Q2 2014 Earnings Call

Company Participants

- Barry Lee Stowe
- Jackie Hunt
- Michael Andrew Wells
- Nicolaos Andreas Nicandrou
- Tidjane Thiam

Other Participants

- Abid Hussain
- Andy Hughes
- Blair T. Stewart
- Jon M. Hocking
- Oliver G. Steel

MANAGEMENT DISCUSSION SECTION

Tidjane Thiam {BIO 7518525 <GO>}

Hello. Hello. Okay, good morning, everybody. Let's start. You will see that we have adopted a kind of politburo configuration, and you'll probably wonder why. The truth is you cannot see this, but they keep making faces at me, particularly Barry Stowe over there, so I've decided to change the layout of this topic, so I can be focused.

No, more seriously, welcome to the 2014 Interim Results for Prudential. We have produced, we believe, a good result across the board; broad-based performance with growth and cash coming out of all four business units. And we promised you a while back more of the same, and I think we have delivered more of the same.

So I will start with, fundamentally, taking you through the highlights of group performance, and some of the, I think, key features of our strategy; then I'll cover Asia; and I'll do a bit at the regional level, a bit of country-by-country; I will then cover – I will cover Jackson. And Jackie, because she's almost at her first anniversary with us, and she's had a lively first half in the UK, will take the stage and talk to you a little bit about her views on the UK and give a quick update. And I'll come back to do M&G, talk to you about cash and dividend before Nic does the financial review of the business and I'll come back at the end for outlook and we'll then move to questions and answers.

So, if you look at the numbers and the results, these results in my mind standout, because we have faced a very challenging environment in the first half of the year. If you take into account the macroeconomic volatility in some of our key Asian markets, like Indonesia or Thailand, depreciation of the U.S. dollar, the events in the UK market. It's been a very lively first year and I think that these numbers are very strong in that context.

You will see that we've shaded in grey, the CER column, I mean, for this audience, I won't belabor the point about exchange rates, but we do run local businesses, but have no mismatches in currency. We have no economic FX exposure. So, we really think that if you want to understand the underlying performance of the businesses, this is what you need to look at, and I – with the media, I've used this analogy, but we do measure the UK business in British pounds. This seems to make sense. So, it makes sense to do the same thing in Indonesia with the rupiah, rather than some other foreign currency. And I think we are progressively expecting that.

The flows in which you get the money, the currency, in which you get your flows is relevant. Assets, liabilities and so much it make sense. We accept the challenge on remittances, but they are strong in pounds.

If you look – there is no difference here in the columns. We are up 15%, free surplus, up 13%. So, we think that across the board, it's a really, a pleasing performance and even taking the toughest metric, which would be AER, there is still progression. So, really I think the teams and the businesses have done very well.

So, we've added one bar to this now familiar chart that we show you every time, NBP, IFRS and cash. We've very good progression across the board and no major issues. So, I think we've been able to deliver as you say in English, through thick and thin and probably more thin than thick.

If you look at this chart we've used also a number of times, shows you every year. I've been here seven years. I cannot remember a quietest year. First, it was the survival of the financial services sector of the economy in 2008, 2009. Then we had the challenges to VAs from low interest rates and high equity volatility, then we had the sovereign debt in the Eurozone, when we had a potential China slowdown. So through this period, we've delivered those steady increases, I believe, in the face of many, many challenges.

The two blue ovals are about objectives we've delivered. Some of you may remember that we were aiming to double 2005 in Asia by 2009. We were able to do that in spite of the crisis. And we then promised we'd double 2009, in 2013, we were able to do that, and that's important. But you will tell me, well, that's all the past. We don't really care. It's only for future that matters.

If you go 2014, I think we've continued what as we call a tradition of headwinds. I mentioned the steep currency depreciation in key Asian markets, the challenges in the UK, the Presidential election in Indonesia. I'm sure we'll come back to that. That was an important factor. This year is not over yet – the military coup in Thailand, so also a lot of headwinds and very good performance, very good delivery.

The next slide I want to show you is really about the 2017 objectives. You will remember that we use the same format to track the 2013 objective in 2009, 2010, 2011, and 2012. I want to say here is it's 10 half-years, five years, we've done three. So, it's still early days and there is no point, I think, getting overly excited about this. Or we can say that we're making good progress, but it's still very early days in that period.

Our strategy is unchanged. We are focused on three major opportunities, savings and protection gap in Asia, baby-boomers in the U.S. and the savings gap and the ageing population in the UK. We always talk to you about those and our main way to restructure this is through allocating capital. And I'd like to take a few minutes now to run our capital allocation and our track record there.

It's another chart you're familiar with now, we introduced it in 2008, you can see the new business strain, it shows I think amazing stability in terms of quantum. So, you can see that basically the capital invested has been flat over the period. And the group has changed scale several times, as you can see on the right, the new business profit have grown 2.5 times for about the same amount of capital.

I'll pause for a minute maybe on the 2014 bar. If you look at, parallel stories, the reduction of the investment in the UK. You can see it going up, okay, so we've invested £22 million more in the UK that's basically bulks, okay, and with that we've generated £60 million of IFRS profit, and £69 million of NBP. So that's how I would like you to think about those £22 million, okay.

So, we think they've been put to good use. And that's about the extent of the trend you can expect in the UK, so it's not something that is hyper material on the scale of this group, but it is a good investment that has generated very good return for UK, and has allowed us to more than offset the changes and the disruption to the UK market. So, that's the global story.

Let's now take a look at Asia, the U.S. and the UK in that context. In Asia, what we've done really is, I think, well summarizing this slide is we've driving this health and protection, H&P, sorry, it's easier to say H&P proposition. You can see that went from 8% of our sales to 30% that's a very successfully executed strategy and the profits have increased by 6 times, 7 times in the period.

Now that's absolutely transformational, because it's made the business won more resilient to financial market and variation in these financial markets, these are premiums. Let me correct, it's not interest rate, it's not equity returns, and it's also made it more cash generative, because we've grown the product line that has much shorter payback and the rest of the business. So, it's been a very, very and good enough bars now that we can say this is a real story.

And again, it shows you how we allocate capital and the effectiveness of that capital allocation. That's not the only story. If you look at the U.S., we have done a similar thing. Jackson used be a FA shop, fixed annuity shop. So, mostly interest spread in terms of income and by basically creating a VA business alongside the FI business.

We have changed the income stream. And if you look at the fee income, it's part of a good news in these results. The fee income has been growing up very, very strongly, you see that it's growing 6.6 times in the period and has had a phenomenal impact on our results.

The next example, I would like to use is the UK. It's PruFund. PruFund is one of our with-profit product. For most of you who were here in 2008, we decided not to reattribute the inherited estate, on the basis that the with-profit was a very good product, with very strong prospects. And if you look in 2008, when we were making that decision PruFund was £300 million.

I think that we've proven right here because it's now £10 billion and it's been an extremely successful product in the UK market and it's something that Jackie will talk to you about later, but that she will use to drive part of her strategy in the UK, whether it's wrapping it into an ISA, or putting on platform, et cetera. So, again a very capital efficient way, because it's in the with-profit funds of growing and generating earnings for our group.

So, if you consolidate all that - and this chart you're also familiar with, it's a - the evolution of our IFRS earning by sources of income, you can see that if you did - you combine insurance income and fee income, it's grown from 24% of our profit to 64% of a total which itself has almost trebled in the period. That is, I would say 90% of Pru story in the period. But the point that I would make there is that we have, I think a strong track record of growing material businesses from a small base. If you look at those curves I've showed you whether it's for health and protection in Asia or it's VA in the U.S., or it's PruFund here, I mean, it's something the group is good at.

And so, I think that gives us confidence. When we see the volatility in the world that whether it's in Africa, or whether it's with SCB, every time - whether it's UOB, UOB is 4 times where it was four years ago. There is something about our ability to take a business and make it grow 3, 4, 5 times and even that across geographies. And that's a very precious, I think, skill that the company has.

Now, it's good to have earnings, but it's even better to have cash. What we've done in the next slide is show you the dividend and the growth of the dividend. One thing we like to emphasize is that we haven't just delivered relative growth. We've delivered absolute growth, all right from the pre-crisis levels. There were a lot of dividend cuts during the crisis. So these dividend has grown not just on a relative basis, it's also grown on an absolute basis.

And you can see the difference, whether it's with the UK life peers or the financial peers. And I think you draw the strategy and a dividend over a long period of time, which is why we took 2006/2013. A lot of the comparisons made around two or three years, but we - it's much as where you've cut on it.

So, we're quite proud of this track record. And we want to keep it growing. We are committed to giving you a growing dividend and if look at our dividend policy, it says that very, very clearly even during the crisis we grew the dividend at 5%. We're also committed to reinvesting into a business. I'll come back to SCB later. But when you see the amount we invested in that deal, that's for a group in Asia, that's made at a very good returns. So, we want the ability to reinvest and we want to keep some financial flexibility.

You often ask us why don't you grow the dividend faster, well, we like to keep, as we say every time, those growth between the earnings growth and the dividend growth, because the unexpected happens. If you look at the six months what happened in Indonesia and Thailand across Asia. You understand the need for a buffer there. And I will add as less consideration, the need to reinvest in the balance sheet, because as the group fortunately gets bigger and bigger, the balance sheet has to grow and we have to retain some capital.

So, when you put all that together, I think we take a very prudent long-term approach to the dividend. We're committed to giving you a growing dividend, but also to invest in the business.

Maybe one comment on our numbers, you've seen that the remittance ratio has grown up. I just want to caution you, against reading too much into that, it's mostly timing effects. The Jackson has paid a $580 million dividend as you've noticed in the first half and obviously UK dividend is coming in the first half. And the third comment is that we hedge the Asian dividend intra-year, and we've got a lot of the benefit of that. And that we unwind later in the year and that's something that Nic will cover in his presentation as well.

So, I'll stop here for the group and maybe move to Asia, another good bar, another red bar there you see the new business profit, IFRS we are particularly pleased with. We've got eight countries in Asia that grew IFRS at double-digits. India, Korea, China, Taiwan, Indonesia, Philippines, Vietnam have all grown and Thailand have all grown - that's the eighth one have all grown double-digit. So really a very, very strong performance and the cash also has been very strong satisfactorily.

I'd just like, if you allow me to, reuse two charts I used at the December Investor Day, I think they help to tell the story. This is the first one and you recognize it. What it says is that, single premium sales are sentiment-led - sensitive to macro and volatile, so referring you the MSCI and single premium sales and you can see the correlation there.

And then, the second chart was the one showing you the regular premiums, and saying that regular premiums were a source of resilient growth, okay. So, it's almost - I mean, it's pleasing for us that that is exactly what we saw in the first half in Asia.

If you look at the regular premium, PCA, up 15%; and if you look at the single premium, down 2%, there is always textbook reaction to a macro shift that's what happens. That's what has happened every time and that's what we have guided you to expect. So when people ask us can you defy gravity? The answer is always no, we cannot. Look at the single premium. But luckily we have a strategy, but it's focused on regular premium and that is the central point and that's 90% of our sales, okay. So you can count on that. So I must say when I see swings - well, swings in our share price sometimes are new, Asia macro news, I just don't understand, because frankly, if you accept that - sorry, 2% of £97 million is not at all compared to 15% of £785 million. Okay. That's why the APE is 13%, okay. It's very simple, a very simple arithmetic. And actually the trend - I have Raghu and it is not a completely verified number, but I have Raghu look at that. And we think that this does usually kind of 4%, 5%, okay. This is 14%, 15%, okay, so we're talking 16%, 18%. So, what we've had is a drop in the single premiums as you would expect given what's happened in Asia in the macro. And it should almost be enough to show this slide, to explain everything you've seen in Asia, it's all in here.

A word on Indonesia, because, of course, it's always and rightly the object of a lot of focus, but we actually think Indonesia is a good story, okay. You all saw what happened last year of the external shock. We think that the policy response was a textbook policy response, okay.

The central bank did exactly the right thing. I saw the Minster of Finance in January. He was laser-focused on correcting the big imbalances, the current account, the balance of trade, et cetera, and they let the rupiah drop, which is one of the lessons from 1997, 1998. You don't defend unrealistic parities. You have to have flexible exchange rate in an open world where you trade. So, he did the right thing. I think more importantly, and that's really for me, very impressive. They raised interest rates in the face of a presidential election, okay.

I haven't done the work to go back and look at various central banks and their behavior, but it would not argue that that's on the rare side of kind of virtuous behavior. And when you know you need to raise interest rates for macroeconomic reasons, and you see an election coming, to do it is actually quite courageous. It's really one of the things that give me confidence in the fact that not only do they know what they're doing, they're courageous. And they're doing right thing.

And I'm really pleased that they've been rewarded by the markets, that the long-term rates are going down; their market is up 19% from January 1. And for us it's a good story, okay. And the rupiah is coming back. So, of course, it has impacted our ability to sell, the willingness of people to make long-term decisions in that type of climate is limited.

So, what you've seen is the case size hold up, but you've seen people deferring decisions. And that's what comes for ourselves, just people deferring. And that's what the agents tell us when they talk to the customers. But we've continued to recruit. We always believe in countercyclical investment. We've continued to recruit, recruitment is going forward, and that has actually allowed us to be flat in local currency, which unless, again I think was a very, very strong, very strong performance. So, maybe a world under macro, that part of the world, there's a very good study that the IMF published in June 2007; it's called Emerging Markets in Transition: Growth Prospects and Challenges in June 2014. If you haven't seen it, I invite you to read it.

But that's the conclusion of the study from Southeast Asia. We're saying fundamentally the slowdown is cyclical, but the structural growth is expected to be at 6.6%, and the 1.9% is a potential upside, when the U.S. recovers and advanced economies grow stronger, and that gives us a lot of comfort again that we are in the right place. But these countries will continue to grow faster than advanced economies for the medium-term, which will then drive currency appreciation, which I believe is a source of value.

Maybe a few words on Standard Chartered because we've given you some disclosures on that. We're delighted to have that agreement, okay, it's 15 year agreement. It's all about distribution in Asia, okay. So, we've secured 15 years of distribution of the prime franchise. What it does, is letting the number of existing countries, it's improved the terms. We either have exclusivity, where we didn't have it before or preferred status where exclusivity is not allowed. I can try and let me correct, simply not allowed, but it's all upside. And we have great business plans in each of those countries to drive sales up. Then we have new countries, India is really pleasing. Chanda Kochhar from ICICI was here recently, and we're really pleased, we've already started selling for SCB and that's doing very well. ICICI was up 21% in the first half in India, that's a good result.

And then we have new countries, Cambodia, Laos, Bangladesh, that's 178 million people. Yes, completely new market, we're quite excited about Bangladesh. Barry and his team can give you more color when we do the Q&A. But it's really very promising, very encouraging. And just to say a word about Standard Chartered, in June, our sales have been more at 36%. So, that's a partnership that's going extremely well, 36% in June.

We also have Africa, which is very exciting, 200 branches. And they have some existing agreements, because frankly we were not enough recovered to very recently. So, they had some agreements in place that we will announce in the next four years or five years. We have a 15-year agreement now going forward.

And the last word is really on price. We've given you the numbers, £503 million paid this year in 2014 and another £228 million in total which will be paid in two installments over two following years, over the three years, £731 million. We're convinced that we're going to recover that many times over 15 years and that was a good price to pay that we're very, very comfortable with.

A little more maybe on countries. Hong Kong. Hong Kong is up very, very strongly 30% in APE, 32% in NBP. (21:10) which had suffered a little bit has come back also very strongly in Q2. And we have always said that we wanted to drive the H&P sales up in the Hong Kong business, and we have launched a number of new products and initiatives, PruShield (21:24), that have really increased H&P by 53%, and that's good news and very promising. So, this is an upside in Hong Kong most definitely.

Singapore, we're up 11%. That's an increasing market share, some market did less on that, so we're pleased with that performance. It's better than market. And we have continued to drive the agency forward. And we have been talking to you about high net worth in Singapore and how it's been going up in our numbers. The NBP on high-net-worth is up 73%. We had the business rated by S&P to AA rating, and we found a great plus in selling to high-net-worth in the region, it's something they value; so a very good performance there.

Indonesia, I've talked about a little bit. We've continued to recruit. As we say here, pushing the recruitments is very important. We've been flat in sales, but the IFRS profit, because of regular premium inflows, was up 32% to a very, very comfortable and very significant number. And we'll remain completely optimistic about the prospects of the country. Nothing has changed in our view. It's still a huge population, growing very well. And we actually see a demographic peaceful election us having increased the value of Indonesia and not decreased it. It's very good news. We're now able to run this process and do that well.

Thailand is next. The profits up 2.5 times what they were over previous year. Thanachart is a great success, good contribution of IFRS to us. We've doubled market share in one year and frankly no impact yet from the political trouble. And our business in Thailand is doing very well.

The Philippines is an interesting case. As you see the top line number is going down, the underlying evolution is - regular premium is up 21%. That's a number you need to keep in mind.

We have shifted the strategy there to focus the agency force on regular premium, and when you do that there is always an impact on your short-term numbers, but medium-terms is very promising. IFRS is up 38% and we're happy, very happy with the performance. So, that's for the life business.

Just a word on Eastspring, very good performance, very strong net inflows, £2.5 billion in the first half; of that £1.6 billion is equity. So equity has increased 3.6 times in the period, okay. And IFRS profit at £42 million, that's how you get the £525 million, is £484 million life and £42 million Eastspring will get you to £525 million. $42 million is more than 20% of growth prior year. So really very good performance at Eastspring, we're very pleased. We're getting institutional flows in equities, and it's a good story and it's taken the firms up 22% to £67 billion.

So really overall in Asia, we've guided you to focus on two things; IFRS and free surplus, and IFRS is up 19% and free surplus nicely up 19%. So, we're pleased with our performance. We think that the fundamentals, the structural positives in the region are intact and the next one - intact, whether it is the demography, young, growing population, the improving education, the urbanization.

And if you refer the underdevelopment of the welfare system with an underinsured middle-class remained really the kind of strong long-term drivers of the business. So, they are all in place. We have a superb platform in all of these markets, around the agency, our bank side and very not recent but we have very good management team that is able to deliver on everything we promise and continues to deliver profitable growth. So, we're very confident on the delivery, extremely confident.

So, let's move to Jackson. And you're familiar with the Jackson strategy. We've driven cash, we've driven earnings. What I want to show you is, our VA sales, because it's always much discussed. That's what they look like. So, if you look at 2008-2009, yes, we've been opportunistic. We expanded aggressively. You remember half of the providers had grown up, and we had margin went from 40%-ish to 80%, so we have a once in a cycle opportunity to write business at extremely attractive margins.

So, while in 2010 the business has doubled. And we understand some of the nervousness around growth like that and one can be forgiven for. When looking at these two things that this is uncontrolled growth, but it's not and that's - I'd like to get under the surface and show you few of our curves. The first one will be VA with living benefits. Okay, if you track our sales of VAs with living benefits that's what they are.

So through product changes, we went from here to here. And then that's when we started changing the products in the future, to continuously enhance the return on the product and control the volumes. I really think that that is not the mental image that people have for our growth in VAs or strategy in VAs, right? How did we do that, because we have VAs without living benefits. We've created Elite Access here, in 2012. Okay, we sold £4 billion of it in the first half of 2014, and we've sold £7.9 billion since inception. And we also have other VAs without living benefit, GMDBs, which sold $2.4 billion. So VA without living benefits have grown from 11% of our sales to 31%. Okay, that's a story we like, because it allowed us to both control the risks and grow the top line.

Now, let me tell before that we haven't necessarily told the story in booster. But that's what drives all those good numbers, you are seeing out of Jackson. Another way to look at this is a quarterly cut, which we've done here. That one we really like, because what it shows you is the sales of VAs with living benefits over 14 quarters average is £4 billion, okay. So, we've moved between £3.3 billion and £4.8 billion every quarter for 14 quarters. So, it doesn't look like an erratic strategy.

I think Jackson know what they are doing. They are very good at controlling their volumes, they are very good at controlling their pricing and their product features to lend exactly wherever they want and that's a track record we're actually quite pleased with, which we think has generated great earnings, £686 million in the first half. That's as my profit as we used to do a year for Prudential worldwide a few years ago. And very nice £180 million cash dividend, thank you very much, Mike, that we have received. So, overall a good story.

Now if you look at the book, it's very healthy, we keep showing you this slide, but it seems 1% in the money. I should say maybe a word just about Curian, because I should imagine it's going to come back later. You've noticed that we had the loss this is about the technical error, which we can explain to you. Nic will come back to that and I'm sure he'll tell about it in Q&A, but it's a technical error, business is doing very well, the book is very healthy. And this is what allows us, if you wish to, to sleep at night and feel comfortable. 62% of the book has been written at 30% or lower than current market levels. 62% of the book, that's a very good statistic and we're pleased with that.

So, the last slide on that is, is really the dividend. I think what Jackson has been able to do is to limit the downside during the crisis, and really give us huge upside when equity markets aren't supportive, and you've seen those profits turning into cash over time.

So, with this, I will stop on Jackson, and I will give the floor to Jackie, who is going to talk to you about the UK for a few minutes. Thank you.

Jackie Hunt {BIO 16204866 <GO>}

Thanks, Tidjane, and good morning, everyone. Now, as you well know, the UK market has continued to be heavily influenced by an unprecedented level of regulatory and legislative change over the last six months. And I think, we've delivered a resilient performance against those headwinds with the majority of our metrics ahead of 2013, and Nic will go through those in more detail in his section.

The end of compulsory annuitization and the increase in the number of customers who've actually deferred converting their pension savings into retirement income, led to a reduction in our new business operating profit of £29 million. This financial impact was more than offset by higher levels of bulk annuities and by increased sales of both onshore and offshore bonds, up 23% and 57%, respectively.

Now the growth in our bond sales reflects the strength of our investment proposition and a broadening of our distribution capability and that proposition is supported in part by PruFund, which Tidjane referred to earlier.

We've also seen a doubling of sales in our income draw-down products, albeit from a low base, and when we talk about how we see the product suite developing of the future, draw-down and implementation of a flexible draw-down product is obviously fundamentally important.

It's worth pointing out that in-force IFRS remains strong. This will continue to be an underpin to our results as we go forward and when we combine that with the improved sales performance, it enabled us to deliver £374 million of IFRS operating profit at the half-year.

Now, we flagged to you in December that we see the bulks market as an attractive opportunity in which we want to participate more fully and several of the deals that we've actually announced through the first half of this year were transactions on which we began working in late 2013. So, our bulk strategy really shouldn't be seen as a response to budget changes, it's really a continuation of what I set-out in December last year.

The strong demand for bulk annuity solutions is driven by, we believe, three particular factors. Firstly, the improving economic environment means that there has been a reduction in the level of deficits and that means that the funding gaps that employers and sponsors need to address as they go into solution have reduced significantly. That creates a good environment in which they can start looking at external solutions to their challenges.

Secondly, we are well aware that those schemes that have large gilt holdings see a time of potentially rising interest rates, and again Tidjane has mentioned this as being a good time to look at offloading some of these obligations.

And finally, what we've seen a significant change around is the willingness of employers and trustees to partition liabilities into multiple segments and that facilitates off-laying some of the liabilities, while holding on to those where they maybe bigger unfunded gaps as they wait for the funds to strengthen over time.

And it's those current market factors which is driving the very significant demand for bulk solutions in the market and which means that we can continue to participate very selectively with significant financial discipline and I'm sure we'll come back to this in the second, but in a strongly growing demand-based environment.

Now as we look forward, we do expect opportunities in bulk market to remain both resilient and very profitable. Many of you have asked about the UK's strategy and the UK business continues to evolve with strategy. We see the market challenges that I laid out in December is unchanged, so we have a significant savings gap. We've got the concentration of wealth from the over 50s, the transfer of risk from government and corporates to individuals and also the reduction in the access of advice for the mass market, all creating opportunities with modest levels of investments, we believe we can generate good returns.

Now we expect that investment to moderate the cash remitted by the UK business by around £50 million per annum for the next two years. And we believe that our insight and our capabilities leave us well positioned to help our customers through this period of change. And I wanted to flag that our program of product and proposition development, which I've talked to many of you about, remains on track through this process.

If we highlight some of those, we are broadening our retirement income proposition, for example, by developing a flexible draw-down product that has PruFund inside it, again focusing on this very strong investment proposition that is delivered for our customers. We're also evolving our existing with-profits product suite and again – and this is in the form of an ISA wrapper, so the budget has made ISAs far more attractive products and that's on track for launch in the first quarter of 2015.

And finally, we're developing our unique packaged products, so they'll fit into the platform market space. So, you continue to see our strategy evolving and you should expect us to see us delivering for our customers with a shortened and a much more dynamic innovation cycle, responding more quickly to customer needs and to changes in the market in terms of our products, our proposition and our distribution.

But I want to highlight that all of that will be against the back of continued focus on strong financial performance and also the support of what we see is a very resilient portfolio across the UK business as a whole.

So with that, I'll hand back to Tidjane.

Tidjane Thiam {BIO 7518525 <GO>}

All right. Thank you, Jackie. The last thing I have to cover really is M&G. The results have been very, very strong. If you look at the retail assets, M&G has been able to continue to diversify very successfully, a very strong performance in Continental Europe, where they're up 32% – I think that anybody who can grow at 32% in Europe has done well from year-on-year.

And if you step back and look at the total assets, an internal versus external, very good performance. We've crossed really a point, the external are now more than half our assets, which is something we like, so the business is both larger and with a richer mix, because of course, the profitability is better here.

So, the total has grown 1.5 times and the external is going faster, 1.9 times. And that is what's driving the profits that you see on the next slide. £227 million, that's the highest ever for M&G, in the first half. I don't know, it must be probably a shock to Michael, he didn't show up today. More seriously, he is on holiday, but he is following us, up 11% in profits, a very creditable performance. So another very, very, very good story in the UK – of our UK business and very pleasant.

So just to wrap-up, all I think in the end has to translate into cash, we've always talked about that. I encourage you to focus on it. So, if you look at the free surplus generation and the dividend and the reinvestment rate, it's all a very, very nice story, very nice story, 2.4 times the free surplus we generated in 2008 through the crisis. So that's something, I think, the group has been really good at, developed a good track record and my last slide will be really the dividend, which I believe is a good story, both on an absolute and on a relative basis, 91% growth from before the crisis and 11.19 pence as you would expect is one-third on prior dividend in the first half of this year.

So, overall, I think we are allowed to say that this was a very good first half, with a very broad-based performance across the board. And I will now hand over to Nic, who is going to give you much more detail and much more color on how these numbers were generated by our businesses. Nic?

Nicolaos Andreas Nicandrou {BIO 15589153 <GO>}

Thank you, Tidjane, and good afternoon, everyone. In my presentation, I will provide you with a detailed look at the drivers of our financial performance in the first half of 2014 and give you a brief update on our balance sheet.

Starting with the financial headlines, the group has delivered strong performance in the first half with good progress in all of the key financial metrics shown on the slide. This performance stems from the disciplined execution of our strategy, which has seen us continue to attract sizeable and highly profitable new flows and manage our in-force business for value.

As a result, once the currency translations effects are removed, IFRS operating profit increased by 17% to £1.5 billion. Free surplus generation was up 13% to £1.2 billion. New business profit on a post-tax basis rose by 24% to just over £1 billion. And embedded value operating profit also on a post-tax basis was 18% higher at £1.9 billion.

With long term yields at the end of June being broadly similar to those a year ago, interest rates are not a significant factor when comparing the performance between the two periods. The rise in equity markets has provided tailwinds for our fee income businesses, and I will highlight the effect of this as I step through the presentation.

Because we're reporting in sterling, the main external market influence on our headline results are the currency translation effect and I would like to tackle this first before turning to the underlying business performance.

As the pie chart on the left show, the majority of our profits are earned in U.S. dollars and in various Asian currencies, which we translate into sterling when reporting our headline results. In line with our previous guidance and as illustrated on the right, for our major markets, the translation effect of the stronger pound has now worked its way through the 2014 reported numbers.

I would reiterate what Tidjane has said, that this effect on our results is purely translational. We run local currency businesses in each of our markets, where assets and liabilities are currency matched and have no transactional cross-currency exposures.

Therefore for the purposes of my presentation, I have expressed the 2013 comparative results on a constant exchange rate basis. The slide shows the effect of this retranslation and the four main financial metrics that I am about to cover. You can see the impact on each metric that comes from Jackson in dark blue and the impact that comes from Asia in the lighter blue.

If the half-year average exchange rates persist for the rest of 2014, I would expect these translational effects to repeat at the full-year albeit at a reduced level. We have updated the full-year sensitivities that we provided back in March and we have included these in the appendix to your slides.

With this covered, I will now focus on the underlying drivers of our business performance. Looking at the contribution of the four businesses to each financial metric, you can see that the improvement in performance has been broad-based. Asia has delivered strong double-digit growth across all measures demonstrating the effectiveness of our execution, the benefits of ongoing investment in our distribution capabilities and our well-known preference for regular premium business with the high health and protection content.

In the U.S., Jackson's improved results reflect the continuation of robust trading inflows and a significant growth in the market value of separate account assets over the last 12 months. Jackson's disciplined approach to writing new business on attractive economics while appropriately managing the balance of risks remains central to its success.

In our UK life business, we have increased our selective and profitable participation in the bulk annuity market, which has offset the pressures on our retail business and has enabled us to deliver high overall new business and operating profits.

Finally, M&G has continued to attract positive flows in the first half resulting in record funds under management profits and cash. I would now like to look at each financial measure in more details starting with IFRS. Total operating profit increased by 17% to £1,521 million, which is equivalent to an annualized return on opening IFRS equity of 24%.

Within this total, the contribution from our life operations increased by 20% to £1,543 million. The chart on the right analyzes the overall increase in life IFRS profits by reference to the various sources of earnings. We continue to have a bias for fee and insurance income ahead of spread income, as these two sources are more predictable and more resilient to volatility in economic and investment market conditions. It is therefore pleasing to see that these two higher quality sources are driving most of the increase.

Life expenses are also higher reflecting our business growth. The £158 million shown in the chart represents an 11% increase in the expense base, which was outpaced by the 16% rise in total life income. This evidences once again the benefit of operational leverage across our businesses.

Turning to the IFRS results for each business and starting with Asia, our overall profit from Asia was up 19% with strong growth in both life and asset management. Life profits increased to £483 million, reflecting the benefit of our focus in Hong Kong and Southeast Asia, which together accounted for over 90% of the improvement. Noteworthy within this, was the result from Indonesia, which increased its contribution by 32%.

Furthermore, the smaller Southeast Asian businesses of Thailand, the Philippines and Vietnam have doubled their collective contribution to £63 million and now represent 13% of the life total up from 8% a year ago. The improvement in profit is directly linked to the growing scale of our life book, driven by the high and rising level of regular premium sales each year.

As you can see in the chart in the top right, our growing scale is represented by the increase in policyholder liabilities, which were 16% higher than this time last year. A major factor in this positive trend has been the ongoing growth of premium inflows from our in-force book. These flows have increased to £1,192 million in 2014, reflecting improved customer retention and the addition of another sizeable cohort of regular premium new business.

The chart below shows how this growth in scale translates into high profits. As you can see insurance margin has grown fastest at 20%, reflecting our ongoing focus on health and protection. You can also see that taking together the various sources of income are growing at a faster rate than the 8% increase in costs net of DAC, highlighting the operational efficiency of the business.

The slide showing the detailed analysis of the sources of earnings that I normally walk you through are included, but this time I have put them in the appendix. So, the dynamic of layering new highly profitable regular premium cohorts on top of a very sticky in-force book, all processed through a scalable platform remain a powerful underpin of our earnings momentum in Asia.

Turning to Eastspring briefly, IFRS profit was up 24% to £42 million. As shown in the box in the top right, the improved performance is driven by a 13% increase in fee income and a 4 point reduction in the cost ratio.

The rising fees is directly linked to the growth in average AUM, which are up 12% as shown in the box below. Eastspring are seeing record inflows both from its internal and external client mandates with an increasing flow of assets into equities over the period, driving a positive mix effect and improving the average fee margins.

Turning to the U.S., IFRS profit was up strongly at £681 million, driven by a 28% increase in Jackson's life result. You may recall that the 2013 result was itself 29% up on the prior period, which demonstrates the momentum of Jackson's business model, particularly when the macro and market conditions are supportive.

The step-up in Jackson's profitability has been accompanied by an improvement in the mix of earnings as illustrated in the chart, in the top right. You can see fee income and technical margin are the fastest growing sources and between them, they now represent nearly three quarters of the total.

Spread income has also increased, albeit at a slower rate as the average crediting rates continue to fall faster than the reduction in the gross yield. Technical margin has benefited from a £100 million contribution from REALIC. And this is equivalent to 7 percentage points of the 24 percentage points shown in the chart for this source.

Underpinning the 28% increase in fee income is the growth in the scale of our variable annuity business, shown in the box underneath. Separate account assets have increased by 34% between the two periods to just over $122 billion. As you can see, this is driven by the high levels of positive net inflows and the rise in the S&P 500.

The progress that Jackson has made with Elite Access has contributed roughly $4.5 billion of the $13.8 billion of inflows shown in the chart. Elite Access AUM now represents about 7% of the separate account assets. So, 7% of the £ 122 billion, which is a testament to both the wholesaling capabilities of Jackson and its focus on improving the overall risk profile of the business. Even though the risk adjusted returns of Elite Access are excellent, the absolute fees charged are lower and this has the effect of diluting slightly the overall increase in fee income.

Earnings relating to Jackson's other operations are lower. This year at minus £5 million, following an internal review, we detected the Curian may have breached a small number of ERISA rules on client fees. The 2014 result, therefore, includes a provision of £33 million, relating primarily to the potential refund of certain fees by Curian.

Moving to the UK, the overall increase in IFRS operating profit is driven by a 10% rise in the life result to £374 million. This is analyzed further in the table on the right. You can see in the dotted box that the £60 million contribution from bulks exceeded the £29 million reduction in profits from new retail annuities, which are £25 million represent the modest proportion of the overall group result.

The main source of annuity profit is the sizeable in-force book, which has contributed £147 million in the period. This component, together with the with-profits result, represents a reliable and sustainable source of future IFRS profit for our UK business.

We remain selective in our approach to the bulk annuity market, and we will only write the business when the returns are sufficiently attractive to us. This approach will mean that the UK life result will be a little more uneven as we move forward.

Staying in the UK and turning to M&G. IFRS operating profit was 11% higher, up £227 million reflecting the increased scale of the business. As shown in the box in the top right, the improved result was driven by a 10% increase in underlying fee income. The rise in fee income is directly linked to the growth in AUM shown in the box below. Total AUM at 30 June exceeded the £250 billion mark for the first time, following another six months of strong third-party inflows totaling £4.2 billion and positive market movements.

The increasing proportion of higher margin retail business has seen M&G's average fee income improve to 38 basis points. The higher overall fee income levels have helped to absorb a larger cost base, reflecting M&G's continued investment in people and infrastructure. As a result, the cost income ratio was 54% unchanged from last year.

I would remind you that as in previous years, M&G's cost base has a second half bias, so please allow for this in your forecasts. In 2013, for example, the full-year cost ratio was 5-points higher than in the first half.

I will now move to free surplus, which is a measure that we used to track the internal cash generation of our group. As you can see on the left, free surplus generation before investment in new business increased by 11% to £1.6 billion. The main driver for this was the expected return from the life in-force book, which increased by 14% at £1.1 billion, demonstrating once again the powerful capital dynamics on focusing on higher return, fast payback new business.

Positive experience of £187 million, which this time excludes any assumption change effects, has augmented our cash generation further. On the top right, you can see that all three life businesses are making significant contributions to the in-force total with a strong uplift from Asia and the U.S., where the capital dynamic I referred to earlier is most evident.

In the UK free surplus generation has been maintained as this measure is relatively insensitive to the disruption in the retail annuity market. We remained disciplined in the redeployment of capital, directing our investment towards low strain, high return, and short payback opportunities. In the first half, investment in new business of £382 million increased less rapidly than new business sales and profit, highlighting the capital-efficient nature of our growth.

As you can see in the bottom right, Asia's new business strength was in line with sales, while that for Jackson was 11% lower, despite the increase in sales volumes. This reflects the beneficial effect of higher valuation interest rates, proactive actions to restrict sales of higher strain products and changes in the overall sales mix. Consumption in the UK has increased, reflecting additional capital for bulks and a modest rise in unit costs and individual annuities driven by lower volumes.

My next slide shows how this cash generation has impacted the stock of free surplus on the left and central cash on the right. Starting on the left, you can see that market movements which include a negative currency effect have been relatively benign in the period. The increase in the overall stock has, therefore, been driven by our operational performance, and this has in turn enabled our businesses to remit £974 million to group.

I would remind you that our approach to remittances is underpinned by our stance that the natural home for capital is at the local business level. Decisions on the level of remittances to group are driven by balancing the desire to retain capital locally, so it can be invested in profitable opportunities with the need for cash at group to fund central costs, dividends and corporate actions.

The remittances by business units in the breakout box on the right captures the outcome of this approach. The 14% increase from Asia to £216 million reflects the cash generative nature of our growth in the region. Jackson remitted its full-year dividend of £352 million in the first half, which represents as new high as you've heard already, reflecting its strong performance at this point in the cycle.

The UK remittance is also higher and like Jackson it has a strong first half bias as it includes the with-profits transfer of £193 million. The increased remittance from M&G reinforces the importance of this business to the cash dynamics of our group.

Remittances so far this year have been supported by our approach to hedging sizeable non-sterling flows up to 12 months in advance. This approach has sheltered the U.S. and Asia cash flows from the full effects of the sterling appreciation observed around this time last year.

The transitory benefit of this approach will, therefore, unwind through the second half of 2014 and into 2015. Furthermore as highlighted by Jackie, the investment that we're making in response to the budget and other regulatory initiatives will have a moderating effect on UK remittances reducing these by up to £50 million for the next couple of years.

Now for a group of our size, these effects are manageable. I would reiterate that cash flow from business to the center continues to be underpinned by our disciplined approach to capital generation and consumption and the powerful business dynamic of growth with cash.

Finally, included under the item marked corporate actions in the right hand chart is the £0.5 billion initial upfront payment for SCB. As Tidjane has said, there are two further payments totaling just over £0.2 billion, which will be settled in two equal parts in 2015 and 2016.

I will now briefly cover the EEV results, before turning to the balance sheet. On this basis, total operating profit was 18% higher at £1,943 million, equivalent to an annualized return on opening embedded value of 16%.

As shown on the left, the result is driven by our life operations, where profits were up 19% to £1,997 million, reflecting strong double-digit increases in all three businesses. With interest rates at June 2013 and 2014 being broadly similar, the impact of economic assumption changes is less than £20 million. So, the improvement that you see in the result is purely performance-driven. Okay, there's no economic assumption effects. The chart on the right analyzes the contribution from new and in-force life business. New business profit was up 24%, and I will come back to that in the next slide. In-force profit was 15% higher at £982 million. And again, every single of our three businesses reported double-digit growth in their in-force result.

As shown in the breakout box, the overall increase reflects the growth in our book, which comes through the line labeled unwind and which is 16% higher at £749 million. Favorable experience totaled £224 million, reflecting our focus on managing the back book for value and our prudence in setting EEV assumptions.

Finally, other than in relation to a small regulatory-driven change, we have the further booking of any assumption changes for the second half of the year. You shouldn't read anything into this, not least because experience was positive so far this year.

New business profit shown on this next slide was up 24% to £1,015 million. The table in the top right analyzes the drivers of this growth, with items under management's control, namely sales volumes, bulks, pricing and product actions driving most of the increase. All three regions continue to write new business at internal rates of return of more than 20% with short payback periods.

In Asia, new business profit was 15% higher at £494 million, despite a broadly flat result from Indonesia, highlighting the benefit of having an extensive and diversified regional platform.

Our NBP performance in the region is both robust and resilient, underpinned by a 15% increase from our Southeast Asian sweet spot, a 15% rise from agency and a contribution from health and protection, which was 14% higher.

In the U.S., NBP increased by 31% to £376 million. Although interest rates remain low, the beneficial impact of product initiatives implemented in previous years has enabled us to write new business in 2014 on economic returns that are close to post-financial crisis highs.

Almost the entire improvement is attributed to VAs, including Elite Access, which together have reported an NBP increase of 29%, so VAs with Elite Access 29%, ahead of the 24% growth in sales.

UK NBP was 45% higher, driven by bulks which contributed £69 million. At the retail level, NBP was 24% lower, reflecting a reduction in the contribution from individual annuities, mitigated in part by the higher NBP from with-profit bonds.

Moving now to the rest of the profit and loss account which is summarized here for both our reporting basis. In IFRS, investment variances were neutral. This reflect the offsetting effects from the fall in yields, which generated positive value movements on our fixed income portfolios and the U.S. interest rate hedges, and the rise in equities which generated negative value movements on Jackson's equity hedges, net of changes to related guarantee reserves.

In 2013, the negative value effects of the rise in interest rates and equity markets compounded, which is why IFRS profit after-tax has increased by 214% year-on-year to £1.1 billion. The fall in U.S. yields in the first half of the year also gave rise to a £0.5 billion unrealized gain on Jackson's fixed income assets, which are accounted as available for sale. After deducting the final dividend, our overall IFRS retained earnings were positive £1 billion, equivalent to 37 pence per share.

Investment variances in EEV were also neutral in the first half. Therefore, the operating result was the main driver of the increase in the group's embedded value to £25.9 billion, equivalent now to £10.09 per share.

I have provided you on this slide the usual update on the balance sheet. In short, the overall picture is unchanged and we're remained well-capitalized and defensively positioned. The group's IGD surplus at the end of June was estimated at £4.1 billion, after deducting the full upfront SCB fee of £0.7 billion. As you can see, IGD surplus is higher than this time last year and is equivalent of healthy cover of 2.3 times.

We continue to work towards the implementation of Solvency II; and as previously flagged, we will provide you with an update of our economic capital position based on our internal model, at full-year 2014.

Our roll-forward estimates indicate that the surplus position at the half-year stage has not changed markedly. With the positive contribution from trading activities and market movements being offset by the final dividend payment, the effect of the SCB initial fee, the impact of Hong Kong domestication, the synergies and foreign exchange.

We have renewed our liquidity facilities, raising them from £2.1 billion to £2.4 billion and have extended the term to 2019. We experienced no defaults in the first half, but have nevertheless maintained our UK credit provisions and remain generally conservative when it comes to credit risk.

Our balance sheet assets remain cautiously invested in high quality securities. We continue to have minimal exposure to trouble European sovereigns. Our direct holdings of securities and corporates that are on the Russian sanction list totaled £4 million, while holdings in Banco Espirito Santo amount to £28 million, and we have no exposure to Argentinian Sovereign debt.

Finally, on Jackson, our stance on variable annuity hedging is unchanged. Policyholder behavior is in line with our pricing assumptions. We remain focused on being appropriately diversified within the VA book; be it by vintage, types of guarantees offered and benefit levels. Updates to the usual additional information that we provide you on Jackson are included in the appendix to your slides.

So to conclude, our disciplined execution combined with our relentless focus on cash generative growth from our attractive and increasingly diverse business portfolio has delivered strong high quality and broad-based financial performance. This along with our conservative approach to risk management underpins our confidence in the future prospects of our business.

I will now hand you back to Tidjane.

Tidjane Thiam {BIO 7518525 <GO>}

All right. Thank you, Nic. So, I think you'll agree with us that this has been a strong first half and I think Nic's presentation confirms the breadth and the strengths of that performance. I believe it underlines the quality of our strategy, we have the right strategy, the quality of the execution of all our teams across the world, and many of them are in the room today. But I also think the fact that we've been effective in allocating capital and we've given you a few examples.

It's very easy to underestimate the value of the levels we have, the optionality we have, the breadth of business and channels we have, and how that allows us to generate at group level for best outcomes for our shareholder. And I must say that having said everything we have to say about CER, I think the group numbers even on AER are very defensible. It's really a very strong performance in a very challenging environment.

So back to the macro and this is really our outlook. On the positive side, we believe there is a recovery in the U.S., in the UK, and it's very strong. And that is a strong tailwind for the company going forward in the U.S., in the UK for our businesses in those markets, but also in Asia to which we're exposed very significantly. On a more cautious side, there is the geopolitical uncertainty we're all aware of what's going on in the world.

And there is also the transition to a less accommodative world, particularly in the U.S. And we remain cautious regarding the potential unintended consequences of that, and you see us holding on to a number of reserves and being very strongly capitalized, because we are always keeping an eye on credit and credit risk in that scenario. But it's a risk, but we think we are well-positioned to deal with it.

And looking at it regionally, we've discussed some of the short-term cyclical headwinds in Asia, we believe they are completely short-term and completely cyclical. I believe in the long-term potential on those economies is intact. We firmly believe we're going to outperform the Western economies in terms of growth. We believe that we'll drive appreciation of their currencies in the medium to long-term. And that view has not changed, we remain extremely bullish on Asia.

In the U.S., with a recovery on top of all the rest and the strong position and the quality business we have, again, we're very bullish, very strong. And in the UK as illustrated in this first half, there are new opportunities. We believe we have all the skills to take advantage of those, so really in a nutshell, a very good first half, a very bullish outlook for the rest of the year.

And I think now we're ready to take your questions. So, I'll move to the other side of the stage and we'll start the Q&A.

If you have any question, raise your hand. We have two roving mics around. And once you get the mic, please state your name and your firm's name and go with your questions. We'll go to Jon here.

Actually, sorry, I wasn't sure that we're able to set this up quickly. So, I'm going to go back here, it's easier. There you go.

Q&A

Q - Jon M. Hocking {BIO 2163183 <GO>}

Good afternoon. It's Jon Hocking from Morgan Stanley. I've got three questions, please?

A - Tidjane Thiam {BIO 7518525 <GO>}

Yeah, go ahead.

Q - Jon M. Hocking {BIO 2163183 <GO>}

Firstly, Nic, you talked about the hedging impact on cash in the first half, but there's also some phasing impacts. I just wonder if you could break that out a little bit more in terms of what the hedging benefit was on the cash for the first half, please? Secondly, on the U.S., I just wondered whether you've made any pricing changes to the living benefit product, given how well equity markets have done in the U.S. Have you changed the features at all there? And then finally, just on Solvency II, I wonder if you could give us an update on what your expectations are for equivalents in the U.S., and also the PRA implementation and matching adjustment for the annuity book? Thank you.

A - Tidjane Thiam {BIO 7518525 <GO>}

Thank you, Jon. Nic, do you want to start with hedging?

A - Nicolaos Andreas Nicandrou {BIO 15589153 <GO>}

Yeah, I'm not going to give you a running commentary on the effectiveness of our hedging or otherwise. There are many moving parts. We only hedge part of the remittances. It's not everything. We only hedge the sizeable ones. The timing and the size, we're very - depending on the type of instruments that are available to us and indeed when we know that we have outflows in currencies, we factor that into our cash planning.

So beyond, really, the reason for raising is, I didn't want to give you the impression that the cash that you've seen from Asia in the second half of last year, indeed in the first half of this year was after, if you like, absorbing the currency effect. That is to come through and it will come through as we go through in the second half of the year and beyond.

There are no one-offs outside that. We've said before that we're not looking to increase the remittance ratios, if you like, go deeper into the internal remittance ratios, we guided you in the past that remittances from the business will grow in sync with free surplus generation. We like the buffers that we have in those businesses. We've always said that in the past that we will retain enough capital, not only so that we can direct it to the most profitable opportunities. And there are many in these countries as you've seen in the results, but also for uncertainty. And as you've seen the overall, even though free surplus stock has increased, the coverage ratio has remained broadly unchanged, reflecting that the book is growing all the time.

A - Tidjane Thiam {BIO 7518525 <GO>}

I think just - okay, go ahead. But I'd like to build on that.

Q - Jon M. Hocking {BIO 2163183 <GO>}

Any hedging in place now or all the hedges have rolled off pretty much in the first half?

A - Nicolaos Andreas Nicandrou {BIO 15589153 <GO>}

Well, it's a rolling thing. So, as we look into the second half of this year and then into next half, we've started that process; but no the - as I said, it's up to 12 months that we hedge and the drop in currencies came around this time last year.

A - Tidjane Thiam {BIO 7518525 <GO>}

We really hedge more for budget reasons than for economic reasons. And it's something that predates all of us. When I arrived at the group, it was already the policy and we've kept it, because it's just for to cover expenses; but fundamentally, we continue to believe those currencies will appreciate, okay?

We don't want to hedge too long into the future because we think that is economically wrong and also, as Nic said, a lot of those countries don't have forward markets anyway. We told them, you cannot hedge. I would say, at one level you're going to have to trust us on that. If we focus on the free surplus generation, that's really the hard data you need to look at. Is the business generating the cash? After that, where we need the cash? This is why we're always reluctant to give you short-term remittance target.

You've seen all the remittance targets always cumulative, so we're very confident that over four years or five years, we're going to extract x amount of cash. Within that, it's a bit of management call. Sometimes you leave it in this place because you know you have an outlay coming. You wait a little, it's, of course, the internal cuisine, which is in French – it's not – there is no economic value attached to that. And we will manage it to optimize, of course, ultimately the value in pounds of that.

But it's hard to tell you in H2 2015, we're going to extract this much because currencies may move in a way or it's okay. Fine, we're going to hedge the Korean one (71:28) there's a deep liquid market inflows; but frankly you're just going to wait in Vietnam, because the currency is weak and we should probably extract it next year. So, those factors are at play.

But the key takeaway is the dividend is not at risk, okay, it's so well covered, so deeply covered. We have so much cash at the center, and so much capital. And that's why really I wanted us to be in that position, where you don't end up doing silly things that are economically silly for cosmetic reasons, okay. That's value destructive for our shareholder.

We have enough capital and we're very comfortable. We can meet all our obligations and on top of that, we do a kind of economic optimization. So, I wouldn't worry too much, given as Nic said, those amounts are not material at the scale of the group, you're talking about £10 million here, £20 million there. It's not worth, if you wish to show a big optical number in H2, I think, destroying economic value, and that's what you would be doing. Second was, is that okay, Jon.

Q - Jon M. Hocking {BIO 2163183 <GO>}

Yeah.

A - Tidjane Thiam {BIO 7518525 <GO>}

Pricing changes in the U.S. with the S&P level?

A - Michael Andrew Wells {BIO 4211236 <GO>}

Yeah, Jon, we did, in April. So, in Q2, we did a commission reduction and we did a suspension of certain withdrawal and debt benefits. We have the ability to turn those back on if we chose to, but the net effect of those – the benefit piece was affected about 31% of the sales going into that cycle. So, you're not seeing a dollar for dollar reduction in sales, but just to give you an idea that the magnitude of the change.

A - Tidjane Thiam {BIO 7518525 <GO>}

The other thing, I should mention in addition is that we're also using the current environment to – as we've always want to hedge deeper into the tail, okay. So, we have really very, very low volatility, very high equity market levels; that's a good time, that's the right time to go a bit further, and a bit deeper in the tail, that's a good move to make at this point.

Solvency II an update, look we're developing our internal model. I think that's progressing well. On the equivalent, we are probably more optimistic than we've ever been. But provisional equivalents with the U.S. looks very likely, so we don't see any real reason to worry there. The other development, I should probably mention, I know other companies have commented on it, that is the BCR, if you think of GSII, it's a positive development that also moving well, I think the regulators have done what they've said.

In meetings, they've told us that it would not - it would be set according to what it's called, the basic capital requirement, so relatively low hurdle. And everything, we've seen there makes us feel quit relaxed about it. I don't know, Nic, probably if you want to add anything? Blair?

Q - Blair T. Stewart {BIO 4191309 <GO>}

Thanks very much. It's Blair Stewart from BofA Merrill starting - three questions. Starting with the U.S., I think every time you report, you say that the spread income will start to come under pressure or the spread will come under pressure - never seems to. So, just can you update on that, it's been relatively good, again?

Secondly, in Asia, was Singapore a little disappointing? It wasn't one of your double-digit markets, I don't think. And I guess one for Jackie, maybe a few words on the new product initiatives you seem to be spending £100 million or so over the next couple of years. Is it lack of the platform, a drawback when you think about draw-down et cetera? Thank you.

A - Tidjane Thiam {BIO 7518525 <GO>}

Okay. Thank you, Blair. Nic, do you want to take the spreads?

A - Barry Lee Stowe {BIO 15021253 <GO>}

If you'll see that the size of our general account isn't increasing. I'll just give you a little more color. So, what's happening is you have new business coming in and it's mostly from the fixed annuity option that is offered as part of the VA offering. And on that the crediting rate is 1%, okay. So, yes, we're investing it into the new securities that have lower yield, but the crediting rate is lower. So, as you put more of that on to the book and some of the older stuff moves on, you'll see the average crediting rate and the average yields come down and brought roughly that explains the statement I made earlier.

We have - we did do some - we did enter into some swaps back in 2010. And candidly, the benefit that we got from those has lasted longer than we were expected, not least because interest rates have stayed lower for longer, which is why that is coming through. Interest rates will normalize at some stage. So, I stick to my guidance to you that this thing will come down. It will head towards the 200 basis point level. This is typically where we've operated. So, that's where we're headed. And my prediction of getting there by around now has not proved right, but I didn't think interest rate will stay as low as they have done.

A - Tidjane Thiam {BIO 7518525 <GO>}

And one case where you're happy to be wrong. So, it's okay. Barry, were you disappointed by Singapore?

A - Barry Lee Stowe {BIO 15021253 <GO>}

No, not really. I mean, obviously 11% growth is not as good as 25% or 30%, I mean, that's always more fun and easier to explain. But the reality is in most of the markets across the region, we're experiencing headwinds of different kinds. And Singapore is not immune to that. So, at 11% growth, we gained share in Singapore. I think that's probably the key takeaway.

Bank came off a little bit; the Maybank relationship that we've had there that sort of deals with the middle markets, one of our smaller relationships. It's been a good relationship. They are taking that in-house, they're bringing Etiqa, which is their own company from Malaysia into Singapore. And they've made the decision to take that in-house. That impacts us a little bit. It's not huge, but it impacts us a little bit.

But, we're making up for that really in the near-term with agency, where we've actually recruited some additional agents, some experienced agents, which is unusual. In Singapore, you usually don't see a lot of agency growth. You just try to focus on remaining, highly productive, and it is already a highly productive agency for us; but even having said that, in addition to growing the scale, we also improved the productivity by about 5%. So, I think it's a good result.

A - Tidjane Thiam {BIO 7518525 <GO>}

Yeah. Well, thanks for flagging. But please note, we are losing some distribution in Singapore. How can I say this? Two sides to every coin. The problem is, I think our success and how transparent we are about it, it does attract a lot of attention, sometimes unwanted. So, we're losing SingPost...

A - Barry Lee Stowe {BIO 15021253 <GO>}

Yeah, SingPost, which was quite small and then Maybank.

A - Tidjane Thiam {BIO 7518525 <GO>}

Yeah. But we're happy to lose it, because you will never see us chasing volume. You'll see us chasing value, not volume. At the price, at which, it went, we're very pleased...

A - Barry Lee Stowe {BIO 15021253 <GO>}

It tells well, yeah, I mean.

A - Tidjane Thiam {BIO 7518525 <GO>}

I'm pleased we're losing it. It's fine. And I wish good luck to the new operators.

A - Barry Lee Stowe {BIO 15021253 <GO>}

Yeah.

A - Tidjane Thiam {BIO 7518525 <GO>}

And generally when you see us losing bancassurance volume, it's for value reasons. So, we're losing SingPost. Maybank, as you said, they're taking it inside...

A - Barry Lee Stowe {BIO 15021253 <GO>}

Maybank, they're taking it in-house, they...

A - Tidjane Thiam {BIO 7518525 <GO>}

They stopped working. So basically, the thing in Singapore, you've got very good market statistics. Market went up 1.4%. So, 11% in, Barry was being modest in the market that went up 1% is very good. And within that, agency went up 21%.

A - Barry Lee Stowe {BIO 15021253 <GO>}

Yeah. We're still number one in linked. We're still number one in PRUshield, or health shield products. So that is actually quite a strong performance.

A - Tidjane Thiam {BIO 7518525 <GO>}

The pressure is on the banking. Sorry?

Q - Blair T. Stewart {BIO 4191309 <GO>}

[Question Inaudible] (79:25)?

A - Tidjane Thiam {BIO 7518525 <GO>}

Into the region, yeah. The volatility in the region, the uncertainty, Singapore has an explicit strategy of having a beta greater than one to the regional economy. Of course, when there is a bump, I guess...

A - Barry Lee Stowe {BIO 15021253 <GO>}

It's also just one other point that a lot of our competitors are driving most of their growth by selling Universal Life to high-net-worth customers. A lot of those customers come from Indonesia, okay? So, the Indonesia play – what's happening there plays directly into what happens in the high-net-worth space in Singapore.

A - Tidjane Thiam {BIO 7518525 <GO>}

Correct. So, actually, the performance is quite strong. And we're under pressure in bank. That's why we're very pleased to have SCB, where we can work in quality for 15 years. We've got 15 years with Standard Chartered; we've got 10 years with UOB; other relationships, I think, will be transacted because some people are so desperate to show

Asian growth, but they literally will pay any price for any Asian volume and we have a big enough platform, but we're just not willing to do that.

So from time-to-time, someone comes to us and says, pay five times, and we say, no. And then we have to stand here and explain to you why in market A or B, we went backwards. There is a big story embedded in these numbers and really have a limited time. We had slides on that too, and we haven't put them up, but there is some pressure on the banking side. We lost (80:52) in the Philippines, some good questions, HSBC basically closed down....

A - Barry Lee Stowe {BIO 15021253 <GO>}

They stopped selling.

A - Tidjane Thiam {BIO 7518525 <GO>}

...they stopped selling. That will explain the numbers and there is some pressure from Citi. That's why we're so happy, but our bank distribution is mostly long-term deals where we have really a long-term partner to work with and that's very good. Sorry for long answer. Jackie, our new products into the UK?

A - Jackie Hunt {BIO 16204866 <GO>}

Yeah. So, when we talk about moderation of the cash remittances to the group to the tune of up to around £50 million per annum. It's actually a very broad-based range of products and propositions and in fact some of our core systems that we're investing in, the ones we've been vocal about, we've talked about in the past, PruFund or ISA, flexible draw-down products, getting on to external platform. I should say the platform solution, we think is critical, but actually it's single-digit millions in terms of its investment, so pretty modest.

And then also just broadening sort of our digital capabilities, we have almost no way in which customers can interact with us on a digital basis and some new business strain. So, I think, it is a mix of a very wide range of potential solutions, longevity solutions. We think annuities will remain a suitable product for many customers as we go forward into 2015, they're likely probably to buy it later in their lives, but actually many will still be looking for some sort of longevity protection.

So, it's really looking at the opportunities that the budget has given us. And we think, actually the underlying direction of traveler is very positive for the UK business, because we think releasing a need on the compulsory annuitization will encourage people to save more. And I think that create opportunities for us and it's broad-based in its nature.

A - Tidjane Thiam {BIO 7518525 <GO>}

I think there was a question on platforms, too, Blair, you were asking – is not having a platform an issue?

A - Jackie Hunt {BIO 16204866 <GO>}

Yeah, I mean, so I talked in December about my view on platforms, so if you look at money is moving on to platforms, it's where customers want to deal with us. It's the way in which our advisors want to deal with us. I don't think we necessarily need to own a platform. We need to have technology that can – and products that can work on various solutions.

I think the lines are actually blurring between right platforms, for example, in some of the policy admin systems. So, I think directionally moving into digitally enabled world is important for us. It's part of this underlying investment, but it's not in the kind of way in which we might have talked about this, sort of, three years, four years ago. I think it's just much more blurred sort of environment now.

Q - Blair T. Stewart {BIO 4191309 <GO>}

Okay. Thank you.

A - Tidjane Thiam {BIO 7518525 <GO>}

Who's next?

Q - Andy Hughes {BIO 15036395 <GO>}

Hi. Andy Hughes at Exane BNP Paribas. First question is on the U.S., on the kind of the provision you've made. Presumably, given it's the U.S. it's not too rude to ask how much the fine is likely to be rather than whether you will have a fine. Presumably, you're not the first to make this kind of error, so have other people who've done this before been fined for this? And if so, roughly how can we estimate what a range it might be?

And second question on Indonesia, I'm bit confused with the message on Asia that it's very robust in regular premium, and therefore, not subject to the economy. But then in Indonesia, we're saying their long-term investment decision is that fall off is going back to the full-year results when we said, when the – obviously, the inflation – sorry – the election was then – concerns about the election at that stage. I think we said in March that the Asian sales were up 19% year-on-year. So, I'm just trying to work out what's happened in terms of election of since March time, when things appeared to be at their worst? Thank you.

A - Tidjane Thiam {BIO 7518525 <GO>}

Okay. Thank you. On the U.S. and Curian, Mike, do you want to take that and Barry I'll come to you...

A - Michael Andrew Wells {BIO 4211236 <GO>}

Yeah. So, to put some color around the Curian issue. So, through an internal review, we found that certain fees that we're collecting around the wrap fee portion of Curian, probably aren't compliant with ERISA. So, we self reported to the regulators that's – all the U.S. regulators and the PRA, we sort of an external sourced investigation to go through the entire process to make sure that both Curian and Jackson's funds and platforms were reviewed.

There is no – we're almost complete with that process, Andy, there's no suggestion of any intentional wrongdoing. To your point on fees, there is – the issues seem to be around ERISA, which the Department of Labor, which generally charges a percentage tax. And we talk to them every week through the process, but we've yet to get to the point with them, where we're discussing those levels. So beyond that, given we're engaged with the regulators on it, I don't really have much more I can tell you. We think the provision that we put up is what we estimate the effect to be; and by year-end, we'll have all the clients, any fees that were collected that shouldn't have been – will be rebated to the clients, plus the tax implications by year-end. And that system's work is in place now.

Q - Andy Hughes {BIO 15036395 <GO>}

Okay.

A - Michael Andrew Wells {BIO 4211236 <GO>}

Again, nothing to do with the main Jackson business, to be clear.

A - Tidjane Thiam {BIO 7518525 <GO>}

Okay. The next one was Indonesia; can we just explain better what happened there.

A - Barry Lee Stowe {BIO 15021253 <GO>}

Sure. So, the reason that we are flat and everyone else in Indonesia is down most by double-digit, some pretty significant double-digit drops is because the resilience of our agency force. Although, the agency force is stable, and Tidjane alluded to in his presentation, recruitment continues, number of active agents is up about 4% in the first half, case sizes are stable, but the number of cases per active is down slightly.

So, again, what you're seeing is not that people are buying less, what you're really seeing is that people are delaying. And one of the reasons they're delaying is because – we also alluded to the fact that interest rates have been moved up, government took the smart decision to do the right thing, which is in some respect, it's kind of painful, but they did it. So, you've seen a corresponding increase in deposit rates. So, what customers are doing in an environment where there is some uncertainty, and I'll come back to that point in just a second. They have a choice to say okay, I've got a $1,000, I'm either going to agree to give you $1,000 a year for the next 20 years, or maybe I'll put the $1,000 in a bank at a pretty high interest rate and wait three months and see what's happening and that's effectively what's happened.

We've seen it happen before in markets when interest rates go up. It particularly hits the bancassurance players, because deposits are now so attractive that you've seen our competitors who are heavily reliant upon bank distribution, which we are not in Indonesia, you've seen their results really crater. And I suspect that will continue in the short-term until things stabilize. As to the political situation and what impact that has had. Two elections this year, the first was in April, everyone expected...

A - Tidjane Thiam {BIO 7518525 <GO>}

The legislative elections.

A - Barry Lee Stowe {BIO 15021253 <GO>}

The legislative election, right. So, the first one was legislative. And everyone expected Jakowi's party to dominate that parliamentary election, and then that would, sort of, be the read through to what would happen in July in the Presidential election. His party won, but by a fairly narrow margin, and so that's really when people started wondering what was going to happen and if actually they had predicted the right horse was going to win the race.

Ultimately as you know, we got to the election last month. Jakowi did win, 53%, his challenger is now contesting that in the constitutional court, which does create again some uncertainty and disruption. That's not without President; I mean elections have been challenged. SBY was challenged before when he was elected. The expectation is that the election was fair and clean. It's a pretty reasonable margin of victory. So most people assume that he will be certified sometime later this month, early next month, and then you'll get to an inauguration of the new President towards the end of October. And our hope is about the fourth quarter then things will sort of perk back up and will stabilize. But that's essentially what it feels like on the ground, right now.

A - Tidjane Thiam {BIO 7518525 <GO>}

I think that's exactly right. Q3 is going to be very much like the rest of the year, no fireworks. And the upside in Q4, really – when the President is inaugurated, is in October?

A - Barry Lee Stowe {BIO 15021253 <GO>}

October 21.

A - Tidjane Thiam {BIO 7518525 <GO>}

After that, you'll have a much clearer horizon. We can take probably one more question. I think we are over time already.

Q - Oliver G. Steel {BIO 6068696 <GO>}

Oliver Steel, Deutsche Bank. Three questions, if I'm allowed that. The first is, just going back to the U.S. re-pricing and, sort of, changing of terms and I mean normally there's a bit of lag effect where volume actually even sometimes goes up after you've changed that. So, I was just wondering if you could quantify that and perhaps give us some easy guidance looking forward into the second half.

And secondly, on the UK, the extra £50 million a year, rather the reduced £50 million a year of cash remittance just, say, that it's clear, how does that sort of breakdown into, say, the IFRS effect versus cash. I suppose how much is sort of new business strain and capital strain rather than just sort of straight costs? And then the third thing is the U.S. remittance, certainly surprised me on the upside.

A - Tidjane Thiam {BIO 7518525 <GO>}

Good.

Q - Oliver G. Steel {BIO 6068696 <GO>}

Is that just normal remittance or is there something behind that. And perhaps especially linked to my questions, I thought you were looking to make bolt-on acquisitions in the States, and yet you do seem to have raised remittance quite strongly?

A - Tidjane Thiam {BIO 7518525 <GO>}

Okay. Thank you, Oliver, U.S. re-pricing more detail on how it's going to play out in terms of volume, yeah?

A - Michael Andrew Wells {BIO 4211236 <GO>}

Yeah. So, Oliver, I think, one of the competencies now the U.S. carriers have to have including us is you have this balance when you're re-pricing your product between giving the advisors notice to not surprise them when they have trades in process, and meetings with clients. Again it's typically three or four meetings with the consumer before they actually select the product. The more notice you give them, the more of a fire sale before the changes you get, okay? The sooner you have to make the changes to get to the desired sales level you want. So, it's this very interesting relationship in the two.

The reason you see the surge in sales with us and competitors after the changes is the 1035 pipeline. So the amount of exchanges from other VA contracts that come to us, those can land anywhere from three days to weeks later, and so we get this backup of business that's processed in the typically four weeks following. So, it gives you impression you had more sales after the change, you actually had them leading right up to the changes, okay?

So, our intent is to do - I gave you an idea of the scale of the business impacted by the changes, my earlier comments. I think there, we have the group risk appetite and how much VA we want to write with living benefits obviously where - the EA franchise is outside of that. We clearly have strong demand for our products. Every time I've been up here we've talked about the product changes. And we've made them all way through the post-crisis every quarter now almost.

Where the key is, I think, the core product is still really good, if you ends for the consumer, it's still I think the best variable annuity contract that consumer can buy both in performance in line funds, control of funds, and pricing. So, that was - the commission change was a unique one for us. We've never done that before, but again, we're trying to keep the consumer proposition rate where it needs to be. And I think if you talk to U.S. advisors when you go there - I think that's the consistent view, as it's the best product on the Street. So you see it in the earnings growth; that these clients actually participated in the market on the way up, consistent with the allocation to equities. So, we have lots of demand, we'll continue to manage it to the levels that plan ones - the group. And we've chosen to bring them in at.

Q - Oliver G. Steel {BIO 6068696 <GO>}

Yeah, absolutely. IFRS and cash impact of lower remittance?

A - Jackie Hunt {BIO 16204866 <GO>}

Yeah. Oliver, a straightforward question, so how is the cash going to play through into IFRS, I mean, if we talk first about the product initiatives, there are split between those that will be written into the with-profits fund, clearly anything that benefits with-profit funds, they compensate for some of the investment costs associated with that.

And then there will be an element of new business strain and new business strain is one for one and to IFRS results either. You know, very roughly, I would say, if you're looking first half of this year, new business strain was up about £22 million, roughly double-ish and this is in the forecast, so to say you could kind of commenced the sort of £40 million, and then sort of £10 million or £15 million development, it kind of feels at the right sort of order. But clearly, we haven't, many of these things are at an early stage of development. We haven't really gone through all of the sort of process yet.

A - Tidjane Thiam {BIO 7518525 <GO>}

We discussed very much whether to give you a number, or not. We're giving you one, so, you understand, this is not material. Yes, there is investment, but on the scale of the group and the commitment we have, it doesn't change anything, it doesn't move the needle. But it'll have a very beneficial impact on the UK business we hope.

Why such big returns when you have bolt-ons? I'll take this one. We don't store cash in the U.S., if you wish, in the expectation of bolt-ons. The way we manage the group is that we remit what we can. There is no major friction at that level. The business is left with an RBC of 427 or after paying the dividend, so it's really comfortable. Happy to have it at the center, probably it's not exceptional. It is justified given the size of the business, the size of the upside and the scale of a profits generated, which are very, very strong. We're just pleased. And this is playing out positively. It's a very, very strong dividend. So, thank you again. We like to have cash at the center. I always listen to my IR. I think you should take one more question. So, one more, and then we will stop.

Q - Abid Hussain {BIO 17127644 <GO>}

Abid here. Just two questions. One on U.S. fixed annuities. Can you talk about your appetite to write fixed annuities should U.S. rates rise over the next two years to three years? And the second question is back on the UK. In the UK, the payback period increased to five years, is that driven by both annuities and can you just tell us how should we think about that going forward?

A - Tidjane Thiam {BIO 7518525 <GO>}

Okay. Thank you. (96:09).

A - Michael Andrew Wells {BIO 4211236 <GO>}

The fixed annuities and the fixed index annuities, in particular, we really like. I think both require both higher rates and better spreads. It's not just the rate increase; you actually need to be able to generate some yield above treasuries that you're happy with the risk you're getting.

So, in a more normal – if both of those two were more normal; yes, we have definite appetite. The FIAs, we've talked before is a natural offset to the withdrawal benefit and the VA. But it is – if you look in the documents you got it were shorter on duration higher on credit. We keep being conservative with the portfolio right now, it just doesn't feel like the time to annoy up some competitors out there, so a lot of stuff. But just doesn't feel like the time to be pushing that part of the price. My biggest concern whether the rates go up, those clients will need to surrender and we'll be able to afford the surrender to get into new, higher yielding products, if you think about material shift in rates, couple hundred basis points. So, we just won't be as sticky a vintage, in my view.

A - Tidjane Thiam {BIO 7518525 <GO>}

Yeah. The UK payback periods Nic or Jackie?

A - Nicolaos Andreas Nicandrou {BIO 15589153 <GO>}

The impact – sorry, it's an average, of course, depending on the link to the product that we're writing. The major change has been the fact that we've written less retail annuity. Retail annuity had a positive strength so almost an instant payback in that sense. So, the fact that we're writing less of it means that the average is longer.

Your question on bulks, now when we say that we only write bulks on attractive economics, we don't only look at the IRR, but we also look at the payback. So, it is in bulks, there is no relaxation or change, if you like in the payback pattern that we're expecting from the bulks that we're writing. It's purely the effect of mix and retail annuities just coming back a little.

A - Tidjane Thiam {BIO 7518525 <GO>}

That's a really important comment, because the bulks, we are focused under the high-end of the market, if you wish, because really when we talk about capital allocation and the competition for capital inside the group, it is real.

The only way exactly we can hold our head up is if everybody thinks that I'm not giving her, what you say an easy passage – an easy pass literally or given her a pass on capital when she is writing – they're quite merciless in their competition really. So, basically, the capital that goes into the UK as a group risk adjusted return, otherwise she doesn't get it. So, really the bulks we write, we're actually very proud of, we can look anybody in the eye and say this is good value and that money I'm happy not to invest in Asia or not to invest in the U.S., because if it wasn't the case, she just wouldn't do it.

We don't do things for volume reasons or cosmetic reasons. So her, the deal she has done with the team, and the others are really excellent. So, you should not expect the deterioration of any of our core metrics, because we are starting to reimburse, other than the strain and we gave you a magnitude in H1 is £22 million, it is not going to deteriorate any thing.

So with that, thank you for your patience and I have real pointing at the screen there, like another slide, there we go, because you are cordially invited to join us in Asia on December 1. It will be a two part trip Singapore, where our main event will be and we will show you – showcase the business and talk about other parts of the group too. And then, a special for Jakarta. For those who want, that will be optional. But we will be lift the lid on Indonesia, for those who've never seen it, or for those who want to see it again and it's always a very worthwhile trip.

So, again, thank you for your patience and have a good holiday for those who are going on holiday, we certainly are in a few days. Thank you.