Q4 2016 Earnings Call

Company Participants

- Anne Helen Richards, Chief Executive, M&G
- Barry Lee Stowe, Chairman and Chief Executive Officer, North American Business Unit
- Michael Andrew Wells, Group Chief Executive Officer & Executive Director
- Nicolaos Andreas Nicandrou, Chief Financial Officer & Executive Director
- Paul Chad Myers, Chief Financial Officer & Executive Vice President
- Raghu Hariharan, Director of Strategy and Capital Market Relations
- Richard Gradidge, Director of Capital Market Relations
- Tony Wilkey, Chief Executive-Prudential Corporation Asia & Executive Director

Other Participants

- Abid Hussain, Analyst
- Andy Hughes, Analyst
- Arjan van Veen, Analyst
- Blair Stewart, Analyst
- Edward Houghton, Analyst
- Greig N. Paterson, Analyst
- Jon M. Hocking, Analyst
- Nick Holmes, Analyst
- Oliver Steel, Analyst

MANAGEMENT DISCUSSION SECTION

Michael Andrew Wells {BIO 4211236 <GO>}

Good morning, everybody. If you don't mind, it's one after; we'll go ahead and get started. So I know most of you. I'm Mike Wells, I'm Group Chief Executive of Prudential; I should be able to get that right.

Starting my 22nd year with the group, and some of you I've known a decent part of that, and those of you who are new, welcome. It's – I'm obviously very pleased with the results for the year, I think I was kidding with a colleague in the States who called at a very early hour, and he said it looks like you guys had a very easy year. I don't think there's anybody in the team here or I think anybody in the audience that would suggest last year was – didn't have its challenges. We saw regulatory changes, we saw political changes, we saw rate movements that were – I would think volatile is a fair description and equity movement, and quite across all of our geographies and against that backdrop, I guess, I'm exceptionally pleased with the results.

I'm going to assume you've all read and reviewed the normal caveats about forward-looking statements, et cetera, and get right to it. So how did the year look, how did the year finish more importantly? We ended up with £4.3 billion of IFRS operating income. And we think that's a very good number for the year, the £3.6 billion of cash equally is important, up 10%. The Asia earnings driving that up 15% to £1.6 billion and again their cash up 15% as it should be to £859 million.

Strong progress towards the objectives. So I'll give you a bit of an update on those in just a minute. And then, from a Solvency point of view, we've - we're pretty well rehearsed in our view that Solvency II understates our capital position. But even on that basis, we came in at over 200%, £12.5 billion of surplus, and we think that shows the strength and resilience in any metric you'd like to measure the group and again pleased with that outcome and just how much capital this Group can generate. And then finally did that translate through to dividend? It's a 12% increase in the 2016 ordinary dividend. So we think the breadth and the consistency of the results across the year and across key metrics were key.

What's embedded in there a bit it's a little harder to see, I think was how good the second half was for us. I think there was someone said when we're up here for 2015; we said it was a tale of two years. I think the 2016 was almost to the week. But what you did see in the second half was broader success in Asia, better inflows in M&G, a shift in direction of winds, if you will, on the U.S. and I'll get into those a bit, but again the second half of the year felt better than the first.

So I did review some of my previous presentations with you prior to today. And one of the terms I use a lot is scale. And so I wanted, if I could to - if you'll indulge me to just put a little context around the thinking on that and how we view it, because I think it's important when we talk about the group, why you own it and also how it competes in its capabilities.

So one of the measurements of scale, and this is arbitrary and you could argue it's a bit self-serving, is our ability to increase our earnings by £1 billion. I would argue that's scale. It's an adult number. So one of the measurements of, can you see the business that you own improving is the frequency at which we can get the additional £1 billion of earnings.

I think if you look at that, it would imply the underlying business has to be doing things more efficiently and more effectively with its capital and its resources to accelerate that growth, so one argument I'd make with you. Okay. And again I think the growth is unique to the sector and certainly that level of growth is unique to the sector.

If its quality, okay, so that's frequency, how do I measure the quality of the scale, how do I know that you're actually building something that's sustainable, how do I know that it actually produces measurable, tangible results that that will come back to the shareholder and that's, I think the dividend.

So a lot of discussion around dividends, let's look at it in the short-term and long-term up 12% year-over-year, now totaling £6.8 billion of dividend to our shareholders in the last decade, okay. And that again that's scale translating to quality measured in terms of simply nothing more complicated than can it produce cash, forgetting any insurance accounting.

And then I think the biggest challenge that I heard over the year in 200 plus investor meetings we did, north of that was is it repeatable, okay. Can you do it again, is it possible that Prudential can continue to grow, right. So today in the results that we're going to talk about most today are about the red bars here, the portion of which we penetrated, where our successes are and some of this is well rehearsed and we'll go through it a bit again with you as the day progresses.

The upside, structural demand in these markets is a great piece, okay. So is there room in our various markets for us to continue to grow and I think there is, I think we've chosen our markets carefully and I think you're seeing that execution today. So there's significant upside in the businesses and in the markets we've chosen to play and it's our responsibility, not just to deliver the results we gave you this year, but to make sure the franchises are built to address that demand, right.

We've said it's a value over volume strategy, right. So discipline is a word that I know gets thrown around. We are disciplined with your capital. We are disciplined with the way we run the firm, can you measure that. Yes, the allocation choices we make. The businesses we've chosen to exit UK annuities, effectively Universal Life business in Asia, Japan, Korea, but when we choose to go further into a JV or not, these are all conscious decisions made by this group to look at the shape of the earnings that we have for you in total. And we look at the total rate of return, we look at the source of the earnings and we look at the return of the capital, which - what's the frequency of that. Can you measure that? You can. You can measure that in an IFRS ROE number, which for us is 26%. So we think we're reinvesting for you at rates of return that are highly competitive, okay, and payback periods that are very short, okay, and this is what we mean when we say a capital-light, right, again agile learning organization.

Is it repeatable? Asia's probably got one of the most dramatic slides in the deck on this. So, this is their 30th consecutive quarter of year-over-year growth, okay. And to be clear, this is not with a top line orientation other than the competitive nature of the team, okay. They are not paid on market share. They're not given every product that they could sell, the competitors have to drive market share. There is no product in the sector, in the broadest definition of Asia that we can't replicate if we chose to, right. There is no secret sauce if you will right now in Asia or any other market we're in. The conscious decisions where we have or haven't chosen to allocate our people, our systems and our capital.

So, the growth we're getting is in the segments we chose, leaving behind certain segments and it's still I think extremely compelling. And again, why? Because it aligns with market demand. How do you measure quality of earnings in Asia? One of them was recurrence. Again, 93% of what they're selling, we have a long-term client relationship that continues year after year after year and both the benefit we provide to that consumer and the earnings that provides our investors. So I think this one, it's an interesting look at our - at the revenue of our Asian model. So this sort of captures the historic success, clearly these numbers are dramatic, I mean if you look at the $3.5 billion, in the blue in the bottom here, if you will, so what's the effect of that revenue from the previous slide, it's very dramatic, it's also the level of the back book roughly in 2008.

So what you're seeing here is the compounding effect of the existing clients as those vintages we're talking about staying with us year-after-year. Okay.

Now, all the success our teams have, all the great choices they've made, the correct choice of markets, products, et cetera, we've grown in this slide from 7 million to 15 million clients, okay, a little bit upside left there given the greater population of Asia. Okay. And second, that is an increase in 20 basis points of market share effectively ex-China. Right. So is this team capable of doing more? Absolutely. Tony and the team since November have been looking at what Asia should look like at the next 5 years and 10 years, and we'll come back to that a little bit more later in the day, and we'll give you a lot of detail on that later in the year at the Investor Day.

But we think there's much, much more to do, and the simple structural demand of Asia is measurable, and the success we've had again at these sorts of incremental levels has produced the dramatic results financially.

So again, I think the revenue and relevance of this is there. You're not going to get there without asset management. It's incredibly low penetration business still in Asia, while wealth is growing at a multiple of it. So we think there's tons of upside, we told you we're investing in systems and people, in Eastspring you've seen us do that, and we'll continue to do that. And Eastspring had another great year.

Is it producing profitable growth? Yes. This is driving towards the objectives. Multiple times now this Asia business has doubled in its operating income. Okay. And you see the trajectory from the previous slides, its earning power from those existing relationships having sold the right products, having priced the products correctly, right. The tailwind that gives you. Okay. So we're obviously very pleased with it.

Going to the U.S., fairly material shift I think in the wins here politically. You may have noticed there was an election. It's a – the major impact for us was the DOL change. There's lots going on in a country. Are lower taxes good for us at the consumer level, yes. Are they are good for us at the corporate level, yes. There's bipartisan support I think for both. The Department of Labor language that was in the previous administration's past changes can certainly use a clearer, more consumer-centric review. It's getting that now. That we think has shifted from a bit of a headwind to a tailwind. Is it a flight to quality, is it saying that advice should be better, product should be better? It is, there's bipartisan agreement on that.

Flight to quality in the U.S., as you've seen previously, is a flight towards Jackson. It has the best products in the segment. It has the best technology in the segment. It has the best wholesaling in the segment. All those capabilities will be key where it's going, but it had a very good year last year. It captured the majority if not 100% of the industry's net inflows in the variable annuity business. A good growth for the consumers and the shareholders of the separate account assets, and you saw a very strong capital position. And again, this is after we renewed the permitted practice.

In the UK, as we shift these businesses to a capital-light model, the demand we're addressing here is the self-reliant savers in the UK, a lot of pieces moving. I talked to a lot of retirees here. I talked to a lot of pre-retirees here socially. People are trying to figure out as they are in the States how to navigate the retirement assets in a relatively or an absolutely low yield environment where you're going further and further up the risk spectrum. So we have unique products and services. Through that, we have an excellent asset management firm. Okay. And Pru UK can generate smooth blended products, be it draw-down or accumulation that are working very well in the marketplace.

As the consumer gets more and more control of their assets, they're demanding more stability of the underlying product. They're getting longer term in their thinking. That is our piece of the market. That is our segment. We're not a short-term trading account. We're the part that they want stability and predictable returns as they head into retirement and as they are in retirement. So again, the structural demand is there. Both our UK businesses are meeting it. And on the institutional side, you see M&G producing the unique, longer term, in some cases less liquid solutions for institutional clients at scale.

The objectives, I'm feeling pretty good about them now. I'll let you back into your forecasts and if you think we'll hit them or not from here, but you can see where we are in the progress of them. We think they're solid, also think they were the right metrics. Again, you're measuring earnings and cash back to how we look at the business. And again, we think the support at the group level and what we've seen in Asia were consistent with what we stood up here and told you when we placed these targets in front of you.

And finally, before I hand it over to Nic, just a quick recap. So we don't see any material change in the structural demand we have for the products and services of the company. If anything, in the U.S. and a bit in the UK, that demand is up. Asia continues to underpin the growth, just given the absolute scale of the structural demand of that part of the world and our ever-improving capability to address their needs. Our ability to execute in a variety of climates, political, regulatory, interest rate, equity, continues to improve. I think we've demonstrated that. I think we are agile, and agile is good for a firm our size. It's something that we challenge ourselves with, can we compete. And that could be anything from an entrance to a new market to an exit from a market. Both require the same basic skills corporately, and I think we've demonstrated that. And then you see a very strong balance sheet, very defensively positioned, again, the right way to be we think in this sort of climate and well positioned to capture some very long-term value for you.

So with that, I'm going to turn it over to Nic and let him walk you through some of the more granular financial details. Nic?

Nicolaos Andreas Nicandrou {BIO 15589153 <GO>}

Okay. Thank you, Mike, and good morning, everyone. So in my presentation, I will take you through our full-year results, highlighting the key drivers of our performance in 2016. And I will then cover the group's capital position.

Starting with the financial headlines, in 2016, Prudential delivered another strong performance across our main growth and cash measures and achieved new highs during a very challenging year. As you can see, new business profit increased by 11% to £3.088 billion, IFRS operating profit moved to £4.256 billion, and free surplus generation was up 10% to £3.588 billion. Currency effects have been a significant positive, adding between 8 and 13 points to our results when reported on a sterling basis. This performance demonstrates once again the benefit of the group's structural positioning, the strength of our earnings diversity by geography, currency, and source, and our ability to execute with discipline and focus.

The sizable contribution from operating earnings combined with our effective management of the balance sheet have driven our group solvency surplus higher to £12.5 billion and increased our embedded value by 22% to over £15 per share.

Our strong performance during 2016 has enabled us to rebase the full year ordinary dividend to £0.435 per share, representing an increase of 12%. So while last year was a true test to the qualities of our group's strategic and financial attributes, in my view, these results tick all the boxes with strong earnings and cash levels backed by a robust balance sheet.

Before looking at the results in detail, I want to take a few minutes to remind you of the key drivers that underpin the group's earning momentum both now and in the future. We said on a number of occasions that the diversity, quality, and scale of our franchises provide us with enormous strategic flexibility. Asia exemplifies these attributes and anchors the group's performance.

Our platform in this region has become adept at consistently capturing recurring revenue across market cycles. PCA's broad product offering, wide distribution reach, and pan-regional presence saw it attract £3.4 billion of new regular premiums in 2016, up 20% from the previous year. Adding this new business cohort to our already sizable in-force book increases the recurring premium base by 21% to £12.6 billion, a clear illustration of the power of compounding.

Underlying this growth in premium revenues is a relentless focus on quality. Our preference for health and protection income, which is uncorrelated to markets, is a well-known fact. We have maintained our emphasis in this area during 2016 and increased the contribution from insurance income by 24% to over £1 billion for the first time. This growth is broad-based. And as shown in the chart on the right, all our life operations have reported healthy increases. So our strategic choices, product, country and distribution mix, continue to translate these revenues into profitable earnings growth. The enduring nature of consumer demand in the region and the consistency of our execution drive strong annual profit progression and underpin the long-term outlook of our business in Asia.

Moving to our asset gathering businesses, the dynamics here are similar in that we are accumulating assets in our chosen market segments in a disciplined manner. Our ability to grow earnings in these businesses is dependent on consistently attracting profitable new flows while retaining existing assets and on managing costs with discipline. In 2016, we were among the very few in the U.S. industry to generate positive flows into our variable annuity business. This is a commendable performance in a year that has been disrupted by regulatory uncertainty and highlights the strength of Jackson's position in the industry. Overall, separate account assets were up 11% to $148.8 billion.

In the UK, we continue to benefit from the strong consumer preference for proof on smooth return multi-asset characteristics, which we make available through a broad range of products. Our strong momentum here is generating significant inflows, which are close to reversing the outflows from our legacy portfolio that have been present for many years.

In our asset management businesses, we saw an improved picture in the second half of the year, with Eastspring generating external net inflows of £2.2 billion in this period, and M&G reporting positive retail net flows of £0.9 billion in the fourth quarter. Taken together with the effect of the market rebound, M&G grew third-party assets by 8% to £136.8 billion, and Eastspring increased total AUM by 13% to a new high of £117.9 billion. This positive momentum in our four asset gathering businesses bodes well for future earnings.

Our ability to translate top line growth into earnings and then quickly into cash remains a distinctive feature of our group. We do this by consistently directing a new business investment in a disciplined manner, targeting capital life opportunities with high return and fast payback characteristics. This value and cash-based risk management philosophy pervades everything that we do as a business.

We will not hesitate to take actions, which protect our ability to grow future cash, even if this means that we have an uncomfortable top-line message in a given quarter or year. Consistent with this philosophy, during 2016, we took a number of steps to scale down our presence in UK annuities, stopped selling Universal Life in Asia and took multiple pricing actions in response to low rates. As a result, the £903 million invested last year will be recouped in just over two years and will generate sizeable free cash thereafter.

The capital velocity created by successive additions of profitable new business vintages, combined with the disciplined management of our large in-force book, underpin the group's future growth and cash momentum.

The capital generative nature of our business comes through an old financial metrics, including Solvency II. Driven largely by organic capital generation, our year-end Solvency II surplus increased to £12.5 billion, equivalent to a cover of 201%. By taking actions throughout the year, we also improved the resilience of our Solvency II market shocks as illustrated by the more muted sensitivities at the end of 2016.

I will repeat my previous comment that Solvency II is an imperfect fit for Prudential given our predominantly non-EU business footprint. As I have shown you before, Solvency II underplays the true strength of the group as it excludes meaningful sources of real economic value, which are shown on the right.

So what my introductory slides demonstrate is that Prudential enjoys a distinctive set of financial attributes, which are a key source of strength and resilience and provide us with the flexibility to adapt to all parts of the cycle without compromising delivery.

Returning to our results for the year, IFRS operating profit increased to a record level in sterling terms of £4.256 billion, equivalent to a return on equity of 26%. Once we exclude the positive currency effects, IFRS profit was 2% lower in 2016, influenced by the areas of anticipated decline that I referenced last year, which are played out largely as expected. These areas related to lower spread earnings from the U.S. due to the effects of declining yields, weaker profit from M&G as a result of retail outflows and a slightly reduced UK core profit, reflecting the effect on annual earnings of higher longevity reinsurance.

The financial impact of these items are summarized in the gray box on the right. The chart also shows the contribution from UK non-core being annuity profits in the white boxes and those from management actions and other items in pink. These were lower overall in 2016, and I will come back to the reasons later in the presentation.

We have seen strong growth from our two largest contributors to profit, mainly Asia where earnings increased by 15%, adding £213 million to our total profit and Jackson's fee business were profits were rose by 21%, adding a further £266 million. Between them, these two components account for 76% of our IFRS profit. The ongoing strength of our performance here has enabled us to absorb both the cyclical challenges in other parts of the group and the reduction in UK non-core items.

Turning to the results of each business, I will start with Asia where we continue to deliver strong and consistent growth across all metrics. New business profit increased by 22% to £2,030 million, outpacing the 19% growth in sales. This 3-point uplift is primarily driven by favorable country mix. The contribution to NBP from health and protection remained significant, rising 22% in the year. We saw strong new business momentum in the fourth quarter, with APE exceeding the $1 billion mark for the first time and eight countries posting sales growth of more than 20%. This pattern of broad-based growth has continued in the first two months of 2017.

Sales in Indonesia stabilized in the final quarter of 2016, and we're broadly in line with the fourth quarter of the previous year. Here the long-term prospects remain strong, and we continue to take steps to enhance the capabilities and expand our distribution reach.

Life IFRS profit in the region increased by 15% to €1.5 billion for all the reasons that I outlined earlier, with earnings in six of our markets growing at an even faster rate. Free surplus generation was also 15% higher, reflecting disciplined business growth. This strong cash generation is being delivered alongside growing our store of future value, represented by PCA's embedded value of €18.7 billion, up 35% from the previous year and twice as big as four years ago.

In a year where the U.S. life market experienced significant regulatory disruption, Jackson generated positive variable annuity net flows and delivered higher earnings, whilst at the same time positioning the business for the new environment post DOL. Although VA sales were down 25% overall, roughly in line with the industry, new business profit declined at a lower rate of 13% due to a shift in mix towards higher margin sales. In line with our guidance, spread margins declined to 217 basis points as the impact of lower yield is now feeding through. We still expect spread margin to trend towards the 150 basis point mark over the next two years to three years. While risk-free rates have risen since we last updated our guidance, the impact on yields has been offset by narrow credit spreads.

Fee income remains the key contributor to our U.S. earnings, representing roughly three-quarters of Jackson's total IFRS profit. Fee income rose in line with the growth in average separate account assets, with fee business profit rising faster due to a combination of lower strain, ongoing cost efficiencies and a positive effect of DAC deceleration. The $10 billion increase in separate account assets in the second half of the year is a clear positive for Jackson going into 2017.

The results from our UK life business have a number of moving parts in 2016. So before I cover some specifics, I will summarize the three key takeaways for the year. The first is that we experienced strong demand for the PruFund product proposition, reflecting its structural advantages in the current environment and its excellent performance track record. The strong volume increase in 2016 was primarily driven by market share capture in drawdown, personal pensions and ISA's new business flows, products where we historically punched below our weight. Going forward, market penetration-led growth will inevitably moderate.

The second takeaway is that the contribution from the core with-profits and annuity in-force business continues to track in line with our guidance, producing a stable earnings stream, which totaled £601 million in 2016. And the third takeaway is that the UK life result is entirely driven by the outcome of commercial transactions with no contribution from reserve releases.

Turning now to a few specific items. In the second half of the year, we took further actions to underpin PAC's solvency, which, combined with those taken earlier in the year, delivered £197 million of profit from longevity reinsurance fields and £135 million of profit from repositioning the asset portfolio. Our longevity reinsurance program now covers £14.4 billion of annuity liabilities, which is 42% of the book. While the value trade-off is appropriate, the additional reinsurance would reduce the 2015 core earnings - the 2016 core earnings space by a further £15 million per annum.

Furthermore, we have established a provision of £175 million for the cost of undertaking a review of internally vested annuities witnessed since July 2008 and the related potential redress. While the outcome remains uncertain, please note that we have not factored any potential insurance recoveries of up to £175 million.

Finally, new annuities profit declined in 2016 as we scaled down our presence in this market. From February this year, Western customers wishing to annuitize are being directed to a panel of third party providers, so you should expect this line to fall further in 2017.

Turning to our asset management operations. After a more difficult start to the year, M&G and Eastspring both reported improved performance in the second half of 2016 in terms of profit, net flows and assets managed. At M&G, profit declined by 4% to £425 million, reflecting the negative revenue impact of six consecutive quarters of retail net outflows. The effect of which was only partially mitigated by higher fee income from institutional business. Improved fund performance produced the positive retail flow picture in the fourth quarter which has continued into the first two months of 2017.

In line with our guidance, the cost-income ratio moved higher to 59% as M&G continues to invest in its proposition, develop its infrastructure and take structural steps in relation to its European source business. For these reasons, you should expect the cost-income ratio to remain around the 60% level in 2017.

Eastspring had another good year with double-digit growth in both profit and AUM. Revenue growth was slower at 5% due to a shift in business mix. However, our tight control of costs drove a 2-point improvement in the cost-income ratio.

Moving to cash generation, free surplus after investment in new business increased by 10% to £3,588 million. This result primarily reflects higher contributions from our life in-force portfolio, driven mainly by Asia and the U.S. Experience remains positive and includes the net benefit of the UK non-core items and a £236 million contribution from a contingent financing transaction on certain U.S. term life reserves.

Asia remains the primary destination of our new business investment. Here strain has grown at a slower rate than sales, reflecting shift in business mix. The unchanged strain in the U.S. is also mix-related, driven by higher GICs and lower Elite Access sales. It also reflects the higher proportion of new VA premiums directed to the fixed account option, which was up 4 points to 23%.

The increased strain in the UK is driven by the higher capital intensity of annuity business under Solvency II, which despite the modest level of sales consumed a €110 million of capital. I have provided you with further analysis on this next slide, which draws out those aspects of free surplus generation that are part of our normal recurring activities and those which are less regular in nature are not expected to recur.

You can see in the pink bar that the total contribution from all capital optimization activities net of the provision was higher in 2016 at €442 million. Working the other way was the additional strain on UK annuities, which, as I said a minute ago, will decline in 2017. The recurring component of our 2016 free surplus generation shown in the red bar is both substantial and growing at a healthy rate.

The next slide shows how the annual free surplus generation has impacted stock on the left and cash on the right. Free surplus stock grew in 2016 as our organic generation has absorbed the negative market effects and supported increased remittances to group of €1.7 billion. Asia became the largest remitting business in 2016, exceeding the £500 million threshold for the first time. U.S. remittances were lower than those in the previous two years when more supported markets enhance capital formation. Finally, at the end of 2016, central cash was also higher at £2.6 billion.

Completing the overall earnings picture for the year, operating performance remains the dominant contributor to the overall increase in shareholders' equity under both IFRS and EEV. The negative IFRS investment variance of £1.2 billion is primarily driven by the asymmetry between asset and liability accounting in the U.S. Jackson continues to hedge on an economic basis and its hedging program has remained effective.

However, under IFRS reporting, as equity markets rose, equity derivatives marked down immediately while the hedge liabilities reset more slowly. This negative IFRS variance runs counter to the fact that the higher end 2016 equity and interest rate levels are a clear economic positive for Jackson. Under EEV, which more closely reflects underlying economics, the negative effect is more muted. Here the variance reflects the cost of increased downside protection both when equity markets were low during the year.

Further down the earnings statement, currency movements were a large positive, a consequence of our sizeable non-sterling assets. So after dividends and the loss on the disposal of Korea, shareholders' equity on an IFRS basis rose by 13% to £14.7 billion, while on an EEV basis, it increased by 22% to £38.9 billion, equivalent to £15.10 a share.

Moving to capital, this next slide summarizes the solvency position of our main regulated businesses. As you can see, at the end of a very volatile year, solvency levels have improved across the board, demonstrating the strength of our operational delivery and the quality of our risk management programs.

While the group position incorporates Asia on a Solvency II basis, it is the local solvency regimes that define both capital capacity and strength in each operation. We continue to hold appropriately strong local solvency buffers in all our businesses across the region.

Jackson's RBC ratio stood at 485% at the end of 2016. We renewed the committed practice and have therefore excluded from Jackson's capital the unrealized gains on interest rate swaps of $413 million, thereby reducing the RBC ratio by 38 points.

In the UK, operating capital generation and management actions have combined to improve the solvency of PAC's shareholder business to a 163%. The solvency position of PAC's with-profit business has also remained strong.

Turning now to the group's Solvency II position. You can see on the left that the main driver behind the improvement this year was our strong operating capital generation. Together with the management actions, our business has collectively generated £2.7 billion of capital, roughly equivalent to 25 points of solvency. The negative drag from market effects improved from minus £2.4 billion at the half year to minus £1.1 billion shown on the slide. This impact was softened by favorable currency movements.

We took proactive steps during the year to improve the resilience of this measure to market shocks, which included longevity and other liability actions, asset switches, duration lengthening and additional hedging. The benefit of these actions is captured in the updated sensitivities on the right, which demonstrate that the impact of these stresses is manageable.

In summary, our performance on this measure in 2016 demonstrates that we have both the operational and financial levers to respond to market cycles without comprising our strategic delivery. We have also disclosed today the contribution of transitionals to the group Solvency II surplus, which totals €2.5 billion. As we have said before, transitionals constitute core tier 1 capital, which we can legitimately include in our base solvency and can take credit for in our dividend planning.

I would remind you that this concept was established on transition to Solvency II, designed to offset the negative day one impact created by the introduction of the risk margin. It only applies to business in-force at January 1, 2016, and is not available to offset the risk margin on business written after that date.

So for us, the transitional is primarily held against the risk margin attaching to our UK annuities and will be amortized in a straight line over the next 15 years. However, the fact that we have stopped writing new annuity business means that this amortization effect will be covered by the runoff of the risk margin in our now closed UK annuity book.

Turning to dividend, as I indicated at the November Investor Day when commenting on the updated dividend policy, our approach to setting the external dividend is unchanged. We assess affordability by reference to a number of financial measures and pay close regard to the strong growth prospects of our business, the need for investment and the vulnerability of our earnings and cash to events outside of our control, such as market stresses. We then set the dividend at a level, which provides us with a high degree of confidence that we can grow it by 5% each year.

At the annual assessment point, the board considers the potential for additional distributions, but these would only be made if we're convinced that the 5% growth track is not put at risk. So our decision this year to rebase the annual ordinary dividend upwards to £0.435 representing an increase of 12% took account of the strong performance in 2016 and reflected the output of the annual assessment exercise. We remain focused on growing the dividend given its importance to our shareholders and in doing so we aim to strike the right balance between certainty for investors and sensible flexibility.

The results that we achieved in 2016 underline the strength of Prudential and its franchises. We operate at scale in some very attractive markets with the right products, the right capabilities and we're executing well. Each year, we're adding to our asset base by attracting consistently high-quality new business flows and we work hard to retain them by delivering value to our customers. This not only provides the foundation for growth in the group's earnings, it also increases our resilience to unexpected events and affords us the flexibility to adapt to all parts of the cycle. Our highly efficient, high return, low capital intensity business model has enabled us to consistently grow the intrinsic value of our business while increasing payouts to shareholders.

I will conclude by summarizing on this final slide, the key financial measures which best demonstrate our strong and consistent progress. As I said at the start, 2016 was a true test of the qualities of our strategic and financial attributes. By staying true to our disciplines and our beliefs, we ensured that our structural value drivers have remained intact. We have improved the scale and quality of our business and have enhanced the strength and resilience of our capital.

With that, I will now hand you back to Mike.

Michael Andrew Wells {BIO 4211236 <GO>}

Thank you.

So I just want to spend a few minutes on our priorities. So one of the questions I get when talking to various stakeholders is what is it your management team is focused on? Obviously, execution is first and foremost in each of the markets, but where are we going next, what are the things on the future agenda. So I want to spend just a couple of minutes with you on this. There are a couple of things I have to position very carefully with you. One is we already reinvest in all of our businesses, so let's start with that.

When we look at how we invest in the businesses, we think about it in terms of when we get cost savings, what do we need to do to compete at levels of price and levels of structure with new entrants, with competitors, et cetera, and if we reinvest that savings, what do we expect for those returns. The same discipline you think on capital, on new products we apply on how we look at our costs.

So there are a couple of major themes I want to walk you through that we're more focused on. One is accelerating Asia. Now, given the success our team has had in Asia, that sounds like an interesting - you're fixing something that's not broken would be a fair summary there. But the work that Tony and the team started in November effectively first was the question of are we positioned for what's coming next in the next say 5 to 10 years in Asia. You can then address that from the - if you started over today with a blank sheet of paper, but more importantly starting from the strengths we already have. What can we do that others can't do, and I think that's a critical distinction when you look at some of these markets.

Our existing positions give us options that competitors don't have, so I'm going to spend a little time on that. In the U.S. and the UK, we have changing landscapes, regulatory, political, product demand-wise. I'm going to walk you through where we're committing resources there, and at the group level, as you've heard repeatedly over the last few years, the focus on how we view capital and what we think we can do with that going forward and structure.

So let's go right to Asia. On the left hand side of this chart is effectively what we have, and again it's unique. So you've got an excellent agency force. You've got excellent access to consumers through branches. You've got strong leadership positions in key markets and have the 3.3 billion people in the serviceable universe for us that we could bring solutions to. We have about 15 million of them as clients. So it's fair to say there's some upside.

Two-thirds of those clients, we are their first financial transaction. We're the first financial product they've purchased. So a variety of things need to happen for us to succeed in Asia at another level to grow even further. That is, we have to continue the relationships with existing clients that we have and give them that second and third and fourth opportunity across the pitch to have a lifetime relationship with Prudential.

We need to expand the capability of what's already best-in-class agency force. Why? Because advice time and time again comes out of the surveys in Asia as a key part of how people make decisions. So we need to continue to make sure that our agency force has the tools; that's products, services, technology to compete with anyone and to better service their clients.

In the bancassurance business, we need to move it from wealth products, which is the traditional model that we created effectively in the region, to health and protection on top of the wealth solutions we brought to that category.

And then when you hear the term digital, the trend there to watch most closely is convergence. We see this in the West as well. Do we have the capabilities to stay with the client and provide the convenience that the client wants, when if they want to look at a statement online and they want advice, and to meet a client anywhere across that spectrum of advice from no advice to light advice to heavy advice, and do we do that in a way that provides the statements of interactions on technology that they want to see?

This is not a new direction or travel for us. We spent almost $1 billion U.S. as a group on technology, just to be clear. There is no unique piece of technology out there that we haven't looked at or embedded in our business models, and we're looking at the same thing everyone else is in terms of what some of the new tools can or can't provide for the marketplace. But we do that from enhancing relationships; we already have. We own the clients. We have a great relationship with our consumers, and the question is what elements of technology further lever that.

On the convergence side, I would suggest you look at some of the online life providers, robo-advisors, some of the very creative Chinese platform-based - mobile-based technologies. All of them are trying to figure out how you get a person in front of that consumer. We own that relationship. All we're doing is enhancing some of the technology around it, and a lot of it is already existing for us. So you'll see us continue to expand our capability there. This is not a new journey for us, a new travel.

One thing you may not have focused on is our success in health. So there's a huge need, as I mentioned earlier, in Asia. Very few of the jurisdictions - countries we do business in have state-supported healthcare. The models are evolving quickly at the health provider level. It's a very innovative and interesting thing there. There's a quite an interesting blur between health and wellness, if you will, on a variety of fronts, and we are participating in that. And we are already, if you look at the APE numbers there on the left, one of the largest providers in the marketplace with tremendous upside here.

So you'll see us continue to expand that footprint. There's much more we can do in this space. There are some innovative things coming again that we're participating in, but we think this is a key element of our strategy in Asia going forward. There could be - and most of our - again, most of our markets have the structural demand.

And then the last piece of course is retail asset management. You've seen tremendous growth of wealth in Asia and tremendously low penetration levels of the fund business, still low teens, relative to Western markets where they're highly penetrated markets in terms of households. So I've told you a few years back, we're investing in Eastspring in its technology, its scalability, its people, the breadth of its portfolios, all the things we need to do to make sure as those clients grow in net worth, we're a logical place for them to leave those assets that are targeted for accumulation. So you'll continue to see that, so that's the acceleration of Asia.

In the U.S., there is a shift. The political shift is important. The social shift in the investment community has got a different dynamic to it. I think it could be summed up, and this started post-crisis and it's come now to a regulatory political discussion that's critical, and it's the shift from accumulation of assets to how much income do I have per month at retirement. It's a much more granular discussion. Candidly, I think it's a better discussion for the consumer. It occurred in financial planning offices when clients did financial plans. But the social narrative in the U.S. is shifting, the political discussion of our illustration is going to be required, what do they look like. These illustrations are not how much did the accounts grow to, the illustrations would be, what does my income look like in retirement with various assumptions.

That's a material shift that will drive retail behavior in the U.S. market. It won't happen overnight. It won't happen in second quarter if the new deal - but it's clearly the direction of travel. Jackson's product suite and its capability of manufacturing product is in the secured income space. The product they effectively produce better than anybody in class is a fully funded, personal defined benefit plan. That's how it functions in practice.

So that product set is suddenly getting a very different conversation and suddenly being the last year or so with key distributors. How it's integrated into their technology, how it's integrated into larger asset pools, in the IRA space, in the platforms versus the variable annuity and insurance space is ongoing, is in-flight work, and the regulation is catching that work now as it changes I think is a fair summary. We're not waiting for something to pass to start. But the broker dealers in the United States, the advice providers are looking at their models different. You can read that in the industry trades, and we're a good partner for them in providing those solutions for consumers long term.

So there's a material shift occurring in the U.S. Is it two months out? No. Is it predictable in what month it lands or what quarter it lands? No. There are variables here, but it will be capability based. Can you manufacture the technology? Do you have the quality of product that competes with the other offering? Do you have the ability to train the advisors at scale in a new regulatory, new consumer paradigm? All those things are the best parts of Jackson's business model. So we feel very good about where this is going. Does it lever technology we own? Yes. Does it preclude bolt-ons? No. Are there other things we can do concurrently to that? Absolutely, we saw that last year, okay. It's not abandoning markets we're in, but it's positioning in front of with some material shift in the marketplace there.

In the UK, lot of reasons we're doing this, but as we've told you here before, we're driving these businesses towards highly efficient, capital-light, consumer solution-based asset management and wealth management products. Part of it is regulatory, the capital requirements of the annuity business don't fit - don't meet our risk-adjusted return hurdles. Part of it is consumer demand, the number of consumers that actually want to lock in a yield at this point versus want to participate in some potential upside in the market from well-managed, well-positioned products, and the demand for asset management continues to grow.

You've seen Anne and the team shift not only product launches but in the preparation for whatever Brexit might look like, as - to make sure they can address their European clients. So there is movement in this marketplace. Underlying all this, the desire to get the businesses more efficient, more effective in their service, more consumer-centric and they operate at lower and lower marginal cost, so we can pass on some of that savings to the consumer and some of that at earnings gained to our investors. There is no strategic piece missing for us in the UK. We have quality products, quality brands and the management teams to compete in this market with anybody.

On capital, so we start from a very strong capital position, well rehearsed today. That said, we have more opportunities as a management team and as a company to deploy capital profitably when we have capital, so just be clear. I mentioned earlier, there is nothing occurring in any of our marketplaces that has some black box model that we can't unwind. The question is, how does that deployment of capital effect our other objectives. So those objectives are, what is the payback period on that capital for our shareholders, or the risk associated with it, interest rate, equity, currency, political, regulatory, those are all factors in the environment, competitive, all of those things, right, go into our decisions on where we do - are deploying capital. It's a very, very disciplined process.

We recognized that shareholders want a growing dividend. The narrative on this is well rehearsed and I'm not sure we've ever correctly landed it, but the - our intent is to have the dividend be incredibly resilient, across cycles, right. And so one of our tests, when we look at capital was, would it impact our ability to grow our dividend at the stated levels we've given you across the cycle. So it's a part of the capital allocation discussion which sows the growth of the business.

Does that redeployment of capital give us the ability to get a return that's consistent with options we have globally? We're a global firm. Does entrants to the market have a long-term potential at adding J-curves and structures, the business lines we don't have. Africa is a good example of that. Yes, it does. We entered new markets in Asia, are we trying to fill the map with pins to say we are in every market? No. We strategically enter some markets. We strategically exit some markets. We strategically exit product lines in certain businesses, sometimes because of rates are equity, sometimes because of competitive behavior.

That's the optionality on the bottom. We have a broad enough footprint that we don't need to stay and play in any one market that gets irrational, and lots of things can drive irrational behavior. But you task us with a long-term look at the return on capital and the long-term management of the company, and given the decisions made even ahead of a lot of us, the options we have are broad, and vast. There is a lot of places we can go to get returns, right. We don't need to bet on a single market to produce an outcome. We have the ability to diversify that and the benefit of that I think is clear in today's results. So high capital velocity, adapt to the changing landscapes, and maintain agility and optionality and what business lines we're in and what markets we emphasize and don't emphasize.

I've commented before. This is my favorite slide. It stays there. I would tell you this, a challenge to you. It's ours. We compete with firms that choose one or two of these graphs. If 22 years from now, if someone looks back and says what does Pru do, if we maintain the relationship between these numbers, if we maintain the integrity and discipline to grow our profits, our sales and our cash with some reasonable relationship over time, then you have a well-balanced business, incredibly resilient and will succeed across cycles. Any one of these, we can change the shape of quickly, usually at the cost of the other two.

This is the key. This has always been the key. We could take this back further than this chart. This is the piece, when I say we compete against ourselves, this is the hardest thing to do day in and day out and the most important thing that this team is delivering on. These should all grow in a relationship. We can do this a variety of – there's macro cuts in this, you could do it 10 different ways but it produces the same general question to us. Are you growing one of these at the expense of the other? And I would argue we're not. It's good, balanced, incredibly high-quality growth.

Okay. So what have you got? You got a strategy that's well rehearsed and we think you know, you know where the enhancements are coming. We'll show you a more granular look at that at the Investor Day towards the end of the year. You have material leadership positions with Prudential in the markets that we think provide the greatest opportunity. That's a – gives us a great franchise to continue to build and grow from. We think the operational execution and the resilience of that across markets is well proven. That was not a linear period of time that those charts were produced in, right. The markets bounced around and the results were far more consistent than the variables in the market. And that continues to be a strength of the firm.

And then, again, you're seeing the emergence of the leverage of this firm scale. Go back to the slides before and it came up. The – if we do a good job for these consumers, they stay with us. If they stay with us, we just keep adding cohort, cohort, cohort of successful relationship with clients, and that grows the earnings of this firm materially faster than the sales can grow, even though the sales are growing as fast as anybody in the industry. So that combination is unique. That's what we're trying to deliver for you, that's what you own. And we think it positions us well for the future.

So with that, I'd like to ask my colleagues to come up and join us for the Q&A. We'll open up before – Raghu, if you don't mind heading up the Q&A, and go from there.

Q&A

A - Raghu Hariharan {BIO 20434535 <GO>}

Couple of housekeeping items. Just wait for the microphone to get to you, please state your firms name, and your name before asking your questions. Why don't we start with Jon here?

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

Hi. Good afternoon, everybody. I've got three questions, please. It's Jon Hocking from Morgan Stanley. On the first question on DOL, obviously quite an unclear picture. I wonder if you could talk about what your expectations are in terms of the process from here and what we should be looking for in terms of signposts for the fee-based VA to be rolled out, and what the penetration could be there over a reasonable timeframe. That's the first question.

Second question on the U.S. again, in terms of the capital remittance. I can see the headwinds this year. For 2017, it looks more promising given the growth in the account values in the second half of the year. Permitted practice has already been rolled over et cetera. What should we be thinking about in terms of remittance for the U.S. for 2017?

And then finally UK annuity book, given you're closing your business now on individual, on bulk, is the group exploring ways to release capital from that block? Thank you.

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

So, Barry, do you want to give an update on the DOL process, you're as close to as anybody.

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

Sure. So we've been deeply engaged in this from the very beginning. It's a complicated bureaucratic process to get a rule in place. And so as you can imagine, there's an equally complicated bureaucratic process to get rid of the rule. It started when President Trump on February 3 issued an Executive Order asking some questions about the impact of the DL rule – DOL rule, would it impact access, would it create turmoil in the retirement investment market, and would it spur additional litigation, there's obviously already even without the applicability of the rule being firmly in place, there's already evidence that suggests it does all those things and more.

So we're now in the midst of a process that we believe will produce a delay in the applicability of the rule. I would not expect that you would see the delay actually formally, finally announced with -in a definitive way, until right about the time that it was meant to be applicable. In other words, the first week of April or so. That's the timing that we believe will play out because there are so many steps and comment periods and so forth that we have to go through in order to achieve the delay. But the delay obviously is just the first step of a long-end game.

Now the intent of the DOL rule was to raise the standard of advice that retiring consumers are given and obviously we are a huge proponent of that. We're just saying that the ultimate rule created lot of unintended consequences that we'd like to repair. And we would ideally, and I think there will be bipartisan support for this, we would ideally like to see the new rule put in place not via the rule-making process, this is what the Obama administration did, but rather through legislation.

And we've spent a lot of time in Washington meeting principally with Democratic senators who are very interested in this issue, and we are optimistic that once the delay is put in place, then they say that the rule will change, that we can get a broad bipartisan group together to craft the bill. There's all the good things that the rule did, but eliminates some of the downsides, and effectively opens these products to greater numbers of Americans who're approaching retirement.

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

On the remittance, Jon, I think we're going to pass on a forecast on the UK – or the U.S. But it's a strong business, and you've got the historicals and we'll leave it at that, if you don't mind. Do you want to say anything further on that?

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

No, other than to say the – a little disrespectful to the U.S., to the Michigan regulator to guide the market before we have a conversation with them. Look, you see on slide 75 in the appendix that the size of order remittances that we've had from the U.S. clearly will depend ultimately on capital creation in the year, but the business is producing good capital, so we will look to it to return an appropriate share.

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

And on the optionality of the UK book, I'll speak for John and the team, that there's two ways to look at that. I mean, it's very profitable, successful book for us. You see the earnings impact of it. I know in the marketplace that makes it desirable to others, I've read those reports. I think there is a – there are – there's work we can always do with existing products and services we have to improve capital efficiency and there is strategic work we can do, we always look at both. We're not – but I'm not going to comment on either at this point.

A - Raghu Hariharan {BIO 20434535 <GO>}

So Greig, please.

Q - Greig N. Paterson {BIO 6587493 <GO>}

Good morning. Greig Paterson, KBW. Three questions and a request. I note the Asian life outflows, I mean that's something we used to look at it few years back, and has improved from I think it was 13% last year to 11%, it's still pretty high. I was wondering if there's any further, I mean if work's been done there, also some further capacity to get that done and provide the unit linked surrender as the maturities in the Asian book?

Second thing is, you used to provide - last year, I think your productivity increased and the agency channel was 25% year on year. I couldn't find it in today's release. I wonder if you could give us that number.

And then the third question is, just in terms of the Solvency II, the 201% number. Have you done a pro forma recalculation of the transition over there, or have you assumed no transitional recalculation because the test hasn't been passed? It just doesn't make - just as a reminder, if we could get the required capital splits per region under EEV, you took that disclosure out last year, it was useful for modeling purposes? Thanks.

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

So, Tony, do you want to talk about Asia life and just generally on productivity.

A - Tony Wilkey {BIO 19184129 <GO>}

You know the various sides of productivity. If you look first at the growth in manpower across the region, and we're going to look at the macros, but it's very important to then go country-by-country because the dynamics are very different. Manpower reached an all-time high, closing manpower for the year with 601,000 agents, so an all-time high.

Much of the growth coming in China and strong recruiting growth as well in Indonesia. The productivity dramatically varies by country. Singapore is very high productivity and we can give you the breakdown. Singapore is very high productivity as is Hong Kong, and that's obviously skewed by the Mainland Chinese business, which is slightly larger tickets than the domestic piece but across the board I think productivity - manpower is slightly stronger than productivity last year with the exception of Hong Kong and Singapore.

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

On surrenders, on the unit linked side, okay, I appreciate the slide - I point you to slide 67, which actually gives you the calculation of those ratios. Part of the reason for the decrease that you referenced Greig, is the fact that now Korea is not included in these numbers, and Korea was a big outflow company.

So what we did on slide 67, we re-spread, we recast the historic information to exclude Korea. And what you'll actually see when you turn to that is that yes, there's been a - the improvement that we saw last year we held onto, and therefore no real change in the underlying position in the course of 2016.

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

And, Nic, Solvency II question?

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

Okay. Solvency II. So what happened is we recalculated the transitional at the half-year point, with the PRA's approval. In the second half of the year, interest rates improved, so the risk margin came down. And therefore, it follows that the transitional should come down as well. So for the purposes of what we published today, the £12.5 billion, the 201% we've done the virtuous thing of reducing the transitional to compensate.

We have applied to the PRA to have that recalculation approved. They're in the process of considering that application. They said they would let us know before we have to file our quarterly QRT and produce the SFCR for the market. And now if we get that approval, then we will publish on the basis of the numbers that you see here. If we don't, then the numbers will increase by £0.4 billion, which is equivalent to around four points of solvency at the group level. What we've done, as I said, we've done the virtuous thing and rolled the transitional down to compensate for the favorable movement in risk margin in the second half.

A - Richard Gradidge {BIO 7262556 <GO>}

Andy Hughes, please?

Q - Andy Hughes {BIO 15036395 <GO>}

Thanks, Richard. Andy Hughes, Macquarie. Three questions if I could. The first one again on the U.S. transfer. So the financial equity in place has that - was that sort of impacted the transfer rule? Is that post transfer this year, so is that a new thing that would be taken into account by regulator for the 2017 transfer?

And again some sort of looking to some guidance as to how you'd expect the U.S. transfers to correlate with these surplus generated in the U.S.? Because clearly, the surplus is quite big and the transfers follow a different path at the moment, so any guidance you can give on that will be helpful?

And then on the UK, I guess you hinted that the offer estate is getting bigger in the UK and the business is getting smaller, albeit that the PruFund is offsetting the net flows and the PruFund requires much less capital, so I'm just wondering. How close are you to paying some sort of - doing something with the excess surplus if there is any in the UK?

And could you give us the PruFund number ex-bonuses because obviously the problem with PruFund is obviously is not regenerating any earnings in the IFRS terms, so it will be quite good to track how much the bonus component has grown in PruFund, so we can see how much you've gotten in the bank if you like? Thank you.

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

Okay. So in terms of the U.S. transfers, yes, it's effectively a triple-X transaction in relation to part of the term life book that we brought across with. We bought REALIC. It produced around 30 points of RBC solvency. It is included in the RBC number. So it's good capital in that sense.

I guess I'll repeat my answer to John that for us, if you look at our track record, we have remitted a considerable proportion of Jackson's annual stock basis generation each year, and you should continue to expect us to do that as we go forward.

Now in relation to the UK solvency, clearly any, yeah, with profit solvency position, we'll move up and down depending on investment performance, and on the reinvestment as we reinvest the estate into writing more PruFund business.

As your question was on the shareholder side, a 163% appreciate that, that is outside kind of the range that we guided you last year, but I did say at the time that it wasn't a hard range. I said that if we fell below 130%, it didn't mean that we can't take out dividends. Equally, if we go above 150%, it doesn't mean that there is suddenly sort of quite a lot of excess capital. We continue to keep the range kind of under review.

2016 has proven to us that these things can swing, that Solvency can swing to the bottom of the range, from the top of the range to the bottom back up to the top. So we're comfortable with where it is, and at 163%, yes, I would agree, we have some surplus capital, but I wouldn't expect us having significant excess capital.

A - Raghu Hariharan {BIO 20434535 <GO>}

Go to Blair, one row back.

Q - Blair Stewart {BIO 4191309 <GO>}

Thanks very much. Good afternoon. It's Blair Stewart from B-of-A Merrill. Three questions. Firstly on the U.S., Barry, can you give us any update on the NAIC proposed changes, wherever that's got to over the last few months, what impact that might have moving to an economic approach? Indonesia and Hong Kong often talked about, I just wonder if you can just clarify a little bit more about what's going on in Indonesia, and just towards the end of the year, you just stated said that there's been a real pickup, and I was wondering what's – what was driving that? And you've hinted that there is no real impact from the more stringent exchange controls in Hong Kong, just a little bit of extra color on that, if possible?

And the final question, Nic if you could just remind us what's left in the tank from FX Tier 1s going into this year, if possible. And also on the fee-based business, where our current AUM or end of year AUM relative to the average of last year's, again what's the tailwind going into 2017? Thank you.

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

So, Chad or Barry, do you want to spend some more time on it?

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

Yes, I will. I'll say few words and see if Chad wants to add some additional color. I think the process is moving along, first of all, to answer your questions simply, I mean, we're in Quiz 2 now. We are maintaining close contact with the commissioners, generally with some very influential commissioners, in particular, to make sure we are in tune with what their thinking is and helping to guide their thinking where we can.

I think the important thing to understand is that it's – at the highest levels of NAIC, right now, this is not really a front of mind issue. We were at the most recent meeting out in California, commissioners meeting, and asked the question, because this work is going on at lower levels, does it imply that you have some concern about capitalization of the industry in the United States? And the definitive answer was absolutely not.

So while there is work going on at lower levels and there are people that are taking enormous level of interest in this, I don't think it would be accurate to suggest that at the highest level of the organization where ultimately policies made and decisions are made, that there is a high level of concern or any level of concern candidly about the capitalization in the industry. So we'll continue to monitor this closely, and again try to shape the outcome, if you will. But at this point, we're not alarmed by it, but we're obviously very watchful of it. And Chad, I don't know if you want to add any more technical detail. You had – Chad had some more detailed discussions with some of the commissioners.

A - Paul Chad Myers {BIO 2234559 <GO>}

Yeah. I guess, I'd just say, keep in mind that this started off as a process to go through looking and getting rid of captives in the U.S. or alleviating the need to have captives, not to get rid of that. But just if the concern being that there is non-economic reserving going on or to the extent that there was, that it wasn't matching up with the way some people were hedging, so they were using captives to really bridge that gap. That's what this started off as. It's grown into something bigger. I'd say couple of things on that. One is, if it goes off the rails for some reason, what that's really going to do is drive more in the captives, not less in the captives, so that's clearly not where the regulators want to go.

So back to what Barry said, they are not stating a view that we have an undercapitalized industry, they are just trying to get more alignment between the reserves and the hedging. That said, we're just in our Quiz 2. That's a process that's going to run through the rest of this year on a highly optimistic basis. If you're Oliver Wyman, who is running the process, 1/1/2019 would probably be as good as you're going to get at this point. That's assuming nothing comes out of Quiz 2 that stalls that more.

So I think what we've seen is we have a long ways to go through the Quiz 2 process. We're engaged in the Quiz 2 process or in some respects leading portions of it on the industry side. And we think we'll get to a reasonable resolution. But like I said, if for some reason it doesn't get to a reasonable resolution, captives become a viable alternative to make sure that you've got reasonable capital there.

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

Indonesia.

A - Tony Wilkey {BIO 19184129 <GO>}

I think we talked about this at the Investors Day, how when these businesses are going through challenging conditions, we tend to micro or even nano-manage the businesses and look at sequential progress in new sales and push where and when appropriate. So what you have is in terms of momentum, second half grew over first half by 10%, Q4 grew over Q3 by 57%. December was our biggest month all year and showed positive growth for the year. Underlying that was average recruit-in throughout the year of 6,000 agents. We onboarded 244,000 new customers throughout the year. That's something like 650 new customers per day, so pretty good underlying momentum in the machine there.

I think it's important to bear in mind that while Prudential Indonesia just celebrated its 21st year anniversary, it's essentially a 10-year-old business. I mean that's when we really galvanized it and started to drive it. Further, if you look at the penetration, an interesting statistic in the market there is there are only 18 million policies in force in Indonesia in the whole country. There are 31 million people living in Jakarta. There are 250 million people living in the country. So it's still very much early days, and the momentum is progressing quite well.

Hong Kong, we were plagued with the events during last year in this regard. Where we find ourselves today, and I think what we indicated to you last year was the Mainland customers who buy products in Hong Kong, something like 80% of them have bank accounts in Hong Kong. The series of events we saw was the cessation of the UnionPay card and then on to MasterCard, and these were with certain limitations. Today, the majority of new business premiums are being paid via Hong Kong bank accounts.

The shape of the business has changed somewhat. You may recall that towards the middle of Q2 last year, we backed away from the broker business. This is typically larger cases that we are not comfortable with for a whole series of reasons. So as you carve that piece out, the average case size has started to come down on the Mainland business being written in Hong Kong. But momentum continues, agency force at record high in Hong Kong, 18,700, recruiting 400-plus every month, and a pretty solid story.

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

Okay. On FX, clearly we only picked up half the benefit that we saw in the year, given that we're using average for the year, so the early part of the year, sterling was stronger, weakened in the second half. In your appendix slides, page 120 and 121, we illustrate to you, if you like, what the 2016 results would have been on our various operating metrics, IFRS, free surplus, new business EEV had we used the year-end spot rates, and that gives you a sense of how much, using your expression, tank, gas there was in the tank. Clearly, of course, these things will depend with what actually happens in the course of 2017. So bear that in mind before you put those in your models.

Your second question on the difference between average and closing, so in the U.S., the average growth in separate account assets was about 5%. It compares with an 11% growth in the closing. So again, that gives you an indication of some tailwind there. In Eastspring, the average was up 9% and the closing was up 13%. But before you put in the full 4% in, we did see a shift, a slight shift in the mix of business towards bonds/stock institutional type products. So that you should factor that as well. And in M&G, the average was slightly down, minus 2%, broadly in line with what you saw in revenues, and the closing was plus 8%. But again, the closing is boosted by a bigger growth rate in the institutional business, which is lower margin than the retail.

A - Raghu Hariharan {BIO 20434535 <GO>}

Go, Arjan, just behind Lance.

Q - Arjan van Veen {BIO 5197778 <GO>}

Thank you, Arjan van Veen from UBS, two questions on Asia, please. Firstly on Hong Kong, we saw a very strong improvement in the margin first half to second half, 62% in the first half, 79% in the second half. I assume it's to do with partially the broker agent mix, but with also the stuff you talked about in the presentation around more protection and health. Given the level of margin now in Hong Kong, is there also an ability to take that outside into other markets? It sounds like you've done maybe some pilots there or initiatives in Hong Kong.

And the second question is on China. You spent quite a bit of time talking about the opportunity in China at the Investor Day, talking about the margin opportunity there, and we've gone from 20% in the first half to 46% in the second half. It feels like the way you were talking in November there's still some way to go in the margin there. And Tony maybe can give a bit of color.

A - Tony Wilkey {BIO 19184129 <GO>}

Do you want me to do China? I'll do China. Yeah, China. I think we started flagging the opportunity some years ago and also in the context of the Hong Kong business, our strategy long-term was needing to win on both sides of the border. So we've been expanding with a clear intent and that is to grow the agency force to sell more health and protection, and that's exactly what's happened. The closing manpower for China was 33,000 agents. It's still a terribly small number for China, but it's high quality. Within that, it ramped up from 15,000 agents 18 months ago to 33,000 agents, and activity level stayed the same. It's an excellent reflection of discipline. They're selling a lot of health and protection, which is directly driving the margin.

It's also important to note that we've simultaneously expanded the footprint. Not many of our foreign competitors in China are able to do this. Last November we expanded into Anhui province, which is essentially the Silicon Valley of China. And recently, we just announced we've got CIRC approval to enter Sichuan province. Sichuan province is the fourth most populous province in China. It's got 80 million people. Look at this like we just added another Vietnam. It's like adding another country.

And when the one belt, one road goes through Sichuan. The economy is just going to continue to go from strength to strength and so is our opportunity. It's a joint venture with

Citigroup, 15 years old now, and the relationship is on an excellent footing. The conversations in the boardroom are around growth in NBP and embedded value, very different than what one might have seen 10 years ago where the conversation would focus on market share. So it's a quality story moving in the right direction in China.

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

Maybe some specifics then on the margin. Really we guide you not to take these things segmentally because they're impacted by what interest rates do, and there is also another effect the way we calculate NBP at the half year, for example, on any business that we've written up until that stage is to count the profit only in relation to what was produced in the first six months. So there is an effect when we bring in the second half profits.

But I'd echo what Tony said. The improvement in the margin for Hong Kong is driven by mix predominantly, in China also mix. And also now the business is getting to a scale where we're beginning to see some efficiencies come through the numbers as well.

A - Raghu Hariharan {BIO 20434535 <GO>}

Oliver over here, please?

Q - Oliver Steel {BIO 6068696 <GO>}

Oliver Steel, Deutsche Bank. Thank you very much, three questions. First of all, I guess I have to ask about M&G and whether in the light of Standard Life's announced merger, whether you feel it's too small. Singapore sales, I must have got my forecasts badly wrong. It appears to have surged quite a lot in the second half. So I'm just wondering what's driving that.

And then sorry, I've just got a techie question. The normal amortization of your U.S. DAC seems to have fallen year-on-year, again I assume an increase in the actual size of the DAC. So I'm just wondering what drove that and whether you've got a sort of guidance figure for 2017 on that business.

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

So, Anne, do you want to go first on M&G, we'll see if we have the same answer?

A - Anne Helen Richards {BIO 4145347 <GO>}

I think after the news from the First Minister yesterday, I think, Aberdeen and Standard Life is no longer the bigger story in Scotland, which is kind of interesting. But, I mean, I think it's interesting when you look at the deals that we've seen recently, that there is a big conversation going on in the industry around about scale. And scale is important, but I think the scale is sometime confused with having large single strategies and when they go off the boil what looks like scale, then starts perhaps not to feel so much like scale.

So I think from our point of view, we're much more focused on having propositions that are exciting and interesting for our client base at every point in the market cycle. And so we're very much focused on that, ensuring that the continued innovation is going through.

And then on the stuff that we can deliver around the systems and the way that we can produce that product in a cost effective way. So we're really focused on the stuff that we can control. And as you've seen from the sales figures in the fourth quarter, when we get that stuff right, the business continues to move along in a positive way, and I think that's very much where our internal focus is. So we're not looking over our shoulder in that respect.

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

You're looking at me, I guess I should go on. So no, I think, it's well said. I think as I mentioned earlier, I think size and scale are confused, and asset management business is a classic example of a space where it happens all the time. So we don't need every portfolio that is available in the marketplace. Some of them - some of them, the clients are choosing to access that sort of return in a different way. We have to have value for the consumer across the cycle; we have to have whether they're likely to go with the money if they move out of one investment class into another. We have to have the cost synergies and effectiveness and tools that make us be able to keep with anybody. And only some of that in the industry now you can lease, some of it you need to own. And we certainly have the size and earnings and assets and talent to access the best of what's out there.

So I don't view us as lacking anything with M&G. Eastspring, we've said we want to continue to develop the talent. We don't need to buy anything there. We're looking to, we've certainly lift out teams that we thought filled gaps that we don't have in portfolio management, but we're getting the same systems and capability that we're putting in M&G, and our business in the U.S. is more institutional focused, but again aligns with those strategies as well.

There are other benefits that roll back to the group from that sort of discipline, Penny's [James] area in risk. Our ability to look quickly at counterparties and positions holistically matters. Those are intangibles you get from getting proper systems and proper capability in place and then obviously the earnings that come from running it well and having clients stay longer because the funds do well, and all of that rolls up as well. So I think we have size and we have scale and we'll continue to improve the attributes of scale in the asset management businesses.

You also asked about Singapore.

A - Tony Wilkey {BIO 19184129 <GO>}

Singapore, a very strong second half. Across the board, agency very strong, recruited 1,000 agents in Singapore throughout the year, which may not sound like a large number but it is in the context of Singapore taking our agency force set at 4,200, the largest it's ever been. It is the most productive agency force in Singapore. The LIA results, the local organization results just came out. We are the number one provider of regular premium products in Singapore and we are the number one agency company. So that's the perfect fit for, for how we like to deliver those type of products in Singapore. Also excellent rebound in the second half for our bank partners there, both Standard Chartered, Q4 was a record for SEB in Singapore, largest quarter ever, and you'll be coming back, you'll be coming back more on the basis of product mix, selling a lot more regular premium than they had in the past, which flows through to the new business profit margin.

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

Okay. And on the DAC, there was a £93 million effect in the full year for DAC deceleration, around £20 million of that related to the fact that we did better or the separate account return was higher than what we had assumed in the mean reversion number. And the balance were around £70 million odd, comes from the fact that – comes with a rate mean reversion work. So we dropped off, 2013 dropped off that had a very strong performance into that calculation, that gave us an uplift. There is the usual analysis that we provide on appendix slide 76, which gives you – effectively gives you that color.

A - Raghu Hariharan {BIO 20434535 <GO>}

Nick and then Abid. Nick?

Q - Nick Holmes {BIO 3387435 <GO>}

Sorry. I apologize. Nick Holmes at Soc Gen. Couple of questions on the U.S. again, I'm afraid. First one is, how concerned are you about the growth in fixed indexed annuities, because these products are really taking the market by storm at the moment? And I wonder, is it a product you're actually tempted to offer yourself?

And the second question again on the U.S. is can you tell us more about your review of the policyholder behavior assumptions in your variable annuity book? How are your assumptions holding up, I imagine given markets are probably pretty good, but is there anything that you would be concerned about, that you would give us a bit more color about? Thank you.

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

Yeah. There has been a surge in fixed income product, a lot of that I would attribute to the presumption that fixed indexed annuities would not lose their status under 84-24, they did in the new DOL rule, now who knows where they will come out. So that's going to mute to some degree, I think the prospect for fixed indexed annuities going forward. I mean there's fundamentally there's nothing wrong with the concept of the product, we have a product in the marketplace, ours is not very competitive, because we believe in this environment is difficult to manufacture one, that's extremely competitive. And to do so in a way that provides solid benefits for the consumer and for the shareholder. And so we've struggled with that a little bit. Conceptually in the right environment, would we be willing to write FIAs, yes, we would. We have in the past, would again. Fixed annuities as well if you get a change in the interest environment, just plain old vanilla fixed – fixed annuity – it could be a logical thing for a lot of people.

The reason we focused on VAs, first and foremost is because we think in an environment where you expect interest rates to be relatively low for a long time and in an environment where most Americans approaching retirement are under saved that it's really only by being able to invest with a great deal of freedom in the equities market that we can do the real job that the consumer needs done, which is allow them to have a guaranteed amount of income that they know they can count on, that they cannot un-live, that they cannot outlive, and that is insulated, protected from whatever investment decisions they make, which may be good or bad, and only the VA really does that, and that is - because of the consumers' interest in that product that we have focused on that product, and we continue to see that, in our view that product is going to be from a social utility perspective the strongest product in the marketplace.

Your other question was on, oh, on policyholder behavior, I guess the short answer is, no. Our -we've spent an enormous amount of time sweating the details on this, and we review it frequently, regulators review it as well and in our view there's nothing in there right now that would cause us any concern, which is not to suggest we would never change it, because it gets tweaked constantly, but as we see emerging trends, but yeah there's no - nothing in there right now. And, Chad, I don't know if you want to add any more color to that or?

A - Paul Chad Myers {BIO 2234559 <GO>}

The only thing I'd add is thematically what we've seen over the years is a little bit more persistency, so lower lapses. this is a thematic thing, very minor tweak, but the general trend has been towards that. That's a little bit difficult to figure out whether that's really where the market is going for more desired income or whether it's just not any really good products to 1035 into at this point in time. So but again that's, that's the only one there's no trended point on this. It's a good one for us economically.

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

You can make a strong case that it is actually the latter. Because, as you may know, we're the only variable annuity investment in the marketplace today that offers investment freedom. We'll write the guarantees around all 91 funds on the platform. No one else is doing that. So if they say, well, I'm going to take my Jackson policy and move it to XYZ, and I want to buy guarantees and they're going to be whatever their platform is, call it 90 funds they're going to be forced to choose from 10 vol-controlled funds, which consistently underperformed the market. So a rational investor wouldn't leave investment freedom and go for vol-controlled funds.

A - Paul Chad Myers {BIO 2234559 <GO>}

And the compliance department?

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

Yeah.

A - Paul Chad Myers {BIO 2234559 <GO>}

On the other side, we've had a hard time proving that trade.

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

That's a good point. Yeah, the broker dealer would never let it get through, because it's not as good a product.

Q - Abid Hussain {BIO 20229932 <GO>}

Hi, it's Abid Hussain from Credit Suisse. Two questions if I can. Firstly, on Solvency II. How should we think about the potential management actions on the Solvency II capital going forward, will you be seeking to increase longevity reinsurance or hedging elsewhere, so just really could you provide a flavor of possible actions going forward, please? And the second question is on your 2017 targets. It looks like you can achieve the group cumulative free surplus target of at least £10 billion by the half year. So I'm just wondering will you be - should we be expecting new targets at that point?

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

I mean on optimization, there's still an array of actions we can take, whether it's - if we needed to, whether it's more longevity where insurance clearly does a trade-off there with earnings. There's still a little more we can do on the matching adjustment. We've got around 96.5% eligibility, there is a bit more we can do. So there is always tweaking and we'll evaluate it as and when the opportunity arises, or as and when we deem it, we deem it appropriate.

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

I guess on the targets, let us get there first. I think it's, I think one of the problems with targets is everybody declares victory before you actually cross the line. There's quite a bit of work still to do. And relative to the marketplace, I think there's - they are impressive when you accomplish them.

From - if you look at the Asia centricity of the targets, there were an attempt I think, I've seen three sets now in my career to prove proof-of-concept in the market, right. The first discussion was can you take this sort of NBP-centric business, and convert it, double it again, and convert it to more cash metrics, and is it still scalable the third time? And all these were that the discussions in this room and rooms like it along the way. I think we have demonstrated that that's a real business and that it's producing real returns. And so I would say to buy something we need to do a similar sort of exercise again. And they are limiting at some level, that there's something strategically learned. We want to do, we'll review it - we'll review it at the board level, we'll decide what we want to do, but I think the original objective of the targets was to give you some understanding of what Asia could look like.

And I'd like to think at this point that the, given the recurring earnings, the scale of it, the - it's market positions, I think that point's been made, I would like to think that point's being made.

A - Raghu Hariharan {BIO 20434535 <GO>}

Just maybe one last one, just in time. Ed here please.

Q - Edward Houghton {BIO 17612475 <GO>}

Hi. It's Ed Houghton from Bernstein. Can you sustain an IFRS ROE above 25% for the next five years?

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

Can I pick – Ed, can I pick all the assumptions and interest rates and equity? So it's – that's obviously very forward-looking, but there are variables in the market that go with those sorts of returns. And I think that's why a single metric isn't the right way to look at it, but that's a good one, and I think we're proud of it.

A - Raghu Hariharan {BIO 20434535 <GO>}

Thank you.

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

Okay. Thank you everybody for a full session. We take your support; we'll be around individually if you have any last questions. And enjoy the afternoon. Thank you.

A - Raghu Hariharan {BIO 20434535 <GO>}

That does conclude today's call. Thank you for joining and enjoy the rest of your day.