Q4 2017 Earnings Call

Company Participants

- Alexander Rijn Wynaendts, Chief Executive Officer & Chairman
- Matthew J. Rider, Chief Financial Officer & Member-Executive & Management Board
- Willem van den Berg, Head-Investor Relations

Other Participants

- Andy Hughes, Analyst
- Ashik Musaddi, Analyst
- Farooq Hanif, Analyst
- Johnny Vo, Analyst
- Mark Cathcart, Analyst
- Nadine van der Meulen, Analyst
- Nick Holmes, Managing Director
- Robin van den Broek, Analyst
- Steven Haywood, Analyst
- William Hawkins, Analyst

MANAGEMENT DISCUSSION SECTION

Operator

Good day and welcome to the Aegon Q3 2017 Results Conference Call. Today's conference is being recorded. At this time, I would like to turn the conference over to Willem van den Berg, Head of Investor Relations. Please go ahead.

Willem van den Berg {BIO 15203834 <GO>}

Thank you. Good morning, everyone, and thank you for joining this conference call on Aegon's fourth quarter 2017 results. We would appreciate it if you take a moment to review our disclaimer on forward-looking statements which you can find at the back of the presentation.

Our CEO, Alex Wynaendts will first provide an overview of our key strategic achievements for 2017 and he will then hand it over to our CFO, Matt Rider who will walk you through our fourth quarter 2017 results. As always, we will leave plenty of time to address all of your questions.

I'll now hand it over to Alex.

Alexander Rijn Wynaendts {BIO 1821092 <GO>}

Good morning, everyone. Thank you all for your continued interest in Aegon and for joining us for today's earning call. I'm pleased that this was a good quarter both financially and strategically and one that concludes a very strong year for Aegon. Let me begin by providing you with an overview of the most important strategic achievements we have realized since our last earnings call.

We've made significant progress with improving our Solvency II ratio to 201% while at the same time, greatly enhancing the quality of our capital. We announced a partnership with Tata Consultancy Services in the U.S. to outsource the administration of our life and annuity businesses. This will lead to considerable cost savings.

Also in the U.S., we exceeded our target to reduce capital allocated to our run-off businesses by $1 billion and this is one year ahead of our 2018 target. Throughout the year, we continued to make significant progress on our strategic priority to transform our business through our continued digitization efforts. And finally, I would like to highlight our strong sales for the quarter.

I will take you through these achievements in more detail before concluding with the progress we are making towards our 2018 financial targets. Let's begin by taking a closer look at the improvements we made in our Solvency II ratio on the next slide.

I'm in slide 3 now. I'm very pleased with the progress we made during 2017 to improve our Solvency II ratio to 201%, which is at the top end of our capital management target zone. This was achieved through working closely across the group and with our regulators on a number of important items. And this included successfully recapitalization our Dutch unit back to dividend paying status by injecting €1 billion from the holding. We were able to fund this capital contribution internally, including through divestments. In the Netherlands, we divested William Penn (00:03:07), an insurance brokerage firm; and in the U.S., we divested our BOLI/COLI and payout annuity run-off businesses. This enabled us to make a one-time special remittance to the holding in the fourth quarter.

We also reached an agreement with our regulator to update conversion methodology for U.S. business. This resulted in a 15 percentage point uplift to our group Solvency II ratio. And in addition, we reached an agreement on the treatment of the loss absorbing capacity of deferred taxes confirming a (00:03:42) factor of 75% for the Netherlands.

I'm also pleased that at the same time, we greatly improved the quality of our capital over the course of 2017 through management actions, improving Tier 1 capital as a percentage of SCR by 34 percentage points year-over-year to 166%.

I would now like to turn to the next slide and walk you through the benefits partnering with TCS in the U.S. As I mentioned earlier, the outsourcing agreement we recently concluded with TCS represents a major component of the $300 million cost savings target by the end of 2018 for Transamerica.

Before I get into the key financials of the agreement, I'd first like to take a minute to highlight the strategic rationale behind this partnership. Under the agreement, TCS will take over the administration and servicing of more than 10 million life, annuity, supplemental health, and voluntary benefit policies. And what makes this partnership different from most outsourcing agreements is that we will also transfer to TCS approximately 2,100 Transamerica employees currently responsible for the administration and service of these policies. This will enable a smooth transition and will allow us to maintain high service levels for our customers.

The partnership will also lead to a further improvement of service levels to both existing and new customers as TCS will provide our customers improved digitization and automation while we continue to focus on product innovation, further digitization of our retirement platform, and enhancing our distribution reach.

Returning to the financials, the agreement is expected to result in cost savings of approximately $70 million annually, growing to $100 million annually when fully transitioned. As part of the transition and related conversion, we expect to incur approximately $280 million in charges over the next three years with $150 million in 2018. Overall, we're very excited about this partnership with TCS and believe it will enhance the customer experience while resulting in significant cost synergies.

I would now like to turn to slide 5 which shows a reduction in capital allocated to our run-off businesses. As you can see, we had not only exceeded our $1 billion target to reduce capital allocated to our run-off businesses by the end of 2018 but executed on this one year ahead of target. In total, we have reduced IFRS capital allocated to our run-off businesses by approximately $5 billion since 2009, including an additional $1.1 billion in 2017 alone.

The majority of the run-off capital reduction in 2017 was related to the divestment of BOLI/COLI and payout annuities. The transaction was completed at a price to book of 1.2 times. This released $700 million of capital that was upstream to the holding in the fourth quarter and significantly enhanced capital flexibility of the group. The remainder of the reduction of run-off capital was achieved through a series of management actions, including the recently announced divestment of half of the remaining life insurance business this quarter. And this reduction in capital effectively eliminates a drag on the group return on equity from run-off businesses and positions us well to reach a 10% group ROE target towards the end of 2018.

Let's now turn to slide 6 where you can see some of the many digitization efforts underway across Aegon.

The key strategic initiatives for us continue to be the transformation of digitization of our businesses. Throughout the year, we continue to make significant progress. Let me provide you here with a few examples. In the Netherlands, we implemented robotics to handle customer requests to change address or bank account details for products that have recurring premiums collected.

And by using robotics, 95% of all requests can now be automatically completed with no manual intervention from employees, freeing them up to provide better service or more challenging customer inquiries. In the U.S., we completed the initial conversion of our universal life block of business to a new modeling system that enables us to set reserves for universal life insurance policies on a policy-by-policy basis.

Sticking with our U.S. life businesses, we are transforming how we issue policies. Currently, issuing a policy is a labor-intensive process, taking over 35 days and can also be intrusive and time consuming for customers. We are currently investing in our digital underwriting capabilities to reduce the process to only take 48 to 72 hours and become 100% electronic from submission to contract and servicing.

And sometimes the best way to transform is by working with peers. As you may recall, in 2016, we were one of the five founding members of the B3i Blockchain Initiative. In September, B3i took a significant step forward by launching the market beta testing of its reinsurance blockchain prototype. This technology is expected to lead to significant productivity gains in the future. And these are just a few examples of the digitization efforts we are implementing across the group and we will continue to invest in these transformative project as part of our efforts to create more efficiencies and improve customer experience moving forward.

Let's now turn to slide 7 where I will show you developments in deposits. In the fourth quarter, gross deposits continued to be strong, amounting to €35 billion. Our UK platform, in particular, recorded another very good quarter in terms of deposits with institutional sales totaling close to €7.4 billion. These institutional sales are often large in size and can fluctuate quarter-to-quarter.

Asset Management reported higher gross deposits across all regions, in particular in our strategic partnerships in the Americas. I would like to mention here that our Asset Management business is in negotiations with the SEC on a settlement relating to errors in quantitative models for one of our investment funds, its implementation and whether appropriate disclosures were made to our clients. We believe that we are close to reaching an agreement with the SEC and expect that the investigation will come to a conclusion in 2018. This has been a process that has been going on for several years after we self-reported the issue to the SEC. After concluding this process, our Asset Management organization is ready to put this behind them and concentrate on executing its growth strategy.

Now returning to deposits, across our businesses, we experienced outflows of approximately €13 billion as we continue to see contract discontinuances in the retirement business acquired from Mercer. These outflows were in line with the guidance provided last quarter and are driven by the conversion of customers to the Transamerica platform.

Now that these conversions have been completed, net deposits are expected to improve substantially as a result of the momentum that Transamerica is continuing to build in the retirement plan market. The outflows from the U.S. partly offset by continued Asset Management inflows which reported positive flows for the sixth consecutive year and increased inflows on the platform in the UK. Revenue-generating investments increased 10% year-on-year to €817 billion.

Let me now turn to the next slide where I will take you through our life and health sales for the quarter. New life sales amounted to €225 million and the decrease of 6% was driven by adverse currency movements and lower term life and indexed universal life sales in the U.S. with the latter having resulted from focusing on profitability in markets with increased competition. This focus on profitability is reflected in our stable MCVNB margin for life products which has remained well over 3% throughout 2017 and is indicative of our strict adherence to our pricing policy.

In Asia, we had some growth in our High-Net-Worth businesses due to highly successful sales campaign, and in China, due to continued success of our critical illness product. New premiums for accident & health sales decreased by 22% as product exits and lower supplemental health sales in the U.S. more than offset increased general insurance production in Hungary.

And as announced at our 2016 Analyst and Investor Day in New York, we have exited the Affinity, Direct TV, and Direct Mail distribution channels as these channels and associated products do not fit strategically with our Wealth + Health platform (00:13:54) which we launched last week. For this reason, we expect travel sales to decrease by approximately €300 million (00:14:01) in 2018 compared to previous years.

I would like to conclude the strategic part of the presentation by addressing our 2018 financial targets. So, as you can see on slide 9, we made very significant progress in 2017 and this means that we are well on track to deliver on our targets in 2018.

The TCS partnership in the U.S., along with other expense-saving initiatives across the group, have enabled us to achieve significant run rate expense savings; and I'm confident that we will deliver on our program by year-end 2018. As a reminder, our program consists of a $300 million program in the U.S., €50 million in the Netherlands, and €15 million for the holding.

At the same time, we continue to see strong sales momentum across our businesses as 2017 was a record year for gross deposits. The growth of our business and a successfully-implemented expense savings program, together with expected benefits from the U.S. tax reform supports our confidence in achieving our return on equity target of 10% at the end of 2018.

And finally, I am pleased that we are, today, announcing an increase in our final dividend to €0.14 per share. By paying a sustainable and growing dividend, we will meet our target to return €2.1 billion of capital to shareholders over the period 2016 through 2018.

So, overall, 2017 was a year for us to be proud of as we continue to execute on our strategy, deliver on our financial targets and, importantly, help our customers achieve a lifetime of financial security.

I will now turn it over to Matt so that he can walk you through our strong fourth quarter 2017 results before we take your questions together. Matt?

Matthew J. Rider {BIO 20002664 <GO>}

Thanks, Alex, and good morning, everyone. I'd like to begin by taking you through our financial highlights for the quarter starting with our earnings. I'm on slide 11 now. As you can see during the fourth quarter, underlying earnings were impacted by the weakening of the U.S. dollar year-on-year, while at a constant currency basis, underlying earnings remained stable at €525 million.

The continued successful execution of our expense savings program resulted in a €20 million uplift to underlying earnings in the quarter, which was offset by one-time expenses and the write-off of IT systems totaling €23 million. Also, benefits from improved claims experience in the U.S. and higher fee income from favorable equity markets were offset by unfavorable adjustments to deferred acquisition costs.

During the course of 2017, we have achieved run rate expense savings of €188 million across the group, of which close to €150 million are from the U.S., approximately €30 million from the Netherlands, and the remainder from the holding.

Including the partnership agreement with TCS that we announced in January, our current total annualized run rate expense savings increased to approximately €280 million since inception of the program in January of 2016. For the full year, these expense savings and the strategic repositioning of our business towards fee-based businesses have driven our improved underlying earnings as higher account balances benefited from new business and higher equity markets.

Let's now turn to slide 12 so that I can take you through the development of our net income. As you can see, net income for the quarter was very strong amounting to €986 million. A significant increase compared with the fourth quarter of last year was the result of strong non-underlying earnings improvement and in particular, a sizeable tax benefit which I will address separately later on.

The gain from fair value items was mainly driven by positive revaluations on investments and hedging gains in Netherlands and in the U.S. These more than offset the negative result on the guarantee provision in the Netherlands. Realized gains totaled €91 million in the quarter and were mainly related to normal trading activity in the U.S., and sale of bonds in the U.K. to fund remittances to the group.

Other charges amounted to €132 million as €208 million gain related to the divestment of UMG in the Netherlands was more than offset by integration expenses in the UK and charges in the U.S. in Asset Management. Other charges in the U.S. were mainly caused by a loss of €105 million from the divestment of an additional block of life reinsurance business to SCOR, which was previously announced in December.

In addition, there was a charge of €100 million related to model updates which were driven by a true-up related to the conversion of the largest block of universal life business to a new model and a model update in Fixed Annuities. Additionally, other charges contains a provision of $100 million related to the aforementioned potential settlement with the SEC.

Finally, income tax amounted to a benefit of €460 million as this quarter included the tax-exempt gain on the sale of UMG and a onetime impact of €554 million from U.S. tax reform. Even excluding the onetime impact from the U.S. tax reform, we reported positive below-the-line items which is shown on the next slide.

For six consecutive quarters, our net income has exceeded our net underlying earnings with net income averaging 111% of net underlying earnings over this period. This excludes the benefit related to U.S. tax reform in the fourth quarter. The favorable below-the-line items include fair value items on balance being positive which has been in part driven by hedging gains reflecting changes to our U.S. macro equity hedge program. Net impairments amounted to only 3 basis points in 2017, which have been well below the long-term average of 25 basis points and realized gains on investments which more than offset the impact of restructuring in model and assumption-related charges.

On the next slide, I'd like to run you through the impacts of tax reform in the U.S. and our expectations for IFRS and capital. The U.S. Tax Cuts and Jobs Act, which was signed into law at the end of December, lowers the nominal corporate tax rate from 35% to 21%. This tax change led to a €554 million benefit on net income and a total increase in shareholders' equity of €1 billion. This was the result of a reduction in net deferred tax liabilities on an IFRS basis.

The onetime impact from tax reform on shareholders' equity, plus the strong quarterly results further reduced the group financial leverage by approximately 60 basis points to 28.6% at the end of 2017. From 2018 on, we expect net underlying earnings to benefit from the lower corporate tax rate. The uplift in earnings more than offsets the higher shareholders' equity as approximately half of the onetime benefit in equity went through the revaluation reserve. This will lead to an increase in the U.S. return on IFRS capital by roughly 75 basis points and an improvement of approximately 55 basis points on the group's return on equity. Additionally, capital generation will improve by approximately $100 million which increases our annual capital generation in the U.S. from $1 billion to $1.1 billion.

From a solvency capital perspective, there was a onetime negative impact for the quarter on the RBC ratio of the U.S. life companies of approximately 16 percentage points which relates to 5 percentage points on group Solvency II ratio. The impact was due to a reduction of deferred tax assets. This is reflected in the fourth quarter U.S. RBC ratio of 472%, which is still well-above our target range of 350% to 450%.

An additional onetime negative impact is expected as the NAIC is anticipated to incorporate the new tax rate into its RBC calculation methodology in the future. We expect that the RBC ratio of our U.S. business will remain well above the midpoint of its

350% to 450% target range in 2018. As a result, we foresee no changes to the remittances that we expect to receive from our U.S. operations. Furthermore, the group Solvency II ratio is expected to remain well within the upper half of the 150% to 200% target range. On that note, I'd like to focus on our current group capital position on the next slide.

As Alex shared with you earlier, our Solvency II ratio has increased 6 percentage points to 201% during the fourth quarter. The increase was the result of our own funds remaining stable despite the impact of U.S. tax reform while the SCR declined slightly. Our own funds were unchanged during the quarter as strong capital generation net of new business of about €400 million was offset by €300 million due to unfavorable equity markets in the UK and the adverse interest rate movements in the UK and the U.S. and Asia.

Onetime items and other netted to zero as the benefits relating to the divestments of UMG and a life reinsurance block to SCOR were offset by the reduction in U.S. deferred tax assets as a result of tax reform.

Meanwhile, the SCR declined by approximately €300 million. This was driven by separate account de-risking in the Netherlands and management actions following the divestments of the majority of the run-off businesses in the U.S. which more than offset the impact of tax legislation change in the UK. In addition to our strong group ratio, each of our main reporting units are well within the top end of their capital management target zones and are expected to remit capital to the holding during 2018.

Now, I'd like to briefly highlight our strong excess capital position at the holding on the next slide.

During the fourth quarter, excess capital at the holding increased significantly to €1.4 billion. This was driven by substantial remittances from one, our U.S. operations, which upstreamed €625 million mainly resulting from the sale of the majority of the run-off businesses; from our UK business which delivered on their commitment of a special remittance of €167 million; and our businesses in Spain and Portugal and Hungary and Asset Management which all upstreamed cash to the holding during the fourth quarter.

These remittances were only partly offset by capital injections to support further growth of the business and cash outflows related to share buyback to neutralize the final 2016 and 2017 stock dividends in addition to holding, funding and operating expenses. As a result, our excess capital position sits firmly in the upper end of our target range as we indicated during our second quarter call.

Let me remind you that excess capital and our gross financial leverage ratio go hand in hand as repaying debt out of excess capital would reduce our leverage ratio at the same time. We expect this to materialize in the third quarter of 2018 when we expect to redeem the €500 million one-year senior debt that was issued in the third quarter of this year.

Moving to capital return. Our strong excess capital position enables us to pay a sustainable growing dividend. As Alex said earlier, we're increasing our 2017 final dividend payment to €0.14. This means that we've grown our dividend for six consecutive years. The growing dividends are well funded by the remittances from our business units, while also allowing for investments in strategic priorities and new business.

During the year, our operating units generated approximately €1.3 billion of capital excluding market impacts and onetime items. This is nearly 10% increase in normalized capital generation year-on-year, and we expect to grow it further in 2018 to €1.4 billion.

After holding and funding costs of approximately €300 million, we had €1 billion of free cash flows in 2017, which more than covers our capital return to shareholders for the year of approximately €600 million. This underscores our commitment and ability to return €2.1 billion to shareholders over the period 2016 to 2018.

In summary, this was not only a strong year from an earnings and capital perspective. It was also one in which we made a series of significant steps forward in the execution of our strategy and to further deliver on our commitments for 2018. I'm confident that we can further improve our performance by successfully executing on our expense savings program and growing our business. At the same time, we will continue with our transformation to become a more fee and protection-based company which serves its customers throughout their lives.

Alex and I are now ready to take your questions.

Q&A

Operator

Thank you. We will now take our first question from Nadine van der Meulen from Morgan Stanley. Please go ahead.

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

Yes. Good morning. Congratulations on the results this morning, and thank you for taking my questions. I suppose the first question is on the U.S. tax reform and the impact on RBC. So, the NAIC's decision on how to incorporate the tax change, when do you expect to get more clarity there? And based on your current expectations, what would be the look-through basis on the group Solvency II ratio?

Yeah. And second question is in the U.S, you have from the tax changes and - or you indicate $140 million IFRS benefit, but it's $100 million on capital generation. If you could just touch upon the bridge between the two?

And lastly, what can we further expect on model update given that you, again, have shown charges there? Thank you so much.

A - Matthew J. Rider {BIO 20002664 <GO>}

Thanks, Nadine. Let's say, on the U.S. tax reform, as we've mentioned in our press release, the NAIC will ultimately make changes to the RBC factors, the risk-based capital factors, as a consequence of the lower tax rate. It's unclear to us whether that might happen in 2018 or 2019 at this point. But we are confident that even under a worst-case scenario, we'll remain in the top half of our target range on U.S. capitalization and the impact to group solvency is quite manageable. So, I think that one is pretty okay.

On the – you recognized that there is a difference between the impact on our, let's say, IFRS earnings and our capital generation going forward. I think there are quite some differences between an IFRS balance sheet and a statutory balance sheet for a capital basis, and the only thing that has changed is not the tax rate alone. There are also some things which expand the tax base especially on an RBC through – on a capital basis. For instance, changes in the way that the dividend received deduction gets incorporated in, but there are many other smaller changes that are quite technical in nature.

With respect to model updates, you've noted that we've taken €100 million charge for the quarter related to – it's really two model updates. The first relates to the so-called access conversion of universal life contracts that we reported on in the third quarter. And I would say that when we took our charge, and it was a $280 million charge in the third quarter, that was based on our best estimate of the model impacts. During the course of the fourth quarter, we actually put it into a production environment and into our full control environment and recognized that we needed to take an additional $63 million charge on that one. Again, I would just reemphasize that this is the biggest model that we have converted. It is now safely in a control environment, so I think on this one, we wouldn't expect anything going forward.

There was an additional $50 million impact on a model relating to Fixed Annuities that we recognized during the course of the quarter as well. And not that I would discount the possibility for further charges or gains, our best estimate is zero, in fact. But we do review these models quite significantly from time to time. So, we would like to think that over time, this will normalize. But our best estimate is zero going forward.

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

Thank you very much. Very clear.

Operator

We will now take our next question from Farooq Hanif from Credit Suisse. Please go ahead.

Q - Farooq Hanif {BIO 4780978 <GO>}

Hi there. Thank you very much. I've got a question first on U.S. yields, they moved up year-to-date quite significantly, and then, obviously, there's a chance that they continue to improve. What is your thought on the product mix in the U.S. in light of this? So, are you feeling any greater love for traditional universal life or Fixed Annuities? And do you see also on the reverse side, high yields helping to get rid of more books in the U.S.? That's question one.

Question two is, given your capital position in the Netherlands, you've indicated the first half dividend. What – I mean, do we double that for the full year? Do you think you can pay more than €100 million out of the Netherlands now given that capital position?

And lastly, you've got to the end of the leakage of customers in Mercer in the U.S. What kind of growth rate in participants or assets should we bake in? Thank you.

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

Hi, Farooq. Good morning. I'll talk you a little bit through what we think we'll see in the product mix. I think we've always been clear that higher interest rate is good for us, is good for our customers. There will be more margin in traditional life. We will see better pricing for the guarantees on Variable Annuities. And I think that you will therefore see an improvement in these market segments as a consequence of higher interest rates.

As you know, we had to withdraw a number of products in the past because of the low interest rate environment where we felt the products did not make sense nor for our customers, nor for ourselves. So, that is clearly going to support it. In addition, obviously, to the fact that as you know, we provided our sensitivities, higher interest rates are a positive for our capital and a positive for our earnings going forward.

Just a few things on Mercer and Matt will take the question on the capital in the Netherlands. On Mercer, when we acquired Mercer, we anticipated that through the conversion over a period of time, we would indeed see customers actually leave us or effectively not leave us, but never come to us. So, I think that what we're seeing right now is the end of this whole process where we have now converted all the customers that are convertible on to our platform.

At the same time, what is important to keep in mind is that the acquisition of Mercer has given us this capability in the jumbo markets to the very large cases where we were not present before. And that means that, today, we are present in all the segments of the market – in the pension market which is very important for us going forward as part of our strategy. And additionally, as part of this deal, we have been selected as a sole record keeper for Mercer's primary U.S. retirement plan platform which they call Mercer Wise. It was launched in 2017 and that's creating additional business for us.

So, we should not only look at the Mercer transaction in conversion of the old plans on its own, but we need to look at the overall broadening of the capability and extension of our distribution with Mercer. So, we are pleased with this transaction because it's firmly placed us now in one of the top players in the pension market in the U.S.

A - Matthew J. Rider {BIO 20002664 <GO>}

Yeah. On the Netherlands capital position and the dividend, it was interesting, I did an interview this morning with one of the wire services and the reporter noted that while I'm looking at the front page of your press release, and I don't see a problem with the Dutch dividends or rather the Dutch capital, and I said, yes, that's exactly the point. So, I think that we took care of this one in the second quarter and so far we've seen this actually being quite successful.

So, right now, the Dutch insurance organization stands at a capital level of 199% which is well above their target range. At this moment in time, they have to go through their normal governance to pay an interim dividend. But we would expect given a benign market environment that we're in that they would be able to pay it. And then going forward, I think we've telegraphed in the past that we expect an interim and a final dividend pattern two times a year just like we do in the U.S., so I would just guide you to that that's a reasonable way to think about it.

Q - Farooq Hanif {BIO 4780978 <GO>}

Just following up on that, I mean, in the U.S., do you pay an equal amount in the first half and the second half?

A - Matthew J. Rider {BIO 20002664 <GO>}

It's imbalanced, but it's generally two payments.

Q - Farooq Hanif {BIO 4780978 <GO>}

Okay. Thank you very much.

Operator

We will now take our next question from Nick Holmes from Societe Generale. Please go ahead.

Q - Nick Holmes {BIO 16747973 <GO>}

Hi there. Thank you very much. I wanted to ask about the Variable Annuity book and, in particular, how has the hedging been holding up during the last few weeks of market turmoil?

And secondly, still on Variable Annuities, how well positioned do you think you are if we see a bigger correction? Thank you very much.

A - Matthew J. Rider {BIO 20002664 <GO>}

Thanks for your questions, Nick. I think, generally, in terms of hedging, we have seen some market volatility, but the move especially on the macro hedge to a more put option-based strategy, we basically – this was sort of by design, buying put options at a time when volatilities are low. And now that volatilities have spiked, we're getting actually benefits from that strategy. So, that one, I think, goes well.

With respect to other Variable Annuity books guide, I think that we're very well positioned, in fact. I think you recognize that a large portion of our book is exactly matched off. And then for the macro hedge, we try to manage around the regulatory capital band. So, I think the idea of protecting our capital base, not only for the VA business, but for the entire business as a whole, that's one that we're fairly happy with right now.

Q - Nick Holmes {BIO 16747973 <GO>}

So, in brief, you don't - you're not worried about a bigger correction if that was to occur? That's not on your radar screen as being a threat?

A - Matthew J. Rider {BIO 20002664 <GO>}

It's on everybody's radar screen. We have highly-trained people and experienced people looking at these hedging programs every day, intraday. So, is it something that I worry about? No. I think we've got good people on the ground that are able to manage this.

Q - Nick Holmes {BIO 16747973 <GO>}

That's great. Thank you very much.

Operator

We will now take our next question from Robin van den Broek from Mediobanca. Please go ahead.

Q - Robin van den Broek {BIO 17002948 <GO>}

Yes. Good morning, everybody. My first question is quite simple. On the U.S. remittances, why isn't the $100 million upgrade to capital generation not translated to remittances also given the fact you're quite comfortable on the RBC ratio?

Secondly, maybe to come back to the moving parts still to come through from the NAIC, I think we have the asset charge discussion that is still out there, you mentioned the required capital. Since you're trying to guide towards above the mid end of the 350% to 450% range, is it fair to assume that you currently foresee an estimate of 60 (00:40:17) percentage point RBC ratio impact which would translate to 15% group for the - Solvency II ratio for the group? Is that a fair assessment?

And the third question is on the separate account de-risking you mentioned as being a positive driver for the Solvency II ratio development. Could you maybe provide the size of the benefit and the reasoning behind it, and whether this is an ongoing thing, and if there's any impact on capital generation on the back of it? Thank you.

A - Matthew J. Rider {BIO 20002664 <GO>}

Okay. Thank you for your questions. On the remittances for the - yeah, we expect to see about a $100 million benefit in capital generation. But as you said in your second question, we are going to have knock-on impacts from the NAIC both as a consequence of increasing asset-based - risk-based capital charges and also reflecting the lower tax rate in RBC charges. So, let's be a little bit cautious right now. We're going to keep the remittances the way that they are, the way that we've committed to the market.

We are more focused on returning the €2.1 billion of capital to shareholders through the course of 2016 to 2018. So, we're actually not going to require the U.S. to pay up another $100 million at this moment in time. There could be the potential in the future, but at this moment, that's not what we're thinking.

With respect to what is out there in the market, with respect to impacts on RBC ratios and the group ratio, I'd say, it's a fair assessment. We don't know exactly how it's going to come through, when we don't know exactly when it's going to come through, but we do know that when it does come through, even according to our worst-case scenarios, we still stay above the midpoint of the U.S. target range, and the group is comfortably in the top part of its target range.

With respect to the separate accounts de-risking, this is really credit risk management within the separate accounts in the guarantee portfolios for the Dutch pension business. And I would say that the impact to the SCR for the quarter was about €100 million.

Q - Robin van den Broek {BIO 17002948 <GO>}

Okay. And the 60 (00:42:30) percentage points we mentioned before, that is the worst case in your view or is that more a base case (00:42:36)?

A - Matthew J. Rider {BIO 20002664 <GO>}

All we did is, we took a look at it on the base of – we sort of know what's going to happen on the asset base charges, and if you just do a mechanical approach to reflecting the new tax rate in the RBC factors, that's what you come up with. The NAIC maybe a little bit more liberal than that, but we don't know.

Q - Robin van den Broek {BIO 17002948 <GO>}

Thank you very much.

Operator

We will now take our next question from Mark Cathcart from Jefferies. Please go ahead.

Q - Mark Cathcart {BIO 19783252 <GO>}

Yeah. Hello. I'm just wondering if part of the reason why you're not willing to increase the remittance from the U.S. by that $100 million is because of concerns that the tax change in the U.S., all it's going to do is encourage competition. So, if you look out one to two years, your retirement margins are going to go down and, therefore, you're back to square one. I just wondered what was your read on how pricing for life products in the likes of retirement? How do you think they are going to develop? And do you think that in three years' time that $100 million, which was down to, say, $25 million? Thanks.

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

Hi, Mark. Let me answer this question of you. First of all, we should be reminded that the vast majority of our earnings in 2017 and for the coming years actually comes from business that have a long duration, for example, universal life, Variable Annuities, and on these books, we'll, by definition, retain the benefits because it's been locked in already.

So, I would say, the impact of lower taxes, in our view, will only be passed on gradually and over time in the form of new business pricing. That's not something we expect to happen overnight. It will, in our view, take time before that takes. And therefore, it's also important we continue to grow our new business, so that we offset this impact by further scale improvements.

So, this is how we look at it. And the reason that Matt answered this question previously was also to be clear that the impact is going to be over time. We have quite a lot of things that we're doing in the company. As you know, we are outsourcing our business which will provide a benefit, but it also takes a charge initially, and that's why it makes no sense further to increase the remittances. It's really too early to answer that question.

Q - Mark Cathcart {BIO 19783252 <GO>}

Okay. Thanks, Alex. And the other one, I just wondered if you're in a real dilemma at the moment in relation to Fixed Annuities because back in December 2016, you highlighted it as a business that you'd potentially exit and we've seen what Voya has done and how the share price re-raised (00:45:26) there. But at the same time, with rising interest rates, that benefits the profitability of your business. So, I'm just wondering given the current backdrop, are you more or less inclined to keep your Fixed Annuity business? Is it more core or less core?

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

You see we are executing on a strategy where we have de-emphasized Fixed Annuities. You're right to say that rates have moved up, so in itself, it becomes a little bit more attractive for our customers. But we have a business that we are running off. We have a very low cost base, and this is from a economical point of view by far the most attractive way for our shareholders.

Q - Mark Cathcart {BIO 19783252 <GO>}

In other words, to get rid of it.

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

To run it off as we're doing right now with very low expenses, and that's what we're doing. We've come to the view that this is the most effective way of enhancing shareholders' value.

Q - Mark Cathcart {BIO 19783252 <GO>}

Okay. Thanks, Alex. That's excellent. Thank you.

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

Thank you.

Operator

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

Q - Ashik Musaddi {BIO 15847584 <GO>}

Hi. Good morning, Alex. Good morning, Matt. Just one question from my end. When I look at your Solvency II roll forward, it's an 8% improvement because of the separate account de-risking divestment and impact from U.S. So, if I remove the impact from U.S., it's actually 13 point positive impact. Would you mind giving a bit of color on that? How much is because of NLV risking (00:46:55) and how much is because of divestment? And apologies in case I missed that earlier.

And the second thing is, can you just remind us about the annual cash flows again? So, are we still sticking with €1 billion (00:47:06) from U.S., €100 million from Netherlands, and around €100 million from other units? So, any changes to that? Thank you.

A - Matthew J. Rider {BIO 20002664 <GO>}

Okay. On your first one, I think you've noticed in our little roll forward there for the solvency ratio for the group, you effectively have a zero impact on own funds for the year. We stayed stable for the quarter, we stayed stable at €15.6 billion. But underlying that there's actually quite a number of moving pieces. So, you see the expected returns of €400 million. You see the market variances of minus €300 million. And then there are quite a number of one-off things that include U.S. tax reform that actually net to zero.

So, if you're – just maybe on high level numbers, we have the UMG sale that's adding €200 million. We have some impacts from reflecting, let's say, some full year U.S. tax issues not related to the tax reform of about €200 million (00:48:11). You've got a plus €100 million from the SCOR reinsurance transaction. And then the SEC issue subtracts minus €100 million (00:48:21) and then U.S. DTA write-off of about €400 million (00:48:26). So net-net, you're on zero.

Where the big action is actually happening is more in the SCR side of it for the quarter. Now, I will tell you that our long running ambition is clearly to drive forward own funds as because that is going to be a very serious valuation metric for us going forward and we're seeing great capital generation in the quarter. But there are some one-off things that – of course, tax reform is one of them that detracted from that.

But on the SCR side, we had – so, it's basically three things. We had, let's say, de-risking related to the separate account portfolio in the Netherlands that accounted for about €100 million. You had management actions that took place following the divestment of the COLI/BOLI run-off portfolio of about €100 million. And then there was about €100 million of other very small things, but some of which was improved diversification benefits within the group. So, that was the – I guess, that's really the Solvency II roll forward.

Now, when we talk about -

Q - Ashik Musaddi {BIO 15847584 <GO>}

Can you break that thing (00:49:37)?

A - Matthew J. Rider {BIO 20002664 <GO>}

Yeah. When we talk about remittances, we're thinking on the order of $100 million from the U.S. We've already signaled €100 million from the Netherlands as the interim dividend. And again, we would normally expect an interim and a final like all the other businesses. We would expect something on the order of €100 million from the UK, €100 million from Asset Management, and from sort of all the rest, about €50 million. And you get to a total that's a little bit more than €1.1 billion.

Q - Ashik Musaddi {BIO 15847584 <GO>}

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

Operator

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

Q - William Hawkins {BIO 1822411 <GO>}

Hi. Thanks very much. I'm slightly following on from what you were just saying. I'm still a bit confused about the recon for the U.S. RBC ratio. I wondered if you could just be a bit clearer about how we get to 470%. So, first of all, just could you tell us what the numerator and the denominator is for that ratio? And then, by my math, we were in the mid-440s last time you disclosed. I was expecting kind of a 20-point hit from the tax reform and then a similar hit for the dividend. So, I mean, it sounds to me like we've got sort of somewhere like 50 to 70 points of positive. So, could you just be a bit clearer about how we get that upswing in the RBC ratio? Thank you.

A - Matthew J. Rider {BIO 20002664 <GO>}

I'm not going to go through a detailed walk for it, but I can give you some of the information that we have. So, just impact of tax reform was 16 percentage points. The way that we think about the RBC ratio in the U.S., we think of it as the available capital versus the required capital. To get to the 472% number, the available capital is about – it's almost spot on $10 billion, $9.958 billion (00:51:35) I think it is, and then $2.1 billion of required capital. That's in dollars. And for – we don't normally provide a walk for it. It would actually be quite complicated to do that. So, yeah.

Operator

Are you ready for the next question?

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

Yes, we are.

Operator

Okay. I wasn't sure. We will now take our next question from Johnny Vo from Goldman Sachs. Please go ahead.

Q - Johnny Vo {BIO 5509843 <GO>}

Yeah. Thanks, guys. Just a couple of quick questions. Just, you know, with the change in capital generation in the U.S., does this change anything in relation to your holding company buffer, particularly given that most of your holding company cash is in the U.S. holding company and – which hasn't moved in a while? So, that's the first question.

Number two is, also I've noticed that you're not accruing for the dividend in solvency roll forward, which you did last year. So, on a pro forma basis, taking into consideration the likely decline in RBC ratio and dividend accrual, I get to a sort of pro forma solvency ratio of about 180%. Does this seem fair? Thanks.

A - Matthew J. Rider {BIO 20002664 <GO>}

With respect to your first question on capital generation in the U.S., at this point we're not going to consider changing the buffer in the holding. So, we target something between €1 billion and €1.5 billion. We're sitting comfortably at €1.4 billion. We would expect to maintain that going forward.

With respect to the not accruing for the dividend, we accrue for that when it's formalized and it had not been as of year-end, that's only going through our own governance process now. And our – and overall group solvency ratio in a 180% range sounds a little light to me, but we'll see how this progresses.

I guess that before, it will quite depend on how the NAIC changes to the risk-based capital factors and how they do the tax rates, the timing of when that – whether it's going to be 2018 or 2019. But again, we're confident that we can remain in the top half of our range.

Q - Johnny Vo {BIO 5509843 <GO>}

Okay. Brilliant. Thank you.

Operator

We will now take our next question from Andy Hughes from Macquarie. Please go ahead.

Q - Andy Hughes {BIO 15036395 <GO>}

Hi. A couple of questions. First one is about the Irish disposal, presumably the €180 million isn't in the kind of repatriation numbers you're showing here?

And the second one is on the kind of U.S. solvency here. So, if the extra $100 million (00:54:20) of cash generation is used to kind of build back solvency, presumably that would kind of restore the group's solvency levels as well, is that part of the plan?

And the third question is just on the €2.1 billion. I just want to check, so to get from here to the €2.1 billion, given what you've shown already, are you including the full year final dividend at the end of 2018 is paid in 2019? So, basically you're saying you don't need to increase the dividend from here to get to the €2.1 billion, is that right? Thank you.

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

On the Irish transaction that we are actually well on track and closing, and then obviously the proceeds have not yet been received and therefore are not yet included in our numbers. In terms of the – to your question related to $100 million (00:55:10) additional we get from the tax, yes it will improve our solvency. By the way, our solvency has also been improved by a number of management actions we're taking to try to optimize our risk, improve ALM. A lot of different actions that we are taking. And as you can see, we have positive results here because we have been able to get our Solvency II up.

And your final question around the €2.1 billion, it doesn't include the full dividend 2018, the answer is yes.

Q - Andy Hughes {BIO 15036395 <GO>}

Okay. Thank you.

Operator

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

Q - Steven Haywood {BIO 15743259 <GO>}

Good morning. Thank you. You mentioned on the UK dividend being around €100 million. Is that per year on a normalized basis going forward after the one-off especially you've done so far? Because that appears to be a significant over 100% sort of earnings – yearly earnings of the UK business there.

And then my second question is, you mentioned in your call earlier about the SEC investigation into the Asset Management business in the U.S. Can you give a bit more specifics here, and is there any sort of estimate or cost you can provide if there's any settlement costs here, and have you set up any provisions for this as well? Thank you.

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

Steven, the €100 million (00:56:34) from the UK is £100 million. It used to be very close to €100 million. It's slightly more than €100 million. That is what we expect going forward. You also need to keep in mind that we are in the phase of integrating the Cofunds transaction which will lead to significant expense reductions – expense synergies which were not reflected yet in the 2017 numbers. So, once these get reflected, you will understand that the £100 million effectively is very much a normalized kind of dividend we can pay out from the new Aegon after the cost initiatives have been taken out.

In terms of the SEC investigation, I mentioned it briefly in my introductory notes. This is a process that's been going on for quite a number of years. We had a number of models that we used in our Asset Management, quantitative models, asset allocation models that we discovered at a certain point that there were some errors and that was not properly implemented.

We also discovered that the communication with our customers also required some sort of clarity and we reported that to the SEC. Following our self-report to the SEC, as you can imagine, a full investigation has taken place and we expect now to be able to conclude this this year. We made really good progress and that's why we've taken a provision that was mentioned and it's included in 2017 numbers of $100 million. So that's all I can say at this point in time.

Q - Steven Haywood {BIO 15743259 <GO>}

Okay. That's great. Thanks very much.

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

Well, I take this opportunity to thank you, and thank you for your continued interest in Aegon, and I wish you a good and I think a busy day today with other companies. Take care.

Operator

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