Investor Day

Company Participants

- Clare Bousfield, Chief Financial Officer
- John Foley, Chief Executive Officer
- Spencer Horgan, Director, Investor Relations

Other Participants

- Abid Hussain, Analyst
- Andrew Baker, Analyst
- Andrew Crean, Analyst
- Colm Kelly, Analyst
- Dominic O'Mahony, Analyst
- Johnny Vo, Analyst
- Jon Hocking, Analyst
- Patrick Hosking, Analyst

Presentation

Spencer Horgan {BIO 4241901 <GO>}

Good morning, everybody.

Welcome to you all, and welcome back to those of you who joined us for the presentation in July. This morning, we are going to go through a shorter version of what we went through in July. We are going to start with John Foley, who is going to remind you of some of the key aspects of our investment case, our strategies, our unique capabilities and why we are excited about our future life as an independent company. Then, we are going to move on to Clare, who is going to take you through some of the financial details, particularly the capital generation, our financial management framework and the feed through to dividend policy.

Thank you all again for coming and let's get going. I will pass the floor over to John.

John Foley {BIO 4239156 <GO>}

Thanks, Spencer. So, ladies and gentlemen, good morning. Welcome back to our offices here at 10 Fenchurch Avenue. So our prospectus runs to 330 pages, which I am sure all of us will read to the last letter. I have done that any number of times.

So the purpose of today is to home in on the key points. So over the next hour or so Clare and I will set out the case for investment in the shares of M&G plc and there is obviously the chance to ask us some questions afterwards. So Clare's presentation is the real substance of today.

She will run through the main numbers and take a deep dive into PruFund. I will just take 20 minutes or so of your time to set the scene. In my session, I want to remind you how our unique mix of businesses will generate attractive total returns for shareholders, what differentiates us from others, and the multiple sources of competitive advantage that we have.

How we intend to grow assets and clients, supported by favorable economic and social trends around the world. And I will touch on how our transformation work under this new leadership team,is already re-energizing a business with a long record of value creation. And above all, I want to share with you how excited the leadership team and I are about the opportunity that demerger brings. How growth is in our very DNA here at M&G and how this growth will generate attractive returns for you, the shareholders.

Now you have seen this slide in early July, but here is a quick reminder of M&G in key numbers. Our history stretches back to 1848, but the purpose of our business has changed very little over that time. Put simply, we are here to help people manage and grow their savings so that they can live the life that they want. And along the way, we try to make the world a little better by how and where we invest their savings. Today, we are both asset manager and asset owner. We look after the savings of more than five million people and manage assets of GBP341 billion. It is a genuinely international business, with 20 distribution offices, serving customers and clients in 28 markets. And we approach all aspects of our business in line with our core value, a deep sense of care for our customers and our colleagues.

Our aim is to become the best-loved and most successful savings and investment company by creating great customer outcomes through high value-added solutions. Now before we get into the investment case proper, here is a quick reminder of how we run our business. We have a GBP210 billion savings and asset management business. That's everything under the M&G Investments brand and the Prudential retail savings franchise, including PruFund, our anchor retail proposition in the UK. This contains all of our open products and propositions.

We manage this business for profitable growth and sustainable value creation. We also have a GBP131 billion Heritage business. Although closed to new customers, it remains fundamental to our business and to our future growth. The Heritage business is home to our traditional with-profits products as well as our shareholder-backed annuities. It's a large book of sticky assets, gives our asset management business scale, and crucially, underpins the breadth of its capabilities. It also provides shareholders with a stream of stable earnings. Our strategy for the Heritage business is optimization, improving customer outcomes, creating efficiencies and maximizing cash flow for shareholders.

So why hold shares in new M&G? Or better still why not buy more? Now this slide summarizes our investment case. In a single sentence, we have a unique mix of businesses that puts us in an ideal position to outperform both the market and our competitors over time. We covered a lot of this last time. Why? As both asset manager and asset owner, we are uniquely placed for the growth opportunities in our market. And I will cover transformation, an enabler of our growth, a little bit later on.

So let me start with a question I often hear from shareholders, how is holding M&G better than holding a pure asset manager and a consolidator of closed books separately? My answer is that we can create value for both customers and shareholders in ways which are impossible if the asset manager and the asset owner are kept apart.

I want to share some examples with you. So, as you saw when we met in July, we have a first-rate institutional asset management business, which today manages GBP70 billion on behalf of external clients. We have grown this business over 20 years by leveraging capabilities and ideas originally developed for the internal client, the asset owner.

The type of capabilities and ideas, which can only be developed if backed by a large book of sticky assets and a strong balance sheet. So as we approach demerger, we have a growing institutional business. Since we last met, we have won a series of new mandates of several billions pounds and its fee levels are resilient. As Clare will show later, our average fee here has actually risen from 22 basis points in 2016 to 26 basis points today.

One reason why our institutional business is thriving, is our strength and scale in private assets. It was the demands of the internal client, the asset owner, that meant that we were an early entrant to this market. If you use the bridge across the Thames at Dartford, then you can thank us because we financed it, although we are not taking any responsibility for the traffic jams.

Today, we have GBP60 billion in private assets, with roughly half sourced on behalf of external clients and at good fee levels. There are many other ways this unique combination enables us to create value for customers and shareholders alike. So my second example illustrates our ability to deploy seed funding rapidly. How we selectively take capital from the Heritage business to open up our in-house innovations to fee-paying external clients.

So back in 2000, we developed a long-lease strategy for our annuities. We spotted that the inbuilt rent increases on properties like supermarkets, were a good match for clients with long-term fixed and inflation-linked liabilities. Today, our annuity book has GBP2.8 billion in long-term lease strategies. But we thought the idea was so good that we went on to develop a fund for third-party clients seeded with money from the life funds.

Now fast-forward to the present day and the secure property income fund has GBP5 billion of external money, again at decent margins. And better still, the life fund has been able to withdraw its seed capital and re-deploy it elsewhere, having already made a good return. You can see that as an asset owner we are well placed to understand the needs of institutional clients and even to anticipate them through our asset management business. Many third party clients also like the fact that we have skin in the game.

Co-investment into new strategies is growing in popularity. My third example is our Impact Financing Fund, which was jointly developed with Mistra, a Swedish environmental organisation and Big Society Capital, a finance house with a strong social mission. Both partners contributed seed capital to complement money from the life funds for a thematic strategy that goes beyond standard ESG.

Now, what does our asset manager and asset owner combination mean for earnings? So take a look at the bottom right section of this slide. My first point here is that our differentiated investment capabilities mean that we are very well placed to grow the earnings from our asset management business. Demand for high value-added savings and investments solutions is strong and growing. We have a proven record of meeting this demand.

Second, you can expect a more resilient flow of earnings than you would from a pure asset manager. The source of our revenues is diverse, including a long-term stable cash flow. The high, but cyclical fee income from asset management is smoothed by the long-term earnings from the Heritage book and the growing store of value from PruFund. Third, we retain upside potential from the optimization of the capital in our Heritage book through management actions such as asset trading.

So let's look now in more detail at the sources of our competitive advantage. What I want to hammer home here is that this unique combination of businesses gives us multiple sources of competitive advantage, and those advantages enable us to create sustainable value for shareholders at scale, internationally and repeatedly.

First, there is the breadth and depth of our active investment capability. It's why we are one of Europe's largest providers of multi-asset solutions for retail customers. Second, we have a private assets franchise of scale, which has grown by 36% since 2015. Demand for private assets remains strong and profit margins are resilient. Third, we have a unique proposition in PruFund.

Now at GBP50 billion, only a group like M&G could create such a proposition on this scale. PruFund requires a combination of strong balance sheet, insurance expertise, first-rate active investment management, good distribution and a trusted brand. And you need a with-profits fund of scale. At GBP144 billion, our with-profits fund is the largest in the UK by some distance.

Now, Clare will take you through the mechanics and financials of PruFund a little bit later. And fourth, we have built an international footprint for distribution over the past 15 years. We already have critical mass in Europe, with GBP50 billion managed on behalf of retail and institutional clients, and our international network is growing steadily, with new openings in the US and Australia this year. These competitive advantages position us well for the future.

First, the depth of our investment capabilities across M&G's asset managers is central to our strategic asset allocation in the with-profits fund. One of our many great opportunities is to take this proven approach to asset allocation and make it available to more customers, both at home and internationally. That can be through PruFund in Europe or broader investment solutions in other markets.

Second, the scale of our private assets franchise, backed by capital of the with-profits fund, means we can move quickly to acquire assets of size when value opportunities surface. For example, we are about to take advantage of a temporary weakness in the commercial property market to acquire a major office redevelopment here in the city.

And third, demand for PruFund gives us an opportunity to sell other propositions. Remember, PruFund sits on our proprietary platform, advisors have to come to us for it. At the start of the year, we launched PruFolio, which also sits on this platform. It is a range of risk-adjusted fund options for advisors that combines PruFund with M&G's mutual funds.

It has already attracted more than GBP1 billion in gross inflows. And finally, we have a distribution footprint, which is the springboard for international growth. Our international business already accounts for roughly 20% of our total assets under management and generated revenues of over GBP350 million last year. And let's not forget our brands, two of the strongest in our industry.

We announced at the half-year that when we list our shares, it will be under the name of M&G plc. It is a brand we can use globally and enables us to avoid confusion with the other corporate Prudential's. The launch of our new corporate identity will take place at the point of demerger. And today, we are just previewing it. We are, of course, keeping the Prudential brand for our retail savings business in the UK and Europe and for asset management in South Africa. M&G Investments remains our brand for asset management globally.

Now, let's look at how these competitive advantages enabled us to create sustainable value in the recent past, and how we plan to keep doing this, but at greater scale and at pace. This slide shows three of the key savings and investment franchises over the past ten years. PruFund we have already touched on. I am sometimes asked about the capacity of PruFund. Surely, there must be some constraints on its growth. The truth is that we see no real investment constraints to the future growth of PruFund. In fact, greater scale opens up a wider universe of investable opportunities, including asset sizes that many others can't easily digest.

In the middle, you see the 400% growth in our international retail asset management business over the last 10 years, as we have deepened our presence and expanded our offering in Europe and further afield. And on the right is the 300% growth in third-party institutional client assets over the same period. Growth of this type is in our DNA. Demerger gives us the opportunity and means to scale and accelerate this successful approach to growth. Along the way, we will create sustainable shareholder value.

When we met last, I talked in some detail of the supportive economic and social forces for our business. Aging societies, the widening savings gap and the vast amounts of money sitting idle in cash. You know this. So, I won't spend further time on it. It is enough to say that the wind is at our backs.

Instead, I want to talk about the four principles behind our growth strategy and where we will apply them. Principle number one is that we will leverage our existing capabilities. We already have most of the right capabilities and people here at M&G. And when we identify opportunities requiring new capabilities, we have developed our own.

Principle number two is that our growth plans will be capital efficient for shareholders. You, shareholders, entrust us with the good use of your capital. If we can't find an efficient use for your capital, then we will return it. The third principle is that we will pursue only profitable growth. There will be no loss leaders or dash for market share simply for its own sake. And principle four is that we will always be responsible investors. In line with our core value of care, we have a duty to all stakeholders to invest in this way.

Our immediate focus is to apply these four growth principles to key areas of our business. One strand is the continuing development of our investment capabilities to underpin further growth of our high-value added savings solutions. The other is an expansion of our customer proposition and an extension of our distribution so that we can serve more clients, both in the UK and internationally.

On this slide, you can see how we will keep the investment engine tuned. Our high-level priority here is to leverage M&G's in-house asset allocation capabilities to produce a wider set of outcome-orientated solutions for a wider set of clients. In short, more of our expertise in the savings portfolios of more customers, in more markets. In order to address this, we will focus on two areas.

First, to satisfy client demand for private assets, we will add to our origination capabilities by building teams who can source assets locally, both in the US and Asia. This will be through a combination of hiring local people and transfers from London. We have already moved a couple of private debt experts from here to Singapore.

Second, we want to strengthen our offering in public assets in regions which are important to our clients. So, we are gradually developing a hub and spoke model for investment and research teams. Now an important step here was the hire earlier this month of a seven-strong Asia Pacific equity management and research team, most of whom will be based in the region.

And when it comes to distribution, we have three immediate priorities. First, for UK retail customers who typically deal with us under the Prudential brand, we will use the pull of PruFund to broaden our proposition, while also improving the digital experience. Second, for our international retail customers, our aim is to leverage our existing local presence, particularly our critical mass in Europe, and our strong relationships with private banks. And third, for institutional clients, we will expand our proven partnership model by providing more on-the-ground support in key regions.

We see major scope for growth in many of our chosen markets as pension schemes open up to higher value-added strategy. Also, European insurers are looking to outsource investment management as Solvency II bites.

So to ensure we generate attractive returns for shareholders, we need our organization to be in top shape, and that's where transformation comes in. This investment of GBP250 million of shareholder capital is not just about creating efficiencies and reinvigorating our Heritage business, it also aims to give us a scalable, operational platform to support our international growth ambitions, and improve the experience for all of our customers. And we remain on track to deliver annual cost savings of GBP145 million by full-year 2022. So, that's our growth story.

I would like to finish by touching on the primary financial target for our business and on our approach to dividends. So, we want to offer a good balance of growth and cash. Shareholders tell us that capital generation is critical for them, and so this is the keystone of our financial plans. We have agreed with the Board a three-year cumulative capital generation target of GBP2.2 billion after interest, corporate center costs and tax. This capital generation will underpin our dividend policy.

There are four main elements to our policy. First, we will seek to pay a stable or increasing dividend in absolute terms over time. Second, we will be making two dividend payments a year, the interim one being set to one third of the previous year's total. Third, we expect our final ordinary dividend for 2019 to be GBP310 million, implying a pro forma total ordinary dividend of GBP465 million.

Finally, we will align the growth in the ordinary dividend to long-term progression of capital generation. Capital generation will underpin much of what we do. So, incentives for management will be primarily aligned with the target. Capital generation will determine 60% of the value of the executive directors' long-term incentive plan. And as you can imagine, I am going to be all over that. The remaining 40% will be driven by total returns for shareholders, bolstering alignment there.

Now before I hand over to Clare, I want to summarize the investment case for M&G. We have a unique and compelling business mix at M&G. We are both an asset manager and an asset owner. This business mix enables us to create sustainable value in ways that our competitors struggle to match, such as PruFund. It has allowed us to focus increasingly on high-value added savings and investment solutions where the demand is strong and profit margins resilient.

We have a proven record for growing high-value savings and investment franchises at home, and internationally, repeatedly. It is in our DNA. Our strategy is to focus on sustainable and organic growth, with our customary discipline on capital. We are leveraging existing capabilities and we are getting on with it. World structural trends are on our side. Aging societies and the search for yield would create huge opportunities for us for many years to come. And all of this enables us to offer shareholders an attractive total return profile as we balance capital discipline with profitable growth.

Personally, I am incredibly excited by the demerger. It opens many doors for us. Customers, colleagues and above all shareholders should benefit enormously from this.

Thank you. And I am now going to hand over to Clare.

Clare Bousfield {BIO 16746072 <GO>}

Thank you, John, and good morning, everyone.

Now to the numbers, which I have been waiting for -- which I know you have all been waiting for. I will show you the key financials in a way that I hope you will find helpful and transparent. This will be our approach as an independent company. I am going to cover four areas today. Firstly, an overview of the first-half results showing new segmentation, which I will do quickly since you have already seen the Prudential plc disclosures. I will also give you an update on the outlook.

Secondly, a deep dive on the PruFund, both from a customer and a shareholder perspective. I will answer some of the key questions that you have asked. Thirdly, I will cover capital generation. As I said last time, capital generation is absolutely fundamental to this Group and is the primary management focus. I will guide you through the day one balance sheet and the key drivers of our capital generation, and then I will conclude with the strategy for financial management as a listed company.

So to the first-half results. Performance has been resilient despite the economic and operating environment, which is difficult, particularly across the asset management industry. Being an asset owner and an asset manager gives us diversity to maintain strong earnings despite particularly volatile market conditions. Assets under management were in the first six months, but lower than the same period last year, which resulted in lower asset management fees. With a stable asset management cost base, this translated through into lower operating profit for the Savings & Asset Management segment, despite the growth in the PruFund result.

The Heritage adjusted operating profit remained strong across the board. All of this was achieved while we remain focused on executing our merger and transformation program. John has reminded you of the benefits from this program. We remain on track to deliver the GBP145 million of shareholder cost savings by 2022 as planned.

Solvency was 170% on a pro-forma basis at 30th of June, in line with our initial guidance. Since June, the solvency position has been impacted by market conditions, particularly interest rates, but remains at a comfortable level and well within our risk appetite.

Next to the segments. As John mentioned, our Savings & Asset Management segment houses all the lines of business open to new customers and is a key growth area. It includes all of our retail and institutional asset management business and our savings business.

Our savings business consists primarily of the PruFund but also other open businesses, for example our international savings and insurance branches. The Heritage book is closed to new customers, but is expected to be strongly cash generative for many years to come. The main drivers here are the portfolio of shareholder annuities and the traditional with-profits book.

Moving on to the financial performance. Assets under management were up 6% from the year end to GBP341 billion at the end of June, mainly a function of positive market developments. However, retail investor sentiment remains poor in the current macroeconomic and political environment and net client flows have been challenging, particularly in our retail asset management business.

In this environment, the PruFund demonstrated its resilience once again, even with the sharp contraction in the DB pension transfers across the industry, net client inflows were GBP3.5 billion, helping to drive assets up 15% over the first half to almost GBP50 billion.

The following slide shows the key drivers of the earnings by segment. For our Savings & Asset Management segment, PruFund earnings continued to grow strongly. The earnings from the PruFund proposition are back-end loaded, which means they are still relatively low in absolute terms.

Operating profit on asset management reduced, reflecting the market environment. Heritage was close to flat, despite a one-off recovery from our professional indemnity insurers last year. That is driven by continued underlying profitability, together with a release of GBP127 million for longevity, reflecting the impact of implementing CMI17 and reflecting current experience. Finally, you will see the corporate center costs increasing, as we have previously indicated, due to the build-out of the corporate function ahead of the listing.

Now to the sources of our earnings, starting with Asset Management. You will see that actually the fee margin is stable at 39 basis points, a good achievement within an industry context. Our expenses were also broadly stable in absolute terms. However, the revenue impact of the lower average assets under management resulted in a lower adjusted operating result and a higher cost-income ratio.

Breaking that down between Institutional and our Retail books, our Institutional business has continued to perform strongly. Flows were slightly negative in the period, due to, in particular to one relatively large mandate. But as John spoke to, we are excited about this business and we have had some substantial mandate wins so far in the second half. Fee margins remain very resilient, reflecting our continued focus on value-added solutions for our clients.

This strong performance in Institutional offsets what is still quite a difficult market in Retail Asset Management. Here, we have felt the industry-wide pressure on fees and the flow picture remains challenging, with investor confidence undermined by the various geopolitical issues. Fund performance has remained good over the longer period, though on a small number of funds, shorter term performance has been weaker, and needs to be improved. This is something we are actively focused on.

Flows across the industry were very weak in quarter four 2018. We have seen a slightly better picture in 2019, but still net outflow. The trend so far in the second half remains quite similar to the first. However in our view, this is cyclical rather than structural. John spoke to the strongly supportive fundamentals and the customer needs within the markets we operate, and the initiatives we are executing, which we expect will generate substantial inflows over the medium term.

PruFund, our leading modern With-Profits proposition, has proven its resilience once again. It's delivered strong positive net flows in the first half, despite the well-known contraction in DB transfer activity across the market. This growth and the increasing maturity of the previously written business, has driven shareholder transfers higher. Overall, operating profits were up 26% for the With-Profits business, in the Savings & Asset Management segment.

Our Heritage With-Profits business, which is primarily invested in the same With-Profits Fund as PruFund, also continue to perform well. Though this proposition is close to new customers, market performance drove assets under management higher over the first six months, and the adjusted operating result also grew. The shareholder transfers before the impact of hedging was stable, as we expected.

Lastly, the shareholder annuity and other earnings within Heritage; here you will see quite a stable result, from the return on excess assets and the margin releases. Although the margin releases have decreased due to the Rothesay transaction, this was compensated by good returns on the excess assets.

Looking at the more volatile sources of earnings, the results from asset trading and optimisation fell somewhat, with significant optimisation done following the implementation of Solvency II, we expect this line to remain positive, but a lower level than in the past.

We booked GBP127 million credit in respect to longevity in the first half of this year, resulting from the adoption of CMI '17. We would normally do such adjustments at the year end, but since we announced the ambition to complete the demerger in the fourth quarter, and hence on the basis of the first half balance sheet, we felt it was appropriate to review the experience earlier in the year.

Having made this adjustment now, we would not expect further material developments on longevity in the second half of 2019, unless experience deviates materially.

Last year, we had a recovery from our insurers in respect of the costs of the FCA's review of past annuity sales or TRASP, of GBP166 million, which by its nature is one-off and was not repeated this year. Overall on TRASP, we continue to hold a provision of GBP400 million. We are aiming to complete the work before the end of the year, at which point we will have final certainty on the numbers, including any financial penalty that we may agree to, as a result of the FCA's enforcement investigation.

Finally, there is an improvement in the other result of GBP69 million in the first half. This is mainly due to various positive one-offs, of which GBP29 million was in respect of changes to the staff pension schemes. I'd therefore not expect this line to be as high in the future.

And then finally on to our IFRS results and our outlook going forward; in our Savings & Asset Management business, we expect fee margins in institutional to remain resilient, given our increasing focus on value-added solutions for our clients.

On the other hand, Retail fees are likely to remain challenging across the industry. While the flow picture also remains difficult for now in Retail, we are excited about the long-term opportunities that our growth initiatives will bring. And in Institutional, while the first half was uncharacteristically weaker, as I said, we have seen significant mandate wins into the second half of this year.

For With-Profits, driven by PruFund, shareholder transfers should continue to grow, due to the continued rapid growth in the size of the book and the back-ended profit profile. Within Heritage, as I told you in July, we expect With-Profits transfers to remain broadly stable for the next years.

On the annuity business, I will show you when we come to capital generation, the long run-off profile of the book. We are expecting only a gradual decline in underlying earnings power over time. The main uncertainty in the future is in relation to longevity.

Finally, the corporate centre, which has two main expenses; interest costs and the head office costs. We expect head office costs to be in the GBP80 million to GBP100 million range. The coupons on the GBP3.2 billion of debt, which we expect to be transferred from Prudential plc, will be around GBP190 million per annum post demerger.

I have also repeated here the chart that I showed you in Singapore last year, which illustrates the prospective shareholder transfers from the With-Profits business. This chart is based on the economic conditions at the end of June 2019. There are three key components. The first is the book of traditional with-profits business and this has a long run-off profile. As you can see, the shareholder transfers decline only very slowly over the next decade, despite the book being closed to new customers.

Secondly, the PruFund business already on the balance sheet will generate increasing transfers over the next years. And then finally, to help your modelling, we have shown shareholder transfers on a range of new business scenarios, of GBP5 billion, GBP10 billion and GBP15 billion of annual gross inflows as compared to the GBP5.5 billion we wrote during the first half of this year.

To wrap up on IFRS, it is also worth touching on longevity again. As I mentioned, we are not expecting further developments in the second half. We'll continue to observe and model carefully mortality improvements. This chart shows you the recent trends and improvements year by year, which have reduced, on average, over the last few years. This trend has driven our reserving lower. However, as you can see, there is some volatility. In fact so far in 2019, mortality improvements have been strong. This is exactly why we take a cautious approach.

Now to the second section of my presentation, the deep-dive on PruFund. We have talked about PruFund before, and it's clear from the feedback after our events in July that many of you would like to deepen your understanding. I recognize that the next few slides are quite detailed, but there are two simple things to keep in mind.

Firstly, from a customer point of view, PruFund looks in some ways much like any other investment fund. There is a daily price for the fund value and there is an annual management fee charged to the fund. The key difference is what our customers are investing in. Our with-profits fund, with its enviable performance track record, its smoothing mechanism and its powerful financial strength. Secondly, for shareholders, PruFund is a unique proposition strategically, and is the anchor product for our broader offering. It is a growing source of capital-light earnings.

Last time, we covered the breadth of the with-profits fund strategic asset allocation and the historical performance it delivered. Today, we'll focus on the mechanics of the PruFund and how they work from a customer, with-profits fund and shareholder perspective.

Before we start looking at some worked examples though, I want to share with you a brief video we make available to our customers. Seeing the proposition from our customers' perspective will help you better grasp PruFund's financial mechanics as well.

[Video Presentation]

I hope you enjoyed the video. I believe it's very powerful in the way it clearly illustrates the diversification and the smoothing benefits of investing in the PruFund.

When considering an investment in the PruFund, either through an independent or one of our PFP advisors, customers need to make three important decisions. Firstly, the choice of the wrapper, as PruFund is a multi-wrapper product, available through retirement accounts, ISAs, or on-shore or offshore bonds.

Secondly, what is the right risk profile? The final choice concerns the opportunity to select a guaranteed option to safeguard the principal invested or the income. This option, initially generates a lot of interest from customers, but it has not seen a significant take-up rate in recent years, due to its cost in a low interest rate environment, and the strong, consistent long-term performance of the With-Profit Fund.

Recent experience is that less than 1% of our customers decide to take the guarantee. Expected growth rates vary both by wrapper and risk profile, and the level is reviewed on a quarterly basis by our With-Profit Directors, taking into account the expected long-term returns of the underlying portfolio of assets backing the fund.

The product, wrapper and any guarantee charges, are also applied daily and deducted from the expected growth rate. The With-Profit Fund receives the charges from our customers, and credits the expected growth rate for short EGR to each of our customers. The shareholder receives no benefit until the customers withdraw some or all of their funds. There is one other element that affects our customer returns and that is the so-called unit price adjustments, which can either be up or down.

To explain what unit price adjustments are, we need to take a step back, and talk about the smoothing mechanism that makes PruFund so unique. As you can see in the illustrative example on the slide, when a customer purchases PruFund, the price our customer pays is the smoothed unit price, which entitles them to a share of the ownership of the diversified pool of assets, underpinning the fund's strategic asset allocation.

We also calculate an unsmoothed price, which corresponds to the market value of the underlying assets. The unsmoothed price can be higher, lower, or identical to the smoothed price, but it's not visible to our customers so as to remove any opportunity for arbitrage. The smoothed price fluctuates on a daily basis with the markets -- sorry, the unsmoothed price fluctuates on a daily basis with the markets.

The smoothed price grows with the expected growth rate after deduction of the annual management charges. This is the smoothing process that our customers value as it removes short-term moderate volatility in their policy value. It is made possible because the with-profits estate absorbs any positive or negative differences between the smoothed and unsmoothed price were any customer to exit.

Nevertheless, in periods of particularly strong market movements, the unsmoothed price can move above or below the tolerance limits. Whenever this happens, the smooth price is adjusted up or down to bring the unsmoothed price back into the tolerance band. This is what we call unit price adjustments.

On this slide, you can see some real life examples. For instance, we had a series of downward adjustments in the aftermath of the global financial crisis followed by several upward ones. This chart highlights another crucial point worth repeating. The PruFund proposition is not just about smoothing. It is also about access to our unique with-profits fund, which includes the investment expertise, scale and diversification. This has resulted in exceptional and consistent investment performance over the longer term.

So far, all of the dynamics we have talked about purely concern our customers in the with-profits fund. It is the fund that pays the returns to our customers and our customers that pay the fees to the fund. So where does the shareholder come into our picture? It does so at the point of withdrawal. Whether customers withdraw all of their funds or through regular instalments, the shareholders are entitled to a cash transfer, equivalent to one-ninth of the investment returns, net of fees generated for our customers.

Under normal market assumptions, longer holding periods allow the generation of greater returns through the compounding of the expected growth rate. This increases the transfer to the shareholder, as well as to our customers. It's important to remember, that the transfer is not netted off our customers returns at the point of withdrawal. Instead, like all other expenses of the With-Profit Fund, its paid out of the annual management charges, which the fund has previously levied on our customers.

I will now move from a single customer example, to a simple illustrative cohort representing, GBP10 billion of inflows, roughly the annual average we have seen over the last couple of years. On the left, you can see the purple line illustrating an example lapse profile for a cohort of customers over 30 years. On withdrawal, customers receive the investment returns, in orange, on top of the principal in light blue. Taking as an assumption, a 5% expected growth rate, the cumulative, undiscounted, net investment returns generated by this illustrative cohort, are expected to be around GBP7.5 billion. This would therefore result in a shareholder transfer being around GBP830 million, being one-ninth of the net investment returns. If we were to assume a 5% discount rate, the net present value of the shareholder transfer would be around GBP340 million. Solvency II requires us to consider the risk neutral scenario, in which investments only grow at the risk free rates, but also where the shareholder transfers are discounted at a risk-free discount rate.

Taking our illustrative cohort and applying these assumptions, the cumulative undiscounted shareholder transfer would be around GBP75 million in current market conditions, and the present value at around GBP55 million. The present value of GBP55 million is recognised within the Solvency II Own Funds as value on day one. At the same time, a solvency capital requirement is generated, to cover the risks associated with the underlying PruFund assets, to which the shareholder is now exposed.

The present value of future shareholder transfers, less the corresponding capital requirements, normally creates a small new business strain on day one. It typically corresponds to 1% to 2% of the PruFund inflows. The size of the strain is sensitive to prevailing interest rates. As time goes by, the own funds increase, as the discount rate unwinds and real market returns returns replace risk-free. Any transfers paid to the shareholders in the meantime does not affect the own funds, as it effectively converts the present value of shareholder transfers into cash. While own funds grow, capital requirements decline progressively, as the present value of shareholder transfers converts into cash, thereby reducing the shareholders' market exposure.

I hope this makes the mechanics of the PruFund clearer. The PruFund has significant financial value and is a great strategic asset. This slide summarizes the mechanics for the three stakeholders. I won't go through it now, but it's there for your future reference.

So now, I want to get to the most important part of the presentation, capital and capital generation. This slide shows you the pro forma capital position. On demerger, we will inherit debt from Prudential plc and in return, distribute a dividend back up, essentially swapping equity for debt. The two amounts, combined with other closing adjustments, more or less offset each other to give a pro forma solvency ratio at the end of June of 170%.

The actual solvency ratio at the time of demerger will depend on other factors, including accrued earnings and market movements. One effect that is not in the pro forma balance sheet is the demerger-related dividend of GBP100 million we intend to pay in addition to the final ordinary dividend in May next year. This is a one-off top-up to reflect the fact that we were operating without debt interest and other central costs for the majority of 2019.

One final point I'd note is the recent court decision to not sanction the Part VII in respect of the transfer of annuities to Rothesay . This has a very limited capital impact. The long-term reinsurance arrangement between ourselves and Rothesay remains in place. Therefore, the majority of the economic risks and rewards remain transferred.

The only financial consequence for us is that around GBP100 million of counterparty credit risk relating to the reinsurance contract, which is already in the capital requirements at the first half, will now not be released. We have, however, decided to appeal the judgement.

This slide sets out the structure of our pro forma balance sheet. The own funds of GBP9.6 billion after the transaction will include the debt transferred. We calculate a leverage ratio based off the nominal value of the debt as a percentage of total own funds, which is 34%. Within the Own Funds, is a benefit of GBP1.7 billion from the Solvency II transitional measures known as TMTP. In our case, this is more than offset by the risk margin.

For both Own Funds and capital requirements, we have shown the With-Profit present value of shareholder transfers separately. This is not related to the With-Profit Fund itself, where the capital and the capital requirements are ring-fenced.

Now on to the capital generation framework, we define capital generation as the movement between the two Solvency II balance sheets. The drivers are different to IFRS earnings, as this slide sets out, although the actual amounts are similar.

This chart shows you the movements in the Own Funds and capital requirements for the full year 2018 and the first half of 2019. The analysis of the movements is similar to the embedded value disclosures historically used by the industry. As you can see, the main driver is operating capital generation. Economic variances didn't have a significant impact in 2018, though they positively contributed in the first half of 2019. These movements are all before tax, which is shown separately.

Finally, we have capital movements, which in 2018, reflects dividends paid to Prudential plc. In the first half of 2019, the amounts shown also include intra-group loans converted into dividends.

This slide shows you in detail, how the operating capital has been generated for the full year 2018. The underlying capital generation, being the expected surplus from the in-force and the new business, is on the left. On the right, you see the impacts of the more volatile items, which we include in operating capital generation.

Starting with the underlying on the left, in the Savings & Asset Management segment, the capital generation for the pure asset management business is accounted for here simply as the IFRS earnings. There are some minor differences in the actual capital recognition, but these are typically small timing differences, which we have put into variances for simplicity.

We'd normally not expect capital requirements to move around significantly for the asset management related business, though you will see there was some movement last year, as a result of increased costs.

For With-Profits, i.e. the PruFund, we've shown the in-force contributions separately from the new business. The in-force contribution comprises the Own Funds element, which is essentially the unwinding of discount and the growth due to the expected real world returns in excess of risk-free. There is a small increase in the capital requirement for the in-force business. This is mainly due to the run-off of the hedging program over time. The benefit of any future new hedging program we put in place will be booked as a management action in other operating capital generation when it is put in place, and then likewise, the run-off of the benefit will be included within the underlying capital generation.

The new business contribution is negative for the reasons I described before around how PruFund works. In the current interest rate environment, the capital requirements are larger than the own funds, creating a net strain. We have mitigated some of this net new business strain with an internal hedging arrangement between the shareholder and policyholder funds. The numbers you see here are net of this mitigation. In the Heritage book, the with-profits business behaves in the same way as for the Savings & Asset Management.

Again, the increase in capital requirements is impacted by the natural run-off of the hedging program we have in place. The shareholder annuity book is a strong contributor, with own funds generated from the income on surplus assets and the credit spread earned on assets, backing the best estimate liabilities.

The book is releasing capital requirements as the portfolio runs off. On the right-hand side are the other sources of operating capital generation outside of the underlying. And these should be quite familiar to you, as they are similar to the IFRS impacts you would have seen in 2018.

For the first half of 2019, the underlying capital generation looks proportionally similar to 2018 in total. Asset management was higher without the increase in capital requirements in 2018, while with-profits was lower, due to the lower level of future shareholder transfers, mainly driven by lower levels of equity markets at the beginning of the year. Other operating capital generation amounted to just under GBP300 million, roughly evenly split between the longevity release, portfolio management actions and other items.

Focusing now on the annuity book. Over the next few years, we expect the emergency surplus capital to remain at healthy levels. The chart shows you quite a gradual decline in the capital generation, before there is a spike up in 2032, as the amortization of the transitional measures comes to an end. The line excludes any potential further longevity developments or management actions.

It's interesting to compare the annuity portfolio to the debt. The last call day on the GBP3.2 billion of debt we expect to inherit from Prudential plc on demerger, is in the year 2048. The annuity book alone will generate more capital and cash, than is needed to repay all of the debt we have outstanding, with interest. And to repeat, that's even assuming no further longevity developments or other management actions.

In terms of cash flow, subject to the entities remaining appropriately capitalised, we typically expect to pay most, if not all, of the capital generated by the operating companies up to the HoldCo, in the form of dividends. Our holding company's own costs and interest payments on debt can be also more or less considered cash. Therefore our measure of capital generation should be close to the actual cash flows of the HoldCo.

Having been through how the Group will generate capital, I want to finish by giving you an idea of how we are thinking about deploying that capital over time. Capital generation is a core focus for us, and the most relevant measure by which John, myself and the senior leadership team are compensated. Our target, which we will be measured on, is to generate at least GBP2.2 billion of capital over the next three years to 2022.

There are essentially four things we could consider doing with this capital, with the action we'd take depending on how we see the situation and the opportunities at any particular time. These include, strengthening financial metrics, paying ordinary dividends, investing in the business or a distribution through an extraordinary return to shareholders.

To put that GBP2.2 billion in context of our recent financial performance, this slide shows you how it compares to the run-rate of the underlying capital generation. Over the 18 month period ended 30 June, underlying capital generation was GBP1.4 billion. So pro rata for the three year period, this would imply GBP2.8 billion of underlying capital generation. However, from next year, we will be bearing full annual interest and head office costs of GBP190 million and GBP80 million to GBP100 million respectively, as I spoke about before. After tax, that means a pro-forma equivalent, over a three-year period, of GBP1.6 billion. So from that basis, we'll need to grow underlying capital generation or create management actions of another GBP600 million, to achieve the mid-point of the target range. And because of the inclusive definition of capital generation, it means we will also need to compensate for any unexpected bad news, for example, adverse market movements.

Now to our financial flexibility over solvency, debt leverage and liquidity. As we announced last year, we targeted an initial solvency position of 170% based off market conditions at the time. This is a comfortable level given the nature of the risks we are taking.

The vast majority of the capital requirement of the Group arises from two sources; the annuity book, and the capital requirements we hold against future shareholder transfers, expected to emerge from the with-profits book. Our internal risk appetite framework defines the theoretical level at which we'd consider taking actions to defend and restore solvency.

But in practical terms, we will actively manage the balance sheet before we get there. For example, we proactively increased interest rate hedging over the summer, despite being far away from the risk appetite level. We will also consider debt leverage. We believe that the best measure of debt is debt as a percentage of total own funds, as I showed you before, as it's a simple economic measure for the business, which also appropriately represents the with-profit fund. The starting ratio is 34%, which we are very comfortable with, though, we will be aiming to gradually reduce that over time.

The last measure is liquidity. We look at this in terms of the parent company's stock of liquid assets in relation to expected outgo, including dividends over a one-year time horizon. On average, we are aiming to keep a liquidity buffer of at least one year's worth of parent company outflows, including dividends.

Assuming our forward-looking view of financial flexibility is adequate, then we are committed to paying attractive dividends. We intend to pay two dividends each year; an interim dividend, which will be mechanically set at one third of the previous financial year's total dividend and then a final dividend.

As you may have already read in the prospectus, the Board currently expects to pay a final ordinary dividend to our new shareholders in May next year of GBP310 million. This would be in line with the final dividends we'd have expected to have paid if we had been operating independently for the whole of 2019. Based on the one third and two-thirds policy I just mentioned, you can think of around GBP465 million as being a reasonable pro-forma in respect of the full-year 2019, which we think is an attractive and sustainable starting point.

We want to keep the dividend stable or growing over time, and the average growth rate over the years should be linked to our ability to grow capital generation. If you cast your mind back to July, we told you about a number of growth initiatives, which we have begun to execute on. The benefits of these will take a little time to come through, and therefore, we expect the growth rate of the dividends from this starting point to be lower over the next couple of years or so. We then expect it to accelerate, as the additional capital generation from these initiatives emerges.

Apart from paying dividends, we would also deploy capital to grow the business, where it is attractive to do so in a highly disciplined way. Whatever the call for investment there might be, we will only deploy that capital, if we are absolutely convinced it's strategically the right thing to do, and where risk adjusted financial returns are attractive.

As John said earlier, we will be very disciplined about returning capital, if we find ourselves in a position of excess financial strength, and there are no attractive opportunities to invest in the business. However, I do not envisage, we would be in that position in the short term.

So that wraps up the session. The message I really want you to take away from today, is that capital generation is absolutely fundamental to this company. The key measure of value creation and the measure that myself and the rest of the management team are absolutely focused on. I also hope that you have picked up a clear message that we will be deploying that capital in the most value creative way possible, be that through improving financial flexibility if needed, investing in the business, maintaining a highly attractive ordinary dividend, or making additional returns of capital on top of that, if that's the right thing to do.

We are well positioned to capture the opportunities to grow the business, and grow capital generation, driven by our unique business model, our investment capabilities and our distribution footprint. As John has shown you, we have a successful track record of leveraging these strengths, to build franchises like the PruFund, our Institutional Asset Management, or our International Retail business.

Thank you, and now I will hand back to Spencer.

Spencer Horgan {BIO 4241901 <GO>}

Thank you, John. Thank you, Clare. So we have got the Q&A session coming up next. But before we do that, we will take a quick break for coffee. So if we could take about 20 minutes please and be back in here just before 11:30. We'll see you back here.

Let's begin the Q&A session. We will run at the same time as last time, for those of you who are familiar with it. So we don't have the roving microphones. So if you want to ask a question, please raise your hand and then you will see there's a microphone in the seat in front of you. For the webcast, if you can press the button on the microphone to use it, so we can hear you. State your name and organisation and again, if we can keep it to two questions at a time, that would be appreciated.

So with that, who wants to go first? Colm?

Questions And Answers

Q - Colm Kelly {BIO 19140684 <GO>}

Thanks a lot. It's Colm Kelly, UBS. And can I just ask questions around the regulatory Solvency II ratio? I think 139% was the number for the half year. Are you able to give any update on where that is today? And you also talked about appropriate capitalization risk appetite levels. Can you give detail on what that risk appetite level is on a regulatory solvency basis, and the level at which cash distributions could be impacted?

And on the underlying capital generation targets, it is implying, I suppose flat, underlying, capital generation going forward versus what has been experienced in the last 18 months. Is that just due to prudence? Should I look at that as an outlook metric for growth? And is that implying that we are likely to see a flat dividend coming out, given that the dividend is linked to the capital generation progression?

And also, on the pay out ratio, if we look at the net underlying capital generation and compare the dividend, it is implying a payout ratio of about 95%. Can I just understand the thinking about that payout ratio in the context of a business with quite sizeable annuity and credit book, and with a regulatory solvency of a bit below 140%? Thank you.

A - Clare Bousfield {BIO 16746072 <GO>}

So Colin, you didn't --

A - John Foley {BIO 4239156 <GO>}

That was four.

A - Clare Bousfield {BIO 16746072 <GO>}

That was four questions rather than two. But anyway -- so from a solvency position perspective in terms of giving an update, the update from a solvency perspective, if you look at the sensitivities in the appendix, it will show you the sensitivities from a shareholder perspective, and then in July, we gave you the sensitivities on a regulatory basis. The market, if you just effectively translated that particularly around interest rate, you should get a pretty good view of where the solvency position is today. So there is nothing else unusual in terms of what we look at. We are obviously monitoring that very closely given the volatile market conditions.

From a risk appetite perspective, we are well above the risk appetite level. So, we are comfortable with the position in terms of where we sit today and we don't have any restrictions around, or we are not close to any point where from a dividend perspective. In terms of capital generation, as I talked about in the proforma, that I showed in terms of how you would get to the GBP2.2 billion, you can see in there, we have included an amount around management actions. We are obviously incentivized to overachieve in terms of that GBP2.2 billion.

Historically, we have obviously delivered significant management actions, particularly around longevity and also asset optimization.The asset optimization was heavily driven by the implementation of Solvency II. Since I have guided the asset optimisation, I would expect it to be lower, but we still have significant opportunity, and obviously longevity developments are very uncertain. And then there are other management actions that we have around, whether it's hedging the equities, or from driving the underlying growth of the business.

So John showed a couple of slides up there in terms of the growth in PruFund, and the growth of both our retail and institutional book over the last 10 years. We are very comfortable there around the underlying growth, but obviously we are in quite challenging markets from a retail asset management perspective, in terms of being cyclical. So we see a lot of opportunities for growth. But in terms of the guidance over the next couple of years, yes, we are saying that we are expecting it to be more stable, and then the growth to kick in, into the later years.

From a pay-out ratio perspective, if you look at those numbers on the chart, in terms of the GBP1.4 billion versus the pay out, you are looking at a pay-out ratio of just under 70%, in terms of where we are at. We see the management actions that we take, as part of, effectively the job that we have to do, in terms of managing the business. So we think of it more in that pay-out ratio, rather than the looking at the underlying.

A - John Foley {BIO 4239156 <GO>}

And I'd just make one comment on the cap gen of GBP2.2 billion, because we have the Chairman in the room. I mean, we think that is a stretching target. If you look at, I think slide 62, how we adjust the three-year run rate, so the GBP2.8 billion and then the standalone, pro-forma corporate center costs, and the tax of GBP1.6 billion. You know that gives us a fairly hefty challenge to get up to GBP2.2 billion over three years. So that'sa meaty target.

Q - Colm Kelly {BIO 19140684 <GO>}

Can I just follow up, sorry, this probably means a fifth question. Of the 0.6 additional capital generation, is that expected to be cash or is it going to be capital, because clearly that's key for the dividend distribution?

A - Clare Bousfield {BIO 16746072 <GO>}

So it will be a combination of the two. But from a distributable profits perspective, we don't have any concerns around that in terms of the cash element.

Q - Colm Kelly {BIO 19140684 <GO>}

Okay, thank you.

Q - Johnny Vo {BIO 5509843 <GO>}

Its Johnny Vo from Goldman Sachs. Just two questions if I may, I know that you are comfortable with the leverage ratio as it is, but I guess over the long term, where would you like that leverage ratio to be, so we get a sense of deployment of capital? And the second thing, just from a starting balance sheet perspective, in terms of holding company liquidity today, or as you list, what would that number be? Thank you.

A - Clare Bousfield {BIO 16746072 <GO>}

So around the leverage ratio, you're right. We've talked about the 34% in terms of being very comfortable with that leverage ratio, and we have talked about the gradually reducing that over time. And the best guidance I can give you is to look at the call dates around the debt to give you some indication in terms of what we might be looking to do in terms of the longer-term objectives.

In terms of the liquidity from a HoldCo perspective, as I talked about in my presentation, the way that we look at that liquidity is effectively to make sure that we've got sufficient liquidity for the next year, taking into account the dividends. And we are comfortable that the level of liquidity that we would hold at the HoldCo is sufficient to basically cover that amount.

A - Spencer Horgan {BIO 4241901 <GO>}

Abid?

Q - Abid Hussain {BIO 20229932 <GO>}

Hi. It's Abid Hussain from Credit Suisse. Just two questions. So just coming back on to the earlier question on the debt leverage. What is the rationale of sort of starting out on listing with above average debt leverage and then having to pay that down? And could you sort of give sort of more clearer quantification of where you want to get it to, whether it is on the own funds, debt leverage basis, which is at 34%? Do you want that to go down to 30%, just so we have an idea? And can you quantify that, please?

And the second question is on the annuity transfer, the GBP12 billion. So, you are going to appeal the court process, but just wondering, even if at the appeal, you lose the court case, what are the ramifications for your unit costs on a longer-term basis, assuming you have to retain them?

A - John Foley {BIO 4239156 <GO>}

What was that last bit, Abid?

Q - Abid Hussain {BIO 20229932 <GO>}

So assuming, you have to retain the GBP12 billion annuity book on your own book, what happens to your unit costs? Do they gradually rise or do they -- are they variablized and do they sort of reduce over time?

Q - Colm Kelly {BIO 19140684 <GO>}

So on the debt leverage -- so absolutely, when we put out the guidance 18 months ago, the guidance was that our debt leverage would be around GBP3.5 billion. And as part of the final position, the debt is at GBP3.2 billion. So to your point around do we want the debt to be as low as we can, from a starting point, absolutely. And that's why we basically stuck at GBP3.2 billion rather than GBP3.5 billion. From my perspective, the annuity book has got very strong earnings, very strong cash, as I've shown in terms of the duration of the book, and that more than supports the debt levels that we have, plus the interest. So, we are very comfortable with the position as it is today in terms of the debt leverage.

From a Rothesay perspective, in terms of the unit costs, that is obviously part of the reinsurance, so the long-term reinsurance arrangement that we have. And as part of that, there is an amount in terms of the unit cost, in terms of what we will be charging to Rothesay. There are a number of different options in terms of how we can manage that, both in terms of them actually taking the administration or using a third-party to do it. So, we are very comfortable that those unit costs are appropriate.

A - Spencer Horgan {BIO 4241901 <GO>}

Dominic?

Q - Dominic O'Mahony

Hi, Dom O'Mahony, Exane-BNP Paribas. So just two questions; the first is, you pointed out the risk margin and the transitional relief are quite different numbers. I think there is about GBP600 million difference there. Some other insurers have looked to close that number at the conversations with the regulator, is that something that you are looking at? I notice that GBP600 million is the bridge you need to get to your GBP2.2 billion capital generation.

And second question is, on page 61, in terms of use of surplus capital, you didn't use the word acquisition, you might have thought that a fifth quadrant of your -- of the little square might have been bolt-ons. Have you deliberately said no, actually bolt-on is not part of our go-forward strategy or should I consider that within the -- investing in the business category? Thank you.

A - John Foley {BIO 4239156 <GO>}

I'll take that one. So do you want me --

A - Clare Bousfield {BIO 16746072 <GO>}

Yeah, do you want to do that?

A - John Foley {BIO 4239156 <GO>}

So, let's cover that one. Of course we've thought long and hard about it. We decided not to put it as one of the boxes, because it's a remote possibility, in our view. I never say never, as you would have heard me say before. But the reality is, that from our perspective, we build businesses, we create more value for shareholders by developing products and capabilities in-house, and we have done that pretty much in the last 20 years, since I've been here anyway. And we've seen that some of these opportunities don't often bring the fruits that are thought about in the first instance. So, I am not going to rule anything out, but it is remote.

A - Clare Bousfield {BIO 16746072 <GO>}

And then on risk margin and the TMTP, obviously because it's a closed book, we've probably got less drivers than others have, in terms of actually closing that gap. We are quite comfortable overall, in terms of where the Solvency position is. But clearly if there is an opportunity there to generate a better capital position, we would definitely look at it.

A - Spencer Horgan {BIO 4241901 <GO>}

Andrew.

Q - Andrew Crean {BIO 16513202 <GO>}

Its Andrew Crean here with Autonomous. I wonder whether we could get that slide 61 up, and just -- I just wanted to run through it. GBP2.2 billion, if you hold your dividend for three years, that will be a retention of just over GBP800 million. You've done the dividends in that top right hand box, you said return on excess capital is unlikely in the short term, so that -- does that box. You say that you are not going to repay dividends early, and the first call date is five years, so that's not going to cover that box, which means, you are not going to do -- or it is remote that you're going to do M&A, but you say you are going to invest GBP800 million in the business, that is hell of an investment. I wonder whether you could comment on that as a question? And then the second question, of the GBP5.6 billion of SCR, how much of that relates to the annuity business? And what's the annual rate of run-off of that and the with-profits Heritage book?

A - Clare Bousfield {BIO 16746072 <GO>}

So, obviously, in terms of being a brand new listed company, the Board and management, we took quite a long time to consider what the appropriate dividend policy was for the business. From our perspective, we wanted to balance all the different elements, whether it's investing in the business, driving attractive dividend returns, but also being able to have the financial flexibility to manage the business. So, market conditions and volatility are also an important part of it. Investing in the business, as I said, we would only invest in the business if we believed that we can generate sufficient, attractive financial returns in terms of what we achieve. And clearly reducing the debt leverage over time is also an element in terms of what we're looking at.

Q - Andrew Crean {BIO 16513202 <GO>}

But you're not going to do any debt in the next three years, you said that. You're going to respect the call dates and you also said that you've set the GBP2.2 billion up, having taken cognizance of volatile markets, GBP800 million?

A - John Foley {BIO 4239156 <GO>}

Yeah, but GBP2.2 billion is a target. If you look at the run rate, it is considerably lower than that. And as we've gone through these different boxes, I think we've been careful to point out what the issues are, what we face. And as Clare said, we are a new company, so we are bound to be a bit cautious. I mean this management team, if we hit GBP2.2 billion, we're not going to put our feet up either and say, well that's that job done, we will move on. So, it is a bit influx, but I suspect we won't be investing GBP800 million in the business unless one of those really off-the-wall opportunities arise that I don't expect.

A - Clare Bousfield {BIO 16746072 <GO>}

And the SCR, in terms of, I'm going to get Spencer to pull up the relevant chart. So, you can see there in terms of the SCR, the split between the shareholder annuities, yeah, and the capital requirements for the shareholders. So that makes it an easy question, Andrew?

Q - Andrew Crean {BIO 16513202 <GO>}

So to be clear, that's not purely annuity, that GBP3.8 billion, but, obviously, annuities is most of it.

A - John Foley {BIO 4239156 <GO>}

Yeah.

A - Spencer Horgan {BIO 4241901 <GO>}

John? Sorry.

Q - Jon Hocking {BIO 2163183 <GO>}

It's Jon Hocking, Morgan Stanley. I've got two questions, please. For your return target, does that suggest that you are long-term owners of that residual book? Or does that suggest you are long-term owners for the purposes of the target? So, can you talk about that a little bit please?

And then secondly, in terms of the deleveraging, if you didn't hit the GBP0.6 billion of target, would you be de-leveraging over the planned period? Can you talk a little bit about that, and do you know how crucial the deleveraging is over the three-year versus a longer time period?

A - John Foley {BIO 4239156 <GO>}

So on the annuity book, I don 't think I've really explained that one very well, over the time we've been talking about it. So I will just go back a bit, if I may. So when I first took over the U.K. business, I think I did it on day one, I stopped writing annuity business. The return on capital on Solvency II didn't seem to be adequate. So then it became a Heritage business overnight, and our decisions around it, strategically, shifted from growth, to what do we do with the book?

There were a number of considerations there; P&L, cash flow, impacts on the fund management business, because clearly, at that time there was a GBP35 billion book, and that would have been managed by M&G, so there would have been impacts there. And as we've discussed here, there would have been knock-on impacts in the M&G world, to their third party mandates, in terms of this symbiotic relationship that we talk about. So, all of that was in the mix. And we concluded at the time, plus the fact if you do go to sell a chunk of the book or the entire book, as you've seen, it's not that -- the outcome is not that certain.

So we have been -- the approach has been optimisation, as we've said. And if you fast-forward that decision to today, over that three and a half years, the profits generated on that book were close to GBP4 billion, which gives you a pretty healthy double-digit return on capital. That includes management actions and longevity releases of course. Plus, you've got the non-financial impacts of M&G managing the book and having the knock on effect with third-party customers. So John, my crystal ball is no better than yours, in the sense that I don't know what is going to happen in the future. But that is how we think about managing that book.

So I put it slightly differently, when asked the question before, about would we sell, what circumstances and so on. I don 't think it is a straightforward thing to do. But the way we think about the book is optimisation, and if we had have -- not that we'd have been able to, but if we'd closed that book off or sold that book three and a half years ago, those are the things we would have foregone, which I don 't think would have been smart. So that is the benefit of hindsight. And going forward, that's how we are thinking about that and the Heritage business generally. Okay.

A - Clare Bousfield {BIO 16746072 <GO>}

Just to check on your second -- so was your second question around what we would be looking to do, in terms of financially moving towards the kind of, debt over the period to 2022.

Q - Jon Hocking {BIO 2163183 <GO>}

[Inaudible Question].

A - Clare Bousfield {BIO 16746072 <GO>}

No, because we can't delever until 2024, because that's the first call date.

Q - Jon Hocking {BIO 2163183 <GO>}

[Inaudible Question].

A - Clare Bousfield {BIO 16746072 <GO>}

Yeah, correct. So clearly, if we didn't deliver the management actions, that would reduce our financial flexibility significantly, for some of the reasons actually that Andrew is challenging...

A - John Foley {BIO 4239156 <GO>}

Yeah.

A - Clare Bousfield {BIO 16746072 <GO>}

So yeah, that is exactly it.

Q - Andrew Baker {BIO 20402705 <GO>}

Hi, Andrew Baker, Citi. Two questions on PruFund, if I may. So, correct me if I'm wrong here, but it looks like the value to the client is really the access to the underlying fund versus the smoother mechanism, because the smoother mechanism sort of changes how you get to the ultimate return. But ultimately, the underlying return that the client receives net of fees, is close to the underlying asset returns. So how much of the sales pitch to clients, is tied to the smoothing mechanism versus the access to the underlying funds, is the first question? And then similarly, as you think about taking PruFunds to Europe, which markets are you specifically looking at and how does the PruFund product stack up with some of the existing products which have savings products that have guarantees and a smoothing mechanism of their own? Thank you.

A - Clare Bousfield {BIO 16746072 <GO>}

So on the first question, in terms of -- you are absolutely right, the underlying strength is heavily driven by the performance -- the investment performance of the fund, in terms of the consistency, but also the over-performances has delivered consistently over time. The customers do still value the smoothing mechanism, because if you think about the smoothing mechanism, it's not smoothing just within their returns, it's smoothing it across the portfolio. So they do get more benefit than just, if they effectively just smooth their own returns across that -- across their kind of individual policy.

In terms of PruFund in Europe, we are obviously exploring a number of different options across a number of different countries, in terms of what we are looking to do. But the structure of the product would be very similar to the way that we are operating in the U.K. One of the challenges, we would offer a guaranteed solution, but in the current interest rate environment, that's almost certainly not going to have any traction in terms of that piece. But the concept of the transparency in terms of having a unit price, rather than the more typical annual bonus that you would have seen in the old style U.K. products, which you also see in the more typical European products, we would look to effectively replicate more of what we have today, because that's the value of it. It's much more transparent than the old style With-Profit products.

A - John Foley {BIO 4239156 <GO>}

And look, we are working with our bank partners in certain markets in Europe on this to develop the next phase -- the next sort of iteration of PruFund, that will go well in that market. And those conversations have been going on for some time. And I would like to say we are close, but we have got to go through all the regulatory hurdles to be able to actually sell the opportunity into those markets. But there is certainly appetite. And talking to our bank partners who own the market, they know what they are talking about in those territories, are very positive about the development of the product.

A - Spencer Horgan {BIO 4241901 <GO>}

Yes, (inaudible). Press the button.

Q - Patrick Hosking

Patrick Hosking, The Times. I just wanted to ask a little bit about the downside -- the downside risk to the dividends. What kind of shock would be needed for you to be in the awkward position of having to cut the dividend? How safe is the dividend?

And the other thing I wanted to ask was about the Woodford affair. How much damage do you think that has done to active fund management more generally? And what proportion of your funds are in illiquid assets like property or unlisted securities?

A - Clare Bousfield {BIO 16746072 <GO>}

So, on the dividend, I'm going to point you in the direction of the sensitivities that we have in terms of the Solvency position and because the capital generation is heavily driven by the solvency position. Then if you take any one of these sensitivities and basically stress them, you can actually work out, based off the chart that I gave you in terms of the GBP2.2 billion in terms of what that level is.

Absolutely, as a brand new listed company, that is one of the elements that we have absolutely taken into account to make sure that we are comfortable that the dividend is sustainable, yet attractive to our shareholders. But we have to take into account the volatility of the market conditions and what we need to sustain.

A - John Foley {BIO 4239156 <GO>}

On Woodford, clearly that's not been positive for the industry, and you feel like you are on the back foot when explaining, what you do as a participant in the industry. I can tell you that we have no, and it has been our policy never to have illiquid assets in our mutual fund range, but further than that I probably shouldn't comment.

Q - Patrick Hosking

Sorry. Do you not have any property fund?

A - John Foley {BIO 4239156 <GO>}

Yes, but they are separate property funds. In the mutual funds, we don't have that have daily pricing. We don't have illiquid assets.

A - Spencer Horgan {BIO 4241901 <GO>}

Any other questions?

Q - Andrew Crean {BIO 16513202 <GO>}

So it's Andrew Crean again, a cheap way of getting more than two questions. Could you talk a little bit about -- possibly about the Solvency bandwidth on the upside? So what sort of coverage ratio would you be signalling to us that you would be delivering for capital return? And then secondly, what is your plan for the hedging of the PruFund in the -- because I think in July, you slightly hinted that you might drop the hedging to improve the profitability? What's your thinking now?

A - Clare Bousfield {BIO 16746072 <GO>}

So we set a Solvency target of 170%, as being the sort of target point from a Solvency perspective,and we have obviously got a risk appetite that we operate in, in terms of what level we feel comfortable before we start taking action to restore Solvency. Obviously, as a newly listed company, what we want to do, is basically see how that develops over time, rather than necessarily giving you a top band to say at that level, that's when we'd start to return capital.

On the hedging, you are absolutely right, we talked in July about the hedging in terms of the equity exposure on the shareholder transfers on the With-Profit fund. We are still looking at what the options are, in terms of whether we continue to hedge and for the half-year, we allowed some of the hedging to unwind. But we are also, more importantly, looking at the structure of what that hedging might look like, to see if we can basically optimise the risk return and the cost of the hedging program, in terms of what we do.

Q - Andrew Crean {BIO 16513202 <GO>}

Is that a part of the process?

A - Clare Bousfield {BIO 16746072 <GO>}

Potentially yes.

A - Spencer Horgan {BIO 4241901 <GO>}

Any other questions?

Q - Johnny Vo {BIO 5509843 <GO>}

Maybe one more question, just in relation to the MA spread in your annuity book, what is the MA spread and how much further do you have to do something, with regards to that book to generate more profit?

A - Clare Bousfield {BIO 16746072 <GO>}

I didn't quite hear that Johnny?

Q - Johnny Vo {BIO 5509843 <GO>}

The MA spread within your annuity book, what bps is that?

A - Clare Bousfield {BIO 16746072 <GO>}

I don't know that number off the top of my head, in terms of what the spreads are. But we certainly, in terms of actually the asset optimization and the opportunity in order to invest in more illiquids and improving the kind of risk and reward, we have plenty of bandwidth in terms of actually being able to drive more asset optimization. But as I said, it will be at lower levels than we have historically seen in terms of where we go.

Q - Johnny Vo {BIO 5509843 <GO>}

Okay. Thank you.

A - Spencer Horgan {BIO 4241901 <GO>}

Anymore. No? If not, thank you very much indeed for coming, or to those of you on the web, thank you very much for listening. For those of you who are in the room, please do join us for a bite to eat afterwards. And if you've got any questions, please do get in contact with myself or one of the investor relations team. You will find their contact details in the back of the pack. Thank you again for coming.