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Farquhar Murray  Autonomous Research - Analyst
Ashik Musaddi  JPMorgan - Analyst
William Hawkins  KBW - Analyst
William Elderkin  Goldman Sachs - Analyst
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Steven Haywood  HSBC - Analyst

PRESENTATION

Operator

Good day and welcome to the Aegon Q1 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. Please go ahead sir.

Willem van den Berg  Aegon NV - Head of IR

Thank you. Good morning and thank you for joining this conference call on Aegon’s first quarter 2015 results. As always we will focus on the key items to keep today’s presentation short, leaving plenty of time to address your questions. We would appreciate it if you take a moment to review our disclaimer on forward-looking statements which is at the back of this presentation. Our CEO, Alex Wynaendts, will now provide an overview of this quarter’s performance and will answer your questions, together with our CFO, Darryl Button. With that, I’ll hand it over to Alex.

Alex Wynaendts  Aegon NV - Chairman and CEO

Thank you Willem and good morning everyone. Again also thank you for joining us today. So our results this quarter were clearly mixed, with disappointing underlying earnings contrasting with very strong life sales and deposits. In this call we would like to provide you with some more color on the key drivers behind these results before addressing where we stand today on Solvency II.

As you can see on slide 3, the biggest item impacting our underlying earnings this quarter is adverse claims experience in our US business. The main element of this adverse experience is adverse mortality of $63m. While we usually see seasonal effect on mortality in the first quarter, this time the seasonal effect was more severe, driven by both frequency and severity of claims. Over the last few years we’ve recaptured a number of reinsurance treaties on all the blocks of business and mortality results have therefore become more volatile, which became apparent this quarter.

At the same time in the US accident and health business we also saw adverse claims experience amounting to $27m. This was a result of seasonality in our supplemental health business and higher long-term care claims.
Let me reiterate that we’re clearly disappointed by these higher claims as they overshadow the very strong growth of our business, as we’ll cover on the next two slides.

In the first quarter our sales grew by 32%. There were three main drivers for this growth. First, record deposits, both on a gross and net basis, which I’ll come back to in a moment. Second, new life sales, which were especially strong in the US and in Asia. And third, higher accident and health sales supported by the US.

While it’s clear from these numbers that the customers continue to value the products and services that we provide, these sales also contribute to the creation of long-term shareholder value. The value generated by new business this quarter was $140m and although this number has come down from the previous quarter, we are pleased with this result considering the very low interest rate environment in which we operate.

Let me turn to slide 5 and share some more details on this quarter’s record deposits. In the US the production of variable annuities continues to be strong. This, despite product changes to improve profitability in the low interest rate environment.

Our US retirement business is also performing very well, with deposits up 12% to over $9b and with 80% of the quarter’s growth coming from recurring deposits. This growth is the result of the success we’ve had in better connecting with plan participants. Through outreach programs and digital tools such as mobile apps and customized websites we’ve been able to help plan participants better understand their retirement needs, leading to higher recurring deposits.

If we now take a brief look beyond the Americas. In the Netherlands we saw deposits increase to EUR1b at our unique online retail bank, Knab. Aegon Asset Management had strong third party deposits, up 24%, driven by absolute return fund in the UK and Dutch mortgage fund. And our platform in the UK we’ve had GBP1b of inflows for the first time in any quarter, driven in part by the success of our customer upgrade program.

I would also like to highlight here that the new business strain as a percentage of sales further improved this quarter, clear evidence that we’re executing on a strategy to become more capital efficient.

And on that note, let’s move to capital management on slide 6. Our gross financial leverage ratio is now well within our target range of 26% to 30%, a result of the significant deleveraging we’ve implemented over the last three years. Being within our target range, together with excess capital holding of EUR1.4b, creates great financial flexibility. And furthermore, during the second quarter we will upstream an increased interim dividend of $700m from our US business as US, with $1.5b of excess capital, is now well over its buffer level as per our capital policy.

So turning to slide 7, let me now give you a short update on Solvency II. As you know, implementing this new capital framework is a significant undertaking for us and for the entire industry here in Europe. Many of our colleagues at Aegon across the various businesses are working very hard to ensure we are ready by January 1 2016. And as the implementation date approaches we’re gaining greater insights on implementation process of Solvency II.

A number of key items do, however, remain uncertain and will need to be resolved over the course of this year. In particular, we will be submitting our internal models for regulatory approval for our Dutch and UK businesses and we will do this before the end of the second quarter. And for US business we assume equivalence while the conversion of the life insurance company’s RBC ratio is still under discussion with our Dutch regulator.

Taking into account not only these uncertainties but also the progress we’ve made so far, I can today reaffirm that we expect our Group Solvency II ratio to be within the range of 150% to 200%.

One last point on Solvency II that I’d like to make here is that there has been significant attention on where Group ratios in the industry will land. Our view however is that the local ratios will be more important because it’s these ratios that will ultimately drive cash flows through the holding and ultimately to our shareholders.

So in summary, while I recognize that this was a difficult quarter from an underlying earnings perspective, I am pleased that despite the challenging low interest rate environment in which we operate our customer focus is allowing us to grow profitably. And by taking the right steps to ensure
that the Company is well capitalized we are confident that we can operate effectively on Solvency II and continue to help ever more customers secure their financial futures.

Darryl and I are now happy to take your questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions). David Andrich, Morgan Stanley.

David Andrich - Morgan Stanley - Analyst

Hi. Good morning. Thank you for taking my questions. Three questions on my side. First of all, I was just wondering in terms of the increase in operating free cash flow in the quarter, I was just wondering if you could give a bit more detail on the one-off impacts coming through.

Second of all, on slide 22 I couldn’t help but notice that you drop the indication lines for target level and buffer levels of capital in the Netherlands and the UK, and I was just wondering if there was anything that we could -- anything that we should read from that?

And then finally, I was just wondering if you could give any indication or affirmation whether the UK and the Netherlands are also within the 150% to 200% Solvency II range? Thank you.

Darryl Button - Aegon NV - CFO

Hi David. Tt’s Darryl. Let me hit those questions. The first one on operating free cash flow, yes, the one-time items was really tax-related as it related to the US. And actually we did some recapture of some of our captives that we had in Bermuda and in doing that we were able to actually utilize net operating losses that existed down there from our variable annuity hedging program. So we were able to crystallize that and turn that into capital benefits in the US, and that was the bulk of the one-time items.

You’re correct in noting that we did drop the target buffer lines of the Netherlands and the UK this quarter and we did that because we really are transitioning over to Solvency II. So what we’re finding is on the local ratios that we’re really -- the IGD 1 ratios and the Pillar 1 ratios are really drifting into the background as not our most relevant conversation that we’re having with the regulator.

So we know that that’s a bit of a hole and we have to follow up, and we will follow up in January with a new capital policy that’s all linked to Solvency II. But that basically represents where we are with the gap -- the information gap we have with Solvency II out there right now.

And the third question, I need a little help remembering what that was. Sorry.

David Andrich - Morgan Stanley - Analyst

Just wondering if you could give any indication of whether the Netherlands and the UK are within the 150% to 200% Solvency II range that you’ve cited for the Group number?
Darryl Button - Aegon NV - CFO

Yes so we’re not actually giving any guidance on the country units on this quarter. I actually hope that on Q2 that actually that would be -- so in August might be the right time to start to give you some guidance on where we are on the country units.

A lot of that has to do with there’s still so many open items on the internal model approval process. Alex mentioned in his opening remarks we’re going to be filing that in June and we should have a much better indication at the end of June at least where we sit. We’ll have some open regulatory approvals still in August but I think we’ll be in a much better position to tell you where the country units are coming in.

David Andrich - Morgan Stanley - Analyst

Okay. Thank you very much.

Operator

Farooq Hanif, Citigroup.

Farooq Hanif - Citigroup - Analyst

Hi there. Thanks for taking my questions. Firstly, on the 150% to 200% range, you've reiterated it. Obviously stuff has changed. Maybe I can ask it this way. In that 150% at the bottom end of the range are you allowing for adverse development on all of those uncertainties that you've listed on your slide? That's question one.

Secondly, long term care has obviously gone up as an issue in the US. You obviously have peers who have also had poor experience. What comfort can you give us that we're not going to see this repeat going forward, particularly given lower reinsurance but also just given lower yields?

And the last thing is there's kind of been a change in message it appears to me on the Group ratio. So last time I think we spoke you were worried about the Group ratio being a driver of dividend policy but now you're saying well actually it's the local regulators and how they interpret Solvency II driving internal dividends but at the hold co what we've got is what we've got. Can you just explain why you've changed that message? Thank you.

Darryl Button - Aegon NV - CFO

Yes Farooq. It’s Darryl. Actually let me deal with the last question first. I don’t think that that’s a change in message at all actually. I think I’ve been fairly clear in delivering the message I think from the beginning, which is the most important part of Solvency II will be the local ratios because that will drive cash across the organization.

It’s true that there is Group supervision underneath Solvency II and that we will have a Group ratio, and we'll have to have our dialogues with the Dutch Central Bank on exactly what that means from managing a Group capital position. But by far the most important part of cash movement across the organization will be driven by the solo ratios.

Farooq Hanif - Citigroup - Analyst

Can I just come back on that quickly? So obviously the solo ratios drive cash movements in the Group but you seem to be suggesting that in terms of your overall dividend policy -- is that what you're saying? Your overall dividend policy is not really going to be determined by that? Is that correct or not?
Darryl Button - Aegon NV - CFO

Well, I think we have to get into that conversation. We will have some Group targets as part of our overall capital policy; I think that’s fair to say. We have a Group ratio today. We have it under our Group IGD 1 ratio, which is we use in dialogue with the Dutch Central Bank on capitalization across the Group. It’s more of an indicator on where aggregate capital sits across the Group. If the Group ratio, I think it’s fair to say if the Group ratio is troubled or under pressure it’s going to be because there’s an underlying solo issue somewhere. So I still think it comes down to the solos.

The Group ratio is impacted by things like the debt in the holding and things like that and there will be opportunity over time to further reduce senior debt and replace that with Tier 2 over time and that will impact the capital ratio as well. So those are the kinds of things that we have to take into account when we think about a Group ratio dialogue.

You asked about, in your first question you asked about our range, does the range cover negative outcomes across the different threads. Yes, that’s the purpose of the range. So we try to put out there what we think is a realistic range given the uncertainties that still remain and we still think that that’s an appropriate range. But we do think we can start tightening that in when we get into the second half of the year and obviously by the time we get into Q3, Q4 we’ll know exactly where we’re coming out.

We’ll look to try to maybe tighten that down maybe even already in August, as I mentioned before, depending on how our final outcomes in the next month or two go. But it does cover some uncertainties, both within Europe and largely related to the internal model process if you will, and also in the US as we continue our dialogue. We have a working assumption of the 200% conversion rate on the RBC but that’s very much a working assumption and we’re in the middle of the dialogue with the Dutch Central Bank on that right now.

The second question, your middle question I think was on long term care. Yes, all I can say there is we saw some -- it was a bit of an unlucky quarter for us quite frankly. We had a lot of the claims story out of the US all went in the wrong direction and long term care happened to be one of those. We had some accident and health underperformance in the quarter. About half of that was long term care and the other half was our supplemental health business in the US, both experiencing negative results.

I don’t have anything to suggest that it isn’t just a fluctuation at this point. I think on the medical supplement products it’s more of a seasonal impact and I think the long term care is more of a fluctuation.

Farooq Hanif - Citigroup - Analyst

Okay. Thank you very much. Thank you.

Operator

Farquhar Murray, Autonomous.

Farquhar Murray - Autonomous Research - Analyst

Morning gentlemen. Just two questions if I may, both around capital. Firstly, when Aegon originally introduced the buffer and target thresholds for the S&P level, the intention was to upstream anything above the buffer level. Yet if we look at the upstream of $700m in the second quarter, that would still leave you running somewhat above the buffer level, and I’m just wondering what’s the rationale for that.

And then secondly on Solvency II, where are we with regards to discussions around the RBC conversion ratio? I think the Solvency II projection for [1116] of 150% to 200% assumes a 200% conversion factor but there always seemed to be a possibility that it could be somewhat higher than that. I’m just wondering where the debate is possibly heading on that? Thanks.
Darryl Button - Aegon NV - CFO

Yes, Farquhar. It's Darryl. I'll take those. Yes, I think on the S&P, you're absolutely right, we have been running on the high end of the capital range in the US and we've been capital generative in the US and in fact we are going to be upstreaming increasing the normal half-year dividend because of that fact. So I think we are living to the policy if you will.

A think a broader question is but why are we operating towards the higher end. I think in this interest rate environment we feel fairly comfortable actually running towards the higher end of our stated range. I think where interest rates and volatilities are in the market it would not be the right time to bring capital ratios in the US to the bottom end of the range. So I think you can continue to look for us to run towards the upper end of our stated ranges but managing within our capital policy.

On the RBC conversion, really all I can say is we're in the middle of the dialogue. We have used 200%. It's what we used in our Solvency I framework so it was the natural placeholder. We think that's actually a good number but quite frankly we're in the middle of the dialogue with the Dutch Central Bank on that. There is some discussion, I know the Dutch Central Bank's having some discussion with IOPA in that there does appear to be some inconsistencies on what some of the other companies are using. So we're just going to have to sit back and wait for that dialogue to play through to see if there's an attempt to try and bring some consistency to play.

I actually hope by August that we'll actually have that discussion finalized and I'll be able to tell you where we land. We've allowed for some slippage in that ratio in the range that we've given but -- so the base number is 200. We've allowed for some slippage but quite frankly I can't say anymore than that at this point.

Farquhar Murray - Autonomous Research - Analyst

Okay. Thanks very much.

Operator

Ashik Musaddi, JPMorgan.

Ashik Musaddi - JPMorgan - Analyst

Hi, thank you and good morning everyone. Just a few questions. First of all on leverage, it looks like you're indicating you can re-lever the balance sheet a bit. Can you give us some indication as to how much will that mean? So, for example, 1 percentage point you mentioned is $400m cash at the holding company; what would that mean from Solvency II number perspective? And is 30% a max number that you would look to go to? And what will be the main driver of that basically? Is it covering for solvency or doing M&A etc? That's the first one.

Secondly, you're talking about fungibility on the Solvency II so I guess this is in -- you mentioned it earlier as well, Darryl, but just some more color. Is fungibility totally dependent on local ratios or there is more to that? So for example when we need to think about fungibility from US, is it purely dependent on RBC and your buffer level target or is there anything else determining that as well?

And thirdly is what is the right number for the holding company cash flow? Because you are currently running at $1.4b, you're getting a good decent cash from US in second quarter and hopefully, if you can do it, in line numbers for next three quarters in US, you'll be getting a chunky dividend again from US. So that means by the end of the year we will end up at around $2.7b, $2.8b of cash at the holding company. So what are we missing on that? What sort of level are you planning to run that? Thank you.
Okay, Ashik. A number of questions there. Let me try to take those in order.

Leverage ratio, yes we try to highlight that really when you look at our excess capital position in the holding you also have to bring in the fact that there’s leverage capacity. And that was the purpose for putting the 1% $400m sensitivity out. That’s the same number really we think under Solvency II. And specifically to your question, 30%, I’ve said all along I’m comfortable anywhere in the 26% to 30% range. So I think as long as we’re inside that range I look at it as flexibility to optimize and manage the cap structure. It’s an attractive market out there right now in Tier 2 space so it’s possible that we would actually entertain tapping at Tier 2.

And in terms of what exactly we would deploy that for, we would make final calls when we get into the fourth quarter when we know the final Solvency II outcome. But there’s a number of things that we can do in terms of refinancing some of the perpetuals that we have. We have our ambition for the $400m share buyback that we talked about before. So we have a number of things that we’d like to do with the cap structure so tapping the Tier 2 market in these attractive terms is probably something that’s on our radar screen.

You mentioned fungibility in the US. Really we’re just flagging it because we’re still having the conversations on the equivalence issue in the US. It’s really about RBC ratios and conversion but there is some language in Solvency II that requires us to look through to the fungibility of that capital whatever we include in the Group ratio and so we have to go through the work and have the dialogue with the regulator to get comfortable that whatever excess capital we do count in the Group ratio from the US is in fact — we can demonstrate it’s fungible over time. So that’s just a constraint that’s part of the dialogue and the reason we list it on the page for transparency.

The $1.4b you were rolling forward excess capital for the US, I’m certainly not going to give a forecast of excess capital for the end of the year but the only thing I would adjust maybe in your thinking is on the US we’re obviously looking to upsize the half-year dividend because of where we sit relative to the Group policy. But I don’t think I would take that and normalize that as the new standard annual dividend from the US. I think you need to kind of get back to the operating free cash flows for the US which are running around $300m a quarter. So I would just temper a little bit a notion of doubling the $700m and calling that the dividend for the year.

I get your point on this point but just a bit of clarification. So I think you mentioned you’ll be trying to run at the top end of the range which is around $700m and you just mentioned $300m as a normal — $300m is around the normal cash flow so you get around $900m in the next three quarters. So that means still then if you upstream that $900m it’s still a big number. I’m not saying you’ll do that but still it looks like if you want to retain at around $700m capital in US it’s still -- there is a lot of flexibility in that?

Yes, the only thing I would maybe add to my comments earlier on Farquhar’s question is that, yes, in the low interest rate environment we want to be at the upper end. But the other comment I made I think last quarter and I’ll repeat again is that as interest rates have fallen, we’ve had some abnormal capital benefits in the US, which is a little bit of a nuance in the capital ratios in the US. They’re not fully economic-based. So some of our hedge programs, interest rate hedge programs have been kicking us some additional capital accretion. And as rates rise I expect that to reverse itself.

So since our managing expectation is for rates to rise in the US, we’re looking more right on that in the last couple of days. But I do expect the capital to come down a little bit from that perspective as well. And I think you have to bake that into what you’re looking at.

Okay. That’s very clear. Thank you.
William Hawkins - KBW - Analyst

Hi. Thank you very much. Can we just talk a bit more about the US mortality losses and where you have confidence that we’re seeing one-off bad luck and where you don’t have that confidence. So maybe a bit more detail about the contracts that are affected, the type and the origin, specifically in the context of the fact that you just changed a lot of mortality assumptions six months ago.

And I suppose finally on that point, can you also talk a bit about what you’re seeing gross versus net in your experience because again you flagged your changes in reinsurance experience. And if your gross experience isn’t changing and this is just a change in net, then to me that would be very clearly a trend rather than one-off. So more color on that would be helpful.

And then secondly, in the UK, it looks like you have seen, as expected, a good spike in conversion onto your platform in the first quarter after the FCA approval. Can you just comment generally? Does that mean that we’re now seeing conversion rates that are more in line with your expectations? And given that we’re looking at about GBP900m for the first quarter, how could that look in the next few quarters because I think you have indicated that that could be lumpy this year. Thank you.

Darryl Button - Aegon NV - CFO

Yes. Let me take the first one on mortality. Actually let me deal with the second part of your question first because I think it is an important part of the story. We have recaptured some reinsurance treaties over the last couple of years. What that means is that we have less reinsurance coverage than we have had in the past. We have been analyzing those books that we have recaptured. And the performance this quarter on those books was poor, but not any more poor than the rest of our book. So it was very spread across our book.

But with less reinsurance coverage, what it means is when we enter into a negative quarter, like we just had in Q1, we have less dampening effect. And we saw EUR30m less reinsurance recoveries than we did in the same quarter prior year, so last year. So already EUR30m of our EUR63m adverse results in fact are the result of having less reinsurance in place.

From a gross perspective, what are we seeing in terms of trends? It is, as I said, it’s fairly spread across the book. It’s a combination of both frequency and severity. We certainly had an uptick in larger claims and that definitely played a factor. We’re seeing our universal life book impacted more than our term book. That does mean that it is a little more concentrated in the older ages.

And as I mentioned before, we’re used to seeing a Q1 adverse impact due to seasonality. And we would normally put that at EUR25m to EUR30m. So at EUR60m we were definitely larger than what we expected. But I would say closer to a 2 standard deviation event for us. But I absolutely expect that to come back in the next couple of quarters so we’ll have to -- we’ll basically be monitoring it very closely to make sure that there isn’t a trend developing there that we weren’t otherwise aware of.

William Hawkins - KBW - Analyst

So, Darryl, have you already launched a review of assumptions in the context of these figures?
Darryl Button - Aegon NV - CFO

No. I think in any one quarter -- one quarter of fluctuation is not enough to move an assumption. And it takes -- it's a statistical business at the end of the day. It's a lot-of-large-numbers business. So it takes several quarters of data. And, as I mentioned, doing the analysis to look at whether these are random fluctuations or whether there's a need to change the mean.

As I mentioned, we would put this quarter at closer to a 2 standard deviation event. That can happen from time to time. And it's not unusual when you consider the Q1 seasonality that we normally see. So when you factor in the seasonality, it would come back away from a 2 standard deviation event, more probable. So I think it's a case where we just need to continue to watch a couple more quarters of experience and make sure that a lot of this is seasonality. And we'll be watching closely to see to make sure there isn't a trend.

Alex Wynaendts - Aegon NV - Chairman and CEO

Let me take your question on the UK and the upgrade of the platform. Yes, the first quarter we upgraded around 25,000 customers. And the assets that were upgraded with the 25,000 amount around GBP500m, which is roughly half of the increase you see on the platform.

What's been very positive is that the opt-out rate has been very low. As you know, this is a process for which we needed approval and support of the FCA. That's taken somewhat longer. But the upgrade was successful, with a low opt-out rate. What we've also seen, and that's particularly relevant, is that these are customers that are also more and more consolidating assets from other places towards our platform.

So the objective is to upgrade those customers where we expect that we only hold a small portion of the assets. To give you an idea, we actually believe that we probably hold an average only 15% of their pension assets. We upgrade them on our platform with the intention to attract the assets which are with other providers.

So the first batch was 20,000 to 25,000 customers. And we expect to be able to upgrade another 70,000 customers in the second quarter with assets of around GBP1bn assets. And again here we expect also to see more consolidation, which is going to drive further growth and is also offsetting the fact that the margins and the fees we're charging on the platform are lower than what they used to be charged on the older environment.

William Hawkins - KBW - Analyst

Great. So for now that upgrade is on track with your expectations.

Alex Wynaendts - Aegon NV - Chairman and CEO

It is certainly on track with our expectations, not only from a customer point of view in numbers and assets, but also very importantly from an operational point of view. We've been able to upgrade in a very efficient way with, as I said, very limited opt-out, very limited manual involvement. And that's exactly what we were trying to achieve with this platform.

William Hawkins - KBW - Analyst

Cool. Thank you.

Alex Wynaendts - Aegon NV - Chairman and CEO

We still have a, but we still have a way to go, William.
William Elderkin - Goldman Sachs - Analyst

Thank you and good morning everyone. A couple of questions, please. Just back on the US and the one-time effects, my understanding of your answer to the previous question was really none of the adverse movements we’ve seen in the first quarter should be structurally recurring in terms of the kind of earnings model guidance you’ve provided. But could you just clarify that?

Secondly, back on the UK. I know you’ve had very positive inflows that you’ve just discussed. I’d say your press release has some quite cautious statements related to the UK as well. Can you give us a sense of what the lapse experience has been on the back book over the second quarter so far?

Secondly, has the UK business in terms of its cost structure really reached your target level or are there further cost improvements that we should expect to come through?

Then thirdly, in terms of the effect of the DWP pricing cap, I guess that comes through in on revenues in the second quarter. But I think you’ve also warned that commission payments are likely to continue through into 2016. And I was wondering, does the 25m to 25m annual earnings impact you’ve given in relation to DWP still hold for this year given that you’ve got the revenue hit but no offsetting commission effect? If you could just clarify that.

And then finally, completely separately, you seem to be making fairly positive noises on capital and capital generation. Is it still reasonable to expect a so-called capital return in relation to the preference share transaction, I think at the beginning of last year, in this calendar year? Thank you.

Darryl Button - Aegon NV - CFO

Okay. Let’s -- William, that was a lot of questions. I think we’ve jotted them all down here so we’re going to try and take them in order. On the mortality run rate, really not much else I can add. I really think that the Q1 was an aberration and we saw a deeper seasonal effect than we normally see. But all I can repeat as before, it’s something that we’re going to watch very closely going forward to make sure that there isn’t a change to the mean that we weren’t otherwise anticipating. But it’s not my expectation at this point.

On the UK lapse rate, on the actual specific lapse rate for the quarter, I’m going to have to have Willem follow up with you. I actually don’t have that available.

Willem van den Berg - Aegon NV - Head of IR

We’ve seen actually an improvement on the corporate side while the lapse on the individual side has not been very much changed.

Darryl Button - Aegon NV - CFO

Yes. Directionally I can say it’s probably a little slower than what we had been expecting and that there’s a lot of activity but not a lot of movement. So there’s a lot of people that are making phones calls in our call centers and our quotes are through the roof. But there isn’t a lot of money in motion yet is my directional. But I’ll have Willem give you some statistics on that.

UK cost structure, all I can say is that one, costs have to come down as we progress into the new platform environment. It’s a transition that we’re moving from the old business into the new business and that’s part of our strategic plans in terms of the forward direction of the business.
And so that’s something we continue to focus on and work towards, particularly as we upgrade customers and move over into a full platform environment. And that is a lower-cost-over-revenue environment, as you pointed out.

On the pricing caps, the only thing I would add there is because a lot of customers have decided to wait until 2016 in terms of reducing the commission, some of the effect is going to drag in. It’s going to leak in over time effectively. So we’ll start to see some small impacts on that now and we’ll work our way up to that over the next four, five quarters or so.

Share buyback? Yes.

Alex Wynaendts - Aegon NV - Chairman and CEO
Yes. As you said, Darryl, earlier, it is very clearly our intention to execute on the return on capital. And obviously we will do that once we get clarity around Solvency II. So let’s be very clear.

Darryl Button - Aegon NV - CFO
Yes. I think we’ve been consistent, that’ll be a fourth-quarter decision for us once we have the final clarity we need on Solvency II.

William Elderkin - Goldman Sachs - Analyst
Cool. Great. Thank you.

Operator
Nick Holmes, Societe Generale.

Nick Holmes - Societe Generale - Analyst
Hi there. Thank you very much. I just wanted to follow up, sorry for pressing you a bit further, on the mortality issue. Is it -- can we infer from what you’re saying that on balance you think that the likelihood of another big mortality reserve review which would trigger another big hit this year is really pretty remote? That’s the first question.

Second question is looking at your ROE target of 10% to 12%, what would you say about that at this stage of the year? What should you -- what guidance would you give on that?

And then looking at, just last question, looking at variable annuities, you said that there were some product adjustments you've made in the last couple of quarters. Just wondered if you could take us through those and how they could affect sales this year. Thanks very much.

Darryl Button - Aegon NV - CFO
Okay, Nick. Let’s see. On Q3, yes, sorry if it sounds like I’m beating a dead horse, I, really at this point I look at Q3 as a seasonal aberration. I actually think that my expectation is the mortality results will come back, already starting next quarter. I can’t promise that there won’t be an impact on the Q3 assumption because that will very much depend on how the results play out in the next couple of quarters and our comfort zone, if you will, to make sure that there isn’t a new trend line. So it’s really based on the data that’s going to continue to emerge on the books.
But what I can do is repeat what I said before. Any one quarter's experience is not enough data to move a trend line. And I think that's probably the strongest statement that I can make on that.

And the terms of the 10% to 12% ROE guidance, well, we're not going to make that for this year. I think that we have been making good progress on moving towards that number. I think this first quarter now has set us back. I think if you remove the first quarter, we're continuing the trend and the trajectory, if you will, to get there. But we are going to come short of the 10% to 12% for this year. I think that's clear.

On the VA on product?

**Alex Wynaendts - Aegon NV - Chairman and CEO**

Yes. On the product, what we have done is taken into account the fact that interest rates have come down and, as such, we've had to make some adjustments in product to reflect that and to maintain profitability. We see mostly that impact in the fourth quarter, while actually in the first quarter what you see is that we've had pretty strong sales in a market that has not been growing.

So effectively we are clearly maintaining our position in the market on variable annuities. And we want to make sure that we continue to sell our products profitably, and that's why we've adjusted our sales. But fortunately we see that more adjustments are being made in the market and as such we are able to maintain our position.

**Nick Holmes - Societe Generale - Analyst**

Okay. Thank you for that. Can I just, sorry, come back very quickly on the ROE target, 10% to 12%? Would you, if you were to take out the one-offs, mortality, other things, would you be confident that the underlying ROE will be in the range of -- in the region of 10%? Is that what you're realistically hoping for?

**Darryl Button - Aegon NV - CFO**

No, Nick, I think honestly, if we hadn’t taken this one -- this mortality impact out of this quarter, we were still going to track a little short of that 10% to 12%. And a lot of that had to do with the persisting low interest rates that we’ve been experiencing. We’re a little delayed on getting the Canada sale executed, which was going to help that number for this year. So there’s a number of items that were just providing us some headwinds to getting to that 10% to 12% on a normalized basis.

So when you step back and look at the bigger picture, we were getting closer. But I think we were on trajectory to fall a little short. And then this, unfortunately this first quarter then sets us further back.

**Nick Holmes - Societe Generale - Analyst**

Okay. Thank you very much.

**Operator**

Gordon Aitken, RBC.
Gordon Aitken - RBC - Analyst

Thanks. Morning. A couple of questions please. First on Solvency II transitionals. We had several UK companies said last week they would be using transitionals. So the question is will you be applying for a transitional deduction from your technical provisions? And, if so, in respect of which legal entities? And if you could just talk a bit, will it limit dividends from those legal entities?

And the second question is you've clearly upstreamed -- you've said you'll upstream the $700m from the US business. When do you expect to next pay a dividend or upstream a dividend from the Dutch subsidiary and the UK subsidiary, please? Thanks.

Darryl Button - Aegon NV - CFO

Yes. Hi Gordon. Let me see. On the Solvency II, no, we're not really -- the transitionals is not really a material part of our Solvency II story. We really, in the UK, we've been managing on a Pillar 2 economic basis for a while anyway. So transitioning over to Solvency II is somewhat similar to the Pillar 2 framework. And we've also been on a fair value framework here in the Netherlands as well. So we're not really using transitionals as it relates to the biggest one, being the yield curve transition. We're going right to a swap curve plus either matching adjustment or volatility adjuster.

Will it limit dividends? I guess that comes into your next question. On the US, we typically pay -- because of the size of magnitude of the US business and the relevance and importance in the Group, we tend to pay an interim dividend in the second quarter and then we'll chew up our final dividend in the fourth quarter. And that's been our historical practice and I see that continuing this year.

In the UK, we've not been paying a dividend for quite a while. And, as I've mentioned before, I expect it to be -- we really need to get into Solvency II and see at least one, if not two years of experience under Solvency II before we can upstream a dividend out of the UK. And so that's -- I would push that off till 2017 earliest.

And in the Netherlands, it's really just a situation where we're really basically waiting to assess the final Solvency II position. We did not pay a dividend last year because of the uncertainty around Solvency II. And I think, as I mentioned earlier in the call, I think August would be a good time for us to try to start to narrow in on where we think the country unit capital ranges or these ranges are coming in subject to regulatory approvals.

Gordon Aitken - RBC - Analyst

So it could be this year from the Netherlands?

Darryl Button - Aegon NV - CFO

Yes, it very much, well, it very much, again very much depends on the Solvency II, the final Solvency II outcome.

Gordon Aitken - RBC - Analyst

Okay. Thank you.

Operator

Steven Haywood, HSBC.
Hi. Good morning. I see that the US value of new business dropped dramatically in the first quarter this year, obviously because of the low-yield impact. And you’ve done quite a lot of product changes here as well. So do you think that due to these product changes this impact will reverse throughout the rest of this year, or is there more product changes that will be required, or has the yield also changed again since the first quarter and therefore the product changes need to be implemented further?

And then also just a random question on your fair-value items. Now for once they were in line with what consensus was going for, but do you ever see the absolute size of these reducing any time in the future?

On the -- hi Steven. On the first question I would say that in terms of product changes, yes, the US VNB came down substantially. It’s really, I would say, there’s two products I would call out. The variable annuities, which had actually, I would say, for the better part of the last 18 months had very wide margins, particularly going back early last year when interest rates were higher. And so we’ve seen those margins come down to the point where really we got down to more of our marginal cost of capital, which shrinks the VNB from excess margin down to about zero. And that’s really where we got to in the first quarter.

Now we made a couple of product changes to try and put positive excess margin back into the product, and that will product some positive MC VNBs. And then just in the last few days, interest rates have come back up. And of course that will help as well. So I do think that the variable annuity margins will come back up. But the product is still very viable and growing.

And the other product I would say is that we actually had on our universal life secondary guarantee, which is a more interest-rate-sensitive product, actually drifted down into negative territory, negative MC VNB. So we were getting below our cost of capital. So there the impact was more profound so we actually had no choice but to pull the product, and we did that back in February. And that of course will improve the MC VNBs by removing the negatives that started to come in.

We’re shifting our life production over into a less interest-rate-sensitive product in terms of IUL and some of the term business. So both of those are the product changes that will improve the VNB numbers going forward.

Fair -- your second question was on fair value. Yes, the fair value line will continue to be volatile. I think that by definition we have a number of accounting mismatch items that are down in there that don’t necessarily always follow the economics of the business every quarter. So we try to call those out and speak to those.

In this particular quarter I would highlight that we have a good example, is that we have a hedge that we hedge some of our perpetuals which are issued on the Dutch government bond and we swapped them to Euribor. And because they’re perpetuals they go directly to equity, but the derivative that does the hedging goes through that fair value income line. It creates some volatility quarter to quarter. But this quarter was, I would say, extraordinary because interest rate volatility spiked fourfold, in Europe fivefold. And so we took some P&L losses related to that. There was a bit of an offset in the Dutch guarantee business for the same issue on the other side.

So we still see lots of volatility that goes down through there. But it’s something that we do monitor and we do look to see if there’s a way to bring that volatility down over time.

Okay. Thank you.
Willem van den Berg - Aegon NV - Head of IR

Yes. And thank you for participating in this call. I hope we've been able to answer your questions. And we still have a few questions available for the press and the journalists.

Operator

(Operator Instructions). As there are no further questions in the phone queue, that will conclude today's Q&A session. I would now like to turn the call back to the speakers for any additional remarks.

Willem van den Berg - Aegon NV - Head of IR

Thank you very much and have a great day. Thank you for listening into it. Bye.

Operator

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