

Q3 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

- Ashik Musaddi, Analyst
- Farooq Hanif, Analyst
- Farquhar C. Murray, Analyst
- Gordon Aitken, Analyst
- Jan Willem Knoll, Analyst
- Mark David Cathcart, Analyst
- Nadine A. van der Meulen, Sales Associate
- 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 Q3 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>}

Good morning, everyone, and thank you for joining this conference call on Aegon's third quarter 2015 results. As always, we will keep today's presentation short, leaving plenty of time to address your questions. We would appreciate it if you take a moment to review our disclaimer on forward-looking statements, which is at the back of this presentation.

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

Alexander Rijn Wynaendts {BIO 1821092 <GO>}

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Good morning, everyone, and thank you for your continued interest in Aegon. Let me begin by providing you with a brief overview of the key developments of the third quarter.

Our earnings were impacted by assumption changes, which I will address in more detail shortly. An important step in executing on our strategy to optimize our portfolio was closing the sale of our low-returning business in Canada. This is the main driver behind the net loss this quarter. At the same time, we continued to generate solid cash flows while maintaining a high level of profitable sales.

I'll now turn to slide 3, which gives you a breakdown on the different elements of our earnings in Q3. Underlying earnings before tax on a comparable basis were up by 4% to €436 million. In the U.S., favorable currency movements and positive mortality experience were partly offset by the impact of divestments, by the reduction in fixed annuity earnings and by lower run rate earnings due to assumption changes and model updates. Our businesses in the Netherlands, UK and new markets performed well and in line with our expectations. As you are aware, we review our actuarial and economic assumptions annually in this third quarter.

This year, our review of actuarial assumptions led to a charge of €96 million in underlying earnings. While economic assumption changes led to a benefit of €101 million in fair value items. Excluding actuarial assumption changes, our third quarter earnings were €532 million and our return on equity, 8.1%. This is below our 2015 target and we will update you at our Investor Day in early January on the steps we are taking and will be taking to further improve our returns. Other charges of €950 million relate to the anticipated €750 million book loss on the disposal of Canada and model updates.

Let's go to slide 4, where we will look at assumption changes and model updates in greater detail. These changes and updates impacted our result in three ways. The first item of €96 million in underlying earnings relates to our actuarial assumption changes. This amount is split between our Life & Protection and annuity businesses.

In Life & Protection, we further reduced our lapse assumptions on the closed long-term care book which led to a charge of €17 million. In fixed annuities, the successful reduction in balances, which is a result from the strategic repositioning of our business, led to an increase in our unit expense assumption and this explains the majority of the €79 million charges in Investments & Retirement.

The second item is a gain of around €100 million in fair value items related to economic assumption updates. This is the result of adjustments to the discount rate on a variable annuity liabilities by taking into account the differences between the treasury and swap curves to better match our hedge programs.

And the third item is the loss and other charges as a result of model refinements. As I'm sure you're well aware, we have been putting significant focus on our work to review and enhance all our models. The charge this quarter mainly related to enhanced modeling in universal life business.

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We're not only reviewing and enhancing our models, but at the same time, we have strengthened our processes and improved our governance around our models. And as a result, we are now in a stronger position. In addition to the onetime impacts, these three items will have a recurring negative impact on underlying earnings before tax of approximately €20 million to €25 million per quarter.

Let me now turn to capital on slide 5. As you can see, our group IGD ratio increased significantly this quarter from 206% to 225%, a reflection of the strong increase in the Solvency I ratio in the Netherlands, the benefits from divestments, and the effect of onetime adjustments. The increase in the Dutch capital ratio is mainly the result of the higher valuation of mortgages in the general account as spreads tightened.

Our U.S. excess capital position was impacted by the assumption changes, by model updates, and hedging losses, but remains healthy at \$600 million over the S&P AA level.

Holding excess capital increased to €1.8 billion, while our gross financial leverage ratio rose to 28.8%. Both of these were impacted by the divestment of our Canadian business. We have made good progress in preparing for Solvency II. This gives us confidence that we are well-positioned to operate successfully in this new regulatory framework, and we look forward to updating you on our Solvency II position at our Investor Day in January.

Moving to slide 6. This quarter we once again generated strong sales in our deposit businesses which drove overall sales up 12%. We are very pleased that our asset management, our U.S. retirement plan and Dutch bank businesses all performed well, attracting new customers while retaining existing ones through our user-friendly platforms, wide range of products, and excellent customer service.

As a result, gross deposits increased to over €19 billion for the quarter, while net deposits remained strong at over €4 billion. We did, however, see a decrease in life and accident & health sales this quarter. In life, this was mainly a reflection of the large pension buyout that took place in the Netherlands last year and the divestment of our Canadian business. Excluding this buyout, life sales remained relatively stable.

In accident & health, sales were down compared with last year as the effect of a stronger U.S. dollar was more than offset by fewer portfolio acquisitions in the U.S.

Let's now focus on our U.S. retirement business on slide 7. Also here, I'm very pleased that we've been able to strengthen our position in the U.S. retirement sector, which is one of our key growth areas through the acquisition of Mercer's pension administration business. This latest strategic development demonstrates how we are further growing and diversifying our customer base together while expanding our attractive offering of fee-based retirement solutions. As a result of the Mercer transaction, Transamerica is now Mercer's preferred defined contribution retirement plan provider.

Pension assets under administration, as well as the number of retirement plan participants, will both increase substantially. Indeed, by servicing close to 5 million participants, we are now one of the top five retirement providers in the U.S., which is the

largest pension market in the world. The acquisition provides us with additional skill that will help us build on a strong performance of our U.S. retirement business as evidenced by the profitable growth in recent years.

Before wrapping up, I would like to update you on one other recent significant development for the company, the designation of Aegon as a globally systemically important insurer. As many of you will have read in the last week's press release, we will work closely with our regulators to comply with the G-SII framework. We currently do not expect the capital requirements to be binding constraints for us.

Now to conclude, while this was a challenging quarter from an earnings perspective, it was also one in which we made a series of significant steps in the execution of our strategy. Our management team, Darryl and I, look forward to seeing you in person at our Investor Day in January where we will provide you with an update on our business strategy, on our capital framework on the Solvency II, and how our businesses will execute on our plans to further improve our returns.

Thanks again for your time this morning. Darryl and I are now happy to take any questions you may have. Thank you.

Q&A

Operator

Thank you, sir. For this first question-and-answer session, we will invite analyst and investor to ask your question. We will pause for just a moment to allow everyone to signal.

We will now take our first question from Farooq Hanif from Citigroup. Please go ahead. Your line is open.

Q - Farooq Hanif {BIO 4780978 <GO>}

Hi, everybody. Thank you very much. Firstly, can I ask about further risk to fixed annuity unit costs as that book runs down? Secondly, is there not a risk now to U.S. cash flow given that we're seeing this ever-decreasing level of surplus capital in the U.S.?

And lastly, what is driving the reduction in the U.S. VA sales? I mean, it was down 2Q on 1Q and also now down 3Q on 2Q. So what's going on? Is this some sort of pre-DOL related concern? I mean, can you run through that? Thank you.

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

Yeah. Hi, Farooq. It's Darryl. Let me jump in on some of those questions. On the fixed annuities, yeah, we think we've taken what we need to basically continue to run the book down. So, obviously, there's been some pressure on unit costs as the book continues to drive its way down. We have taken costs out of that business as well to fit within the new

projection, if you will, and combining the run-off for that business with our existing annuity business in the U.S. So I don't see a further degradation coming from that going forward.

Your second question was on U.S. cash flows. There is an impact on U.S. operating free cash flows coming from the model and assumption updates. It's around similar size to the number that we're talking about on the IFRS side. So somewhere in that \$20 million to \$25 million range. So, I do see the U.S. cash flow is coming down for that, but I don't see any further reduction in that. So, I still think the U.S. cash flow projections will still continue to be fairly robust

On the VA sales...

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

Yeah. Let me say here, Farooq, that we're still one of, as you know, top 10 providers in the U.S., which very much fits in our strategy to sell products that make sense for both our customers and ourselves. With interest rates, where they have been, we have taken actions to ensure that we maintain profitability, and that really is our focus.

In relation to DOL, we, at this point in time, do not see any change in sales pattern. As you know, on DOL, they have now indicated the final rule to address many of the thousands of comments that they received. We expect that the DOL proposal will now come only to us back in the middle of next year. But what I think here is, and I'd like to say here, is that I strongly believe that we have the track record of being able to adjust our product offering, our product design and also sales and marketing practices in order to reflect what the new regulation will be. And we've shown that flexibility and we expect that to be able with that flexibility, we'll remain very strongly positioned in a market that is providing products that millions of customers in the U.S. continue to need.

Q - Farooq Hanif {BIO 4780978 <GO>}

Thank you very much. Can I just come back quickly on the U.S. cash flow, would you encourage us to adjust our forecast for the upstream from the U.S.?

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

Are you talking in the near term, Farooq, or?

Q - Farooq Hanif {BIO 4780978 <GO>}

Yeah. In the near term? I mean, I know you're looking to mitigate. But I mean, of course, you can't encourage us to change our forecasting. But would you say that it's something that's sensible given underlying cash flow is going to be lower?

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

No. Well, on the U.S. capital position, I mean, we are still very much at the top end of our excess capital range in the U.S. So, we're \$600 million over and above our AA thresholds in the U.S. So, the capital ratios are very strong in the U.S. We're not disclosing our RBC

ratios on a quarterly basis but they still remain in the neighborhood of 500%. So capital ratios are strong and I expect the dividends to continue to flow in upstream from the U.S. according to our plans.

Q - Farooq Hanif {BIO 4780978 <GO>}

Thank you very much. Thank you.

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

Yep.

Operator

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

Q - Ashik Musaddi {BIO 15847584 <GO>}

Yes. Hi. Good morning, Alex. Good morning, Darryl. Just a few questions. First of all, can you just give us a bit more update on these model updates? I mean, what I'm trying to understand here is, is this an acceleration process you are doing ahead of your Investor Day? Or is it like business as usual, i.e., there is many more model updates we should expect going forward as well because clearly this has been a phenomena of your results for quite a few quarters now?

For example, again, this quarter you were expecting a big model update change or assumption change on mortality, whereas, it was fixed annuities related this time. So, how should we think about that? That's the first one.

Secondly is given that your capital has gone up quite a lot, IGD 206% to 225%, is it sensible to read across that your Solvency II position must have improved as well on the back of that? And - but do you really see any risk of capital raising because the market is clearly worried about your capital position? So, that's the second one.

And thirdly is related to that, is your Dutch capital has improved materially to 250% Solvency I, which I would assume, say, give or take around 160%, 170% Solvency II, I mean, how should we think about cash flows from Netherlands because I think this has been an issue in the past that you are not really expecting to extract cash out of Netherlands? But do you think that the Dutch business is in a good shape to start extracting cash or do you think it's just too early to talk about that? Thank you.

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

Yeah. Hi, Ashik. It's Darryl. Well, first of all, let me try to hit those in order. On the model updates, I would say we're not in business as usual but we are certainly transitioning to that. So, we've had a very - as we talked about last year, a very intensive review program underway across the organization to independently validate, review, and subject all of our

models to just a new higher level of standard of governance going forward. So, that is a blitz program that we've been putting in place.

We're two years into that program. We have moved on to the - more the medium-sized models in the organization and we do see pluses and minuses coming out of that activity. But the one area where we've taken charges here relates really to our universal life business in the U.S., and this is just continued remediation from some of the issues we've found last year. But the core issue on the universal life is that modeling by nature is simplifying down your policy set to be able to work within the technology that you have to do that to the modeling.

And what we're finding is that that simplifying process was too simple for some of the complex guarantees in universal life, which in particular have become more valuable in the low interest rate environment. So, we have done a lot of work with new models and new technology to get to a more granular level of universal life modeling, which is showing some losses on those complex guarantees.

You'll note that that's where some of our experiences has been poor throughout the years. It's always been centered on that universal life business. So, I think we're doing what we can to get on top of that issue and get that right to the forefront. We're certainly transitioning into as we get on to the smaller models into a BAU environment, but the last two years have not been business as usual because of that program.

Q - Ashik Musaddi {BIO 15847584 <GO>}

Yeah. Just a follow-up on that before we're going to the other question. Just a follow-up that. I mean, should we be expecting a bit more update on this at your Investor Day as to what are your plans in coming quarters in respect to model updates because this has been one of the biggest noise that we are seeing in the results for quite some quarter? Or is it worth saying that, yeah, these things will more or less end? I mean, I'm not talking about small model update, that's fine but because that's a part and parcel of a life company, but is it fair to say that once you are done with your strategy update, probably these things will not reoccur after that?

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

Yeah. Certainly, we will talk about it in January and Marc and Michiel (19:26) will be there as well and can talk about what the U.S. is doing on that front. The irony areas that we acknowledged that some of the modeling surprises that we've had over the years, which is why we've entered into this program. So these aren't falling on us. I mean, we are going through with the whole in-depth deep dive across our entire modeling environment for the organization. It's ambitious but we're doing that with the sole objective of taking down surprises going forward.

But unfortunately, that means we have to live with and deal with the findings that we have when we have them. And right now, it's primarily in the universal life, I would say, the complexity of the modeling in the U.S. So, we will address that further in January when the U.S. team is there.

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Your second question was on the strong IGD results. Is there a read-through to Solvency II? Yeah. That's fair. It's not one-for-one. But some of the – particularly in the Netherlands with the stronger performance on the mortgage valuation, that will cut across and go in to Solvency II. And there's other pluses and minuses on that. So, there does tend to be some read-through on some of the components. But I would say, it's not one-for-one and not all of them but directionally, for sure.

And then on the Netherlands, specific, you asked on the strength of the IGD ratio. Yeah. So, obviously, we're still focused on completing the IMAP approval process for Solvency II. We're really not providing an update to any of our ranges at this point. They still have all the same unknowns. We haven't received our internal model approval yet, but I would say that the tone and conversations are going well. So, I expect to hear in December on that.

And then, as we've said many times, we really won't make a decision on dividends related to the Netherlands business until we have that final answer. Maybe the only other caveat I would add to that is taxes still remains very much an issue, an open issue for the industry in the Netherlands. And we're waiting for Dutch Central feedback, Dutch Central Bank feedback on the modeling of taxes and that's still very much an open item.

Q - Ashik Musaddi {BIO 15847584 <GO>}

Yeah. And just a follow-up on that second point. In last quarter if I remember correctly, you did mention that you still have a lot levers to be pulled and not thinking of a capital raising. Would you stick with that argument at this point, as well?

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

Yeah. I mean, I think our – we're still solidly within the group ratio range that we gave before, and we think that that's a solid range, and I don't see the need for any capital raising in that regard.

Q - Ashik Musaddi {BIO 15847584 <GO>}

Yeah. Thank you. That's very clear.

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

Okay.

Operator

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

Q - William Hawkins {BIO 1822411 <GO>}

Hello. Thanks, guys. First of all, can you just give a bit more clarity on what's driven the impact on earnings that you've guided to? You've mentioned a lot of different things that have hit the 3Q. When you're talking about the €20 million to €25 million recurring, what more exactly is driving that?

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And then just more philosophically, I don't really understand accounting but the whole point of taking charges is to reduce the drag on future earnings. So, how come we've got a charge from assumption changes and the drag on future earnings? If you could just educate me on that.

And then secondly very briefly. Alex, you deliberately mentioned that figure of €532 million of profits for the 3Q if we add back the €96 million charge. Are you suggesting that that is a level that we can annualize, so that's a sort of a clean figure? And if not, can you just remind me apart from the €96 million you've adjusted, what would be another material thing I should be thinking about if can't annualize that €530 million? Thank you.

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

William, let me take the first one. On the underlying earnings guidance, it's about \$25 million that fits into €20 million to €25 million range that we talked about. That would come off the U.S. life numbers. That's where that's coming from. A lot of that comes back down to the universal life issues that I mentioned before. Specifically, your question why is there a running cost and an upfront, that's the nature of the accounting. A lot of times, these are really coming down to forward DAC projections and reserve calculations. And there's always an upfront component which represents sort of the history brought forward. And then, there's a going-forward component which is either reserved, billed, or a DAC amortizing trajectory that's impacted as well.

So, that's very common that – as accounting that when you have a deterioration in the cash flow projections, there is an upfront component and a running component.

Q - William Hawkins {BIO 1822411 <GO>}

So you've matched \$25 million with the €209 million model charge?

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

Yeah. They're largely related to the same issues, yeah

Q - William Hawkins {BIO 1822411 <GO>}

Thanks.

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

That's a real...

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

In the U.S. life would be where it would show up geographically. And then, Alex?

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

Yeah. William, I can confirm what you are saying and also confirm that the impact that we've mentioned on the run rate from these assumption changes is included in the Q3

numbers. And therefore, the number corrected for the - that's corrected for the €96 million should be a good indicator. But I'd also like to repeat here what I said earlier, this means that we are below our target that gets us to 8.1% return on equity.

We've been very clear and I want to repeat it here that this is below our target. And we will update you in January on the steps we're taking in our businesses to further improve our returns. I would not like to elaborate more here. I would like to do that in person and give you the broader context, and you'll also be able to see management who are going to be executing on these steps which we'll be taking.

Q - William Hawkins {BIO 1822411 <GO>}

That's excellent. Very clear. Thank you.

Operator

Thank you. We will now take our next question from Jan Willem Knoll from ABN AMRO. Please go ahead. Your line is open. Please go ahead, Jan, and please make sure your phone is not on mute. We're unable to hear you.

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

Can you hear me now?

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

Yes.

Operator

Yes, we can.

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

Oh, excellent. Thank you. Thanks for taking my questions. On the Dutch markets revaluation was obviously a quite large number. Can you quantify the impact, Darryl, on the Dutch IGD ratio and what the impact was of the order market movements?

And can you also indicate how much organic capital generation there was ex the market impacts and how much are added to the Dutch IGD ratio? And given the strong jump in the Dutch IGD ratio, can we expect sort of a similar movement in the Dutch Solvency II ratio? That will be helpful.

And just on the drop in the U.S. excess capital, you mentioned it won't impact the capacity of U.S. operations in terms of upstreaming dividends? But you mentioned one of the drivers has been a negative impact of the hedging adjustments. Can you explain a little bit more what you did, what sort of hedging adjustments were you talking about here? And can we expect more of these adjustments to your current hedging programs? Thanks.

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

Hi, Jan. Jan Willem. I would say, yeah, on the mortgage adjustment, what we saw was - roughly speaking, we saw about a 50-basis-point reduction in the spreads, maybe a little bit less than that. That would be translated to about a €400 million, €450 million impact on the Dutch capital position and under the IGD ratio. So that's putting it in terms of - in euros.

In particular, on your U.S. question on hedges - and what we saw on the U.S. hedging program, it was also in part related to the model and assumption updates where we really when we completed the quarter, what would happen, and what it showed us in retrospect, is that we were under-hedged for the quarter because of the new projections of the liabilities under the new assumptions.

And that was in a market where S&P returns were down 8% on the quarter. So what it had, it showed us was some ineffectiveness on the hedging because of the changes to the liability projections throughout the quarter in combination with the down market.

Obviously, those two things worked together to produce some additional losses inside the hedge programs than what we would normally expect going forward. That's all been tried up going forward and we wouldn't expect that kind of volatility.

In addition, there were some basis losses inside the hedge program, too, as well. So, net-net, I would say there was two or three different things that happened inside the U.S. VA hedge program. It all went in the same direction and produced negative results and we expect that to be a lot tighter going forward.

I apologize. I missed your second question, which I think was also related to the Netherlands situation.

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

Yes. Just on the big jump you saw in the Dutch IGD ratio. I assume that we can see a similar impact, a similar improvement at least, in the Dutch Solvency II ratio. I would just wonder whether you could shed some light on that.

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

Yeah. And related to the mortgage valuation, that's absolutely true. That carries across - obviously, that's some volatility in both current IGD ratios, and we'll have some volatility in the Solvency II ratio that we have to be cognizant of and aware of, but that does read across and read through. There is another component, this quarter we were able to - because of what we've been able to accomplish on the Opti side, we were able to release a restriction on our Solvency I IGD ratio. That's also improving the ratio this quarter but that would not have a read-through into our Solvency II because of a different treatment on the Solvency II basis. So some reads across and some does not.

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

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Okay. Fair enough. Thanks.

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

Yeah.

Operator

Thank you. We will now take our next question from William Elderkin from Goldman Sachs. Please go ahead. Your line is open.

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

Thank you, and good morning, everyone. A couple of questions. Just firstly on the Dutch Solvency II ratios – the range you indicated with the second quarter results. From your commentary, can I take it that that range remains robust and a good guide to where you expect to end up?

Second, I think you mentioned you expect to get the answer back from the Dutch regulator in December. Will you be sort of letting the market know the outcome of that process in December or will we have to wait for January?

And then lastly, if I remember correctly from the second quarter conference call. I think, Alex, you were, seem to me, fairly optimistic in terms of Aegon's ability to return capital to shareholders once the Solvency II modeling process is complete. Are you still bullish that that was a fair description given what you know now? And I think that will do for the moment. Thank you.

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

Hey, William. Let me take the first two. On the NL Solvency II ratio, we're not going to update ranges at this point. And we are going to save that for January 13. And the primary reason being, even though the conversations and the tone and everything is going well on the IMAP approval, we don't have the approval yet, so I just want to be cautious on that. I do expect it sometime in December. So, I think we will hold off until January to make any formal announcement on that because I don't exactly know when in December we'll get it. So, that's the answer to your second question. And then on...

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

Just on that, what I was getting at is the 125% to 150% you indicated, is that bandwidth still good?

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

Yeah.

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

I know there's nuance within it, but just the bandwidth.

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

I think the difficulty and I think intentionally, because we're really in no different space in terms of formal answers, we're not going to formally change the range. There is some - as I mentioned before, there is some read across from the mortgage valuation, which will come forward into the Netherlands numbers and improve those. And the conversations, as I said on the IMAP, are going well. So, I would say, officially, we're not going to change the range. But the tone is in the right direction, and we're headed to the right, I would say, the right side. On - yes.

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

On the return of capital, William, I'm certainly reiterating our commitment to returning capitals to shareholders, in particular, in relation to the transaction around the Association Aegon, the €400 million. Obviously, I've said that we want to have clarity first, and we will need to have clarity first but I remain committed to returning that capital.

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

Great. Thank you.

Operator

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

Q - Gordon Aitken {BIO 3846728 <GO>}

Thank you. Morning, gents. Just a quick one on the - back to this €20 million to €25 million charge. I mean, Darryl, you said this comment of an assumption change and an ongoing drag. I mean, is that common in the U.S. because it's not common in Europe? So, can you just explain that?

Second question is on the acquired Mercer's pensions administration business. So, you acquired \$71 billion of assets. What's the average revenue charge on those assets? And if you can just tell us a bit more about why Mercer was happy to get out of that business and are there other potential consultants who are new, big in administration who also want to get out?

And the final question is on the Dutch sales, and they're obviously down a bit, quite a bit. I mean, you explained the exception on the bulk last year. Just wondering what percentage of your DB schemes are up for renewal in the third quarter and if you can say what percentage of those decided to stay with you and which decided to leave. Thank you.

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

Okay. Yeah, let me take the first one. Yeah, it is a little bit more common on U.S. GAAP accounting, which is the basis that was still on the insurance accounting we use inside IFRS to have - that's the way the U.S. DAC unlocking and SOP reserves work under U.S. GAAP,

which forms the IFRS basis for our U.S. business to have an upfront and a running component.

It is a little bit different. I do understand in Europe, in particular, for instance in our UK annuity business works differently where you don't have the running component. You have a loss recognition if and when your DAC is not recoverable. So, there is a fundamental difference between core U.S. GAAP and some of the traditional European GAAP measures. On...

The Mercer transaction, again, let me say again, that we are really very pleased that we have been able to conclude with Mercer this transaction. Let me give you a little bit of a background there.

First of all, I think it's important to recognize that this business is a scale business. And I think this gives you the answer to why Mercer was actually looking for a solution to their business. The \$70 billion that they have in assets add well to ours, so we have now over €210 billion of assets. What it also brings us is the capability in the big schemes. As you know, Transamerica was very much focused on smaller- and medium-sized schemes, which by the way in the U.S. are already quite big schemes. But, now, with the capabilities that Mercer is bringing, we also have a presence in the big schemes.

It's a scale business. It's because we see revenue obviously under pressure, but where we see the big opportunity, and that's why we talk about the number of plan participants is that we know that each of these plan participants at a certain point in time will retire. Each of them will need advice, they will need guidance, and they also will need products to be able to retire.

And that is really the equation, and the way we're looking at the equation is not only about the assets we're getting on the book. Now, it's the million plan participants that we are now going to have a nice system that we're going to be able to service at the time they retire. We're not disclosing specifically revenues or more financials. But it really is a question of expanding the scale, the breadth of our business.

Now, in the Netherlands, you're right to point out to the big sale, we had this bulk annuity with the Dutch miners or the former miners I should say because all of them have retired for quite some time and that distorts the comparison between this quarter and last quarter. And in terms of conversion, it's a bit early to say this because a lot of the conversions actually taking place in the fourth quarter and, therefore, only at the end of the fourth quarter we will have a better view about conversion.

But what I can say is that we are looking in conversion not only in terms of maintaining a similar contract, but also we see a lot of DB schemes moving to DC schemes. We're using our PPIs. Number schemes also are moving towards an investment-only solution. So, the conversion is not keeping the scheme in place, though, it is offering our customers the best solutions right now, particularly taking into account the very low interest rates. And we maintain, as you know, a significant market share in this part of the business with close to 25% market share.

Q - Gordon Aitken {BIO 3846728 <GO>}

Great. Thank you.

Operator

Thank you. We will now take our next question from Mark Cathcart from Jefferies. Please go ahead. Your line is open.

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

Yeah, I've got a couple of questions. Darryl, you mentioned that you've been driving the company towards a high level of governance and now that you're a G-SIFI company, do you think at all that your governance - wider governance needs modernizing and I'm talking about the foundation that's there to protect the interest of the employees, the shareholders, and the policyholders.

I understand and correct me if I'm wrong that 16 of the 17 on the board are Dutch, and one is Canadian, and I noticed that you sold your Canadian business last year. So, I'm just wondering, do you think the composition of the foundation is appropriate now for a global G-SIFI company?

And the second question is obviously a year ago at Q2, we were told there were going to be Q3 charges but there was going to be no drag on earnings going forward, but there was a drag on earnings going forward. We were told at the beginning of this year that it was really lower level staff that was going to be impacting the profitability in terms of modeling changes, but the modeling changes that was high if not higher I believe than they were a year ago. In addition to which, you've now got this drag of €100 million. So, I would suggest that management have got a very low visibility on the future earnings potential of that company, and I'm just wondering where this responsibility within your group lie? Is it with the Chief Risk Officer? And I noticed that the Chief Risk Officer has held that role since 2003.

And the third question is in relation to your cheerfulness that your return on equity would be over 8% without these exceptionals, but how can we possibly trust that we will ever get to over 8% if the underlying underlying always comes through 30% to 40% lower in terms of the net income? So, those are my questions. Thanks.

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

Mark, let me start by answering a number of your questions in relation to the Aegon Association. It's not a foundation. It's an association. Just to remind you the context, the Aegon Association was established when two companies merged, a stock company and a mutual company in 1983, and the interest of the mutual company were transferred in the association.

The Aegon Association is a legitimate shareholder like any other shareholder, owns around 15% of the economic rights. And it's a shareholder where according to the Articles of Association, which are public, they need to look after the interest of all stakeholders

related to Aegon; that means our customers, that means our shareholders, and that means our employees.

Now, in terms of the questions on responsibility around earnings...

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

Yeah. So sorry, just going back to those, but why are all the members Dutch when it's a global company now? Why can't you enlarge the remit if you can actually sit on the board? Why is it people in the Dutch legal profession because this could effectively be a blocking shareholder? And I'm just wondering if you really believe that's the best corporate governance for the group as a G-SIFI company.

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

Mark, as I explained...

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

Your policyholders are global and not Dutch.

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

As I explained, the association comes from the merger of two Dutch entities in 1983. A mutual Dutch entity, AGO, and a Dutch entity called Ennia, together. It's not surprising that if they came from a merged - from two Dutch entities here in Holland, (40:53) of the board members that are Dutch.

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

Yeah. But you've evolved into a global company. Your company was predominantly Dutch back in 1983.

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

Again, the association has clear Articles of Association. As I said, they have to look after the interest of all stakeholders and they are looking after the interest of all stakeholders.

Now, in terms of future earnings, clearly we are disappointed that we're seeing a drag on earnings from model changes, from assumption changes. I think it's important that you recognize, as Darryl has said, that most of the impact is coming from our universal life business. That's a book of business that has been put in place for quite some - has been in place for quite some time. A lot of them has been acquired at the end of the 1990s, early 2000. And today, what we're doing is to try to ensure that we have models and assumptions that we are effectively aligning as close as possible with the reality. And it's our collective responsibility and probably I am the first one responsible for ensuring that we have good models, that we are transparent about how we deal with our models. But also, that we ensure that our long-term assumptions are as close as possible to reality. That is really our responsibility, and we're sticking to that responsibility.

And that's why you see also that it does lead to some changes. And obviously, we would like to - would have preferred not to have these changes. Let me repeat to you again, in January 13, so you don't need to be very patient anymore, you will hear from us very clear plans as what we will be doing to further enhance our returns. I hope this helps.

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

Yeah. Yeah. Thank you.

Operator

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

Q - Nick Holmes {BIO 3387435 <GO>}

Oh, hi there. Thank you very much. Yes, I had a couple of questions on Solvency II. The first is, can you tell us what you think of (43:04) new guidance on the U.S. equivalents? They're saying 150% RBC coverage, which one of your competitors is using. And I just wondered have you asked the DNB to revisit their decision to increase your ratio from 200% to 250% in the light of this guidance?

And then the second question is coming back on your capital plans, once you have Solvency II in place. I wondered could you tell us - I mean, if you are at the bottom end of the range, say at 140%, what are the implications can you share with us at the moment do you think for dividend for the share buyback through the association? I think William asked that question about the share buyback. I mean, is that something that you think you would still be committed to even if your ratio on January 13 is below end of your guidance range? Thanks very much.

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

Yeah. Nick, this is Darryl. On the Solvency II, on the question on 150% calibration, the answer is no. We have not gone back. The 250% calibration is set and that's in the agreement that we have with the Dutch Central Bank. I'm well aware that others are using a lower number. In fact, actually, I think the one you're talking about will be increasing to get to the 150% level.

It shows a little bit of where the Dutch Central Bank has wanted to calibrate our capital ranges back into. I think it also shows that some of the rigor and discipline that we put through on the European side as well in that - when we look at those ranges and we look at that 140% to 170% group range that we put out there, we think that that's a very tolerable and acceptable range to pay dividends, manage capital, and operate the company. So, I think it's a little bit of level setting in terms of what is an acceptable outcome, and the acceptable outcome itself is a function of how much rigor went underneath the calculations in the first place.

So, I'm a little cautious. I'm not going to talk a lot about the capital plans and what if this and what if that on dividends. That's what January 13 is for. And in part, because as we

finish up the Solvency II calculations, I will be having several conversations with the Dutch Central Bank around the outcomes and what that means for our capital plans and dividend policy. So, those are still, I would say, dialogues in motion, which is why we scheduled January 13 for when we did.

Q - Nick Holmes {BIO 3387435 <GO>}

Okay. So, just a quick follow-up. I mean, you say that the 140% to 170% range is a robust level. I mean, in broad principle, would you say at this stage that if you are at the lower end of it, taking into consideration that your RBC ratio is at 250%, others are at 150%, would you say that if you were to come out at 140%, then that would be commensurately a better ratio than some other peers and that therefore, your dividend prospects, your capital plans would not be impaired.

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

Yeah. I think on the one specific point you're raising, I think it's absolutely fair to say. If we were to change the 250% down to a 150%, then I think you would see that the 140% to 170% expectation would go up along with the ratio going up. So, I think it's definitely a closed loop, so you get comfortable and more comfortable with a smaller ratio when you have more rigorous capital underneath.

And on the U.S., we have the higher conversion ratio. In the Netherlands, we don't have the benefit of transitionals and other things that are in other jurisdictions, so there's not a real apples-to-apples and level playing field that's out there. And I think certainly in our conversations with the Dutch Central Bank, they're aware of the tougher position we've taken on the U.S. calibration, but also the fact that the Dutch market doesn't have the benefit from transitionals like some of the other markets have and that factors into getting comfortable with the different levels of ranges; and I think that's an important part.

Q - Nick Holmes {BIO 3387435 <GO>}

Okay. That's great. Thanks very much.

Operator

Thank you. We may now take our next question from Farquhar Murray from Autonomous. Please go ahead. Your line is open.

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

Morning, gentlemen. Just two questions if I may. Firstly, on the assumption change impact. It's, obviously, very clear that we're looking at €20 million to €25 million pre-tax per quarter on the underlying earnings. But when you say the impact from cash generation is the same magnitude, do you mean €20 million to €25 million per quarter post tax on cash? And why would the pre-tax figure on earnings and the post-tax figure on cash be the same? Just what I'm trying to understand there. And also obviously, that would seem to imply the U.S. cash guidance is now possibly falling below \$1 billion per annum. Is that right?

And then secondly on the S&P surplus position, I think you had previously stated that this was running at the upper end of the target range because of the flattering impact from low interest rate, which could obviously reverse quickly if rates rose. Has that changed particularly? Thanks.

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

Yeah. Hi, Farquhar. Yeah. The short answer is that one is pre-tax and one is after-tax. The impact that we're seeing on the capital side is a little bit bigger than we're seeing on the IFRS side. There are two different accounting frameworks. So directionally they're certainly aligned, but it's a little bit of a coincidence that they come back to around the same number.

What that means for operating free cash flows from the U.S., what it means is we're going to be right around that \$1 billion that you mentioned. So I think we've been running around \$275 million per quarter. I see that moving to more of a \$250 million per quarter level. So that's the answer on that.

On your second question on the S&P excess capital, I'm sorry and I missed the question in particular. The \$600 million excess capital, we still consider that to be at the high end of our operating range still. So, it's true that we had been in the first half of the year, over and above the top end of that range, and we did accelerate some dividend in the first half of the year. But we're still very much operating with a very robust RBC ratio in the U.S., meaning the capital is fungible, and we're seeing S&P excess capital towards the top end of our range. So, I expect to continue to see healthy dividends flowing from the U.S. in line with the plan.

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

So, just on that second question. The second question was that I think previously you stated you're running at the upper end of that S&P surplus range because the interest rates were very low and if they rose, you can potentially reverse that and has that changed particularly?

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

We do. I think generally speaking, that's still true. We do see and we continue to see some perverse capital numbers, if you will, as it relates to interest rates. They're not overly material. But it is easy to see \$100 million to \$200 million swings in our capital position depending on the movement of interest rates. Interest rates are going back up already as we stand here today, and that will have a significant positive economic impact in the long term, but we'll have a short-term capital impact on the U.S. capital ratio. But it'll be - but these are moderate numbers. These are in the \$100 million to \$200 million kind of ranges.

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

Okay. Thanks so much.

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

And, Farquhar, I like to remind you that the question around the cash flow is pre-measures that we'll be announcing in January 13.

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

Yeah.

Operator

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

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

Good morning, everyone. I just wanted to follow up on a couple of questions that were asked earlier. Just to double check that how many recurring charges have you now got in your underlying result because you announced the €20 million negative one for quarter last year, and you've got the €20 million to €25 million this year. Is that all also recurring charges that we have going through the underlying result and do you think - or is there any chance or possibility that this can be reversed in the future?

And then on model updates, can you just sort of give us an idea of how many are left to do? And do you have a process or a plan to implement the sort of model review process going forward in an ongoing basis, or do you know how many years it will be until your next model update process? Thank you.

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

Yeah. Hi, Steven. You're correct on the recurring, so it is the \$25 million that we indicated last year at this time, and it's the €20 million to €25 million that we're indicating here this time. So, those are the only few components that we have. Obviously, I want to reiterate the message that Alex mentioned earlier is that we will be in January coming to you with a broader set of management action plans, which are not factored into those run rates at that point, but those are the two impacts from last year and this year.

In terms of the model updates, we are two years into this program and we still have a series of smaller and mid-sized models that still have to be reviewed this year. I will say that I've seen the experience coming out for those to be much more neutral in terms of some positives and negatives and equal chance of offsetting. So, my expectation is still small on those.

The exception being and again reiterating what I said earlier, the universal life is where we've seen the low interest-rate environment combined with the complexity of the guarantees, where our modeling has not kept up with what is required to get that optionality value appropriately through, and that's why we've taken the charges in this quarter.

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

Yeah. Just following up on the first bit. Is there any chance that the recurring impacts being reversed in the earnings?

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

Oh, well, yeah. I think that you are going to see some – these are the outcome of the model and assumption update reviews. And, again, in January, we'll be discussing around broader management plans that will address the earnings and the overall ROE comment that Alex said and what our plans are to get the returns to the organization up in the near to medium term.

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

Okay. I understand. Thank you.

Operator

Thank you. We will now take our last question from Nadine van der Meulen from Morgan Stanley. Please go ahead. Your line is open.

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

Yes. Hi. Good morning. With regard to senior debt position at the HoldCo level, that will mature in the next couple of years. How are you thinking about refinancing that by hybrids? I appreciate it won't make much difference on the entity levels, but I'm just trying to get an idea on how significant this could be sort of optically on the group Solvency II rate of 140% to 170% that you indicated at the first half? Thank you.

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

Yeah. It's a good question. Actually, we have about \$2.5 billion of seniors in our cap structure right now, and \$500 million will mature in December. And we've already said that we are not going to refinance that. That's what the proceeds from the Canada sale are going to help cover. So, we see the overall level of seniors coming down.

In the Solvency II context, we do have capacity for Tier 2. So, over time, I think it's reasonable to assume that the seniors will get replaced with Tier 2 or a qualifying own funds, instruments under Solvency II basis which will, yeah, you're right, won't change the solo levels but will provide some upward uplift on the group ratio. So, there is an embedded drag in the group ratio right now from the fact that we're carrying those seniors, which are – received no capital content under Solvency II basis.

So, I think you'll see a general shift for us over the coming years to move away from seniors and into Tier 2 qualifying securities.

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

Thank you. Very clear.

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

This was the last question. So, may I thank you, all, again for attending these conference calls. And Darryl and I, the whole management team very much look forward to seeing you all in person in January 13 in London. Thanks a lot. Bye-bye.

Operator

Thank you. This will conclude today's conference call. Thank you for your participation. Ladies and gentlemen, you may now disconnect.

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