Q4 2014 Earnings Call

Company Participants

- Clifford Abrahams, Finance Director-Aviva UK General Insurance
- David Barral, Chief Executive Officer-UK & Ireland Life
- John McFarlane, Non-Executive Chairman
- Mark Andrew Wilson, Group Chief Executive Officer & Executive Director
- Maurice Tulloch, CEO-United Kingdom & Ireland General Insurance
- Thomas D. Stoddard, Chief Financial Officer & Executive Director

Other Participants

- Abid Hussain, Analyst
- Andrew J. Crean, Analyst
- Ashik Musaddi, Analyst
- Barrie Cornes, Analyst
- Blair T. Stewart, Analyst
- Chris J. Esson, Analyst
- Fahad U. Changazi, Analyst
- Gordon Aitken, Analyst
- Jon M. Hocking, Analyst
- Oliver G. Steel, Analyst

MANAGEMENT DISCUSSION SECTION

Mark Andrew Wilson {BIO 7102576 <GO>}

Well, good morning, everyone, and welcome to Aviva. For those of you that were in the room for the Friends Life presentation this morning, I hope you enjoyed it as much as I did. I must confess, it was an interesting experience sitting on the other side at a results presentation. What was going through my mind at the time, I was imagining all those difficult and obscure questions I could think of. But congratulations, Malcolm and Andy and Tim and the team. Using my vernacular, very satisfactory results.

Now when I arrived at Aviva a couple years ago, it was clear that there were a number of issues to address and I've always been very consistent that there is much to do. There still is. But taking a step back, I think you would agree today that today's results show tangible progress and leads us nicely into the Friends deal from here on.

So, let's look at the numbers. The numbers are to, I guess, coin a phrase, entirely adequate, with all the key metrics moving in the right direction. Cash, which, of course, is our most important metric, that's up 11% to £1.4 billion. But probably, more importantly, our holding company excess cash flow, or as my friend Tom here calls it, our after, after, after cash, that's up 65% to £692 million. That's very satisfactory progress towards our £0.8 billion target.

Operating profit for the group, that's up 6% to £2.2 billion, and that's despite those headwinds in foreign currency and lower interest rates and lower annuities, but there's some headwinds and tailwinds there that we'll take you through later.

And our operating EPS is, of course, at more than that because of the restructuring done with the business, in particular with the minority interest. And so, EPS is up 10% to £0.47.

In 2014, we continued our drive for efficiency throughout the business. And we're bumping on this journey for a while and we're going to be on it for a lot longer as well. Now, total expenses are down 7% in the year to £2.8 billion, and that shows a cost reduction of £571 million on the 2011 base line of expenses. That was, of course, as you know, against our £400 million target.

Our value of new business, which we look at as our growth metric in life insurance, that increased 15% in constant currency to just over £1 billion. That's actually the first time we've ever surpassed the £1 billion mark in our history.

In general insurance, our combined operating ratio has improved to 95.7%, and this has been our underwriting result. Now, the underlying underwriting result is the true measure of growth in general insurance, and that has grown 54%.

Our balance sheet has also improved. IFRS book value per share is up 26% to £3.40. And MCEV book value is 14% higher at £5.27 per share.

Now, I recognize that this result on book value could be characterized as - I don't know - surprisingly desirable. But I don't want us to all get carried away just yet. Some of this move was from IAS 19 in terms of the pension accounting, and Tom will take you through that in some depth later.

Debt is also lower. And so, leverage ratios today are now almost within our target, and that's before the impact of the Friends acquisition. Our economic capital surplus is stable and our liquidity is also within our risk appetite, again, before the Friends transaction.

So the natural consequence, I guess, of an improved financial position and performance is an increase in dividend. And our 2014 dividend, as you know, was 30% higher, taking the total 2014 dividend to £0.181 for an overall full year increase of 21%.

Now, hopefully by now, you've become accustomed to my style. We've had quite a few meetings like this. I like to focus on our problems more than I do our successes, and that's certainly the way we run our group. And one of the benefits of coming to Aviva is that there's been no shortage of problems to address. And as I outlined in July to you in the Analyst Day, I outlined the summary of the key issues as I saw them.

Now, these – I'll call them historical issues, because obviously some of these have been addressed a little bit quicker than we had anticipated, but these historical issues fit into two buckets; cash flow on one hand and growth on the other, which, as you know, encapsulates our investment thesis.

Now, you've seen these issues before on the slide. So first, let's look at the cash flow issues as we see them. On efficiencies, as you remember, we set out a target in July of achieving an expense ratio of below 50% by the end of 2016. In 2014, the expense ratio has reduced to 51.5%. So we are on track, but frankly you know as well as I do, more can be done.

Secondly, our excess cash flow has long been inadequate at the group center. And I think what's probably unique in an insurance company is the way we define excess cash flow, that really it is this after, after, after. And our excess cash flow historically had been inadequate even to cover the dividend at the group center. Our 2014 excess holding cash flow is 65% higher and, for the first time, the surplus more than covers the cost of the full year dividend.

Now, while our standalone target of £0.8 billion of holding company excess cash flow, we've announced that our Friends Life deal was expected to add a further £0.6 billion to this. And the question, of course, is how quickly can we achieve it.

The third issue. The third issue I mentioned was that our Life back books are inefficient and capital-intensive. And today, we announced just under £300 million of profit from net – that's pluses and minuses – from our back book initiatives. Now, I've also articulated that there are many more, hundreds of millions of operating profit that come from our back book projects around the group, and this will happen over a number of years.

And finally, on this slide of the issues, our leverage has been an issue that has hampered our flexibility for a long time. Now, you've seen the results today. This is clearly much less of an issue now than it was even a year ago. And our 2014 leverage ratios are 41% of tangible capital and 28% on my preferred S&P basis, which is also within our target range.

And the combination with Friends takes the issue of our external leverage off the table for the first time in a long time. Now, I think that position itself would have seemed totally unrealistic to many just two years ago.

Now, growth is the second part of our investment thesis. And it's clear that as our cash improves and as our dividend payout ratio normalizes to the 2 times, we need to deliver on growth. And over the next three years, you will see us much more actively reallocate resources – that's both capital and people – to the growth businesses and the growth cells around the group.

So the question, of course, is where will we allocate this capital? Now, you know that I think it is total nonsense to look at insurance by region as each market has its own regulation and characteristics. There is little in the way of economies of scale regionally in insurance, in Asia or Europe or anywhere else for that matter. That's why we look at insurance market by market, and even within that, frankly, cell by cell.

So you will see us seek out growth from businesses and cells in both mature and developing markets alike. We look at Asia in some markets like Indonesia, like China, like Singapore; and in Europe in places like Poland and Turkey, where we have some leading positions in some of these exciting insurance markets.

But the point is also that the UK has very attractive prospects for growth in certain segments. For example, the UK corporate pensions, we expect to capitalize on our clear scale and cost advantage. And we do have a cost advantage now in a market that should triple within 10 years. In addition, our grand and composite position gives us a systemic, competitive advantage in general insurance, if we can make use of it.

And we've also made it clear that we need to go contribution from profits from our asset management business. I'd like that to be a much bigger part of our profit contribution. And the best way to do this is by growing scale and by growing our third-party fund flows. Now, the Friends transaction takes care of the scale point. That's the first part.

And for our external fund flows, we are focusing on our AIMS range of products. And the AIMS fund currently – this is eight months after launch -- currently has just over £1 billion of funds under management. And we would, especially with our recent distribution agreement with Virtus, we would expect that momentum to continue. There's a bit of expectation on the Euan for AIMS, just as an aside.

Now, the net fund flows across the group are also important. In 2014, we had £2.7 billion of positive Life flows. That's obviously excluding the profits. And our UK fund platform now has over £5 billion in it. That's double what it was last year.

And what about cross-sell? We've spoken about that before as well. Now, I know I'm not going to convince many of you in this room that this is going to make a meaningful difference in the near term. That's okay for now. Indeed, history is littered with failed attempts at financial firms trying to increase cross-sell.

But, of course, the difference between this current environment and that of the past is that the impact of digital on how we sell to our products and how we engage with our consumers and the substantially lower number of intermediaries in the market. That's just life in the digital world. And I would note that we do have some pedigree in this business, and last year alone we wrote over £1 billion of digital and direct revenue in 2014.

So now to a few remarks on the Friends transaction. I've read a lot of research. In fact, I read all of your research. But I've read a lot of research that's on us that suggests we're going to be distracted by the Friends Life integration. Keep on writing it because – why I say this because it helps me manage the change that we need. It adds impetus to more dramatically overhaul the way we do business. You see the way I look at transformation and turnaround in a business like Aviva is you need a catalyst. And this is a great catalyst. But I do agree it's not going to be easy. We need to integrate as fast as we can knowing there will be some pain in 2015, and it will be messy.

But let me just remind you about the size of the prize once we execute. The transaction should give us £600 million of incremental cash flow. And I think we've proven when we put numbers out there, we will generally deliver. That will give us £225 million of expense synergies, the ability to move to two times cover ratio on our dividend.

Strategically, it secures our leading position in the home market of the UK. That's good. It brings 5 million customers to Aviva for us to cross-sell our broader range of products into, whether it be GI or the wider range of Life products or asset management. It gives us a bigger back book from which we can extract synergies and greater expertise in this area from the, I think, exceptional job the Friends Life team has done on their heritage books. The deal adds scale to Aviva Investors by in-sourcing up to £70 billion of funds under management, helping it become a bigger contributor to overall profits.

And finally, of course - and please don't underestimate this - but finally, it gives us higher levels of capital and cash, and that allows for opportunities for investment in other growth cells and growth markets where we see high returns and high growth.

Now, I have full confidence in Andy, who you've heard speak this morning; and, of course, Nick Amin, our Integration Director. I have full confidence that they will extract the synergies we have targeted. And detailed planning on this is, as you would expect, well under way.

Now that we are able to even contemplate such a transaction such as Friends Life I think shows improvements we've made over the last couple of years, including repairing the balance sheet, reducing costs, and growing the profitable segments of the business.

So, when you think about it all in that context, and before when I was talking to a number of you, a couple said, are you happy with where Aviva was at? Well, of course not, because I think we've got a long way to go, but I guess I'm happy with the progress that we have made. And as the numbers show, we have come a long way in a couple of years.

And talking of the numbers, to talk you through these in more detail, I will hand over to our CFO, Tom Stoddard.

Thomas D. Stoddard {BIO 15071280 <GO>}

Thanks, Mark. Good morning, everyone. Aviva's transformation is continuing and I'll take you through more of the details. As our results show, we continue to lay the foundation for the future, making progress on improving our financial performance and increasing our financial flexibility.

Full-year results are positive. We've achieved a good bottom line despite unexpected adversity, regulatory change and competition. As you work your way down the left-hand side of this slide, you can see that the results get better and better. Overall operating profit is up 6% to £2.173 billion. After restructuring costs, we're up 21%. And profit after tax is 91% higher at £1.7 billion.

Looking at the bottom-right, the number I focus on is operating EPS, which is up 10% in a difficult environment. We've had both headwinds and tailwinds this year, so let's look at the upper-right of the slide and start by ticking off the headwinds against us.

Outside the UK, foreign exchange has been a big drag, with the euro, Canadian dollar and other currencies depreciating against sterling. This has depressed operating profit by £87 million.

Here in the UK, regulatory actions have set us back as well with our Life operating profit from individual annuities down £70 million. And not having Aseval and CxG in Spain, Eurovita in Italy and our River Road Asset Management business in the U.S. meant forgoing £42 million of operating profit relative to 2013.

Adding that all up comes to about £200 million of negatives against profits over time, and I haven't even mentioned the low interest environment, some bad weather in Canada and the recently announced FCA settlement costing us £18 million in other operations.

Nevertheless, as you can see from the slide, our focus on efficiency has paid off, enabling us to sustain our overall momentum with expense reductions and back book impacts, including the tailwind of favorable mortality experience on our approximately £30 billion of annuity reserves, enabling us to achieve operating profit growth.

At the same time, we've continued to recruit talent in the organization, with expenditures on digital, customer and asset management initiatives reducing current profits but enhancing our prospects for the future.

Now, this next slide is a new one, to take a closer look at operating EPS and ROE, consistent with my theme of paying attention to the bottom line after, after, after. The key thing to take away here is that, in addition to growing operating profit, we reduced the cost of minority interest through our restructuring efforts in Italy and Spain. These directly benefit shareholders by adding to EPS.

Also note that in 2015, the DCI costs will be lower given that we called the capital instrument in November, having pre-financed it with hybrid debt in July.

The other observation to make on this slide is on IFRS return on equity. While we're very focused on improving returns on capital and we really like the increase shown, on this page up over 200 basis points to 17.4%, you should note that we compute and report ROE based on opening equity, which was a little less than £8 billion for 2014.

However, as you'll see on the next slide, our book value has gone up significantly this year to £10 billion. So, opening equity for 2015 will be much higher. That will obviously affect the ROE number that we'll report next year. In any event, we focus primarily on long-term economic returns.

So, moving on to book value. The growth in net asset value per share, NAV, has exceeded my expectations, increasing 26% to £3.40. The contribution from retained earnings is satisfactory, but note that the movement in the pension fund is especially favorable and highly dependent on factors outside of our control such as interest rates and credit spreads.

We do not manage our pension funds on an IFRS basis, so you should expect continued volatility from this line as we report it under IAS 19. We looked at hedging the accounting impact, but the cost is expensive and probably not in the best interest of shareholders.

Instead, we manage our staff pension funds on an economic basis in accordance with the actual funding requirements. On that basis, the Aviva staff pension scheme is about fully funded but not overfunded as the IAS 19 reporting would suggest.

So, we're effectively over-hedged in some respects relative to the IFRS surplus. And in 2014, this meant that widening UK corporate bond spreads and falling interest rates resulted in a £1.3 billion increase in our pension surplus on an IFRS basis. Put simply, the £0.70 increase in NAV is more than what I would ordinarily expect in a year.

What I would have expected, ignoring the pension fund, investment variances and foreign exchange but deducting dividends and restructuring costs, would be approximately a £0.30 increase from operating activities. In any event, we'll continue to watch NAV closely as growth in book value will be important to sustain future growth in the business.

Now, turning now to our individual business units. Our largest, UK Life, has had a momentous year, beginning with changes to the annuity market and ending with the proposed combination with Friends Life. In the midst of this, the UK Life has delivered 9% increase in operating profit and a 30% increase in cash remitted to the group center.

As you know, we've been managing UK Life to increase cash remittances and they have, rising from £150 million in 2012 to £300 million last year and £390 million this year. The business has benefited from an active capital management program and de-risking activities.

Now, the cost of these de-risking and hedging activities has been a negative to operating profits, but they benefit capital and cash so I consider them worthwhile. At the same time, our operating profits have been further reduced by lower volumes of individual annuities, which certainly was not desirable.

So, profitability in UK Life would have been down if we had not also benefited from a 7% reduction in operating expenses, as well as from favorable mortality experience. For 2014, we released £282 million relating to longevity assumptions versus £66 million in 2013.

From the half year, you will also recall that we had released a significant expense reserve, but this has now broadly been offset by a charge we've taken to DAC primarily related to the DWP pension cap. We did not have a comparable expense reserve release in the second half. But as Mark said, we may in the future, and we continue to take actions affecting our back book.

In terms of trading, our results on value of new business recovered nicely in the second half and ended approximately even for the year, with strong results in equity release, bulk purchase annuities, and protection offsetting declines in individual annuities. Net funds flow were a positive £1.5 billion, driven by an 88% increase in managed assets on our UK Life platform.

So despite adversity, this business has delivered in its role of providing increasing cash to the group while also responding to a changing marketplace. We look forward to improving it still further with the addition of Andy Briggs and the combination with Friends.

Now turning to UK GI, our underwriting profit was up 70% to £199 million. The combined operating ratio was the best in 15 years, coming in at 94.8%, reflecting expense efficiencies and relatively favorable reserve development compared with the prior year when we strengthened commercial motor reserves. Net premiums written were down 4%, with most of the decline happening in the first half of the year. The last quarter of the year was basically flat, with an encouraging pipeline going into 2015.

Overall, UK GI did well to deliver operating profit growth of up 6% to £455 million despite earning £70 million less investment income because the internal loan ran at a lower balance on average in 2014. Bear in mind that the investment income on the internal loan to UK GI is an expense to the center and is eliminated in consolidated results.

The GI market remains very competitive, so we're continuing to focus on expense efficiency, underwriting, better investment management and capital management.

Results in Europe have been solid, with operating profit up 9%, value of new business up 27% in constant currency, and cash remittances up 17% to £454 million despite adverse foreign exchange movements.

VNB in Europe has benefited from higher sales and margins of unit-linked products in France as well as margin improvements in Italy and Spain from management actions to reduce the level of guarantees on with-profits products.

In France, our largest business in Europe, operating profit was £452 million, which is about the same size as UK GI. Italy was a star in turning around cash, VNB and operating profit. Spain returned significant cash and capital. And Poland delivered £192 million of operating profit, VNB growth of 31% and cash remittances of £106 million – cash flow and growth.

In Turkey, we completed the successful IPO of our life insurance business, AvivaSA, and extended our bank insurance joint venture with Sabanci Holding (sic) [Holdings] (24:54) for another seven years. We're also pleased to have completed the exit of our GI business in Turkey in December.

In Canada, we experienced good growth with net written premiums up 6% on a local currency basis, but the Canadian dollar was 13% lower against sterling on average during the year. Nevertheless, cash remittances were also up 6% in sterling to £138 million.

Large losses, weather and less favorable reserve development affected COR, but management has been disciplined on expenses. So, the net result overall is that COR in Canada deteriorated 1.5 percentage points to 96.1%.

In any event, Aviva Canada is one of the core cash generators in the group, with a high return on capital plus opportunities for profitable growth. We will continue to focus on underwriting results here while also advancing our customer and digital agendas.

Okay, switching back to the overall perspective. Value of new business for the group was up 15% in constant currency, which shows the benefits of diversity and indicates the potential for growth across Aviva. In the UK, strong margins in equity release and higher volumes of bulk purchase annuities helped keep us even for the year despite all the changes to the annuity market.

Meanwhile, our growth markets of Poland, Turkey and Asia accounted for 22% of group VNB and have grown collectively 25%. Turkey was down 3% in constant currency, in part driven by local market conditions and in part by the IPO diluting our share of the total. China, meanwhile, doubled its VNB, continuing very strong growth.

And at the bottom of this slide, you'll see that our new business margin was up overall and, in fact, it was up in virtually all of our individual markets.

Now, the next slide illustrates components of our GI combined operating ratio for the group. In our disclosures, we've also added a new table showing how this breaks out regionally in the UK and Ireland, Europe and Canada.

Overall, as you can see, in 2014 we had slightly higher underlying loss ratio, but we benefited from improved expense management and had fewer lines where we needed to strengthen reserves. So, our overall net development was more positive. In total, the group COR improved to 95.7%.

We still believe there's room for improvement in the COR, but we want to balance this with growth as the point is to increase underwriting profit year-over-year. In 2014, Aviva's underwriting profit was up 54% to £321 million.

As you know, at Aviva, our business units are all very focused on continuous improvement, and you can see that from the segment expense ratios here. Life operations have led the way, with a significant improvement in expense ratio from 33.3% down to 30.1%. GI has made progress, while Fund Management and our smaller Health segment had been about flat.

We expect to continue to grow Aviva Investors, which means spending money on people, product development and distribution in the short term, so it'll be harder to improve the Fund Management expense ratio until we bring in more assets under management. That's the scale point Mark was making.

Overall, the expense ratio is down to 51.5%, which is progress towards our target of getting below 50%.

Putting it all together, our business units have performed well, with cash remittances in sterling increasing 11% year-over-year. This will continue to be an area of focus for us as we look to improve the cash flow efficiency of the group relative to our operating profitability.

Moving down the slide, we've also become more efficient at the center, with the net effect being that excess cash flow at the center is up £272 million, a 65% increase, and good progress towards our standalone target of £800 million. This provides good support for the long-term sustainability of growth in our shareholder dividend, which we've raised to £0.181 for the year.

And we still have much more work to do to improve our cash flow on a standalone basis. However, as I've said before, proposed acquisition of Friends Life is accretive to cash flow coverage and cash flow per share.

You can also see that our operating EPS dividend cover ratio has moved from 2.8 times to 2.6 times, and we are reiterating our intention to move to 2 times over the medium term. This is consistent with our investment thesis of cash flow and growth, in that order.

Turning finally to the balance sheet. We've managed our economic capital surplus throughout the year to stay within our risk appetite while continuing to improve our overall financial flexibility and resiliency to stress. On a like-for-like basis, our economic capital is up slightly, and our cover ratio is exactly the same as last year at 182%. This year is a little different, however, in that we announced our final dividend early in December, at the same time as the Friends Life transaction announcement.

Our liquidity also remains within our comfort levels at approximately £1 billion. It was more elevated a year ago, including proceeds from the sale of our U.S. operation which closed in 2013.

We've used cash to improve our financial position in 2014, reducing external debt by £305 million, bringing down the internal loan, and investing in subsidiaries such as the internal reinsurance mixer. Through cash and non-cash actions, we brought down the balance of the internal loan another £1.3 billion to £2.8 billion now. And we remain on track to get the balance to the target of £2.2 billion level by the end of the year in 2015.

As Mark pointed out, our debt leverage has improved to the point where our current priority is to reduce our financing cost and improve the composition of capital. Our leverage stands at 28% on an S&P basis, which we consider a better measure than the TNAV basis where we've improved to 41%. With the Friends Life acquisition, we see no further requirement to delever.

The Friends transaction will make our reporting a bit more complicated during 2015. But once the deal is approved and closed, we will work with the analyst community to help you understand what the combined company should look like.

And that concludes my review of our results. 2014 was an exciting year for Aviva and 2015 is shaping up to be another one to watch. We enter the year with better financials and better prospects and yet still much more to do, starting with the combination with Friends Life.

So before we go to questions, I'll turn it back over to you, Mark.

Mark Andrew Wilson {BIO 7102576 <GO>}

Thanks, Tom. I'm always interested when my CFO describes it as exciting. I'm not sure whether that's a good descriptor or not. But it has been two years, isn't it, since we launched our cash flow plus growth investment thesis, and I've got to agree that today's results show some tangible progress in all those key areas. Certainly, we've identified the major issues to overcome and we've tackled these. We've launched our strategic anchor, we've launched our value set, and we are seeing the early signs of changing our business model and these are emerging. But then, frankly, they need to continue to emerge. We've completed the major acquisition. Well, sorry: we have a major acquisition to complete. We haven't completed it yet. We have a major acquisition to complete and to integrate. And with all of that, it's going to be quite a year.

But before I open up to Q&A, I just wanted to take a few moments, just for a few comments about John McFarlane. So, this is indeed his last results presentation as Chairman of Aviva. And as you all know, John is taking up the role of Chairman of Barclays, and I'm sure, John, they will benefit greatly from your experience and your insights and your wisdom. And of course, it was John who kicked off the initial turnaround of Aviva. And, indeed, John is the reason that I'm here as well.

And personally, John's been a great support for me. He's offered wise counsel and plenty of challenge. And John, I will miss your guidance, but I know you'd agree totally that John and I and the team are delighted that we have the board continuity and will greatly benefit from the experience of Sir Adrian Montague. Adrian's got an outstanding experience and we know him well and he's been a key part of this journey that we've been on with the board. And also, we of course have someone of the pedigree of Sir Malcolm as our new SID.

So we, I guess, say goodbye to John and welcome Adrian as the Chairman and welcome Malcolm and, of course, Andy to the board as well. So, John, best of luck at Barclays.

John McFarlane {BIO 1509370 <GO>}

I haven't gone yet.

Mark Andrew Wilson {BIO 7102576 <GO>}

I should point out, John is really going to be judged on an AGM that is on the 26th of March and an AGM shortly to follow it after. So, John, don't screw it up.

And with that, ladies and gentlemen, let's open up for Q&A. As usual, I have some of my team here, and we can move on.

Now, I understand, Jon, is you can't write any notes. So, I know your conflict about writing notes, so you get the chance for the first question, then we'll move onward.

Q&A

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

Thank you. So Jon Hocking from Morgan Stanley. I've got three questions, please. First, on capital, just wonder if you give us an update on how confident you are with the Solvency II approval process and just practically how it's going to work with Friends? Does that create complications in the transition year, and would you expect to go the full economic capital benefits of the merger?

A - Mark Andrew Wilson {BIO 7102576 <GO>}

Okay. A few comments and I'll pass over to Tom on how we're going to do with Friends. Solvency II, as you know, has come a long way in the last couple of years. I think when I first came here, it was, I would say, unsatisfactory to say the least, I mean, this performance of (35:01) Solvency II. And each month that's gone past, you've had more certainty and more clarity and as we've through an internal model, where as we work through that process about where we thought it would be.

But I always put a strong caveat on this: still unknowns, there's still a lot of unknowns you still have to work through, but the process is going in line with where we expected. Tom?

A - Thomas D. Stoddard {BIO 15071280 <GO>}

Thanks, Jon. Obviously, Solvency II has been a big area of focus for us, and with the upcoming transaction, an even bigger area of focus. So as you might imagine, we've spent quite a lot of time with the regulators talking about the implications of that transaction and trying to get comfortable from a Solvency II perspective and we obviously have.

In terms of exactly how we're going to manage the transition, Friends will be on a standard formula basis to start. And again, once we complete the transaction, we'll start the transition to bring them on to our partial internal model.

A - Mark Andrew Wilson {BIO 7102576 <GO>}

And as you point out that not all of our countries will be on the internal model and some of our countries are just (36:06) partly time and regulators and focus. Some will be on the standard model to start with in some of the smaller countries.

Andrew, you've the next?

Q - Andrew J. Crean {BIO 16513202 <GO>}

It's Andrew Crean from Autonomous. Three question. Firstly, could you – you used to give us what the value of the buyout basis on the pension fund is. I wonder whether you could supply that. May be in the documents. I'm not sure.

Secondly, you talked quite a lot about hundreds of millions of potential benefits, particularly in the UK Life side. Can you give us a bit more visibility on this? One we're particularly focused on is the expense loadings relative to where your expenses currently are. It'd be useful to have some visibility around that. And then thirdly, you're aiming at this £1.4 billion after, after, after. Can you talk a little bit about what – and that's free of any encumbrances on it. Why shouldn't one pay the whole of that out?

A - Mark Andrew Wilson {BIO 7102576 <GO>}

I'm going to answer the third question first and then I'll pass over Tom. When you're in a business and the thesis is cash flow and growth, obviously, you need to balance that out. Why we're not paying it all out is we have a two times cover as we were targeting. Of course, you could, couldn't you? But I'm not going to give any guidance on that today. So the answer to your question is, of course, you could. Of course, you could, but the only guidance we're going to give on dividend today is that we've got a two times earnings cover. Okay? So, I know this is not particularly helpful for modeling but, of course, you could. (38:07).

A - Thomas D. Stoddard {BIO 15071280 <GO>}

Sure. I'll give you my perspectives, which I agree with Mark 100%, but a part of the decision will be where can we invest capital and get good returns. And if we don't see good returns, we'll look to return that to shareholders. And if we think we can get good returns, we'll continue to invest in the business.

In terms of your three questions, first, on the pension schemes, we're approximately fully funded right now on an economic basis. I don't think we've provided anything around what the cost would be to buy it out. But I can say that right now, the way we manage this, we're approximately fully funded.

In terms of back book actions and expense policies, we haven't provided any guidance on precisely the amount and timing in terms of predicting when those actions may come through. We will be developing policies in terms of how we report that and in terms of securing expense saves. And so, we'll work with the analyst community once we've got the transaction completed and closed to sort of talk about those policies. I think that covers it, Mark.

A - Mark Andrew Wilson {BIO 7102576 <GO>}

Yeah. There's a lot of actions to take in the back book, isn't it? So some of them, for example, as you say, expense savings, and you know how it works, because they're all capitalized and then you release some of it.

So, it's tangible management actions that lead to that stuff. We've got a pretty good idea on what we're planning on the next few years. But we got to execute, and there's a lot of work to do. And I think the big plus is we've got Andy and his team that, frankly, have more experience on it than we do as well. So, there's lot more to go on that.

Yeah, Chris.

Q - Chris J. Esson {BIO 6194371 <GO>}

Hello. Chris Esson from Credit Suisse. Two questions, please. Firstly, so you progressed pretty solidly on value of new business. But when I look at your undiscounted free surplus, it fell on aggregate over the course of the year. Now, you alluded to FX playing a role on that, but I wondered if you could please provide some sort of breakdown between underlying progression of free surplus and the FX component of that change.

Secondly, just looking at sort of half-by-half numbers, there was quite a big improvement in your business trends the second half of 2014 compared with the previous three half years, and that seemed to be driven by the UK where you had policy strain of £37 million in the second half. Just would be interested if you could provide some details on what caused that as well, please.

A - Mark Andrew Wilson {BIO 7102576 <GO>}

Tom.

A - Thomas D. Stoddard {BIO 15071280 <GO>}

Sure, I'll take both of those. On the undiscounted free surplus, I think if look at that closely, you'll see that almost all of the impact there is in the final bucket, sort of the very long-term cash flows, 20 years and further. And so, it's driven by two factors. One is foreign exchange, but the other is just the impact of a lower interest rate environment over a very long term. Some of that is in our business in France. We haven't split out those two components separately.

In terms of the new business strain, let me ask Clifford if we got that, but I believe that's because of the product mix here in the UK.

A - Clifford Abrahams {BIO 7425676 <GO>}

That's right. We've had a strong half year for equity release in particular.

A - Mark Andrew Wilson {BIO 7102576 <GO>}

And, I mean, just from a product mix, so if you have a look also in other countries like Italy for example, because we structure those business, we were able to be in control of the product mix and we maintain the product mix.

So, our business now isn't as sensitive to interest rates as most. We've been operating the environment for a long time, the high-guaranteed products and the high-guaranteed businesses. The U.S., we sold the U.S. because it simply didn't work for us in Solvency II. Sri Lanka, Eurovita...

A - Thomas D. Stoddard {BIO 15071280 <GO>}

Yeah, (41:42).

A - Mark Andrew Wilson {BIO 7102576 <GO>}

So, all these – a lot of the high-guaranteed businesses are being sold out and you've seen that come through in the results. You've also seen that as well, we're posting our margins in VNB. And so, you're seeing all those actions over the last couple of years coming through in these sorts of results, and you should continue to see that.

Oliver, (42:14) get down in the back and another, so.

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

Oliver Steel, Deutsche Bank. Two questions on the pension fund. I'm not particularly fussed about the volatility through the TNAV, but what number are you putting in to the economic Solvency? How volatile is the pension fund number in the economic Solvency calculation and does that have an effect on your required capital?

And then, if that counts as sort of one question, the other question I've got is what progress have you made in reducing the tax, taking the central costs and interests?

A - Thomas D. Stoddard {BIO 15071280 <GO>}

Sure, I'll take both of these questions. So on the impact of the pension fund on Solvency II, I guess what I'd say simply there is there is still uncertainty around Solvency II in terms the precise application of a number of different policies and issues. So, I really can't give you any good guidance on that at this point. Obviously, when we get to the end of the year, once we've gotten model approval, et cetera, we'll be reporting on Solvency II basis and can take you through all that detail once we get there.

In terms of tax, we really haven't changed our tax policy at all. We continue to do things to try to manage our capital efficiency around the group. But there's really no update on tax matters.

Q - Ashik Musaddi {BIO 15847584 <GO>}

Hi. Thank you. Ashik Musaddi from JPMorgan. A couple of questions, first on bulk annuities. You mentioned that there's some uptick on the value of new business from bulk annuities and, at the same point, one of your peers is kind of putting a word of caution on bulk annuities ahead of Solvency II. So, I mean what's your take on bulk annuities ahead of Solvency II from a capital perspective?

Secondly, there's quite a lot of improvement in your combined ratio, especially in the UK. Can you give us some color about how to think about in the future? I mean, you earlier talked about when your underwriting is going up, you can switch the tap on for new business, higher volume. So, some thoughts on that and sustainability on combined ratio. Thank you.

A - Mark Andrew Wilson {BIO 7102576 <GO>}

Okay. So the bulk annuities, I'm not going to talk about our competitors at all. I do, however – I will point out that last time we were together where we had this question, I can't remember which one asked that, and I seem to be alone in the market thinking that the bulk annuities margins would decline. And I also seem to be alone in the market thinking that that didn't work in some of the large areas. Now, it appears that that was probably getting closer to our views, doesn't it?

So, we are sticking to the mid-range bulk annuities. This is where we've been operating in because that's where we see the margins. And frankly, one of the reasons for that is that's because that's how our investment process is set up. So, we're set up we're just more efficient in that segment of the market.

So what you saw in annuities, to be clear, you saw overall, I think, I might say (45:23) 16% drop in total annuities in terms of VNB. Within that though, you saw about £100 million in terms of VNB come off on individual, and then they got made up by some of the other products that make up that category. So, that's the way to think about it.

Now, the £100 million, I'll congratulate Tom on his guidance, it was objectively our guidance and that's basically where we ended up. So, there's a bit of luck in that (45:41) on the guidelines I guess.

The second point was on the COR. And Maurice and the team have done an extraordinary amount of work getting out of the products that we didn't think were profitable. There were certain segments of the market here that we didn't like. There was bands, for example, in terms of commercial that causes problems, so we make some tough calls in there. And in the first part of the year and the year before, it did hit a little bit of our volume. And we just focused on the segments that we thought were good.

Now, an interesting thing about Aviva, I've outlived a few legacies, but one of the positive legacies that got lived by my ancestors here is the brand. And we can track this. We know that for the same price point, we're going to pick up more of the market share. And this is pretty much the same in annuities or car or home or whatever. So all other things being equal, so for a similar pricing point, we'll pick up more of the market share. And that's - the only thing we can put that down to are our claims experience is good, but fundamentally I think - and I don't know for sure - I think it's our brand.

And so, you've seen us do a bit of that. We put in predictive analytics. So obviously, we weren't hit in the floods last year as much we everyone else because of our predictive analytics. But guidance for next year, I can't give you any. One thing that Maurice hasn't worked out yet is how to control the weather. And we will get factors throughout the year. I'm sure we'll get some surprises. But it's been going in the right direction, hasn't it? So I'm not able to give you any guidance, but I can just give you the factors that impact it. If we get big weather events, we'll tell you about it. But, yeah, that result, particularly from the UK business, was very satisfactory - very.

Yeah, and then I'll come this side next.

Q - Abid Hussain {BIO 20229932 <GO>}

Good morning. It's Abid Hussain from Soc Gén. Just two questions, please. Can you give us any idea of the size of the potential capital synergies on your own back book on a standalone basis going forward? And secondly, how much capital would you like to allocate to the growth territories and how much do you think is actually possible over the medium term?

A - Mark Andrew Wilson {BIO 7102576 <GO>}

The first answer is no, but I'll see what Tom wants to add to it.

A - Thomas D. Stoddard {BIO 15071280 <GO>}

No, no. Look, we've got an active back book program going on. Friends has an active back book program going on. We're going to bring that together and you'll really look at what we can do together. But there's really not more information that I can provide.

Q - Abid Hussain {BIO 20229932 <GO>}

(48:20)

A - Thomas D. Stoddard {BIO 15071280 <GO>}

Well, yeah, in terms of the transaction, there's sort of four major areas where we expect to get benefits. Some of that would be from diversification, and I've talked about that before both within the Life business and then across the group. Some of the expense actions can be accelerated and released from reserves. There's optimization on a Solvency II basis. We've been doing a lot of work there that we can apply to the Friends Life product range and balance sheet.

And finally, there's just the way we sort of manage capital in our subsidiaries. When we bring their businesses over and merge them into ours through Part VII transactions, it will effectively create some benefits by managing them under our capital policies.

A - Mark Andrew Wilson {BIO 7102576 <GO>}

And then, where we're going to allocate the capital and how much, the answer – and I'm not being evasive, but the answer depends. I see capital as a competitive sport. And when you have a look at the capital sport, as I call it, let's say, it's a good job to allocate capital to the cells in the countries and then to use it in the most effective way. And so, how much we allocate depends on the business cases and how certain they are.

We're still doing a lot of work with Jason and the team on the capital allocation model. We're not finished with that yet, by a long shot frankly. But you look at number of factors, then you'll see. Look at returns, obviously. You look at the strategic fit. And thirdly, you look at the track record of the business. And we've had some good cases recently, we've said this, no, because that cell hasn't been delivering. So, we're not going to get capitals to somebody who's not delivering, much like investors I guess in that regard.

So, if we can't find the right mechanisms and the right places to put it, that they have got returns in the right period, well, we'll give it back to the shareholders if we've got excess. So, I mean that's sort of the way we think about it.

Q - Abid Hussain {BIO 20229932 <GO>}

Can I just to go back on the first question to Tom? How many Part VII transfers do you have in mind?

A - Thomas D. Stoddard {BIO 15071280 <GO>}

Wow. It's...

A - Mark Andrew Wilson {BIO 7102576 <GO>}

(50:23)

A - Thomas D. Stoddard {BIO 15071280 <GO>}

...it's really two. We sort of got internally our annuity business and our own subsidiary, that the parent there, we want to merge together sort of independently, and then we want to bring in the Friends subsidiary. So, it's effectively two in sort of broad-brush. The actual transaction details are very, very complicated.

A - Mark Andrew Wilson {BIO 7102576 <GO>}

Yeah. I wouldn't want to give you the impression that this is a sure piece of work, because it's extraordinarily complicated. It's doable. It's quite complicated.

Now, over this side. Blair?

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

Hey. Thanks very much. It's Blair Stewart from BofA Merrill. Three questions, if I can. A couple for Tom. Tom, on slide 10, you helpfully isolate some of the one-offs. But I just wondered if you can clarify a little bit further, because you mentioned there's back book actions. Of course, there was also the mortality aspect in the UK. So, just a little bit clarity there, because I don't see the mortality explicitly mentioned. And also, the impact that it has on cash, presumably a straight return to cash as well from those.

Secondly, just coming back to the combined ratio and looking again at the helpful disclosure on slide 18. I think there's an underlying loss ratio deterioration. I just wonder if you expect that to stabilize, whether you think 1.6 points is the appropriate level of reserve release going forwards and whether the expense ratio can fall further. That's probably more than enough, thank you.

A - Thomas D. Stoddard {BIO 15071280 <GO>}

Okay. A lot in that. So one-offs, we try to highlight on one of my first slides sort of the net impact year-over-year of back book actions. So that's in part due to expense actions and in part due to the longevity reserve releases. And so, just to come back on that, it's primarily favorable mortality experience in the annuity business that is driving that release of longevity reserves.

And in terms of cash, what I would say is that we're managing the UK Life balance sheet sort of holistically and looking at improving the resiliency of that business, and reducing exposures there. So, yes, in theory it translates into cash. But as a practical matter, we're sort of managing the balance sheet there more holistically.

Moving on to the loss ratio question, generally, we've got a mix of businesses this year. So, I think you have to look at each of the businesses and the trends there. The deterioration in the underlying is primarily large losses and weather that was worse than the prior year, but, again, we can't really predict, as Mark was saying, exactly what the results are going to be next year, but we're trying to improve that all the time.

I'll turn it over to Maurice here in just a second, but in terms of favorable development, we would expect a certain amount of favorable development year in, year out. It's hard to predict that on any particular year. The prior year, we had some exceptional strengthening around commercial motor, maybe we went too far on that because we had quite good results there this year. And in terms of expenses, I think we can do better on the expense ratio. So, Maurice?

A - Maurice Tulloch {BIO 17683736 <GO>}

Yeah. Let me just add a couple of comments. I think if you look at the reserve movement, let's talk about the two large GI businesses. So, Canada was 5.5% in 2013 and favorable, and down slightly to 3.5%. That's largely driven by Ontario Auto. And if you look at the UK, we strengthened 13.7% and this year it was favorable by the 1.5%.

In the UK, if you look over the last five years, you have to remember, we're largely in a short sell business. Through the last five years, in the UK, we've been between plus 2% and minus 2%. So we're not like some of our competitors that are in the minus 10%s and minus 13%s. And your last question on expenses, I think the best way for me to answer it, am I satisfied? All the businesses have made improvement, but I'm still not satisfied. I think we have a ways to go on our expense ratio.

A - Mark Andrew Wilson {BIO 7102576 <GO>}

I think on the expense ratio, we've done more in the Life business than we have in the GI business, frankly. And you can do expense ratio by two things: You can grow some volume, which helps and there's – I mean, we modeled the optimum volume for the expenses as well. And I think I said at the half year last year, we probably pushed some of that a bit far and there's a balance between volume and expenses. And so that's going to be a ever-changing test for us.

Yeah, Barrie, and then you're next.

Q - Barrie Cornes {BIO 2389115 <GO>}

Good morning. It's Barrie Cornes from Panmure Gordon. A couple of questions, if I may. First of all, going back to GI, you talked about COR. You also mentioned in the presentation about going for growth. Many, many years ago, the company did a dash for growth which was a bit of a disaster. So what sort of controls will you have on that growth? Which areas are you going to grow in?

The second question, again, one of your peers starts to move into equity release and made an announcement yesterday. Can you give us a shape (55:44) of what you think will happen with the margins in the market itself in equity release in the UK, please?

A - Mark Andrew Wilson {BIO 7102576 <GO>}

Sounds like bulk purchase annuities, doesn't it? GI growth, I need to be really clear what I'm talking about as growth. I don't care less about the top line. I don't remunerate anyone in this business for top line because I think it's totally irrelevant. So growth to me is value of new business, which comes out in cash flow later in terms of Life. And for these guys it's about growth and underlying profit is the true measure.

So, Maurice and his team don't get paid £0.01 of bonus for growth in top line, just to be absolutely clear, because it's not relevant. So just to – so this is an old hobbyhorse of mine that the oldest game in the GI book is you grow the top line. The market seems to think it's good, really? Well, I don't.

Now, equity release. Equity release is a growing segment of the UK. It's something certainly that with the pensions gap in the UK in particular, you see the government, and I think with every government in power, I think you would see the government quite supportive of equity release because it helps fill that pension gap. Now, we've been doing it for how many years, David, help me out?

A - David Barral {BIO 17035123 <GO>}

About 16, 17 years.

A - Mark Andrew Wilson {BIO 7102576 <GO>}

16, 17 years, we have quite a few tens of thousands of homes in it where our maximum loan to value that we take is 25% or 26% – around that 26%, okay, 26%. So, it's pretty conservative. We've been doing it.

We haven't found that to be – it's not a market that's driven by the competitive dynamics per se. It's driven by the distribution dynamics and the brand name and that sort of stuff. So we welcome all competitors in that. We think it's good for the UK. We think it is going to be a substantially growing market. What's the old phrase? A rising tide? I think that's going to be a rising tide but you're going to get much more equity release over that time.

Now, for us, more the question is, how much capital we're going to put in it? How much concentration want to put in and we know we need the limits and that sort of thing yet, but it's more those sort of questions that we look constantly at about, that like any other cell where are we going to put our capital. So, that's the first question I've asked.

And the second question is the execution capability, that's it. But we have actually the person who heads in up in the far corner. So I'm sure it'd be – well, I won't cover it now but, Fahad, you can have a chat with people after the meeting if you wish. Yeah.

Q - Fahad U. Changazi {BIO 15216120 <GO>}

Yeah. Fahad Changazi from Nomura. Just very two quick questions, on your 90-day core integration program, will you be in a position to after that affirm or otherwise the cost synergy targets for Friends Life? And the second question is on UK motor, could you just tell us briefly what's happened in Q1? Where do you think the market is going, UK motor? And given your comments on growth...

A - Mark Andrew Wilson {BIO 7102576 <GO>}

Yeah.

Q - Fahad U. Changazi {BIO 15216120 <GO>}

...and expense ratio, will you be following the market or doing something else?

A - Mark Andrew Wilson {BIO 7102576 <GO>}

I don't think I'll – from the start, I'll hand over that to Maurice in a sec. Our role isn't to follow a market. Our role isn't to follow competitors. I think as a company, what we try to do is we look internally and say, this is where we want to play. But what we do find is when we have a certain price point, if we match the market's price point, we'll pick up more of the natural market share. The question is do we want to match that price point? And there's segments in the market that clearly, as we've shown what we've done, we make the calls to get out.

Do you want to add something to that? And then we'll come back to you, (59:40).

A - Maurice Tulloch {BIO 17683736 <GO>}

Sure. Thanks, Mark. I mean, if you look at last year, rates were down above 6%. Now, that followed a decrease of about 8% the previous year. Certainly – and there's three firms that quoted. So if you look at Towers or if you look at AA, the market did flatten out in Q4, arguably up 1% to 2%. We've seen the exact same sort of valuations in that range.

I'm not going to speculate on what the market's going to do. For every single risk that we write, we have a technical price and we look at the attributes. But we also look at, to Mark's point, we look at the cross holdings. We look at the broader view of brand. We look at the service proposition. I think if you think out a little bit, and we start to look at two customer composites, certainly understanding the market, we'll also price based on the individual attributes that come to Aviva.

A - Mark Andrew Wilson {BIO 7102576 <GO>}

So if we – just taking that forward, and this will be a lot of years to get where we want, but our strategic advantage is we're in quite a few countries that we're a composite. And obviously, we're the only major composite here so we have a strategic advantage.

In the digital world, if people have a pension scheme in motor and house, and you can have one statement or one premium and it's all online. And therefore, you only have one set of underwriting. You've got one set of admin that's all automated. And we're going fast. We now have the technology to do this stuff. You can see that you can take a more holistic view of the customer if you can get more of a total package from us. Good for them because it's simpler, they get discounts, and it's good for us because it's much more efficient to administer.

On your other question on the Friends Life, I'm not going to give anymore guidance than the £225 million. There is nothing – what I can say, there is nothing we have seen that wouldn't suggest we will meet that target. But I'm not going to go any further than say anything on that, which I'm sure you'll appreciate.

Yeah.

Q - Gordon Aitken {BIO 3846728 <GO>}

Thanks. Gordon Aitken from RBC. Just three questions, please. First, we've heard in an earlier presentation the FCA's view on back books in the UK. And just can you tell us what your share of greater than 1% charge schemes are relative to your market share? That's the first question.

Second question on – is back to the question on bulks and margin. I hear your view at the moment on large versus sort of medium sized. I know actual view on margins can depend on your ability to swap the gilts that the pension schemes are holding with high-yielding assets, and you already were investing in the asset management business that you have. Obviously, this deal adds a huge amount of scale. I was just wondering – here you know, but your ability to get those high-yielding assets is obviously picking up. So, is the view going to change on large-sized bulks maybe a year down the line?

Third question just on the pension scheme. You did a longevity swap last year. We set up a captive. Just wondering the favorable longevity you're reporting today, did you manage to lock that in in the deal that you cut with the reinsurers?

A - Mark Andrew Wilson {BIO 7102576 <GO>}

Okay. So, Tom will take the second. I'll take the first and I'll get part of the answer from (1:02:45). Just on the FCA review, just to be clear, we're not in it, okay? Just because the synergy of our bulk business, the market that would be covered by the review is small and they're very aware of what we've done. So, we're not in that review. And that probably helps.

On the other two?

A - Thomas D. Stoddard {BIO 15071280 <GO>}

On the bulks, in terms of the assets, we're investing there in a range of assets. We're continuing to look at potentially new asset classes over time. But we've been getting good returns and equity release in commercial mortgages, so that effectively drives part of our appetite going forward. But so far, we've had pretty good performance there.

And on the longevity swap question, John Lister, I mean – I guess I'd say that we've locked in the results in that transaction. I'm really not sure where the question's going though.

A - Mark Andrew Wilson {BIO 7102576 <GO>}

I think your question is, did we get the right terms on that transaction? In which case, the answer is yes. So, we were looking forward on the actuarial tables. Clearly, pensions is different to immediate annuities. We had a very competitive process. We've got a good rate and we're happy with it.

I mean our philosophy on all these things is you've got a market at the moment that creates yield, that creates return. And so, the way we look at our business is we keep on standing back and saying, look at areas of risk in the business like that one. And if the prices you can get at the moment make absolute compelling sense, well, we say we do those, and that's one example of that for us.

Q - Gordon Aitken {BIO 3846728 <GO>}

Okay.

A - Mark Andrew Wilson {BIO 7102576 <GO>}

Any further questions? Well, I think on that note, ladies and gentlemen, thank you as always for your participation. And I, as always, look forward to reading what you write.