S1 2019 Earnings Call

Company Participants

- Mark FitzPatrick, Group Chief Financial Officer and Chief Operating Officer
- Michael Falcon, Chairman and Chief Executive, Jackson Holdings LLC
- Mike Wells, Group Chief Executive
- Nic Nicandrou, Chief Executive, Prudential Corporation Asia
- P. Chad Myers, Executive Vice President and Chief Financial Officer, Jackson National Life Insurance Company
- Patrick Bowes, Investor Relations
- Unidentified Speaker

Other Participants

- Andrew Baker, Analyst
- Andrew Crean, Analyst
- Blair Stewart, Analyst
- David Motemaden, Analyst
- Greig Paterson, Analyst
- Johnny Vo, Analyst
- Jon Hocking, Analyst
- Nick Holmes, Analyst
- Oliver Steel, Analyst

Presentation

Mike Wells {BIO 4211236 <GO>}

Good morning, everybody. Thank you for coming out on this warm and sunny London summer day. For those of you -- first off, thank you for joining us, a little more serious note. And those of you via telecast and also I know on the phone, thank you for joining us. I'm Mike Wells, Group Chief Executive of Prudential. Our structure today is going to be a little different format than we've used previously. So I'm going to do a quick overview of the strategy and a demerger update; then we're going to ask Nic to do an update on Asia and the success we've had in the first half of the year in quality, quantity, all the various metrics; Michael Falcon will come up to walk you through Jackson's success and also his view of some strategic challenges and where he wants to go with that business, opportunities it has; Mark will walk you through some of the financial highlights; and then I'll come back and make some closing remarks. And we should do this in less than an hour and leave you plenty of time for any questions you have.

But we think it's important a shift to have the business heads discussing the business performance with you more directly and so we'll get your feedback on the format after we're done. So, I guess key message is we're moving forward with the demerger this year fourth quarter. That tells you what's done and the amount of work that went into unwinding a 170-plus years of relationships inside the Company and structure and things and I couldn't be prouder of the work that was done. But also the -- we told you originally we're doing this from a position of strength and that was one of the key drivers and that was a -- we had to maintain that. So the businesses themselves had to continue to perform, grow, add dimensions, and all the things that you see in these first-half results while we were doing the work on the demerger. And I'm incredibly proud of the team for getting all of that done at the same time.

As I've told a number of you, I've always believed the bandwidth in this organization is unique and I think you've seen that. So, done from a position of strength. What does the financial performance look like? Well, it's broad, it's high quality, it's Asian led. All of the key metrics in Asia, let's start there, and I must -- for John's benefit and Clare's with us too here in the front row; from a standard accounting procedure point of view, the UK businesses from this point will be considered discontinued. It's a fairly harsh term for businesses that quality that are growing and doing well so my apologies to my colleagues of many years, but that is the framing. So we talk about continuous operation that refers to the United States, Asia, and Africa. So, the results of continuing operations. Asia growth up 10%; Asia value the new business metric up 10%; earnings up 14%, cash again a free surplus generation, one of our favorite metrics up. At the Group level; dividend up 5% in line with our policy and at this point -- this stage effectively a mechanical calculation.

And then at the Group level again including our colleagues at M&GPrudential, embedded value up GBP53 -- to GBP53 billion. So, all key metrics strong. Again as we've said many times up here, all of the metrics that we think are critical going up, similar slope, similar growth rates, and the kind of performance we would like to think you expect from us. What's behind that and I'll let the CEOs get into the specifics, but eight out of 10 markets in Asia with double-digit growth of earnings, US up 14%. Mike will get in -- and Mark will get into the calculation where that comes from. Eastspring, outstanding performance in earnings and in flows. The US, you're going to see diversification of product on the organic side, the integration of their last bolt-on Hancock transaction and so -- and then quality wise, I'll let Nic get to the specifics, but both in regular premium and in recurring premium, the client relationships, these metrics are in the 90%s.

So, the absolute quality of the earnings that we're producing have never been better. So, we're continuing to invest in organic as you see from the materials. And again I appreciate, there's a ton of materials you've been given today in a new format given the change. So, we'll try and give you some guidance on where to look and then obviously take a little while to go through them. But the inorganic and organic investments we're continuing to make are material and they're paying off. On the organic side, you saw GBP500 million invested in new business in the first half of the year. I often get the question does Asia need more capital. There is no market we have in Asia that doesn't have all the capital it needs for organic growth, okay. And then the inorganic activity is driving a number of objectives. It is extending and broadening distribution relationships.

So in the case of United Overseas Bank, we renewed that partnership. It's not only the 400-plus branches they have in five markets, but it's also we're working with them on TMRW, their new digital bank platform, that's the name of it, and brings another dimension to that relationship. On the -- I think a number of you saw is we launched Pulse and Nic and I and a number of us were in the front row. We were in Malaysia last week with the Minister of Health and his team launching our new health ecosystem platform and again that's going to be rolled out across 10 markets in the next year. It's got a -- we met with our key agents in the morning and the leaders of our largest businesses there in Malaysia and they understand the dimensions it brings, the brand recognition, the client acquisition, the positioning, and of course from a social point of view, they see the value of something with that capability coming to the market that addresses prevention, postponement of illness, better information, those sorts of things.

So, the investment in that is to the point now where it is actionable and in the field. We continue to upgrade the value chain across the globe of the businesses. 80%-plus of the business written in Asia came in electronically in the first half of the year. Again this is efficiency of agency operation, this is the tools they have, this is our ability to process faster and to interact with clients in the ways they want to be interacted with. And then modernizing some of our distribution capabilities, you may have seen, with the partnership with OVO we announced. That's the largest payment provider digitally in Indonesia. So, it's 115 million devices that their technology reaches and again I'll let Nic give you a little more color on that. So modernization of what's already working, broadening, deepening, all of it. And this gets to the decisions on how we allocate capital. So, we're continuing to grow these businesses organically.

We are looking first and foremost at markets with structural growth. That will be the first lens for any business in the international group.

So second is risk-adjusted returns, a variety of other metrics that we're going to keep a little closer to the vest, but at the end of the day, the portfolio needs to include markets or the products that we produce are in demand. Now that sounds simple, but for insurers that's a finite number of markets globally, and we think we have leadership positions in those markets, and we think we're demonstrating, we're broadening those positions with a variety of initiatives. Again I'm going to let Nic give you a little color on the types of things we're doing and testing. And I've never seen this organization better at moving good ideas across business units. So that's part of our scale and what we expect a benefit to come from our scale.

So risk-adjusted, high-quality returns, you can't say that and not be willing to exit businesses. So you see some of the businesses that we've invested heavily in and the types of returns we're getting on the right. That's organic. You also see some of the businesses we've exited. Isn't necessarily a reflection on the quality of the business, but it's a reflection of our view of where it fits inside the Group. So to that, a very high-quality business that will no longer be part of the group is M&GM&GPrudential.

So there's a number of things going on around the demerger, just going to come back to from a position of strength, why are we doing it? It's a great business. It's alignment, so capital, investor base, currency, regulatory model, shape of the earnings, cash flows, all those sorts of things are getting very different, and the synergies as we discussed at the time, more and more limited. So we think this gives you, as a shareholder, the ability to decide if you want to hold or if you want to sell or buy more, it'll be dividended to our existing shareholders in the fourth quarter, so they can decide the combination of the investment characteristics of these two companies that they think is appropriate for their portfolio.

And again we think that's a decision you should make. So there's no IPO, there's no equity raise. I can tell you if you talk to these teams before -- excuse me, after the session today, what you'll find is this sort of exercise brings a level of focus that's unique. You look at everything. I was commenting to a friend in the weekend, it's the opposite of M&A. M&A you present an idea to your Board and your shareholders and say this is what we're going to buy and this is what we think we can do with it 18 months after, and this is what we think the finished product will look like. In this case, we said to you this is what the finished product has to look like. We did the work first, okay. So these businesses are tuned up, are in great shape. The management teams are focused and they've never been more competitive in their marketplaces, and I say that with 24 years of being with the Group.

So the final steps involved there's a process where we have to produce the prospectus and other documentation available to you in the marketplace. John's team will do a market's day again with this numerically centric to give you more detail and get really comfortable with what the demerged entity will look like. We'll have an Extraordinary General Meeting, an EGM. That's -- and then with, of course, a vote with the shareholders to approve the demerger, and we (inaudible) having all of that done again in the fourth quarter.

So with that I'm going to turn it over to Nic to give you an update on some of the success we're having in Asia.

Nic Nicandrou {BIO 15589153 <GO>}

Okay. Thank you, Mike, for the opportunity to present on the business. Good morning, everyone. It feels a little like old times presenting to you during interim results.

Now, in my presentation I will provide an update on the progress that we're making in delivering our strategic priorities and cover how these are driving our current financial performance while building a platform for sustainable high-quality growth.

Prudential Corporation remains focused on the four clear strategic priorities shown here, which we first outlined in 2017. Through these, we're looking to extend our reach and build on our established business strengths through a broader range of products, wider market access, and seamless customer experience. Let me step through a few operational highlights.

Starting with enhancing the core in the top part of this slide. Our new product initiatives such as the launch of group insurance and the high-net-worth propositions in Singapore, our entry into retail pensions in Hong Kong, and our enhanced non-linked offering in Indonesia have contributed around half of the NBP increase in the first half of this year.

On distribution, our renewal of UOB for another 15 years across five markets in our region has reenergized this partnership delivering our best-ever performance for a six-month period with sales up 27%. Our joint teams are hard at work to make our offering accessible to a wider UOB customer set, both in branch and digitally. Meanwhile, our increased emphasis on high-end agency has seen our MDRT qualifies across the region rise by 11% to over 8,000 for the first time.

Moving next to health. Mike and I were in Kuala Lumpur last week for the official launch of our AI-powered digital health platform branded Pulse by Prudential. This offers Babylon's health services alongside telemedicine, wellness, and other bespoke services to 32 million Malaysians. Pulse will be available in 10 markets by this time next year, with Singapore, Hong Kong, and Indonesia launching the app in the fourth quarter. To support this regional-wide rollout, we have secured digital services from 10 partners so far, with more to come as we look to enrich the Pulse offering.

The Pulse platform significantly broadens our current business [ph] remit through developing new customer solutions which cover the entire spectrum from wellness, diagnosis and treatment, to recovery, Pulse marks Prudential's move towards taking a more preventive role alongside our established protection role. With over 20,000 registered users already, we're off to a very good start.

At Eastspring, we're beginning to see the benefit of the investment made across multiple business dimensions over the last 18 months: a geographic expansion through TMB Asset Management in Thailand and the WFOE in China has delivered a positive start. In Thailand, Southeast Asia's largest and fastest-growing mutual fund market last year, we have an opportunity to further consolidate our market entry through the acquisition of a controlling stake in Thanachart Fund Management Company, the ninth largest player with AUM of GBP5.4 billion. In China our expanded presence, build out of distribution, and new product launches have delivered a strong first half for new business sales and profits in both absolute and relative terms. More on this later in my presentation.

So in summary, we're not only building accelerants to sustain our current performance. We're also looking to build new future growth engines at the same time. This is good news for shareholders as the power of our brand, customer propositions, broad distribution reach, and proven execution track record position us exceptionally well to deliver on our sector's multi-decade opportunity in Asia.

Now delivering results is in PCA's DNA and the first half provided yet another proof point. APE and NBP were both up 10% on constant currency, the latter despite a two percentage point drag from lower rates and up 14% and 15%, respectively, on a reported basis. IFRS operating profit and free surplus generation were also up 14% and 13%, respectively, on constant currency. And finally on this slide, both AUM and EV rose by 23% compared to a year ago, a clearly positive development for our future earnings momentum.

Our strong headline performance continues to be underpinned by three key attributes, namely: diversity, quality, and momentum. The power of our diverse business platform is evident in multiple ways. Firstly, through the number of markets delivering double-digit APE growth in both quarters this year; secondly, and more importantly, through NBP where performance was broad-based, both geographically and by distribution channel.

As you can see, both agency and bank-sourced NBP grew strongly and seven of our life markets grew NBP at a double-digit rate, producing a 17% increase outside Hong Kong, while Hong Kong's underlying increase of 10% was dampened by the effect of lower rates. And lastly, the power of diversity is also evident through nine businesses delivering double-digit growth in IFRS operating profit.

Our focus on quality, which provides low correlation to investment markets, is evident through the high regular premium content of our sales at 93%, through our strong customer retention rate of 95%, and through our continued emphasis on driving health and protection where NBP was up 8%, premiums received were up 12%, and IFRS insurance margin was up 14%. And finally, on this slide, our forward momentum is evident through the increase in our recurring revenue base, which benefited from the addition of another regular premium cohort and sustained high customer retention. The compounding nature of this growth delivered through thick and thin over many years also brings us considerable earnings resilience to go along with our capital resilience with the aggregate local solvency position of our policyholder and shareholder funds at 30 June staying roughly level at 312% relative to the equivalent position at end 2018.

The growing level of recurring premium revenue and high consumer loyalty delivered a 23% rise in our total liability base year-on-year to a new high of GBP94.6 billion. As we have said before, this liability base is a good proxy for our IFRS earnings base. The combination of a higher balance sheet and the rich protection content of our business has driven total life IFRS earnings 14% higher with eight life businesses growing at a double-digit rate, led by Hong Kong up 29%, Singapore up 18%, Malaysia up 10%, China up 28% on an after-tax basis, with only Indonesia seeing a fall in earnings, reflecting the impact of declining sales in recent periods. And finally, our earnings exposure to interest rates remains de minimis given our health and protection product bias and modest reliance on spread business.

I will now give you some market color on the four largest contributors to our life results, starting with Hong Kong. This business has developed a playbook that we want all our businesses to follow. On products, Hong Kong continues to leverage its with-profit strengths and to innovate in health. It successfully launched a tax-deferred retirement offering on April 1st which contributed 14% of sales in the second quarter. Prudential Hong Kong has maintained its market leadership in agency growing sales by 9% through this channel and headcount by 16% to over 23,000 agents.

Our business has benefited from resilient and rising mainland China consumer demand, supported by a 16% increase in visitor numbers in the first half of this year to over 27 million. Local sales have also grown through success enjoyed in the government-led annuity and VHIS initiatives. All of Hong Kong's key lead earnings indicators are growing at a double-digit rate, supported by a 98% regular premium new business mix and a 99%

customer retention rate. As a result, customer numbers are 10% higher, renewal premium is 16% higher, and embedded value is 29% higher than a year ago. All these factors contributed to the 29% increase in Hong Kong's IFRS operating profit.

Now I'm sure that you're all familiar with recent developments in Hong Kong. We did not see an impact in our July sales which maintained the positive growth trajectory, but of course we're monitoring developments on a daily basis. The earnings dynamic of a strongly compounding revenue base here immunizes our business from any potential short-term sales fluctuations.

Turning next to our China joint venture operations. In the last 12 months, we continued to broaden our presence by entering two new provinces, Hunan and Shaanxi, and opening offices in another 12 cities. At the same time we have deepened our presence within our current footprint with both channels delivering NBP growth in excess of 25%. Post-tax IFRS profit was up 28%, supported by a 27% increase in regular premium sales and 97% customer retention. Like Hong Kong, the key lead indicators of our China JV point to strong future earnings growth track with year-on-year customer numbers up 14% to 1.4 million, total assets up 35% to GBP10.5 billion, and EEV up 37% to GBP3 billion on a 100% basis. I believe that we remain uniquely positioned amongst the foreign players to benefit from both operational delivery, given a low penetration and our access to over 80% of China's GDP and from strategic tailwinds given the foreign ownership relaxation.

Moving next to Indonesia, the team here has been working hard to drive a return to growth by addressing both the lack of product diversification an agency channel effectiveness. A broader product suite was introduced over the last year including a new non-linked savings product in January, an upgraded medical offering for the mass market in April, supplemented by our entry into the employee benefit insurance space in June using the digitally-enabled PRUworks platform.

Additionally, we've made progress in segmenting and retooling our agency with good early results from the Elite segment. Encouragingly sales rebounded in the second quarter once these initiatives took attraction, increasing by 48% compared to the same period of 2018 with sales from the Elite agents more than doubling.

Our product pipeline in the second half we'll see us introduce a new Shariah non-linked savings product and an affluent version of our flagship linked protection product. Our agency modernization initiatives will continue as we equip leaders [ph] core and rookie agents with new tools and pursue greater productivity from the Elite segment.

As Mike referenced earlier, we have also entered into a strategic partnership with OVO, Indonesia's leading mobile payments platform present in over a 115 million devices. We're working jointly to develop new digital propositions for all those platform users, encompassing both savings and protection products, and we're targeting an end 2019 launch date. There is still a lot that we need to do in Indonesia to realize the full potential of this business, but the team has notched up some encouraging early wins.

Finally, on this slide, as I mentioned at the start, Singapore has led the way amongst our businesses in expanding our reach to new customer segments, such as the high-net-worth individuals and group insurance for large corporates and SMEs. These new offerings contributed 11% of our first half sales in this market. Our focus on quality and innovation saw Prudential lead the way in Singapore in introducing flexible premium terms on saving products and no claims features in retail protection products ahead of regulatory changes. These initiatives have driven a market-leading 13% increase in regular premium in new business and a 12% rise in individual health and protection sales. Importantly, NBP increased by 13% in the first half with both channels delivering double-digit growth on this measure and IFRS profit was also higher by 18%. Singapore is therefore well on the way to support a regional growth agenda.

At Eastspring, the work initiated in the last 18 months to improve performance, broaden offering, expand geographic reach, and reenergize distribution is beginning to pay off. The GBP3.1 billion of net third-party inflows represent a high-water mark for a six-month period with six markets, namely Thailand, Singapore, Korea, India, Japan, and Taiwan producing over GBP0.25 in net inflows. Around 45% of these inflows came from strategies not available 18 months ago with a further 23% coming from institutional client top-ups on the back of strong investment performance. These positive third-party flows, combined with the more reliable, structural flows from our life businesses, positive market movements, and the acquisition of TMB Asset Management drove Eastspring's AUM 23% higher than a year ago to GBP169.5 billion. Consequently, profits rose by 12% to GBP103 million, in line with average AUM as the more muted revenue growth following changes in asset and client mix was offset by action on costs. I believe this performance makes Eastspring stand apart from its global and regional peers in what has been a difficult operating environment for asset managers.

So in conclusion, we have extended a double-digit growth trajectory for our key profit and value metrics supported by strong new business and net flow momentum. Our new segment, product, channel, and digital initiatives are broadening our capabilities and are beginning to contribute meaningfully to our results with much more to come. The structural drivers of demand across Asia remain intact, and notwithstanding cyclical headwinds, a proven execution record coupled with the power of our diverse portfolio, our focus on quality, and our strong business momentum, will see us continue to deliver relative outperformance.

With this, I will now hand you to Michael for an update on Jackson.

Michael Falcon {BIO 17026942 <GO>}

Morning. Thank you, Nic. I'm pleased to be here with all of you today. My name is Michael Falcon and I joined Prudential and Jackson at the start of the year. I've had almost eight months in the business, meeting associates across our company, regulators, distributors, and customers. When I accepted the role, one of the things -- the key things that Mike and the Executive Committee were looking for was a fresh and in-depth review of Jackson's business and strategy. There remains I think a broad consensus that Jackson, as strong and dominant as we've been in the market, can be more than it is today and that we still somehow punch below our weight.

Our challenge -- my challenge is to find the opportunities to unleash value and capability and realize a more robust and fully-valued Jackson. Our review, while ongoing, is fulsome, it's without limitation in scope and without preconceived outcome or conclusion, and as my leadership team and I move past initial assessment stages, I want to share some relevant observations as well as covering the first half 2019 results. I'll include thoughts on indicated actions throughout and conclude with a roadmap on how we expect to go forward.

So let's start. Strategically, I would summarize my assessment in three simple points. First, Jackson is an outstanding business with even greater demonstrated capabilities than are usually noted; second, the US retirement market where we remain committed and focused is large, growing, and offers tremendous opportunities for us; and third, Jackson I believe can deliver a step change in value by more actively diversifying our business mix. I think this reduces requisite hedge cost and thereby increases free cash surplus generation, this to support both growth and increased remittances.

Jackson is a great business with a long and strong history of success. We have a history of innovation, including the modern annuity product where we continue to lead, but we're also leading in new product initiatives such as advisory. Jackson I think was well-placed to grow rapidly in the withdrawal benefit part of the annuity market a decade ago, growing our share to 17%, and we remain well-positioned today given our pricing discipline and risk management approach. Our sales, distribution capacity, and capabilities are outstanding. Advisors, customers, and platforms rate our sales teams, products, and service deliveries very highly, and they all want to do more with us. We're operationally efficient and excellent with best-in-class industry cost structure, quality, and a single-stack technology. We're scalable and we've demonstrated this through numerous bolt-ons.

Our regulatory operational and risk management record I believe is strong and it's highly respected, and we've proven resilient through numerous market cycles and market conditions. Finally, we operate in a massive, fast-growing, albeit complex US retirement market. But understand that people want what we provide, guaranteed lifetime income and protection of principal to and through retirement.

The industry is certainly going through a disruptive change, but I believe that in general it's changing for the better. We see a clearing of the regulatory fog. The SEC regulatory Best Interest rule has been issued. We have bipartisan legislation pending with Safe Harbor rules for insurance and retirement plans. And the most problematic aspects of the previous DoL initiative are less likely, while benefits I think of a smarter and better regulatory framework are being enhanced.

Further, media sentiment towards annuities is softening, even warming, and the customer sentiment towards well-run and trusted financial partners is improving. Most importantly, the direction of intermediary distribution in the US advisory markets are changing, recognizing the benefits that our products can provide. This I believe is being driven by technology and the ability to integrate the benefit of guarantees and to client portfolio outcomes, in planning, in portfolio construction, and in analysis. It's still early days, but the integration of annuities, it's a core advice, asset allocation, and operating systems is finally happening. For the first time advisors are increasingly able to model the cost-benefit for clients and then execute all within their core workstation.

There are, of course, still some headwinds. We remain a relatively high friction product in terms of complexity and the selling, contracting process, but that's improving and I think it's going to continue to improve. We also are deep into the longest expansion in modern US history and a period of, dare I say, even lower for even longer interest rates. The economics of these risks and volatility actually speak quite well to the benefits our products provide, but the behavioral finance results, of course, can vary in terms of end-client behavior, especially in the near-term.

So where does that leave us in terms of strategic assessment and priorities? Jackson has become highly concentrated in variable annuity, driven by the higher returns and lower capital requirements of the VA product. Additionally, over the last few years, companies with what I'll call challenged GMIB, Guaranteed Minimum Income Benefit, back books have come to market. There are big differences in the economic risk profile and accounting dynamics between GMIB and GMWB risks. Fairly or not, I think these elements combine, and today I feel they negatively impact our valuation.

That said, we have an opportunity to increase value through more accelerated diversification which will serve many benefits, both commercially as well as from a capital return perspective. We have a strong business with organic growth that includes non-VA products, plus we are an experienced and logical consolidator and operator of life insurance and annuity blocks. To be clear, Jackson understands and likes VA risks and returns. They represent attractive, long-term through-cycle returns, and we are comfortable and capable to manage the associated risks.

Also to be clear, today Jackson is well capitalized for its current book of business. Still we have opportunities to improve shareholder returns with increasing remittances, by growing into a more diverse book. This can happen organically, as has already been started, but also inorganically through more active stance on bolt-ons. Organic and inorganic growth will require investment, which might at times outpace statutory capital generation. Statutory capital generation is, of course, the constraining factor on remittances which are important for Jackson and the group.

To meet potential needs, we are flexible as to funding options, including, but not limited to, third-party financing within the US corporate structure. This could also include reinsurance deals and structures similar to others that exist which are not uncommon in our market. As a practical matter, given the size of our book, natural aging, attrition, and the current market trends, we do not expect significant organic net growth from VA flows in the near-term. However, we remain bullish on the longer-term VA growth opportunities in the US market. We are not looking to shrink our VA exposure. But we do want to reset the mix of business going forward. This will diversify the calls on capital and free up cash flow by reducing hedging needs executing the strategy while maintaining our current risk appetite. Again, we like Guaranteed Minimum Withdrawal Benefit risk profile. It's often the best solution for investors. The liquidity is supported by NAV. The claims are deferred, and it's a high-value product with fees and fee accumulation that supports the risk transfer.

Now let's take a look at mid-year results and I'll start with sales. After a weak second half last year, further impacted by fourth quarter markets and an even more depressed January, our commercial results are improving. We've seen month-on-month performance build in year-to-date sales for the first half finish only 4% below prior year and 15% above the second half of 2018. This improvement actually has continued year-to-date. We've launched a competitive FIA product early in the year and volume built steadily through the first quarter and continues on pace, despite the recent cap reductions we took in response to lower rates. Again I'd remind all of you of our pricing discipline. And while competitive, we're not the price or cap leader. We sell based on the quality of our product and service and not teaser or loss leader pricing or features.

Fixed index and fixed annuities now make up year to date roughly 20% of sales and that's up from about 5% last year. That said, this change in current year sales does not meaningfully impact our overall business mix yet, given the size of our in-force separate account block. It's important to remember that the VA business will grow with markets and the S&P was up 17% in the first half of the year. Of course, I'll note the margins on VA business are fundamentally more attractive than other product lines as well as less capital intensive, and we see this reflected in new business profit being down this year, which includes both the shift in mix but also the impact of interest rate decline during the period. We have details of that in the EEV disclosures.

Turning to 2019 first half income metrics. Our first half IFRS operating profit grew 14% primarily due to the DAC amortization slowing related to the 17% increase in US equity markets. The drop in equity markets at the end of 2018 reduced our separate account balances at the start of the period and therefore fee income in the current period. Improving markets through June and the performance of our underlying funds had allowed asset values to fully recover at mid-year resulting in fee income close to flat to the current period.

Current interest rates, however, drove a reduction in spread income. As Jackson has experienced before, the significant drop in interest rates in the first half caused a below-the-line IFRS loss. As a reminder, the IFRS equity drift rate is based on current risk-free rates, without a risk premium or mean reversion. So sudden rate drops are notably punitive to below-the-line results. Despite the impact of IFRS methodology on VA reserves, overall IFRS shareholder equity was actually up, both on a six and 12-month basis.

Moving to the middle column, stat operating capital generation was up over prior year, this due to the release of reserves from the John Hancock bolt-on transaction in late 2018. Adjusting for this impact operating capital generation was down slightly, but generally in line with that of the first half of 2018.

Stable operating capital formation along with continued effective hedging supported a 17% increase in remittances to GBP400 million despite these volatile markets. Including the impact of the dividend remittance, stat capital was slightly lower at mid-year reflecting the net impact of reserves and hedging. Again, the 17% increase in US equity markets, given that increase in US equity markets, the net hedging result was negative due to the liability starting to floor out. Additionally, the first half saw an increase in the non-admitted deferred tax asset of close to $200 million. As a result -- I'm sorry, as a reminder, stat capital is very conservative and it restricts admission of the deferred tax asset. Despite these headwinds, June RBC, including the impact of permitted practice, held above 400%, and we expect it to remain in the range of 400% to 450%.

Turning to EEV, which we think captures a more complete and economic view of VA cash flows, net income of GBP900 million was flat to prior year. More importantly, overall, the EEV of shareholder funds, a representation of our market value in-force, increased 9% from a year ago to GBP15.3 billion, this even after paying the increased dividend. Notwithstanding the importance of stat capital metrics, we see EEV as the best relative indicator of long-term value creation.

So bringing this all together, Jackson delivered strong business performance in the first half of 2019. Top line growth has recovered since the second half of '18 on the strength of our diversification efforts. We're well positioned for growth with improved regulatory clarity, better market narrative, and growing distribution. We understand price and manage annuity risks effectively, and we have a proven history of delivering consistent operating returns. Jackson is well capitalized for its current book of business, and we're managing risk accordingly.

To that end, we have already paid the full expected 2019 remittance. As noted, we have opportunities to improve shareholder returns by growing into a more diversified book. The opportunity now is to accelerate Jackson's pace of diversification and to use the resulting natural hedge to reduce external hedge costs. By reducing requisite third-party hedge cost, we can improve cash surplus generation to self-fund growth and increase remittances.

Diversification will be organic, as we've already started, as well as inorganic with a more active approach to bolt-ons. As the investment required to fund our growth, specifically through bolt-ons might at times outpace organic free stat capital generation, we are flexible as to funding options, including third-party financing and reinsurance. The goal is a more diversified and balanced Jackson with more growth, well-managed risk, and increasing remittances.

I'll now turn it over to Mark FitzPatrick.

Mark FitzPatrick {BIO 20178326 <GO>}

Thank you, Michael, and good afternoon to you all. I'd like to cover three main topics today. Firstly, as you have just heard from the CEOs on the performance of their businesses, I'll start by taking you through how the financial performance of PCA and Jackson rolls up into the Group results. Secondly, I'll cover capital and will introduce the new Group regulatory capital framework that will apply after the demerger. And finally, I will update you on the final stages of the demerger process.

Our strong performance in the first half was achieved after a mixed market backdrop. While we generally benefited from the increase in equity markets, we saw the S&P 500 up 17% in the first half of 2019. Rates saw a sharp pullback particularly in the US where the 10-year government bond yields fell nearly 70 basis points. Over time, we have taken actions to position the business to succeed across the economic cycle.

In Asia, regular premium contracts continued to account for 93% of APE sales and their earnings profile is far less correlated to investment markets. In addition, the proportion of new sales represented by health and protection products remained significant. However, lower rates are a headwind, most notably in the US, in respect of spread margins. From a financial as well as a strategic perspective, our businesses are strong and are very well placed for the demerger.

I would draw your attention to the following: Asia new business profits of GBP1.3 billion is up 10% from a high base and driven by higher sales in almost every market. In the US new business profit was 30% below the prior year at just under GBP350 million. About half the reduction in new business profits is a result of the negative impact of economic assumptions using lower period-end rates. Lower variable annuity volumes and changes in business mix explain the remainder. Both the US and Asian businesses delivered 14% growth in IFRS operating profit and both are strong cash generators, each delivering a healthy increase in the period. After the demerger, we will consider the phasing of remittances across the calendar year as we look to optimize capital generation.

In Asia our investment for the future has been significant. Over the past 18 months, this has included the renewal of our regional strategic bancassurance alliance with UOB for a total initial fee of GBP662 million, the acquisition of a 65% stake in TMB Asset Management in Thailand for GBP197 million, and investing GBP738 million of free surplus in new business. This investment to grow value in the business has been achieved whilst retaining strong local and group solvency.

As we said in March, our dividend policy will remain unchanged until demerger. As in previous years, the first interim dividend has been set equal to a third of the preceding full-year ordinary dividend. This equates to a mechanical increase of 5%. Looking forward, the individual dividend policies of Prudential plc and M&GPrudential will be included in the demerger documentation.

Moving into the IFRS results in more detail. The first thing to note is that our headline group IFRS statements look rather different for this reporting period, as Mike has said. You should also note that while the profit from continuing operations includes only our Asia and US businesses, it reflects the full interest costs of our current pre-demerger group structure.

Walking down this page, I'd like to pull out a number of points. Starting with our business unit results, as you've heard from Nic, in Asia, the 14% growth in IFRS operating profit reflects our focus on recurring premium health and protection products. This builds our stock of in-force business and in turn drives a steadily increasing contribution from high-quality insurance margin, which is now over 70% of Asia IFRS income.

In the US, IFRS operating profit also grew by 14% with a positive DAC outcome as a result of strong equity markets, offsetting largely stable fee income and a reduction in spread income. Now this reduction in US spread income reflects the same three drivers we've discussed on number of occasions, namely: the contribution from swaps continues to become less material; the impact of lower reinvestment rates over recent yields on portfolio yield; and we were also impacted by portfolio mix including the John Hancock acquisition.

Assuming market interest rates and business mix remains stable at end June levels, we would expect the overall spread margin to remain in the region of a 100 basis points. Clearly if rates stay materially below end June levels, this would lead to further downward pressure on spread margins.

Moving to interest expense. We issued a GBP300 million note in July, bringing the total debt that can be substituted to M&GPrudential to GBP3.2 billion. The annualized interest cost of core structural borrowings which will remain with the Group post-demerger is estimated at approximately GBP230 million based on end June Forex rates.

Turning to corporate expenditure. This essentially relates to Group head office and Asia regional head office costs. We are assessing the efficiency and effectiveness of our Group-wide functions to ensure that they better reflect the future needs of the business. Updates on this process and an overview of expected benefits and costs to be incurred will be given in due course.

Moving down to short-term fluctuations, which are largely driven by the US, where higher equity markets resulted in equity hedge losses. These were only partially offset by a reduction in policyholder liabilities as the full benefit of the uplift in equity markets was limited by lower long-term interest rates and accounting mismatch effects.

And finally, a few words on M&GPrudential. M&GPrudential's performance over the first half was consistent with the dynamics and trading conditions outlined at the Investor Day in July. PruFund was again a highlight with positive net flows of GBP3.5 billion in the period, which helped mitigate a tougher asset management market environment. Collectively, the core life and asset management pre-tax operating profits were up 11% as stronger annuity-related earnings offset a lower contribution from asset management. M&G revenues fell as a result of lower average assets under management compared with the prior period. Non-core life earnings included GBP127 million benefit of updates to annuitant mortality assumptions and the adoption of the CMI 2017 model.

Now having made the update to assumptions in the first half, further developments are not anticipated in the second half of the year, unless experience materially deviates from assumptions. Overall the resilience of M&GPrudential's results in the first half show the benefits of diversification and a strategic positioning as both asset owner and as asset manager. I'll come back to M&GPrudential's capital positions shortly, but you can expect to hear more from John and his team once we move into the next stage of the demerger process. So to conclude this section, standing back, our businesses have delivered a positive performance for the period driven by Asia-led growth.

Turning to my second main topic this afternoon, which is capital, where I will cover our Solvency II and our new capital basis set by the Hong Kong Insurance Authority. Assuming completion of the demerger in quarter four, this is the last occasion on which Prudential plc will report on a Solvency II basis. The movement in the Group position over the period remains underpinned by continued strong operational capital formation, consistent with the circa 20 percentage points of annual capital generation reported over recent periods. This is offset by the payment of the 2018 second interim dividend in May and the net impact of market movements in the period.

In addition, we redeemed subordinated debt and continued to invest in our franchise notably with the renewal of the UOB distribution agreement, which I mentioned earlier. This, combined with small model changes, led to a modest 3 percentage point reduction in the Group solvency ratio. With the Solvency II surplus of GBP16.7 billion and a cover ratio of 222%, this is a very good place from which to begin the final stage of the demerger process. As we look post-demerger, the Hong Kong Insurance Authority will assume the role of the Group-wide supervisor. Our Regulatory Pillar 1 capital basis from the point of demerger will be the Local Capital Summation Method, the LCSM, rather than Solvency II as agreed with the HKIA. the LCSM is expected to transition to a new Group-wide supervision framework in due course.

The LCSM approach really is what it says, a summation of the available capital and required local capital of each business for regulated entities and IFRS net assets with adjustments for non-regulated entities. Some of the key calibration components are highlighted here on the slide. We have agreed with the HKIA that the subordinated debt expected to be retained by Prudential postie merger will contribute to the LCSM capital resources. On a pro-forma basis, we expect this to be around GBP3.4 billion. Senior debt of GBP0.8 billion is excluded from our LCM capital resources. Our internal economic capital metric will be retained as Pillar 2 within this regulatory framework, and continues to be an important component of our Group Risk Framework.

As I just mentioned, the regulatory framework for all Hong Kong-based groups is expected to transition to a new Group-wide supervisory standard in due course. This is subject to further industry consultation and is not expected to come into force until the second half of 2020 at the earliest, subject to Hong Kong legislative process. So what does all this really mean? So on this LCSM basis, at the end of June, excluding M&GPrudential and after demerger adjustments, the Group would have a strong solvency surplus of GBP7.7 billion with a cover ratio of 340%. This pro forma Group result reflects strong capital positions with Jackson's RBC ratio remaining above 400%.

The Group LCSM measure aligns relatively closely with our established free surplus generation framework on which we have been reporting for many years. The key difference is that the LCSM basis reflects surplus over MCRs within our free surplus measure we allow for additional capital requirements. For example in the US, our free surplus measure uses a 250% RBC capital requirement, whereas we use a 100% in the LCSM. Local solvency positions are the key driver of remittance capacity, and therefore the Group LCSM will deliver closer alignment between capital and cash management. To conclude on Group capital, whichever lens you look at our business through, we have a robust and resilient capital position.

So a few words on M&GPrudential's Solvency II position. As you can see, this is in good shape with a cover ratio of around 170%, both at the end of June and on a pro forma basis. We have updated and condensed the waterfall charts we shared with you previously. These illustrate the adjustments from the end of June to the pro forma position. Based on the market conditions at the end of June, we expect to transfer GBP3.2 billion of debt to M&GPrudential compared with the circa GBP3.5 billion previously indicated. Despite recent volatility in markets and in particular significant movement in interest rates, we expect M&GPrudential's capital position to remain relatively resilient.

And finally onto my third topic that of the demerger. Agreement of the new regulatory framework with the HKIA is just one of the many steps we have taken since we last met in March. In particular, we now have GBP3.2 billion of debt with substitution clauses that enable transfer to M&GPrudential, its head office functions are on track to standalone, and you've heard directly from the M&GPrudential executives at their showcase in July. We are in the final stages of preparing the completion of the transaction and Mike has highlighted our indicative demerger timetable to you.

I look forward to meeting many of you again after we publish the demerger documentation, and with that I will hand back to Mike. Thank you.

Mike Wells {BIO 4211236 <GO>}

Thank you, Mark. So to wrap up here, we think the businesses are positioned extremely well to grow across the cycle, which I think changed in the intermediate term is their ability to execute on more than one axis. You're seeing expansion of distribution, expansion of geographic footprint, you're seeing expansion of product segments we're in, and success in each market at executing at those again.

So how we grow now has more dimensions than it did just a few years ago, and I think that's a key reason we believe looking forward that we have -- that we're uniquely positioned with John's team with M&GPrudential, the ability that -- if you look at those first-half results that with profit product to act in completely different manner than the asset management business in the UK in Europe to bring a -- you're bringing -- you have a series of growth engines embedded in that business that appeal to consumers across different cycles. And again, that's going to be the key for both these companies going forward is to not try and play cycles, to benefit from them when they're appropriate, but they have a product line and products that consumers want and need across cycle, and again I think both businesses are set up to capture that moving forward.

I hope you see we're doing this from a position of strength. The breadth and quality of the earnings in the first half of the year, the sales growth, the expansion and capabilities, the new relationships and distribution, the invigorating some of the existing relationships on distribution, the change in political headwinds in the US on policy and advice and commission, all these things, again, we like the direction of all of them, and we think it puts us in a position to demerge this firm from a position of strength and give us a unique position in the future.

So I'm going to wrap up with this one, and we've had a lot of conversation as a management team about what it is we think we have to be good at going forward, what is it that separates us from other teams, what is it that separates the Company, and there's attributes we all inherited. There's the brand, there's the existing portfolio of businesses, there's regulatory relationships we've had for decades in markets that when you look at something like Pulse that's an example of something that I don't believe another firm could have done because the number of stakeholders you had to bring together, plus the technology, plus the brand, plus the relationships with the governments in 10 markets in Asia, our execution on that was unique to us. And again, it puts us in a situation where customer acquisition and our social role and responsibility changes in a way that's geometric, okay.

It's those sorts of things are where this group is now in capability wise, okay. The technology the US business has, if the advice channel, if RIA is how retirement products and their broadest definition is sold, you'd better have a good back-office, you better have a single-stack technology model, you better be able to connect with the most sophisticated broker-dealer platforms in the United States to distribute those products, because that's how those advisors want to do business.

So again, this is meeting client and distributor needs, advice provider needs where they are, and we think we're demonstrating that across all of our businesses. So structural demand, as I said earlier, absolutely a key lens. All of these markets we're in clients want and need products that we're providing.

We have leading positions. So as markets evolve, we're a logical partner for new relationships, be it distribution, technology, even governments to extend into those markets and new directions. Capital allocation discipline, I think we've shown you that and the demerger is a prime example of the fact we will look at any part of this group carefully into its fit and its capability and when it's best owned as part of Prudential. And when it's not and how to maximize the value and future success of that entity, and that's again no part of the portfolio, nothing in Asia, no market we're in Africa, no market or in period, okay, doesn't get that same lens applied to it, okay. That discipline needs to be there in a way. We will be active portfolio managers.

Risk management across cycles, you're now looking at a business with 80% of the results you're seeing with little to no correlation to interest rates, okay. This is a good, well-positioned business for whatever might come in rates. You all have your own views if rates are going higher or lower, in what markets, positive, negative, et cetera, okay. But again, the recurring revenue, the quality of the sources of earnings and the type of earnings are less and less correlated every year to capital markets, and I think that's a key driver.

And then finally, we're good at leveraging our scale. You're seeing that. You're seeing good ideas taken from one market and shared across others. And that's a relatively recent development in our firm. We tended to be a bit siloed historically and there was some of that informally, but now it's a core discipline. And you're seeing that across the organization, and again I challenge you to talk to our people around the Group. M&GPru you're seeing it and you're certainly seeing it in Prudential itself.

So let me stop there and we'll open it up to questions. We're pretty close to the time we promised you. Patrick?

Questions And Answers

A - Patrick Bowes {BIO 16444249 <GO>}

Thank you, Mike. Good morning. We're going to do some questions here in the room and then we have some calls coming in on the phones and then we'll come back to the room. Who wants to go first? John.

Q - Jon Hocking {BIO 2163183 <GO>}

Good afternoon, everybody. Yes, Jon Hocking from Morgan Stanley. I've got three questions, please. Firstly, starting with Jackson. Can you talk a little bit about what firepower you see for inorganic opportunities? And it sounds from the way you're talking, Michael, that you've ruled out getting any capital from the Group. So, could you talk a little bit more about the sort of full suite of options and is there any circumstances where you'd consider selling an equity stake in Jackson at the subsidiary level? That's the first question.

And then secondly also on Jackson. Am I right to think that you said the risk appetite for Jackson wouldn't change? So I think one of the problems that we've all got with valuing the business is trying to find a sort of a steady-state number. So at the moment you've got this hedging program which protects the economic balance sheet, but it's hard to sort of see the benefit of that in any of the reported numbers. So, is the risk appetite the same or is there a balancing point where you could hedge less and produce more earnings pre the diversification? And then just finally, Nic, on the Chinese operations. You mentioned the sort of foreign ownership changes are a sort of tailwind I think you said. What is the current state of thinking in terms of the stake with CITIC? And absent changing the equity ownership, what is the sort of benefit for PRU from the change in regs? Thank you.

A - Mike Wells {BIO 4211236 <GO>}

Great. So, I can start. First, from the acquisition standpoint, I don't think we rule out or in anything. There are a number of properties that trade in the US marketplace and around the life space that we're comfortable with. We've participated that more actively at certain times than others, as you've seen with the Hancock acquisition late last year. And I see a number of properties that are either in market now or that we would expect to be able to come to market to be available. So, I don't want to sort of tip my hand or front run anything in the marketplace, but we're interested in a lot of things and obviously we're aware it's a pretty transparent marketplace.

In terms of the expectation from Group, I mean obviously our wording is very intense. I don't feel that the investor base or from a Group perspective we're looking at increasing Group capital against the existing profile of Jackson. That's why I emphasize I think from our current book of business we're well capitalized to manage that. I think there is an opportunity -- it relates to your second point around I guess the question around risk appetite. But I think there's an opportunity for us to improve the call it the remittance profile and the growth of remittances by diversifying the base. And the thesis to that is by diversifying the risk, if you will, or the calls on capital deployed albeit more capital deployed, we can lower that external hedge cost and free up cash for return.

So, I don't see that it would preclude capital coming from Group though more importantly, I think we have access to third-party financing that could help us do things faster to create that change and free up cash remittance to Group. And I think that's the measure that you and others are looking for and it's certainly an important measure. It's not the only measure that we look at, but it's an important measure in what we're looking at. From the risk appetite perspective, I think what I mean to say is that we're not looking to change the return profile by taking on more risk, not looking -- there's a lot of debate and wordsmithing around hedge costs or lowering hedge cost or hedge efficiency. I actually think our hedge efficiency effectiveness is very, very good. It's been proven long before I got here through market cycles and conditions that have been stressed.

I think it's extremely efficient and when I sanity-check that against other market players and against market counterparts, that's the feedback that I get I think openly and directly. So -- and we're going to hedge as much as we need to protect ourselves because of the risk appetite and the control environment that we run. That said, if we have less requisite hedging need, we'll hedge less and experience less cost. So, what I'm meaning to say is that we're not going to drive return by taking more risk in investment portfolios or exposure. We maintain our risk appetite, but we think we can reduce the demand, if you will, for third-party hedging.

A - Patrick Bowes {BIO 16444249 <GO>}

Nic? Nic had a question.

A - Nic Nicandrou {BIO 15589153 <GO>}

Okay. So on this strategic point, look, I mean we've said this before. Before we had two hurdles to overcome; one was the regulation precluded ownership of a controlling stake and -- so that was hurdle number one. And the second hurdle was the appetite of a partner to sell a proportion of that business to us. The first hurdle has been removed, and if anything, the timing which full ownership will now be allowed has in fact been brought forward by the Chinese government, but there is no change in the position and the relationship we have with CITIC at this moment. It simply introduces kind of the option to do so at some point in the future.

The other development of course on the asset management side, again announcements earlier in July where they said that wholly foreign-owned entities no longer have to have a three-year track record as a private fund management company before they can operate into the retail space. So again, we have the optionality of using that new vehicle to access a better -- a bigger part of the asset management space. So whilst no change in the -- in the 50-50 and the relationship with CITIC, the option is there on our relationship.

And as we've said before, really the value and what we're focusing on is on the operational leverage of this business. We have now 63.63% of the market. If we can increase that by 10 basis points a year and you can -- you overlay that the projected growth in gross written premiums in that market of 12%-plus, then this business five years from now will produce 3.5 times the NBP. And the first six months of this year, we increased our market share by 16 basis points. So, that's what we're focused on and on the ownership it's just -- it's future optionality.

A - Patrick Bowes {BIO 16444249 <GO>}

Thanks, Jon. Blair -- Blair Stewart.

Q - Blair Stewart {BIO 4191309 <GO>}

Thank you. It's Blair Stewart from BofAML. Two questions please. First one for Michael. Just maybe a little bit more color on what you mean by use of reinsurance third-party cap? So, maybe give us a theoretical example of how that might work. One of the issues, and Jon alluded to this, is the -- I guess the tail risk on the existing VA book. And would reinsurance be a solution to that potentially or are you just looking to diversify the risk and therefore lower the hedging cost? So, do you see reinsurance as a way to facilitate a bolt-on deal or is it a way to perhaps swap some of the earning stream from the existing book into a new earning stream from a bolt-on? Hopefully that makes sense. And secondly, just on the Asian solvency, how should we contextualize the 260%? Mark, is there any way to do that? And what's the outlook for the risk-based model that the Hong Kong authorities are looking at? Presumably then on a risk-based approach you would get some credit for your in-force book or such like. Just a bit more color on the outlook for that. Thank you.

A - Michael Falcon {BIO 17026942 <GO>}

Okay. So again, I'll go first. So, I see reinsurance and third-party financing as a way to execute bolt-on transaction where the -- where the size or relative size of what we might want to do to step change the balance in book would outpace short-term free capital generation in a period. And so you saw with the Hancock, which I think the Hancock acquisition represented roughly about 10% increase in general account balance. We're able to handle that with basically within the organic capital generation of the business last year. So things of similar size can maybe be handled based on market environment and current year flow, but others might require third-party financing and reinsurance would be a way to bring some of that risk in either overtime or to make something smaller that would otherwise be larger by transferring risk.

I don't see right now reinsurance as a strategic path on laying off risk in the current VA book. I think we understand and manage that VA risk I think quite well, and any of the other buyers and the market are going to be looking -- there's an economic return profile and there's a scale and a cost advantage in terms of hedging and managing that risk. And anybody that we would transfer part of that risk to is going to want a return on that transfer, and they're going to arguably be subscale or sub-efficient or effective in terms of the hedging component. I would have to believe that a buyer would have to be able to add more value than we could to it to sort of have a market value on that would be interesting from us remember to return standpoint. So I think shrinking is expensive in that regard. Our preference is to grow and diversify the book going forward, not offload the current risk. Mark?

A - Mark FitzPatrick {BIO 20178326 <GO>}

And then in terms of the LCSM, it'll roll off your tongue soon enough -- in terms of the LCSM, unfortunately, Blair, that's just us, as in it's a bespoke arrangement with the HKIA and until such time as the new Group-wide capital standards come in, the new Group-wide supervisory regime comes in through Hong Kong that will affect our whole industry at the states that will continue to be a regime -- the LCSM will continue to be a regime that applies to us that has been agreed individually with the HKIA.

As for the Hong Kong solo, their risk-based capital work that the HKIA is undertaking for that continues to go through, quiz, interactions with the industry. We're expecting another quiz to come out later on this year and that'll give -- I think when the feedback from that comes out, it'll give us the industry and the HKIA a sense of where that might land and where that might go, but there's a number of years yet before that actually comes into effect.

A - Patrick Bowes {BIO 16444249 <GO>}

Okay. Oliver?

Q - Oliver Steel {BIO 6068696 <GO>}

Oliver Steel, Deutsche Bank. I'm sorry, I'm going to start with another question for Michael. I wonder if you can give us some sort of indications about sort of relative sensitivities. So sort of what sort of deals, what sort of size deals do you need to do or what sort of type of deals you need to do to save what proportion of hedging costs, or improve the capital base by so much? Anything you can give on that would be helpful.

Secondly for Nic. Indonesia sales plus 48% in the second quarter but only plus 4% overall in the first half. So was the first quarter impacted by retraining onto the new products? Does that therefore sort of nullify the 48% growth in the second quarter, if that was just a catch-up? Anything you want to give on that would be helpful.

And thirdly for Mark. You talked about phasing of remittances changing. Can you expand?

A - Michael Falcon {BIO 17026942 <GO>}

So I get to start again, which is fine. The honeymoon's over (inaudible). I've been here eight years now, it's perfect. Look, I -- we have done and continue to do a lot of analysis relative to the types of assets that might be available in the market and the dynamics of how that would affect our book and risk and hedging. I'm not going to share specific trade-offs or rule-of-thumbs, because it's very, very property dependent and, two, we're going to have to buy these -- anything that we do in an M&A sense, in a bolt-on sense is competitive in a market and goes to the underlying evaluation. But I can tell you that we -- I think we understand pretty well the dynamics. When I say we, I mean me, I'm informed by people who have fortunately decades of very, very good experience to all this.

We're not -- what I can tell you is we're looking at things that are that are close to home. They're within the product sets that we already sell and/or service within our book, and there are a number of different ways and paths that we can do this. We're not under any particular time pressure or constraint, though, I do think through market cycles we're going to see opportunities in the market. We want to be positioned to act on those opportunistically. But there's no -- there's no single path, and I don't think there's any shortage of aggregation that we could do to affect the type of change we want to see.

A - Patrick Bowes {BIO 16444249 <GO>}

Nic, do you want to comment on Indonesia.

A - Nic Nicandrou {BIO 15589153 <GO>}

Okay. Yeah, on Indonesia, I mean let me answer the question and then give you some color. No, the second quarter performance really coincides with putting in place many of those new products and some of the early benefits of retooling are at the high end of our -- of our agency force. So it's not substitution for a low quarter -- first quarter.

Now, in terms of a little more color, and we see this from market statistics that are made available. The first quarter was a slow quarter across the whole interest in Indonesia. I've said before that there are broadly four buckets of market in Indonesia. There is the linked agency which across Indonesia has been in decline and that continued to decline through the first quarter, indeed through the second quarter. The second bucket -- and that's about 22% of the market. There's a 12% part of the market that is agency traditional, which also declined in the -- in the first quarter across the market, and we weren't present in that. The bancassurance is another 30% of that market, also in decline in the first quarter. And the only part of the market that was rising was the 30-odd percent that comes from the Group insurance. And again we weren't in that.

So what's happened as we went into the second quarter, we launched a new flagship product that was in the linked agency space. It takes a while when you have 260,000 agents to properly train them. That took through most of the fourth quarter into -- last year into the first quarter of this year. That's now gaining traction. And coupled with the medical product, the rider that we put on, we bucked the trend. So our agency linked is now up when as I said the market is coming down.

We now have a foothold in the -- in the traditional space, which we didn't have before through the very simple product that we launched, and we've done a little better than everyone else in banca and again through some interesting new ideas that we brought in and we now have an entry into the employee benefit space through the PRUworks platform.

So market is down. We're beating -- we beat the market both in Q1 and Q2 on the back of all these propositions that are -- that are coming in. And the retooling of the agency, particularly with the high-end, the MDRTs, the Elite has started and we're seeing some early benefits. So as I said, it's early days, but so far so good. And we're pleased with the performance in the second quarter and many of the ingredients that drove that clearly are in place and in play.

A - Patrick Bowes {BIO 16444249 <GO>}

Mark, on remittances.

A - Mark FitzPatrick {BIO 20178326 <GO>}

And Oliver, on the remittances, effectively the element of rebalancing, effectively what that is looking at is traditionally we've taken pretty much the lion's share of the US remittances in the first half. And what it is that's trying effectively balance them out throughout the calendar year? It's effectively trying to balance capital efficiency and cash flow needs at the center.

A - Patrick Bowes {BIO 16444249 <GO>}

Johnny?

Q - Johnny Vo {BIO 5509843 <GO>}

Yeah, hi. It's Johnny Vo from Goldman Sachs. Just three questions, if I may. Just in terms of the US business in particular, I guess the statutory reserves don't use market interest rate assumptions, and I'm pretty sure you don't hedge for interest rates. So is the effect of low rates on your business the effect on the drift rate, is that -- is that how I should think about it?

The second thing is in terms of assumptions with regards to surrender rates as well, given the low-rate environment, you'll have an assumption with regard to how many policyholders are in the money that would surrender. Do you need to think about reviewing surrender rates at some point if interest rates remain very low?

And a third question, again, just in terms of diversification, again, if you're moving into fixed annuities and fixed indexed annuities, as far as I understand, that's a credit game. So are you just swapping out equity risk and policyholder behavior risk for credit risk?

And last question, just on China as well. The volumes were up quite substantially but the margins were down. So could you just explain that movement? Thank you.

A - Michael Falcon {BIO 17026942 <GO>}

Okay. So I'll go in reverse order on the Jackson question. In terms of the diversification to FIA and FA risk there, we are -- we would be adding in a sense rate risk as opposed to the equity risk component, but the deployment of that against a common capital base creates advantages in the hedging. Also we're not exclusive to spread business. There's also a mortality risk that's available in the market and that's something else that we would look at, which has different dynamics relative to the efficiency in hedging. Though Chad can speak better to that.

In terms of the assumptions around surrenders and all the actuarial assumptions, it's not that we would like need to go back and do review of the actuarial team, which over 70 people is constantly reviewing policyholder behaviors and expected sensitivities (inaudible) relative to behaviors and outcomes from an actuarial perspective. And again, I can ask Chet to comment on some of that as well. But to date we haven't -- we haven't seen big changes in those behaviors, nor have we seen them through prior financial shocks or crises. So they tend to move -- I don't want to say predictably, because we're all sort of circular, but they haven't moved suddenly. But we obviously do sensitize for those moves and risks.

And from a lower rate perspective, I think my comments, if I understand the question correctly, were less related to stat and more talking about the asymmetry of the IFRS reporting. And so IFRS is particularly punitive in short-term relative to fast rate drops, because you're getting all of the pain and none of the benefit and no assumption on any sort of risk premium on equity return or mean reversion on equity return, both of which we would expect from a long-term capital market view. Again it's why we think structurally EEV is a better lens relative to value creation. But Chad, why don't I -- if there were comments on the FIA, FA, or behavior.

A - P. Chad Myers {BIO 15469831 <GO>}

Yeah, I guess just to pick up on that. On the -- specifically on the VA stat and just how we -- think about how we hedge the -- how we're thinking about hedging the interest rates there. It's not the market consistence type of view that IFRS takes. So what we're looking at there is any payments that we're making under VA is going to be contingent on equity market returns. So if you get bad equities, you then generate claims in the out years, you'll have a discounting mechanism with that. That's the part that we hedge.

So you'll see -- you'll see in the accounts that we do have interest rate hedges -- actually fairly substantial interest rate hedges and that's what that's -- that's what that's going against, but you are correct that stat, generally speaking, is not super interest rate sensitive. It does get more interest rate sensitive in extreme low rate scenarios, especially where equities are lower, because you do get the discounting mechanism that comes in.

Just with respect to the surrender rates, I would just add that we've seen low rates before, as fun as this is right now going back precipitously, we did see this back in '16, and I'd say the surrender rates that we saw back then would be consistent with what we would have assumed, and we haven't had to retool anything off of that. We generally are going to be expecting pretty low lapse rates for those types of policies in low-rate environments, but I would also mention them that this is not a -- because of the way people use these products, they need the cash flow. So I mean they're using this for retirement. They're using it to support their lifestyle. So it's not something they can necessarily hold on to and definitely you will see surrenders, you will see withdrawals coming through.

A - Patrick Bowes {BIO 16444249 <GO>}

Thank you. Just (inaudible) we'll go to Nic and then I'll take a call from -- on the phones.

A - Nic Nicandrou {BIO 15589153 <GO>}

On China, no, we haven't secured the sales by lowering the economics of what we sell. We've held on to the economics. The effect that you see coming through is simply a question of mix. So in the first half of this year we sold a little more savings and we sold a little more through banks. And that's what's coming through.

So 45 up -- 45% up on sales, 29% up on NBP. Interestingly that's the flip of what we saw last year. We had flat sales and NBP up 15%. When the markets were slow particularly on the savings in 2018, we used our proprietary distribution to go after quality, which is -- which is what the shape of sales and NBP we had last year. This year appetite for savings returned in the market, so we captured that, and we pushed on the accelerator for health and protection as well.

So if you like over a two-year horizon, our sales were up 45% and 47% and our NBP was up 49%, so that kind of tells you -- tells you what you want to -- tells you what's happened vis-a-vis mix, but the economics are intact.

A - Patrick Bowes {BIO 16444249 <GO>}

Thank you, Nic. Can we go to the -- there is a call on the phone line. Who is it from? Can you put it through please?

Operator

We have -- we have a question from David Motemaden from Evercore ISI. David, please go ahead. Your line is now open.

Q - David Motemaden {BIO 18818634 <GO>}

Hi, good morning. I just had a few questions (inaudible) Michael and maybe Chad. Firstly, just on the change in the business mix that you're looking to diversify away from VA. Just wondering what's the optimal mix that you're targeting maybe two years, three years down the line?

And then secondly, just on the remittances out of the US, the remittance levels have been around 20% to 40% of IFRS earnings over the past five years. Is there a specific target in terms of where you want to sell?

And then finally, just -- could you just talk about your comfort level under the new (inaudible) considering where interest rates are versus when you gave guidance of the 40-point to 50-point hit from adopting the new framework? Thank you.

A - Patrick Bowes {BIO 16444249 <GO>}

Thank you, David. Sorry the line was a bit messy there, but I think there were three -- did you manage to get them ...?

A - Michael Falcon {BIO 17026942 <GO>}

I think optimal mix -- first two I think was what's the optimal mix. The second was the -- regarding the 20% to 40% remittance of IFRS, would we have a target for going forward?

A - Patrick Bowes {BIO 16444249 <GO>}

And the last one was on impact of interest rates on regulatory capital.

A - Michael Falcon {BIO 17026942 <GO>}

Okay so we're -- I would say we have -- we have a range of where I think we could get -- we want to get to in the current environment, but I'm not going to disclose it this time. But I think the direction of travel is more balance of the book. I don't know that the percentage of IFRS remittances, what we would anchor on in terms of going forward, because of all of sort of the shortcomings relative to economics as well as stat capital. So I think the better constraints or indicators to look at rather are the EEV and value creation within the book and how we're growing as well as the stat capital generation, because I think stat capital is more of the constraining mix on that. And relative to the rates, I'll turn to Chad.

A - P. Chad Myers {BIO 15469831 <GO>}

So, David, the dynamic right now with VA and low rates in the new -- in the new model, I think what I mentioned before in previous conversations was that we saw a -- we thought we would see a modest hit to RBC within that, and that it would be less sensitive to market levels. And as we're kind of parallel testing that right now, I'd say those are coming true. We do see less sensitivity. So we expect there'll be less sensitivity to rates in the tails under the new methodology which is -- which is good.

And I would say that based on what we're seeing, it's hard at this point to necessarily reconfirm exactly what the -- what the hit will be on RBC. What I'd say is because one's moving, the other one's moving at the same time, and not quite the same dynamics given the low-rate scenario. And so what I'd say is we're still comfortable, as I've said before, in that 400% to 450% range post paying dividends, post having gone through the NAIC regime. So we're -- I think we're reasonably happy with where the -- where the model came out. And that should be pretty tractable for us going forward.

A - Patrick Bowes {BIO 16444249 <GO>}

Okay, thank you. Just conscious we've got a few more minutes. Greig?

Q - Greig Paterson

Greig Paterson, KBW. Just three questions one is given where we are with spreads, wondering if you could talk about the Jackson BBB book and this whole theme of fallen angels and whether there's a potential for downgrades then hitting the numbers?

Second, in terms of the Pulse rollout that we're seeing now, I'm just trying to understand from Nic whether it's going to result in a spike in APE or it's more like an evolutionary type in terms of timing when you'll see the benefits thereof?

And then the third thing is you mentioned on the FIA you changed the caps recently. I was wondering does that mean that you're going to expect a slowdown in the trajectory of your moving to FIA space or the industry moved their caps as well proportionately and your pricing relativity that didn't change.

A - Patrick Bowes {BIO 16444249 <GO>}

Thanks, Greig. Should we -- should we go with Nic first then?

A - Nic Nicandrou {BIO 15589153 <GO>}

Okay.

A - Patrick Bowes {BIO 16444249 <GO>}

Just to make it up.

A - Nic Nicandrou {BIO 15589153 <GO>}

So we're -- and I think you ask me the same question last time, Greig. We are in the very early roll out phase of what we're doing on Pulse. The Malaysia was our first market. As I said in my prepared remarks, Hong Kong and Indonesia and Singapore will follow. Really our focus and our priorities in the next -- in the next year are to get this out to 10 markets across the region where we are contracted to work with Babylon exclusively to ramp up the number of users. We want people downloading it, we want people registering, in other words giving us their details in terms of how to contact them, and then we want them to use it on a regular basis. And through that we'll get to understand more about the users, and in time provide them with products, propositions, either through offline or online channels.

So that's where we are. That's where we're focused as opposed to necessarily counting on this to give us a spike of APE in the immediate future. There's many other things in the -- we have kind of many other initiatives going on at the moment across high net worth, employee benefit, retirement, and other health initiatives on the critical illness side that will drive our growth in both top line and profitability. Pulse will come in, but it'll be a slower burn.

A - Patrick Bowes {BIO 16444249 <GO>}

Thank you, Nic. Michael, your turn next.

A - Michael Falcon {BIO 17026942 <GO>}

Great. So on the FIA cap reduction, I think that was aligned with market rates and competitor moves as well. And so I don't think -- and we haven't seen a slowing in the FIA flow or the forward book. The market doesn't move quite that fast, but it does move, and we move with competitors. We're not leading or lagging I don't think materially in that case.

In terms of the underlying credit book and BBB exposure, it's obviously important and again we're long and late and in an expansionary cycle. At some point there'll be credit cycle and contraction in credit markets. I think we have really good policies, controls, and analytics in place around that, and the quality of the book has actually been improved over the past several quarters. We hold less BBB minus, we restrict and limit, we're way underweight, the financials within the BBB where we would see probably more vulnerability in the types of market conditions that could cause stress in credit markets, we have limits on positions and holdings with single issuers. So I think there's a lot of prudence in that -- in the management of that book.

We also within the framework of the larger portfolio, we steer clear or relative to competitors under-index, high-yield, and lower credit qualities. We play in mortgage and asset-backed and in safer parts of the market. Our CLO exposure is substantially less than others and higher in the stack. I don't know if there's anything else you would add to that (inaudible)?

A - Unidentified Speaker

The only thing that I would say, Michael, in addition is that kind of 85% of the book is BBB or BBB plus. It's very conservatively positioned and very well reserved for downgrades and default shocks. And as you say, it's tightly controlled and monitored.

A - Patrick Bowes {BIO 16444249 <GO>}

Right. Conscious of time. Andrew is next and then Andrew and then (inaudible).

Q - Andrew Baker {BIO 20402705 <GO>}

Hi. Andrew Baker, Citi. I have three questions please. First, so as part of demerger for M&GPru, we'll get an update in terms of numbers, presumably targets. Is there any plan during the same process to come out with new Group targets for PLC in terms of earnings growth, capital targets, sales, or anything of that nature?

Second, Hong Kong, I appreciate the comment that no impact on July sales. If you look at second quarter year-over-year growth versus first quarter, there was some slowing there. Is that just a base effect or is there anything else that we should be aware of?

And then third, just on the Group capital, so going from LCSM transitioning to the Group-wide supervision by second half 2020, this transition and sort of any uncertainty during that transition, does that have any impact on the way that you think about capital deployment during that timeframe? Thank you.

A - Patrick Bowes {BIO 16444249 <GO>}

Should we get Mark to get the first one? He is scribbling.

A - Michael Falcon {BIO 17026942 <GO>}

I'd like to thank you for not asking me.

A - Patrick Bowes {BIO 16444249 <GO>}

Mark, do you want to get the first one?

A - Mark FitzPatrick {BIO 20178326 <GO>}

Right. So on the -- on the Group capital piece, in the -- over the transition period, we're going to be working and talking very tightly and very closely to HKAI. So what we have at the moment in terms of the LCSM is what we're going to be using, what we're going to be deploying against, and how we're going to be managing and running the business.

And as we've said for quite some time, it's -- when we talk about Solvency II, the thing that truly bites is the underlying capital level in terms of the underlying businesses, especially around Asia and effectively the LCSM gives us a more direct read across on that particular piece. So we're looking to use that on, yeah, for the foreseeable future.

A - Patrick Bowes {BIO 16444249 <GO>}

Nic?

A - Nic Nicandrou {BIO 15589153 <GO>}

On Hong Kong, yes, it is a -- it is a base effect. If we look back in 2018, we had a slow first quarter, and then what we did back then is we brought forward new product launch initiatives, particularly around critical illness and new marketing campaigns into the second quarter. We didn't, as I said, the momentum that we carried coming into this year was strong. We were balancing out the campaigns, we were balancing out the timing of product initiatives, and therefore what you're seeing is the outworking of that.

And to give you one other data point, if you took June alone, 30% of our first half sales in 2018, 30% came in June. So that was the emphasis that we had put into these campaigns last year, whereas this year 22% of our sales -- the first six months' sales came in June. So much more -- much more, even much more normal pattern in 2019.

A - Patrick Bowes {BIO 16444249 <GO>}

Right. Very quickly ...

A - Mike Wells {BIO 4211236 <GO>}

And Andrew, on target, I think the -- I'll do that one (inaudible) pick that. No, on the Group side you won't -- it's M&G's board and management teams to determine, but we did them as sort of proof of concept multiple times, particularly out of Asia, to prove that the businesses could generate cash flow. There's generally -- there's some very good things about targets and this organization tends -- has hit them. There are some negatives to them, in that they tend to be the only thing the organization focuses on if we -- if we put them in place.

So knowing the culture well, our intent going forward is to keep giving you a more granular look at the key businesses so you can see the depth and breadth of the success versus trying to give you a rounded up number that says this is how it looks. And again we will -- we'll watch that. But I think the majority of the businesses, I mean Indonesia, Singapore, Malaysia, Eastspring, Hong Kong, all could be listed entities at this point. So for us the -- I think we're think we're past the proof-of-concept stage and it's more of a show us how each one's working and will continue, like we did today, to give you more granular look at the core businesses and so you have a -- you have a better feeling for the environment as well as the depth and breadth of the performance.

A - Patrick Bowes {BIO 16444249 <GO>}

Thank you. Andrew?

Q - Andrew Crean {BIO 16513202 <GO>}

Good morning. This is Andrew Crean at Autonomous. Michael, sorry to come back to you.

A - Michael Falcon {BIO 17026942 <GO>}

That's fine (inaudible).

A - Mike Wells {BIO 4211236 <GO>}

Which Mike? Oh that Mike.

Q - Andrew Crean {BIO 16513202 <GO>}

I'm still a bit confused. You don't want to write more VAs and in fact you're in net outflows, but they're the highest return lowest capital requirement business you do. You want to write more FIAs and FAs which are lower return but higher capital intensity, and you'll fund some of that -- the inorganic with third parties. Why does that lead to higher remittances from the Group and why does that lead to a higher valuation of the Group by analysts? I suppose what I'm really going to is it's so complicated with EV, IFRS, and stat, all going in different directions, why don't you give us a target for what you think remittances will do from your you US business over the next five years?

A - Michael Falcon {BIO 17026942 <GO>}

Okay. So it's a fair question and let me clarify the first point part of the premise. We are interested in writing more VA business and we're in slight outflow based on the size of the book and where the VA market is today in the US. So long term I'm bullish on it. I'm trying to give an outlook to set a baseline in terms of expectations. We're continuing to write. We're a leader in VA. We think long-term there's growth, but in the short term, the VA market has generally been contracting. That contraction has slowed. Total VA market is actually growing from the last half of last year and in through the first half of this year, but a lot of that growth is in what we would term the structured VA or registered product, and those are more spread products in a VA wrapper than a -- than what we would see as a traditional VA. It's also not a part of the market that we've participated in yet. So I wouldn't want the message to be that we don't want or don't expect to write more VA, and I don't see the book in run-off at all, and over time I do think we can grow -- grow opportunity.

From an operating of return standpoint, from strictly a product, you're right, VA has better operating cash flow generation and lower capital requirement from stat standpoint. The issue with that is against the hedging dynamics and sort of those below-the-line costs. And the objective of having a more -- the benefit of having a more diversified book is to reduce those external hedge costs by having an additional return -- asynchronous return on capital with an asynchronous call, right.

And so the payoff if you -- if we raise financing to buy a stream of income from spread block, and you assume that we buy effectively and manage that effectively, and you're using that return to support that financing and actually pay it down, so you keep the value that you bought, that is going to reduce the requisite hedge spend that we have against that VA book and free up cash for remits.

In terms of target, I'm going to have to confer with my Executive Committee about how we come back and would or wouldn't issue a target. And my understanding is we don't generally issue those types of targets.

A - Mike Wells {BIO 4211236 <GO>}

We understand the importance of demonstrating growing remittance to Jackson. They're up 17% this year, but again you got to then pick equity market assumption, rate assumption, M&A assumption, finance cost. We're not going to put a target on that.

Q - Andrew Crean {BIO 16513202 <GO>}

Okay. Thanks for being very patient.

Q - Nick Holmes {BIO 3387435 <GO>}

Thank you very much. Nick Holmes at SocGen. I will keep this super brief. First question is obviously on the diversification plans for Jackson. Just why haven't you done this before? What reason is the -- for not having done this before?

Secondly, can you remind us of the rationale for the UK demerger rather than the US? I mean clearly all the questions are on the US, not the UK, which is rather nice business in many ways. So why not the US? Thank you.

A - Mike Wells {BIO 4211236 <GO>}

So Nick, appreciate the questions as always. They're challenging and interesting. The diversification in the US is where we are in appreciation in the accounts and the client -- the product has performed as it should for compliance -- for consumers. So if you look at the first half of the year, they've participated in the rising equity markets again, took a fresh look at the business, and the process, and decided this was the right time to do this now. So there's no logic in why it wasn't done before, but if you're looking for the point in time, we continue to see the underlying performance for the consumers. We were together in Singapore. You saw a little bit of a strained market. Since then, that -- those accounts have grown back.

So again, looking forward, which is our job, okay, this is the time to do something like this. As far as looking backwards on the US-UK demerger, there's a number of reasons. The market's got structural growth. We've got a competitive advantage. It's a high return on equity business, okay. And we like the dynamics of it. We like the alignment of capital. All the things you've said on the demerger, I appreciate looking backwards, competitors with GMI books, four of them have exited that business in the US. That's not a great strategy.

A - Patrick Bowes {BIO 16444249 <GO>}

Okay, that's time. Thank you very much. You obviously will be seeing the Jackson management later on this evening for certain groups and then we will I'm sure have lots of engagement in the coming quarter. Thank you very much.

A - Mike Wells {BIO 4211236 <GO>}

Thanks, everybody.