S&P Global
Market Intelligence

Prudential plc LSE:PRU

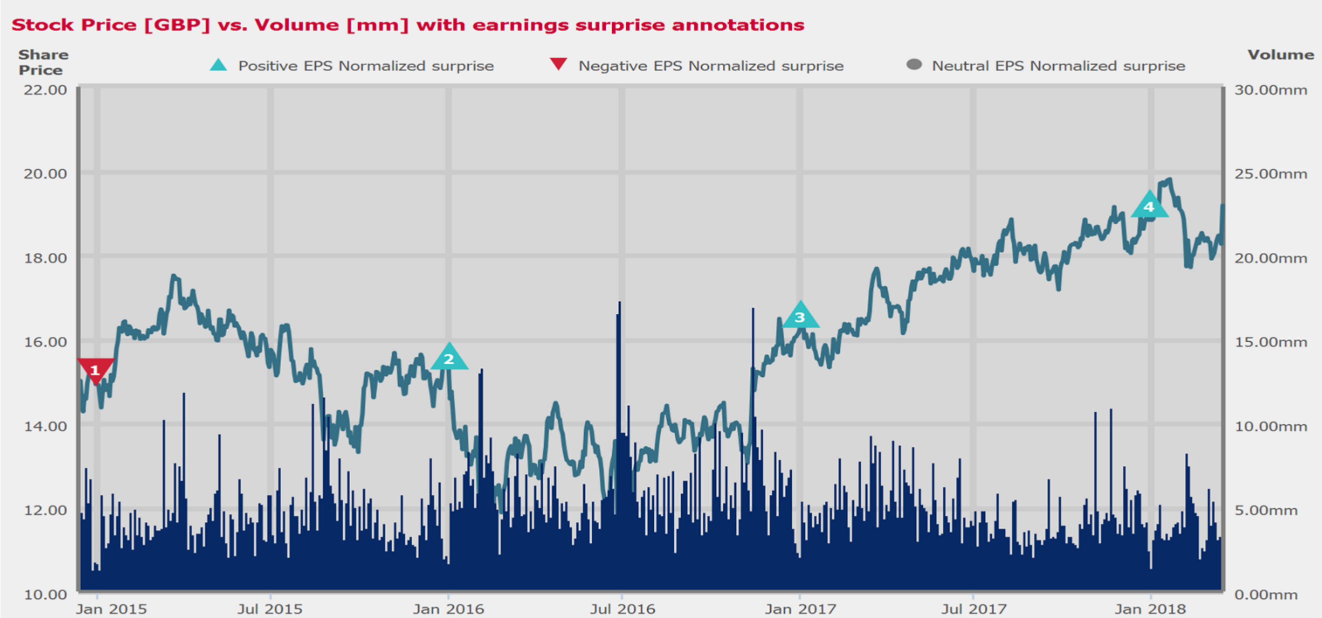
FY 2017 Earnings Call Transcripts

Wednesday, March 14, 2018 11:30 AM GMT

S&P Global Market Intelligence Estimates

	-FY 2017-			-FY 2018-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS
EPS Normalized	1.40	1.45	▲3.57	1.51
Revenue (mm)	40328.48	41943.00	▲4.00	44465.30

Currency: GBP
Consensus as of Mar-14-2018 11:18 AM GMT



	- EPS NORMALIZED -		
	CONSENSUS	ACTUAL	SURPRISE
FY 2016	1.26	1.31	▲1 3.97 %
FY 2017	1.40	1.45	▲2 3.57 %

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Call Participants

EXECUTIVES

Anne Helen Richards
Former Executive Director

Barry Lee Stowe
Adviser

John William Foley
Executive Director & Chief Executive of M&G Prudential

Mark Thomas FitzPatrick
CFO & Executive Director

Michael Andrew Wells
Group Chief Executive & Executive Director

Nicolaos Andreas Nicandrou
Executive Director

Paul Chadwick Myers
Executive VP & CFO

Paul Victor Falzon Sant Manduca
Chairman of the Board

ANALYSTS

Abid Hussain
Crédit Suisse AG, Research Division

Alan George Devlin
Barclays Bank PLC, Research Division

Andrew Hughes
Macquarie Research

Andrew John Crean
Autonomous Research LLP

Arjan Van Veen
UBS Investment Bank, Research Division

Blair Thomson Stewart
BofA Merrill Lynch, Research Division

Greig N. Paterson
Keefe, Bruyette & Woods Limited, Research Division

Jonathan Michael Hocking
Morgan Stanley, Research Division

Marcus William Barnard
Numis Securities Limited, Research Division

Nick Holmes
Societe Generale Cross Asset Research

Oliver George Nigel Steel
Deutsche Bank AG, Research Division

Ravi Tanna
Goldman Sachs Group Inc., Research Division

Presentation

Paul Victor Falzon Sant Manduca
Chairman of the Board

Good morning, and thank you for joining us for this results briefing. As you will have seen, the board has announced today our intention to demerge M&G Prudential, our U.K. and European business, from the group. We've been clear for some time about the importance of creating optionality within our corporate structure. After a rigorous review, we've now decided to exercise one of those options in the interest of both businesses and of all our stakeholders. As a stand-alone business, M&G Prudential has strong capabilities in the growing savings and wealth management marketplace. It will be focused on outperforming its U.K. and European competitors and will no longer compete internally with our businesses in Asia and the U.S.

Following the demerger, Prudential plc will focus on the opportunities we have in the 2 largest insurance markets in the world, meeting the needs of the fast-growing middle-class Asian community and Americans approaching retirement. We're also enthusiastic about the progress we're making in Africa.

The 2 independent groups will be headquartered in London, which we regard as the preeminent city from which to operate global financial service businesses. We would expect both to be members of the FTSE 100.

The board believes this demerger is in the best long-term interest of all our stakeholders. Customers will receive greater focus, employees will be more closely aligned with their businesses and we are confident that this demerger will create market value. Today's strong full year results demonstrate the positive momentum across all our businesses.

With that, I'll hand over to Mike who will talk you through our results and provide some insight into the proposed demerger. Thank you.

Michael Andrew Wells
Group Chief Executive & Executive Director

Thank you, Chairman. Well, good morning, everybody. You've had a slightly quieter morning than I've had. It's been a -- it's been an interesting set of results to try and prepare a summary for you today. I think one of the comments that a number of you have said early is, there's an awful lot in this pack and there're a couple of takeaways. We're going to do our best to get through that. As always, we'll stay and answer any questions you have on the variety of topics and metrics and things that we are report on this.

I want to start at the, if I may, at the top. If you look at the scale of what was done last year, so another incredibly strong record year of earnings. The combination of M&G improved successfully. Some of the businesses, we've increased stakes and decreased stakes hold in, all of the various dynamics. I said to a number of you when I first took this role that one of the things people underestimate about this group is its bandwidth, its capability. And I hope one of the things you'll take away from the just sheer amount of materials that's in here and completed projects and work streams in here is the folks in these couple of rows, even back at third row are capable of producing a tremendous amount for you as shareholders, and I certainly owe them my thanks.

So another strong set of broad, good financials. Let's start on, if we could -- actually, I'll take this, all the key metrics: so new business profits, cash, embedded value, earnings, dividends, capital, okay? Embedded in that is a focus on quality of earnings; health and protection focus; Asia, you have IFRS up 15% in Asia; health and protection, up 26%; the U.S. increase in the fee level, the U.K. record net flows and the M&G at over GBP 17 billion and the with-profits fund as well [at 9%]; IFRS earnings, up 10%; and the M&G Prudential dividend, up 8%, and again, all of this while maintaining a very robust solvency level. So very pleased with the strength and breadth of the financials. And some of the optionality we'll talk about later today simply comes from the fact that we have the strength to do this from and that we're doing this from businesses that are all working well, okay? We're not solving for anything as we get to some of the more strategic conversations today.

Not to be lost in our discussion, all of the 2017 objectives have been achieved. We go back to the, again, my 23 years here, we've run 3 sets of objectives over time through Asia primarily, with some group metrics in them. But I think it was fair to say they were, to demonstrate, proof of concept. At various points, there was tremendous debate about the resilience and validity even of our Asian assumptions. I'll date myself with this number. But when I started in 1985, the IFRS earnings in Asia were GBP 11 million, okay? So yes, I've been here that long and they've done that good a job, both reasonable takeaways from that. But it is incredible the job the teams have done and the resilience and the percentage of that earnings now that's recurring regular premium, health and protection-focused lately, but that recurring earnings stream over -- less dependence on new sales, more dependence on us during the right thing for the existing clients, giving us cohort after cohort of profitability for our shareholders.

While Asia was growing, while they were meeting those objectives, you also saw material changes, active management of the portfolio. So that's everything from the businesses we chose to exit, business markets and products we chose to exit to businesses we entered, new marketplaces. In this period of time you have Laos, you have Cambodia, you have our African expansion, you have product expansion, new distribution relationships all taking place. So this wasn't just to chase a handful of public metric sort of exercise. The overall quality and capability of the businesses improved throughout this period of time, and again, put us in a position capability-wise, not just financially, that we could do things that we couldn't do in 2012. And as I travel the region, it is very clear some of the capabilities that the group has that are new, some of the stuff that's emerging in the sense that it's more forward-looking, it's yet to hit scale and some of the things that are actually benefits of scale all coming through. So tremendous financial metrics. But also, I'd appreciate if you looked at some of the other attributes that are included in there, automation there at the top, 90% of the applications now are auto-processed, 50% under auto written. We have entire markets now where the entire China, as Nic highlighted in November, where almost the entire process is digital. We are getting better and better and better at what we do each year.

Structurally, if you go back a decade, the group mix and its scale has evolved. So if you go back to 2017, embedded value of the group was about GBP 15 billion and half of that was the U.K. You bring that forward to this year, the embedded value is GBP 45 billion and 72% of that is international. So the nature, currency, kind of earnings, what those earnings react to and work, all that has changed. So when we're looking at some of the strategic decisions, this is one of the lenses. It's not just the absolute scale that these businesses -- the interdependence financially is reduced, but it's the -- what attributes do they share, what capabilities they have has changed. And from a market point of view, how we look at the group is nothing more than a reflection of what the group has actually become and then a view of what we think the next 10 years out looks like. So if you -- you all have your own, I know, various views of that. But if you take this out another decade, the international component, if left alone, would be even larger, right, and we'd be having a very different conversation about structure.

So we've been very active managers through this period of time of the portfolio. Again, we've entered and exited markets, entered and exited products, distribution channels, sold noncore businesses, okay, deemphasized businesses. So this has not been a run-it-for-top line decade, this has been improve the quality of earnings, improve the resilience, improve the recurring earnings. I think that comes across in our performance. But now we're in a situation where both the U.K. and the international business have scale, I think, by any attributes, which brings us to the announcement on the demerger.

So what are we trying to achieve? One, better alignment. If you think of the time, you see capital reallocation and alignment; you see resource allocation; we want the people's focus, the government's focus on the markets that are closer to their consumers and where they are, okay? The amount of time that John and Anne spend on the plc board, okay, would be spent 100% on a U.K.-, Europeans- bent focused board, right? Just a simple example. The choices on how we allocate capital, right now, the U.K. competes internally as it should, okay, for opportunities we have around the globe. Okay, those may or may not be higher rates of return than we get in the U.K. and those returns may have different characteristics and how they react to the pound or news here or news in emerging markets or news in the U.S. or political news anywhere now, which seems to be analysts. Those factors all are changing.

So what we know is M&G Prudential is large enough to compete domestically with any firm in its space. It has the breadth of product, capability, management team, technology. It's got everything it needs to succeed domestically. The value of being part of the group that the group brings to it is diminishing. So when you look at the strategy, you look out and say, are we the logical owner? The conclusion of the board is, maybe now, but certainly not over the next decade, okay? So this is the right time for us to do this. Right decision, right timing, and we think it'll unlock benefit for all of our stakeholders.

What you will have. A shareholder today will have the same economic interest if they do nothing and just hold the 2 shares when the demerger takes place: you'll have 1, as the Chairman said, FTSE-listed Prudential plc, which will focus on the United States, Asia and Africa; and you'll have 1 share of M&G Prudential, which will be a national champion on the savings and retirement space, investment space here in the U.K. and Europe, okay? So no -- if an investor said, I want to keep what I have, you can. The choice goes back to the owners of the company and how they want to allocate their capital between the 2 businesses, what they think is the right mix or if they want to do absolutely nothing, okay? The ability to do this, the dividend policy in the interim remains unchanged and we cannot comment on a dividend policy of a future entity that doesn't have its board in place, let's be very clear. That's not our gift. But the divestiture itself doesn't affect the dividend capability of the firm in either structure. So it's not an economic decision. I got asked earlier a couple of times today, what's the dividend policy going forward? We're only responsible for the dividend policy of the entities we govern. So until that's done, obviously that's up to the new board. But both entities should be competitive in their marketplaces on all financial metrics.

What stays the same? Same risk, same, governance both based here, both headquartered here, again listed here, premier listings. We believe from the metrics they'd be FTSE 100 included. So from an index point of view, they'd still be in the FTSE 100. From an execution point of view, from a tools point of view, it's the same people, okay? It's the same cultures. It's the same execution that you've seen to date. They're just split into 2 teams. So all of those things that produced the results, that got these businesses here remain intact and that includes the risk management, governance, all of the elements that control the quality of those earnings, quality of those sales.

So we think it's a great combination of changing the piece that gives greatest optionality and greatest benefit to our stakeholders and keeping in place the piece that produces the most consistent results, the most consistent outcomes, again, for those same stakeholders.

So what is M&G Prudential's space? Where is it going to go? Well, we envision it as a market-leading savings and investment business, and again, delivering very attractive returns on equity. Its ambitions are clearly to take some of the things that are working well in M&G and Asia, some of the things that are working well with the U.K. life side with M&G. There're already work streams in place to share distribution. There're work streams in place to share their digital platforms. We've taken the investment that shareholders made last year, and I'll give you some update on this in a second, but the progress made is towards a single model, not two, as we committed to you, right? So there are energies coming out of that and the marketplaces -- and from a consumer and institutional point of view has not only accepted the logic of a business model, but it's embraced it. You see that in the strong financial performance, you see that in the net flows and you see that in the operating income. We did not lose clients because we merged the entities. We did not lose mandates, right? Both sides of the house had record flows, and as a percentage of flows in the market, tremendous market share. So we think this is working and we think it's a unique set of portfolio skills, a unique set of balance sheet products, a unique set of with-profits products that the business brings to bear, and again, benchmarks nicely against competitors.

Those flows, in particular, you see on the M&G side, on the left here, GBP 17 billion in net flows. And on the PruFund, a record GBP 9 billion of net flows. Combining with the expense management and all of the upgrades in technology and operational models they're doing, net at a 10% increase in operating profit for the year. So headline numbers are great, performance for the consumers, institutional and retail have been excellent. 90% of the institutional products that M&G has now, their 3-year return is over the median for their sectors. These businesses are performing well. They're not distracted, okay? It's business as usual while they're getting integrated and while they're findings synergies as we committed to you they would. And the outcomes are measurable.

So a quick update on the merger and transformation progress. So we committed to GBP 145 million of shareholder cost reductions at the end of the program, that is on track. You've seen the combination of the shared services. We've announced the TCS project where they've replaced capita and we're working on that transition. This is technology that is available now, up and running, agile, the kinds of tools that we want in the business immediately. It's also consumer-facing service capability that we want to upgrade and can very, very quickly with their capabilities. M&G is ready for Brexit regardless of the shape. The SICAV platforms we need up in Luxembourg are almost -- almost everything we need done there is complete. There's one minor project left. I don't want to put too much pressure on the team to have it done by later today, but it's coming soon. We are in a position for anything the political environment can throw at us within reason on that front. As we said before, the group's not particularly sensitive to Brexit, but we were sensitive to M&G's relationship with European clients and distributors and so we've addressed that with fund structures. And then now we're seeing the teams work together on what more can we do, what more -- what are the synergies and distribution and relationships, what do your clients think of the products that are held more broadly by what was the other side of the house before and some very good progress there and that's just going live now. And then, finally, as of very early this morning, the GBP 12 billion annuity transfer to Rothesay. It's part of a larger capital management transition, if you will, we committed to you to get -- to actively manage the capital on the balance sheet, particularly in Pru U.K. So you have the -- we're announcing today the GBP 12 billion of transfer of part of the back book to Rothesay, so that's a reduction in credit risk immediately. We're also -- we're moving Hong Kong, which was originally discussed with you as a -- it'll be earned out. We're pulling that project forward. Instead of an earnout, we'll transfer it, we think, through the middle of next year is the current timeframe. And then the last piece on the Rothesay transaction will be the Part VII, the full transfer, and that is subject to Court approval. So we anticipate from the current information we have, and again this is outside of our gift, that that'll occur sometime late 2019.

So when you're looking at milestones and what do we need to do to be ready for a demerger, it is not a set date on the calendar. It's complete the work here that produces independent balance sheets, strong balance sheets, well-capitalized firms. And then we'll go off, rather the half year or full year results that follow that, so we don't incur additional shareholder expense for the demerger. So -- and the back book transaction with Rothesay released a little over GBP 1 billion in capital and that's going to be retained in the group to maintain the structural and strategic flexibility we're talking about here today.

So the international business. So we're well positioned, we think, to lead in the markets that that entity will compete in. The most interesting stat came out of the work going into this was Asia now has 1 million people a month entering the working population, right? So we've looked at the demographics in Asia multiple ways, but we -- as successful as the team is there -- we've shown you this last year, as successful as our market positions are, as well received as the products are, the demand and the structural elements are still growing as fast as we can produce solutions and distribution to address them. So we think the structural demands in Asia remain unique. There're a variety of different ways to measure it. But we think it's a -- it still has tremendous upside and obviously, we want to capture that and we think the new structure better aligns us for that, focuses execution and should create value for everyone.

The U.S. as well. You have more clarity now on DOL, you have more clarity on the shape of the marketplace, on who distributors want as partners, Jackson's capabilities are up in that space. They've already launched the fee-based product. They've got over 100 firms, we'll come back to that in a second. But they're learning how to be effective wholesalers of a different product, a different structure in a different space. So they're very well positioned to compete, and I'll come back to some of the dynamics on them in a second.

I wanted to give you a slightly different look at the success in Asia. So we've talked about a number of countries where we're top 3, it's 9, 8 countries with double-digit growth. You've seen that before. But here's a different cut on the actual size, the absolute size of the businesses we have in Asia now. And this goes back to scale and this goes back to we do compete with new competitors, their ambitions in Asia are as X amount of countries versus necessarily profit per country and things and that can be challenging and it's one of the many things the local teams have dealt with for as long as I've been here. But I thought this was a really good cut at what you own in Asia. So there are -- the sheer size of these businesses now as individual entities continues to grow, continues to grow profitably. The focus on the teams is on profit. It is not on top line. They are limited in some of the products that we won't let them compete with. It can vary by market based on the irrational behavior of competitors or the credit risk we perceive there or the capital intensity or all of the above. But we think the quality of the earnings we have in these businesses continues to improve as do other key metrics around it. But the absolute scale of them, I think, is something the team there needs to be very proud of. And then, of course, as you would expect, new business profits at GBP 2.4 billion, the IFRS operating profit, up 15%, the free surplus generation, we just keep adding profitable cohort after cohort after cohort to this business and that's the right way for us to build it. You see the new business profit number, health and protection, up 26%, it was a great metric for the team and then, again, the margins continue to stay healthy. But there's quite effective utilization of the brand. There's much more learning cross-border as these businesses gets bigger. If you almost went down the size of these businesses, the issues that the CEOs and their teams deal with get more similar and so the relationships and the sharing gets more enthusiastic. And Nic and the team have done a very good job now, and each successive management team is bringing a slightly different style to it and getting them to work closer and closer together and share more and more as these businesses get more mature.

One more Asia demographic slide, just why health and protection, upper right-hand corner, there is no material change and the amount of money that Asian consumers are spending out-of-pocket, if anything, it's up. In my travels there, it is generally one of -- people's very -- it's one of the earliest conversations they bring up on personal concerns and education tends to be the second for family members. And -- so the changing demographics in the markets we're in is driving a lot of that. If you're in Mainland China, the one by-product of the one-child policy is a young couple is concerned about helping fund retirement for 4 adults and that's true in multiple other markets where historically family was the retirement plan. So there's quite a focus by the parents and the working children on the liability of that model and how you fund that. We're in front of social need, consumer demand and aligned with political and regulatory models with the products and services we're bringing in, you see that in a variety of markets.

On the working-age piece, we just talked about the number of people entering the market. Penetration stays low. On the upper end of the market, you are seeing a very, very fast growth and you hear this from competitors that own advice platforms there in wealth management, in wealth solutions. As the consumers there get more sophisticated, as in every market, they're looking for ways to diversify, participate in markets globally and we have Eastspring well positioned to capture that. But it is a -- the pace of that market and the resources being thrown at it by banks and advisory firms is dramatic and we intend to play a material role in that than we have to date.

Shifting to the U.S. for a second. So the U.S. success can be summed up so that the -- 2017 was again another great year for the U.S. business. It was a great year if you are a consumer and you own the product. Again, you own the top performing product in the industry, okay? The volatility and everything that went on in the market in the early year, your short-term vol and all the dramatic stuff that was in the headlines, there were a few political headlines in the U.S. last year. These consumers know that when they go to retire, they have X amount of income coming and it is no different than with-profits client in the U.K. looking to smooth the edges on the market. Now that said, the amount of exposure, the amount of -- the value of the guarantee, if you will, to our consumers from their market positions, the value their accounts has never been lower because their accounts have done very, very well. They've participated in the market. Remember, these weren't forced allocation models. These were not vol-controlled models, okay? These consumers got to own the underlying funds of some of the top asset managers in the United States. They participated about 70-30 in equities, disproportionately value funds, with very good fund managers, again actively selected, actively added and deleted based on performance, okay, and the balance of it is in bonds and guaranteed funds and they got a very good return relative to market and they own the product for accumulation until it's time to retire, exactly as it was designed to perform, okay?

So with that, with a quality product, you get some very good outcomes. You had a profitable business that generates a lot of cash. I know there's been a lot of discussion about competing models in the U.S. And for those of you that haven't been sitting here a long time, we never believed in the GMIB product. We never believed in some of the distribution models competitors took, we took a lot of heat from that for a number of years because we wouldn't do it, okay? And the difference is you own a company that's produced GBP 4.4 billion in cash to the center, which by any public metric I can get is more than all of our competitors combined, okay? So it is a very differentiated company than some of the other firms that it competes with. It isn't that there aren't good competitors in this space, but this is the best competitor in the space, okay?

So what is that -- how does that position it for what's coming? Well, if you're a consumer, you get the best return. If you're an adviser, it also is rated highest in service, including the mutual fund companies in the United States, so your reputation for service, the time you spend interacting with your clients because there Jackson is appropriate, okay, that matters to advisers. They hate services using companies, it's performed as they suggested it would, that's valuable. So we have trust with advisers. It also has the top-rated wholesaling teams, the support for the advisers in the United States. Okay, well, that's good, and that's retroactive in its measurement. Why it matters is as the landscape is changing and the emergence of the fee-based products and the emergence of post-DOL platforms where a brokerage firm has to decide who are they going to invest millions with to link up technology-wise with a company, one, they've got to believe the firm's committed, they've got to believe they have the technology on the other side and they've got to believe they can actually add enough value to warrant the investment and manage the risk in a way that won't damage the reputation of the firm, okay? Product approvals now in some of these firms go all the way up to the general counsel's office. It's no longer a head of insurance or head of asset management who makes the call. So Jackson's reputation, historic success, client orientation, wholesaling capability, technology suddenly put it at the front of the pack if you're running a brokerage firm and saying, who am I going to put on my new post-DOL platform, okay? Now we will manage capacity on that as we have managed risk exposure on that, as we have and everything else in Jackson. So we can't beat everybody's product. It's a little different structure that way. But that's a capability the firm has as well. So Jackson is incredibly well positioned to deliver on where the U.S. business is going, has a very profitable existing back book and again very happy clients. They're staying longer than we thought. Depending on the accounting metrics, that's good or bad. On an economic basis, it's only good. These are very profitable relationships for them and for us.

All right, I'm going to get Mark up here in just a second. So I've argued with you, I think, since -- as I took this role and with some of you before that, I think this is the fairest cut to look at us. At any point in time and ensure just because the nature of our business and some of the accounting can move one of these needles for a period of time if they choose to, pretty hard to move of all of them consistently. And again, I think this is the best report card on the group. I think it shows the growth is not only in earnings, but its future earnings, it's also in cash and that should translate to and it has a consistent growing dividend. So again, today, we announced an 8% increase in our dividend. It's well supported. And we think from, again, if you've owned the shares awhile, if you go back to 2006, it's GBP 8 billion now in distributed dividends. It's a high-quality dividend. It's a highly predictable dividend and I think that's -- it should rate at the upper end of its peers.

There's a lot to go through today and I think with your indulgence, I will hand it over to Mark and then I'll come back afterward for Q&A. And again, we will -- we'll bring the whole team up here and go through any part of those materials you want at the end of Mark's presentation. Mark?

Mark Thomas FitzPatrick
CFO & Executive Director

Thank you, Mike, and good afternoon to you all.

It is understandable, of course, that our strategic announcement today has drawn most of the interest, but hopefully not to the complete exclusion of our financial performance in 2017. This set of results adds another period in a long-established trend of growth in scale and in quality. This really underlines that we begin the M&G Prudential demerger process from a position of strength right across all our businesses.

With this in mind, I will cover 3 main areas: first, an overview of the key financial highlights; second, a more detailed look at each of our major metrics and the drivers of the performance in the year; and third, I will provide some financial commentary on our plans to demerge M&G Prudential.

So starting with the overview of the group's financial performance for 2017. We have delivered good financial progress with increases across our main profit matrix, alongside higher levels of cash remittances and 8% growth in the ordinary dividend. Our performance has been led by continued positive momentum in Asia, although all of our businesses have made healthy contributions with asset management, in particular, having a standout year.

Turning to our key operating metrics. IFRS operating profit increased by 6% to GBP 4.699 billion. New business profit was 12% higher at GBP 3.616 billion. And free surplus generation at GBP 3.64 billion on a headline basis and was up by 9% on an underlying basis before variances. Throughout the year, we have continued to enhance the mix of our businesses by growing fastest in the products, geographies and channels that offer attractive and sustainable returns through efficient allocation of capital. This continues an established progression that speaks to the absolute and the relative strength of our products and distribution platforms in our chosen market segments and the disciplined focus with which we execute our strategy.

Our fee-based businesses have also benefited from favorable investment market performance, delivering good outcomes for both our customers and our shareholders as I will reference in due course.

Currency effects have added between 3 to 5 percentage points to reported growth rates in 2017. Although with sterling strengthening over the year, this is likely to reverse in 2018 based on current spot rates. As in previous years, we continue to reference constant currency movements as a better indication of the underlying financial progress of the group.

Our healthy balance sheet and Solvency II surplus remains key to our ability to successfully absorb movements in macroeconomic and other external factors.

Moving on to each of our key metrics in turn. Starting with IFRS operating profit, up 6% to GBP 4.699 billion. Now the trends here are consistent with those I flagged to you at the half-year stage. In particular, those are that: one, Asia remains the fastest-growing part of our business; two, that each of our businesses in Asia, the U.S. and U.K. and Europe have delivered growth in earnings across both life and asset management; and three, that consistent with our strategy in the areas that we are looking to grow, we are growing.

As you can see on the right-hand side of the slide, the largest contributions to IFRS growth are coming from our Asia businesses, followed by Jackson's U.S. fee earnings on variable annuity business and a significant uplift in the underlying profit from M&G Prudential. These operations underpin the group results for 2017 and remain the focus of our growth ambitions and capital investment.

We have also indicated in the past that there are some areas that we expect to contribute less in 2017. These include the spread-based earnings in the U.S. where reinvestment yields remained below the portfolio return.

Outside the business unit results, operating profits also include the investment we have made in systems to improve our capabilities across the group, the costs related to M&G Prudential's merger and transformation we announced in August and high-interest costs from the debt issued in 2016.

So overall, another good year of profitable growth based on superior strategic positioning, disciplined execution and a very distinctive and attractive mix of earnings.

Turning now to the IFRS performance of each of our business units, starting with Asia. Both insurance and asset management have contributed to a strong result with growth of 15% and 18%, respectively, highlighting the positive momentum across our regional portfolio of 26 businesses. Fundamental to our progress across our life insurance platform is our continued focus on higher-quality earnings. This is evident through the compounding benefits of a growing renewal premium base and a clear preference for insurance risk by writing health and protection business. On both of these metrics, we have achieved growth of over 20% in 2017, which drives the overall result. It is by continuously improving our scale and enhancing our business mix that we are able to show such broad and repeated levels of growth replicated across country, channel and product.

In asset management, Eastspring has had another good year. The 18% earnings growth reflects a significantly higher asset base, which was up 20% on an average basis due to net inflows and positive markets. Although this was partially moderated by a slightly less favorable mix of client AUM, as you can see in the slight reduction in the revenue margin, the overall result benefited from a stable cost-income ratio and a healthy contribution of GBP 17 million from performance fees.

With combined IFRS profit of GBP 1.975 billion in 2017, our Asia businesses have exceeded their 2017 objectives and continue to generate high levels of growth with increasing quality and breadth.

In the U.S., the accumulation of variable annuity assets continues to drive Jackson's earnings. Average separate account assets increased by 17% to GBP 125 billion, primarily due to strong investment performance, consistent with the rise of the U.S. and international equity markets in 2017 and another year of positive net flows. The remuneration choices of our commission-based distribution partners continue to move away from upfront structures towards trail. As a result, the level of separate account assets under management is expected to have an increasingly direct relationship with trail commission costs. Currently, roughly 40% of our commission-based VA is on a trail basis. However, excluding these commissions, Jackson continues to lead the industry on administration expense efficiency, highlighting our cost discipline and lean operating platform. Overall, fee-based earnings increased by 12% to GBP 1.788 billion.

Earnings from spread-based business decreased by 6%, reflecting the impact of the anticipated reduction in spread margins. This move down in spreads is due to both lower reinvestment yields and lower positive contribution from duration management swaps as they continue to roll off. We would expect these trends to persist, although continued upward movements in U.S. yields may help to reduce the speed of the decline.

The recent U.S. tax reforms are relevant for all of our major financial measures but do not fall evenly across years or reporting metrics. So to help you, I've tried to summarize the major impacts together on this 1 slide. These changes are ultimately positive for Jackson as they should result in higher levels of retained earnings and capital generation, all else being equal. The 2017 year-end balance sheet impacts primarily relate to a lower level of deferred tax assets. So for IFRS, this reflects a lower corporate tax rate on the net DTA balance. For EEV, the reduction in DTA is outweighed by the positive effects of the more favorable tax rate on future profits. And on Jackson statutory capital position, the impact at the year-end includes a combination of DTA calculated at the lower tax rate and the removal of the carryback of net operating losses previously allowed. Notwithstanding this, Jackson obviously remains in excess of 400%.

The stated year-end statutory capital position does not take into account any estimate of the impact of required capital as, at this stage, the NAIC is yet to make public how it intends to incorporate tax reform into its assessment of capital. We expect a period of engagement between the NAIC and the industry to follow over the coming months, likely incorporating some of the other outstanding reform areas such as the C1 asset risk charges. We will, of course, participate fully in these discussions and update you once this position is clearer.

Going forward, we expect Jackson's effective tax rate to improve by roughly 10% from around 28% to approximately 18%. This decline in ETR incorporates a new headline corporate tax rate of 21% and a continued benefit from the DRD, which is worth about another 3 percentage points under the new tax regime. At a group level, we expect the effective tax rate to also benefit and reduce to around 16% to 18% going forward. This lower effective tax rate will be beneficial for earnings and capital generation over the long term.

In the U.K., our newly combined businesses have delivered a very encouraging performance with IFRS up 10% overall to GBP 1.378 billion, emphasizing the benefits of its scale, distinctive investment capabilities and well-seasoned in-force life portfolio. M&G Prudential continues to work towards this transformation to a modern savings and investment business and is on track to deliver the GBP 145 million annual savings we set out in August.

In life insurance, core earnings remained in line with our expectations at around GBP 600 million per annum with a 7% increase in the transfer from with-profits, offsetting lower in-force annuity profits, following longevity reinsurance transactions in 2016 and 2017. The higher transfer from with-profits includes a rising contribution from PruFund business, which now accounts for 15% of the total at GBP 42 million, compared with 10% in 2016. Given the fast-growing scale of the PruFund assets, we expect it to become increasingly material to the U.K. result.

Other movements in the life result are slightly higher overall than in 2016 and these comprise 3 main elements: first, a lower level of contribution for management actions as I flagged at the half-year stage; second, a one-off impact of GBP 204 million as a result of moving the basis of our longevity assumptions from CMI 14 mortality tables to CMI 15; and finally, an increase of GBP 225 million in the provision we set aside for the review of past annuity sales following confirmation from the FCA on the approach for assessing the cost of redress. Our provision does not include the benefit of potential insurance recoveries of up to GBP 175 million.

In asset management, M&G has had a great year with the external net inflows of GBP 17 billion at record levels and the external AUM finishing the year up 20% at GBP 164 billion.

IFRS operating profit has moved up with these underlying drivers, benefiting from higher revenue, a small improvement in the cost-income ratio and higher performance management fees of GBP 53 million. We have seen good results in both retail business where Europe continues to lead our progress and in institutional where we retain a healthy pipeline of future capital commitments on top of the net inflows that exceeded GBP 6 billion in 2017.

With this performance and a positive outlook, M&G Prudential is well positioned for the ongoing transformation process and to begin the path to demerger.

Moving to the rest of the P&L account and covering the remaining items outside the business units' results. I've included within IFRS operating profit, there are 3 main items to note: firstly, the additional restructuring costs of GBP 44 million relating to the M&G Prudential merger and transformation program; secondly, the GBP 50 million cost of implementing the 11 platform across the group; and thirdly, the additional interest cost of GBP 65 million related to debt issued during 2016 together with currency effects.

Within the nonoperating result, investment variances primarily relate to negative marks on derivatives used to protect against downside equity market risk in the U.S. VA portfolio. These are in line with expectations given the appreciation in equity markets and consistent with the movements we saw in the half year. On an EEV basis, the positive offset of higher future fees from higher account values results in an overall gain, which is a better indication of the full economic effects.

2018 has been a more volatile year in the investments market so far. Throughout this period, our hedging program has performed as expected, generating positive below-the-line movement at the low point of the S&P and we have no reason to change our approach in light of these recent market fluctuations. Including the impact of tax reforms already discussed, the gain on the sale of our U.S. broker-dealer, NPH, currency effects on sterling strengthening and the dividend payments in the year, shareholder funds has increased by 10% on an IFRS basis and by 15% to GBP 44.7 billion on an EEV basis driven by operating returns.

Moving now to new business. New business profits increased 12% to GBP 3.616 billion with a broad mix of growth across each of our businesses. This was higher than the 6% increase in APE sales and includes the benefit of continued improvement in Asia's mix towards better-quality business with higher returns. As I flagged at the 9-month stage, the tailwind seen earlier in the year from the rise in yields was no longer a significant contributing factor in the rate of growth by the year-end, although the higher level of yields remain a positive for the overall economics of the business.

In Asia, NBP has increased by 12% with health and protection contributing growth of 26% as we continue to pivot the business towards protection income, in line with our strategic focus. In Hong Kong, NBP was 8% higher; and outside Hong Kong, NBP was up 20%. And both agency and bancassurance channels recorded double-digit growth. Reflecting the progress we have made in this regard, the economics of the new business we wrote in 2017 are at their highest level ever. So behind the sales performance remains our focus on improving quality and economic returns, attributes that we continue to emphasize across the business.

In the U.S., sales were largely unchanged on the prior year with growth in NBP mainly the result of the lower assumed tax rate on future cash flows. Jackson continues to make good progress to position for the growth opportunities in the advisory market, building fee-based platform arrangements with many of its major distribution partners. New business from these sources remains low by comparison to the traditional commission-based business but is accelerating and we are encouraged by the early progress made to date.

In the U.K., new business trends remained favorable with stable economics and sales, driven by individual pensions and income drawdown within the retirement account wrapper, which now stands for 81% of APE in these segments. The success of this business means that sales to the retirement account are nearly 2.5x the peak volumes of retail annuities that we wrote in 2008. This demonstrates clearly the strength of our product proposition and the ability to adapt to external change and to capture the opportunity that this brings.

How and where we invest our capital and how we manage that business once it's on our books has a direct correlation to the conversion of in-force value into cash and capital generation. To capture the underlying progress, I've analyzed out the expected return from the in-force life portfolios and the contribution from the asset management businesses. This highlights that each of our businesses had generated growing contributions as expected, given the growth in the life portfolio and the strong year for our asset management operations. After investment in new business, the underlying movement in 2017 before variances and restructuring costs was an increase of 9% compared to 2016.

Moving to the breakout boxes on the right. Contributions from assumptions and experience variances were in line with the 2016 after adjusting for the one-off contribution from the contingent reserve financing in our U.S. business in 2016. We continue to reinvest a significant proportion of our free surplus in new business, given the returns and growth potential that our superior marketing position and capabilities provide. Asia remains the primary destination of our new business investment, accounting for over half the total in 2017, reflecting the relative scale of the opportunities there.

In the box on the lower right of the slide you can see the increased investment in the U.K. and Europe. This is primarily due to the higher level of new business reached in the period and remains highly efficient given the attractive returns available. Under Solvency II, this includes an amount that relates to the with-profits business, reflecting shareholders' participation in the downside scenarios of some 1-in-200 stress events at current interest levels. In the context of PruFund having gross inflows of GBP 11.8 billion this year, this is a fraction of what would be incurred in writing new annuities with a payback that is over 3x faster and returns that are over 4x higher. The benefit of the recent strength in PruFund flows is now starting to emerge more significantly in earnings, as I covered earlier, and validates our strategy to prioritize growth in this area.

My next slide shows how cash and capital generation moves through to central cash. The strength of the organic capital generation comfortably funds new business strain with the majority of what remains remitted as cash from the life operations to the group and the balance used to reinforce the capital position of our local businesses as they continue to grow in scale.

The chart on the right shows how cash remittances of GBP 1.361 billion from life operations and GBP 427 million from asset management were used to cover the growing dividends and corporate and other costs such as the net retirement of debt in the year.

We continue to run the group to a robust solvency capital position with a shareholder Solvency II surplus of GBP 13.3 billion at the end of 2017. As expected, given the growth in the business, both own funds and the SCR have increased over the period. But the scale of the surplus has also increased, and the cover ratio remains largely in line with the prior year at 202%.

Our strong group solvency position is replicated at the local regulatory level 2 with capital well in excess of regulatory requirements. The impact of U.S. tax reform is the main reason for the reduction in the U.S. RBC ratio, which I've already covered. However, I would also remind you that our U.S. RBC does not include the benefit of swap gains from use of the permitted practice, which, if included, would add another 45 points to the year-end ratio.

My next slide provides you with the usual bridge between the 2016 surplus and the 2017 position. Operating capital generation of GBP 3.2 billion remains the key driver of the change, which has helped to absorb the adverse day 1 impact of U.S. tax reform as well as funding the dividend payments and sub-debt redemption. In addition, management actions relating to the U.K. have added GBP 0.4 billion.

The sensitivities on the right-hand side of the slide continue to demonstrate that our Solvency II position remains resilient to market stress while retaining the upside potential from a favored market position. We continue to hold significant levers within the group and at business unit level, to manage external market effects, combined with appropriate headroom in our Solvency surplus to act as a buffer when required. It is a strength of our operating capital generation and the risk management practices that we have in place around this that have enabled our businesses to successfully navigate external economic stresses without disruption to the underlying businesses.

Now my final slide on the 2017 results, I just wanted to take a step back and provide a view of the major drivers of earnings growth and the quality in the period. It is truly these measures that generate the consistency of the group's financial progress, support the resilience and sustainability of earnings through the economic cycle and provide the scale, which benefits our operational and strategic delivery. In Asia, our growing base of recurring premium business means we start each year with a clear earnings base, which compounds with each subsequent year of new regular premium business. As I have already highlighted, our strategic emphasis on health and protection is also increasing the proportion of earnings derived from insurance income, another indicator that our growth is a high-quality growth.

In the U.S. and in the U.K., it is the distinctive structure of the product proposition and the performance of the funds available to customers that continue to underpin net inflows and appreciation in asset values on which our fee earnings are based. Across each of our businesses, these key drivers are growing well.

Taken together, the combined effect of continued and consistent operational delivery is highlighted in the 15% uplift in embedded value to GBP 45 billion at the end of 2017.

Now stepping away from the FY '17 results and turning to the U.K. annuity sale for a couple of moments. This is a major step in the continued de-risking of the U.K. life business, representing the transfer of around 1/3 of our shareholder-backed annuity portfolio. This is a positive development with attractive terms achieved. It validates the quality of our U.K. annuity portfolio and is another example of our ability to execute well. This sale will ultimately see a reduction in capital held against both credit risk and longevity risk. Credit risk is the larger component of this where we have reduced credit exposure for U.K. PAC on a Solvency II basis by around 30%. On completion of the Part VII transfer, we estimate that the sale will lead to a $1.3 billion reduction in the SCR and a 0.2 billion -- sorry, and a GBP 0.2 billion decrease in own funds, resulting in an increase in PAC's capital surplus of GBP 1.1 billion. Of this, we expect to recognize GBP 0.6 billion at 30th of June under the reinsurance agreement.

The capital benefit from the sale will be retained to support the U.K. demerger process. It puts the solo U.K. regulated insurance entity on an extremely solid capital footing at the outset of the demerger with a pro forma cover ratio of 150% as if it was all completed at the 2017 year-end, including the transfer of Hong Kong subsidiaries. In reality, we would expect organic capital generation over the period before completion to build this number further. This provides us with maximum flexibility as we work to optimize the capital structures of both entities prior to separation.

While the impact on the EEV is less than 1%, on an IFRS basis, we expect to incur a loss on sale of up to GBP 500 million in the first half of 2018. Going forward, your estimates for M&G Prudential's IFRS profits should recognize that the annuity portfolio being sold contributed approximately GBP 140 million to the 2017 U.K. core life operating profit of GBP 597 million. This transaction is a significant milestone for M&G Prudential as it continues to transition towards a de-risked business model and an appropriate balance of risk exposures.

Now it would be remiss of me not to share with you some of the high-level steps we will be taking to effect the demerger of M&G Prudential. Although many activities and actions will run concurrently, as you'd expect, the exact timing of each will be the subject of various factors, including regulatory approvals, the Part VII [transfer] process, and for the debt management operations, suitable market conditions. We will look to many minimize any associated costs during this period, and looking ahead, we will provide you with updates as we move through this process.

To position the businesses for separation, we will optimize the capital structure of each entity to ensure they are both appropriately and robustly capitalized. It will necessitate the creation of a new Holdco entity for the U.K. operating companies and the realignment of the group's debt capital position across the Prudential plc and M&G Prudential entities. This may include redemption or debt liability management for issued debt.

As you will be aware, many of our Asia businesses started life as branches of the U.K. with-profits fund, which provided a highly effective approach to launching in new territories. Over time, as they have grown in scale and to align ownership with operating and regulatory structures, these operations have moved under the ownership of the Asia business as subsidiaries, the last of these is Hong Kong. As the largest and by far the most complex, it's been more appropriate to adopt a 2-stage process. We completed the first stage in January 2014 with the domestication of the Hong Kong branch. And for the second stage, as part of the M&G Prudential demerger process, we will now accelerate our plans to transfer ownership from the U.K. life business to our Asian entities. At this stage of the process, we have had very close engagement with all stakeholders, many of which are firmly in motion.

So in summary, a very encouraging financial performance during a year of significant changes for the group alongside continued positive progress in the key earnings drivers of our business and 8% growth in the dividend. These results are a demonstration of the outcome of the strategic decisions over many years, the scale and positioning of each of the businesses in their chosen segments and the discipline with which we execute the growth opportunity and proactively manage our existing business portfolios. By both growing and enhancing the quality of the business that we write while remaining and maintaining a robust capital position, we are simply reinforcing our confidence in the financial outlook for the group. This resilient underlying position with all of our businesses performing well shows that we begin the demerger process from a position of strength. Following which, both Prudential plc and M&G Prudential will be better placed to maximize their value-creation potential.

Thank you. And with that, I'll hand you back to Mike.

Michael Andrew Wells
Group Chief Executive & Executive Director

Thank you, Mark.

So in summary, again, strong growth in Asia, the balance of the business, the U.S. continues to deliver and probably, the U.K. has a strong performance underlying the rationale for creating a simpler, more focused strategy there. And again, adapting the structure to maximize the opportunities for all of our businesses.
So what I'd like to do, if we could, is invite my colleagues up to join me for the Q&A, and then we will address any individual concerns you have or questions you have in just a moment.

Question and Answer

Michael Andrew Wells
Group Chief Executive & Executive Director

Can we get the mic working, please, for Jon?

Jonathan Michael Hocking
Morgan Stanley, Research Division

Jon Hocking of Morgan Stanley. I've got three questions, please. Firstly, thinking about the go-forward pre-plc business, so U.S., Africa and Asia. How should we think about the binding constraints on capital for that business? I assume you're going to be trying to get out of the Solvency II framework. But I guess the advantages of Solvency II did have for the Asian business which you could get diversification benefit, you could say zip up some of the health and protection business. So I guess I'm asking how do you harvest the diversification benefits across the go-forward growth businesses? That's the first question. Second question, just looking at Jackson's capital. There was a lot of moving parts I guess in that business and that market at the moment. The sort of 400% so or number you've got on the sort of headline basis. You've got a few things to come through that you mentioned C1 changes. I guess we still haven't seen the impact of the new VA framework. So can you give some color, please, in terms of where you think the RBC ratio will settle down for the market? And then what impact there is on the ability of Jackson to remit capital back up to the group going forward? And then a final question, just on China. Interesting to see what your views are on what's happening in China. There're obviously a lot of moving parts at the moment with the merger, with the regulators, et cetera. The regulatory environment seems to be quite fluid. Can you talk a little bit about how you see your business evolving and how well positioned you are?

Michael Andrew Wells
Group Chief Executive & Executive Director

Great, Jon. I think we'll divide these up. And so binding constraint on capital -- Mark, why don't I start and you finish? The -- we've always said that in the -- outside of the U.K., the binding constraint is the local capital regimes. It's not a -- if you think of dividend, fungibility of capital, that's the driver. And the -- where the other jurisdictions recognize Solvency II, their primacy is they're on regulatory regime and how we treat it. The other thing that we should be -- what we're reminded of, we don't run any of the businesses to regulatory minimal capital. There isn't a jurisdiction we do business in that they don't look to us to maintain what is almost a AA level if you were going to put a rating agency sort of mark on it. But if you want to have long-term relationships in these markets with the regulators, they're much more holistic, much less resolution recovery focused than you see in Western markets, particularly in -- obviously, I'm talking about Asia. So they want to see reinvestment in the community, they want to see how we treat clients, they want to see the -- our charitable activities and they want to see a well-capitalized foreign entity again, because you're competing with domestics in almost every market. So we probably could bring some of them down closer to regulatory, but if you want a long-term -- if you want a 90-year position to the market, they have to see you as committed and not as a foreign player that comes in and strips as much as they can out every year. So there're a lot of reasons to maintain well-capitalized firms on the local basis, and then those roll up to Solvency II. We never said -- as we've discussed and was debated earlier on, remember dividend policy of Solvency II. I still don't believe that's the prudent metric for it because it's not a cash metric, it's a capital metric. So it doesn't affect us on dividend. The -- it doesn't affect the financials, if you think about it, from a dividend point of view. There is a -- so the intent is to maintain a very well-capitalized international business with capital levels that rival anyone that we -- anyone we compete with. You can look at that from -- as the regulatory College and our key regulators get together and adjust -- that's just starting now. They're aware of it, but they're not -- that is work that in its early days. So I can't -- I'm not going to commit to you what that model's -- the final model is going to look like. But our intent is -- the board and management of the company is to maintain a highly capitalized, highly rated entity similar to our current position that's in -- effectively in compliance with all international capital standards because we're just too big to not be. So I got asked earlier this morning from someone that's in the media, does G-SIFI matter? It doesn't matter. It's not been a binding constraint for us. We understand the framework. We understand the framework is changing. This is no -- this is not about adjusting an ownership model to adjust to a regulatory or a capital model. We'll maintain well-capitalized businesses, heavy liquidity. Our in-house bias will still be cash -- capital as we've discussed many times. It's a -- so cash flow testing. And we'll share with you more and more metrics on how we do that as I think we're pretty transparent on how we stress the businesses. Did you want to add anything to that?

Mark Thomas FitzPatrick
CFO & Executive Director

The obvious point is that we're going to continue to be subject to Solvency II until the point of demerger. So we'll continue to run the business and be very focused on that. And then over the course of that period, as we discussed with the regulators in terms of what the new capital position and capital model will be, we'll then be in a position to communicate that through.

Michael Andrew Wells
Group Chief Executive & Executive Director

Barry, on Jackson's capital?

Barry Lee Stowe
Adviser

Yes. Well, you're right, Jon. There are a lot of moving parts. I mean, the principal impact that we had this past year was tax reform. So that -- and I think you called that out, Mark, in your comment, so that's over $600 million impact on free surplus generation. That's a onetime hit. So I would say to you broadly -- at the risk of being too forward-looking, but I'd say to you broadly, you should be optimistic about Jackson's ability to continue to generate cash.

Michael Andrew Wells
Group Chief Executive & Executive Director

Chad, did you want to comment on the future direction of NAIC and some of their work?

Paul Chadwick Myers
Executive VP & CFO

Sure. So the -- I'd say there're a couple of things we know that are coming down the road. What we don't know yet is the timing or the magnitude, so we do have the NAIC. They will presumably react with respect to the denominator portion of RBC. We don't know yet what the magnitude of that will be or the timing. They've not actually formed a group yet to do anything about that. They already have an ongoing process with respect to the C1 factors that's expected to come in, in 2019, our hope would be, and we will have this conversation with them when they have the appropriate folks in place. We think those 2 are best put together because there are interactions between their view on long-term default rates and the taxation and recoveries that come through there. So hopefully, that would be -- come together. If it does, that would be better. That would be in 2019 if they came together. If it doesn't, you have the potential for a 2018 denominator or a 2019 C1 factor. And we think the 2020, Oliver Wyman, so there's things -- or the NAIC Oliver Wyman project. So there are things coming down the pipe that will presumably -- again, we don't know the number, but will presumably put downward pressure on the RBC ratio. That said, I think everything we've seen suggests that we -- we're generating capital. We don't have anything at this point that would imply that we don't -- can't continue to support dividends the way -- at the level we've been remitting them. So hope that answers your question.

Michael Andrew Wells
Group Chief Executive & Executive Director

And Nic, on China?

Nicolaos Andreas Nicandrou
Executive Director

Okay. So on regulatory developments. Yes, we've seen the creation of a new regulatory body to regulate both insurance and banking. I mean, look, we see this as the outworking of the decree, if you like, at the October Party Congress, which is -- which set effectively the objective for the industry to return to its core. In other words, go back to its derisking purpose, play a role in the financial development of the economy, a source of financial stability and in time, improve the provision of health services and also care for the elderly. So I think it's step one. I think the other reason why this has come together is to ultimately implement the liberalization of the sector as well. Now in order -- the regulators need to build up their regulatory capacity in order to regulate the sector that potentially more than 50% -- more than 49% can be owned by foreign companies. So this is pretty much in line with the direction that was set back in October. We don't think it will impact our business in the short or medium term. If anything, kind of stronger regulation is good for businesses such as our own. Now, shall I give a business update on China more broadly and the opportunity? So again, with the benefit, I guess, of spending more time there since I addressed you at the Investor Conference, I'm kind of even more excited about the prospects in that market, both on the life and asset management side and our ability actually to harvest those prospects. So now -- I mean, you've heard me talk about the opportunity, I can put some more numbers on that now. China is now the third -- officially the third-largest market in insurance in terms of premium income. It's got to the kind of USD 500 billion level. If you look at the insurance assets that are managed in that market, it's got to the $2 trillion level, $2 trillion is 20% of GDP. And in most developed markets, the penetration of insurance assets get to be something of the order of 270% of GDP. So that's yet another indication of growth. Out of the 1.4 billion Chinese today, only 115 million have insurance, any form of savings or insurance. And typically, they would hold about 1.5 policies per individual. Again, you contrast that to Japan, which is the world's second-largest market and typically, on average, people hold 7 policies per person. So that just talks to, if you like, the opportunity there. And one final stat for you, a lot of the development of the sector has been focused on savings. Health is becoming a big part of that market. 32% of expenditure is out-of-pocket. You compare that to low single digits in Europe. And another developing statistic is that 1/4 of the world's diabetic population is -- which is around 114 million people, are based in China. So the spend just for diabetic treatment is about $110 billion. All these are opportunities for companies like ourselves who play both in the savings and the health space to play a role. And on the asset management side, the market at the end of '17 was USD 1.8 trillion. That's about 15% of GDP. Again, in the EU, asset management, retail asset management is 75% of GDP, so sixfold increase. So I think at China, when it comes to asset management, flows will just dominate those in the next few years. So what have we done in the course of the year for our business? I think we continue to broaden on the life side our footprint and to grow into that. And that's -- that has a compounding effect on the numbers -- on the financials of our business. So we expanded, we added another branch, another province, so we now have 18 in total. We added the Sichuan Province, and we're delighted to have such a broad footprint across China. Because even though China may be liberalized in terms of shareholder ownership, there's nothing to indicate that the rate at which they're approving new licenses in new provinces will change. At the same time, we added 3 more new cities. So we've gone from the 74 that I spoke to you a lot back in November to 77. As we expanded our presence in the Hunan Province, which is an important province because it's got 94 million people and it's the fifth-largest economy in China. We're growing out our agency distribution. We've increased the recruitment rate by 48% since last year. We now have 44,000 agents. That's twice as many 2 years ago and 4x as many 4 years ago. And the sales are increasing at 46% on the agency side. On the banking side, we're increasing even faster at 51% as we leverage more the 4,000 strong branch network that we have across -- that we distribute across our business. On the quality side, we're building the health and protection piece very fast. Given some of the statistics that I mentioned earlier, 41% of our sales in China are health and protection. In fact, even a bigger, a richer proportion of the mix in health was written in the second half in terms of health and protection, more than 50%. This is driving the new business profit up and you've seen that doubled. Building out the digital capabilities is one of our most modern businesses both at the point-of-sale where we can issue 8 out of 10 policies that are issued are in 30 minutes. A lot of work on claims, 99% are processed digitally. 17 services done on a need basis. And all that is -- and a lot of the queries now being dealt with by Chatbots. Generally, 20% to 30% of all traffic from agents and customers are now going through these Chatbots. And it's important in a country like China, given the importance, given that it is leading the digital economy. I can give you 2 more stats on that, 35% of all financial services...

Michael Andrew Wells

Group Chief Executive & Executive Director

We're ordering Chinese food for lunch here in a minute.

Nicolaos Andreas Nicandrou
Executive Director

35% of all financial services' customers will use digital means to transact. And the payments that are made using digital platforms in China are 50x the level that you see in the U.S. So unless you are kind of highly automated and digitized in this market, then this business is pretty much leading the way within our portfolio. Very excited about our prospects. Thank you for your question.

Michael Andrew Wells
Group Chief Executive & Executive Director

Glad you followed. Okay. The -- what other number you did leave out?

Mark Thomas FitzPatrick
CFO & Executive Director

The ICICI rate of the business, number one.

Nicolaos Andreas Nicandrou
Executive Director

No that's fine.

Mark Thomas FitzPatrick
CFO & Executive Director

Which is no small feat.

Anne Helen Richards
Former Executive Director

Okay. Blair?

Blair Thomson Stewart
BofA Merrill Lynch, Research Division

It's Blair Stewart from Bo Merrill. I've got three questions on China.

Nicolaos Andreas Nicandrou
Executive Director

I've given you all I've got.

Blair Thomson Stewart
BofA Merrill Lynch, Research Division

I'm only joking. I do have three questions, though. The -- number one, is the demerger contingent on completion of future U.K. annuity deals? You've still got 2/3 of the book. And have you got the bandwidth to deal with multiple processes? And secondly, if those annuity -- future annuity transactions do take place anything like the one you've just announced, would that imply that excess capital would build up in the U.K. business? And if so, what would be the plan? Maybe too early to talk about that, but the main point is, would there be excess capital emerging in the U.K. businesses if those annuity books were to go as well? And thirdly, just a quick one on the U.S. RBC. Chad, can you remind us of the organic rate of build in RBC points, given that you've just seen a significant drop? What's the organic rate of build, let's say, before paying any dividends to the group?

Michael Andrew Wells
Group Chief Executive & Executive Director

So on the demerger. No, it is not contingent on any future management actions. It is, to Mark's point, though, we need cooperative debt markets as probably the -- if he said what's the variable and we need a court system to approve a Part 7, those two are outside of our control. But we're confident on the debt side. And we're reassured, I would say, on the Part 7 that I don't think there're any obvious barriers, given the process and the regulatory support. On -- John, you want excess capital?

John William Foley
Executive Director & Chief Executive of M&G Prudential

So -- well, on the question of will we do more? We'll keep that option alive. But we have nothing on the table right now. I mean, it's a big deal. And we only closed it at 3 o'clock in the morning. And that's why David's snoring away at the back there. But it's the biggest that's been done. And I'm very proud of the team for doing it. In terms of capital. Well, we have to remit our capital to the group, so they'll tell us what to do with it. But we'll take this -- the annuity book like the rest of our business. We will evaluate it, what's best for shareholders, what's best for our business in the longer term. And for the moment, there're no plans.

Michael Andrew Wells
Group Chief Executive & Executive Director

And Blair, on bandwidth. I think if there's one thing we demonstrated this year, it's bandwidth. I think we tell the teams endlessly, it's business as usual first. And all these projects are sort of nights and weekends. And I think we can -- if we chose to do another tranche, we could. But it is a -- it would be more about optimizing the capital for the new entity. And then if it's excess, it's excess, and we'd look at distributing as we always would. Chad, on RBC capital generation?

Paul Chadwick Myers
Executive VP & CFO

Yes. So Blair, the underlying tends to be around on a stat basis around GBP 1 billion is -- I'd say, is the underlying capital formation that we typically would see. That said, we're in a position right now where stat reserves are floored out. So we get a little bit of an asymmetric dynamic going right now in terms of no real offset for -- no economic offset going on in the stat reserves for the hedges that are coming through, which has tended to drag, call it, GBP 300 million right now, run rate. So the underlying run rate is closer to GBP 1 billion, GBP 1.5 billion, but there is a drag right now because of where the markets are. It's actually a good problem to have but it doesn't look as good on the numbers.

Blair Thomson Stewart
BofA Merrill Lynch, Research Division

[indiscernible] the [300] [indiscernible]

Paul Chadwick Myers
Executive VP & CFO

Use the mic.

Blair Thomson Stewart
BofA Merrill Lynch, Research Division

Maybe with the RBC points...

Paul Chadwick Myers
Executive VP & CFO

Right. So I mean, GBP 1 billion would be equivalent to about 100 RBC points.

Blair Thomson Stewart
BofA Merrill Lynch, Research Division

[indiscernible]

Paul Chadwick Myers
Executive VP & CFO

Yes. I'd say it's an equivalent number right now.

Anne Helen Richards
Former Executive Director

Oliver?

Oliver George Nigel Steel
Deutsche Bank AG, Research Division

Oliver Steel, Deutsche Bank. I'm going to try again on the U.K. Is the GBP 1.1 billion release of improvement in surplus an approximate figure that we can take for future tranches of GBP 12 billion if that happens? Secondly, within the solvency ratio of the U.K. insurance business, how much debt is effectively injected down as presumably Tier 1 capital from the center? And then the third question is on M&G's capital position. What is M&G's current capital requirement? And how much capital has M&G got within the business?

Michael Andrew Wells
Group Chief Executive & Executive Director

John? Let's start this.

John William Foley
Executive Director & Chief Executive of M&G Prudential

Yes. So -- no, Oliver, you wouldn't be able to extrapolate the capital release from the book across the whole book because what we would I think have loved to have done would have been to slice the book vertically and sew components of it. You can't do that. We've broken the book into various cohorts if you like. And they have been sold all to one counterparty, but they could have been sold in different blocks to different people and they will attract different prices. The other thing is that it depends on the market as well at the time. So if you look at where we've done this trade, it's a different price to where other trades have been done. So there are that combination of factors. So I don't think there's any ability to read across directly.

Michael Andrew Wells
Group Chief Executive & Executive Director

I'm sorry. U.K. debt. Mark, do you want to take that?

Mark Thomas FitzPatrick
CFO & Executive Director

So in terms of the U.K. debt. So at this stage, what we're going to look to ensure is that each of the businesses are well capitalized and well set up for success in the future. We will be able to share with you in the future, in due course more information about what that capital structure will look like. But at this stage, it's too early to say.

Oliver George Nigel Steel
Deutsche Bank AG, Research Division

[indiscernible]

Mark Thomas FitzPatrick
CFO & Executive Director

At the moment?

Oliver George Nigel Steel
Deutsche Bank AG, Research Division

[indiscernible]

Mark Thomas FitzPatrick
CFO & Executive Director

No. Yes. It's all [indiscernible].

Michael Andrew Wells
Group Chief Executive & Executive Director

And then M&G capital? Anne, do you want to do that? Or Mark had a...

Anne Helen Richards
Former Executive Director

The number. I'm just not sure that -- what we've actually said publicly on the number before so...

Mark Thomas FitzPatrick
CFO & Executive Director

I don't think it's been -- it's not a particular material number at all, actually.

Anne Helen Richards
Former Executive Director

Not in the grand scheme of things, no.

Mark Thomas FitzPatrick
CFO & Executive Director

Yes.

Michael Andrew Wells
Group Chief Executive & Executive Director

Well, that's a no.

Anne Helen Richards
Former Executive Director

Okay. Greig?

Greig N. Paterson
Keefe, Bruyette & Woods Limited, Research Division

Greig Paterson, KBW. Two questions. One is, if you look back over time as I was discussing earlier on, the Asian bank insurance deals have been financed by the [center] group. On top of the head, that's about GBP 3 billion over the last 5 years. Going forward, you have to renew deals, possible new deals. So in terms of asking about free capital generation in Asia, including that item, what sort of number do you think we should be budgeting annually for that number? I have something like GBP 300 million, GBP 400 million per annum. I might be wrong. Intertwined with that question, are there any -- currently any contingent loans between Asia and any other parts of the group because they used to be? The second question -- well, that was a 2-part one. The second question is like Old Mutual heavily incentivized their management to do the separation, I think cumulatively, this year, got GBP 9 million or something like that, well this year [indiscernible]?

Michael Andrew Wells
Group Chief Executive & Executive Director

Can you show me that later?

Greig N. Paterson
Keefe, Bruyette & Woods Limited, Research Division

Are you going to modify your ultimate schemes in any way for the separation because...

Michael Andrew Wells
Group Chief Executive & Executive Director

Okay. So let me go to a couple...

Greig N. Paterson
Keefe, Bruyette & Woods Limited, Research Division

Last question, sorry.

Michael Andrew Wells
Group Chief Executive & Executive Director

That was three.

Greig N. Paterson
Keefe, Bruyette & Woods Limited, Research Division

No, there was a 2-part.

Michael Andrew Wells
Group Chief Executive & Executive Director

All right.

Greig N. Paterson
Keefe, Bruyette & Woods Limited, Research Division

Contingent financing in the U.S. I was just wondering what the -- contingent reserve funding, what capacity is there to do -- how much extra capital can be released into the RBC ratio through further tranches of that?

Michael Andrew Wells
Group Chief Executive & Executive Director

Right. Let me do the first couple. So we've never disclosed the -- I think most of the bank transactions have confidential agreements per annum. So we've not gone through the specific numbers, and we don't give forward-looking capital creation statements on Asia. Although, you can see from -- there are the metrics on here, our expectations on the back book and the percentage of recurring earnings, which I think gets you a lot of the way to your question from the materials we have distributed. On the -- there're no management incentives tied to the structural changes in the group. We will have to adjust our LTIPs. We've extended out, say, in the duration that we go -- obviously, there are awards that will go past the separation date. We'll have to work with our board and our M code to have those delivered there -- arguably, probably they're dual shares. But there is no financial incentive for anybody sitting up here to do this outside of their normal responsibilities as stewards of the business. And then you asked intercompany, which I don't think we've done yet. Yes, I think that's probably best Greig, to come back with it -- with all of this at once for you. Anne too, will look into pro forma, so I think that's probably a fair look at it, but it's not material.

Greig N. Paterson
Keefe, Bruyette & Woods Limited, Research Division

And obviously, you lose a little bit from this contingent.

Mark Thomas FitzPatrick
CFO & Executive Director

Not much.

Michael Andrew Wells

Group Chief Executive & Executive Director

The contingent financing?

Mark Thomas FitzPatrick
CFO & Executive Director

Not much.

Michael Andrew Wells
Group Chief Executive & Executive Director

Sorry? What we did last year was all we had available. So there's nothing else there on contingent financing in the U.S.

Anne Helen Richards
Former Executive Director

Okay. Arjan?

Arjan Van Veen
UBS Investment Bank, Research Division

Arjan Van Veen, UBS. If I could ask two questions, please. One, on the timing of the transaction and what are some of the key hurdles have you overcome to make it happen? And as cited before, with some of the key things, I suspect the main one is the Hong Kong transfer of ownership. And I think that's the only one that in your release I saw data around, which is end of 2019. Actually, the U.K. Part 7 transfer is within the U.K. So I wouldn't necessarily think that is a showstopper unless you want to move capital out of the U.K. So just maybe a bit more color around where you really need to the approvals to make, for instance, some sense of timing? The second one was -- Nic, just on the Hong Kong RBC quantitative impact study that came out recently. My understanding is your portfolio would be quite benefited by the proposed changes. So if you can maybe talk a bit about that and how material it could be for you?

Michael Andrew Wells
Group Chief Executive & Executive Director

So you're correct, the long work stream in the project is -- the transfer in Hong Kong is actually -- we've discussed that with all key stakeholders. And we don't anticipate a -- we've got to work through all the granular details, but we don't anticipate any barriers. It's just a -- it's a lot of work to get the regulatory models and all of the various stakeholders signed off on it. But we've -- everyone's aware of the transaction. We're not surprising anyone with this. We're not -- we've effectively pre-cleared the activity with all the key regulators. So again, we're quite responsible for following their processes, but we think that's a work stream, not an approval issue. The Part 7 is a U.K. issue. It is dependent on PRA bandwidth and court bandwidth. So we don't want to try and anticipate in front of you that we can manage. The PRA, we have a good relationship with. We know how that would go, and they've been briefed all the way through this process and supportive. The courtside, we know what's best practice. We know what outside firms can -- Alan has worked very hard with our General Counsel's here, at the right way to do that. But we are getting into a different space, and I think we have to be conservative in our estimates there. But those are the two long ones. And then again on the regulatory front, we've got to get all the regulators on-site briefed, ready to go in their normal course of meetings, right? So you probably -- a couple of meetings each. So that's got a good 9-month plus window to it, too. So that gets you to the timing. And then on the financials, I mentioned earlier, our -- we anticipate we would go off of half year or full-year results so we have audited financials to base the materials off of. And so we're not incurring any unique cost to do that. We're trying to keep the frictional cost to this to a minimum. So it's a -- that would define timing as well. The -- when the next window would be, okay? But we'll keep you briefed on those as they occur. We'll keep the releases -- we'd be very public on that -- on the work streams. But it's work-dependent, not an ambition calendar-wise. Your other question?

Arjan Van Veen
UBS Investment Bank, Research Division

The quiz in Hong Kong.

Michael Andrew Wells
Group Chief Executive & Executive Director

The quiz in Hong Kong. Thank you.

Nicolaos Andreas Nicandrou
Executive Director

Well, it's a -- it's too early to draw any definitive conclusions. The quiz that was undertaken kind of was only partial. Not all the parameters were tested. For example, they didn't test in that allowance for diversification. They didn't include any risk margin. So that is all to come in subsequent quizzes. And of course, their level of a liquidity premium that they included in the quiz may well -- or matching adjustment for one to another expression may well change. So there'll be another quiz in the course of 2018 and probably another one after that. We're looking at an implementation in 2022, some time away to align with the potential introduction of IFRS '17. So we've got those two changes to look forward to. But as to your point, whenever we've moved to a more risk-based regime in any parts of Asia, given the nature of what we do, which is a regular premium with a very heavy health and protection content, then we see that providing tailwinds. We saw that in China as moved to [indiscernible] with our solvency level increasing from in the -- to kind of 150, 160, 170s to the high 200s to 90% at the end of 2017. So too early to say. But directionally, it should be positive.

Anne Helen Richards
Former Executive Director

Andy?

Andrew Hughes
Macquarie Research

Andy Hughes, Macquarie. Three questions per company? So first one is just to understand the debt structure because that seems to be the more complex bit about what's going on. So if you are to issue replacement securities in the U.K., would you still get the grandfathering? Or would you just -- are you saying that any new debt straight in the U.K. would have to be Solvency II qualifying and you'd lose the grandfathering to the switch? Second question on the holding company for the remaining business. Presuming all the debt stays in the remaining plc business, which is no longer under Solvency II, so presuming any future debt you raised post the demerger will be senior debt. So does that kind of mean there's an incentive for the sub-debt holders to kind of switch, and that's one way in which you can get people to move from the plc into the U.K. business? And the third question is on Malaysia. Obviously, there's a need for planning by the end of June to sell down 30% of the Malaysian business, which -- or I guess could be GBP 1 billion. So how much do you think it might be? And are there tax implications from that? Just comments on the usage of that. And while we're on potential disposals, are you still fully committed to the 2 Indian businesses, given the valuation there? And the last question within the U.S.

Michael Andrew Wells
Group Chief Executive & Executive Director

That's word six. So let's call it six, okay?

Andrew Hughes
Macquarie Research

Yes. I just wondered if Jackson had to diversify its product mix a bit through M&A as a result of the demerger process, so whether you're going to keep that as it is.

Michael Andrew Wells
Group Chief Executive & Executive Director

Okay. So Mark, you want to start with debt.

Mark Thomas FitzPatrick
CFO & Executive Director

So in terms of the first two debt questions. Andy, I'm not really in a position to say much more than we've said in our release in terms of the debt because we want to be able to have a conversation with everybody, we want to be able to have a conversation in the market in terms of what we do and how it is that we're going to do it. We haven't had any conversation yet in terms of the regulators in terms of what we might do around grandfathering Solvency II components. So I think we would look to have those conversations and be able to give you an update in due course around that. And therefore -- and that would also be the answer to the question in terms of the future debt and the senior debt. I think we'll be able to give you a lot more color about that in due course. But at this stage, just want to give you a sense of the fact that the underlying position is one of ensuring that both entities are going to be well capitalized, strong -- set up for success.

Michael Andrew Wells
Group Chief Executive & Executive Director

Nic, do you want to discuss the conversations with the bank regarding Malaysia?

Nicolaos Andreas Nicandrou
Executive Director

Okay. So as you know, Prudential today enjoys kind of 100% of the economics of our conventional business, even though kind of the law suggests that for an ownership -- for an entity ownership is limited to 70%, that's not unusual. We're not unique in doing that. So our ability -- or otherwise, to continue to operate on this basis is under discussion with the authorities. We don't have an update for you at this point, but we hope to be able to update you shortly. I mean, I'll go back to what Mike said. Look, the -- one of the things that is great about this group is our ability to adapt to new situations. And whatever happens in relation to the level of ownership that we would have, we'll remain very focused on driving value for you, our shareholders.

Michael Andrew Wells
Group Chief Executive & Executive Director

Do you want to discuss India as well?

Nicolaos Andreas Nicandrou
Executive Director

India. I mean, we like India. I gave you lots of stats earlier for China, I could do the same and I will. For India, you have...

Michael Andrew Wells
Group Chief Executive & Executive Director

Just get your book.

Nicolaos Andreas Nicandrou
Executive Director

A sizable population, 2.8% penetration on the insurance side is predicted to increase to 3.9% by 2025. Protection gap of USD 8.5 trillion, 62% -- 60% of health care costs paid out-of-pocket. And you have 1 billion out of the kind of 1.4 billion Indians not being covered from a health perspective. On the asset management side, retail funds. I mean, that's even more nascent. It's USD 350 billion. About 12 million kind of people in India own retail. Asset management funds is 12% of GDP. This is -- both sides are likely to grow. And we have a good presence. In the life company we have a player, which has around 13% market share. It's growing its sales. It grew its sales last year by 26%. It's growing its market share. It's well balanced by reference to both product sets and distribution, growing its distribution force and doing more through the 4,000-or-so ICICI branches. And on the asset management side, we have the #1 player there Again, 13% market share. Today, managing -- of the order of -- I want to say around GBP

17 billion on an AUM on 100% basis. So very strong distribution platform. And there are many very highly performing funds. And the good thing about the asset management side is we can own 50%, which is a great place to be. So no, we like the country and the opportunities to do more are obvious.

Michael Andrew Wells
Group Chief Executive & Executive Director

Yes. And I guess, Andy, what I'd add to that -- we've been down there, we went down there together earlier this year, 20-year anniversary for us there. The -- when we talk about being active managers of the business, it's not trying to time a share price on a -- on the public piece of the life. It's the -- the decision is more is it a market we want a -- an earnings and capability position in over the long haul. And if we do, what structure can we own that in and then how good are we at managing that structure. And that's more of the lens. So I'm -- the last time I was there, I heard some of the multiples that people were throwing around and asset managers. And what it tells you is everyone's trying to get what we have. If someone's going to pay these quite impressive it's -- they're paying a fortune at this point in time, for an entry point because they believe the future. Now do we believe it? Do we have the same view? We actually have a -- we think as a group, we think as a board that India is a part of our future. So the question is out from an earnings point of view, from a capability point of view, from a products distribution, how do we want to do that, not do we think this is the best share price for the Lifeco or -- and again, there're restrictions in what we can and can't do there. It's a -- and the market favors a bit the domestics. So it's a balance. But we like India. And I'd say, if you're looking at it, we're long.

Anne Helen Richards
Former Executive Director

Andrew?

Andrew John Crean
Autonomous Research LLP

It's Andrew Crean speaking. I've just got one question. You were talking about concluding or the board concluding that the U.K. was -- plc was not the logical owner of the U.K. business or wouldn't be fairly soon. Can you go through the parts of that decision and why the thinking would not apply also to the United States?

Michael Andrew Wells
Group Chief Executive & Executive Director

Yes. I think the -- it's -- again, it's multidimensional. It's not a single -- that was not the reason that we're -- sole reason we're divesting. It's -- if you look at it and say -- go back to the other comment I made about what is the business unit getting from the group, is there fair lens, what is the shape of our earnings going forward, what's the capital allocation to earnings -- I mean, all these lenses are applied. And the things we thought that had the most leverage, management focus, the alignment of the capital as you see, moving Hong Kong and getting the quality of capital -- the quality up, the quantum down. Therefore, the return on capital metrics better, and how does that look in the overall group, and how does it look in its relative market. It looks fantastic in its relative market. It still has to compete heavily with the other business units in return. And that's just a function of where it is. It's a more cash-centric earnings, which is a good thing, given it's the U.K. and the dividend demands of a listed entity here. And the market is more mature, so the earnings characteristics of stability, currency, things -- they have a different appeal. So one of our views is as investors, you may want to choose those characteristics not just the absolute return on the earnings. That may be part of your decision or you want pound denominated, do you want less impact from a political statement in Asia -- whatever happens to -- or you're an emerging market portfolio manager, and you want more emerging market earnings and the characteristics that come with that and the waiting in the U.K. diminishes that. So all these things were part of the decision. The best part of the decision was there was nothing to solve for, and probably the most difficult part. So there isn't anything broken. You don't need -- there isn't a part of the asset management business that isn't developed, there isn't a part of the distribution, there isn't a part of the skill set, there isn't the -- an issue on management. So it's the -- the why now was one of the most challenging because it's working very well. And if you think as stewards of the shares and the capital, it's -- that is the right time then to do it, right? You don't -- we shouldn't wait until something isn't the way we want it, right, and let somebody else fix it. That's -- I've seen that argument dozens of times. You've seen it play out in the U.S. recently, right? So this isn't a good bank, bad bank. This is two good businesses. And we think that's -- from a stewardship point of view, the right time to make that call. So it was a very -- this is a long strategic process that started a dozen years ago, and it's evolved. And the -- look how it has been in the U.S. at various times. I think the fundamental -- the -- on the international businesses because you're -- it's -- do we believe their sharing of skills, capital, do we deserve diversification benefit? The answer is, yes. Do we believe what the U.S. knows about asset liability management, retirement, those things can benefit our Asian business where they're going? Yes. Retirement will be the next frontier in Asia. It's already emerging in certain markets in Asia. And so there's capabilities. But we'll come back to you in Singapore with a more clear look at some of the things that we want to do together with them. But I would think of it as good diversification benefit, good capability sharing and future product if not format capability sharing. If -- even in some of the -- we have a few markets in Asia where there's pretty robust retirement plans from the government. Singapore is a great example. We still get asked about supplemental retirement plans when you talk to people there. It's a -- they're savers, and they want to see -- they like some of the products they see elsewhere. So there're a lot of markets that we can do things we haven't done yet with the capabilities we have in Jackson. And again, you asked a question about diversifying Jackson. There is not a U.S. life company, board, CEO that wouldn't kill to diversify into Asia with the footprint we have. I think that's a -- don't forget to write, that's a fair statement. They would -- so this gives us great diversification, U.S. exposure, leading position in retirement income market and growing in the U.S., leading positions in the majority of our markets in Asia and we like the combination. And yes, there's more we can do in the U.S. And we keep looking at different things.

Anne Helen Richards
Former Executive Director

Ravi?

Ravi Tanna
Goldman Sachs Group Inc., Research Division

It's Ravi Tanna from Goldman Sachs. I have three questions, please. The first one is on the Asian business and the strategy there. I think you alluded to some of it just now. But I guess there're a lot of competitors that you've just referenced both in the U.S. and Europe and also very large players in Asia who are looking to expand their scale in the Asian market and looking for good quality franchises. So can you talk to us a little bit about the thought processes around were one of those companies to approach, how you would think about that as an eventual outcome, given the demerger that's currently going on, please? And the second one is on the PRU, M&G PRU go-forward strategy. I suppose one of the areas that the business is perhaps arguably subscale is on the distribution side, and you don't have a retail investment platform where many of your wealth peers do. I was just wondering if you could comment about whether there's any ambitions to expand product or distribution capabilities, please. And the third one was just -- not to put that -- belabor the debts questions but maybe -- what would be quite hopeful I suppose is to understand the leverage capacity. And so in that context, I know you've talked about GBP 500 million write-down to equity following the annuity sale. But could you just please remind us what the IFRS equity for the U.K. entity is, please?

Michael Andrew Wells
Group Chief Executive & Executive Director

Okay. So the housekeeper sort of question. Again, without putting a number on what we think the two businesses are worth, we think in their markets, they're pretty large. And so the -- is there any greater risk of PRU plc being acquired with or without M&G PRU. The couple of firms that might be capable of doing it. I don't think the additional value of PRU, M&G PRU -- of M&G PRU and their model would have made that big a difference in their question. And the ones that -- I think Canton aren't known for doing hostiles. It is always incumbent on us as a management team to demonstrate we're the best stewards of the business. I mean, that's what we get up every day having the right to recognize. So can we run it better than them? This is -- first cut, are we getting returns that are competitive with anybody globally?

Are we growing in a way that produces quality results that are sustainable? All those things are -- the things that make you attractive also would be their defense. At the end of the day, it would be the board's decision if someone came with an obscene amount of money for the business, then that's something that the board obviously has to consider. But it is by no means -- you could back into the likelihood of it, I think we can -- I think these businesses are competitive. And I think we hold our own with anybody globally. So -- and then we have plenty of scale. So we don't need to do any sort of other M&A with someone to get attributes that we don't have now. One of the -- it was on one of the slides, and I probably went by it too fast, but just given the amount of information today, there is no -- the resources we need to do new things, okay, we're not talking a lot about it today just because of the time, but from the smallest, the most innovative startups to the largest tech firms you could think of in the world, we're a really good partner. And we have very -- and they want to do business with us. They want our brand, they want our data, they want our scale, they want our market positions. So we don't lack. I mean, it's an interesting test about, I think, of our relevance. They see us as someone who, if they commit resources and, in some cases their companies, too, the smaller firms, that we'll -- we're going to be there, that we're going to succeed. And I honestly -- from a personal point of view, I think it's one of the more -- it's one of the things I've learned in this role. It's one of the more fascinating looks at the business because it's very much about -- because they have to front load so much of their work and they tie up bandwidth much more than it is to us, and it's a very interesting sort of affirmation of how we are as a business. We have to be good enough. We talked to -- [Elnor] had a digital share, a few -- we have to be good enough to partner with them. We have to have tools they can connect with, data models they can connect with, we have to be modern enough. But I think you'll see us over time, you'll see more partnerships laterally and things that are different than the model now because we can and because to them, they see us as a good business prospect for their long-term plans. And again that -- it goes back to is this a viable business, is it the right ownership structure, is this the right team? I think all of that is embedded in there. But we've really got some interesting projects coming up. And again, they're not on a pure financial basis. They're -- people are bringing us their newest and best stuff. And a lot of cases, we're putting it right to work, which is really great. But no, so I don't worry about a hostile. We have procedures around housekeeper that we look at all those combinations, partials, full, everything. And we'll continue those -- diligently on those work streams as well. U.K. retail platform, John or...

John William Foley
Executive Director & Chief Executive of M&G Prudential

So the go-forward strategy -- thanks for the question, I feel a Nic type answer coming on because I think it's a -- we've really got a big opportunity here. I mean, Mark put up a slide earlier on about how we see the opportunity. The issue I think we have right now is twofold. First of all, we are spending a lot of money to build the right platform for our business, and that's happening as we speak. And we're very confident about the outcomes there. The other thing I would point out to is that we have signed -- recently signed this administration partnership with TCS. That puts us in a fantastic position to do far more with a partner who is already digitally enabled, easier to do than say. And the last thing is that we -- look at what's happening. We've got 36% increase in PruFund. We've got GBP 17.3 billion of inflows into M&G. I mean, one of the issues we have is deployment of capital. And Anne will give you an idea of what that looks like at the moment.

Anne Helen Richards
Former Executive Director

So if you look at the level of capital that we have, I won't give you a precise number, but the assets that have been awarded and not yet funded or awarded and not yet invested, we've really got the largest capital Q that we've ever had. And if you just sort of roll back and look at the last 18 months or so, we've launched more than 20 different investment strategies and capabilities and funds of different -- all of which are net inflow, if you like. So the range of capabilities and the distribution of those capabilities that we've already achieved and the flows that we've got there is pretty comprehensive. So I think there's a lot that we can do on the digital channel, as John has mentioned. But actually, first and foremost, have you got the capabilities in the marketplace that the market actually wants to buy, and that's with the market price across all of the channels, institutional, wholesale across Europe as we've seen as well as in the U.K. And the evidence suggests that we probably do if you looked at infrastructure where we've been doing stuff, alternative credit, private assets as well as the go-anywhere bond funds and multi-asset funds. I mean, the range of what we have that the market is interested in is quite compelling. So I think there's a lot more that we can do. And I think bringing the two businesses closer together will help accelerate that. But we're doing it from a position of strength.

Michael Andrew Wells
Group Chief Executive & Executive Director

And then the debt question. Is there anything you want to add?

Nicolaos Andreas Nicandrou
Executive Director

We'll have more to say in Singapore on that as well. I think we really want to showcase what our strategy and what -- where we think we're going when we get to Singapore.

Paul Chadwick Myers
Executive VP & CFO

And Ravi, in terms of the IFRS equity position. I think you should work on about GBP 6 billion. It's what's in the account for the U.K. annuities piece. So that should give you a sense then against that GBP 500 million.

Anne Helen Richards
Former Executive Director

Okay. Abid?

Abid Hussain
Crédit Suisse AG, Research Division

It's Abid Hussain from Credit Suisse. I just -- two questions, if I can. Firstly, on the U.K. I'm just wondering what sort of Solvency II ratio do you think is ideal for PRU M&G going forward. Is 150% too low? Or is that the sort of right about level? And then secondly on Asia, Asian distribution. Can you just share your thoughts around the long-term viability of the agency channel in Asia. Do you think there's a threat there from the rise of online distribution platforms, particularly in China? How do you see that space evolving?

Michael Andrew Wells
Group Chief Executive & Executive Director

So on Solvency II. No, I think it depends on, I mean -- I'll let Mark comment on this as well. It depends on what the nature of the liabilities are and what the nature of the capital is. So one of the challenges with Solvency II is not all 150s are alike, right? You don't -- and you cross jurisdictions and they're even less so. But I think given the mix of liabilities, to say -- then the other piece with M&G PRU is you have the backstop of the earnings from the asset manager as well. So it's got a new source of liquid earnings, liquid capital generation. So we haven't said what the ultimate number will be. But if you said to me, is that a strong number for that firm given the liabilities it has, the -- what its capital structure looks like and what its earnings prospects look like to generate capital, I think it's a healthy number. I don't know, do you want to disagree with me now publicly?

Mark Thomas FitzPatrick
CFO & Executive Director

I'd never do that. And remember that I suppose 30% of the credit risk is gone. And it's when you move Hong Kong, an element of the interest rate risk goes with that as well. So the risk profile of the business is significantly reduced, significantly less volatile. And therefore, you need to look in that lens what is the appropriate cover ratio.

Michael Andrew Wells
Group Chief Executive & Executive Director

Yes. When you're in the -- if you're in the U.K., the PAC Board meeting, the first lens really is Solvency II, has gotten its -- and the second lens is own risk appetite. So -- and it's -- if you think of that that's everything from our sensitivity interest and equity movements. And it's all of the things that you say, do we believe this is something we should be doing relative to everything else we're doing. And it's much more personalized by company than it is the sort of the more standard metrics. So both by -- both are important and both are certainly important in a governance model. But I think it's fair to say the first lens is, how does this fit with the risk appetite. So if you do reduce the risk, the amount of capital you're holding theoretically should come down. Again, subject to market norms and all of the regulatory and everything else, the more risks you're taking, obviously the higher it should be. But it'll be well capitalized, and everyone will -- we'll have the agreement we need on that from key stakeholders before we let it go. Asian distribution?

Nicolaos Andreas Nicandrou
Executive Director

Clearly, we are alive to the trends. Where we have seen digital distribution gaining traction has been predominantly in the P&C space and kind of very simple low-case size kind of in the health space. Whenever it's come to high-case size or something more complicated and when you're in Hong Kong, you're talking about critical illness products that cover about 113 or so different conditions. Whenever you've seen it increase in complexity, then they don't get a lot of traction. In fact, we do. We have our own sort of digital distribution. We have 1.6 million customers in Ghana alone just doing various low-case size protection and health business on the phone literally a couple of dollars a year. So our view is that digital channels will complement kind of rather than replace what we currently do. What's distribution? I think the winning strategies ultimately will be ones that combine both online and offline. Online, typically to do research. And then offline, when you have to deal with queries, be it on the telephone or face-to-face. So -- and we're developing the tools today. And there are many examples that I can give you pretty much across all our businesses to equip our agents, to equip the people that sell our products in their branches in a way that enables them to do it as digitally as possible, and fulfill ultimately what the customer wants.

Michael Andrew Wells
Group Chief Executive & Executive Director

And parts of that I think at the consumer level are they expect the paperwork, the forms, the processes to be more digital. So if you're in our Singapore -- if you're in Singapore, you take your ID card and our app scans it and pre-populates all the fields. Things like -- the consumers expect that. That -- I mean, it's a -- it may be leading edge for insurance, but where they are elsewhere, other people could do it. So part of our comparative set is the other experience the consumer has is not necessarily what our insurance competitor does. And a lot of it is ease-of-use, not necessarily purchasing. In China, they're doing photos as well as -- not only is it all digitals on the app and issued almost immediately, but facial recognition -- they're taking a photograph because that is a more common way to access security. And -- so there's -- again, there're different dynamics to the -- we have to follow whatever the -- we have to make sure we meet the clients expectations wherever they are. And those certainly are more digital the further east you get.

Anne Helen Richards
Former Executive Director

Okay. Nick?

Nick Holmes
Societe Generale Cross Asset Research

Nick Holmes, SocGen. I will make this very, very quick. Just a couple of questions on the U.S. First, are you thinking of moving away from variable annuity equity guarantees? I mean, we may be at the top of the equity market, who knows? Are you concerned that you're maybe putting on too much equity risk and you want to do more with products like Elite Access, et cetera? And then the second question is, could you tell us the size of the -- net amount at risk? And Mike, I was very intrigued by your comment that policyholders are making very good investment returns from their variable annuity assets, which I'm sure is true. But the net amount at risk is fairly large, I believe. And so there is an underperformance versus the guarantees. And I just wondered what your thinking was on why that is happening. I'm not -- let me make this clear, I'm not suggesting that the net amount at risk is an amount that can be exercised immediately at all. But as an indication of the performance of those assets, it does suggest that not all policyholders through their own selection of funds are actually achieving such great returns.

Michael Andrew Wells
Group Chief Executive & Executive Director

So I can do as much on net amount of risk as Nic can do on China, if you want to do this. It is one of my least favorite metrics and that may sound convenient. If the return -- if the clients have return -- you see the appreciation on one of the slides we showed earlier. And you know the guarantees are sub-5, right? The withdrawal of guarantee after their money is depleted. So if you just think of the simple economics, if they're earning in the 7s net, and the guarantee is sub-5, right? It's very difficult for the net amount at risk -- if it produces a number that's negative to be indicative of them underperforming the guarantee, okay? So it's a -- and it captures a variety of other metrics. The less you sell, the better it looks because it's just going to be a whole bunch wrong with it as a -- in the money nests we've used before, and I'll ask Chad here in a second to comment on it. But Nick, on the guarantee -- on the are we exiting the business because we're timing the top of the market? No. I think we've said before, we reset the guarantee level annually. So they effectively go up on the contract anniversary of the client as does the fee for the guarantee. So if you and I created a variable annuity company today that entered the market, right, and we sold a contract today at this S&P level, assuming they only buy the Index One, they can buy an Index One, we have the same -- we would be the same pricing point as Jackson will be with the client renewing today on the guarantee fee. So the fees for the guarantees stay with the underlying exposure we have to the equity market. And as we've said, we're not trying to make money on the guarantee fees, but it's plenty to hedge the equity exposure. So no, there's no intention. And the client behavior has not changed. We've seen a percent or 2 increase in their equity exposure. It's still nowhere near our pricing assumptions. You wish for the consumers for their retirement accounts, they are slightly less -- I guess, pro-cyclical on their movements but it's the nature of U.S. consumers, they're fairly cautious with retirement money. So we've not seen any material shift in consumer behavior. But Chad, do you want to fill in some color around that?

Paul Chadwick Myers
Executive VP & CFO

Yes. I'd say -- the second one, Mike. So I mean, the net amount of risk is probably the least favorite. And we don't use it for anything of -- for managing the book. It's something that others disclose, so we've made disclosures in the past. I guess the best example I can give you just in terms of the flaws in that amount of risk would be, if you had somebody who was -- who had a $100,000 policy -- had bought a policy with $100,000 that had a benefit of $100,000 left, there's $50,000 of account value, so that would be measured as $50,000 net amount at risk. If they were 95 years old and able to take out $5,000 a year out of their account, that's going to show up as a negative indicator in terms of net amount at risk. The chances of them being able to actually access that for us to go on risk is roughly 0. So that's why we don't like the measure. And if you look at the overall moneyness, I mean, our average policy is basically at the money. And as Mike said, they step up annually with the market and with guarantee. So we're in a position now -- I mean, it's -- actually the book is in the best position that it's ever been. And even if you look at the net amount of risk, which is a flawed number, you'll see it's good as it's been over the years as well.

Michael Andrew Wells
Group Chief Executive & Executive Director

So we're going to keep writing, Nick.

Paul Chadwick Myers
Executive VP & CFO

And just one other thing I'd just add on that. In terms of -- it's -- the markets may look frothy from the equity side, interest rates backing up are actually quite helpful in terms of the overall value of the guarantees, so that's a good indicator.

Michael Andrew Wells
Group Chief Executive & Executive Director

What do you want to do? We've got 3 more. If you want to call it that, then we'll go to -- break for dinner. Is that fair?

Anne Helen Richards
Former Executive Director

Okay. Can you, Marcus?

Marcus William Barnard
Numis Securities Limited, Research Division

Marcus Barnard from Numis. Just a quick question. I'm just interested in why you're going to headquarter the international businesses in London when they haven't got any operations in London. I mean, I would have thought Singapore or America would be a much better location. Is that something you'll review over time? Is that next year's announcement? Or are you committed to London?

Michael Andrew Wells
Group Chief Executive & Executive Director

No. We're committed to London. And I think -- you've still got Africa. We don't have -- I think M&G and PRU would tell you that however motivating visits are from JHO to their business units, they're not critical in the day-to-day operations in the current structure. So I think where the group is centered is not an operational issue. It's a sovereign functions of the business. So it's everything, from the rating agencies, the listing requirements to interfacing with you folks that capital allocation and preparation of financials, risk management, compliance, audit -- those functions and those are staffed and work well here. And I think another argument I'd make on the practical front is with everything -- if you -- so we're talking to the management and what we're saying is business it's business as usual, right? And this stuff is done just proportionately by group and on the nights and weekends, as I said earlier. The exercise to do a redomicile would be massive. You'd have heavy turnover. You'd be replacing people that you know are already good. And you may or may not get cost savings or some new -- I've heard the theory, are we going to get new investors. You know -- we find Asian investors have no problem buying shares on the FTSE, and they tend to gravitate towards our most liquid -- we're on Hong Kong, we're on Singapore, we have an ADR in the U.S. and we're here. The larger investors tend to gravitate to the most liquid market which is here. So we don't see any distinctive answers. We like rule of law. We like the talent. We like living here. There's a lot that says London.

Anne Helen Richards
Former Executive Director

Alan?

Alan George Devlin
Barclays Bank PLC, Research Division

Alan Devlin, Barclays. Just one question. Is it [indiscernible] you're not the best owner of M&G Financial over the long term? If someone else thought they were a better owner, would you consider a sale of the business? Or is this demerger a single-term process?

Michael Andrew Wells
Group Chief Executive & Executive Director

It'd be the board's responsibility to look at anything that came at us. But I think again, given the current success of the business, is it -- there are other businesses about the same size in the U.K. If someone was a buyer there, they have different characteristics each. I recognize this is the best one. And it's a

-- but there is a question of -- we can manage -- if that process occurs, we can manage it. But I think our preference and our intended model would be a standalone entity. When you're in the marketplace, you're subject to market activity. And mean, I wouldn't diminish that that can happen. But I -- we don't anticipate that being the outcome.

Anne Helen Richards
Former Executive Director

And final question?

Alan George Devlin
Barclays Bank PLC, Research Division

Yes. Back to the $6 billion IFRS net assets and annuities. Is that for the entire U.K. annuity book? Or just the slice that you sold? And what are the equivalent numbers in EEV terms? And then a follow-on to that, should I allocate the $300 million EEV loss as a -- on the annuity disposal, the frictional cost of the demerger? Or should I be worried about your EEV assumptions?

Paul Chadwick Myers
Executive VP & CFO

So the $6 billion is the overall. So the whole piece. And in terms of the -- could you -- would you mind repeating the second question?

Michael Andrew Wells
Group Chief Executive & Executive Director

It was the -- is the $300 million EEV loss a frictional cost of the demerger.

Paul Chadwick Myers
Executive VP & CFO

That $300 million is effectively a loss of the result of a loss of future fees from the annuity piece. So I wouldn't see it as a fictional cost of the demerger. It's a result of the sale of the annuity book, which is something that we closed today and is effectively a core part of the derisking of the U.K. business.

Michael Andrew Wells
Group Chief Executive & Executive Director
Are we -- is everybody done? All right. Thank you for your patience and attention through a very long session and your support through the year. Our next meeting is Singapore, November 14 to 15. We hope to see you all there, and we'll see -- if you have any questions, just follow up with our team, and we'll be back in touch. Thank you.