

Company Name: Aegon
Company Ticker: AGN NA
Date: 2013-11-07
Event Description: Q3 2013 Earnings Call

Market Cap: 12,645.95
Current PX: 5.933
YTD Change(\$): +1.13
YTD Change(%): +23.527

Bloomberg Estimates - EPS
Current Quarter: 0.130
Current Year: 0.527
Bloomberg Estimates - Sales
Current Quarter: N.A.
Current Year: 35600.167

Q3 2013 Earnings Call

Company Participants

- Alexander Rijn Wynaendts
- Darryl D. Button

Other Participants

- Farquhar C. Murray
- Farooq Hanif
- David T. Andrich
- Albert Ploegh
- Benoît Pétrarque
- William S. Hawkins
- William H. Elderkin
- Maarten Altena
- Nick Holmes
- François Boissin
- Maud van Gaal

MANAGEMENT DISCUSSION SECTION

Operator

Welcome to the Aegon's Third Quarter 2013 Results Conference Call in the 7th of November 2013. Throughout today's recorded presentation, all participants will be in a listen-only mode. After the presentation, there will be an opportunity to ask questions. [Operator Instructions]

I will now hand the conference over to Mr. Alex Wynaendts. Please go ahead, sir.

Alexander Rijn Wynaendts

Thank you and good morning, everyone. We appreciate that you've joined us today for this call on Aegon's third quarter result. And we're well aware that it's a busy day for you. With me today is Darryl Button, our CFO; and also present is, Willem van den Berg, Head of Investor Relations.

As always, we welcome your questions after the presentation in a usual Q&A session. This is the first quarter for which we have combined the analysts and media earnings call, but we'll still keep the two Q&A sessions separate, and we'll start with the analysts. Before we begin, I'd like to remind you to take a moment to review our disclaimer on forward-looking statements.

This quarter, we saw again that our strategy is yielding positive results as we experienced continued sales momentum, particularly in our accumulation and at-retirement products. Notably, we saw a significant increase in the market consistent value of new business, confirming the strength of our distribution capabilities, and that we continue to sell the right products at the right price.

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In addition to rise in profitable sales, our underlying earnings increased by 7% to €531 million. Our net income amounted to €227 million, despite the significant negative impact of changes made to our long-term economic assumptions to align this better with current margin conditions. Our capital position remains strong while our cash flow this quarter was adversely impacted by movements in the financial markets and several one-time items.

Our performance this year versus our target is shown on the next slide, that's slide three. As you can see on this slide, we are well on track to double our fee-based earnings to between 30% and 35% of underlying earnings and to increase our operational free cash flows to €1.3 billion to €1.6 billion by 2015. We expect to grow underlying earnings from the 2012 base to 2015 by at least 7%, and we are on our trajectory of 8% to 10% ROE.

As we shared with you on June, to reach an ROE of 10% to 12%, additional management actions are required. We therefore continue to critically review businesses that do not meet our strategic objectives. An example of this will be the small transaction, is the sale of our Czech pension business where we lacked scale.

At the same time, we continue to invest in growth opportunities in all our markets and in particular, our digital composition. We maintain our focus on innovative ways to distribute our products to our customers. One such example is the Aegon Retirement Choice platform in UK. We just recently surpassed £1 billion of assets under management.

The review of our various accounting methods across our businesses is ongoing. And we will inform you as soon as we have a full picture of which actions need to be taken and the impact these actions will have on our businesses and results.

Let's now turn to the next page and to the continued sales momentum we are experiencing. In slide four, you can see that overall sales increased by 9% to €1.7 billion. New life sales were up and mainly benefited from higher pension production in the UK. The after effect of RDR and the continuous sales growth on our new platform. Additionally, we've seen strong results from our new joint venture with Santander in Spain.

We were particularly pleased with the €11 billion of gross deposits and €3.4 billion of net deposits for the quarter. Gross deposits for both pensions and variable annuities in the U.S. increased substantially. Net deposits increased even more. U.S. variable annuity deposits tripled and net pension inflows quadrupled this quarter. And in the next slide, I will cover U.S. fee business in more detail. Accident and health and general insurance, however, were 9% lower as a few partnerships in the U.S. were terminated earlier this year.

Overall, we continue to experience strong customer demand for our core products and services, a clear reflection of the strength of our franchise, the depth of our distribution and our focus on offering the right products to our customers.

On slide five, I want to briefly highlight our strategic focus on one of our core growth areas, the At-Retirement segment in the U.S. In this segment, we enjoy a leading presence, thanks to strong brands and expanding distribution network and a suite of innovative products and services.

As you can see here, our variable annuity, pensions and mutual funds businesses have each generated on average double-digit annualized growth since 2009, while at the same time, margins have improved. This is a result of product and service innovations, economies of scale, expanding distribution as well as market dynamics.

In addition, this quarter, 42% of our variable annuity deposits and 53% of our retail mutual funds went into Aegon Asset Management funds. Our strategy is to retain our clients' assets through the entire cycle, helping them accumulate as they prepare for retirement and also helping them manage the drawdown of their assets during retirement. And we believe that the strategy will be a key driver of long-term growth going forward.

The products and services we offer must meet a strict profitability hurdles, meaning that we can be confident that the strong sales growth we see today will also result in strong future earnings. And this is evident in [ph] higher (0:06:34) market consistent value of new business as illustrated on the next slide.

On slide six, as you're well aware, we are committed to offering products and services that provides value to our customers and to the company. And this is clearly reflected in the significant increase in market consistent value of new business we achieved this quarter.

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In the Americas, the value of new businesses more than doubled. Variable annuities were a key driver of this increase, as a consequence of higher volumes and higher margins supported by increasing interest rates. The improvements in the U.S. life business is a result of active re-pricing and the withdrawal of products that did not meet our profitability hurdles.

In The Netherlands, the market consistent value of new business increased significantly on a solid contribution from higher mortgage production. And as the slide indicates, the MCVNB in the UK was impacted by lower margins on the annuities and auto enrolment. And in our new markets, MCVNB benefited from a strong sales in Asia. As you can see, shifting demographics and aging populations have [indiscernible] (0:07:48) in Asia and generate significant demand for products and services. In addition to increase in sales, our profitability is supported by improving efficiency. And therefore, we continued to look with a critical eye at every possibility to further improve these efficiencies.

Now turning to slide seven, on a comparable basis and at constant currencies, operating expenses were up 4% compared to the third quarter last year, mostly due to higher sales and employee performance-related expenses that resulted from strong business growth.

In the Americas, operating expenses were higher, mainly due to increased sales rate expense as a result of strong sales of variable annuities and mutual funds. However, we continue to work towards our stated objective of keeping costs flat while growing the business. An important step towards achieving this is by implementing a significant reorganization by which we'll consolidate our support functions in the Americas into one shared service center called Enterprise Business Services.

At the same time, we're also taking a critical look at parts of our operations that could effectively be outsourced. The total number of positions to be eliminated over the next six to nine months is expected to be approximately 150.

In the UK, the ongoing transformation of our business into a platform model will require additional investment. We are now in the process of creating a fully digital interface for the non-advised clients group in order to facilitate upgrade to the platform.

Significant cost savings have been realized in the UK over the past few years, and these efforts will continue. This year, we have closed sales offices, and we are now working to improve the efficiency of our back office. And these efforts should lead to total reduction of approximately 530 FTEs in 2013.

I will now turn it over to Darryl for more information on earnings and financial position. Darryl?

Darryl D. Button

Thank you, Alex. Here on slide eight, I would like to take a closer look at underlying earnings, which I'm pleased to say rose by 7%, including one-time items of €27 million and favorable mortality of €15 million. In the Americas, higher earnings were driven by pensions and variable annuities as well as favorable mortality in life and protection, and a positive impact of assumption changes and model refinements. This growth was partly offset by unfavorable currency exchange rates. In U.S. dollars, earnings were up 8%.

Underlying earnings in the Netherlands were stable at €85 million. Pension earnings increased and we saw improved results in non-life. This, however, was offset by lower life and savings earnings due mostly to the previously announced reduction in policy charges.

In the UK, reported underlying earnings decreased 4%. At constant currency, results increased as our pension businesses benefited from higher equity markets. Earnings from our new markets increased 6%, due mostly to the benefit of actuarial assumption changes and one-time items in Asia.

Holding results improved by €25 million, mainly the result of lower interest expenses following debt redemptions and reduced operating expenses.

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On slide nine, you can see that the fair value loss of €493 million had a large impact on net income. I will address this further in the next two slides.

Realized gains were mainly driven by portfolio adjustments in the Netherlands to bring it in line with the new regulatory yield curve as well as normal trading activity. Impairments remain low at €45 million and were related to impairments on structured assets in the Americas, a single corporate exposure in the UK, and residential mortgage loans in the Netherlands and Hungary. Impairments in our Dutch residential mortgage portfolio reduced to €8 million this quarter or an annualized 14 basis points.

Other income amounted to a loss of €42 million. Proceeds from the exit of our joint venture with CAM were received in the third quarter. This, along with the gain from the recapture of certain reinsurance contracts in the Americas was more than offset by the write-down of intangibles to our – related to our Polish pension business and restructuring charges in the U.S. The income tax amounted to a benefit of €73 million, mainly driven by the UK, where the corporate tax rate reduced from 23% to 20%.

Slide 10 provides more detail on the impact of fair value items. The results from fair value investments were positive for the quarter. And fair value hedging programs, where we largely have an accounting match, continued to be effective. Fair value hedging without an accounting match resulted in a loss of €116 million in line with expectations.

Strong equity market performance drove losses on both the equity collar hedge as well as on the macro hedge. As you may recall, our guidance for the macro hedge is a quarterly loss of US\$70 million, if markets move in line with our assumptions.

Now that we have adjusted these assumptions, we expect the macro hedge run rate to move closer to a loss of US\$60 million to US\$65 million per quarter. The main driver of the other fair value items was the impact of the changes that we made to our long-term economic assumptions. More information on these assumption changes is on the next slide.

Here on slide 11, you can see that we made more prudent changes to our economic assumptions resulting on a loss of €405 million. Our annual equity market total return assumption, which includes the dividends, has been lowered from 9% to 8%, accounting for €135 million of the total impact.

The long-term assumption for 10-year U.S. treasury yields was lowered by 50 basis points to 4.25% and we have extended the grading period from five to 10 years. The assumed return for separate account bond funds, which mainly relates to variable annuities, is now 4% for 10 years and 6% thereafter. These interest rate-related adjustments accounted for the other €270 million of the total impact.

The updated assumptions are now more in line with the current market conditions, our economic framework, as well as the assumptions used for our regulatory framework. More alignment between the various assumptions creates less discrepancies in, for example, our hedging programs. Please be aware that these changes relate to our IFRS results and do not impact our cash flows, which I will discuss on the next slide.

On slide 12, you can see that operational free cash flows for the quarter were negatively impacted by various market impacts and one-time items. Market impacts include the effect of lower credit spreads in the UK and the tax impact of hedging losses in the U.S. seen this year due to higher equity markets.

Several items impacted our capital position in the third quarter that we consider non-recurring. The primary drivers include increases in required capital, mostly in the U.S., and few exceptional tax-related items. Excluding these exceptional items, the company's normalized operational free cash flows were €291 million for the quarter.

Turning now to Aegon's capital position at the end of the third quarter here on slide 13, our group IGD ratio decreased to 208%. This was driven mostly by our move to the swap curve when calculating the IGD ratio for the Netherlands and the payment of our interim dividend.

S&P excess capital in the Americas increased by approximately US\$100 million as quarterly earnings were partially offset by tax impacts and one-time increases in required capital.

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The IGD ratio in the Netherlands, excluding the bank, was stable at 245%. This ratio and this Q2 comparative shown, reflect our move from the ECB AAA curve to DMV swap curve. Three weeks ago, the DMV provided an update on the progress of Solvency 1.5 and we do not expect this to impact our capital management framework.

We are now managing the UK capital position using the Pillar 1 ratio including the with-profit fund. This ratio was 140% at the end of the third quarter, up from 130% reflecting an additional £150 million of capital we have injected into the business. We are currently working to quantify our internal target and buffer capital levels based on this metric.

Aegon's financial leverage ratio improved to 30.1% as you can see on slide 14. This improvement was driven mostly by a reduction in short-term leverage of approximately €200 million, which followed the US\$750 million senior bond redeemed last quarter.

Holding excess capital decreased to €1.8 billion in Q3 as the proceeds from our CAM divestment were more than offset by the cash used to fund the interim dividend and capital injections into our business.

Alex, back to you.

Alexander Rijn Wynaendts

Thank you, Darryl. And before taking your questions, ladies and gentlemen, let me reiterate. Our third quarter was again a strong quarter in terms of underlying earnings, sales and market consistent value of new business, with net income and cash flows impacted by one-time adjustments.

We are seeing that the actions we are taking to reshape our business are creating value for our stakeholders. And looking ahead, we are confident that the continued execution of our strategy and our strong capital position will enable us to achieve our ambitions.

We're happy to take your questions now.

Q&A

Operator

Thank you. [Operator Instructions] Thank you. Our first question comes from Farquhar Murray. Please state your company name, followed by your question.

<Q - **Farquhar C. Murray**>: Good morning, gentlemen. This is Farquhar Murray from Autonomous Research. Two questions if I may, all related to the cash flow figures on slide 12. Firstly, could you decompose the €112 million one-time items just between the regulatory requirement change and the tax item there? And specifically on the regulatory requirement change, could you just explain what this was? I presume it's the S&P change but some additional color there would be helpful.

And then secondly, even adding back the market and one-time items, the normalized figure of €291 million was a bit weak relative to recent quarters? I just wondered what was driving that and whether there were any other one-time items that we should think, bear in mind within that figure? Thanks.

<A - **Darryl D. Button**>: Hi, Farquhar. It's Darryl. Yeah, let me take your cash flow questions. Specifically, there were a couple of things impacting the cash flows this quarter, some what I would call market-related and some non-market-related. On the non-market related, I think that was maybe more of your question. It was really a number of small items across the group. We had some effect coming through from some of the required capital calculations in the U.S. related to variable annuities. Some of that has [indiscernible] (0:19:58) way we do the – this moving calculation on the required capital. There were some impacts coming in the Netherlands related to the bank. We have brought the bank underneath are internal capital framework this quarter.

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Also back in the U.S., a little bit of strain coming up from the life business because of the captive reviews going on in the U.S. we have not been doing our normal financing of the XXX and AXXX reserves. So that's been postponed in the interim and so that has a little higher strain than normal on the life products.

So it's a number of, I would say, small one-time items that are adding up to give that impact. On the market-related impacts, I'm not sure if you had a question on that, but it was really broadly two categories: the spreads in the UK, these would be improving credit markets that actually have the perverse and inverse relationship on the UK Pillar 1 ratio.

And then in the U.S., because of the tax – because of the losses we've had on the hedge programs, that does create some tax friction in our statutory and regulatory accounts, and that caused an impact this quarter as well. So quite a few number of smaller, negative items that added up this quarter.

<Q - Farquhar C. Murray>: And just to confirm, all those items you've mentioned there, [ph] Darryl, (0:21:20) within the €203 million one-time impact.

<A - Darryl D. Button>: Yeah. And so those are all in there. And then of course what's not in there is just the impact of a weaker dollar that has an impact on the overall cash flows as you measure them in euro, that's not inside the one-time items. And so that's what also impacted the number this quarter a little bit soft.

<Q - Farquhar C. Murray>: Okay. Brilliant. Thanks very much indeed.

<A - Darryl D. Button>: Yes.

Operator

Thank you. The next question comes from Farooq Hanif. Please state your company name, followed by your question.

<Q - Farooq Hanif>: Hi, everybody. Farooq from Citi. Thanks very much for taking my question. First question, could you just talk about some of the rationale for the change in approach in the UK Pillar 1? And does this – is this likely to affect your previous kind of forecast of when the UK could be cash generative for the holding?

Secondly, could you give us a little bit more of the view of the market dynamics of the VAs right now in the U.S., so for example, what your market position is and what you're seeing in terms of competition?

And lastly, any brief update you can give on timing of some kind of decision on Omnibus 2 and Solvency II and what you think is going on there? Thank you.

<A - Alexander Rijn Wynaendts>: Farooq, thank you and Darryl will take the first question and I will cover the second and third question.

<A - Darryl D. Button>: Sure, yeah. Farooq, on the first on the first question, UK Pillar 1, really it's evolving conversations with the PRA. We had been looking at a capital ratio on the – excluding the with-profits funds on the with – yeah, excluding with-profits fund in the past. Through our conversations with the PRA, it's very clear that they look at a combined ratio that includes the with-profits fund.

It's an interesting ratio. The surplus of the with-profit fund is included in both the numerator and the denominator, so it draws the ratio back down towards 100% by definition. I'm not convinced it's necessarily the best way economically to look at the capital but that is the ratio that they're monitoring and managing too.

We're obviously looking at other aspects of the business too. It's not just a singular ratio in terms of how we look at capitalization and look at risks in the UK, and our conversations with the PRA. But suffice it to say, it's through conversations with them that we've decided to convert over to here.

As I mentioned back in June, we're quite happy with the strength of the U.S. and the Netherlands balance sheet. But the UK, we were not, and we were on a path to organically strengthen that balance sheet. And what's happened here is that

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we've decided to accelerate that, strengthening of that balance sheet. And again, that's through conversations with the PRA that led us there.

In terms of your second part of that question, impact on future dividends, I think the trajectory and the path remains intact. The cash flow positions, as I've mentioned in June, of UK do get much stronger as we get to the back end of 2014 and into 2015, and that's when we expect to receive some dividends from the UK, but we've had to accelerate the capital now to stay on that trajectory.

<A - Alexander Rijn Wynaendts>: Okay. Thanks, Darryl. Then, Farooq, on the VA dynamics, I would say it is the same story as the previous quarters. What you're seeing here is that the work we've been doing on expanding distribution, focusing on that segment of the market that we want to be focused on, which is really the living benefits segment, which fits well in our strategy of helping our customers not only to generate assets, but to be able to draw down these assets during retirement, which is of course becoming more, and more important with baby boomers retiring. It's all part, and then you see the results of that strategy right now.

At the same time, we had expanded towards a number of distributors, and we've shared a few with you, names last time. I think the last one I'm happy to share is that we also now are the provider of products for Voya Life, formerly ING.

And just as one example of the expansion of the distribution in a segment that we think is the right segment and that would put us in the right position. As you can also see, and I mentioned that the market consistent value of new business increased and particularly also in the areas of VA, I think it's not surprising with interest rates creeping up a little bit, that gives more room, and that explains also why the margins are improving in addition to the fact that we're increasing our scale and that has a good positive impact on expenses.

Now, in Solvency II, yeah, what is my view? I have the sense, Farooq, and I think that's shared now with my colleagues in Europe, is that we have probably never been as close as to be able to reach – to come to an agreement. I think there is a very clear determination right now from the European institutions and you have many that are involved, Parliament, Commission, the member states, EIOPA, they want to come to an agreement. And I think we're getting very close to what is an agreement that would potentially be acceptable to the different parties involved.

And I'm also therefore more optimistic now about the date of the January 1, 2016 although even if we see an agreement being reached right now in the month of November, it still is and it will be a big challenge to get everything done in time for the November 1, 2016.

I also believe that the discussions in the IAIS around ComFrame and creating more global framework for international active insurance groups, the IAIGs, as they're well-known. It's probably also putting a bit more pressure now on the European institutions to come to an agreement so that at least there is one agreement here in Europe, and it will make the discussions in the context of a global framework will make these discussions easier.

So, I will remain cautious. This is very political. But I do believe that we have never been as close we've been to reaching agreement there.

<Q - Farooq Hanif>: Okay. Thank you, very, very informative as usual. Thank you very much.

Operator

Thank you. The next question comes from David Andrich. Please state your company name followed by your question.

<Q - David T. Andrich>: Hi. Good morning. David Andrich from Morgan Stanley. Just two questions on my side. First of all, I was just wondering in terms of the FTE reductions, both in the U.S. and UK, maybe if you could just give us an idea of kind of a maybe the quantum impact on costs going forward?

And then, just in terms of the strong deposits and sales in the U.S., I was wondering, before in the past, you've discussed the focus on the at-retirement and retention of assets. And I was just wondering if maybe, you could again

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give a bit more granularity in terms of the split between new sales versus retention and how we should expect to see that develop? Thank you.

<A - Alexander Rijn Wynaendts>: David, I'll take your second question. Would you mind to repeat your first one? The line wasn't good.

<Q - David T. Andrich>: Sorry, apologies. I was just wondering about the FTE reductions in the U.S. and UK in particular, the consolidation of the shared service center and what impact that might have on expenses going forward?

<A - Alexander Rijn Wynaendts>: Yeah. Okay. Well, let me take the first question. As I did say in my introduction, we are seeing strong growth in U.S., and what we're seeing as a result of that is that sales-related expenses are increasing especially in the areas of the variable annuities and mutual funds. A lot of our expenses are variable and related to sales there.

Nevertheless, we have very clearly stated our ambition of keeping our expenses flat over – in the coming years. And obviously, that would require in order to achieve that, that we achieve further efficiencies. And that's what we announced here as first step in the shared services, the EBS, Enterprise Business Services, in the U.S., which is a creation where we're bringing together, in particular in the first step, finance and IT functions and that is what is allowing us to reduce expenses through the reduction of head count.

I think the first step we have clearly provided just right now was 150 heads to be – effectively to be eliminated. This is an ongoing process, and it will as such have a significant impact on expenses going forward, and it will allow us to meet our ambition of keeping expenses flat, so that should give you pretty clear ideas to where we believe these expense reductions will come from in the future.

Now in UK, I mean again, this is – it's an ongoing story. And for us, it has been very clear that we need to adjust our expense base to the new reality. And if you look at the new realities with margins that are lower in the platform world post RDR, we have to ensure that our expenses are aligned to this new reality of lower margins. And that's why you will see a continuation of expense reductions in the UK. So we had a first run of 25%, which was completed by the end of 2012.

And I think I've made it very clear that we will continue to see significant reductions going forward. And we will announce them and share them with you, when we'll also announce them internally, you will understand that it's important that we continue to manage the company, that we also continue to keep the people focused on the right things. But I think that in 2013, 530 FTEs is quite a big number, these were mostly related in our sales network.

As you know, we have sales networks all over UK with branches, so quite a lot of staff, we've taken that down. And the next focus is more on the back office, where not only will we try to improve service levels but at the same time, doing this more efficiently. An ongoing story. It is part of our mission to get the expenses to the level that we need to have in the new world.

Your first question on deposits, and I'm pleased that you recognized the strong deposits we see in here in the U.S. This is at the core of our strategy. We've said very clearly to you previously that we are making choices in which business we want to be and business we do not want to be. We've taken action on those that we do not want to be. That now means that we are focusing all our efforts in building this, call it, at-retirement segment.

And why is this important, because we accumulate assets through different forms for our customers. They can do that individually. They can do those through life insurance. They can do it from mutual funds. But also, a lot of them do that through corporate plans, the 401(k) plans or 403(b) plans. And what we are seeing is two things. First of all, that a significant part of those employees that are part of a corporate pension plan effectively were not getting adequate service at the time of retirement. And this is exactly where we are now focusing our efforts on, is to make sure that those employees that are part of the corporate pension plans, when they retire, they stay with us in the system. And that is what you see here also very much reflected.

The second thing and I think is equally important is that a lot of people that have saved in their corporate pension plans, have assets – accumulated assets which is not significant or sufficient for them to be serviced properly by face-to-face

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agents. Just to give you an idea, we believe that for those that have assets below \$1 million, they will not be targeted by agents, life planners, financial planners just because with the complexity of regulation and compliance requirements, it's just not worth it.

So, there's an increasingly growing segment of people that saved in their life that retired. And at the time of retirement, effectively are totally under-served. We believe this is explicitly the segment where we can be successful. It's a segment where we have the products. We have all the products already. It's now about making sure that we connect with those customer at an early stage, that we offer them the service and increasingly, we're doing this fully electronically or through digital channels because that is the most cost-efficient way of doing that.

And so, this is a part of our strategy and you will continue to see us focusing on it and I'm actually therefore very pleased with the very strong development on the accumulation side but also on the dis-accumulation side. This strength in the UK – sorry, in the U.S. is obviously increasing in the UK. We shared with you in the UK that we are going to launch a fully digital capability for our individual customers. Very much focused on those customers that are part of our corporate pensions plans now and that retired and that needs the services and products, which we have available.

<Q - David T. Andrich>: Great. Thank you very much.

Operator

Thank you. The next question comes from Albert Ploegh. Please state your company name followed by your question.

<Q - Albert Ploegh>: Yes. Good morning, all. Albert Ploegh from ING. Thanks for taking my questions. A few questions on, let's say, the gross leverage and also the accounting consistency review on the U.S. debt that has been flagged earlier on, which is a more full-year event. Can you maybe give a bit more feeling of whether or not you change your views on that consistency change and what the impacts might be?

In the past, you've flagged maybe 10% potential impairment on U.S. debt balances. And related to that, in case you're gross leverage as we saw will be above 30% by year-end, is that a concern to you or do you think that's manageable in relation to what rating agencies might expect from you?

Second, two questions on the Dutch business. First of all, on KoersPlan, you already have taken in charge earlier this year following the court ruling. I think there's still some discussions ongoing with associations. Can you maybe give us an update on that? How that is progressing? And the second question on the Dutch business is that one of your peers has basically had an unfavorable ruling in a disability case. Are there several or similar cases also pending with Aegon? Thank you.

<A - Alexander Rijn Wynaendts>: Darryl, would you take the first and second question? I will take the third.

<A - Darryl D. Button>: Yeah. Yeah, I will. Really, on the accounting change, I think all I'll do is repeat what Alex said in his opening remarks, which is the review is ongoing. And we will inform you as soon as we have something. I'd say, nothing, Albert, has changed in any way from the messaging and the guidance that I gave you back in the summer time. So I'd say, we're still on track with that and no change there.

In terms of how we look at that in relation to the leverage ratios, we are tracking right around the 30% now. If it was to lead to a higher leverage ratio at the end of the year, would that be a problem? No. I don't think so. I think we would look to calendar year 2014 to bring it back in line.

So we still maintain those leverage ratio targets. But in terms of discussions with rating agencies, it's never a point-in-time discussion. It is a forward-looking discussion and we've already signaled that we intend to do more deleveraging in 2014. So I think you can look at that as a package and we're still on track with that. Alex?

<A - Alexander Rijn Wynaendts>: Thanks, Darryl, yeah. On the Dutch business, Albert, yeah on KoersPlan, as you're aware, we have settled with the Stichting association, which represent around 35,000 customers. And we've also, I think, issued a press release, which was pretty clear in the sense that, yes, the association and Aegon were pleased

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with the way this was dealt with and it stayed within the provision, which we had shared with you earlier, the €25 million.

<Q - **Albert Ploegh**>: [indiscernible] (0:37:45) more with, let's say, the other cases, the other people that are not part of this settlement, whether you will do anything with them?

<A - **Alexander Rijn Wynaendts**>: Well, what we have said, what we settled in this case is that obviously, we would be looking at on the other policyholders. And we want to make sure – ensure that they have adequate levels of premiums and we would review that. You can imagine these are over 500,000 policies and that will take some time.

On the Dutch business, you are referring to the disability case of another company. Let me just say one thing, it will not impact, we don't expect to have any impact on us, for the simple reason is that we are – have only been increasing the premiums on a contract-by-contract basis upon renewal. And we have not raised an en bloc increase in premiums. And therefore, it is a very different situation for Aegon and that's why we don't expect any impact.

<Q - **Albert Ploegh**>: Okay, thank you.

Operator

Thank you. The next question comes from Benoît Pétrarque. Please state your company name followed by your question.

<Q - **Benoît Pétrarque**>: Yes, good morning. It's Benoît Pétrarque from Kepler Cheuvreux. Yeah, three questions. The first one is on the IGD ratio in the Netherlands 245%, it's a very good level obviously. But given that you moved to the swap curve, what can we expect in terms of new sensitivity of the ratio going forward? I understand that the swap curve is a little bit more volatile. So, could you talk a little bit about the sensitivity there?

And in the Netherlands, clearly, solvency ratio of pension funds have been improving recently. Where do you see the pension pipeline currently? And could you talk a bit about margins on this pension business? Actually, you've allocated some more mortgages to the pension group, but how much margin could we expect in percentage of AUMs will be useful.

And then, last question is on the holding expenses, it's just €25 million this quarter. It came down a lot in the past two years. How much of the €25 million is kind of recurring? Is that a good level to forecast for 2014? Thanks.

<A - **Alexander Rijn Wynaendts**>: Darryl, on the IGD and the holding expenses?

<A - **Darryl D. Button**>: Yeah. Let me jump in with those two. In terms of the NL IGD ratio at 245%, you're right. I'll concur with you, it is at a good strong level. We're happy with that. In terms of volatility going forward, that's actually why we incurred quite a few realized gains this quarter.

We have been reiterating the asset portfolio to have a better match with the underlying swap curve on the liability side to actually take that volatility down. So we were a net seller of German and French sovereigns this quarter, and reinvesting in something that gives us a little bit better match with the underlying swap curves. So that's something that we will continue to manage, and manage that volatility down by making our ALM decisions.

On the holding, the holding expenses, the holding costs are down. They're down really on the debt redemptions that we did last year as well as cost reductions that we've been taking here at the holding as well. And Alex, I'll turn it to you.

<A - **Alexander Rijn Wynaendts**>: Yeah, thank you, Darryl. You see on the holding, I think we need to be clear that we are expecting from our country units and business units that increase the efficiency. And we're implementing that in all the country units, and therefore it's also very clear that we have the same approach here to the holding and that's what you see reflected here and I'm pleased to see the results.

On the pension market here in the Netherlands, as you know, this is always been of a lumpy business. So it's difficult to look at quarter's – sorry, sales on a quarter-by-quarter basis. And you're absolutely right, ratios have improved and that

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means it is not going to be easier for pension funds to transfer the liability to insured solutions.

Therefore, we expect also going forward that our strong brand name in the market combined with our strong capital position, which I think is really important here, because these decisions are long-term decisions, where you're transferring the liabilities, our pension fund for many years in insurance company will drive more of the business coming – going to us.

What is important? And as you know, we've been very consistent there. What's really important is that we maintain our pricing discipline. And therefore, with a relatively lump – small number of players and us being the one with clearly, the strongest capital position, we will maintain our pricing discipline. And with the pipeline that is now close to come to us, we will see, in my opinion, in the coming quarters good sales development at attractive margins because we are not interested, as you know, in taking big tickets on our book if we're not able to get the right margins. With the number of providers diminishing, it is clear that margins will be better for company like Aegon.

<Q - **Benoît Pétrarque**>: Just on the holding costs. So the €25 million per quarter, is that a good run rate for 2014?

<A - **Darryl D. Button**>: Yeah. I think it's pretty close, maybe a little bit, might be a little bit higher, but I think it's close. It represents the new cost base where we are right now and the debt redemptions that we've had.

<Q - **Benoît Pétrarque**>: Cool. Thank you very much.

Operator

Thank you. The next question comes from William Hawkins. Please state your company name followed by your question.

<Q - **William S. Hawkins**>: Thank you very much. Good morning. It's William Hawkins at KBW. In the context of how the markets are moving and how you just changed your assumptions, how are you feeling about rolling the collar hedge that you've got for U.S. variable annuities next year?

And then secondly, could you explain a little bit more about this reinsurance recapture that you've done. I understand that it has to do with life and protection in the U.S. but I'm trying to make my mind up about whether long-term this is a good or a bad thing. Often, when you recapture reinsurance, there can be an upfront profit and then there's a lot of losses that follow afterwards. So could you explain the context and then the future financials of that reinsurance recapture? Thank you.

<A - **Darryl D. Button**>: Yeah, William, I'll take those two questions. How we're feeling about the collar hedge? Actually, really, the collar hedge itself is a macro hedge, in addition to the macro hedge we had before. So we're actually going to step back and take a look at both hedges and look at restructuring both of those, and probably execute that in the first quarter.

So in the interim, while we – so we are working on that now. So in the interim, we're going to just continue to roll the delta of the two hedges forward until we complete that restructure. So I think in terms of giving any kind of forward look or guidance from the restructured hedge up, that will have to wait until Q1.

We are of the opinion though, I mean, the markets have done very well this year. We think that's largely the wrong time to be taking a lot of hedges off. So we're really not in the market timing game. So we'll roll the existing deltas forward and restructure both hedges in the first quarter.

Reinsurance capture, yeah, no, you're right. It was a negotiation between us and the reinsurer. We did recapture the business. We did receive an upfront premium to do that, and that's what got booked through in the below the underlying earnings.

It was a relatively, I would say, economically neutral transaction for us. So unfortunately, the accounting is not great on this. I think better accounting would have been to defer that gain over the life of the business and then I would have

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been able to say, no change because we did have to upfront some of that profit because of the cash payment and it wasn't economically neutral transaction. That means that effectively creates some headwinds spread over the next 25 years if you will. That's probably the best way to think about that gain that came through.

<Q - **William S. Hawkins**>: Over the next 25 years. So this is effectively some kind of royalty recapture, is it?

<A - **Darryl D. Button**>: Correct. Correct. Yes.

<Q - **William S. Hawkins**>: Cool. Thank you.

Operator

Thank you. The next question comes from William Elderkin. Please state your company name followed by your prior question.

<Q - **William H. Elderkin**>: Thanks. Good morning everybody. It's Will Elderkin from Goldman. Couple of questions on the UK business please. First of all, in terms of all of the expense reductions you've put through this year in the UK operation, to what extent this was third quarter profit that we can see reflect those expense benefits? In other words, some stuff you've already done, are there further benefits to flow in?

Secondly, in terms of the UK tax rate, historically, that UK tax rate has been very volatile in the business. Can you just give a sense of what we should be using on our models going forward, reference to that UK corporate rate of 20%.

And finally, in terms of auto enrollment, can you just give a sense of is that developing as you expect and do you have any sort of broader thoughts on the opportunity for you there?

<A - **Alexander Rijn Wynaendts**>: Yeah. In terms of expense reductions, as you know, it has to do with timing. Secondly, what you also have to look at, William, is what type of expense reductions, is it maintenance expense or acquisition expenses. And I did here make the point that we have focused on sales related expenses so acquisition expenses, which means that you'll only see partial impact in your earnings because the other part has been deferred.

So I think you need to see a couple of quarters before you get a very clear understanding of to what extent the expense reductions will be impacted because there are a number of factors playing a role. What is important is that it's clear to us, and we need to take our expenses further down. We will take them further down. We've now focused on acquisition expenses going forward, we'll now be focusing more and more on the administrative expense, which are maintenance expenses, which will have a bigger impact, immediate impact on underlying earnings.

In terms of auto enrolment, I do think it's a bit early right now. As you know, there's many discussions around it in terms of what margins we can apply in terms of commissions because obviously it has very much to do with commissions. And so I think we are in – it's too early now to say that we have a clear view as to how auto enrolment is going to work out for us.

One good thing clearly is that you get more assets. That is clear. Now the question is at what commissions, and there's now a new debate as you know going on about from the regulator to what extent we are indeed – sorry, whether we have to pay commissions on the part of the business, which obviously will affect the profitability there. In terms of the tax rates, Darryl?

<A - **Darryl D. Button**>: It will be very short answer, I don't have a better number than the 20%. So I have no insight beyond that. So if it was me, I guess I'd use 20%.

<Q - **William H. Elderkin**>: Thank you. May I ask one follow up, I should have asked at the start, I mean in terms of this broader debate about a 75 basis points charging cap on pensions in the UK. But does that have any particular implications for the UK pension operation?

<A - **Alexander Rijn Wynaendts**>: Well, as you know we have a book, which is quite an old book because we've been in the business for a long time. We have a lot of corporate business. We have individual business. What we've

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given you is the total – for the total book that we – for the old book we have around 110 basis points. But there is a mix of corporate pension plans, which are clearly lower and individual pension and other products that where margins are higher. And so I don't expect this to have a big impact on the back book, certainly if it's 100 basis points or potentially 75 basis points. But again here, it has to do with the discussion I mentioned earlier about commission. Is it backwards looking, is it going to be forward-looking? And to what extent is forward looking only will that have an impact on the back book? Too early to say but what we are now assuming that it's mostly going to be forward looking and to be applied as such, pension which is new business on the books.

<Q - William H. Elderkin>: Okay, great, thank you very much.

Operator

Thank you. The next question comes from Maarten Altena. Please state your company name, followed by your question.

<Q - Maarten Altena>: Yes, good morning. Maarten Altena of Mediobanca speaking. Three questions from my side. The first is on the economic assumptions. You seem quite conservative with your 10-year assumptions instead of five-year to now reach 4.25% for U.S. treasury. However, in order to be really conservative, could you give us a ballpark figure what the impact will be if we assume the current interest rate levels over 10 years as some kind of sensitivity?

The second one is on the U.S. pensions as your U.S. pension balances and margins both developed favorably. And according to the well-known baby-boomer story, the balances are likely to continue to increase, but what further room do we have to sustain a beneficial margin trend, maybe some color on that?

And briefly on the Netherlands, as you talk about impairments on residential mortgage loans in the Netherlands of 14 bps, could you elaborate on the trend here, whether it's accelerating, decelerating, stabilizing or maybe rather protected by the government guarantee? Thanks.

<A - Alexander Rijn Wynaendts>: Darryl, you take the first question.

<A - Darryl D. Button>: Yeah, let me jump on the first one. You asked for a sensitivity on the, I think, if interest rates remain flat. First of all, on your conservative comment, what this does do is it brings our IFRS assumptions almost on top of the forward curve. So for the first time I think in a long time, we've had really market assumptions inside the IFRS numbers, which I think is a real positive for the organization in many ways in taking that disconnect, discontinuity down between our different assumptions that we work within.

In terms of on sensitivity, I think the best I can do is just break the €405 million impact, which really came across three different pieces, the equity change from 9% to 8%, the change on the interest rate curve and then the separate account bond fund return.

When I look at the interest rate, only component of that, which is the, I think, the sensitivity you're looking for, that was about half of the €405 million. So when you map it out and draw it out and look at the change we made, the piece from dropping by 50 basis points and flattening out the long term curve that was €200 million.

I don't have another or better sensitivity that I can give you at this time. Pension margins in the U.S.

<A - Alexander Rijn Wynaendts>: Yes. No, obviously, we are pleased with the pension margins, 26 basis points, that is above our target of 25 basis points. The combination of strong sales but also continued efficiency improvement, we'll continue to see that. We are continuously looking at ways of reducing our expenses. As you know, we are bringing our businesses together. We had, call it the big ticket, diversified and smaller cases, Transamerica and all under one, in pension business.

And in terms of margins, what we are seeing is that in the big cases, margin compression and margins are still under pressure. It's a line with what we see in the market, on the smaller cases, let's say, up to €100 million, there is less

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margin pressure. However, I think we should take into account the fact that more and more of our competitors will also be focusing on that part of the market where we see less margin pressure. And then therefore you could expect more pressure coming in in the future, which only reconfirms our position and strategy, which is about being more efficient and taking expenses down and we will continue to take expenses down so that we can maintain our margins at this level.

The second element which is not included in the margins and I raised that in the previous question is that we are more and more focusing now on retaining these assets that mature with an employee retiring in our system. So they will be looking at the total chain much more than the individual pieces. So we'll have the accumulation piece, but we believe that we only today had very small parts of these assets that mature that stay with Aegon, And that more and more we're focusing on keeping these assets with us, which will effectively as you can imagine strengthen the value chain and allow us to take a bigger part of the total value chain particularly in area where margins are higher.

<Q - **Maarten Altena**>: If I can comment on that one, would you be able to come up with a ratio, which number of clients are retained now and how they developed over the last for, let's say, 10 years and where you expect it to go to?

<A - **Alexander Rijn Wynaendts**>: Yeah. It's difficult to say where we expected to go to. I can tell you that we are working very hard in developing plans on increasing that. Today the percentage is relatively low. It's single digits. I mean that's where it is. It is not much more than that. The reason also being we've never so much focused on it. And with our strategy of focusing on retirement segment within, as you know, our purpose to helping customers securing financial futures, we're much more focusing now on this on an integrated basis. And we see that in increasing that percentage, we'll rather like to update you when we have a strategy session in June as to where our visions are there. And clearly, it is possible to increase the amount we retain significantly compared to where we are today.

In terms of mortgages, you mentioned 14 basis points, keep in mind that we had a very significant part of our book in mortgages with a Dutch government guarantee, these famous NHG that clearly helps. We have seen mortgages with very low impairments, 14 basis points, very low. We should take into account obviously with the environment not being as good as you would like it to be and that could trend very slowly up but still well within our pricing assumptions.

<Q - **Maarten Altena**>: Okay. Perfect. Thanks so much.

Operator

Thank you. The next question comes from Nick Holmes. Please state your company name followed by your question.

<Q - **Nick Holmes**>: Hi, there. It's Nick Holmes of SocGén. I had just a couple more questions on the economic assumption changes. First one is, how conservative do you think you are compared with the U.S. peer group? And secondly, can you give us a split of the €270 million between the three elements? Thanks.

<A - **Alexander Rijn Wynaendts**>: Darryl?

<A - **Darryl D. Button**>: Yeah. Nick, I'll take that. How conservative are we now relative to the U.S. peer group? The answer is very, very conservative. So we actually see some, I see some statistics on that, so I can say that fairly confidently that we're top quartile in terms of – on that metric.

In terms of a split, I can give you – yeah, I can give you a split on the equity market component of the €405 million was €135 million, little under €200 million for the interest component and about €70 million on the bond fund component.

<Q - **Nick Holmes**>: Right. And yeah, just coming back the U.S., so I mean, you feel that you are significantly, well, you are more conservative. And therefore, I mean, I saw some debates within the U.S. industry that you are kind of moving away from the peer group and consensus. Do you find other companies raising questions about what you may be doing?

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<A - Darryl D. Button>: Well, I don't know. I guess, that's really – I can't comment too much on the other companies so I'll stay with ours. I would add a couple of other proof points to that too. Sometimes you'll find just total separate account return assumptions. We do break ours between the equity and the bond fund components and our bond fund returns are down at 4%. And you have about – on the annuities in particular, we have about a 50/50 split between equity and bond funds. So when you start to factor in that, that's what really pushes us down on the level of conservatism.

On the interest rate assumptions, same as well, we're towards the lower end now with these new assumption set. So all I can do, Nick, is comment on where we are. And I feel good about where we are and I feel good about lining these assumptions up with, as I said before, with the market, which gives us impacts or it gives us, I would say, beneficial impacts as we go and do things like hedge programs and capital market transactions. So I feel good about our position.

<Q - Nick Holmes>: Okay. That's great. Thank you very much.

<A - Alexander Rijn Wynaendts>: Yeah.

Operator

Thank you. The next question comes from François Boissin. Please state your company name, followed by your question.

<A - Alexander Rijn Wynaendts>: Yes.

<Q - François Boissin>: Yes, very good morning, everybody. This is François Boissin from Exane BNP Paribas. Two questions, please. The first one really is on the value of new business has been increasing quite significantly year-on-year. Could you comment on how much was the – on order of magnitude, how much of the increase comes from better market conditions and how much comes from more efficient operating costs? And a comment on the sustainability of this level of value of new business would be quite useful.

The second question regard to your investment strategy, can you comment on your current investment yield on your backlog, in your reinvestment yield and also the kind of breakdown of your new investments would be quite useful. Thank you very much.

<A - Alexander Rijn Wynaendts>: On the value of new business, I think what we see here is the implementation and execution of our strategy. We said very clearly as the strategy of the company, we want to sell the right products to the right customers at the right price, the after trade value for the customers and the after trade value for us. Otherwise, it's not a sustainable business model in which we're operating in.

So the improvements has and mostly to do with the fact that we have priced our products in line with the market realities. And as you know for variable annuities, for example, of guarantees, we hedge the delta and we hedge interest rate. Most important here is that we have re-priced products.

We have taken products off the shelf, where we were not able in this environment to make them work. We've taken our expenses down. So the answer to your question is that most of the impact is management efficiency to re-price the products, not sell products that are not meeting our hurdle rate and being prepared and being courageous enough to take old product lines off the shelf because we just don't see how they work in this environment. So it's a lot of negatives, which you don't see coming up again, which has turned this number to a positive number. And it also means that therefore we believe that these levels are sustainable going forward because we'll continue and maintain our strategy.

<Q - François Boissin>: I'm sorry. Just to follow up on that, do you think there is more to come, i.e. are you able to further increase margins or do you think that at some point in time, you might see pressure from competitors?

<A - Alexander Rijn Wynaendts>: What you see is that margins, this specific quarter, have clearly have had a benefit from increased margins of variable annuity. Market conditions there had helped a bit, that's clear, because when rates go up and volatility goes down, you get more room in pricing for the guarantees. So we will continue with our strategy

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of only selling products that add value to our customers and add value to us.

We have effectively taken a lot of measures already in the past. The most important measures we have taken them. I've been very clear in previous quarters about universal life, re-pricing and withdrawing products. What I can say today is that in the value of new business, which is as presented, most of all the negatives are those items and those product lines that created negative value, have now been eliminated. So therefore, this is a sustainable level but you should not be expecting the same rate of increases. It will now very much depend on the volume of sales. Darryl, do you have something to add.

<A - Darryl D. Button>: Yeah. Let me give you on the two big general accounts in the U.S., our back-book yields are about 4.70% right now. And new money yields going on in the books are somewhere in the 4.25% and 4.50% range.

In the Netherlands back-book yield is 3.70%. It's about a point lower and new money yields going into the Netherlands is right on top of that, above 3.70%

<Q - François Boissin>: Okay. And in terms of the breakdown, maybe in the U.S. in terms of your new investments?

<A - Darryl D. Button>: Well, it's high-grade corporate credit. It's also some long sovereign, long U.S. treasuries, high grade corporate credit, a little bit of structured assets as well. I would say the new money mix looks very similar to the in-force portfolio.

<Q - François Boissin>: Okay. Thank you very much.

<A - Darryl D. Button>: Yeah.

<A - Alexander Rijn Wynaendts>: So I'd like to thank you for attending this conference call. Again I know it's a busy day, thank you very much. And I'd like to open the floor now to the press for any remaining questions you may have.

Operator

Thank you. We will now take questions from the media. [Operator Instructions] Thank you. Our first question comes from Maud van Gaal please state your company name followed by your question.

<Q - Maud van Gaal>: Yes. Hi, this is Maud van Gaal from Bloomberg News. I had a question with regards to your comment on the Solvency II and also your remark on Solvency 1.5 in the press release. I was wondering what comments have you submitted to the consultation if any? And if you are more optimistic on Solvency II, would that make you urge the Dutch government not to go ahead with 1.5 or the Central Bank? Thank you.

<A - Alexander Rijn Wynaendts>: Let me start with Solvency II. As I just said in the call and as you know, I'm pretty closely involved in the whole process with the industry. I believe that we are at a point that we have never been closer to having the different parties that need to be involved and come to a conclusion. There's a number of outstanding points.

But I think everybody now knows that if, by the end of November, there is no agreement then the deadline of – sorry, I would say its target date of the 1st of January 2016 becomes really impossible. Even if in November an agreement has reached by on the big items, there still is a lot of work to be done and it is questionable to what extent that can be done within the timeframe. But I believe that there is now a very clear desire and determination from all the parties involved to come to an agreement to set this aside and to move forward.

Darryl, you've been involved with Solvency 1 and the Dutch Central Bank. So, do you like to comment?

<A - Darryl D. Button>: Yes. Solvency 1.5 applies to our Dutch business only. It is a stop-gap measure if you will, that here in the Netherlands are implementing while they're waiting for Solvency II. It works off at Solvency 1 framework. It basically stress tests the Solvency 1 framework and then creates a corridor approach where the DNB, the regulator here in Holland, has approval rates over whether companies can pay dividends or not.

Company Name: Aegon
Company Ticker: AGN NA
Date: 2013-11-07
Event Description: Q3 2013 Earnings Call

Market Cap: 12,645.95
Current PX: 5.933
YTD Change(\$): +1.13
YTD Change(%): +23.527

Bloomberg Estimates - EPS
Current Quarter: 0.130
Current Year: 0.527
Bloomberg Estimates - Sales
Current Quarter: N.A.
Current Year: 35600.167

We've been working with them on the stress testing. We've submitted all of that. They've come back here recently. They went through a calibration exercise to calibrate it. Their intention is not to change the overall capitalization for an industry as a whole but it may have individual impacts.

We are fairly confident we come out on the strong end in the local markets. So in terms of that recalibration process, we've fared pretty well. So that's leading behind the comments where we do not expect Solvency 1.5 to have a unique impact to Aegon.

<A - Alexander Rijn Wynaendts>: Thank you, Maud.

Operator

Thank you. [Operator Instructions] Thank you. I'd like to hand the call back to your host. There appears to be no further questions.

Alexander Rijn Wynaendts

Many thanks to all of you that have attended and wish you a good day. Good bye.

Operator

Thank you. Ladies and gentlemen, this concludes today's Aegon's third quarter 2013 results conference call. Thank you for participating. You may now disconnect.

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