Aviva PLC Q1 2013 Interim Management Statement Conference Call

Company Participants

- David Barral, CEO Aviva UK & Ireland Life
- Jason Windsor, Chief Strategy Development Officer
- Mark Wilson, Group CEO
- Maurice Tulloch, President and CEO Aviva Canada
- Patrick Regan, CFO
- Robin Spencer, CEO Aviva UK & Ireland General Assurance

Other Participants

- Abid Hussain, Analyst
- Andy Hughes, Analyst
- Blair Stewart, Analyst
- Chris Esson, Analyst
- Fahad Changazi, Analyst
- James Pearce, Analyst
- Kevin Ryan, Analyst
- Marcus Barnard, Analyst
- Oliver Steel, Analyst
- Paul Diaz, Analyst

Presentation

Operator

Good day and welcome to the 2013 Q1 IMS teleconference call. Today's conference is being recorded. At this time, I would like to hand the conference over to Mr. Mark Wilson. Please go ahead, sir.

Mark Wilson {BIO 7102576 <GO>}

Yes. Well. Good morning, everyone. Welcome to the call. I've got a number of my senior team joining me, including Pat Regan as CFO and the heads of the major business units.

Today's results demonstrate, I think, early steps. Good first steps towards delivery of our investment thesis. We spoke a lot about cash flow and growth. That's what we're focusing on as a business. What I'll do is go through the highlights and lowlights of the results and then we'll have plenty of time to take questions from thereon.

We have clear objectives. We've got clear plans and in the First Quarter, basically, we're delivering what we said we would. And from my perspective, it's been a satisfactory start to the year and we have a great deal more to do for our shareholders.

Now, as we covered in the investment thesis of the full year, we're managing our business by focusing on five key metrics. Cash flow, expenses, value of new business, combined operating ratio in the GI business and, of course, the IFRS operating profit. And as usual, we'll update on the targets of the half year rather than at the quarter.

So in the First Quarter we've made progress against these metrics. We're focusing the business on cash. We're focusing on reducing expenses. We're focused on growing the value of new business and maintaining the profitability of the General Insurance book. We've also strengthened the balance sheet in the quarter.

So if I take each of these metrics in turn and just go over the key points, I think. So firstly, cash flow. So as you know, we have four main contributors to cash flow in the group. UK Life, UK General Insurance, France and Canada. And we're managing these businesses together with the other established markets to improve cash flows.

Now, the operating cash generation, as you know, is a precursor to cash and in the First Quarter we generated GBP0.5 billion of OCG. This is in line with the previous year. We're taking action to improve the remittance ratios for mostly GB[ph] dividend. And obviously we won't be able to give much of an update on that until as we go through the year. But that's progressing very much on plan.

Reducing the expenses is important for us to remain efficient and competitive and get the cash flows through. And there are two key parts to our expense plan. So the first, as you know, is to deliver the GBP400 million on a cost saving target. The second part then and frankly equally as important is to reduce the restructuring costs. We're focused on those. As you know, the restructuring costs, we've had restructuring costs every year for many years and it's up to us to get them to a more modest level.

So in the First Quarter, the Group's expenses fell by 10%. That's operating expenses. And we're on track to deliver the GBP400 million run rate cost savings target for the end of the year. Now, frankly, we can deliver more cost savings. What we're still ascertaining is what we do with those. And some of the cost savings above that level will be reallocated to important things, like fixing IT and doing other things like that. It's pretty much as I said at the full year results.

Reducing our costs involves some very tough calls. We announced last month that we will reduce our global staff by 2,000 roles across the Group. That's about 6% of our global workforce. And we're doing other savings in things like consultancy and IT and rental accommodation. You know, there's a whole long list that Nick Amin and his team are focusing on and, again, making satisfactory progress.

Now, as well as the GBP400 million target that I mentioned before, of course, we need to lower the restructuring costs over time and you'll be aware, last year these costs were

GBP460m. I think if you go back 10 years its average is probably between GBP250 million and the GBP460m.

In the First Quarter, these restructuring costs were GBP54m. I expect this quarterly run rate will increase during the year. I mean this doesn't include, obviously, the 2,000 redundancies, or it does include some of them but not many of the 2,000 redundancies. And so you would expect the run rate of that cost, restructuring cost to increase.

In future years, we would expect these costs to be much more modest. Although in 2013 you will still see reasonably substantial costs in this area, although lower than the GBP460 million we saw last year.

Now, the second part of our investment thesis of course, is growth. And I said at full year, I don't expect you to give us a whole lot of credit for growth yet, we're a turnaround story at this point in time. But we do have good options for growth in both established markets and in emerging markets, particularly in Poland, Turkey and Asia.

As I said at the full-year results, our key measure of growth is value of new business. Let's be clear, this is an MCV basis. So it's a fairly conservative basis but that basis on a like for like, which it is, increased by 18% -- to GBP191m.

Now, I'm aware that these levels of growth would be consistent with a growth stock and I just want to manage expectations here a little bit. That in this regard we have a lot of work to do, to get consistency in these and get the product margins we require. We're only just starting on this journey. I wouldn't expect that level of growth to continue throughout the whole year because we can get good growth but 18% I think is pretty good across the Group.

Now, highlights in our developed markets were the UK and France. In the UK, the valued new business was up 33% and that's as a result of a number of actions. It's a large part pricing, reduction in expenses, mix of product. There's a whole lot of things in it. In particular, annuities did well but I do expect the growth rate in UK Life will moderate from these levels in the second half of the year in particular.

The UK Life business, while we're on that point, is adapting well to the introduction of the retail distribution review. And it's an important point, I guess, that 80% of the business has got nothing to do with the yadi-ya in our Life business and it's performed well. The platform business and some other initiatives we've taken, going pretty well at the moment. And again, I would classify it as satisfactory, I think, at this time.

In France, the value of new business is up about 11% and that's a strong performance from AFER group. And protection sales have been good, which that mix of business has helped us in terms of our value of new business.

And the growth markets, Poland, Turkey and Asia. Poland was I think, somewhat disappointing. We've got a lot of work to do. We do see this as a very attractive market and we've got much to do and we're making some progress. David McMillan has taking over all of that European operations and he's getting to grips with those issues very quickly indeed.

Turkey, we have an excellent local partner, the Sabanci Group, which I'm sure most of you will know of. And that increased by -- value of new business -- by 67%. That's showing some nice growth in the execution of the plans.

Asia as well was also very strong, 29%. We're delighted with the start Khor Hock Seng is making. There's a lot of work to do on pricing and product mix and we're really only really just starting what we do there. The performance in Asia, I guess, is more in line with my expectations and we had particularly good performance from Singapore and China, in particular, delivered strong VNB.

The value of the new business in several other markets, frankly, was disappointing and there's clear scope for improvement. In Spain and Italy the value of new business fell to GBP3 million and GBP4 million respectively, partly driven by the lower euro risk-free rate used to calculate VNB -- the value of new business on MCEV basis. That adds a little bit of volatility that perhaps you don't see in others that don't use a full MCEV basis, like we do. And that's also partly due to mix and some product issues.

So those businesses under David McMillan's leadership are a work in progress. We're continuing to take action and that is a key focus for the Group and we have some work to do. And that's the work on pricing, on product mix, on managing guarantees and reducing expenses. And that will take some time.

In general insurance, our key performance metric is the COR and this was level on the First Quarter at 96%. Strong performance in Canada, where the COR was 93%. And that's really, again, our highly sophisticated pricing and the selection coming through. In the UK the COR was 98%. That's in line with our expectations for the -- and it was a, I'll call it, a resilient performance in the winter quarter. The UK motor rates continue to soften and we didn't chase the share on that.

In Ireland, our performance is unsatisfactory and that had a COR of 108% and remains very much a work in progress. Again, that would be one of the business much caught in the turnaround space. And we're taking a number of actions in Ireland, including substantial cost reduction. And also leveraging the scale and underwriting expertise of the UK business, running part of that operation from the UK. And that will take some time.

But finally, we've also taken further steps to simplify the business and to strengthen the balance sheet and, again, I think that's a highly satisfactory quarter. In the quarter, we sold our remaining stake in Delta Lloyd for GBP353m. We completed the sale of our business in Malaysia for GBP152m. We completed the sale of Russian business. And in April, of course, we receive the EUR608 million in cash for the transfer of Aseval to Bankia in Spain.

Now, it's important to note I think, as well, that the businesses that we sold, their contribution to OCG has in the past been minimal and the dividends minimal or some years negative. So we haven't had major impacts in the earning, or OCG and cash, or more particularly, the OCG and cash, which is our investment thesis, from the sale of these businesses and that's helpful.

I should point out we are still cleaning up and simplifying our business further. There will be further sales. I wouldn't expect them in the next quarter and there are -- these are some complicated and tricky sales, they don't account for a whole lot of cash. And we'll announce those as they come along. They also don't account for any earnings so it shouldn't impact the earnings profile of the Group.

Now, in line with our aim to reduce internal leverage, that we've said to you all at the half year, by GBP600 million over three years. We have reduced the balance by GBP300 million to date, which is helpful. The balance sheet has been strengthened. The net asset value per share increased by 9% to 302p and that was primarily due to profits in the quarter. A little bit of favorable investment variance as well. But mainly profits. Our economic capital position remains within our target range, increased marginally, with a pro forma economic capital surplus of 173%, or GBP7.3b.

So that's, I think, the summary. I think this is a turnaround story, these results demonstrates some early steps in delivering our investment thesis of cash flow and growth. I am trying to manage expectations a bit. The results are, I think, encouraging and the feedback this morning seems to be that they are positive. But I am also very conscious of the challenges and I don't want to set the expectations at an unrealistic level. The progress so far has been satisfactory, or very satisfactory. And there is a great deal more we need to do for our shareholders. So on that note and I have my team here as well, I'd like to open the line to questions.

Questions And Answers

Operator

Thank you, Mr. Wilson. (Operator Instructions) We will now take our first question. Please go ahead.

Q - James Pearce {BIO 16758460 <GO>}

Morning. It's James Pearce, from UBS. Can you hear me?

A - Mark Wilson {BIO 7102576 <GO>}

Yes. We can, James. Good morning.

Q - James Pearce {BIO 16758460 <GO>}

Morning. A couple of things. First of all, you've already hit your target for internal debt repayment. Do you want to set a revised target for the rest of the year or how should we think about that?

Second, can you update us on the US disposal process and when you can expect to see the money in your bank account from them?

And thirdly, could you talk about Canadian, or specifically Ontario, motor pricing in light of recent fiscal noise?

A - Mark Wilson {BIO 7102576 <GO>}

Sure, James. We can do those three. Firstly, on internal debt, the internal debt is in line with our expectations. We had hoped to be able to pay that early and things have gone well. We're not going to change, just to be very clear on this, we're not going to change our cash flow target for internal debt replacement.

I'm choosing my words very carefully. The target was GBP600 million over three years in cash and GBP300 million this year and we've already done our GBP300 million this year. However, I wouldn't assume that all of the actions you can take on internal leverage of our cash flow. There are a number of structural things we can do over time and, they won't be short timeframes at all. But over time, there are a number of other structural things you can do that don't involve cash flow.

Now, I know the next question will be, well, what are they? We're not going to give any guidance on that at all today. But there's a lot of work going on and this is a long-term initiative. So just to be clear, no, we don't have any intention of paying that debt down more out of cash flow.

The US sale, I'll get Jason to update on it, it is going to plan. There's really not a whole lot of news to update. Do you want to comment, Jason?

A - Jason Windsor {BIO 17967688 <GO>}

Sure. Hi, James. There's not a lot to say. It's on track. The filings went into the Iowa and New York regulators as expected and we are in that process with those regulators and we expect the completion during the course of the second half.

A - Mark Wilson {BIO 7102576 <GO>}

And on Canada, we've been -- I'm not sure whether Maurice is on the line in Canada but Maurice has been very actively involved in Ontario motor issue.

A - Maurice Tulloch {BIO 17683736 <GO>}

Mark, I am on the line. Can you hear me?

A - Mark Wilson {BIO 7102576 <GO>}

Yes. Well Maurice, how about you update on that, as you have been the one in discussions with the government?

A - Maurice Tulloch {BIO 17683736 <GO>}

Sure. Thanks, Mark. Morning. James, probably some useful context. You do reference political noise. The noise commenced about four weeks ago. We have a three party system here in Ontario and the NDP party started making demands on the government, numerous demands and one of them at the bottom of the list was auto insurance. And they were demanding rate reductions in the magnitude of 15%.

Over the last four weeks, myself, a couple of other CEOs and the Insurance Bureau of Canada have lobbied for hundreds of hours with the government. And I think that resulted about 10 days ago in a pretty pleasing statement in the Ontario budget. And the budget effectively says that the government announced its intention to achieve an average rate reduction of 15% within a period of time to be subscribed by regulation.

But I think what's really key is, the government has linked any rate reduction to a cost reduction strategy. And the industry has very much lobbied that, at the end of the day, rates can certainly fall. They need to fall correspondingly with product reform.

At this point, we're still going to wait for the budget to come out. Budget speeches are great but have to move through to regulation. But the industry has been very active and at this point we're pleased with the government's intent to move forward with product reform and corresponding rate reductions. So we're very close to this file and managing it almost daily.

Q - James Pearce {BIO 16758460 <GO>}

Okay. Thanks very much.

Operator

We will now take our next question. Please go ahead.

Q - Blair Stewart {BIO 4191309 <GO>}

Yes. It's Blair Stewart here. Can you hear me okay?

A - Mark Wilson {BIO 7102576 <GO>}

Yes, Blair. Here you are. Good morning.

Q - Blair Stewart {BIO 4191309 <GO>}

Thanks very much. Good morning. I've got a couple of questions. Firstly, Italian volumes were down year on year but they were up quite substantially quarter on quarter. Just wonder what's going on there, given that there was a disappointing VNB result.

Secondly, Asia saw, I guess, conflicting volumes with Singapore up really strongly and Hong Kong down. I just wondered if you could give us a word on what's going on there?

Then in non-life, the price versus volume effect would be -- so, what sorts of pricing is going through, particularly in the UK where volume -- where the premium has dropped 5%?

And just talking about Canada, I just wondered what percentage of your business does come from Ontario? Would be useful, thank you.

A - Mark Wilson {BIO 7102576 <GO>}

Okay. A number of questions. I'll share them around a bit here. Italy is pretty modest in terms of the Group as you know. And it's certainly one of them that hasn't[ph] a turnaround. We're doing a whole lot of actions there and that's (inaudible) works are supporting and needs to do a whole lot more. That's about further reducing -- it's a large amount on product mix and that takes a little bit of time to change. But they are taking the actions needed.

I'll hand it over to Pat. But part of it is a technical issue in terms of what's happening with the spreads and the underlying changes on that, which impacts the value of new business. And that's been a factor. Pat, do you want to comment in more detail?

A - Patrick Regan {BIO 15131018 <GO>}

Yes. Thanks. Hi, Blair. On the volumes below, it's purely a seasonal thing. The First Quarter in Italy is always the biggest quarter of the year and that's been true for the last X number of years and it's true across the industry. So that's why, in volume-wise, you see a higher First Quarter than you saw Fourth Quarter.

As Mark says, in terms of the VNB, there's still actually quite a lot to be done there, both in terms of product mix, more protection, less with profits. We've done a lot of work to bring down guarantee levels but as interest rates keep coming down, there's still more work we need to do on that and the type of products we're selling there. So volumes are seasonal but VNB is definitely still a work in progress.

Q - Blair Stewart {BIO 4191309 <GO>}

Much clearer. Thank you.

A - Mark Wilson {BIO 7102576 <GO>}

On Asia, I'm pretty comfortable with the start Khor has made. Khor is very financially astute. He focuses very much on pricing and margins and that isn't the discipline we've had in Asia. We've got some pretty good operations. We're pretty strong in China, as probably not many people know. And in China, it's about pricing actions, of course taken, frankly. And about mix issues in terms of the business.

So what you're seeing is Khor having a focus on creating value and that is a change of focus in that business. We're very clear. We measure sales not by top line, we measure sales by the value it creates. And that's how we reward our people.

Q - Blair Stewart {BIO 4191309 <GO>}

Is that coming through in Hong Kong as well, Mark?

A - Mark Wilson {BIO 7102576 <GO>}

No, not so much Hong Kong. Our Hong Kong operation is very modest. It's more China and Singapore were really the strong entities. Hong Kong, we haven't taken advantage, really, of the relationship we had with DBS and we will come out to the market later this year. We are pretty set on our Asia strategy. I'm not going to name the countries in it just yet because we will make some more very modest disposals in Asia. We have already said we will dispose of South Korea as one and Taiwan as another. Maybe one or two others as well. And Khor is very set in the strategy. We'll announce that later in the year. For competitive reasons, we're not going to announce that now. But we'll give you more clarity a bit later.

On the UK, Robin, do you want to answer that one?

A - Robin Spencer {BIO 16514830 <GO>}

Hi, Blair. There's a couple of things going on. In terms of your questions, basically on rate. The reason for the overall premium reduction wasn't really rate, if you look at year on year, the rate was pretty much flat. So therefore, why was the -- why did the premium come down? What we decided as we went into Q1, given both the tort reform and the gender directive, was to be fairly prudent in terms of new business as well as our renewal prices.

In going through that period we probably also became a little bit more, from a risk selection perspective, we took on higher quality risk, which reduced the overall average premiums as well. So they were the key impacts of the effects that were going on.

I think you also had one question about the proportion of the business in Ontario, on motor. It's probably best to hand over to Maurice for that.

A - Maurice Tulloch {BIO 17683736 <GO>}

Thanks, Robin. Blair, over the last four years, we've optimized our portfolio rates and our Ontario auto has fallen from 33% to 26.5% and that's now in line with the weight for that line in the market.

Q - Blair Stewart {BIO 4191309 <GO>}

Great. That's very helpful. Thank you very much.

A - Mark Wilson {BIO 7102576 <GO>}

Thanks, Blair.

Operator

We will now take our next question. Please go ahead.

Q - Fahad Changazi {BIO 15216120 <GO>}

Hello. Good morning. This is Fahad Changazi calling from Nomura. I have three questions, please. First, on cash, you recommitted to increasing remittance ratios and I appreciate that UK Life mix has happened later -- besides UK Life, everything else happens later in the year. But qualitatively, could you talk about what progress you have made since the full-year results to increase remittance ratios for the year?

Second is on business value, new business value. You mentioned in the UK it's driven by pricing action but you also mentioned annuities and I presume that means coming out of bulks in H2 last year. So could you perhaps give us the underlying improvement in VNB, excluding that impact?

And third, just very quickly on the combined ratio. Your UK numbers are slightly worse than last year. RSA mentioned benign quarter for weather, where it appears you had a normal quarter so was there anything else happening, for example, large losses impacting your results? Thanks.

A - Mark Wilson {BIO 7102576 <GO>}

Okay. Thanks. On the cash remittance ratios, as I've said. So our remittance ratio, if you assume for the last year, although it was paid this year, it was 300 at our Life business. That makes our remittance ratio about 50%.

Now the market is sort of mid to high 80s, some a bit higher than that and frankly this is going to be a multiyear journey and I can give you some of the examples of the things we're doing without giving you obviously any quantitative guidance on it. But this will very much be a multiyear journey. And we've got a long way to go. You can do the math. If you assume, say, GBP1.8b[ph] in terms of OCG and we've got a 50% ratio, we can get that up to -- it's a very large number and a lot more cash flow through to shareholders.

Some of the things we're doing, some of them are structural. So, for example, one of the reasons of doing the internal debt the way we did was to take out what was going to become a dividend trap there. Some of it is expense. So having all these restructuring costs year after year after year comes directly off the OCG and therefore reduces your remittance ratio. And that's why we've committed to have a much more modest figure in that next year.

Some of its regulators, you have to, in a number of countries negotiate with regulators and make sure that they're happy on passing dividends up. Now, a good example of that would have been France last year, where we had double leverage and the regulator had concerns. We fixed the double leverage, we fixed their concerns and dividends started again.

Some of it is capital. There are some business we would want to hold more capital to be optimal. Some of it product mix. There's a whole load of little structural issues as well on there. So in each country there's literally dozens of initiatives that we're doing over a multiyear program. And I would hope that you would see -- I'll choose my words carefully, I hope you would see steady progress on that, year after year but it is a multiyear initiative.

Pat, on the value of new business. Do you want to talk about the bulk annuities?

A - Patrick Regan {BIO 15131018 <GO>}

Yes. Thank you, Mark. The BPH didn't make a lot of difference. The reason we exited them, they weren't a big contributor to VNB anyway. So they weren't a big number, a very small number in last year and hence a very small number in this year. So the underlying changes will be almost identical with or without BPH.

Q - Fahad Changazi {BIO 15216120 <GO>}

Okay. But you are expecting the value of new business to come down going forward, for UK? That's nothing to do with mix?

A - Mark Wilson {BIO 7102576 <GO>}

At 33% we've certainly don't expect (technical difficulty) 33% on that. We might expect some other countries to improve but you can expect the value of new business in the second half of the year on UK Life to decrease from that number, yes, absolutely. We're doing some good stuff. But I think expecting 33% to continue would be unrealistic.

Q - Fahad Changazi {BIO 15216120 <GO>}

Okay.

A - Mark Wilson {BIO 7102576 <GO>}

And on combined ratio, Robin?

A - Robin Spencer {BIO 16514830 <GO>}

Yes. Fahad, good question. In terms of the -- you're right, we also from a weather perspective, despite being one of the coldest quarters on record, actually it was relatively benign from a claims perspective. So what's going on? Well actually last year in Q1 we had about GBP25 million available releases and this year we didn't have any favorable development coming through in the quarter.

Q - Fahad Changazi {BIO 15216120 <GO>}

Okay. Thank you.

A - Mark Wilson {BIO 7102576 <GO>}

It's in line with the expectations for that business in the fiscal.

Q - Fahad Changazi {BIO 15216120 <GO>}

Thank you very much.

A - Mark Wilson {BIO 7102576 <GO>}

There was another section I should say of Ireland. That we still have a lot of work to do. That's not a satisfactory outcome.

Q - Fahad Changazi {BIO 15216120 <GO>}

Okay. Thank you.

Operator

We will now take our next question. Please go ahead. Hi. Good morning?

Q - Abid Hussain {BIO 17127644 <GO>}

Good morning, can you hear me? Good morning, it's Abid Hussain from Soc Gen. I've got three questions. Can I just come back onto the internal loan? Can you just share your thinking with us on why it might be necessary to reduce the internal loan to less than GBP5.2 billion and the number that you mentioned previously?

Then you also mentioned some non-cash options to reduce that in internal loan. I understand you're not going to go into what they might be but can you just give us an idea of what sort of timeframe those options may kind of, may come through?

And secondly, just on Poland. When should we be expecting the value of new business to grow there?

Then finally, on the US disposal, I think the question may have been asked but I couldn't quite catch the answer. Can you just clarify if all the necessary regulatory hurdles have been met there?

A - Mark Wilson {BIO 7102576 <GO>}

Okay. Thanks. Internal loan, I'm not going to give any more detail today on the non-cash ways to reduce it. And we are committed and sticking to our GBP600 million of cash reduction over the next three years.

I said at the full-year results, there's no magic formula here, there's no formula the regulators have got, it's just an ongoing discussion about what's the best level. I know that some of you said in the analyst reports that they think that level is too high. Well that remains to be seen.

But as I said, the key thing here is, there's a number of non-cash things we can do and this will be an ongoing debate as it should be in every life insurance company or general insurance company about what the optimum level of internal debt is. But there is no magic formula. And that GBP600 million on a cash basis over the next three years remains intact.

Poland. Poland is -- investments and stuff that's going on there, it's a nice business, it's a good cash contributor. And frankly, it is a bit of a change of strategy in Poland. Poland is a very attractive market in our view. We have a very strong position in Poland and we have good partnerships in terms of distribution there. And it will take a little while to get that business up to where we expect it to be in terms of growth in value of new business.

So just to be clear, there's a change in pace for those business. You saw at the full-year results how we went through each country and said where we were focusing the attention and Poland was on value of new business growth. Now, historically that's probably been on cash flow growth and in a growth market like that, we need value growth -- value of new business growth.

I'm not going to give any guidance for when I think that will happen except to say that they had clear plans in place but it is a changed strategy for them. The US?

A - Jason Windsor {BIO 17967688 <GO>}

Sure, not a lot to add to what I said earlier. The regulatory approval processes are ongoing. The filings are in front of those regulators in Iowa and New York. It is a lengthy process, we know that in these US approvals but the completion is expected in the course of the second half.

A - Mark Wilson {BIO 7102576 <GO>}

Yes, I guess it would not be in the first half and it was never planned to be I should point that out.

Q - Abid Hussain {BIO 17127644 <GO>}

Okay. Thanks. Can I just come back just very briefly on the pressure around the internal loan. You mentioned regulatory from a discussion earlier, is it --- should I --- is it right to think that the pressure is coming from the regulator or is an internal dynamic?

A - Mark Wilson {BIO 7102576 <GO>}

It's --- I'd be wrong to say that the regulator wasn't actively involved but we certainly went to them and the regulator didn't set a target or they haven't got a formula but we went to them and we said for percentage of assets --- so what it was the percentage assets we hold in those funds from subsidiaries was too high as a percentage of available assets and that's really the issue. Having indebtedness is quite okay and every company has some form of debt and that can be through branching or through subsidiaries holding other subsidiaries, which was the case in this but it was getting too high. So we formalized the loan and then we agreed to bring it down.

Now just to be clear though, we went through to the legal heirs[ph] and said we want to bring it down on a cash basis by GBP600 million over three years and the regulator is supportive of that and has said they are supportive of that. And I specifically went to them and said I want to be able to say you are supportive of our plans here to give some certainty.

So in the models, you'd be very safe in assuming that we will (inaudible) the GBP600 million over three years of which we have already paid GBP300 million and I've said that we are looking at other non-cash-flow ways as well, over the long term to bring that down and I wouldn't expect anything in the near future. But I hope to get back to a stage where you don't ask me anymore because (technical difficulty) clear plans and I think we can do that. But it will take some time.

Q - Abid Hussain {BIO 17127644 <GO>}

Great. Thanks.

Operator

We will now take our next question. Please go ahead.

Q - Kevin Ryan {BIO 1814771 <GO>}

Morning, it's Kevin Ryan from Investec. Could you please give us a little bit more background on UK Life? I am surprised at the very modest reduction in volumes given that RBS is no longer doing face-to-face advice and so on and so forth. So could you just give us a little bit of a sense of what your strategy is in the UK in the post-RDR world and how you're managing that dynamic of volume and value? Thanks.

A - Mark Wilson {BIO 7102576 <GO>}

Kevin, I'll hand this over to David.

A - David Barral {BIO 17035123 <GO>}

Kevin, hi, David Barral. I think the first thing to say is we are adopting we think pretty well for RDR, it's early days. But you know over 80% of the value of our new business is unaffected by RDR express business and new season protection. You're right about RBS but on the other hand actually our focus is not on investment business with the banks and other strategic partners, it's on the protection business where we excel and we're actually growing that business and we would expect that to continue over the course of this year.

I think on the savings side more generally it's a bit early to tell. The fact is we've still got the savings coming through from pre-RDR[ph] on those personal pensions and that kind of thing so that will take time to play out there. On the individual savings side that's where platform sales are well up on last year. But I come back to we'll focus around value of new business driven by protection and a new key business and (technical difficulty) protections through there.

Q - Kevin Ryan {BIO 1814771 <GO>}

Thanks.

Operator

We will now take our next question. Please go ahead.

Q - Chris Esson {BIO 6194371 <GO>}

Hi. Good morning, everybody. Chris Esson from Credit Suisse. Just a couple of questions. Firstly, one for David again on the UK, I just wondered if you could provide a little bit more detail on the VNB growth and perhaps the contribution of different business mix to that? It looked like volumes were fairly soft but VNB progressed quite well. So I just wanted to get a little bit more color on the breakdown there.

Secondly, I wondered if you would provide or quantify the effect of the investment markets on NAV in the quarter?

And lastly just on Poland, I would be interested in your thoughts in terms of expectations on potential for regulatory reform in pensions and how you are likely to be positioned for that? Thank you.

A - Mark Wilson {BIO 7102576 <GO>}

Hi, thanks, Chris. The three question, we're not going to give any more guidance in terms of mix and stuff today, we'll do that at the half year. You can assume as I said, annuities are strong and yes, we're pretty competitive in the annuity market but we have strengthened our pricing there. And that has been help and we haven't seen any drop off in volumes. So we're not --- but we're not going to give any mix guidance today as we don't. I'll hand over to Pat on the NAV on the investment market and then I'll come back to you on Poland.

A - Patrick Regan {BIO 15131018 <GO>}

Hi, Chris. We don't normally give out every elements of the rec[ph] on the NAV movement. It was a positive single digit to high single digits, hence, obviously (multiple speakers) investment variances.

Q - Chris Esson {BIO 6194371 <GO>}

Okay Great. Thanks.

A - Mark Wilson {BIO 7102576 <GO>}

Yes. The main impact as we said was --- actually you saw the profit results with no surprises. Poland we are very active in these discussions on Poland and there's a lot of noise about it, it's a highly political issue that happens at election times. And as you know we are strongly --- just to be clear though --- we're the cast-outs[ph] as you probably are aware in terms of the unit links on pensions over there that we can get. So it's not a contributor to growth, it's not a contributor to new business and it hasn't been for some time.

But it's a bit unclear how that will flow through and we are active. I think it's always challenging from a market --- from a capital perspective over there if a government says it's going to take funds that are effectively in private provision and nationalize part of it, I think that's challenging and that's all playing out in the media and the politics.

There will be, we expect, some announcements coming up from the government then over a period of time that may have an impact. But just to be clear this isn't part of our ongoing new business, this is part of our in-force base at the moment.

Q - Chris Esson {BIO 6194371 <GO>}

Okay.

A - Mark Wilson {BIO 7102576 <GO>}

We're very close to it. As we get more information, we'll share it and we are active on planning very much.

Q - Chris Esson {BIO 6194371 <GO>}

Okay. Thank you very much.

Operator

We will now take our next question. Please go ahead.

Q - Andy Hughes {BIO 15036395 <GO>}

Hi, hello. It's Andy from Exane BNP Paribas. A couple of questions if I could. The first one is again on the internal item I'm afraid sorry. Just when you talk about the non-cash actions that you can take, obviously there's two ways this can go. You can reduce the internal debt or you can improve the remittances to the holding company. And the way you seem to be suggesting it is that the non-cash action that you make actually reduces the internal debt, is that the way I should interpret it or should I look at it as a mix of improved remittances and also reduced internal debt?

And the second question was about the UK business margin improvement, coming back on Chris's point. Maybe you could split out the benefit of the expense contribution to the new business margin and maybe talk about some of the things that happened post RDR, i.e. lapses, where they've changed.

And the final point is on the OCG generation, am I right that there was GBP100 million one-off financing benefits last year. So actually on a like-for-like basis the OCG has actually improved by GBP100M year on year? And when I think about the life business and the improvement in costs should I be thinking about the benefit in terms of reserving coming through at the end of this year or end of next year? Thank you.

A - Mark Wilson {BIO 7102576 <GO>}

Okay. A lot of questions there. On the remittance, I know you guys are trying to get into detail, which I'm not going to give you on that particular issue today. But I'll give you a little bit of advice. So as you see we've improved from that business and --- but the references would be just that's cash isn't it? So the way you should think about this is other structural ways we can reduce that line and it's structural rather than cash.

Now if you go back to our investment pieces, our investment pieces, there's improving cash towards shareholders year after year after year after year. And so we'll take action that will improve that. But I'm not going to go into any more detail yet. There's a lot of work going on but this is a very long term initiative. Some of the things we're talking about on that are years but what we --- what will come up in the right time is appropriate plans and we'll share them. I don't want one to get too over excited about it yet, in terms of what we sit on this and it's GBP600 million cash over three years.

The OCG pack -- (inaudible) do you want to just cover that?

A - Patrick Regan {BIO 15131018 <GO>}

Yes, hi Andy. The --- you're right to say that there was a GBP100m, just over GBP100 million positive one-time benefit last year in UK Life. The underlying result is actually a bit less than GBP100m, Andy, I wouldn't want you to get too carried away there. The way the roundings work is it's the underlying result but it's a bit less than GBP100m.

On the capitalization of expense reductions, we haven't done that yet. Obviously as time goes on, you know what actuaries are like Andy, it's devil's own job getting them to factor these into the embedded value calculations, I've got some analysts smiling at me. So as we go forward obviously it's a lower expenses, they will begin to flow through into embedded value which will flow then into all the key metrics. So we haven't captured that as of now..

A - Mark Wilson {BIO 7102576 <GO>}

Yes. It's more --- the expenses in that business are down. I think the UK Life business has been one of our leaders in the expense reduction work they've been doing which is great. The biggest improvements here, there's been some pricing changes across all sorts of box. But as I said, annuities is one of the key --- and I keep on saying I'm trying to manage expectations here, maybe unsuccessfully. But I'm trying to manage expectations that we would not expect our growth rate for the Group to end out the year at 18%, we would not expect UK Life to be anywhere near that at the end of the year. Yes. It has had a very satisfactory quarter.

Q - Andy Hughes {BIO 15036395 <GO>}

And reduction in the internal debt. I know you don't want to set any sort of guidance, I'm just trying to get my head around how you balance the --- obviously the question was trying to get my head around the balancing of --- if you do take action which is non-cash related which would --- reduces the capital requirements of AAL, to what extent do you decide to pay down the internal debt and to what extent do you decide to improve the cash for the holding company? I think obviously from previous comments I thought the GBP5.2 billion was a fixed number if you like and any further action you took would lead to higher dividends and now we seem to be suggesting that maybe it's a mixture of two. I'm just trying to understand what's happening there. Thank you.

A - Mark Wilson {BIO 7102576 <GO>}

I think the way to think about, first, is they are related but --- they are related but only partly. I mean I think a lot of people are trying to --- and you're not. But I think a lot of people are trying to assume that internal debt is the same as external debt and clearly it's not. If we merge them both together what happens to the internal debtors is the easiest way to think about it. The actions -- if we can -- I'll phrase it this way, if we can improve the capital position that gives you much more flexibility to pay dividends out of group. So improve -- reducing the internal debt by doing structural actions gives us more flexibility over time.

But from a modeling perspective just assume the GBP300 million this year which we've already done. And the GBP150 million or GBP150 million --- so GBP150 million next year, GBP150 million the year after, from a cash flow perspective. Then I said what we can pay out of that, well that depends on the performance of that business fundamentally.

I know there's been concern on the internal debt and I am signaling there shouldn't be as much concern as probably some think on that aspect. It depends on the performance of that business. But I really aren't going to go into any specifics about the actions we're going to take because we will come to you at the right time and be clear on what we're doing and make sure we can deliver what we say we can.

Q - Andy Hughes {BIO 15036395 <GO>}

Great, thank you very much.

Operator

We will now take our next question. Please go ahead.

Q - Oliver Steel {BIO 6068696 <GO>}

Good morning. It's Oliver Steel at Deutsche. Two questions. The first is given the rise in the MCEV, I was a bit surprised not to see the economic solvency ratio pushing up a bit further than it did so I just wonder if you can reconcile the difference?

Then secondly, following up on Andy's question on the OCG, slightly under GBP100 million increase underlying, I guess it's not on the normal life side, within the life what's driving that? Is that lower strain on new business because certainly that improved dramatically second half versus first half last year, or is that gross cash flow coming off the life business?

A - Mark Wilson {BIO 7102576 <GO>}

Okay. Thanks, Oliver. You're right on the OCG, it was a lower strain and there's been some good work done last year on that and also in the First Quarter so --- and there's still a lot more work to do, getting efficient. We have reduced capital strain in the business quite a bit over the last period and you are seeing that flow through. And MCEV, Pat?

A - Patrick Regan {BIO 15131018 <GO>}

In terms of the actual economic capital surplus, the non-pro forma number, that went up by GBP1b, which is a combination of things as you referred to over the MCEV increasing but also things that were pro forma'd actually now being completed. So they go into the actual number. If you also included improvements in the US (inaudible) that is not included in the pro forma numbers. But excluded actually.

Q - Oliver Steel {BIO 6068696 <GO>}

Okay, sorry, just to come back on that because the pro forma solvency ratio barely moved, I think it was a 1%. So you are saying by implication most of the MCEV movement was US?

A - Patrick Regan {BIO 15131018 <GO>}

No, not most of it, some of it was. A portion of it was related to the US. The US capital surpluses went up on an economic basis and on a local basis for that matter. What we've reflected is a bit coming through on the economic basis. You could make an argument for saying well that would mean we'd receive higher proceeds for such purposes are higher, we haven't reflected that. So we've been quite cautious in how that flows through to the pro forma number.

Q - Oliver Steel {BIO 6068696 <GO>}

Okay. And I'm just trying to work out what the sort of offsetting factor is because --- is the economic solvency --- is there a dividend here that we should be taking into account?

A - Patrick Regan {BIO 15131018 <GO>}

Over the First Quarter, yes, obviously the dividend is factored in at the Q1 numbers, it's not in the full-year number.

Q - Oliver Steel {BIO 6068696 <GO>}

Okay. Thank you.

Operator

(Operator Instructions) We will now take our next question. Please go ahead.

Q - Marcus Barnard {BIO 2103471 <GO>}

Yes, morning, it's Marcus Barnard from Oriel Securities. I'd just like to take you to task on Ireland a bit if I may? You're losing volumes and margin on both GI and Life and that sort of takes some doing. And I just wonder what's going on there? Is it just the economy and lower volumes or have you got a problem there with morale and reputation and your public image particularly after your history of making acquisitions, mergers, opening a European hub and closing it down. And I'd like to know why you think cost cutting's going to fix this other than you can't think of anything else to do? Thanks.

A - Mark Wilson {BIO 7102576 <GO>}

Okay, the -- Ireland is complicated and there's a whole lot of moving parts and we'll try and explain some of them. But I don't think it's a reputation issue so much but I it is a change of business strategy there. And some of its market but I don't think we can sit here and use the market as the excuse for what we're doing. I think it's more what we've been doing that's going take us some time to fix and we've been taking rating action, we've been deliberately reducing our volumes, we've been fundamental cost cutting and that will have an impact on the morale and the business for sure. And we're quite open about that. We have still a lot more work to do and we would expect that to improve throughout the year and it's a disappointing outcome and I guess that's one of the lowlights in a pretty solid set of results. Maybe I'll pass it over to Robin to add some more comment on it.

A - Robin Spencer {BIO 16514830 <GO>}

Yes, just a bit of detail on that, Marcus. Year over year we'll have taken that cost down by about 25% in the Irish business and we've probably got a little bit more to go. What we found is from an underlying perspective both on the personal line side and on the commercial line side. When I stood back from it that really the whole book we needed to re-underwrite, we've got the benefit now of using all of the expertise from the UK market to help do that and we're going through that process. Necessarily that means that we're walking away from some markets, we're walking away from some brokers where we just can't -- we don't feel in the medium to long term we can make good returns for shareholders.

So we are firstly, reducing our premiums, which actually puts its own pressure on the expense base itself. That said, I think given the progress that's been made to date and the actions that have been taken, it will take a while for it to come through in the earnings but actually from a morale and motivation perspective I think we hit a low point last year but we're actually really picking it up, we've got real clarity of strategy and I'm confident that as we go through 2014 you'll start to see the results turning around strongly.

David was just going to say something quickly on the volumes on Life side of things. Yes?

A - David Barral {BIO 17035123 <GO>}

Yes, Marcus, we exited the joint venture with Allied Irish Bank at the end of Q1 last year. So that's reflected a bit in the volumes. Actually, excluding that, volumes were flat. We're actually improving the value of new business in that business by a range of actions including pricing, withdrawing from unprofitable products as well as quite an aggressive cost program. So I think we're quite confident that we'll be able to improve the overall financial performance in the Irish Life business this year.

Q - Marcus Barnard {BIO 2103471 <GO>}

Okay, that's great. Thank you.

A - Mark Wilson {BIO 7102576 <GO>}

The other thing (technical difficulty) should probably mention, Ireland needs to be kept in a little bit of context. It's 3% on the non-life of our business and 2% for the Life. So it's pretty modest, nevertheless, as we keep on saying, it's unsatisfactory and it's up to us to make it turn around.

Q - Marcus Barnard {BIO 2103471 <GO>}

Okay thanks.

Operator

We will now take our next question. Please go ahead.

Q - Andy Hughes {BIO 15036395 <GO>}

Hi guys, it's Andy Hughes, as a former General Accident employee I'd just like to congratulate you on resurrecting the brand. I wonder could you talk a bit more about what you're planning to do with the brand because it seems as if the idea of the General Accident brand in the motor market, obviously you've had relatively weak UK motor revenues, because as I understand it the idea is Quote Me Happy is Internet-based only so appeals to kind of old people like me, paying GBNP300 a year for car insurance but younger people want to buy via the phone. And that was the idea of relaunching General Accident brand. So is the idea to sell more car insurance for younger people again and are you thinking that's now an attractive market again? Thank you very much.

A - Mark Wilson {BIO 7102576 <GO>}

Oh, Andy, I'll hand that over to Robin but I should say that we've got so many ex-employees from General Accident (technical difficulty) the market.

A - Robin Spencer {BIO 16514830 <GO>}

It's totally fine, actually when we did so the testing as to the tax brand, we'd go with General Accident did test really well and it still resonates as well with customers. In terms of what are we doing strategically, 20% of all customers who shop on --- or over 20% of all customers who shop on aggregated still want to actually complete that sale by talking to somebody. As you know --- as you said, Quote Me Happy actually is all Internet so we were really missing out on 21% of customers. And therefore what we have done is we've developed GA on exactly the same platform as a low-cost platform as the Quote Me Happy platform, which gives us the opportunity to capture our car bid[ph] customers and actually right across the board in terms of age range and that we couldn't previously.

As you know it's such a --- from a cost competitiveness perspective it's such a tricky market. You've got to make sure you've got your pricing points exactly right and the General Accident brand and that operating model allows us to do that. So it's only early days at this stage but hopefully we're going to emulate some of the stats of Quote Me Happy.

Q - Andy Hughes {BIO 15036395 <GO>}

Thank you very much.

Operator

We will now take our next question. Please go ahead.

Q - Paul Diaz {BIO 4658200 <GO>}

Hi, can you hear me?

A - Mark Wilson {BIO 7102576 <GO>}

Yes, go ahead.

Q - Paul Diaz {BIO 4658200 <GO>}

Hi there, it's Paul Diaz from RBC. I just really want to have a quick question on disclosures because clearly you've changed the disclosures so you're no longer splitting out the mix in the UK which you've said that you're not going to do. I just wondered what the thinking was there and why we now have a split of the Asian business, which is obviously a much smaller part of the business than the investment case. But we don't get to see what's going on in the UK Annuity and Pensions line?

A - Mark Wilson {BIO 7102576 <GO>}

Hi Paul. Well generally what we tried to do was to just simplify the pack a bit so it's shorter overall and to really focus on the five key metrics. So what we've tried to do is deemphasize the amount of sales data we put in there and just focus on VNB, expenses, etc. Combined ratio, etc. So similarly when we get to the half year and full year we will try and simplify and streamline the pack a bit likewise to really focus on cash remittances, value of new business, expenses, etc.

As we do that, by design we will be cutting some stuff out. It is important we make the pack a bit shorter and simpler. As we go through that if people really find there's a bit of information we cut out that you really want then, feed it into and Dave earlier and we'll take (technical difficulty).

Q - Paul Diaz {BIO 4658200 <GO>}

Yes, certainly I think --- it just strikes me as a little bit strange that the UK is more than half of the business and we don't get any kind of breakdown of that in the numbers and a number of questions have been asked about the performance of the annuities business and the performance of the pensions business which we don't really get to see any detail on that so it seems a little bit strange.

A - Mark Wilson {BIO 7102576 <GO>}

Okay, well, as I say. We'll pick up the comment and as David said -- we went through more than 80% of our VNB is coming from the risk part of annuities and protection and much less on the pension side. So but again, we can pick up the disclosure points as we go forward.

Q - Paul Diaz {BIO 4658200 <GO>}

Okay. Thanks.

Operator

(Operator Instructions) We will now take our next question. Please go ahead.

Q - James Pearce {BIO 16758460 <GO>}

Hi, it's James Pearce at UBS again. I wonder if you could talk briefly about external debt and a couple of points within that. Have you been active in commercial paper market year to date? Has the I think it's GBP0.6 billion balance at year end come down or is it the same or higher even?

And secondly, am I right in thinking that it feels like there's a link between getting the US proceeds and (inaudible) more concrete about what you're going to do with the October hybrid call? And if you could just talk around external debt in general that would be very helpful. Thank you.

A - Mark Wilson {BIO 7102576 <GO>}

Hello, James. Well really there's not a lot of new stuff to say on external debt. As we talked about, the plans to bring it down to a ratio of less than 40% over the medium term. So three or four years and two months in there's not a lot to report to be honest with you.

The only thing on the commercialized paper program we're doing is removing from guaranteed to unguaranteed. So to the extent you see any activity, it's us doing that.

We typically actually don't talk about where our intentions are on a particular call until actually we do it. So the reason we're not saying anything is really in line with that. So I wouldn't expect to hear anything from us on that until later in the year. I think on the US we have been clear that getting the US proceeds is an important part of our capital plan. So as we talked about, that's on track. And I would expect that to happen in the second half of the year. But that's always been an important part of our capital plans.

Q - James Pearce {BIO 16758460 <GO>}

And is the CP balance up or down since (multiple speakers)?

A - Mark Wilson {BIO 7102576 <GO>}

It's the same.

Q - James Pearce {BIO 16758460 <GO>}

Thank you very much.

Operator

There are no further questions, gentlemen.

A - Mark Wilson {BIO 7102576 <GO>}

Okay, well, on that basis I think we can wrap it up, no doubt we can have follow-up calls where appropriate over the coming weeks. I think everyone probably sees these results as being satisfactory. What we're aiming for as we said at the full year though is to get --- and we want to be consistent. We want to be boring, we want to be predictable that we just keep on improving our results quarter after quarter and that's what we're aiming to do and you will see some volatility I think in value of new business as those relates with the extraordinary if we were able to continue them. And we are trying to manage some expectations down on that.

As to the follow-up questions, no doubt we can get them direct from you and provide more clarity where we're able to. So thank you, everyone, for joining us this morning.