

Company Name: Aegon
Company Ticker: AGN NA
Date: 2014-08-14
Event Description: Q2 2014 Earnings Call

Market Cap: 12,332.35
Current PX: 5.767
YTD Change(\$): -1.095
YTD Change(%): -15.957

Bloomberg Estimates - EPS
Current Quarter: 0.170
Current Year: 0.670
Bloomberg Estimates - Sales
Current Quarter: N.A.
Current Year: 27201.500

Q2 2014 Earnings Call

Company Participants

- Willem van den Berg
- Alexander Rijn Wynaendts
- Darryl Button

Other Participants

- David Andrich
- Farooq Hanif
- William Hawkins
- Albert Ploegh
- Nick Holmes
- Benoît Pétrarque
- Ashik Musaddi
- William Elderkin
- Jan Willem Knoll
- Gordon Aitken
- Steven Haywood
- François Boissin
- Michael van Wegen
- Archie van Riemsdijk

MANAGEMENT DISCUSSION SECTION

Operator

Good day, and welcome to the Aegon Second Quarter 2014 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.

Willem van den Berg

Thank you, Jillian. Good morning, and thank you for joining us for this conference on Aegon's second quarter 2014 results. Similar to last quarter, we will keep today's presentation short, leaving plenty of time to address your questions. We would appreciate it if you take a moment to review our disclaimer on forward-looking statements which is at the back of this presentation.

Our CEO, Alex Wynaendts, will share his views on the highlights of this quarter's performance and will then be joined by our CFO, Darryl Button, to answer your questions.

I'll hand it now over to Alex.

Alexander Rijn Wynaendts

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Thank you, Willem, and good morning to everyone. I'm pleased to start this call by saying that we have again delivered a strong set of results, maintaining the positive momentum of the previous quarters. The 7% decrease in our underlying earnings have been driven primarily by three sectors, solar growth of our business, improved operation performance and higher equity markets. These drivers were partially offset by lower U.S. dollar and unfavorable mortality in the U.S., largely related to lower than expected reinsurance recoveries. The impact of continued low interest rate has been modest and in line with the sensitivities we have provided.

I'd also like to mention here that we will update our mortality assumptions in the U.S. as part of our annual assumption with you during the quarter. This includes supplementing our own emerging mortality experience with the results of recent old-age industry studies which is expected to result in somewhat more conservative mortality assumptions.

Sales in MCVNB were also very strong, and our return on equity for the quarter increased to 8.8%. And the real highlight this quarter is our strong net deposits, which increased 75% to €6 billion and helped grow our total revenue, generating investments to over €500 billion for the first time in Aegon's history.

Now, turning to slide 3. And as you can see on slides 3 and 4, our strong performance is the result of continued profitable sales growth. This, together with both of the equity markets, has led to higher asset balances and higher earnings. Asset growth was especially strong in our U.S. variable annuity business and our pension business. Once again, we've seen very strong variable annuity deposits with gross deposits of \$2.5 billion and net deposits of over \$1.3 billion. And we continued to achieve very attractive returns.

Deposits in our U.S. pension business was exceptionally strong with gross deposits of over \$8 billion and net deposit of almost \$4 billion. This is mainly due to larger-than-normal plan takeovers and extends a trend of growing balances driven by initiatives to increase employee awareness and employee participation.

In 2003, we started to make sizeable investments in technology in our pension business, and the aim then was to build a scalable platform from which we could grow and improve service levels. The results of our commitment to investing in technology can be seen both in terms of strong earnings and asset growth now at more than \$135 billion.

And turning to slide 5, the investments we continue to make throughout the company are being made over the same objective, and that is to grow the business in a sustainable way. The required investments are made possible by continued cost reductions. We're creating space to invest in new capabilities as can be seen very clearly on this slide.

Let me share a few examples. Our direct-to-consumer proposition in the UK, Retiready, is gaining popularity and is supporting the asset growth we are seeing on our platform which now stands at nearly £2 billion. In the Netherlands, 400,000 customers are already using our new online portal, Mijn Aegon. And in the U.S., the number of retirement customers that have used our new retirement outlook estimator quickly is approaching 1 million. And we continue to press forward with new initiatives in many of other key markets.

Turning to slide 6 where I'd like to update you on a number of capital-related results. Operational free cash flows this quarter were €370 million. Market impacts, mainly lower interest rate, had a negative impact on cash flows of approximately €25 million. And one-time items had a positive effect of approximately €75 million. The benefit from the redundant reserves financing solution in the U.S. was partially offset by some asset derisking in the UK in preparation for Solvency II and model updates in the Netherlands. We will implement further model updates in the third quarter of this year. Based on the strong capital position and year-to-date cash flows, we will pay interim dividends of €0.11 per share. This represents approximately 50% of the free cash flow.

As you can see on the final slide, 7, we continue to execute successfully our strategy. And today, I'm also pleased to announce that we expanded our partnership in Spain with Banco Santander into Portugal. This is a new market for us. We have now signed a 25-year agreement to distribute life and protection insurance products to over 2 million new customers of Banco Santander in Portugal.

So, in summary, we are proud of we're achieving by executing on our strategy, and this is reflected in a strong set of results. We're growing sustainably in our key markets. Our earnings are up, and we have record revenue-generating assets of over €5 billion. And we are achieving all of these in spite of the persistently low interest rate environment.

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These are exciting times for Aegon as we are well positioned for future challenges and well positioned to take advantage of the many opportunities we see across our businesses.

Darryl and I are now happy to take your questions. Thank you.

Q&A

Operator

We will now take questions from analysis (sic) [analysts] (06:56) and investors first. [Operator Instructions] We will now take our first question from David Andrich from Morgan Stanley. Please go ahead.

<Q - David Andrich>: Hi. Good morning. Thank you for taking my questions. Just on the U.S. mortality experience, I just wonder maybe if you could quantify a little bit what the drag on earnings has been in the past few quarters just to give an idea if there's any potential uplift for earnings once the additional [indiscernible] (07:43) have been made.

And maybe could you also quantify or maybe if you could give a little bit of guidance on what the potential impact is in terms of that quantum. Thank you.

<A - Darryl Button>: Yeah. Hi, David, it's Darryl. Let me jump in with that. As you know, we've been doing a lot of analysis on our mortality the last few quarters. I can – as I look back at the first quarter and here in the second quarter, we're really seeing what I would say would be more random fluctuations, and in first quarter in particular, a lot of the seasonal effect that we normally see. Here in the second quarter, it was lower than expectations but mostly driven by really reinsurance recoveries were lower than expected. However, in that process, we have identified the trend. It's a smaller trend, but it's in the old age part of our market, of our experience. So, I would call that 85, 90-plus.

And there's some recent industry experience out there through a new Tillinghast study that we're looking at carefully there as well. So the actual experience has been small, but in terms of what we see in the older age market combined with the new, I would say, emerging experience, particularly coming from the new industry table, that's an area where I can already look forward to seeing us making some assumption changes in the third quarter.

<Q - David Andrich>: And just any guidance on kind of the quantum or the size of those impacts?

<A - Darryl Button>: Now, we're still – it's our third quarter process and so that's where we do our normal assumption updates. So, we're working through the actual modeling, the reserve and DAC modeling now. What I do have sightline on is the direction of the assumption, and then we will be making changes to the more conservative assumptions in the third quarter. Unfortunately, I can't really size it at this point.

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

Operator

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

<Q - Farooq Hanif>: Hi, everybody. I hope you can hear me clearly. I've just – I just wanted to ask a couple of questions on your free cash flow and dividends. I think I'm just about understanding how interest rates affect your earnings. You're looking at the delta between the recovery you're assuming in your DAC of future yields and kind of the pathway that you're going through. But on cash, you had a €25 million market impact from the low interest rates in the Americas. Can you explain what the sort of direct statutory driver is there that's hitting that and then how we can think about the sensitivity going forward if one day we saw a more positive yield curve environment? That's meant to be question one.

Question two is you've mentioned here a 50% dividend payout of free cash flow which am I right to think it's your first time you've shown that kind of ratio in the presentation? I don't know if it is. But if so, I mean is this kind of the right

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level? Is that how you would think about it going forward? Thank you very much.

<A - Alexander Rijn Wynaendts>: Farooq, let me take your second question first on the dividend. I think on the dividend, we've been consistent and we have a policy, and we are consistent in saying that we would like to have a – sustain a big, growing dividend. We have here given you the number of 50%, but we clearly have an intention to grow sustainably.

The second thing I like to remind you, Farooq, also is that we have expressed our clear intention to execute on the share buyback of those shares we issued in relation to the preference shares that were issued – that were taken in around the association. So, that's how you should be looking at the dividend.

In terms of cash flows, Darryl?

<A - Darryl Button>: Yeah. Farooq, specifically on the interest rate impact, the mechanism for a drop in interest rate to come through capital, I would really break the U.S. business into the life business versus the annuity business. Behind the annuity business is more of an economic calculation with CTE contingent tail kind of capital calculation. That's where a drop in interest rates in any one quarter will come in to that calculation and change the capital. So, we see a bit of capital interest rates sensitivity from the annuity business.

On the life business, the capital was a little more factor-based, and so you have the same decline in earnings which is slow to emerge frankly and doesn't really move the capital needle any one quarter to quarter where it would come through in the life businesses at the end of the year when you do cash flow testing analysis. If you ran out of sufficiency margins, you may have to increase reserves, but we generally have a pretty decent buffer preventing against that, so it does come from the annuity business in the U.S.

<Q - Farooq Hanif>: Okay. So is this kind of – it's a metric then so we should not read too much into 25 and look at the dividend yields. I mean, is it very difficult to your guidance on how it might improve?

<A - Darryl Button>: Yeah. So, I think the sensitivity is – and actually what we have is we have a slightly bigger number of in the 25 coming from the U.S. from the drop in interest rates. The drop in interest rates was pretty profound in the quarter. And then credit spreads tightened and that provides a bit of a capital offset particularly in the Dutch business. So, basically if the yield curve moves in any one quarter you'll find that little bit of capital noise coming off the U.S. annuity business. And then that's a one-time item and then it will be stable if interest rates came back up next quarter. It would reverse next quarter.

<Q - Farooq Hanif>: Okay. Thank you very much.

Operator

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

<Q - William Hawkins>: Hi. Thank you very much. I'm risking repeating a couple of questions. So, forgive me. Just again on the dividend, Alex, in the first half this year, have you just gone back to the old policy of repeating the second half dividend and only making decisions about incremental capital at the end of the year or is the €0.11 sort of a genuine stand-alone decision? And so in theory, in the future, interim dividends could change year-on-year?

And then secondly, I appreciate you don't want to give guidance on what the U.S. mortality charge would be, but I'm feeling like I'm swimming a bit in the dark at the moment about the range of possible expectations. So, maybe the question will be, can you tell us the size of the reserves for the specific buckets that you're reviewing? So, what is the baseline reserves that you're actually starting with?

And also if I can tag on to that, you've mentioned trends, you've mentioned reinsurance recoveries. Now, I just wanted to be clear. To what extent is this review related to a genuine assessment of growth underlying trends and mortality and to what extent may it reflect changes in relationships with your reinsurers because you've mentioned reinsurance recoverables which, to my mind, may have nothing to do with what's actually going on in underlying mortality? Thank

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you.

<A - Alexander Rijn Wynaendts>: Yeah. On the dividends, my answer is simple. It's yes. Theoretically, we make any changes when we want. But again, I want to repeat here, we – what we want to do really is have a dividend that's growing sustainably. I think we've been very consistent in that. And that means to your question, yes.

<Q - William Hawkins>: Thanks.

<A - Darryl Button>: Yeah. On the U.S. mortality, Will, it's – well, first of all, let me give you some of the numbers behind your question on sizing, at least from a reserve perspective. Total life reserves in the U.S. are around 28 billion, but this would only impact universal life because this would be an unlocking event. This would be the FAS 97 business that would have the P&L, and that's about 15 billion of reserves.

It would be an unlocking event as we change the assumption. Let me just reiterate what I said before. It is an emerging experience that we're seeing. It's really the only place where we've seen the mortality thus far deviate from expectations as in the older-age segment. That's age 85-plus. There's a new Tillinghast study that was put out at the end of 2012. We've been studying that as well. It's in the older-age market, so we're basically looking at those two things in our experience, and that's the assumption change that we're looking at making in the third quarter.

So, I apologize that I haven't been able to size it for you. We're still working through the numbers in the calculations, and we're still doing that. That's the one part of the Q3 assumption update that I do have a sight line on and I wanted to give you a heads up for that now.

<Q - William Hawkins>: And there's no way we can be refining further the €15 billion? That's basically a review of mortality across the portfolio?

<A - Darryl Button>: Yeah. I mean, it's a review across – it's really a complete review of all of our mortality, so I don't want to suggest that we're only reviewing the mortality in the older-age segment. We're doing a complete review of all of our mortality assumptions. The only place that I'm seeing at this point that we're coming out with the potential change is in this older-age segment.

<Q - William Hawkins>: Okay. All right. Cool. Thank you.

<A - Darryl Button>: Yes.

Operator

We will now take our next question from Albert Ploegh from ING. Please go ahead. Your line is open, caller. Please go ahead.

<Q - Albert Ploegh>: Oh, yes. Good morning, all. A few questions from my end. First of all, on the normalized cash flows, you mentioned also there is a small negative impact or drag from the auto enrolment in the UK. Can you give some more color on that and what your expectations are going forward?

Second question is on the Dutch business also related to longevity basically. And if I'm correct, by the end of this year, we will have some new tables coming up. Can you maybe share some thoughts of that as well on whether that could be a Q3 or more Q4 event, if anything negative? And if there will be a negative update, how will you account for it? Will you take a one-off charge or you will take it on a quarterly basis going forward, something you have done in the past as well.

And the final question is basically on the UK. You flag also higher investments in IT in the second half. Can you maybe quantify a little bit the step-up there that you might expect? Thank you.

<A - Darryl Button>: Yeah, Albert, let me take your first couple of questions. On the auto-enrollment drag in the UK, yeah, it's part of that cash flow – it's really part of the cash flow story coming out of the UK. The drag right now is about €20 million inside of the UK cash flow numbers. It has to do with basically the auto-enrollment. As we bring

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them on, basically these are typically lower-revenue employees and entrants that we're bringing on, and we have to set up some additional strength relative to that. So, that's just additional statutory reserving strain. It will release in the future, but that's what we're seeing as we bring these auto-enrollees on, and that's inside the cash flow numbers.

You also asked about the Dutch mortality tables. Yeah, we will – part of our annual process, we'll have a look at new tables and new data when it's released later this year. We're not actually expecting – at this point, I'm not expecting anything from that. So, there's nothing I would signal on that front. If we do see anything, it would likely be Q4 by the time we get the data and do the analysis. But at this point, there's nothing I'm expecting there.

<Q - Albert Ploegh>: Okay. Thank you. And to be sure, the 20 million you mentioned for UK, that's pounds or euros?

<A - Darryl Button>: It's pounds.

<Q - Albert Ploegh>: Pounds. Okay. And maybe one final follow-up. On the review that will take basically, typically in Q3, on assumptions, clearly the mortality has been flat. Should we also read into that that, let's say, on the other assumptions at this stage now, meaningful update or changes are expected?

<A - Darryl Button>: Yeah, the only thing I would highlight in addition to the assumption review is we did have a model conversion here in the Netherlands. In the second quarter, we've been converting a lot of our models, particularly on the pension business here in the Netherlands over to new software. Basically, I would say modernizing the modeling platform, if you will. We have taken a block of guarantees over this quarter, and that had a negative P&L impact. That was €78 million that's in the fair value number. We have one last book to convert, and that conversion will also happen in the third quarter. So, I would say I would also look to a model conversion in the third quarter.

<Q - Albert Ploegh>: Okay. Thank you.

<A - Darryl Button>: You had also asked about UK investments. Yeah, we are signaling that we do have, from a sort of a – I guess an expectation from earnings in the next couple of quarters, we do have the final implementation of some of the technology that we have behind Retiready and the platform in the UK that we expect will actually take up expenses relative to what we incurred in the second quarter over the third and fourth quarter. So, we are highlighting that that'll have a small drag on underlying earnings in the third and fourth quarter in the UK.

<Q - Albert Ploegh>: Okay. Thank you very much.

Operator

We will now take our next question from Nick Holmes from Société Générale. Please go ahead.

<Q - Nick Holmes>: Hello. Hi there. Thank you very much. So, a couple of questions. First one is coming back on the dividend. I think to Farooq's question, you said that the interim dividend was held flat partly because of your intentions with the neutralization of the pref share transaction, i.e., your share buyback. I wondered if you could give us more color on that. So you're basically saying that you're looking to do that in H2 and that's why the interim dividend was held flat. That's my first question.

The second one is just looking at the U.S. business. I wondered if you could give us a bit more color on both the variable annuities which are doing very well and also the pensions which are doing perhaps slightly less well. And you cited margin pressure in pensions. I wondered how concerned you are about that. Thank you very much.

<A - Alexander Rijn Wynaendts>: Nick, let me reiterate what I've said on the dividend. We have the policy based on, as you know, balance sheet, cash flows, really strong balance sheet, we're delivering on our cash flows, and we want to have a dividend that is sustainably growing.

In terms of what I repeated here in relation to neutralizing the dilutive effect from the preference share transaction with the association, we've said that that commitment is there, but I have not given an indication around timing and I also don't want to do that right now.

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You asked me about the U.S. business. I think actually our VA business is doing well, very well, but I think our pension business is doing at least as well. Our VA business has been growing as on the back of growth of distribution, getting much closer with our distributors, having the right products right now, being able to price them in a good way, in a way that makes sense for our customers and makes sense for us. We're still making very good margins and good IRRs on this business. As you can see, despite what is a low interest rate environment, which I think is extremely positive, we're gaining market share. Although it is not our ambition to gain market share in itself, what we just see is we are getting deeper and deeper in distribution and adding new distribution.

In terms of our pension business, I actually think this has been a record quarter of our pension business. I mentioned in my call \$8 billion of gross flows, and – was it \$4 billion of net flows. And I do think that if you compare it to some – to what we've seen recently in the industry, this is an extremely strong performance. And this performance is on the back of investments we've been making in the past on our system, which gives us advantages in terms of the best service levels but also scalability.

I want to get that point because we are adding more business while maintaining our expenses more or less flat. And that is I think what is giving us not only a strong business in terms of growth, but also a business that is showing a very good earnings going forward in what is indeed – as you probably recognized, a market where we are seeing pressure.

The second part of this business, I would like to possibly bring back to your attention, and that I think we signaled very clearly in our June conference is that we have now integrated our pension business with our annuity business with the aim of not only improving the coordination of our sales and marketing efforts because, effectively, our wholesalers in both businesses were calling on the same people. We can now put them together and increase our firepower in terms of sales. But equally important is about the whole retention, as you know, the retention of customers, of our pension business that at a certain point in time are going to retire. We've given you the numbers around the June conference. It's around 4 million customers.

And as I said, what we know for sure is that each of these customers at certain point in time will retire, will need products and services that we're going to offer them. So, this business in my view is not only doing well. It's doing very well, but it's also setting and establishing a basis for future growth. That is what we are really truly excited about.

<Q - Nick Holmes>: Alex, thank you very much for that very full answer. May I just follow up again – apologies about this – on the connection with the dividend because you've described a very strong business performance? You're very happy with that. Why did you then keep the dividends flat rather than increasing it, say, 5% or something given the strong underlying performance?

<A - Alexander Rijn Wynaendts>: I can only repeat what I've said, Nick. I've said that we want a dividend that is sustainably growing year-over-year, and I think that's the way we should be looking at it.

<Q - Nick Holmes>: Okay. Thank you very much.

Operator

We will now take our next question from Benoît Pétrarque from Kepler. Please go ahead.

<Q - Benoît Pétrarque>: Yes. Good morning, everyone. Just on prior question again, sorry, the \$4 billion net inflow, what do you see at the margin on this new business? Is that kind of above or below average on the stock? Could you give us a little bit of feeling about this new business?

And also obviously going forward, I mean, what is your kind of outlook on this business net deposit-wise?

And then maybe just on the JV with Santander in Portugal, could you give us a little bit of economics, if not cash outflow probably in the third or fourth quarter and also expected contribution from the JV?

And then last, maybe the improvement in [indiscernible] (27:57) in the UK, do you think it's sustainable? Do you see that actually continuing in the third quarter? Thanks.

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<A - Alexander Rijn Wynaendts>: Benoît, thank you. Just to add on on the question. We've, I think, given you now what we call the return on net revenue which was up 33%, which shows we're making good margins on this business including the new business. But again, I'd like to reiterate, this is the result of a long-term effort of building capabilities that are scalable. That really is the key here, the scalability of our business. And therefore we're able to add business, and I think as we shared with you the, to be exact, 33.9% return on net revenue which I think makes – puts us clearly in the league of those players that are successful in terms of growing and in terms of profitability.

It's always difficult to predict the next quarter because, in this business, part of it is deposits that keep on coming from all our participants. We got over 4 million participants that every quarter in every year have deposits. And the other part of it, and this will be extremely successful this quarter, is takeovers. That means that contracts have moved from another provider to Aegon. And that is never regular. And sometimes it is related to corporate activities. In other words, a customer of ours that does an acquisition and buys another company and integrates suspension fund. That's also takeover. And as you know, we are very strong in what we call the 43B, the hospital area, and that's an area where we do see some activity around consolidation which obviously supports – has been supporting our business.

So, I'm confident, but again it's difficult to predict quarter-on-quarter, but I'm very confident we'll see continued growth on the back of the service. And as you know, we've been winning the award of the best pension provider in the U.S. and all different awards which we shared with you in June, so I don't want to do that again here.

Now your question on Santander, we have not disclosed any amounts, and obviously these amounts are not such that we need to disclose them. What I think is important, Benoît, is to see here that Santander was very keen to expand with us a successful joint venture in Spain. That is what is exciting for us because we have in Spain making great progress. We're working extremely well with them. And to me, the fact that they have asked us to expand in Portugal is the best guarantee that this is working very well, and they are very satisfied with the way we cooperate and the way we're creating a business for the customers.

Obviously, it's two million customers. I mentioned that are potentially customers of the bank that potentially go to buy insurance, it will take a bit of time, but this is the end of the market which is the high end of the market. And it's a very underpenetrated customer base. That's very attractive.

So, on the UK, yes, we obviously see continued improvements. Keep in mind we've been working extremely hard now for a number of years to try to get our expenses down. But I'm not going to remind you the share size of this restructuring, so lower expenses is supporting it. But what we're seeing is that the investments we've made in the platform that these are investments that are supporting growth and that are supporting persistency because at the end, persistency has been one of the drags on our earnings in the past and I'm pleased to see that we see some improvements on our persistency, and I have every reason to believe that that improvement will continue in the future.

<Q - Benoît Pétrarque>: All right. Thank you very much.

Operator

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

<Q - Ashik Musaddi>: Yes. Hi. Hi. Good morning, Alex and Darryl. Just two, three questions. First of all, can you just give us some color about like what your update on the Canada and French review that you've mentioned at the Investor Day [indiscernible] (32:13) view on that? Any update on that?

Secondly, can you give us some color about your net flows in workplace pension? You flagged in the press release around the net flows in the platform which remains very strong at €400 million. So, how's your workplace pension doing? Are you still getting net inflows because it looks like last year it was kind of net outflows from the whole UK pension book? So, any update on that?

And thirdly, I mean, I want to touch base a bit on your deleveraging plans. I know it may be early and you may think of giving those numbers maybe the next business review. But any thoughts on what is the absolute level of gross debt are

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you looking to – are you very happy with or after this deleveraging of 400 million to 500 million which is already planned, do you further want to deleverage your book going forward? Yeah, these three questions. Thank you.

<A - Alexander Rijn Wynaendts>: Yeah. On Canada and France, you know we committed to come back to you before the end of the year. So, we have a little bit more time. And I will promise you that we will come back to you as soon as we have something we want to share and can share with you. That's an ongoing process. In terms of net flows, in the UK, indeed we have positive net flows. I think also, as I just answered in the previous question, it's a combination of new business and better retention. Better retention – because the whole RDR activity is now currently fading down combined with a set that we are having and putting in place in this platform, and we have now the Retiready, which is direct-to-consumer capability. So, we have now much more tools that are helping us to retain the business, and I think that is exactly showing where we want to go.

And finally in terms of net debt, Darryl, would you please take this one?

<A - Darryl Button>: Well, I think, Ashik, as I said before, I think we are committed to managing within a 26% to 30% growth leverage ratio. We're at 31.2% as we stand here today. We also have committed to our maturing the senior in the fourth quarter of this year for €500 million, which will move it down in the range. I think as long as basically I would say my commitment is to manage within that range, as I said before, I'm comfortable at the high end of that range, and over time I would expect this to drift down into the middle, and I think that's fine. I think as long as you see us over that top end of the 30%, that we'll have action plans to get back down within that 26% to 30% range.

<Q - Ashik Musaddi>: That's very clear. Just one follow-up on the workplace on the pension net inflows. The positive net inflows that you mentioned is in workplace or is it the total pension?

<A - Alexander Rijn Wynaendts>: Yeah. I think it's – the way to look at it, Ashik, is you need to see it improve compared to last year. It's an overall – yeah, workplace is corporate pensions, but we have individual pensions, but the area where we've seen the best improvement in persistency is in the workplace area.

<Q - Ashik Musaddi>: Okay. Sure. That's great. Thank you.

Operator

We will now take our next question from William Elderkin from Goldman Sachs. Please go ahead.

<Q - William Elderkin>: Thank you. Good morning, everybody. Just one question on the UK and really following up from the earlier one in terms of the cash flow impact from the expansion of the auto-enrollment, can you just explain how that affects the IFRS earnings you reported. I know you've talked about how it impacts cash. But I was expecting that the underlying UK pension earnings to have at least remain stable quarter-on-quarter, and they seem to have gone done. I just want to understand how that interacts.

<A - Darryl Button>: Yeah. The bigger number, the €20 million that I mentioned, is really the strain that comes through, and we have to set up additional regulatory reserves related to these auto-enrollees. That is not an IFRS impact. That is a statutory or regulatory impact. And those reserves will release. So, we [indiscernible] (36:24) additional capital strain coming in from these enrollees, and then that will turn around and release into the future. In terms of the earnings impact, we have guided that there will be €20 million to €25 million earnings impact once the legislation kicks in and once the [indiscernible] (36:43) put in place. And as a result, now there really isn't a lot of what I would call IFRS earnings impact from the DWP other than the cost that we continue to incur to implement the structure or the project.

<Q - William Elderkin>: All right. Again, thank you.

Operator

We will now take our next question from Jan Willem Knoll from ABN AMRO. Please go ahead.

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<Q - Jan Willem Knoll>: Yes. Good morning, gentlemen. A couple of questions from my side. First, can you explain the background and the impact of the model updates in the Netherlands mentioned on slide 16? And secondly, can you update us on the impact of using the UFR on the Dutch IGD ratio? And lastly, operating expenses rose 8% in the Netherlands. Can you update us on what the normalized run rate – what sort of normalized run rate we should expect going forward? Thank you.

<A - Darryl Button>: Yeah, Jan Willem, it's Darryl. Let me jump in here. The model updates, the short answer is we've been converting our pension business over to a new modeling platform. And what we found this quarter in particular when we moved the block of guarantees over, it's basically new enhanced modeling software. It does a better job. It allows us to put more model points, more data points, better job with stochastic valuations of our guarantees. So, I would say we're getting an enhanced guarantee valuation for the pension business in the Netherlands. As I mentioned before, we have one last block to convert which will come in, in the third quarter.

Operating expenses in the Netherlands, I would say we have what I would consider to be a run rate level of expenses, but we have had some reclassifications which has caused the Netherlands expenses to go up a little bit. We had some expenses that we're going through, the benefit payment line and we've done a deeper analysis on those related to claims handling cost, and we felt that that would be better represented in the operating expense line. So, a lot of that is largely geography on the income statement.

Your second question I think was you are far related. And I must admit I'm going to leave that one and let IR come back to you on that one. I just don't have the – I know we disclosed the number at that time and I just don't have it at my fingertips, so I'm going to ask Willem to come back to you.

<Q - Jan Willem Knoll>: Fair enough. Thanks.

Operator

We will now take our next question from Gordon Aitken from RBC. Please go ahead.

<Q - Gordon Aitken>: Hey. Morning. Gordon Aitken from RBC here. Three questions, please. First on your fee-based businesses in the UK and the U.S., can you just tell us what the revenue basis points and the cost basis points are and where you see that spread going?

Second, on the Dutch buyout market, we're not seeing a lot of activity in Q2 really from anyone. So, wondering why this is and is it the case of schemes? I'm just not buying it at all. Or are they sinking themselves into the industry funds?

And third, on this U.S. mortality, just to what extent are you using standard tables for reserving versus your own emerging mortality assumptions? Thanks.

<A - Alexander Rijn Wynaendts>: Gordon, on the UK, U.S. fee in spreads, these are all different businesses. And I will ask Willem to come back to you and give you some guidance because it would make no sense in taking it on a total overall basis. So, he'll come back to you separately.

Yeah, on the Dutch buyout market, as we said, and we said many times there is, we believe, a strong pipeline. We're comfortable that this pipeline will convert at certain point in time. You're right; we've observed also that Q2 has been a quiet quarter for the market. But this is really no indicator of the next quarters. What I know is that we are well positioned in this market. There is a full pipeline, and I'm very comfortable and confident that we will also be taking a good part of this market.

Also I want to remind you here that we have a very clear pricing discipline. We commit to that pricing discipline. In particular, we can do so because it's only a small number of players in this market. And our strong rating clearly puts us in a relatively stronger position. So, we want to make sure that we do the right deals for our customers but also the right deals for us. But with the pipeline feel that it is, with the activity which I'm aware of taking place, I'm very confident that we will see the good flow of business coming in this area.

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<A - **Darryl Button**>: On the last question, on the U.S. mortality, I mean, as a general rule, when we build our mortality tables, we start obviously with industry tables, but then we've built on our own individual experience. And Transamerica is a very large player and with a large amount of data. So, basically I would say most of our mortality tables are driven more off of our own internal experience and where our data has enough credibility.

Maybe the small exception to that rule would be in this older-age market, where I would say it's emerging data. We don't have as much data, so we're not as credible in our data, so we do look to additional industry data to supplement our own assumptions, and that's exactly what we're doing now. And there's been a new recent study out on older-age mortality, so that's why I flagged earlier that that's the area where I see our assumptions updating in the third quarter.

<Q - **Gordon Aitken**>: Thank you.

Operator

Question from Steven Haywood from HSBC. Please go ahead.

<Q - **Steven Haywood**>: Hello. Good morning. I wonder if you could speak a bit about the U.S. internal mergers and whether there's any update there, particularly in terms of the amount of cost savings possibly coming out here.

And then secondly, with the €20 million to €25 million hit to the UK earnings, will there be any write-off charge in the future for this as well? Thank you.

<A - **Alexander Rijn Wynaendts**>: Yeah. In terms of the reorganization which we have announced in the U.S. at the time we announced it in our June conference, we made it very clear that this was much more about revenue synergies than it was about cost synergies. Yes, obviously there are cost synergies, but it has not been the main driver of the business. The main driver of this decision was about creating a much better coordinated sales force that is approaching distributors, which are, in many case, the same ones. Think about the large wirehouses and broker dealers. And so, we will have some cost initiatives, but I would say that was not really the first and the clear objective.

And the second thing is we also want to be able to have, within one division, a full suite of products that addresses the needs of our customers along the entire life cycle. That means it starts at savings. It starts at corporate pension plans and it ends with annuities, and any other product that helps our customers to retire and to get a flow of income in the way they desire.

So, this is how we should be looking at it, and I think yearly results actually are showing improvements in terms of retention of our business which, as you know, we've been very clear that was an objective of us. If we try to keep more of the assets of the customers, their effective retire and potentially could take the money away from us to keep them with us. That is where the big opportunity is.

In terms of the earnings in the UK, Darryl, would you like to...

<A - **Darryl Button**>: Yeah. In terms of the UK, so the earnings guidance that we've given is based on the fee compression that we see coming from the cap. The way the accounting works, you would only accelerate an amortization of an intangible if we came into a recoverability situation. There isn't an active unlocking mechanism that would bring some of this in their accelerated amortization. And there's nothing that I see, we still have sufficiency to cover that, so I don't see any accelerated amortization of intangibles coming from that. So, I would say no to your questions.

<Q - **Steven Haywood**>: Okay. Thanks very much.

Operator

We will now take our next question from François Boissin from BNP. Please go ahead.

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<Q - François Boissin>: Yes. Good morning, everybody. Three questions, please. The first question is with regards to your model refinement in Netherlands. I just wondered if you could give a bit more details on what you're doing there and what you can expect for the next quarter. Second question, in the UK, you're talking about derisking initiatives. I just wanted to get a feel of what that means for your Solvency II capital base, and if it could impact negatively your earnings going forward?

And third question regarding the overall margin outlook on your business. I mean, you've had stable new business margins Q-on-Q, just quite an achievement given the fact that rates have gone down. I just wondered if it's reasonable to expect growth in margins, going forward. Thanks.

<A - Darryl Button>: Yeah, François. Let me give a shot here. So, on the model changes in NL, as I've mentioned before, we've converted a block of pension guarantee business over to more, what I would call, modern, sophisticated modeling software. It has increased the valuation of those guarantees. I don't have a number to give you for the third quarter, but the block we have left is about the same size of block that we did in the second quarter. So, that might give you a little bit of guide post.

<Q - François Boissin>: And the entire Q3 was close to €100 million, right?

<A - Darryl Button>: In Q2, it was €78 million.

<Q - François Boissin>: In Q2, sorry, yeah. I mean [indiscernible] (46:18)?

<A - Darryl Button>: Yeah. On UK, derisking, that's exactly that we've been doing, is repositioning the portfolio to get ready for Solvency II. We've been taking risk, credit risk, in particular, out of the portfolio. We've sold some callable bonds. We've done some trading to bring in some more inflation-protected guilds as an example. So, this is repositioning for Solvency II that will have a beneficial impact under the mark-to-market capital regime in Solvency II and the volatility that comes with that regime. It has come at a little bit of a cost of giving up some running yield. So, there's been a small impact there and a small impact on the current metrics. But it has been Solvency II repositioning is what I would say there and overall derisking.

Margins on new business, I would just proudly say we're very pleased that we've – with the top line numbers, the sales, as Alex mentioned before, and that we've been able to hold margin that we haven't had to sacrifice our pricing or pricing discipline to hold that top line and margin still holds strong. And I see that continuing into the third and fourth quarter.

<Q - François Boissin>: Thank you.

Operator

We will now take our next question from Michael van Wegen from Bank of America. Please go ahead.

<Q - Michael van Wegen>: Yeah. Good morning. It's Mike van Wegen from America Merrill Lynch. I wanted to go to your slide 5 where you basically show the cost to income ratio. You talked about the improvements that you've made so far. You achieved 59% for H1. Despite the improvement, I think that number is still well above what we consider to be the average for Europe. I suspect a large part of that is driven by the UK. Can you talk a little bit about how that ratio would look like for your main three regions and if you were to be successful with the restructuring on the UK, where that number would be heading to? Thank you.

<A - Alexander Rijn Wynaendts>: Yeah, Michael. We've given this number in June I think for the first time. So, we are giving you this year for the full first six months. Obviously, we want to get this number down. I think you need to be – we need to be careful in comparing this with others because I'm not sure we all do this on the same way. Been seeing it and that was the reason why we have not given you a more granular set of numbers right now because we want to have a good understanding also what others are doing. So, we have something which is comparable because there's a lot of different ways of presenting this. But you're right, the UK clearly does not help this number, and the UK is clearly above the average.

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And as you know, we've been clear that we need to take further – the expenses further down in the UK. There is a plan which needs to be executed between now and 2015, and we're working hard in executing the plan which will take expenses further down in the UK. That will help you [ph] over a number (49:22). But I would just caution you, in making comparisons, we will provide going forward more granularity around this because it is important that what we have is comparable. But the number, yes, will trend down, and the UK will support a further trending down.

<Q - Michael van Wegen>: Okay.

Operator

We will now take questions from the media. [Operator Instructions] We will now take our first question from [ph] Jonathan Goode from Reuters (50:00).

<Q>: Yes. Good morning, everybody. Mr. Wynaendts, I had a question just on the – about the aftermath of the FCA fine on Stonebridge International, whether you see any sort of problems with reputational damage or any impact on sales as a result of the fine. And I wanted to ask whether you expect any litigation to result and also whether the fine itself or the findings of the FCA will require any changes in your management controls or policies there. Thank you.

<A - Alexander Rijn Wynaendts>: Now, we – yes, we have had this fine, and obviously we are not happy with it. We're not pleased with the fact that these things have happened. I like to put it just in the context, these are activities actually which we stopped a couple of years ago. So we have taken action, we've taken action in terms of stopping sales of this product. We have taken action on the management but that has already taken place, and we are making sure that in no other place in our business – and we are reviewing it very thoroughly – there's anything similar. So, we are taking action and have taken actions. And what you see right now is the fine which comes later, obviously, and, as such, should close this whole file. And we're not expecting anything further from here.

<Q>: And so, no litigation on the part of any customers that may have been involved?

<A - Alexander Rijn Wynaendts>: We have been clear also that we are looking at everything a customer – and if there would have been a detriment, we would've made up for it. And on that basis, we do not expect any further activity around this.

<Q>: Okay. Thank you.

Operator

We will now take our next question from Archie van Riemsdijk from Dow Jones. Please go ahead.

<Q - Archie van Riemsdijk>: Yes. Good morning. I have some questions on the pension sales. In the Netherlands, you state that you're confident that there will be – you will take part of the consolidation in a way. But is there another risk that other players will take over the market because it seems that what – that's sort of what has been happening in the second quarter?

<A - Alexander Rijn Wynaendts>: As I said earlier in the call, I just want to be careful not to repeat myself, there is a pipeline. Aegon is very well positioned. Aegon has a very strong balance sheet, has administrative capabilities that are in order. We're well positioned to take advantage of the pipeline. I also said the pipeline is on a regular pipeline. It's not back in flow. It comes and goes. And certain points in time, we see more. And other points in time, we see less. I've made it very clear that I'm comfortable and confident that Aegon will get more than its fair share of the market based on what I'm seeing in terms of pipeline activity but also the capabilities we have in the sector.

<Q - Archie van Riemsdijk>: All right. Thank you very much. If I may, just additional question on the pension contracts in the United States. Could you give some color on the type of contracts that you won there, and what's in store there for the next quarter?

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<A - Alexander Rijn Wynaendts>: Well, in the U.S., we see two elements here. One is deposits that come from all our customers, all our customers save for their pensions directly to employers. Sometimes they also add themselves, their only contribution. So, that's a big part of the flows we're getting.

In addition to that, we've been very successful taking pension plans over for other participants -from other, excuse me, providers. And these are pension plans for companies that have decided that they want to take advantage of the services and capabilities of Aegon and Transamerica in the U.S. And these are large corporate plans for 401(k) plans or what you're very familiar with.

And I think as I said earlier, this is on the back of really strong capabilities in terms of services we provide, the whole way we interact with the employees, and that's what employers like. Secondly, because we have a very scalable pension capabilities, we're also able to provide this an attractive pricing. And we're able to be competitive in the market, which is quite a tough market. That's scalability. That is supporting our success in the business. And as such, I have every reason to believe and to be confident that the positive momentum will continue.

<Q - Archie van Riemsdijk>: All right. Thank you very much.

Operator

We will now take our next question from [ph] Corina Ruhe (54:48) from Bloomberg. Please go ahead.

<Q>: Good morning. A few questions. The first one, the Dutch government puts up Reaal for sale. Is Aegon planning to play any part of it – in it?

<A - Alexander Rijn Wynaendts>: Yeah. You're right that the Dutch commerce are planning to put it for sale. Just I would like to repeat here again that we've been clear that our priority is organic growth and that we're well positioned to grow in all the segments in which we are present.

<Q>: Okay. Thank you. My second question, well, it was already discussed earlier in the analyst call, the sale of the French and the Canadian operations. Will you keep the goal to sell those businesses before year-end?

<A - Alexander Rijn Wynaendts>: Again, I think I've been very clear and there's nothing more I can add to it.

<Q>: Okay. Thank you very much.

<A - Alexander Rijn Wynaendts>: Thank you.

Operator

We will now take our next question from Archie van Riemsdijk's from Dow Jones. Please go ahead.

<Q - Archie van Riemsdijk>: Yes. I had one additional question. I understand that Solvency II regulations will cause Aegon to lose kind of a capital benefit due to diversification. Is this something that could have strategic consequences, and maybe you can expand a bit on the effect of Solvency II in this respect.

<A - Darryl Button>: Yeah, Archie, it's Darryl. I wouldn't say that Solvency II causes us to lose a diversification benefit. We have – diversification comes in our business in various ways. There's diversification in really in most of the capital formulas and the regions that we operate within. There's been an open debate within the Solvency II paradigm itself around how much diversification benefit should be taken once you start doing the group calculations which is a new element of Solvency II. And that continues to be a fluid debate backed by conversations on fungibility of capital and things like that.

So, that's a – I would consider that a fluid debate that's still happening on the overall aggregate Solvency II. It doesn't impact any of the solo capital calculations, then I would not characterize it as us losing anything that we already have.

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That's for sure.

<Q - Archie van Riemsdijk>: All right. That's it. Sorry, am I still on the call?

<A - Alexander Rijn Wynaendts>: You are.

<Q - Archie van Riemsdijk>: Okay. On the – well, to explain it a little bit better, does it – could the results mean that you will have to keep on increasing your capital more, or is this not for a longer time than expected earlier? Or is this within the balance of your strategy?

<A - Darryl Button>: Well, I certainly can't comment any more than we did in June in terms of where the overall Solvency II work is at for the company, so I would point you back to our presentation in June. What I would say is, again, it comes back to – even within Solvency II, it's a matter of managing capital in the solo which would be the individual country regions of where we do business. And so, I don't see a restriction related to group diversification in Solvency II coming in that causes a material change from how we manage capital locally. And that's really all I can say in the context of we're still finalizing the Solvency II framework.

<Q - Archie van Riemsdijk>: All right. Okay. Thank you very much.

<A - Darryl Button>: Yeah.

Operator

That will conclude today's question-and-answer session. I would now like to turn you back to Alex Wynaendts for any additional or closing remarks.

Alexander Rijn Wynaendts

Well, I'd like to thank everybody that participated, that's still in the call and also those that already left the call for participating and a continued interest in Aegon. Thanks a lot and have a great day.

Operator

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

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