S1 2019 Earnings Call

Company Participants

- Alex Wynaendts, Chief Executive Officer, Chairman of the Executive Board, Chairman of the Management Board
- Jan Willem Weidema, Head of Investor Relations
- Matthew Rider, Chief Financial Officer, Member of the Management Board, Member of the Executive Board

Other Participants

- Albert Ploegh, Analyst
- Ashik Musaddi, Analyst
- David Motemaden, Analyst
- Farooq Hanif, Analyst
- Fulin Liang, Analyst
- Johnny Vo, Analyst
- Matthias de Wit, Analyst
- Nick Holmes, Analyst
- Patrick Lemmens, Analyst
- Robin van den Broek, Analyst

Presentation

Operator

Ladies and gentlemen, good day and welcome to the Aegon First Half Year 2019 Results Conference Call. Today's conference is being recorded. At this time, I would like to turn the conference over to Jan Willem Weidema, CO, Aegon. Please go ahead.

Jan Willem Weidema {BIO 15133400 <GO>}

Thank you.0 Good morning, everyone, and thank you for joining this conference call on Aegon's first half 2019 results. We would appreciate if you could take a moment to review our disclaimer on forward-looking statements, which you can find in the back of the presentation.

We will start today with our CEO, Alex Wynaendts, who will give an overview of where we stand with regard to the delivery of our strategy and our achievements in the first half of the year. After this, our CFO, Matt Rider will walk you through the financial highlights of the first half of 2019. At the end of the presentation, we will of course leave more than sufficient time for your questions.

I will now hand it over to Alex.

Alex Wynaendts {BIO 1821092 <GO>}

Thank you Jan Willem, and good morning everyone. And also thank you all of you for your continued interest in Aegon and for joining us on today's call, which is a busy day, as we all know.

You will remember, in February we provided you with new medium-term targets. The economic context in the first half of this year has been challenging with interest rates falling to historic lows in many of our key markets. In this environment, our hedging progress protected us well and we have achieved significant progress in many of the strategically important areas. Very importantly, we have maintained a strong capital position and have been able to increase our dividend to our shareholders.

Before going into more details on the actions we have taken and the underlying developments, let's first together have a look at the progress we've made towards our targets. Normalized capital generation, the cornerstone of our targets has increased by 20% compared to the first half of 2018. With normalized capital generation of EUR740 million, we are well on track to deliver on our target of EUR4.1 billion for the three year period 2019 to 2021. And what's more, in this period, we have maintained a strong capital position.

Our Group Solvency II ratio of 197% is at the top end of our range and our holding cash buffer has been increased. This allows us to raise our interim dividend by 7% to EUR0.15 per share. As a result, our dividend payout ratio of normalized capital generation is 43% and this puts us on track towards a full year target of 45% to 55%. The dividend is supported by well-diversified remittances from our subsidiaries of EUR765 million. This is in line with our full year guidance.

The Netherlands retained its planned remittance, as a result of being just below its new Solvency II ratio target zone. Our return on equity at 9.6% is slightly below our 10% target, although, we remain fully committed to do everything we can to achieving a return on equity of more than 10% while recognizing the challenges that the current environment brings. In line with our strategy, we have taken several key portfolio actions as we have shown on Slide 3.

As you are by now hopefully well aware of, we have regrouped our businesses in three distinct strategic portfolio categories. In each of these categories, we are making good progress. In the Manage for Value category, we focus on optimizing our capital position and reducing expenses. In the first half of 2019, we have started a process of transferring the administration of the defined pension book from Aegon Leven in the Netherlands to our in-house low cost administrator TKP. This process is unique in the Netherlands and will allow us to achieve a more variable and lower cost base in our Life business. Furthermore, we are considering various options to accelerate the release of required capital in the Netherlands.

Our Drive for Growth businesses are the cornerstone of our growth strategy. The vast majority of the new business trend is to invest in this category and we are focused on accelerating growth in these businesses. As an example, in the US business, we have created dedicated leadership teams for Workplace Solutions and Individual Solutions. This allows us to sharpen our focus on the specific market segment and customer requirements. We are already seeing increased commercial momentum in the organization.

Our partnership with TCS is bearing fruit as demonstrated by notably increasing customer satisfaction. An excellent customer experience is key to achieving our growth targets in a sustainable way.

In the UK, we successfully financed the Cofunds integration. The migration of the Nationwide portfolio has happened smoothly as we have applied the learnings from the retail migration last year. Our team in the UK is now realizing to remain cost efficiencies as we dismantle the Cofunds system. Furthermore, a number of actions have been taken in Scale-up for the Future business. We announced in May that we are divesting Aegon stake in the Japanese joint ventures for EUR130 million, we expect to realize a book gain of EUR50 million. We've also decided to wind down our Mexican joint venture as it did not meet our financial objectives. And in India, we are building the leading digital insurance company of the country and we have just agreed a distribution partnership with MobiKwik, the country's second largest mobile wallet provider. We're confident that we'll be partnered with more leading e-commerce providers to increase our reach in the vast and developing Indian market. And finally, here in the Netherlands, we are in the process of regionally integrating Aegon Bank and Knab to strengthen our leading position as a digital bank.

I'm now turning to Slide 4. As mentioned, capital generation is significantly higher compared with last year's first half. Capital generation has increased in all strategic categories and it was mainly driven by inforce earnings, as a result of the actions we've taken earlier, just rate increases in long-term care and our universal life book. In line with our targets, the vast majority of the new business strain is invested in the Drive for Growth category. We invested mainly in indexed universal life new business in the US. Also the evolving business mix leads to a higher new business strain, for example from continued growth in a Scale-up for the Future market in Spain.

On the right-hand graph, you can see the distribution of capital allocated across the three strategic categories. And as expected, capital allocated to demand for value category is slowly declining as a result of the run-off of the large underlying Life Insurance books in the UK and here in the Netherlands. And consequently, we therefore able to allocate now more capital to the other two categories.

On Slide 5, we show the development of our gross and net deposits. Obviously, we are not satisfied with the overall negative net deposits. However, underlying, we observe an improving commercial momentum with gross deposits increasing in most regions and this will lead to positive net deposits over time. In the US, we recorded higher takeover deposits of retirement plans, higher Variable Annuity deposits reflecting product advancements and increased fixed indexed annuity sales. Unfortunately, net deposits in the US were negative, mainly due to contract discontinuances in the retirement plans. We will take a deeper dive into the US operations on the next slide. Aegon Asset Management continues to grow its third-party business, whereby our Chinese asset management joint venture is a strong contributor.

Let's now take a quick look at Life and General Insurance sales on slide 6. Although we are not yet where we want to be, Life sales in the US increased in strategically relevant distribution channels, also sales in China are developing positively. In Accident Health, the decline in new business is mostly driven by last year's management decision to discontinue certain product lines. In the US we saw positive developments in our Individual business as we gain market share, while the competitive environment in Employee Benefit business resulted in lower new production. Looking forward, let me share with you the challenges, we're seeing in our markets, and the actions we are taking.

And now on Slide 7. So, clearly the financial markets are challenging at the moment. This is mainly the case in two areas. Firstly, the lower interest rates put our Variable Annuity and Life New business in the US under pressure. It is difficult to provide attractively-priced products to our customers, while also ensuring economic pricing of our products. We are well equipped to meet this challenge with a strong capital position and the unique franchise.

Secondly, dislocated credit spreads impact our Dutch capital position negatively, as Matt will explain in more detail in a moment. And as a result of this market environment, we will continue to expand the less capital intensive service businesses and selectively consider other options to optimize the Dutch capital position. In the US, we're improving our service delivery in the Retirement Plan business to stop the current outflows and retain more customers. Furthermore, we are addressing the intense competition in the US workplace market by bundling products to provide attractive employee benefit propositions to customers and leverage a cross-selling potential.

In the UK, we've financed the Cofunds migration, it can now fully concentrate on growing and expanding divisions. Customers will benefit from leading propositions and further enhance platform functionality. Operationally, our biggest challenge is to lower expenses in our back books to make them more variable. And for this, we have partnerships with TCS in the US and Atos in the UK, and we're making good progress with the implementation of these partnerships, recognizing full implementation will take several years. Also in our other markets, we are actively addressing our challenges. Our High Net Worth business in Asia is expanding its product range, its geographic reach and is developing new distribution capacity to counter the increased competition in the market.

And in Spain, our joint venture with Santander is developing according to our plans and we have now the opportunity to expand the business to the Banco Popular branches that Santander acquired. Now at the same time, we are in a turnaround process for our own business to improve profitability in Spain.

Let me give you some more insights on what we're doing in the US on the next slides. And now on Slide 8. As mentioned briefly before, we have realigned our Transamerica organization. All workplace related businesses such as Retirement Plans, Employee Benefits and Stable Value Solutions are now under a single management under the leadership of Blake Bostwick. This alignment is making Transamerica much more responsive in the competitive market environment. And the renewed market focus is already visible in the improving commercial momentum in the workplace area.

We are seeing that written sales have significant increased and we are proud to have won several large mandates including one mandate with EUR3 billion of assets. This large case reflects the skills and capabilities that we have a plan for the Mercer acquisition which allows us now to compete effectively in the large case markets.

However, we also experienced net outflows in Retirement Plans in the first half of 2019. Due to the nature of the business, net flows can be lumpy. Current outflows are partly due to some service challenges we had experienced in the Workplace Solutions areas in the past. That's why we are making the needed investments and the team is working very hard to reestablish the service levels that customers should be able to expect from Transamerica.

And in addition, we continue to rollout our bundled propositions. Managed Advice is now available in the middle market and customers are responding positively to this proposition. So overall, we are confident that we are back on track to stand out in the US workplace business with a compelling brand narrative and integrated solutions. Let's now turn to Individual solutions on the following slides.

In the Slide 9, under the leadership of Dave Paulsen, the Individual Solutions team is implementing an integrated view across all of our distribution channels and the product suite for individuals. As a first sign of success, we increased our market shares in recent months for some of our key strategic products, the Indexed Universal Life, Variable Annuities and Fixed-Indexed Annuities, and this demonstrates the competitiveness of our product range.

Our partnership with TCS is also contributing to this progress. With higher customer satisfaction, as evidenced with by significant increase of the tNPS scores since we announced the partnership. The next step is to bring the first new products under the bank's platform over the next quarters. And in addition to our cooperation with TCS, we are now also partnering with a specialist provider for long-term care - Long Term Care Group . In the last week, we started to implement this new partnership which brings extensive expertise in managing long-term care cases efficiently , cost efficiently, and with higher customer services scores. So let me now summarize. We're starting to see good commercial momentum in key areas, but we will need to continue to invest into a harder to improve retention. Overall, we've made good progress in the execution of our strategy, by driving efficiencies in those businesses we manage for value by allocating capital to those activities with the best growth prospects.

Let us now turn to more insights into the financial results for the first half this year. And Matt, can you please take us through these figures?

Matthew Rider {BIO 20002664 <GO>}

Thanks, Alex, and good morning everyone. Let me start by talking you through the financial highlights for the first six months of 2019. Underlying earnings before tax were slightly lower mainly as a result of lower earnings from the United States, which I will elaborate on later in my presentation.

So far this year, markets have been turbulent with interest rates falling to historically low levels in all of our markets. Despite these developments, we have maintained a strong group capital position with the Group Solvency II ratio being at the upper end of our target range. In addition, we increased normalized capital generation and maintained a solid excess cash buffer at the holding. This allows us to raise our interim dividend to EUR0.15 per share, which is an increase of 7% versus the first half of 2018. I will discuss the capital position in more detail on the following slides.

As you can see on Slide 12, our Group Solvency II ratio declined to 197% in the first half of 2019, but remains at the top end of our target range. Own funds grew over the period, driven by strong capital generation, despite the approximately EUR300 million paid out for the final 2018 dividend. Model & assumption changes had on balance, a negative impact of 9 percentage points on the Group Solvency ratio. This was mainly due to the lowering of the ultimate forward rate and a methodology change in the Netherlands relating to capital charges for illiquid investments. After discussions with the Dutch Central Bank, certain illiquid investments will be treated as equities under the standard formula instead of loans under the internal model. This resulted in a significant increase in required capital.

We also updated our actuarial and other assumptions in our US and Asian businesses in the first half of 2019, in line with our normal practices. In Asia, a change in expense allocations, reflecting a lower sales outlook in Transamerica Life Bermuda resulted in lower owned funds. The SCR increased by EUR700 million mainly as a result of adverse market movements, which negatively impacted the Group ratio by 15 percentage points. The impact on the ratio was almost fully driven by adverse spread movements in the Netherlands. Interest rates and equity market movements had no material impact. Lastly, one-time items had a positive impact on balance mainly driven by the proceeds from the divestment of Aegon's businesses in the Czech Republic and Slovakia.

Now let's turn to Slide 13 and briefly discuss the solvency ratios of each of our main operating units. The solvency ratios in the US and the UK remains strong. In the United States, the RBC ratio improved by 7 percentage points to a strong 472%. This improvement was driven by retained capital generation and favorable market impacts.

In the second half of the year, we expect to see a benefit of close to 10 percentage points from the merger of two of our legal entities - TALIC and TLIC. In the United Kingdom, the Solvency II ratio decreased by 19 percentage points to 165%. This decline was mainly driven by GBP160 million of remittances to the holding, including an extraordinary dividend of GBP100 million on the back of Aegon UK's solid and resilient capital position.

As announced at the full year 2018 results, we reviewed the Solvency II target range for the Netherlands following a change to the modeling of the dynamic volatility adjuster. This resulted in increased credit sensitivities for the Dutch business and therefore we decided to increase the bottom end of the target range by 5 percentage points to 155%. In the Netherlands, the Solvency II ratio fell slightly below the target range to 152% due to several factors, most notably, increased capital charges for the the illiquid investments, the lowering of the UFR and adverse credit spread movements on which I'll elaborate on later on in the presentation.

Furthermore, Aegon Bank has been removed from the calculation of the Solvency II ratio of Aegon the Netherlands to be in-line with peers and to be consistent with the calculation of Aegon's Group Solvency II ratio. The change had a positive impact of 3 percentage points on the Dutch ratio while management actions contributed a positive 9 percentage points.

Before turning to our IFRS results, let me first provide some additional color on the market movements which impacted the capital position of Aegon the Netherlands on the following slides.

As you can see on Slide 14, adverse credit spread movements account for a 38 Percentage point decline in the Solvency II ratio of Aegon the Netherlands. On one hand, mortgage spreads widened as mortgage issuers did not adjust consumer prices, while risk free rates dropped sharply. This negatively impacted the value of the mortgage portfolio. On the other hand, spread tightening in the bond market led to a decline in the EIOPA VA from 24 basis points to 9 basis points, which resulted in an increase in the value of insurance liabilities.

Let me stress that these are counter intuitive movements for a company that holds its assets to maturity. In our view, this reflects imperfections in the Solvency II regime and is not a reflection of deteriorating economics or the credit quality of our mortgage portfolio. Previously, we had addressed the basis risk in credit spreads through our dynamic volatility adjuster. As you may recall, we changed the modeling of the dynamic volatility adjuster in the second half of 2018 to better align with guidance from EIOPA. If the previous DVA would still have been applied at the end of June, the Solvency II ratio of the Netherlands would have been 10 to 15 percentage points higher. Other market movements, including lower interest rates had no material impact on the ratio due to the effectiveness of our hedging programs in the Netherlands.

On the next slide, I would like to provide some historic context around mortgage spreads. As you can see on the chart on the left hand side of Slide 15, mortgage spreads are well above the levels seen in recent years. The increase in mortgage spreads in the first half of 2019, to 171 basis points was driven by a strong decrease in risk free rates, while consumer mortgage rates hardly moved. The spread widening in the first half of 2019 is clearly not a reflection of deterioration of the credit quality of Aegon's mortgage portfolio. Mortgages continue to be an attractive asset class with very low defaults. As a result, we expect the spread widening to translate into normalized -- higher normalized capital generation over the duration of the book. In fact, as Aegon is an active mortgage issuer, we're putting assets on the books of the life company and the bank at very attractive spreads, which will benefit future earnings. If consumer mortgage prices would adjust to the lower interest rate level through competitive dynamics, we would expect a positive impact to the Solvency II ratio of Aegon the Netherlands. If mortgage spreads return to their long-term average of 125 basis points, the Solvency II ratio of Aegon the Netherlands would be expected to return to be within its target range. This of course is provided that all else, including the EIOPA VA, remain equal.

Let me now move on to the next slide which provides a summary of our latest Solvency II sensitivities for the group and for our main units. As you can see on Slide 16, we have expanded the list of sensitivities to better reflect the basis risk associated with the Solvency II position in the Netherlands. Let me highlight again that we do not view mortgage spread widening as an indication of credit deterioration and expect any impacts on the ratio to reverse over time.

Another point I'd like to touch upon is our sensitivity to interest rates. Interest rates fell to historically low levels in all of our markets in recent months. Due to our effective hedging programs, we have been able to maintain a strong capital position in the first half of this year. In the scenario of interest rates dropping another 50 basis points from current levels, the Solvency II ratio of the group would remain well within our target range.

Now let's turn to the IFRS results, starting with underlying earnings. During the first half of 2019, underlying earnings declined by 5 percentage points compared -- 5% compared with the same period last year. This was mainly driven by lower earnings from the Retirement Plan and Variable Annuity businesses in the US. These businesses reported lower fee income from lower asset balances and investments in the business to improve customer experience and drive growth going forward. These developments were offset by strengthening of the US dollar in addition to better claims experience in Life, higher earnings in fixed annuities and a reserve release in long-term care.

Experience in the long-term care business continues to be in-line or slightly better than expected. Earnings and asset management were EUR23 million lower as a result of lower performance fees compared with last year's exceptionally high level. Increased holding expenses resulted from a change in the way interest expenses on certain securities are recorded in the P&L. Interest on Tier 2 securities issued last year are taken through the P&L, while the interest expenses for the perpetuals they replaced used to be recognized directly through equity.

Let us now move to the development of net income in the first half of this year. On Slide 18, you can see that IFRS net income amounted to EUR618 million. The loss from fair value items totaled EUR394 million and was mainly driven by a shortfall in the Liability Adequacy Test in the Netherlands, which I will discuss in more detail later in the presentation. The Liability Adequacy Test or LAT shortfall was partly offset by gains on interest rate hedges and positive real estate revaluations in the Netherlands, as well as fair value gains in the Americas. Realized gains totaled EUR275 million in the first six months of 2019 and primarily related to the sale of bonds in the Netherlands as part of trading designed to optimize the investment portfolio.

Other charges of EUR93 million included EUR64 million of assumption changes, mainly in the US. These were primarily related to mortality, lapse and surrender assumption changes in Life insurance following the annual assumption review. Furthermore, we incurred restructuring charges in the UK and in the US, as well as expenses related to the implementation of IFRS 9 and 17. These charges were partly offset by a EUR70 million gain on the sale of Aegon's operations in the Czech Republic and Slovakia, and the gain resulting from the restructuring of financing agreements related to the merger of two reinsurance captives in the US.

Let's turn to Slide 19. As mentioned on the previous slide, a shortfall in the LAT in the Netherlands was the main driver for the fair value losses in the first half of this year. The LAT is a test, which assesses the adequacy of the insurance technical provisions. This test compares the IFRS carrying amount of insurance liabilities to their fair value, while taking into account the difference between the fair value and carrying amount of mortgages, as well as certain unrealized gains on bonds. In the first half of 2019, mortgage spreads widened. This decreased the value of Aegon's mortgage portfolio. In addition, the reduction in illiquidity premium increased the fair value of IFRS insurance liability. This is similar to what we saw under Solvency II. These two elements combined, drove the shortfall in the LAT, resulting in a strengthening of our IFRS technical provisions.

Note that the impact of lower interest rates on the LAT shortfall was completely offset by fair value gains on interest rate hedges, gains on the guarantee provision, and interest related gains on bond sales. This matching is a consequence of hedging programs we have in place to protect solvency capital in case interest rates decline. These programs were entirely effective during the first half of 2019. However, the impact of credit spread movements on the LAT has no hedging related offset. We view these credit spread movements as non-permanent and expect them to reverse over time. Therefore, we do not hedge them.

Now that we have a LAT efficiency, our IFRS results in the Netherlands will move up and down with market movements, in particular, if basis risk and credit spread movement materializes, interest rate movements will have less of an impact though as both fair value movements on assets and liabilities will be recognized in the P&L.

On the next slide, I will give you more details on the capital generation and remittances of the units. In the first six months of 2019, our units contributed over EUR850 million of normalized capital generation. I would like to point out that our normalized capital generation was largely unaffected by market movements in the first half of the year. Specifically in the Netherlands, higher capital generation as a result of spread movements offset the impact from lower interest rates.

Normalized capital generation and gross remittances from the various units well covered the dividend payment of EUR0.15 per share, which translates to approximately EUR310 million in total external dividend payments. Let me expand on remittances and excess cash in the holding on the next slide.

At the end of the first half of 2019, holding excess cash amounted to EUR1.6 billion. Gross remittances to the holding of EUR765 million included a special dividend of EUR112 million from the U.K, underpinning their resilient capital position and EUR131 million following the divestment of Aegon's operations in the Czech Republic and Slovakia. Planned remittances from the Netherlands were retained over the first half of the year. Aegon the Netherlands intends to resume remittances once it's solvency ratio exceeds the bottom end of its target range. Capital injections of EUR142 million were mainly related to funding growth in our Scale-up for the Future businesses.

In the second half of 2019, we expect to pay EUR115 million of earn-outs related to the performance of the Santander joint venture since the start of the partnership. In addition, we anticipate a payment of EUR215 million to Santander in 2020, as the expansion of our partnership announced in 2018 is expected to close next year. As a result, our pro forma excess capital position sits within our target range of EUR1 billion to EUR1.5 billion.

Before I conclude my presentation, let me summarize the first half of 2019. We have made good progress in driving efficiencies and allocating capital to those activities with the best growth prospects. We have also maintained a solid capital position and increased normalized capital generation. As such, we remain committed to deliver on our targets and increase value to shareholders.

With that, I conclude my presentation. Alex and I are now happy to take your questions.

Questions And Answers

Operator

Thank you. (Operator Instructions) We'll take our first question from the line of Farooq Hanif from Credit Suisse. Your line is open. Please go ahead.

Q - Farooq Hanif {BIO 4780978 <GO>}

Hi, there. Hi, good morning everybody. Can you talk about what actions you can take in the Netherlands, from your own actions rather than depending on the market to put yourself well back into the target range? So I'm thinking around mortgage repricing, modeling changes and any other approaches. Secondly, has your appetite for illliquid now changed? And can you give the details of what particular securities are now treated as equities? Is this something that affects you or everybody in the Netherlands? And thirdly, you talked about optimization in the Netherlands or taking actions to accelerate the release of required capital. Can you talk about what you mean there? Thank you.

A - Alex Wynaendts {BIO 1821092 <GO>}

Hi, Farooq. Alex here, good morning. I think that Matt very clearly laid out the impacts on our Solvency II from a number of items of which most are uneconomical. I'm not suggesting a deteriorating economies rather it's the model and the abnormalities in the model that have led to a lower rates. Having said that, it is clear that Aegon the Netherlands has to pay dividends as every other units does and we need to take the actions and we'll take the actions that will bring it back into at least the middle of the target range so that we can comfortably continue or resume paying dividends out of the Netherlands. There are number of actions that we are considering, I will name a few of them.

For example, we are looking at reinsuring longevity. That is an action that we hope to be able to take before the end of the year and that will have clearly a positive impact and as such improve our ratio. It's also clear that the recent Vivat transaction, that market enter is a priority. Private equity investors in the Dutch Life insurance market is creating a new environment and is also providing a new options for us to consider and we will be considering each of these options very carefully because we do realize that we have an enormous amount of capital that is kind of trapped into Aegon Leven, and as you know this business is part of our Managed for Value category. In the Managed for Value category we have two priorities, it's about reducing cost and variabilizing expenses and accelerating the release of capital. So we're looking at all the options including the recently, I would say, new environments that offers, in our view, much more optionality around the back book and we will explore them aggressively.

A - Matthew Rider {BIO 20002664 <GO>}

Maybe I'd take the illiquid asset point. So as I mentioned in the presentation, the change to the required capital for illiquid investments resulted in about an 8 percentage point decrease in the Dutch solvency ratio. This happened as a consequence of direction from the Dutch Central Bank to treat these illiquid assets as basically equity investments under the standard formula rather than as more debt like securities under our internal model. I would say that we are still in discussions with DNB on the ultimate treatment of these. We took the conservative route for this first half year, but we have not concluded on this with them as yet. We still like the illiquid asset class, the ones that this new approach applies to is really in the consumer loans and direct lending space and maybe just as a reminder, we have about EUR3.2 billion of alternative assets as part of the total alternative asset program in the Netherlands and we added about EUR800 million this year. It will -- so far this year, it will cause us to go back and have a look at basically the trade-off between required capital and excess spread, but again we are in constant discussion with the Dutch Central Bank on the treatment of these new asset classes.

Q - Farooq Hanif {BIO 4780978 <GO>}

Okay, thank you.

Operator

We'll take our next question from the line of Albert Ploegh from ING Bank. Your line is open. Please go ahead.

Q - Albert Ploegh {BIO 3151309 <GO>}

Yes, good morning all. Yeah, for the bit of follow-up question on the previous ones. First of all, on the, -- I hear what you say on the mortgage spreads being an economically, -- that they impact on the solvency ratio. But basically I think Q3 so far, of course, spread effects has actually only started to widen further. So can you give maybe a little bit feeling

-- yeah, how that -- so clearly things worsened further? So I'm sort of little bit puzzled also on your EUR1.5 billion cash remittances guidance for this year. I assume that normally it was something like a EUR100 million to EUR200 million difference for the Dutch business in there. So are you really comfortable that you can pull off something like the reinsurance protection by year-end to deliver on this or are you still basically now zero assumption in the EUR1.5 billion cash remittances service can be made up good elsewhere in the group.

And then basically I had one question more on the -- yeah, on the back book and front book yields in the US. I remember that in the second half of last year, they were more or less at the same level. So no drag on earnings from that. Yeah, obviously that has widened, but can you maybe give a bit of a heads up where we stand today. That will be helpful. Thank you.

A - Matthew Rider {BIO 20002664 <GO>}

Yeah. So let's talk about the mortgage spreads for a moment. Again, it had a considerable impact on our solvency ratio and we see them as extremely wide relative to certainly recent history. Albert, you rightly point out that we have had even slightly more widening in the mortgage spreads and we've also seen interest rate decline and changes in the EIOPA VA. And just to give you a little bit of guidance here, we would estimate something like a 5 percentage point reduction in the Dutch solvency ratio like as of today, based on sort of all the available information. But again, the markets are a bit disconnected now and we would expect these to come back over time.

With respect to the overall gross remittances guidance. Probably the best thing that I can say is, we put out a target at the beginning of the year and based on what we see, we're still going to be able to meet that target. Talking about the back book and the front book yields in the US, I think for the first half of the year, we had new money yields sitting at 4.09% and the back book yield was at 4.65% and I think that covers those questions.

Q - Albert Ploegh {BIO 3151309 <GO>}

Okay. Thank you.

Operator

(Operator Instructions) We'll take our next question from the line of Robin van den Broek from Mediobanca. Please go ahead.

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

Yes, good morning everybody. First of all, on your Dutch Solvency II ratio above 155% you indicate that you feel comfortable to remit capital to the group. Just wondering if you could talk about, do you afar benefit within that ratio, seems to me that on the back of the current curve that's well over a 100 percentage point. Is the regulator still comfortable with remitting capital on ex-UFR ratios like that? Secondly, I think it's interesting that you specify in the slides that the mortgage spreads beneficial for capital generation is more than offsetting the headwinds coming from interest rates. Can you quantify those two dynamics because I think in the past you said that one bip of rates movement downwards is roughly 1 million of capital generation. So, year-to-date interest rates are a pretty big headwind. So could you maybe give us also the number on what tailwind do you expect from the mortgage side and confirm that, that one bips for 1 million is still valid?

Then aggressively looking for ways to offload balance sheet in the Netherlands, can you comment a little bit more about that -- I presume you're talking about private equity coming into the market. Can you talk a little bit more about to how aggressive things can go there, because given the multiples that Athora has paid, you could argue that private equity is a better owner for this books of business, but would you go as far to offload your entire book or could we just expect to see something small happening here?

And lastly on your normalized capital generation, you're already hitting numbers above EUR700 million, that puts your annualized number above EUR1.4 billion that's over a three year framework assuming no further growth. You're already at EUR4.2 billion versus a EUR4.1 billion target. Can you talk a little bit about the quality of that sprint in H1? It seems to me that the quality has improved year-over-year and also because your strain has gone up, but are there any one-offs in there that we should think about or can we actually expect you guys to deliver on something materially better than the EUR4.1 billion target? Thank you.

A - Matthew Rider {BIO 20002664 <GO>}

Okay. On the Dutch Solvency II ratio, the idea is -- the bottom end of the target range 155%, as long as we can get over that one, then we will feel comfortable paying a dividend. I think as you well know, the UFR continues to be a drag, both in terms of our normalized capital generation, but also were reflecting in the first half of the year, the 15 basis point decline in the UFR when -- but I think your question was more specifically, does the Dutch regulator look at solvency ratio after -- or taking out the UFR. The way that we look at economic reality is we look at that as a flow issue, not so much a stock issue. So as long as we see our dividend base increasing, including the reduction in the UFR over time, then that's really the basis by which we are able to rationalize paying dividends out of the Dutch organization.

On the second point, I can validate the 1 basis point -- for the 1 basis point change in interest rates gives EUR1 million benefit. For the rest of it, the mortgage piece of it, let's refer that to IR later. The explanation is quite detailed to do that one on the call now. When you talk about aggressively pursuing, say management actions to release capital from the Dutch business, I think we've been very clear with respect to our strategy for that -- for these Manage for Value businesses, we really -- we really focus on capital optimization, variabilizing expenses, but most notably accelerating capital repatriation to the holding over time. Now, there are many ways to do this. There are other management actions that we can take to release capital. For example longevity reinsurance which we'll pursue in the second half of the year.

But the entrance of private equity into the Dutch Life market as a consequence of the Vivat transaction has opened up opportunities. There is interest out there for long duration Dutch Life liabilities. And we have to factor that into our thinking, there is a bit of a new reality. We all knew that it was coming after we saw so much private equity interest in the Vivat transaction. So this is, let's just say that it creates additional options to release capital in accordance with our strategy for managing for value books.

The normalized capital generation your math -- your math is right, and we've seen some actually some good increases in new business strain, it's largely mix of business related, but I would actually expect -- I would -- that's normalized capital generation target over three years. I would like to see some additional production that would increase new business strain. So right now, if we don't grow the business, yes, normalized capital generation will -- we will easily hit our target. But I'd rather invest for the future, invest in new business, and then that will generate capital going forward in years to come.

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

Yeah, thank you for that.

Operator

We'll take our next question from the line of Matthias de Wit from Kempen. Your line is open. Please go ahead.

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

Yes, good morning. I've got three questions please. First is, just to come back on the longevity reinsurance. Is there currently a lot of appetite in the market to absorb large parts of -- or significant portions of longevity risk because we've only seen quite small transactions so far in the Netherlands? Can you maybe also say something about how much or what proportion of the SCR and risk margin is currently linked to longevity? And then secondly, can you provide some guidance on the impact of low rates on earnings and capital generation at group level and maybe also provide some comments on the long-term care book which is particularly sensitive to rates and then very small last one on Retirement Services, outflows are slowing down and so I wonder if you could already expect a return to inflows as of the second half. Thank you.

A - Matthew Rider {BIO 20002664 <GO>}

So on the longevity reinsurance, yes, we have indications from several reinsurance companies that there is capacity to handle a reasonable transaction. I think with respect to the SCR related to longevity, I would just refer you to the FSCR. The information is contained there. Let's see, impact of low interest rates on earnings, so, basically, so earnings, so let's say, underlying earnings in the US as an example, basically 10 basis points interest results in 10 million additional deck unlocking, so that comes through above the line, given you some pretty good -- I think we've given you some pretty good guidance on IFRS sensitivities. There is not so -- how do you want to say it -- on the, so -- on interest rate sensitivities elsewhere on, let's say capital, we've given the sensitivities on Slide 16 for the major units and the (Technical Difficulty) group. Long-term care, not so much interest rate sensitive simply because we had locked in long-term interest rates long ago with forward starting swaps and those things are still in place and effective and maybe Alex, you can take the retirement...

A - Alex Wynaendts {BIO 1821092 <GO>}

Yeah, on the Retirement Services and the gross deposits. So we had very significant gross deposits with EUR65 billion. But, what is more encouraging is to see that our written sales and that means the contracts that we have closed on our retirement, and they take usually six to nine months before effectively the deposits are being transfered, we see that for written sales, there was an increase of 74% to EUR10 billion. So we know that EUR10 billion of inflows will be coming in the next six to nine months. And I'm positive about the momentum here, because we are now seeing that we're also becoming -- to become successful in the large case segment of the market, with two sales in excess of EUR1 billion in the large case and there -- here what we see, we are able now to leverage the skills and capabilities that we have acquired with the Mercer transaction. But at the same time in our annuities, in particular, variable annuities, you see, we've been able to increase our market share and the gross deposits on the new product, Retirement Income Choice product has been increased by 76%. So positive momentum on gross deposits.

Now, I will certainly say that on retirement, it is a lumpy business. So inflows and outflows don't always match in terms of timing, but the positive is to see that written sales have started to increase significantly.

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

Okay, thank you.

Operator

We will take our next question from the line of Nick Holmes from Societe Generale. Your line is open. Please go ahead.

Q - Nick Holmes {BIO 3387435 <GO>}

Oh. Hi, there. Thanks very much. Just a couple of quick questions on the US. So the first one, I know this fixed annuity sales grew by 75%. My question is, why do you think now is a good time to sell these when bond yields are obviously falling and also, is the interest rate guarantee on these products re-settable so that you can reset for lower rates? And then secondly, I'm surprised that US Life sales were down 12%. I would have thought this is a key product for you. Wondered if you could give us a bit more color. Thank you.

A - Alex Wynaendts {BIO 1821092 <GO>}

Nick, good morning. The fixed annuities are indexed fixed annuities. So it's not the traditional fixed annuities of which you know we've effectively put in run-off and that's why the sales, by the way, from a relatively low level have increased very significantly. And there we do not have the type of guarantees and this type of spread risk that we had in the traditional fixed annuities. In terms of Life, what we're seeing is that we are making clearly progress in our IUL, Index Universal Life in particular through our distribution channel WFG, where we are now gaining share in the market. So we're getting a bigger proportion of their sales. And that has been a positive. While at the same time, we are re-launching a number of our more traditional products, which as you know are products that are becoming more and more commoditized and also, where the price -- the pressure is important. So we need to balance the sales versus productivity -- profitability of the product in particular with low interest rates.

Q - Nick Holmes {BIO 3387435 <GO>}

That's great. Very clear. Thank you, Alex.

Operator

Thank you. We'll take our next line -- from the line of Johnny Vo from Goldman Sachs. Your line is open. Please go ahead.

Q - Johnny Vo {BIO 5509843 <GO>}

Yes, thank you very much. Just a couple of quick questions. I mean, when I think about what's going on, it stems from your very overweight position in mortgages, and previously, you had a valuation which followed the liabilities very well. You were forced to then change, it had an effect on your solvency and now it's falling apart again, even if it's not economic, but do you think that there could be some wholesale changes you can make in the asset mix to better match your assets and liabilities such that they move together because it seems that it's emanating from the same place? That's the first question.

The second question is, the illiquid asset that you talked about, these are the peer-to-peer loans, if I'm correct. So these are unsecured personal credit. I guess why did -- I mean, these are, I guess, relatively risky sort of assets -- and but I wonder why the regulator has now decided to change the approach you've used to calibrate to the standard formula.

And the third question is just in relation to remittances, it appears that you had fairly large remittances from the European business, which appears a bit one-off, you've obviously got one-off from the UK and the US was actually -- the remittance from the US was quite low. So, can you explain that as well? Thank you.

A - Matthew Rider {BIO 20002664 <GO>}

So on the first one, I mean, the issue that we're having in Dutch Solvency is the disconnect between the portfolio -- the asset portfolio and as you rightfully say, largely overweight on mortgages relative to what's going on with the EIOPA VA. The way to solve that mismatch problem would be to invest in the basket of securities that represents the reference portfolio for EIOPA VA which includes, for example, Italian government bonds. So that's something that from an economic standpoint, we choose to look at the economics, yes, there is volatility in the solvency ratio. There is no question about this. I think that changes to the way that the volatility adjuster works will be a top priority for the whole insurance industry in Europe as we go into the 2020 review of Solvency II partial internal models. So at this point, yes, there are technically wholesale changes that we can make to the investment portfolio, but we have no intention of doing that.

With regard to the illiquid assets and the Dutch Central Banks now asking us to go to standard formula equity treatment, your question was, why do they do that at this moment in time. We are constantly reviewed by the Dutch Central Bank on a number of issues, for example, the dynamic volatility adjuster in the second half of 2018, our adjustments to that model came at the request of DNB. And strictly speaking, according to EIOPA guidance as well. That had muted a bit. It acted as a little bit of a dampener in terms of volatility that we are experiencing in the volatility adjuster. Similarly with mortgage valuations, at one moment in time, we had a smoothing mechanism where we would look at consumer prices over a relatively short period of time, and now, we look at them at a moment in time, which is adding additional volatility. So it's a challenge, I think, as all companies are getting used to implementing Solvency II and not only companies but also regulators. I think they are filling in the gray areas at this moment in time, but that's the state of play with the Dutch Central Bank at this point.

With regard to your question about US remittances, saying that they are low, this is just simply timing issue. So we have a budget for planned remittances from the US and we feel very confident that they are going to be able to meet their budget for the overall year.

Q - Johnny Vo {BIO 5509843 <GO>}

Okay, thank you.

Operator

We'll take our next question from the line of David Motemaden from Evercore. Your line is open. Please go ahead.

Q - David Motemaden {BIO 18818634 <GO>}

Hi. Just a question for Matt, on [Audio Gap] if rates are around this level when you guys do your statutory cash flow testing, I guess, do you have any sense for the size, if there will be a charge at the end of the year on a stat basis and how big that may be? And then on this point, in the past you've said that the long-term care book has had a deficiency on a cash flow basis, but you've been able to aggregate with other lines of business and resulted in you guys not having to add reserves there. Just given the move-in rates, is that still the case? And then finally, just on the IFRS assumptions in the US, some of your peers have now moved below 4% on their 10 year assumption. Just wondering what sort of sensitivity there is to IFRS book value, if you were to lower your assumption by 50 basis points. Thank you.

A - Matthew Rider {BIO 20002664 <GO>}

Sure. So first of all, on the cash flow testing. I think the best way to answer the question is to refer you to the capital sensitivities on interest rates. And that takes into account all that we know including, where we would think year-end cash flow testing would end up. So I think that, that is a pretty good guide for thinking about the US capital situation. But effectively we are in, -- I think we're in pretty good shape. But the same -- you can just look through to the sensitivities. On the long-term care testing, the more binding constraint is on the premium deficiency reserve testing and given the fact that we have had continued good experience in the block, we do not view the lower interest rates as putting that one into danger. So, but again on the overall sensitivities to interest rates, I can refer you to the capital sensitivities that we're publishing.

On the IFRS assumptions in the US, I think you know well, currently, we are assuming an increase to 4.25% on the 10 year -- over the next 10 years. I don't -- we just went through our economic assumption review. We decided not to change that figure and at this moment, I don't really have an estimate of what our deck unlocking would be, if we move that it would certainly depend on how we did the grading but that's something that we can -- that we can get to you.

Operator

Thank you. We'll get our next question from the line of Patrick Lemmens from Robeco. Your line is open. Please go ahead.

Q - Patrick Lemmens {BIO 2551607 <GO>}

Yes, hello, good morning. I would like to start with the observation, which is, well, if mortgage spreads are going up that much in the Netherlands, it must also be banks who are facing ever tougher interest conditions and need to get higher mortgage spreads to compensate for that, but maybe two questions, if I may. The first one is, if you look at the capital unlock in the Netherlands, let's say, for example, you could do a 25% of the total book selling or getting sort of getting it off your hands, what would be the impact on capital and also what would be the timeframe to do this and probably also given sort of the changing future leadership, could that be done also before March next year or would you want to wait with those kind of strategic decisions?

A - Matthew Rider {BIO 20002664 <GO>}

So, may be on your observation, yeah, I think you're entirely right that banks are certainly looking for yield here and in a low interest rate environment. So you can imagine that they wouldn't be so anxious to reduce consumer pricing. And in fact, I mean we're issuing quite some mortgages ourselves putting it in the balance sheet of the bank, putting it under the balance sheet of the Life company. So we actually like writing these mortgages at attractive spreads and I think we did over EUR3 billion in mortgage production in the first half of the year.

So it was quite some good business that we've been able to put on the book, but you're right, we don't know the direction of mortgage spreads going forward. But we would expect to a certain extent that they would ultimately compete it away. But we'll see, we'll see. With respect to the, let's say, the capital unlocking in the Dutch business, I think it's very difficult to comment on timing or what the financial consequences would be simply because you have to identify the piece of business that you might be willing to sell or re-insure or whatsoever and then you would have to have a good understanding of the price. But I think the read through from the Vivat transaction is that for the entirety of the Life business, they were able to get a price that was quite a high percentage of their own funds. So that's probably the best way to look at it, but in terms of timing and structure and so on, that's difficult to comment on.

Operator

We'll get our next question from the line of Fulin Liang from Morgan Stanley. Please go ahead.

Q - Fulin Liang {BIO 21126177 <GO>}

Hello. Thank you. Just a couple of quick questions on the new business. If I look at your new business, if I measure your efficiency of how you efficiently use the capital, the new business strain to generate new business and then if I look at that, in the first half of 2019, you used actually more new business strain but generate less new business value compared to the 2018. I just wonder why is that the case and also a related question is actually, if I look at this, this number actually this kind of ratio efficiency actually fluctuate quite a lot from 2017, 2018, now in 2019. So what is actually the driving force underlying this kind of efficiency if I measure it that way?

And then secondly is, again you talked about the PE coming into Netherlands actually open the optionality for you to think about the Netherlands book. Just wonder where is, given your governance structure and, you know, there is association there and where, kind of, where is the discussion with association regarding to this. And then the last thing is about small question about the bank. So obviously, you're combining the bank with Knab. I just wonder, the franchise-wise and also I understood that the customer base of these two kind of banks are very different and what's the plan and why you're doing this, I just wonder? Thank you.

A - Matthew Rider {BIO 20002664 <GO>}

Let me take your points here. So on the first one, the -- let's say, the efficiency ratio that you're looking at is, I would say, a little bit of a distorted view. So I'm assuming that you're looking at new business strain compared to MCVNB. And in that context, it's a little bit of an apple and an orange. But in broad terms, in broad terms, I can say the following. What we saw is an increase in new business strain over the first half of the year relative to prior periods, but it was mainly due to mix of business and it comes down to business that where we sold a little bit more Indexed Universal Life, which has a higher strain, little bit more Variable Annuity, has a higher strain, more strain in the workplace business in the UK. And even though production was reasonably flattish, the mix of business had a change. Now, you do raise an important point on the MCVNB and that is the impact of lower interest rates. And I think if you look through carefully here, we are still trying to grow the Variable Annuity business in the United States, but what we're seeing is interest rates are coming down and we're creating negative MCVNB's. But in order to drive commercial momentum in that business, we are at this moment still emphasizing being competitive in the market. We do not want to lose our market competitive position. We do not, in this case, want to be a first mover on price. We think that other companies will react to the low interest rates, we want to be a fast follower but not a leader in this context.

You talked about PE coming into the Netherlands. I think the -- probably -- and I think Patrick was alluding to this earlier, we are going to evaluate options for the Dutch Life Insurance business on many dimensions, but looking at the core strategy for Manage for Value businesses, which is to release capital. We are not going to wait for a new CEO to come in. Alex, certainly has a mandate through May of 2020 and Alex and I are going to run the business the way that it needs to be run in the best interest of all stakeholders, including foremost shareholders.

Now the (Inaudible) Aegon is an important player in this. They have a responsibility toward all stakeholders, including employees, the public at large, and so on. So they'll need to be taken along this journey. They own slightly more than 14% of our common shares, they need to be taken, -- they need to be taken along and -- but I think the most important point is that we would not sit on our hands and wait to take action.

A - Alex Wynaendts {BIO 1821092 <GO>}

Should I add a few comments on Knab and the integration? Well, actually, it's very simple. You're absolutely right. There is not exactly the same customer base in Knab. We have a big percentage of self-employed. But the reality is that we are looking for synergies and cost efficiencies but also process efficiencies around compliance everywhere where we can. So, it's, I think, obvious that having Knab on one side, with its systems, its compliant systems, its Know-Your-Customer, all the money laundering issues as you know become more and very heavy and have that alongside in the Aegon Bank being duplicated doesn't make a lot of sense. So, we're bringing it all onto one platform, one system, one management to ensure efficiency from cost but also efficiencies on areas of compliance, on the areas of Know-Your-Customer and there it is not so relevant if the customers are different, we need to make sure we do it and that's why we are doing this integration that will drive also quite some significant cost reductions.

Operator

We'll take our last question from the line of Ashik Musaddi from JPMorgan. Your line is open. Please go ahead.

Q - Ashik Musaddi {BIO 15847584 <GO>}

Yeah, hi, good morning, Alex. Good morning, Matt. Just couple of questions. I mean, yeah, I mean this private equity thing is pretty interesting, I mean people have paid some crazy multiples for businesses, not crazy over, I mean it's a logical multiple. But it's clearly the best way to unlock value, but what I struggle with that is how would you unlock value up to a full extent. I mean, the best way to do it is to split the US and the other businesses.

Now, if you just try and do reinsurance, basically, I mean, Aegon Netherlands will again become a very small part of the group basically. I mean UK is like 5%, you have some of the European businesses, which in aggregate is a 10%, Netherlands will be like 5%, 10%. So what is still the logic of keeping this altogether? I mean there is clear -- clearly better value unlocking that can happen if we think about doing a split. So that's one question. Second -- I mean, and we have discussed this in past as well, but just trying to think again just because this private equity debate is picking up.

Secondly is, in terms of Netherlands cash generation and capital generation. I used to remember that it was EUR300 million, EUR325 million and it looks like your first half run rate is suggesting EUR400 million annual. So if I'm missing anything on there and the last bit would be, can you just remind us as to what the US cash flows for the year should be, the dividends, the remittance from US? Thank you.

A - Matthew Rider {BIO 20002664 <GO>}

Okay. So on the first one, I mean, as we've talked about private equity entering into the Dutch market does create some interesting opportunities. You can think of a variety of structures to unlock capital and all I can say is that we would look at all options. Now depending on what those options are, they could ultimately have strategic consequences with the structure of the group. But we're going to take a little bit of time and think about how best to optimize the capital structure in the Netherlands, get them back into dividend-paying status, and again, as I have said, to accelerate the repatriation of capital out of the Dutch Life business to the group.

With respect to the Netherlands capital generation, yeah, I mean, the point is that their capital generation is quite good. It's growing. It is a consequence, in fact, of the illiquid asset program and expense reduction measures and many other things that we do on the management side to be able to accelerate capital generation. So it is a bit frustrating to see that normalized capital generation, while increasing, we have strange market movements that are affecting the solvency ratio and it's obviously -- the part that's frustrating is the sort of non-economic elements of Solvency II that are creating headwinds for us at this moment in time. But you have it right. Our capital generation is improving. So that is a good thing. In terms of the US cash flows for the year, I think we're definitely on target and we would expect something in the EUR900 million range for the year and I would think growing from there.

Operator

We have no further questions. Please go ahead for any additional closing remarks.

A - Alex Wynaendts {BIO 1821092 <GO>}

Thank you, everybody, and I wish you a good day. And wish you also a good rest of the summer and see you all soon. Thank you. Bye-bye.

Operator

That concludes today's conference call. Thank you everyone for your participation. You may now disconnect.