Prudential plc
2016 Half-Year Results

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Highlights

Mike Wells

Group Chief Executive, Prudential plc

Welcome

Good morning. I am Mike Wells. I think I know everybody in the room. We are going to follow the same format as the last presentation where you are going to have me go through some high-level comments and Nic will do a very detailed drill-down on the financials. I am going to come back up and give you some comments on outlook in general. Then we will bring a variety of the senior management team up here to answer Q&A for you and we have some other of our key associates in the audience as well, so we will get to any level of detail you would like in the conversation.

Group strong progress

That said, let us go over delivery. Commenting with our colleagues beforehand, it was an interesting first half of the year. I mean, no question, lots of different challenges globally. I am very pleased with our success in delivering both cash and growth. IFRS up 6%. Free surplus generation up 10%. The dividend, as you know, is mechanical but up 5%. Solvency ratio at 175%, which again, as we have said, I think it is a good number. We would never consider this a particularly good fit for us, given about a quarter of our business or less is actually in the regional targeted solvency structure and the local regulators use their own capital regimes. However, again, I think from a headline point of view, until this number matures in the industry, it is important we have a strong number and we think that is a strong number. We thought it was good clear results in a fairly tumultuous period.

Group clear positioning

What I wanted to focus on the opening today is what I think are going to be three of your key questions. One is the resilience and the relevance of our growth. The second being the positioning for us in markets, whether volatility of interest rates or equities and just competitively in general; then the third and final piece that comes up a lot is Brexit and its impact on the Group or little impact on the Group as the case may be. Then I will get to more general comments on the business.

Growth

I think what you saw on the first half on growth, the structural model we have, the strategic decision of going with the uninsured middle-class, the still seeing two-thirds of our Asian clients not having owned a product before; that is detached from markets. You do not have a high correlation between those transactions and their view on interest or equity. That is turning out to be a very, very good piece of our business.

In the US and the UK, more and more, it is about our ability to gather assets effectively, perform well for the clients and price and distribute effectively. So those are slightly more opportunistic but given the general demographics in those markets, as you saw from the first half results, even in a climate like this consumers are looking to derisk. They are more and more responsible for solutions. Again, it is giving us very predictable and robust growth.

Then the last piece which I will get into a little more detail later is we are continuing to invest for scale. One of the questions, I think it is fair, is our continuing size – each year we get bigger and bigger and bigger: can we continue to grow? I am not sure we spend enough time on all of the things we are doing to invest for that growth, but we think we have plenty going to continue to grow at the rates we have seen historically.

Markets

Moving to markets, again, 16% of the revenue is now coming from spread-based products. We moved away from these ten years ago. It was the start. It has taken time. This can be anything from de-emphasising fixed in the US, moving away from bulks in the UK, moving away from UL, the Asian markets.

There is an implication of top line, so a competitor can hold up a graph now and say, 'We have them beat in this part of this market.' I would ask you to consider when you see those sorts of comments, 'Does Pru have the ability to manufacture that product?' The answer is usually, yes, and we probably already had it, systems-wise and capability-wise. Second, 'do we have the ability to distribute it?' The answer, again, I think is generally a resounding yes.

It is a conscious decision for us to participate and, in the case of interest-sensitive products, not participate in markets because we have better uses of the capital. If they can or cannot make money, depends on the company, and my role is not to tell you which of them can or cannot make money. However, I can tell you, for us, we have higher uses of capital and I will show you some of those returns as we see them in the lenses we are using now.

However, I want to challenge the thesis, if someone has it, that we cannot capture that market share if we chose to. If we gave the US and the UK and Tony the highest-priced product in each market, we would be out of capital in about two hours with the distribution firepower we have and we are clearly not going to do that. However, I think that is a key element in this discussion is we choose the growth we want. We choose the markets it is in. We choose the value of those earnings over the volume.

The balance sheet itself; extremely defensive. We have not stretched for yield. We are not into aggressive asset classes. We have been talking for the last four years, if you will, about going up an asset class, managing duration carefully, up in quality. Nic will get you into some detail on this, but disproportionately what we own is investment grade. You will see that in the shocks on spread and we do not think this is what our core business proposition is and nor do we think it is the right time in the cycle for taking tremendous investment risks. We have an extremely conservative portfolio, an actively managed balance sheet. You saw that in the first half of the year. I will let Nic get in some of the details there, but very pleased with the quality of the credit portfolio, quality of the hedging in the US and quality of underlying assets on the balance sheet and the Group.

A proactive approach to value across the cycle. An interesting thing, we were talking before about Solvency II, so that is a pro-cyclical regime. We are arguably a counter-cyclical player, if you look at what we do best, certainly some of the results you see here. That is a by-product of our conservatism at different points in the cycle. I think that these sorts of times, these stresses show what we can and we certainly can do more than this. Again, I will come back to that in the second half. However, I think it shows the nature of the business and what we want to do. However, our intent at this size, we have a great growing stable earnings base; 90% of IFRS earnings now come from existing clients and if you think of it in those terms for stability. The incremental things we will do from here, we should be more counter-cyclical. You should expect that. We should get paid more for that. We should get better pricing. We should be able to create more unique solutions for consumers from that.

Brexit

Finally, on Brexit, our UK participation has been selective. I think that is the key takeaway there. 10% of the M&G's team's assets roughly are in Europe. Poland, if you remember, has a rep office for our UK business. We are not a European-facing insurer by any means and, in the asset management business, we will see what solutions come for those clients to be serviced effectively and transact effectively with M&G. It is a little early but, obviously, M&G had contingency plans in place and continues to work those. We want to maintain a seamless relationship with those consumers. It is clear as Brexit evolves, at least in my view, you will see clients as you did when we saw a real run-up in our bond fund sales that want to own pound-denominated products, that London's success will continue as a financial centre because of rule of law, currency, all the various things that have succeeded over a very long period of time. We will make shares available to clients as they need and the jurisdictions they want to buy them in the forms they want to buy them. However, that is an evolving process as the rules evolve and we are fully capable of managing that. Brexit, in general for us, minimal strategic and certainly minimal financial impact to the Group.

Asia

High quality, defensive growth

Let us go to Asia. Where does the confidence come from and the growth? It is the quality of the growth. I am going to bring you back to the recurring premium versus single premium. The quality of what is sold, the health and protection focus and then, absolutely critically, the pan-regional model. I understand there have been a few questions about this, so let me go through a couple of these.

The blue shadow box on your far-right of the screen shows, as it should, that the first half of the year, regardless of what was going on, looks a lot like the history of this business. There is no material change in the shape of the business, a continued focus on health and protection, continued long-term focus on relationships with the clients, as it should be.

Why does the pan-regional model matter? Seven of the 11 markets were up double digits in terms of earnings. We cannot predict which markets on a portfolio that big will have a political turmoil, will have rate movement, will have other options, will have an irrational competitor; all those things are the nature of, including our Western markets, but certainly our Asian markets.

The footprint we have gives us the ability to be disciplined. It allows us to back off on a product segment, a market, a country if we needed to and to accelerate if we see the opportunity there being unique. I think you see that in this half's results. It was an interesting period of time, lots going on, pretty broad Asian results and getting to the clients we want with the products we want, with the earnings we want; again, value over volume because we have choices. We are not defined by our limited licenses, limited distribution options, limited product or systems capability. That is where I think you will see us continue to succeed across a broad set of economic environments in Asia. We have tremendous optionality there and, again, it is an attribute of scale.

Growing earnings base

Should translate to earnings for you, it does. Again, the earnings base is strongly driven by existing clients. Not that new business profits in the sales to new clients are not important, we want to keep adding cohorts of profitable clients to the business year after year after year as we do in the US business, as we do in the UK business, as we do in M&G. That is the long-term stability of the earnings of the Group, comes from that. However, again, not a particularly unique shape in the first half of the year with the historic shape of the business and good year-over-year numbers in an interesting period of time. Very, very pleased with the execution of the team and an extension of what they have been doing for a long time.

Delivering 'Growth and Cash'

Reasonable expectation and that should turn in to both growth and cash. Earnings and free surplus generation, both up 15%. Good number. Again, I mentioned seven of the 11 countries in double-digit earnings, including Indonesia. Markets where we are seeing irrational competition, we are accelerating other parts of the business, getting good earnings growth out of it, good profitability out of it. Again, you see the breadth of the portfolio producing very, very good outcomes for our investors.

If you spend time in the region, what you also see is the footprint allows us to recruit very talented people. We not only brought a new CEO into Indonesia, it is incredible add to the staff. People in the business units can move from one country to another as both their interest and ambitions and skills evolve, so it allows us to recruit talent. It allows regulators to look across the region and say, 'How do they behave for consumers? Are they a good partner for the social solutions that we bring to the market?' There is tremendous leverage in our footprint in region and it is not simply earnings-based.

The learnings we have for one market we apply to another. I thought the most interesting one of these – just personally, it is not material in your models yet, will be someday – we are spending some time with the Cambodia team. You see our learnings from multiple markets in that effectively start-up, I think it is important a firm our size can still do start-ups. You see us doing it in Africa, Laos, Cambodia, other markets, but what you also see is a very familiar business plan, some familiar faces and very, very good execution very early on in the life of those business plans.

The other place you see it is on the bank relationships. As I mentioned to some of you before, the bank relationships are not linear. There is a learning curve. There is a relationship development phase. There is a product development phase. We are pretty good at accelerating that just given the sheer experience we have and Standard Chartered still being the standout bank relationship with, I think, any insurer in that region. The others we have are maturing nicely.

Consistent delivery

What does this produce? Pretty consistent delivery. 2017 targets, the objectives we put out, double earnings still look in line and on target. Then, of course, if you back into that, that implies a ten-fold increase in 11 years. Again, these are strong growth rates.

Other subjective comment on the ground, I know a number of you have been there. The businesses feel materially different than they did a year ago or three years ago, five years ago, ten years ago. This is a portfolio of standalone companies run with similar sense of purpose, similar sense of value, similar risk management. They are maturing very, very evenly and very effectively. It is quite impressive to spend time with these teams.

US

Disciplined execution

Jumping to the west, let us go the US. The main event in the US we have been talking about the last year is DOL. You have the rules out. You have in April next year implementation. We said to you at that time that this was going to be a sales event, not an earnings event. As you see, VA earnings are up 9%. Jackson pretty much captured all of the net flows in the US VA industry in the first half of the year. That is mostly going to the Perspective II product, their flagship product. As you can imagine, Elite access without a guarantee in this sort of climate is not as popular with clients as a product with a guarantee. You also are still seeing some of the broker dealers looking as if it should be on their qualified plan platforms.

Jackson has put a number of products and processes in place for the distributors, going in to DOL, fee-based products, BICE as it turns out, the final interpretation of that is a little broader and a little better for the broker dealers. Most of them are looking at that as they can, in fact, charge commissions, so we will have a two-tier approach to this – the traditional product approach and a fee-based product approach.

There is a part of the industry that believes that the rules will get better. That is the upside. We are fine with the rules as they are. If they get better; we are more fine with that. It certainly could be a little clearer, but that said, we can function with them as written. The value to the consumer, we will see if that plays out over time but we think we can build good product for consumers both in the fee-based structure and we know we have a good product for consumers in the traditional structure and our VA products.

We also in the US are continuing to look opportunistically at bolt-ons and, hopefully, at this point in the cycle, there is something we can do. However, again, nothing to report at this time.

I mentioned net flows, they are excellent. Hedges are holding up well. At this point, as the rules in DOL stabilise, Jackson should see more opportunity.

UK

Navigating change

The UK is probably one of the most interesting stories, I think, for us. This, I think, defines our Group’s versatility at this point. Sales now in the Life company post RDR, post pensions reform, post Solvency II, post annuity review are now higher than they have ever been. Not surprising the with-profit product in its various forms, the distribution team has done a great job of getting this in front of consumers who are now responsible for funding their own pension.

Coming into my second year living here, lots and lots of conversations with people all around the city about what they are doing with their money, what are they putting in their ISAs. And I am shocked at the number of them that are cash, candidly. I hope they look more at investments but a lot of the bank-sold stuff seems to be cash-centric and we are getting a lot of it, and that is a great thing.

I think this product provides good asset diversification, good smoothing for the client, it is a good long-term hold. It is really an appropriate product for long-term retirement savings. The more volatility we see, the more demand we see for the product.

The team has shifted nicely to a capital-light model, as requested, and as market-driven. John continues to staff out his team. We will show you more of that in November, given a few folks are not officially on board with us yet. However, I think you will be pleased at the level of talent he has brought to bear on that business. Again, this is a good example of our ability to pivot.

M&G, controlling costs, the earnings again at the guidance levels we gave you at the full-year. Clearly, there have been some challenges in outflows for UK fund managers in general. However, M&G continues to work on not only the current climate we are in – the second half was better than first half – but also what they need to be for the next ten years.

Again, I am going to ask your indulgence, with Anne and the team, they have been working on this since January. However, we will let Anne and the team, since she has just joined, have a good portion of the November investor meeting and show you where they are going at that point in time, but she will obviously answer direct questions for you today on where they are at this point in time. However, again, very pleased with what they are doing, good combination. The two entities give us great capability and market.

We talked about this before and I think it has been a bit more important in this first half. Diversification by type of earnings, diversification by currency, diversification by the types of exposures we have and then, of course, the earnings and profits following that model. We like the footprint, we continue to de-emphasise spread. This gives us resilience. It gives us good cushion against some of the rate movement. We think it positions the group extremely well for this climate.

Summary

I am going to stop there. Last comment, I guess, before I turn it over to Nic, we think, having watched what has been going on in the industry, these are good results both on a relative basis and an absolute basis. I think you guys know my bias is to compare them to ourselves and I think they are consistent with what we have been able to do in the past as far as client acquisition, profitability, flexibility of the firm, its ability to adjust to challenges.

I will come back up after Nic and I will give you some comments on outlook, but if I could ask Nic to come up, please.

2016 Half-Year Results

Nic Nicandrou

Chief Financial Officer, Prudential plc

Key financial highlights

Okay, thank you, Mike, and good morning, everyone. In my presentation, I will take you through the half-year results, highlighting the key drivers of our performance in the period and then I will cover the group’s capital position.

Continued delivery of growth and cash

Starting with the financial headlines. Prudential has delivered another strong performance across our main growth and cash measures despite the effect of lower rates and the expected reductions from US spread, UK annuities and M&G retail, which I flagged to you back in March. Our progress in the face of these headwinds was achieved by making the most out of our structural advantages in the countries that we operate and by executing with discipline and focus.

On a constant currency basis, IFRS operating profit increased by 6% to £2,059 million. New business profit was up 8% at £1,260 million and free surplus generation was 10% higher at £1,609 million. Currency effects were positive, adding between 3 and 5 points to our underlying performance. This performance is entirely driven by the outcome of commercial transactions and does not benefit from any changes to our reserving prudence. Furthermore, no aggressive actions were taken in any of our businesses to stimulate short-term sales as we continue to prioritise long-term value creation of our volume.

These results demonstrate the benefit of our earnings diversity by geography, currency and source, and the power of our Asian platform, which continues to compound strongly, supported by largely uncorrelated structural drivers. Our ability to deliver growing levels of profit and cash also provides meaningful protection at times of extreme market volatility. Therefore, even though interest rates fell to unprecedented levels, our Solvency II capital at 30th June was trimmed back by only £0.6 billion, at £9.1 billion. In contrast, our embedded value, which is a fairer measure of economic value as it has no artificial restrictions and is not subject to excessive regulatory prudence, was up 9% in the first half to 1356p per share.

2017 financial objectives

Delivery remains on track

The first half performance takes us another step closer to the 2017 objectives. Our Asia IFRS operating profit and free surplus generation continue to compound nicely towards the 2017 target levels, demonstrating the ability of the PCA team to successfully execute against the secular opportunity in the region.

The market cyclicality that we have experienced so far in 2016 confirms why targets for our other businesses are not sensible. Here, the focus is on remaining discipline and on balancing the trade-offs between risk, value and capital. Cash generation is the best way of measuring how effective we are at doing this, which is why we have a cumulative free surplus generation target. As you can see, we are also on track to deliver this goal.

Group

High quality and resilient earnings

The actions we have taken over the years to improve the quality of our earnings and to manage risk provide us with meaningful protection, as Mike has already said, against low rates. Therefore, before turning to the results, I would like to take a few minutes to remind you what underpins our resilience to the current market environment.

Starting with earnings on this slide, we have spoken many times of our strategic focus on insurance and fee income as these sources are less sensitive to the interest rate cycle. In today's environment, this is a significant strength. Compared to 2011, which was the last time that we saw a material drop in rates, we have more than doubled the size of insurance and fee income and increased each share of the total to 76%.

We can also draw more comfort now from the greater diversity in our earnings with the amount of profit coming from our overseas markets being 2.3 times higher than in 2011, representing nearly 70% of the total. At the same time, our business growth has not detracted from our careful management of costs which have grown at a slower rate than revenues. In most of our operations, our flexible and scalable platforms will continue to generate unit efficiencies which will, in turn, help absorb the impact of natural business cyclicality.

Moving to capital. Our ability to generate sizeable Solvency II operational capital and a healthy start of the year position have enabled us to absorb the effect of markets on this metric and report a surplus of £9.1 billion at 30th June. Our financial resources remain strong and provide ample buffers to absorb further downward moves from here.

By taking actions, we have also significantly reduced the sensitivity of our capital ratio. The sensitivity shown here reflects protection currently in place and incorporates the effect of actions which have already been taken or are within our control. More can be done if required.

As I have said before, given our predominant non-EU business footprint, Solvency II is an imperfect fit for Prudential. It therefore underplays the strength of the Group as it excludes sources of real economic value, such as the shareholder's share of estate surplus of £0.4 billion, the further surplus in the ring-fenced UK with-profit funds of £3.1 billion, the unrealised gains on Jackson's interest rate swaps of £0.8 billion, the deduction of £1.6 billion of Asian surplus due to regulatory prudence and the £2 billion of economic diversification benefits between Jackson and the rest of the group. If we were to incorporate all these items, then our solvency would materially improve to a level that more closely reflects the true capital strength of the Group.

Conservative approach to balance sheet risk

We continue to manage our balance sheet cautiously. At 30th June, the proportion of investment grade holdings in both our US and UK credit portfolios was at 98%. These portfolios are well-diversified and subject to strict concentration limits. We continue to prioritise quality over yield, an approach that has been in place for many years and is consistent with our overall philosophy on risk. The fact that both portfolios are higher quality, more diversified and with smaller individual exposures means that we are in a better position now than at any point in our recent history to weather credit events.

The balance sheet exposure to product risk is also well-managed. In variable annuities, we protect our downside risk with extensive hedges which continue to perform well. We have updated the charts that show the unhedged VA cash flows at 30th June and have included them in the appendix slides. These charts compare the net present value of future guarantee fees with the value of future policyholder benefits, which were then stressed under a down rate and a down equity scenario.

The output, which is summarised on the right, shows that the base position is unaffected by the fall in rates seen so far this year. The down rates scenario from here does not alter this picture. The down equity scenario produces an overall negative value but, again, this is not markedly different to the position at the start of the year. In this scenario, of course, gains on existing hedges would turn the number into a positive. These cash flow projections confirm the ongoing health of Jackson's VA back book, "in-the-moneyness" has remained broadly unchanged since year-end at around 9%.

In summary, our confidence in our ability to successfully navigate the current market environment reflects the fact that our earnings are high quality and resilient to market cycles, our capital and economic financial resources remain healthy and our approach to risk management continues to be robust.

Earnings growth driven by Asia and US fee business

Returning to our half-year results, IFRS operating profit was up 6% to £2,059 million, equivalent to an annualised return on equity of 24%. I flagged in March that our 2016 earnings would be adversely impacted in the UK, reflecting a reduced appetite for annuities, in the US, from the impact of lower yields on spread margin and in M&G as a result of net outflows. These effects have come through as expected, reducing IFRS profit by a combined £112 million and will continue to be a feature in the second half. Our profit improvement in the period was predominantly led by Asia, where earnings were 15% higher, reflecting increased income from insurance business and by Jackson's fee business which benefited from stable margins and growth in the large base of variable annuity assets.

The half-year results also benefited from an extra contribution to profit of £74 million, reflecting the effect of actions taken to improve the UK solvency, which I will come back to shortly. While there are a number of moving parts, this first half picture highlights that our business has the scale, positioning and flexibility to successfully manage through the current cyclical challenges.

Asia

Earnings prospects driven by high quality, regular premium business

I now want to turn to each business in turn. Asia has delivered another excellent set of results, improving all of its growth and cash' measures by 15% or more. Our focus on quality delivered a 21% increase in regular premium new business, representing 94% of APE. The result was underpinned by another strong performance from agency, where sales were up 22%, driven by improved productivity.

The strong growth in Hong Kong, Vietnam, Malaysia and China continues to afford us the flexibility to make strategic decisions on a country level, whichstrike the right balance between protecting our overall long-term economics and short-term sales headlines.

New business profit increased at a faster rate of 20%, boosted by favourable changes in country and product mix. The NBP improvement is supported by a 26% increase in the contribution from health and protection business which accounts for two-thirds of Asia's NBP. IFRS operating profit and free surplus generation were both up 15%, driven by ongoing growth in the scale of the business and the strong bias towards insurance. At a country level, as Mike has said, we have seen double-digit earnings growth in seven markets, led by Hong Kong, Indonesia and Malaysia.

Eastspring increased assets managed; however, a shift in asset mix meant that revenues were broadly unchanged. Cost control improved margin by 2 points to deliver operating profit of £61 million just ahead of last year. Finally, underlying cash remittances were higher at £258 million, tracking the growth of the business.

Now, as Mike said, all of the quality drivers which underpin Asia's momentum are intact, which bodes well for our future earnings prospects in the region. Our strategic preference for new regular premium business with a high protection content provides an in-force premium base that is both large and growing.

Together with our focus on customer retention, this produces a higher liability base, up 22% compared to a year ago, which includes a sizeable insurance risk component. This forms a stable and highly valuable source of predictable income, both in good times and bad, underpinning the positive performance outlook for our business in the region.

US

Disciplined execution

Jackson's results continue to reflect its disciplined value-based approach to managing the business. Sales in the first half were impacted by volatile markets and by the uncertainty which surrounded the Department of Labor ruling. As a result, total VA sale were down 27%, broadly in line with observed market trends.

Elite Access sales were similarly impacted but were also affected by lower demand from qualified accounts. This product remains the leading investment only VA in the market and drives the 28% non-living benefit mix of our sales.

New business profit fell due to lower sales and the decline in rates. Nevertheless, the overall margins remain very attractive.

Despite these cyclical headwinds, Jackson maintained its IFRS operating profit at 215 levels. The contribution from fee business proved resilient, but was offset by the anticipated effect of lower yields on spread business.

Spread margin

Spread margin fell by 27 points to 217 basis points. If rates remain at current levels, we expect this margin to now drift towards the 150 basis point level by 2020. Jackson remitted another sizeable dividend to the group at 339 million. This was lower than 2015 when capital formation was stronger reflecting the more benign market conditions at the time.

Fee income

Fee income on variable annuity business remains the dominant component of Jackson's earnings. This is driven by separate account asset values which have continued to benefit from net inflows despite the reduction in gross sales in the period.

Combined with a small gain from market movements, the separate account balance increased to 138.9 billion, having traded below the start of year value for most of the first quarter. As a result, fee income was flat compared to last year.

We have extended our analysis of Jackson's sources of earnings to now show the profit contribution for each product. This shows that after deducting direct and allocated costs, profits from fee business increased by 9%, benefiting from lower strength.

The increase also confirms what we have previously said that DOL is a gross sales not an earnings event.

UK Life

Positive response to new environment

At a time when asset yields are declining and consumers are becoming more self-reliant, our UK proposition in retail risk managed products is becoming more popular. Retail sales were 51% higher with PruFund attracting the lion share of these sales.

As a result of the onerous Solvency II capital requirements, we have stopped writing bulk annuity business. Indeed, in the current rate environment, the higher Solvency II strain has reduced the attractiveness of retail annuities and we have taken steps starting in July to scale down our presence in this market.

Our core with profits and in-force annuity business has delivered stable profits of 306 million in line with 2015. During the first half of the year we took actions to support the Solvency position of the UK. These actions delivered a 66 million profit from longevity reinsurance transactions and a 74 million profit, reflecting the effect of repositioning the asset portfolio. Our longevity reinsurance programme now covers 10.7 billion of annuity liabilities which is about a third of the book.

While the value trade-off is appropriate, in our minds, these actions will reduce future annual earnings by between 10 million and 15 million on top of the previous guidance of 25 million.

Finally, in line with our normal practice, remittances from the UK in the first half reflected the 2016 with profit transfer.

M&G

Taking action to address short-term challenges

The effect of a market-wide retrenchment from equities in the first half combined with continued withdrawals from optimal income led to a 6.1 billion retail net outflows from M&G in the first half.

I indicated in March that retail business accounted for two-thirds of M&G's total revenue. The 14% decline in retail AUM was the main driver for the 10% drop in fee income to 440 million. Actions on costs mitigated the overall impact on margin to deliver operating profit of 225 million, down 10%.

Absent the meaningful recovery in net flows, the first half revenue trends will persist for the rest of the year which, together with the usual seasonality of costs, will see the cost income ratio move to around 60% for the full year.

Group

Free surplus generation momentum maintained

Moving on to cash generation. Free surplus after investment in our new business increased by 10% to 1,609 million. The life in-force result grew by 14% and was underpinned by the sizeable expected return of 1,437 million augmented by positive experience of 374 million. The former was dampened by the effect of rates, while the latter benefited from UK management actions that I covered earlier.

As you can see on the top right, Asia's in-force momentum provides important support to this metric and acts as a buffer to the cyclical impacts elsewhere.

New business strain is higher at 502 million. In Asia, strain has grown at a slower rate than sales due to changes in business mix.

The US increase is also mix-related, driven by higher GICs and lower Elite Access sales. It also reflects the higher proportion of new VA premiums directed to the fixed account, which was up 4 points to 22%. In both Asia and the US, the investment in new growth opportunities remains highly capital efficient with returns well in excess of 20% insured payback periods.

The new business strain in the UK for 2016 is on the more onerous Solvency II basis. The increase here is driven by retail annuities which, despite the modest sales levels, consumed 69 million of free surplus equivalent to 24% of single premiums.

Mindful of the many moving parts this time around, this next slide provides you with some additional detail on the movement of the free surplus generation between the two periods. I will leave you to study that at your leisure, but I will draw out a few points. As you move from left to right, you can see the negative 128 million interest rate effect on this metric which mostly relates to Jackson, about 70 million relates to Jackson. You can also see the positive 138 million offset provided by the UK actions and the additional 147 million from our ongoing focus to grow and manage the business for value, which represents the underlying growth driver of free surplus.

You can also see the effect of Solvency II on UK free surplus generation where, in line with our guidance, the expected return from in-force after amortising the transitional was 22 million higher in the top row, and where our shift in focus to capital light products contained the more onerous strain effects of this regime to only 31 million. The negative interest rate effect does not detract from our ability to continue to grow this measure. As I said at the start, we remain on track to exceed the 10 billion cumulative free surplus target for 2017.

Resilient free surplus and strong central cash

The next slide shows how the annual free surplus generation has impacted stock on the left and cash on the right. I would remind you that from this year the UK insurance contribution to free surplus, stock and flow is based on Solvency II. For the rest of the Group, free surplus continues to be based on local measures as these remain the biting constraint.

Stock has increased overall driven by resilient operating performance. Market effects were more adverse this time reflecting, for the most part, higher negatives in the UK, given the more market sensitive nature of the new regime.

After remittances, free surplus stock finished higher as I mentioned. Central cash was also up at 2.5 billion.

Equity shareholders' funds

Benefiting from natural offsets in our business

Completing the overall earnings picture for the period, items outside the operating result have made an overall net positive contribution on EEV and have largely offset on IFRS. In the IFRS table, the negative investment variance of 0.9 billion was primarily driven by the asset and liability accounting asymmetry in the US. This has further accentuated this year as Jackson opted to achieve economic protection against falls in rates by increasing allocations to long-dated treasuries instead of buying more traditional instruments.

Unrealised gains in these treasuries are included within the 1.1 billion positive shown on the next line alongside the gains on other fixed income securities. Otherwise, there was no change to Jackson's hedging approach, which remains economically effective.

The net negative investing variance under EEV, which coincidentally is also 0.9 billion, mostly reflects the effect of the lower assumed future investment returns on VA M&E fees. As under our methodology, these future returns are actively set.

Given the Group's sizeable non-sterling assets, currency movements contributed positively in the first half under both reporting basis. The effect of adopting Solvency II trimmed 473 million off our UK Life EEV, reflecting the extra cost of holding higher capital.

The fact that both IFRS and EEV shareholders' funds increased in the period by 13% and 9% respectively is testament to the consistency of our operational delivery and the natural offsets which exists across our businesses.

Solvency II

Strong Group capital position and lowered sensitivities

I summarise on this slide the movement in the Solvency II surplus during the first half of 2016. Our operating performance remains an important and reliable source of capital contributing 1.2 billion to the surplus in the first half. Market effects were negative 2.4 billion.

Around a third of this total relates to Asia, reflecting the highest Solvency II risk margin at lower rates. Now unlike UK and European domicile businesses, transitional relief is not available to us to cushion this effect.

Just over a third of the market effect relates to Jackson where the instruments we use to hedge against falls in rates are brought in at book value, which means that the sizeable gains of around 0.8 billion made this year have been excluded. Finally, about a quarter arises in the UK where lower rates increased the annuity SCR and reduce the contribution from with-profit transfers.

At 0.9 billion, currency also provided a meaningful positive on the Solvency measure. As I have already mentioned, we took action in the course of the year to mitigate the adverse effect of lower rates and to improve the sensitivity of our surplus to further market shocks. These included longevity and other liability actions, asset switches, asset duration lengthening and additional hedging within business and at Group.

In summary, we remain comfortable with the overall capital level. We have the operational and financial growth to mitigate negative market effect and we are back and protected six months ago against the shocks from here.

I have provided on this next slide a capital update for our main businesses. The contribution of our Asia operations to the group Solvency II surplus has been maintained at 5.1 billion as operating capital generation in currency positives have offset the higher risk margin effect. However, it is the locally driven free surplus of 1.8 billion that remains the relevant measure for cash and capital, which is extremely stable.

The US local stat basis capital has been impacted by the fall in rates. The permitted practice currently in place means that the offsetting gains on the hedge instruments that we use to protect against falls in rates are not brought into account.

Here, unwinding the permitted practice, which is up for renewal next month would recapture $1 billion of post-tax hedge gains and restore Jackson's capital to near start of year levels.

In the UK, shareholder Solvency II surplus of 2.9 billion has benefitted from the actions that we have taken. With a ratio of 138%, solvency remains within our target range. The UK with-profits solvency surplus has improved to 3.5 billion, equivalent to a ratio of 176%.

I will conclude my presentation by reiterating two key points.

Operating performance remains a key source of capital

The first is our belief that the most important source of capital is the consistent delivery of a growing level of high quality earnings. This is precisely what we have achieved so far this year, delivering higher IFRS operating profit and improving operating free surplus and Solvency II capital generation.

Conservative balance sheet and resilient business model

The second point is the resilience that comes from having a large economically effective and well diversified balance sheet which is both secure and growing in scale. While we are not immune to the economic and market cycles, we are in a strong positive to trade profitably through any environment.

With this, I will hand you back to Mike.

Outlook

Mike Wells

Group Chief Executive, Prudential plc

Footprint aligned to long-term trends

Just a little bit on outlook. We obviously feel pretty good about where the Group is and its ability to capitalise on the market and what is going on in this next phase of the cycle. A couple of fundamental reasons, one being strategic. The behaviour of the growing Asian middle class, the behaviour of what someone referred to as the greying middle class in the Western markets, as one getting grey hair I took that slightly personally, but there is consistent behaviour which is this de-risking of their financial assets of various concerns and directly towards products and services that we provide.

The footprint we have, the capabilities we have, the services we have seem to be fitting the major demographic trends and the more volatility we are getting, the more investors perceive rates harder to live on or asset returns at lower levels and more concerning, the more valuable our solutions consistently seem to be for clients across the globe.

Investing for growth

There has been a lot of discussion in the industry about cutting. I want to address this very clearly. This has two issues for us. One, we manage expenses very tightly all the time. Can we get better? Always. Is that a challenge to the team up here? Always. Okay. We are actually investing, investing pretty heavily in this company. We view investing on three levels. First, there are the things we do that improve the relationship we have with existing clients, be it service, technology, their access to other products we have or anything that grows and develops that relationship and makes them more likely to buy something and stay with us longer – again, to protect the long-term operating earnings we have now.

The second area is scalability. We invest in things that we see improve our marginal cost, improve our capabilities and allow us to do things our competitors cannot do, which can be on risk, on our asset management platforms or in the life businesses. It is a key element because as we get bigger we should produce a higher return for our shareholders and we should produce a better product for our consumers, and we are doing both of those, again, at scale and in multiple countries.

Lastly, there are things we do for innovation, new opportunities or new relationships, which can be anything from a bank relationship to entering a new market in Africa or Asia, to recruiting a portfolio team for one of the asset managers, be it Eastspring or M&G – all of those things that take us into businesses that we did not have or capabilities that we did not have quickly. For example, M&As in the US and bolt-ons. There are many things in that category, and when we look at the capital we are willing to put behind the products, the lens is as it has always been – it is on cash payback, it is IFRS-centric, it is on the cash flow signatures, it is on the strain and it is on the interest rate sensitivity.

However, I want to be very clear: we can be more efficient as a group and we will continue to work on that, but our earnings growth is not based on us coming up with a material reduction in what we already have and cutting our way to profitability. It is based on growing from here.

Again, I want to reiterate that we have more options for capital than we have capital. We could invest more, grow more and do more if we chose to, and we understand the balance required with our shareholders on those metrics.

Growing value at consistent returns

What does that look like? What is the discipline of that? We know that there is an expectation on the growth, as we do this investment, to do it from an ongoing basis and not one-offs. We are trying to give you a very high rate of return of growth and trying to do that at very attractive returns. The bottom grey box is a return on embedded value. I am going to be defensive about the half-year, because it bugs me that is 14%. 1% of that is interest rates and 1% of that is front-end loading of expenses in our business model, so it is actually a little stronger than it looks. Nonetheless, we think that these are competitive returns in this market, given where our risk-free rates are and the alternatives. Again, we think they demonstrate our scale and our ability to grow at scale.

Growing earnings and dividends

There have also been many questions about dividends in the meetings after the 2015 full-year results. Why do we think it is sustainable? Why is it a better dividend if we are not growing it at 5-plus the incremental, as we did? Where does the confidence come from for that?

First of all, it comes from the fact that, in our view, dividends should be aligned with earnings growth. Post-crisis, you have seen a lot of our competitors not growing earnings per share and growing dividend per share, and that is not what this management team is going to do. I want to be very clear about that. This is a long-term growth business, growing earnings first and dividends second. Additionally, we are doing both as we are growing the value of the company, so all three of those metrics are moving at pretty effective rates. I do not believe that the other model is sustainable. If you are growing dividends faster than you are growing earnings, there is only a couple of ways that can end: you either had an awful lot of capital to start with or you need an event later to recapitalise that. We do not believe that either of those are necessary for us. We are growing earnings in a very strong, predictable manner.

Long-term track record

To come back to our long-term track record, our earnings in the first half look like they have for the past decade. This is how you should hold us up. We have a responsibility to deliver for you quarter after quarter, but the context of that should be against our own performance and against how the growth looks, how the profitability looks, how the cash generation looks over the cycle. The relationships that we have with consumers, if we do them correctly, are decades long. You should get the benefit of that as a shareholder. I think this is one of the most effective ways to look at it. There are a lot of good slides in the deck and in the appendix, but if I only had one, this would be the one I would use. I think this is a business where the short-term things we can do can increase one of these lines and that is not our objective. We want to grow growth, grow value and grow dividend.

Summary

This has covered what we have been doing, the team that has been doing it, the markets we have been in and all the things that you knew before coming in. I think the results, on an absolute and a relative level, are pretty good. Is there up-side? What else could happen? Given the Asian numbers and the pace at which they are doubling, any more normalcy in Asia is clearly up-side for them. In the western markets, given our success at gathering assets and managing them, any improvement in market performance or any lighter version of the DOL, if that comes into play, is better. A broader capture of assets and more RIA assets coming to Jackson are not factored in to how we are looking at the business, but they are clearly part of its capabilities. We can also see up-side in the improvements we are making to our UK businesses – scalability, capital-light, positioning them for where that market is going. The general climate for consumers, or the blend between the new expectations of what returns are and what expertise they need, is driving them towards the things we are good at and the markets we are good at.

This is a challenging time – we are not suggesting otherwise – but we think we are very well-positioned to succeed in what, for a lot of firms, seems to be a very difficult time, and we are growing cash, growing earnings and growing dividend.

Q&A

Jon Hocking (Morgan Stanley): I've got three questions, please; two on the US, and then one on the Group capital sensitivities. First question, on the US, just in terms of the net flows you have seen in the VA product in the first half – and I appreciate we did not get the rules on DOL until the beginning of the second quarter and you are going to relaunch in the third quarter – how should we think about the outlook for flows for the second half of the year?

Because we have not really had a normal run rate here and obviously we did not get an update for the first quarter. That's the first question.

Second question, the GICs; I'm slightly surprised that you are writing GICs again in size in the US. What is the return on capital of that product and is this just an expense play? Are you worried about the general account depleting? That's the second question.

And then just finally on the Solvency II rates down sensitivities; just the 2.4 billion that Nic ran through, it sounded like a lot of that was rates and risk margin, but the rate sensitivity you gave to the 50 bps down on the right-hand side of that slide looked reasonably small. I just wondered if you could talk through how much of that is assets versus how much is liabilities and how much of it is risk margin-related. Thank you.

Barry Stowe: Yes sure. So the slowdown, it is correct that we did not actually get the rule change until April, but it was highly anticipated, and because there was uncertainty around grandfathering although we ultimately ended up with an element of grandfathering, which was helpful, its not full grandfathering – the slowdown in production of new business actually started much earlier, back in the second half of 2015. So that is the reason for the flows.

In terms of the GIC, it was opportunistic. This is something we do periodically.

Chad Myers: Sure. So our returns generally speaking, we target about 12% unleveraged on those types of products. So I think that is generally speaking what we saw. Keep in mind that this used to be a material portion of our overall balance sheet. The ability to actually earn spread has not been there for a while because financial paper has been relatively pricy, post-crisis, but that is finally starting to go away. So we are actually seeing an opportunity now to lever off of our AA rating and be able to invest well against that to earn a good spread.

Jon Hocking: Okay. If I come back on the GIC question, what were the GIC's, because historically I think you have said that you reinvest to make a greater than 20% IRR across new business. Is that 12% unleveraged return a return on capital rather than an IRR metric? Or is it the two aren't the same number.

Chad Myers: Return on capital. On AA statutory capital.

Nic Nicandrou: Sure. There are other advantages, but, as you say, maintaining a stable general account level has a lot of benefits across the business. It certainly helps with liquidity as well. We take everything into consideration.

On the sensitivities, you have to appreciate that Solvency II is only very new. The sensitivities we gave you reflected the balance sheet that we had at the time. The balance sheet was not optimised at that time to withstand those sensitivities. We have taken both liability and asset-side actions. I referenced one of the liability actions in relation to the longevity, which we had started doing, in any event, in the course of last year.

On the asset side, there is a key thing here that across our UK business, but also across certainly some of the Asian countries which contribute to the overall Solvency II surplus, we match our assets to the best estimate flows. We do not match the assets to the one in 200 cash flows so when interest rates fall, as they did immediately in the aftermath of the 1st January and then again, you have a mismatch, effectively, that comes from having shorter assets than the liabilities on the SCR. So what we have done in the course of the year as we look to optimise the position, both in the UK and elsewhere, we traded a lot of our excess assets, if you like, and increased their duration. So where did we do that? We did that with some of the excess assets that we have backing our excess capital in the UK, so we switched 2 billion and extended the duration by something like 15 years. Opportunistically, there was another 2.8 billion that we did elsewhere in the group, across the piece, which also gives us economic protection for that. Other areas where we did this was the matching adjustment, which was quite efficient. We entered the year with a 95% efficiency. There were some ineligible assets. You get to the law of diminishing returns, but we effectively sold 400 million of ineligible assets, which gave us some further protection against that. We did some general asset trading within the matching adjustment constraint, to improve, if you like, the risk versus yield position. There was another 1.2 billion of that. Then, of course, we did some more equity hedging, as I said, elsewhere in the group. So there were a whole host of actions that in effect, by 30th June, had shifted our matching to not just beyond the best estimate liabilities but to be best estimate liabilities plus – not all the way to the one in 200 cash flows, we do not think that is sensible, but enough to bring the sensitivities down.

Andy Hughes (Macquarie): First question, 24% of strain of the single premium for individual annuities, presumably for bulk annuities it would be even bigger. I know you are outsourcing some of the annuity teams to Mumbai. I would suggest you could probably outsource them to Mars instead. That is a huge strain. Is there something specific to Prudential about that? Is there an expense override number?

Nic Nicandrou: No. There is no expense and the people that we are transferring is to administer the sizable back book. It is what the numbers show. About 17% or so is SCR and the rest is risk margin. 18% to 20%, depending on where the interest rates were in the quarter, with the rest being risk margin. We dialled up prices as we entered the year, but you come to a point where you run against the constraint of value for money from a customer perspective. Therefore, we have moved the pricing as much as we can without giving ourselves problems with the FCA.

Of course, it is without the benefit of any reinsurance. The numbers that we have given you are without that. But, even if we re-run the numbers and you assumed we reinsure 80% of that, and you add a 4% or so fee, which is a typical fee for this type of reinsurance, you save a little of the strain and you remove the risk margin component, but it still leaves you in the teens. You save some capital but you give away enough of the returns, it gives you a small IRR pick-up but it is still at or just above the cost of capital. This is why we said we have taken action to withdraw. We wrote around £27 million of APE, £270 million of single premium. About a quarter of that comes from open market sales and sales with partnerships. We announced in June that we are stopping selling to the open market and we have given notice to our partners, effective from 1st July, that we will not take any annuities. About half of it comes from the with-profit fund, people vesting, which was reinsured under the shareholder account. Again, we stopped doing that from 1st July and that leaves us with the guaranteed annuities, which we are trying to find a solution for.

It is onerous and that is why we stopped bulks, and this is why, in this interest rate environment, you will see us pull back from retail annuities as well.

Andy Hughes: My second question relates to US VAs. Mike, I know you personally love dollar for dollar withdrawals for GMIB and I see that some of your competitors have had a lot of problems in those products. Is that going to impact the competitive landscape for the second half of the year? Are you going to see products on the GMIB side being pulled? Additionally, on lapse rates, obviously MetLife brought forward their investigation, so if lapse rates in your US business come down, it looks like that is probably positive based on your cash flow disclosures. If DOL drops lapse rates, is that positive?

Mike Wells: You have a number of experts on this here in the room, but as a general comment on lapse rates, one US competitor wrote off 2.1 billion and one added 1 billion. We look at our assumptions at year-end. I am glad we do not have the GMIB exposure, the structures you are talking about, for many years we have stood up here and said that was the wrong product. I would not wish that problem on anybody, but some firms have it. I think the bigger issue in the market with DOL is that you are going from a regulatory standard that historically was based around suitability of product – are you selling a product suitable for the client? There had to be a good reason for a sale with security and a good reason for a buy, and that all had to be justified in the US market. It was a pretty prudent model. It has been upped now to what is basically the same as the reasons [inaudible] here: the best product. You are signing off that this is basically the right product. It is much more specific and there is much more liability. If you are wrong, it has a different recourse. We think the quality of the VA product that the advisers sell becomes even more important: the performance matters and the flexibility matters. One of the other topics that Andy did not bring up that we did not like was the vol control. I will leave you to do your own homework, but go back and look at those funds versus the funds that we have for our consumers. I have never been a fan of that model, and if you are paying for that and paying for a guarantee, it has always been a question in our minds. I think Jackson has a very good product set for where the market is going and, knowing what some of the broker dealers think, they see that. You are likely to see more concentration of the broker dealers, because there is more technical support and more IT support to go onto these RIA platforms and things. It is a good question for you on your travels for the heads of the broker dealers: which products are they willing to invest in to have on their platforms? I think quality will be a major cut and I think we are in good shape on that.

Lance Burbidge (Autonomous Research): I also have a couple of questions on Jackson. Firstly, in terms of the launching of the fee-based version of the product, I wonder, Barry, if you could talk about that. Presumably this is attractive for a salesperson to sell, because they get a recurring fee which is higher than their commission if the product lasts long enough, but how does that play with the consumers who presumably would be worse off, which is not what DOL was trying to do in the first place? Secondly, going back to something that Mike has talked about in the past – namely that as interest rates fall, is there a point where this product, from a guaranteed perspective, becomes unattractive, either from your perspective or from the customer's perspective – could you maybe talk about that as well? Lastly, on the sensitivity for Solvency II, you, like other companies, do not put negative rates into your sensitivity. I just wondered, Nic, if you have looked at what that does or if there is nothing in there.

Barry Stowe: The fee-based product will be introduced. The Perspective II version will be introduced in September. What it really does, I think, as much as anything else is give an alternative to the broker or the advisor who does not want to deal with BICE or the regulatory complexity of operating under that. It gives them an alternative that, from a compliance perspective, is a little easier. For a sale that is made that has a long duration, there is the prospect that the agent gets paid more. Typically what companies like us do in order to fund, if you will, the up-front commission, is you build in about 100 basis points for distribution. If you accept that the standard fee is going to be about 100 basis points, the customer is really not going to see a material difference. As we discussed before the session, there is the prospect that as you move towards more fee-based products, and, let us say, 100 basis points gets locked in as the typical fee level, then over time there would be pressure on that to be pushed down to 75 basis points or 50 basis points, and that could certainly happen. However, I do not think that it is going to disadvantage the consumer in any way, but what it is going to do is give a choice to the financial adviser, which is really important.

In talking with broker dealers and talking with the wire houses, what we are hearing overwhelmingly is that they will operate under the BICE. They accept that and have got their heads around that. Some of them view it as a long-term proposition and others view it as a bridge and plan to have transitioned completely away from commission-based sales within three to five years and be totally on fee-based sales. There is no doubt that there is going to be an evolution around distribution in the industry and that, in fact, is what I think regulators are trying to get at, because we spend a lot of time also talking to political leaders, regulatory leaders and people within the Department of Labor and the SEC. What comes through overwhelmingly is that they think the product is complicated for consumers. The reality is that the industry has complicated it; it is really not a terribly complicated product for a consumer to understand. Therefore, we need to change the way we talk about it and use different, simpler language, which the regulators welcome. However, they love the product itself. They love the idea of a product that provides up-side, that only equity markets are going to be able to give for the foreseeable future, combined with some level – although it is a modest level – of guaranteed income for life, around which someone approaching retirement or entering retirement can plan. They really like the product, so there is cause for real optimism for organisations who have a track record of being flexible and adaptable and get on the cutting edge of things. That is where I think Jackson is.

Mike Wells: I think on the interest rate piece, there are a couple of issues. We have the ability to adjust guarantees down, as you have seen us do, and the systems have the flexibility to do that. From the accounting point of view, IFRS has effectively a market-consistent element in the drift rate. The discount rate is defined by the current rate and then the drift rate under the equity assumed performance is defined by rate, so as rates get lower, the accounting can get quite a way away from what would be reasonable economic assumptions. That is one of the challenges and it is a discussion for us as a management team and with you, as our investors, about how we view that. But, at the lower levels, the drift rate assumptions feel kind of ridiculous that a portfolio with every asset class available basically on the globe cannot produce a 100 basis point return over 20 years is a bit of a stretch. If you actually believe that, you probably would offer a different product. So that is where I think you will see the noise, but again we are looking at it. And we do have the flexibility if we believe the true economics of lowering the guarantees and we have done that on the withdrawal rates.

Nic Nicandrou: Okay. Can I answer the question on the floor? So you are referring to our internal model, which floors interest rates post shocks at zero. Just to be clear, so we start with the swap curves in the various markets that we operate. We then apply the one in 200 shock. In all cases, that stays above zero. And then we apply the 50 basis points from there. The only place where that drops to below zero is in year one in Singapore and our cash flows in Asia pretty much across the piece. The average are ten years plus out, so immaterial impact.

The other place where it drops to below zero is in the UK between years nought years today and year five. That is in the minus 50. Our cash flows in the UK are even longer. So they go out 20 years plus. So that impact is immaterial.

Arjan van Veen (UBS): Thank you. Two questions, if I may? First one on Solvency II capital movements. So, firstly, thank you for your detailed disclosure on page 76 on the movements there. The 1 billion of underlying organic capital into generation represents about 10% of your opening SCR which annualises at 20% which is the top end of your peer range. It is also relatively stable compared to the 2 billion in 2015. So looking for a comment on, can we use that as a starting point to build forward? There is nothing untoward in that number.

Second question is on Asia in two parts. Firstly on Hong Kong, so obviously the strong growth has continued there and there is obviously concern around both sustainability of growth and also some regulatory tail risk. So, Tony, if you can give some comments around the growth side and also particularly on the tail risk, the initiatives from the Hong Kong regulator, which I think will help manage that a bit.

On the non-Hong Kong side, we saw obviously some negative growth in this half. You have obviously a strong switch towards regular premium. There are some management initiatives in Indonesia. You stopped selling Universal Life in Singapore. So I am just curious, all these different actions, are we seeing some light in terms of where you see that stabilising and picking up again, given all the different moving parts?

Nic Nicandrou: Thank you, and I think your analysis is correct. I mean, clearly there are some management actions in there that benefit, which you have accounted for them. We have a business that generates capital. When you consider that effectively the US comes in on a local basis and you have seen the very strong capital formation from the US that we have reported year after year, as the business has grown. There is no reason to believe that its contribution to that number is going to do anything other than what it has done in the past, plus.

Of course the UK is under Solvency II and we gave you the Solvency II VIF monetisation profiles at the year-end. On an underlying level, you saw £300 million or so come through, it is £600 million for the year, okay? We have a trim a little off that but what works against that is the new business strain which will eliminate as we go into the second half and beyond. And of course, we have a positive experience that contributes.

So no, we are confident in the same way as we are against all the metrics that we ask you to judge us against. We are confident that we can continue to have a positive slope.

Tony Wilkey: Hong Kong growth continues strong at 58% at the half, again continued driven by mainland Chinese and correlated quite well with the growth in the agency force, which I think is now close to 16,000. In the first half, in Hong Kong, we have recruited about 700-800 new agents every month and so that is feeding through nicely.

In terms of the actions from regulators – and there has been a lot of activity in the first half – I think the most interesting ones are declaration put out by the China regulators, CIRC, I think towards the end of Q1/early Q2. That, they actually put out I guess to the Chinese citizens on their websites. It was stated that if you are going to buy product in Hong Kong, these are a couple of things you need to be aware of. I view this as good news. Honestly, in part codification of the process is okay for the business to continue under certain controls.

We did, as we have always done, we immediately took those CIRC statements and put them in an additional disclosure at point of sale that the agents and customers had to sign. Now what the Hong Kong regulator, OCI, has done is taken those standards and created a formal forum, disclosure forum, that effective 1st September all mainland customers purchasing in Hong Kong will have to execute. So based on everything we have seen so far, not materially concerned about the impact and again and, as usual, we are ahead of the curve in terms of implementing those standards.

In terms of the rest of Asia, I think you might have answered the question. Yes, there have been some economic headwinds, most probably most notably in Indonesia where GDP has struggled for an extended period of time. And that for us – I think we talked about this in the past – that has flown through into, on the coal face, the consumer sentiment index, which has been depressed. Remember in Indonesia we sell to the middle market, the mass market, not the mass affluent, so household disposable income; a little bit more sensitive than it might be in some of the upper segments, which are typically the people who are actually buying product to bancassurance, not agency.

So yes, we have felt some impacts but we have continued to grow the business. I mean, even though the comparable is not great, if you look at the business, we averaged about IDR 370 billion rupiah per month of new businesses in the first half. That is £21 million of new business, margin staying in line and almost £200 million of IFRS profit coming through. We also added on average 7,000 new agents every month in the first half and I think we acquired 160,000+ new customers, so 800 new customers a day. I am a little disappointed that that is not per hour but we will get there.

So look at the lead-in indicators, the drivers, for direction. Q2 over Q1 grew by 11%. That is great news. If you look at Q2 over Q1 last year, it was flat. And the growth coming through APE per active. So agents are actually starting to have a lot more success at point of sale. So I think if you want to add on the final macro of Jokowi's new cabinet, especially with his new Minister of Finance, I think we feel pretty good about maybe the economy is – you guys probably know the economy in Indonesia better than I do but it feels like it might have bottomed out. Currency stable, JCI is up 20% year to date, looks a little bit better. As the economy recovers, our business will recover.

Oliver Steel (Deutsche Bank): Three questions. First I am afraid back to the US. Are you able to give us a sort of indication of how much sales from qualifying accounts actually fell in the first half and by implication what happened on the non-qualifying accounts and how you see particularly on the qualifying accounts how that will develop over the next one, two, three years, if you can?

Secondly, the flows at both M&G and Eastspring were a bit below my expectations, so Eastspring, can you tell us what is happening there? Because they were remarkable good this year but they were not so good – sorry, they were remarkable good last year but less so in the first half. M&G, perhaps an update on particular funds and how much is left in each of these.

And then the third question, perhaps a bit left field is, you talked about raising the dividend in line with earnings but obviously your earnings are benefiting quite a lot from sterling currency weakness and your dividend is paid in sterling. So how are you thinking about sterling relative to your dividend decision?

Barry Stowe: We talked about this outside I think, Oliver, the Elite Access sales from qualified accounts have dropped to essentially zero almost. They have fallen precipitously because, as Mike alluded to I think earlier or maybe it was Nic in the presentation, most of the broker dealers are now not allowing advisors to sell EA into qualified because they feel like the fee in return for the advantage that you get from the tax wrapper, which obviously you do not get with the qualified, it is not a new advantage. So that has been hit very hard. Overall sales, do we have that number at our fingertips? How much qualified is down versus non-qual?

Chad Myers: We do not have the number in terms of percentage down, but what I would say is that the mix is about the same as it was last year. So you are looking at roughly 65% is qualified in the non EA.

Barry Stowe: So EA has been hit very hard. In terms of how we expect it to develop, broadly we think that a recovery is afoot. It is not like it is going to come roaring back in the third quarter or the fourth quarter. I think it is a gradual thing over a series of quarters to return to the historical levels of flows across the industry. But I do think that there is, based on some of the comments I made earlier about the way regulators actually are embracing the product concept and just want to look at distribution, I think as we are successful in evolving distribution, I think there is strong prospect that we will see growth in flows – there need to be. When you look at the number of baby boomers are retiring, the assets that are going to be looking for a home, the fact that interest rate orientated, our parents and grandparents retired on CDs which were paying 10% and 12% interest, that is not an option. So there are few alternatives to people other than going into equities and the prospect of a guarantee with the equity upside just, I think, is becoming increasingly appealing.

So do not look for instantaneous change in sales levels but, over time, I think there is real cause for optimism.

Mike Wells: Oliver, if you think of the problem you are solving for the consumer, it does not materially change with the new product structure. You are going to have some assets already in qualified plans rolling over and you are going to have supplemental savings for retirement. So they may go fee, they may go commission but the fundamental problem we are solving is the same, regardless of DOL. So I would not, just if I was guessing, I would not think you would see a material shift in qualified and non-qualified mix in the US.

The exception to that may be in our fee-based Elite Access. You get into a different – I am just thinking aloud. It should be the same problem you are solving with effectively the same tools, just different optionality in how they are structured. So I think we get the same outcome.

We just happen to have the CEO of Eastspring. Guy, you want to comment on flows?

Guy Strapp: So if we just wind back slightly, second half of last year, flows started to slow after China intervened in both currency and stock market. So sentiment in Asia started to shift after a very strong 2014 and for us a very strong first half of 2015. You translate it into 2016 and investor appetite for equity product has evaporated largely. It is money market pockets of high yield. All ten countries that we run money in in Asia, except two, had positive flow for the first half. So it was confined to Japan, where we saw outflow mainly through dividend distributions in Asia equity income product and a very short duration product, which almost money market quasi product in China, which management decided to close down, were the only two funds that were in outflow in the first half. So eight out of ten countries positive flow.

Anne Richards: Yes, I think there are a couple of things to comment on. Two main reasons I think why flows have been under pressure over the last 18 months or so; first was very obviously related to performance; and I think the second bigger driver was around Brexit and uncertainty in Brexit ahead of that.

So, maybe touching on performance. Some challenges over 18 months or so but if you look back over the last six months, over 60% of funds in the retail range are now above median so there is a bit of work to do to repair some of the slightly longer-term relative performance. But you could see the direction of travel is right. And in particular, optimal income, which is the single biggest fund there we are now seeing against the European sector, which is the most important sector for that fund. The European share class there, we are now first quartile year-to-date one year and five years again so we have really rebuilt that track record. And over three years again, we are second quartile so direction of travel very much in the right direction there.

And if you look at the broader context of flows, actually what is quite encouraging is to see that we have got net inflows across quite a few different strategies both on the retail side and importantly on the institutional side as well, and quite a range of different things: real estate, some of the private debt markets and so forth, global macro multi-asset. So there is a lot of work to do to turn net outflows into net inflows. But we have some of the building blocks already in place there.

I think the Brexit vote obviously has relevance in particular to the 25 billion or so of assets under management that we manage for Continental European clients. And I think we still do not have perfect foresight in terms of how that is likely to progress going forward. So that is the area where we are looking at focusing really on client service as we wait to hopefully get a little bit more unravelling and visibility on the extent to which, for example, we still have European passporting as the Brexit negotiations go down the line. But in the round that is the picture on that.

Nic Nicandrou: Dividend, is it a factor? Yes, it is a factor. Is it more important when we stress test the dividend to the impact on shocks? No. Is it more important than when we weigh up the growth opportunities? No. we take the rough with the smooth. Now that being said we have always maintained that currency and the parts of the world that we are exposed to is a tailwind for this business. At the end of the day, over the medium- to longer-term currency should follow growth in GDP. And if you are operating in countries where GDP is growing faster than the currency in which you are reporting then over time that will come through into additional earnings. So no: day in day out, it is a factor, but not that significant. You know, longer term, I think it is rightly a tailwind for us.

Mike Wells: We have historically hedged dividend payments, not hedged earnings, and so we try to dampen some of that a bit.

Blair Stewart (Bank of America Merrill Lynch): Thank you very much. Three questions please. Nic, you talked about the permitted practice in the US. I just wonder if you could expand on that. Is that something you are looking to explore and could you give us what the RBC in the US actually was? I am thinking if that is a route to getting more capital or more cash out of the US? It would not be results presentation let me complaining about cash coming of the US. And the second question on Indonesia, I noticed the profits growth has slowed to 12% growth. Is that simply a function to investing in the business during a period of time where sales are coming down on. I suspect it is. And, thirdly, on back to management actions, Nic, just wondering what more can be done especially to capture some of that surpluses disallowed? I am thinking particularly on the with-profits estate, if there is anything smarter that could be done that. Thank you.

Nic Nicandrou: Maybe I will say one or two things and then pass on to Chad. I mean permitted practice is something that we carried, put in place after the last financial crisis at the time. If you like, the balance of the book was more on the general account where interest rates up with a predominant risk. Balance of the book is gradually shifting and, clearly given where interest rates are, the point at which it becomes the permitted practice is a benefit to us is further away. That being said, we have had strong capital formation even with this in place over the years. But it is something that we are looking at. Chad, would you add anything to that?

Chad Myers: I think it is the bulk of the answer right there. So with permitted practice we view that as something where interest rates are low enough and we are deep enough in the money, if you will, that there is a pretty good offset up and down with reserves now so there is a logical reason why you might take the permitted practice off, and that will be part of the conversation we have with the state. The reason we have had on to begin with this is where you would have rates move up significantly then there is going to be an asymmetry between the mark on the swap book and the reserves because the reserves will floor out under stat. And so there is still that kind of tail risk, if you will. If you got a big inflationary environment or something like that where rates start moving back up rapidly, we would have a disconnect. I think it would be harder for us to get that back on having taken it off. So we would not do so lightly, but it is certainly an active discussion just given the fact that we are seeing now a kind of one-sided mark against us even though that economic hedge is in place.

Mike Wells: The other that there as you see them the use more of treasuries as part of the hedging strategy just because more efficient, less volatile etc. They are also under stat carried at book. So you are getting a quite an understatement of the financial strength of

Jackson. We have not ever given RBC other than when we published at year-end, but it is still a very acceptable range for us.

Tony Wilkey: Yes, Blair, you are absolutely right. We have been investing in the business. Mike often talks about countercyclical opportunities. We continued to invest. We have expanded new branches. We have hired more agents. We have upgraded our people and we have invested quite heavily in technology to make the whole process more efficient on the back-end and the front-end so obviously that has some impact. I do not know, Nic, if you want to expand on any further?

Nic Nicandrou: I am extremely frustrated that I cannot include that with-profit estate into the ratio, not least because it seems we are the only business now that has a sizable amount. Nevertheless, we have had that debate. The rules have been interpreted in the way in which they have been interpreted and we excluded. How can we access it? We could distribute it. But that would not be what we wanted to do. It is the thing that is underpinning, providing the working capital and the risk coverage to invest in the way that we do in the with-profit fund which is now attracting the phenomenal flows that we are getting. There is things you can do from this point. To get more credit upfront you could monetise the SHIFT or you could hedge the SHIFT further, but you are giving up to upside. Now, as I said, we would do if we needed to within reason. But on the with-profit side it is difficult to bring more credit through on to the ratio.

Nick Holmes (Société Générale): Thank you very much. A couple of questions on the variable annuity book again. I just wanted to follow-up on the policyholder behaviour assumptions. I know this is an incredibly difficult to take area. But I wondered if you could try to give us a sense of your level of confidence about your assumptions, not just lapse, but also guarantee utilisation. Perhaps looking backwards, what did the last review tell you and what were you pleased about? What are you worried about? And then the second question is I noticed that there was a very large unrealised loss below the operating line. Now this we all know is a familiar feature of insurance accounting. But I think in your case quite a lot of it is to do with the hedge programme. And I just wondered what is your thinking about communicating the performance of the hedging of your variable annuities? Are you at all inclined to start reporting in an economic type of – I know that is subjective in itself, but in there is one very large European company that does this and it puts it in its operating earnings. Now is this something that you would be interested in doing in the future because my sense is that it would be very helpful for people to understand the true performance of the variable annuity guarantees and hedging. Thank you.

Mike Wells: I will start with both and lean to a few US colleagues for help. On the hedging, I think there are two elements. If you remember the New York meeting a number of you were out and we sort of gave you 11.5 hours of everything you want to know about Jackson. One of the things that we did there was we showed you some of the internal work we do on cash flow testing. Because of the industry's varying descriptions of metrics, the choices management teams have to define hedging, define risk. We have always looked at those, if you remember, unhedged. And then we can tell you what the hedge looks like in that shock in terms of value at a given point in time. We are not getting in a debate of what type of hedge should, and how is it structured, and is that better than METs or PRUs or Lincolns etc.

With various investments we will keep showing you those sorts of measures because I think personally that is the single best way to look at a VA block and how it is going to perform. If you remember one of the things we said is it is not just the PV, which is the easy one for us to summarise for you, but it is also how does a given year shock look versus your capital. You know, insurers fail for cash at the end of the day. So those stresses are important and our intent is to keep showing you that. I think that gets you a better look at our non-hedged liabilities. There was a question that came out of one of the meetings about net amount at risk versus in the money. Net amount at risk is a shock event. That is not how our liabilities are structured. It is an 'everybody goes at once' sort of model.

So for us it is an incredibly inefficient way of looking at our liabilities. It may fit a life company with pure mortality, particularly if it is concentrated in one region. You start to get to: is that viable? But, for us, with the fact that the guarantee plays out over decades, shocking it to one day can even structurally occur. They all cannot collect. So that is not a particularly good metric. So I do think the cash flow metrics assuming very efficient utilisation is the best way to say: do you like to look at what is there? The actual value the hedges we can mark to market in any given day, you see some of that below. Some of the below at this time was interest rate as well, just the severity of the rate movement in the US.

And your other question on policyholder reviews, there are multiple levels in the US on policyholder review. There is an ongoing sort of intellectual challenge quarterly. There is a team that gets together and says look for any inefficiency, look for any behaviour that is changed. Look for anything that would suggest that our models are wrong. Look for new combinations. Anybody in that committee can bring up any combination of variables they want to be run and tested. It is quite detailed and then we have our formal processes that we follow as all US carriers do to review our assumption setting, and we typically do those in the second half of the year.

The challenge you guys have – I appreciate this – as investors is you have firms in the US that have different structures of liabilities. In the VA they have different assumptions. There are a lot of assumptions to your earlier point inside our policyholder behaviour. It is not just one number. When you look at that you got to say: do you agree with all the things you are seeing in the marketplace? We have had this discussion with external consultants. How valid for Jackson is marketplace data that is GMIB-based or they have gone back and raised the fees or they have gone back and put forced allocation or vol control on versus our clients. It is directionally of some value but we would not build pricing based on it. It is not just opaque. It is a confusing space, but you will see us disclose sensitivities to. We have shown before what we think of lapse rates, what our stresses look like and the financial implications. We will continue to give you those.

Nic Nicandrou: Mike, can I comment on the reporting as well? Look I am aware of what other companies do in this regard. You know our position on accounting disclosure. We thought long and hard about how we best project that. But you hit on two of the key points. The first challenge you run into is what is economic. Is it real world or is it market consistent? And there can be different judgments that are applied in that regard or something in between. Then you hit the other challenge which is to say do you then depart from US GAAP and bring in the entire guarantee fees into the calculation of the way you think of the reserves or the element that you brought in on day one, which is when you locked them in to produce the zero profit on day one.

We took the view that the more you depart and make judgments from the base US accounting, the less comparable your numbers are with the way that everyone else does it. And in the end we decided that it is better to take that volatility and be more comparable and answer your questions rather than make judgments that put us out of kilter with the way the rest of the industry is reporting. So yes, what would we then refer you back to? The cash flow on the one side and the other thing is the embedded value because ultimately that does capture all the fees and does factor in the way you move forward, how your hedging programme will react and there are stochastic elements that are run within that to capture some of the variability of some of the assumptions. So now we look at it, but we just thought if we moved it would be just too artificial.

Barry Stowe: One other data point that might be interesting to you too is around the policyholder behaviour and the validity of the assumptions. And as Mike has said, we are constantly going through the process of reviewing and we occasionally tweak as a result of that analysis. But historically, our assumptions have held very, very well. I would argue that given that we have provided – Mike alluded this as well – probably the most stable consumer experience of anyone in the industry, around these products and given the scale of our book, I would say that historical data that we produce on our book is probably the most credible data available in the industry.

Alan Devlin (Barclays Capital): Thanks, just one question. You mentioned about bolt-on deals I think in reference to the US. Can you give some colour on what kind of things you were considering with the Department of Labor forcing new players potentially out of the market? Thanks.

Mike Wells: No, the Department of Labor does not have anything to do for us on bolt-ons. We would not buy. We are not looking for VA blocks, for example. We have been pretty clear that that is not a something we have an appetite for. What we look for is life. So life policy technical revenue, further diversification. There is covariance benefit. There are a lot of things we get. The last 24 months you have had some interesting new players in the market, private equity, some of the Japanese firms and things and they bid things up. Typically, what you see more at this point in the cycle is a little more rational pricing. But you have got some new players. We got some pension funds, multiple Canadian pension funds vehicles now. Actually, a very good liability for pension fund. You think about it. The cash flow signature of their lives look lot like the cash flow signature of the underlying lives paying premiums. So there is competition still, but we are looking. We continue to look. For all the years I have stood up here, we are always looking. If we see something we like, we would do it but there is no obligation or capital allocated specifically for that. It will be opportunistic as it is always has been. But you do on a very low cost platform in the US that can integrate those and produce a return in addition to the return the existing owner is getting; so there is value there.

Andy Hughes (Exane BNP Paribas): Hi. I have a couple more questions. And I think Nic would be a bit disappointed if we did not ask about the 30% fall in sales in Indonesia, just to double check the persistency and lapses are okay because that would be by main concern. I can see there is not much EEV hit from lapses in the numbers so obviously just double check that.

And the second point on Asia, obviously you are sticking with your growth target. But obviously Indonesia adds a lot more to the IFRS earnings in the near term than Hong Kong. So is that kind of the mix going to a bit of the headwind in terms of growth going forward?

The third question is on VAs and regulatory change. So AXA hinted they were holding back some cash for potential changes in the US VA rules, which may or may not happen. Obviously they have a big captive and you do not. But they almost sounded like they expected VA rules become more economic, which might lead to higher capital requirements. Could you comment on that? Thanks.

Nic Nicandrou: Now lapses, you are right you can see the numbers you know come through, the persistency pretty much across the portfolio on the protection side is strong. You know, from time to time you will see some spikes if equity markets are not performing. You see some partial withdrawals, maybe people taking money out, but we have seen nothing different this time around to what we have seen before. On the impact of Indonesia on the growth rates, I think the answer is the strength of the platform. Do not underestimate the growth in Hong Kong. Yes, a lot of it comes from the success of our with-profits offering there. But growth within that of health and protection which, as you know, has a very attractive IFRS signature is not to be underestimated. We are building some nice momentum in Hong Kong on the back of layering, if you like, more protection business to what was previously there. Hong Kong was underweight in our earnings before, and it is now gradually drifting up to its appropriate weight. So yes, there are some pluses and minuses.

Barry Stowe: In terms of regulatory question, Andy, there is always the prospect that regulations evolve over time, but we have always had and continued to enjoy a very positive and productive relationship with Jackson's lead regulator, which is the state of Michigan. And I mean there are literally weekly, multiple weekly meetings between Jackson and the state. And I think they are comfortable with the existing regulatory regime under which Jackson operates and, even more so, happy with the manner in which we have complied with that regime. I do not see a huge risk such as you have described.

Mike Wells: I just want to thank everybody for a very long session, and appreciate the time and the questions. Thank you.

[END OF TRANSCRIPT]