actually quite successful in promoting. So, on the longer term, maybe the first quarter, we will see a clear drop in sales because it just takes a bit of time to get your new product.

Our sales organization, our wholesalers and our brokers are acquainted with this product. But the reality is that what you see in this market is that also the distribution, they also need to be able to sell something. And that's why they will be looking at alternatives, and we believe we have good alternatives for our customers. But we're really very committed not to sell the product where we just do not think it makes sense for both the customer and ourselves. So you will see, clearly, an impact, an immediate impact. But I expect this actually to be recovered very quickly by products, which are different products.

Now on the reinvestment yield, I think I can confirm that your understanding is correct. But Darryl?

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

Yes. I think your math is right on that. What we're basically saying is that the 2014 earnings already included a headwind due to rates staying low relative to 2013 of €10 million. By sliding the guidance forward, what we're saying is, if rates stay here, 2015 will be another €10 million relative to 2014. I think, in that regard, the €20 million that you came up with is accurate. And that is a little heavier than what the €15 million was that would have been a year ago when we gave that guidance. So, that's maybe even also related to the question

that Farquhar asked earlier, and that's basically because rates have not only trended low but trended even lower.

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

Okay. That's perfect. Thank you.

Operator

Thank you. As there's no further questions in the queue, that will conclude today's question-and-answer session. I would now like to turn the call back over to you, Willem. Please go ahead.

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

Yes. I just would like to say thank you to everybody. Thank you to both sell side and the media. Thank you for your continued interest in Aegon. 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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