Prudential plc 2010 Half Year Financial Results **12th August 2010**

Duration: 01:50:24

Harvey McGrath:

Right, everyone, I think we should get under way. Welcome to Prudential's 2010 First Half Results Presentation.

I think you will have seen that today the business has, by any measure, produced an outstanding set of results. I think that performance is a consequence of the continued delivery of our strategy, a strategy which is underpinned by a discipline of rigorous capital allocation, of strong risk management and balanced and transparent metrics. I want to give full credit to the Management Team of the Pru not only for steering the Company so effectively through the financial crisis, but for ensuring that we emerged as one of the clear winners and very well-positioned, as you can see, to benefit from the return to more normal market conditions.

That the strong results announced today have been delivered against the backdrop of a first half dominated, as it was, by the AIA transaction I think demonstrates two important things. The first is that despite the real potential here for distraction caused by the transaction we have remained very, very focused on the business and delivering the results that we reported today. Secondly and in a way more importantly these results evidence that Prudential is a fast-growing, well-capitalised, highly profitable business with excellent growth prospects. This underlines the fact that our desire to acquire AIA was not driven by a need to find a solution to a problem within the Group's businesses; rather it was a unique opportunity to accelerate our Asian growth. As such, it was absolutely in line with the Group's strategy and, as a Board, we believe that the acquisition would have generated significant incremental, long-term and sustainable shareholder value.

Now in the event, as we all know, we were not in a position to conclude a deal and, as we made it clear at the time, we not only regret the passing of the opportunity, but the costs incurred in the process. We've worked hard to minimise these and you will see some of that detail in today's disclosures.

Now since AIG rejected our revised offer I, along with a number of other Board members, have met with many of our shareholders to discuss the deal, to discuss the current state of the business and to hear their views directly. These discussions have been thorough, they've been open, they've been frank, they've been constructive and have, of course, been set in the context of the business at large. I can say on behalf of every member of the Prudential Board that we are here to serve our shareholders and, of course, we recognise that we are fully accountable to them.

Our core purpose remains to deliver long-term sustainable shareholder value and to outperform our competitors, and I hope you can see from this morning's results and from the presentation that follows that this is precisely what we have done and it's what we have every intention of doing, as we go forward.

It's now my pleasure to hand over to Tidjane and to Nic to take us through the details of today's results.

Tidjane Thiam:

Thank you, Harvey, and good morning everyone. Today I will take you through the highlights of our results for the first half of 2010 and put this in the context of our strategy and operating principles. Nic will cover our H1 2010 performance in some more detail and I will back at the end to talk about our outlook for the rest and, as always, we will then take your questions. The Executive Team and a number of key people from our operations around the world in Asia, the US, are here this morning and we look forward to a dialogue.

Let me begin with some context for these results. As you know, over the past couple of years we have been focused on rigorously managing the business for clear and consistent operating principles. Our priorities have been to accelerate our growth in Asia, to emphasise growth and sustainable cash generation in the US, to focus on strong cash generation ahead of growth in the UK, and in our Asset Management business the priority has been to generation strong investment performance to underpin our ability to increase assets under management.

The events of the past few months have not diverted us from this strategic and operational focus. As a result of our actions over the last two years, I am pleased to report a very strong set of results across all our businesses. In fact, they are the best ever on all measures and across all businesses.

I am conscious that the main focus of interest over the past few months has been the AIA transaction and following Harvey's comments I, too, would like to say a few words.

It was an opportunity to accelerate our strategy of focusing on high growth markets and I share Harvey's, and the team's, disappointment that we could not complete the deal. I recognise the costs of terminating the transaction and I recognise that they are of concern to shareholders. These costs have been reduced from our original estimate of 450 million to 377 pre-tax and 284 million post-tax.

As a team, we remain energised by the challenge of leading this Company, which continues as today's number show, to have great profitable growth potential, so let us now move on to our first half of the year numbers, which, as I stated earlier, are the best ever on all measures and across all businesses.

Starting with new business, Life new business APE was up 28% and new business profits increased by 27% to 892 million. The average margin across the Group was maintained at 54% and that's important because it repeats the performance of H1 '09, which marked a step change from our 38% in H1 '08..

With strong new business growth, net inflows in the Life business, which are a key driver of IFRS profits, doubled to 4.4 billion and Asset Management net inflows over the period were also 4.4 billion. That's a coincidence but it was our numbers.

Moving to operating earnings, underlying IFRS operating profit excluding the 123 million one-off hedge accounting gain in the US is up 19% at 845; as a progression for the statutory earnings, 19% considering what we've done on EEV and cash is a very satisfactory number on an increasingly important metric for the Group. Nic will cover in more detail later the make-up of the 123 and why we think it should be excluded from the analysis of the underlying.

Finally, looking at the balance sheet, shareholders' funds on an EEV basis increased by 9% to 16.7 billion or 6.57 per share and, as an indicator of our cash and capital generation, which you know we've been using now for two/three years for free surplus, across the Life and Asset Management operations, free surplus increased to 3.2 billion, up from 2.5 at the end of '09, and from 0.9 at the end of '08, so an increase of over 2 billion in 2.5 years. Our returns on capital are high. The IFRS return on equity is 20% annualised.

In line with our progressive dividend policy and considering these results, the Board has decided to increase the interim dividend by 5%. This reflects our confidence in the business and our intention to make sure the dividend grows at a sustainable pace.

These results are just a snapshot of our performance. To take their full meaning they must be looked at over a longer period, which is what I would like to do now, looking at five years of performance.

Over five years we have achieved double-digit growth across all key measures of embedded value, IFRS and cash. We have grown new business profit (NBP) at 17% per annum compound with a significant pick-up since 2008 to over 25% compound. IFRS profits have grown at 15% compound with a significant acceleration since 2008, particularly in Asia. We'll come back to that in the next presentation.

Underlying free surplus from the back book net of new business trade has grown at 40% per annum and each element of our portfolio has contributed to this progression. Asia and the US have generated strong profitable growth. The UK has produced good cash generation and our Asset Management business in the UK and Asia have contributed also strong profitable growth, so delivering across all these measures over a sustained period is, we believe, a real testament to our strategy and an indication of the value we have created.

Another way to look at this is to assess total shareholder return, which we're doing on this slide, over ten years from 2000 onwards. The total shareholder return we have generated has been above that of our European peers. Even if I can't really say that over the beginning of this, but over ten years it is a fact. From June to July 2010 our total shareholder return was 37% ahead of the average for our peer group, as it's defined on the slide with AXA, Allianz and many others. As you can see, most of that outperformance has come since 2008, so let's try to get under the reasons for this?

Again our key priorities have been clear, to accelerate growth in Asia, build on our strengths in the US, participate selectively in the UK, so we clearly balance new business writing with cash and capital, and optimising our Asset Management performance. These have remained broadly consistent since 2006. However, since 2008 we insisted and defined some operating principles, which we have been implementing, I believe, with rigour.

First we decided to take a more balanced approach to performance management across EEV, IFRS and cash with an increased emphasis on IFRS and cash, and that happened for us in 2008.

Second, we have focused rigorously on allocating capital to the highest return opportunities.

Third, we took a much more proactive approach to managing risk and capital across the cycle, so let's look at each of these three in turn, starting with the metrics.

Our Group historically – and it wasn't alone in that, I think it's fair to say most of the sector – was too focused, I believe, on embedded value at the expense of other measures leading sometimes to growth without real value creation.

From 2008 onwards we were explicit with you that we would manage with a much better balance across EEV, IFRS and cash to ensure value creation over the long-term, and we maintained this stance because there was an overall emphasis on EEV; we're not saying EEV is worthless. That's not at all what we're saying. We think it's important to optimise all three of them.

Since 2008 we have also realigned our management incentive structures and we haven't talked a lot about that publicly, but we have to reflect this new focus on IFRS and cash, and the specific role we assigned to each of our businesses and this has had an impact on our performance, as we'll see later on.

We have also increased and improved our transparency and disclosure. We've put in considerable effort over the last two years to improving our IFRS and cash disclosures, and I hope you've seen that, instead of moving to MCEV and I expect this emphasis on IFRS and cash to continue.

Moving on to capital allocation, life insurance companies have in-force books, which generate large amounts of cash. The challenged that we all face is to make sure we allocated capital in a disciplined way and in line with our strategy. Central to this is the Company's understanding and management of its business trend. We have been explicitly focused on this since 2008 and have updated the market regularly on the evolution of this important KPI. Our focus on capital efficiency has had a significant impact on the way we run our business and on our results.

In H1 2010, as we show here, we generated sales that were 40% higher than in 2006. During that same period we grew our new business profits by 90%

with an absolute new business strain actually lower than H1 2006, so we almost doubled new business profits while reducing the new business strain.

A number of actions taken right across the Group allowed us to achieve this step-change, so looking at each of our major businesses in turn, starting with Asia.

Asia, as you know, is our preferred destination for capital. It does not mean, however, that our discipline there is any less strict. As a result, we closed Japan to new business early this year and you will see in our numbers that we have significantly reduced volumes in Korea.

If you take the US, we have restricted GICs and capital-intensive fixed annuities and focused on more capital efficient VAs, and in the UK we are becoming increasingly selective in participation, applying a high hurdle to writing bulk annuities, closing our lifetime mortgage business, managing individual annuities for value and refocusing our corporate pensions business.

Another way to assess distribution is to look at how much post-tax new business profit we have generated for each Pound invested in new business across the Group over time.

Here, again, you can see a strong progression since 2005 with a clear inflection from 2008 where this ratio increased from 1.2 to 1.9 – an increase of more than 50% in two years. Overall, this ratio has more than doubled over five years.

Let's look more closely at the last three years. During that period we increased NBP by 59% whilst consuming 1% less capital. Our focus on capital efficiency has had consequences for our geographic allocation of capital as well as on our product allocation. If you look at 2008, you can see here that we were investing as much in the UK as we were in Asia in absolute terms. In 2010 we invested almost four times more capital in Asia than in the UK. Clearly Asia remains our preferred long-term destination for new business capital and its share will only continue to grow in the future.

During the last two years we have invested high levels of capital in the US in light of the exceptional returns available to us there at this point in the cycle, but we will not hesitate to lose market share if conditions were to change.

In terms of products we've focused overall the business more explicitly on retail and de-emphasised wholesale businesses. We are now, essentially, a retail shop which is the risk adjusted returns for our shareholders are the highest. As you can see, our approach to capital allocation has changed significantly and the same can be said about risk and capital management.

As you know, we've been proactive in managing our capital position throughout this crisis. We're in the strong absolute and relative position with a cover of 270% and we are able to take advantage of the growth opportunities that we see across the board such as UOB in January, which we signed.

Since the end of 2008 the IGD surplus has increased from 1.5 to 3.4 billion despite over the period credit losses of 1.4 billion and after putting aside an additional 1 billion to take credit reserves in the UK to 1.7 billion, so overall a net increase of almost 2 billion whilst absorbing in excess of 2.4 billion of negative [rewards].

Our prudent approach also applies to the dividend which we have been able to grow throughout the crisis and not cut. We continue to monitor our key risks and to take action when necessary. For instance, during the first half of this year, and we'll talk about it later in more detail, we have taken advantage of the more normalised credit market conditions to further de-risk in the US, cutting our exposures to RMBS, to high yield corporates, to European banks and increasing our holdings of US treasuries. We have also undertaken some de-risking in the UK credit portfolio and we believe that strengthens our position, given the macroeconomic uncertainties we're facing.

I have covered each of our operating principle, use of balance metrics, disciplined capital allocation, proactive risk management and I will now move on to make a few comments about each of our businesses in turn.

Starting with Asia where, as you know, we've built a strong business over a long period. We have a broad presence across the region, a large agency force and a trusted brand. As a result, AP, NBP and EEV grew strongly, but the IFRS profile always raised questions about the overall value creation of our Asian businesses. Over the last couple of years, Barry and his team have made significant changes in the business, sowing the seeds for future value-creating growth. We have put great emphasis on the high growth high return markets of Hong Kong, Taiwan, Philippines, Vietnam, Malaysia, Indonesia and Singapore. It's what we call South East Asia plus Hong Kong (seven key markets). We have continued to grow the agency force as well as improve its productivity. We have also increased our bancassurance distribution, renewing and extending our agreement with Standard Chartered and signing an agreement with UOB covering Singapore, Thailand and Indonesia, which has contributed very well to the numbers you've seen this morning.

Bancassurance will be increasingly important as Asian customers become wealthier and therefore it is a key area of focus for us. I'm sure you've seen that bancassurance sales have grown by 42% in the first half.

On products we have moved the mix towards health and protection supporting overall margins, and improving, of course, IFRS earnings and cash. As you can see here, the business has enjoyed extraordinary growth, being ten times larger in terms of APE than a decade ago, but the changes we've made during the last two years have also had a big impact on IFRS profits. As you can see here, they are now 3.5 times what they were in 2008. We've cut a number of places where we were taking negatives such as India, Korea and Japan and with a growth of the in-force book, generating increasing flows of IFRS profits and that's really transformational. These earnings are finally becoming commensurate with the scale of our Asian business.

If we go a bit further down in Asia, our focus on the seven countries I mentioned and Hong Kong has continued to pay off, and that's the blue bar here. These markets in blue have achieved 46% growth on aggregate at average margins of 72%, which we believe validates our strategy. By the way I believe that there is a lot of implicit exposure to China in these markets and in this group – that's a question we often get and that's a fact.

There were also good performances in Taiwan, as we develop our bancassurance relationships there, and in India and China. A very important dimension of the Asian insurance landscape, of course, is distribution. In aggregate both the agency and bancassurance channels continued to make very good progress. Average active agents numbers, that's a fundamental statistic for us, across the region excluding India grew by 15% compared to H1 '09. The average APE per active agent has increased 28% in the same period. Finally, bancassurance, as I said probably too early, continues to grow very fast with 42% growth of APE. That's all very encouraging.

Simply, Asia offers us large growth and large return opportunities in the insurance sector and will do so for a generation or more.

Moving now to the US, Clark and the team there have remained focused on long-term value creation, putting value ahead of volume, maintaining pricing and hedging discipline, and delivering excellent service with a low-cost platform. Over the last ten years we have enjoyed strong growth in VA sales, but, as you can see on the bottom left chart, between H1 '07 and H1 '08 our VA sales actually fell by 20%, and that was deliberate. We were willing to accept lower market share in the face of uneconomic pricing behaviour, which prevailed in the market at that time. We do not run our businesses for volume or for market share, but for profit. We all know that a number of players paid a high price for their actions during that period and we are simply benefiting today from that market dislocation.

Clearly, distributors are rewarding VA producers who have maintained a consistent availability of a product and their service throughout the cycle. We have always had stringent return criteria when it comes to adding distribution. We will not change that, but we are adding more reps, more representatives and increasing our penetration. We have had a successful launch, as you know, with Merrill Lynch and we have been building our distribution with Wells Fargo and American funds.

What is going on now is exactly what we expected to happen at this point in the cycle. We are simply opportunistically capturing as much of this volume as we can at good margins. The high net flows we have seen over the last 18 months are already resulting in an increase in IFRS profits. However, we will not hesitate to back away if uneconomic behaviour returns to the market.

There has been speculation about the true drivers of our growth in the VA segment in the US, so what I've done here is that we show you the consistency of Jackson's pricing for GMWBs (in red) compared to the average of the top 15 competitors across the cycle and it's interesting to see how much the average moves.

Here is some clear evidence that the increase, some will say the surge, in our volumes is not the result of changes in our approach to pricing, but rather the result of changes in the behaviour of our competitors and of our distributors.

We have remained constant. Our variable is not price; it's volume. We will lose market share when the pricing is uneconomic and regain market share when people pay the price for having priced uneconomically. It's a very simple story and that's how the cycle unfolds in the US.

Let us now look at the UK. We are seeing very strong sales and IFRS profits growth in Asia and in the US. Our approach in the UK, frankly, is different. The UK is a relatively mature market with lower growth and lower returns on capital. Therefore we have been selective in our participation, focusing on the few profitable products. We are also in the unique position that we don't need to chase volume and we are less dependant on third-party distribution than our peers. 57% of annuity new business and 39% of corporate pensions new business in the first half of 2010 came from internal customers, so recognising the role of the UK within the Group we have aligned the incentives for the UK Management Team with our strategic objectives in this market for generation of stable cash flows and IFRS profits, and continued capital strength.

Rob and the team continued to deliver against these objectives and these were sustained by a continuous drive for increased productivity. We have already achieved the original…well, we are confident that we'll achieve the original 195 million expense saving target set out in 2007 in 2010 a few months early and we will continue to increase our productivity. Sorry, I haven't been clear. Let me say this again. We have achieved the original £195 million expense saving from 2007 six months early and we will continue to increase our productivity beyond that.

All these actions together have led us to produce margins and IRRs that are strong in the context of the UK market. Equally important, the cash transfer to the Group has increased, as our shareholder business has gained scale and through our greater discipline in writing business, a swing of over 200 million in four years and a positive 61 million now. In total, including the with-profits transfer, the UK business is a major contributor to the Group's cash generation, capital strength and ratings.

Moving finally to Asset Management, M&G has had another strong half year. This almost may look like an Asian curve, but they are M&G. This looks like Asia, but this is a continuation of a long track record of success over the last decade for Michael and the M&G team. What this side shows you is the average monthly gross (in blue) and net (in red) retail sales, which have been positive in all periods. We have a real step up here again in the last 18 months. M&G has been the UK's leading retail fund manager, as measured by net flows, in each of the last six quarters. The key driver of this, of course, is sustained investment returns and the long-term performance of our flagship equity bond and property funds, and a number of emerging funds have been strong.

Delivering strong performance across all asset classes, and that's what we're showing you here (equity in red, fixed income in dark blue, property in light blue), is crucial to the M&G model, because it enables us to attract flows at all points in the economic cycle, as demand, especially retail demand, naturally moves from one asset class to the other.

Finally, Asset Management in Asia where I think there is significant untapped potential and upside for Prudential.

In Asia we have a solid base with £46 billion under management across the Life and third-party business, and with broad market coverage. It is a very attractive market where raising affluence will drive continued growth. It is a high margin, high return business and, as you know, with low capital requirements, so we will continue to focus on the retail market, which we have found very attractive. However, in addition, we believe that we can increase our penetration of a fast-growing high net worth segment, which now accounts for around a third of retail firm in the region.

There is also potential in the institutional market where we have already a presence. This is one of the most attractive growth opportunities for the Group. At the beginning of the year I have appointed Graham Mason as Head of our Funds business in Asia. He has moved across from M&G to lead that business, and has been making good progress with profits increasing by 71% in the first half to £36 million; we were about 20 last year.

Before I hand over to Nic, I would like to make a few points. Our strategy is sound and we have implemented our operating principles with discipline and good results. Prudential is a high performing business with IRRs, payback periods and returns on capital that compare favourably to any life insurer globally. We provide excellent exposure to some of the strongest growth markets in the world. We balance this profitable growth with proactive and sounds financial management, and are realising the profit promised from the back book. We generate a growing and sustainable benefit, and we have grown strongly on all measures over a five-year period and the momentum is very good.

With this I will hand over to Nic.

Nic Nicandrou:

Thank you, Tidjane. Now that I've done my usual party piece when I follow Tidjane, let me say good morning to all you here this morning.

In our sector, sustainable value is created by simultaneously growing new business profits, IFRS earnings, cash and capital. This is exactly what we have done and, as you can see on this slide, we are reporting strong improvements in all of these metrics with all of our businesses reporting higher profits.

In the first half our EEV operating profit was up 35% to 1.68 billion, underpinned by a 27% growth in new business profit to 892 million, as we continue to build on the powerful momentum we created in 2009.

Our headline IFRS operating profit of 968 million includes the benefit of a net equity hedge accounting gain on our VA book of 123 million, which will reverse over time. I will cover this in more detail later, but it is appropriate to disregard this gain in assessing our underlying IFRS performance, which was up 19% to 845 million.

Our focus on cash generation from our growing back book coupled with our disciplined approach to new business strain has delivered an impressive 63% increase in operating free surplus from our Life and Asset Management businesses to 947 million. This more than covers our central interest and dividend outgoings, and enhances our capital flexibility going forward.

I'd now like to focus on the increase in new business value that our franchises have delivered in the first half of 2010. As you can see, our Group-wide new business profits have grown by 27%, which in absolute terms is nearly 200 million higher to 892 million. We have maintained our overall margin at 54% and we're pleased to have achieved our strong 2010 volumes growth without giving up any of the margin gains from 2009. We balanced carefully capital consumption and value optimisation, and we have remained disciplined operationally in our emphasis on geographies and products with the highest IRRs and shortest payback periods. As Tidjane has already covered, this has enabled us to achieve the reported uplift in new business profitability whilst consuming a broadly unchanged amount of capital compared to last year.

In Asia new business profits rose by 38% to 396 million and margins improved to 56%. Health and protection products remain the key source of value, accounting for over half of Asian new business profit and continue to grow strongly.

The 1% increase in margin is due to a shift in country mix towards the more profitable countries of South East Asia including Hong Kong. We have included in your packs our normal disclosures on country-specific margins, movements between periods at a country-level are principally due to changes in product mix.

In the US average margins have declined to 64% due to the impact of the narrower spread environment on our fixed and fixed index annuities. Nevertheless, we have grown new business profit by 24% due to the success of our VA strategy where margins have been maintained.

In the UK our value-based focus on annuities and with-profits and our withdrawal from equity release resulted in an 11% growth in new business profit, and a three-point improvement in margins to 35%. What is even more impressive is that the higher profitability was achieved despite the significant reduction in invested capital, as indication of our UK strategy and the execution skills of Rob and the team.

The internal rate of return and payback periods in all of our markets, which are summarised on the right hand slide of this slide, remain in my view the best in the sector.

Let's take a closer look at the US where there has been the most movement in the year-on-year margin. We held our variable annuity margin at 71% as the impacts of lower spreads on the guaranteed funds was offset by an increase in the proportion of customers electing guaranteed benefits. As you can see VA margins are now 22 percentage points higher than the same period in 2008.

The step up in profitability is due to the following three factors, each contributing roughly a third of the increase. 1) The greater proportion of customers seeking downside protection at the point of sale by electing more optional VA benefits. To give you an example, the take up rate for guaranteed withdrawal benefits in 2010 was 88% compared to 68% in 2008. 2) Re-pricing activity in the form of selective reduction in the level of guaranteed benefits offered by Jackson. 3) The more favourable policyholder behaviour on the utilisation of these guaranteed benefits.

Looking at fixed and fixed indexed annuities, margins for these products have declined as a result of the significant contraction in credit spreads that we have seen over the course of the last year or so. The combination of higher capital usage and lower margins has seen us de-emphasise these products in favour of the VAs. Turning to EEV operating profit, this has increased by 35% to 1.68 billion, equivalent to an annualised ROEV of 16% up from 12% this time last year.

Our Life businesses delivered an excellent performance. Earnings were higher by 34% to 1.75 billion with a strong performance from both new business, which I have already covered, and in-force business up from 612 million to 858 million, an increase of 40%. It was encouraging to see the resilience of our in force book demonstrated once again as experience variances in assumption changes contributed a small profit within the period.

Within this, all of our major businesses reported year-on-year improvements in operating performance. Asia in particular grew by an impressive 60% to 633 million and now accounts for well over a third of the total. Profits from asset management and other businesses were up 43% to 217 million. This reflects the significantly higher fund values as market levels rose, but also clearly benefitted from the continuation of exceptionally strong net inflows of the previous 18 months, particularly in M&G retail and increased sales of the more profitable equity products.

Turning to other items, net charges have increased to 289 million due to higher net interest costs of 124 million reflecting the additional debt raised in May and July last year to manage our IGD position during the crisis and costs relating to our Solvency II implementation project amounting to 22 million. You can expect to see a similar level of Solvency II spend in the second half of 2010, high still in 2011, tailing off in 2012.

Moving on to take a closer look at in force profits from each of our Life operations and starting with Asia, you can see the increase in the unwind and expected returns from 248 million to 300 million reflecting the growing maturity of our back book and lower overall experienced losses and assumption changes of 45 million and 14 million respectively. Our focus on customer retention has seen persistency improve. However, it remains negative at 49 million as we continue to incur experience losses in India, Indonesia, Malaysia and Korea ranging individually from 6 million to 12 million. Given the increasing scale of Asia's embedded value at 6.7 billion, these overall experience and assumption changes remain relatively small. The improvement of the US in force profit to 306 million reflects a greater unwind due to the application of high risk discount and earned rates in the US and includes higher positive experience variances and assumption changes.

The improvement here is attributed to a higher spread profit, which has increased from 38 million to 108 million as a result of actions taken by Jackson to lessen its tactically short asset duration position in the general account. Finally, the higher return in the UK is due to refinement in assumptions related to shareholder backed annuity business.

I summarise on this next slide the movement in EEV shareholders funds in the period which at 30th June stood at 16.7 billion. This is equivalent to £6.57 per share. It is 9% higher than the position at the start of the year and 22% higher than June 2009. Going from left to right and picking out key movements you can see the 1.68 billion of operating profit, a negative short-term investment variance of 227 million reflecting the market weakness in the first half of the year, a -377 million representing the finalised costs of the AIA transaction. This is lower than the 450 million estimate we announced on 2nd June and reflects the actual exit cost of the currency hedge, which was lower than we had anticipated and the final settled amounts relating to bank underwriting fees and other advisor costs. After tax deductions the final cost to shareholders is 284 million. Further along the waterfall you see the 318 million cash payment of the 2009 final dividend, which had a lower level of script take-up compared to prior years and the positive impact of the 8% appreciation of the US Dollar was generated at 798 million for an exchange gain.

Before I move on to other metrics I would like to provide you with a high level geographical analysis as of 30th June 2010 embedded value. Asia's embedded value of 6.7 billion is the largest contributor to the group and accounts for approximately 40% of shareholders funds on this basis. The Asian share of embedded value has grown significantly over the last five years from 1.6 billion to 6.7 billion representing a compound annual growth rate of 33% and the 17% annualised ROEV that Asia has developed in the first six months of 2010 shows that this trend is ongoing and will be the key driver of the Group's embedded value growth over the coming years.

Turning to IFRS results, we delivered an improved underlying operating performance of 845 million, up 19% from 2009. Our headline figure of 968 million includes the benefit of a 123 million net equity hedge gain on our VA business which I explain on this next slide. This gain arises due to the differences in accounting between the derivative held to manage equity risk, which are fair valued, and the associated VA guarantee liabilities, a substantial element of which are not fair valued. It is not our practice to hedge VA guarantees on an amounting basis. As Clark explained this time last year, we hedge all VA embedded guarantees together with related fees on an economic basis through a combination of options and futures after taking into account the natural offsets in the book. We regard this as the most appropriate way to manage these risks, which delivers a technical profit over time and we accept the inevitable accounting volatility that ensues. This accounting gain or loss is more pronounced in periods of high equity market volatility and over the last 18 months has become more significant due to the large take-up rate of GMDBs and GMWBs for Life options, the reserving for which is insensitive to market movements. The combination of these two factors has produced a larger than normal IFRS movement of 123 million in the six-month period. I'm happy to take questions on this later, but the key point to note is that this is purely an accounting gain as opposed to an economic profit and it will over time unwind through the profit and loss account with a net cumulative effect being broadly neutral. This is illustrated on the table on the slide which shows that the accumulated impact on operating profits going back 30 months is a 35 million net profit. Given the increased materiality of this effect we will be revisiting our accounting treatment in the second half of this year.

Going back to look at the makeup of our IFRS results excluding this item, the overall performance is underlined by strong profit from Life businesses which are up 19% to 893 million. This healthy increase in profits is more pronounced in our Asian and US businesses which I will cover in more detail on the next slide. I have already commented on the performance on asset management and on other expenses. Clearly, both of these also flow through the overall result on this basis.

On this next slide I'll break out the contribution of each business to the Life result from 2008 to 2010. Taken over the last two years all three regions have reported improved profitability, Asia being the most notable, which now contributes more than a quarter of the total. Asian profits in the first half of 2010 are higher by 25% at 259 million. The improvement continues to be driven by the fast growing in force book which continues to benefit from strong positive net flows, lower absolute levels of new business strain despite the sales growth, a richer mix of health and protection business and the actions taken to turn the younger businesses into positive contributors to IFRS profits.

Turning to the US, excluding the effect of the net equity hedge gain, IFRS operating profit is higher by 36% to 327 million. Fee income has increased as the improved equity market in the latter part of 2009 and early part of 2010 coupled with strong inflows into the VAs have led to a 69% increase in average separate account balances. The US result also benefits from higher spread profits, which arise from the asset duration lengthening I described earlier and from selective crediting rate reductions implemented this year.

The UK, the reported IFRS profit of 307 million is in line with last year with contributions from both with-profits and shareholder business broadly unchanged. Core to the increase in Life profit in Asia and the US is the continued growth in the policyholder liability results. This next slide shows the roll-forward of liability reserves for shareholder backed business in the first six months of 2010. As you can see, net inflows which represent premiums received less claims paid were positive in all of our life operations and amounted to 4.4 billion double those in the first half of 2009. Asia's continued strong net inflows reflect that heavy bias towards regular premium, new business and high customer retention. This is an important feature of the Asian market and provides a strong underpin to earnings growth. Jackson continues to experience minimal outflows on annuities and in the first quarter of 2010 ranked first in the US sector for variable annuity net inflows. This is a result of strong cycle management by Clark and the team and the reserve growth that has resulted has driven our earnings higher in the first half.

The other feature of our 2010 life IFRS results is the more balanced mix of the sources of income. This is illustrated on this next slide which depicts both the absolute growth and the contribution of the various IFRS sources of income to the total. The key point to highlight is the increasing proportion of insurance income shown the by red bars demonstrating the success of our health and protection rider strategy in Asia. This has improved both the quality and the resilience of our earnings.

The analysis also demonstrates the versatility of our other sources. Income from these sources will ultimately be determined by consumer demand which is naturally linked to market conditions. You can see that in the first half of 2009 when equity markets were depressed and fixed income yields were high we successfully increased our spread income. When the market situation reversed in 2010 we were equally successful in capturing higher fee income on unit linked fund and separate account balances.

Turning to the movement in IFRS shareholders Funds, at 30th June 2010 these stood at 7.2 billion, 14% higher than the position at the beginning of the year and 52% higher than June 2009. Again, going from left to right ton the chart, you see the 968 million operating profit, the 377 million relating to the AIA transaction costs, which I've already commented on, a 419 million positive value movement on Jackson's fixed income securities portfolio and again the impact of dividends paid and foreign exchange translation gain on the IFRS balance sheet.

Moving on to capital and in particular the evolution of free surplus, you can see how our level of capital has increased in 2010. In the first six months of the year the free surplus held by the group's Life and Asset Management operations increased by 28% to 3.2 billion. On the left hand side you can see the free surplus generated by our back book of almost 1.3 billion, which was higher than the equivalent figure in 2009 and reflects both the growing maturity of our business and the disciplined management of our in force book, which Tidjane has already covered. The surplus released by the in force covers the investment new business of 339 million, shown in the dark blue bar, by 3.8 times. During the first half a total of 460 million was remitted to group by these businesses. Our approach here is to remit sufficed amounts to allow the centre to meet its operational obligations with a balance held within each business where it can be deployed more profitably. This is an important distinction and it is for this reason that when we look at our ability to cover our central outgoings including the dividend, we use operational free surplus generated by these businesses rather than actual cash remittances and this is illustrated on the next slide where I have combined the operational flows from the previous slide with the central cash costs in the external dividend.

Our disciplined approach to capital conservation and cash generation has seen free surplus after investment in new business rose by 63% from 581 million in the first half of 2009 to 947 million in 2010. After making the deductions for central cash costs and dividends we have generated an underlying free surplus at an operational level in excess of half a billion, illustrated by the grey box on the right hand side. This remains positive after deducting AIA costs paid in the first six months of 261 million and comfortably covers the remaining unpaid element.

For completeness I show on this next slide the actual operating holding company cash flows during 2010. In overview and in line with our practice of only remitting sufficient cash to cover central operating costs the position is broadly neutral. Net remittances from businesses shown in the dark blue bars amounted to 460 million in 2010 and were 85 million higher than last year's 375 million figure. This reflects an increase in net remittances from Asia and from our asset management businesses and includes positive net contribution of 61 million from the UK shareholder business. Dividend paid were higher a 318 million due to the lower scrip take up.

Alongside the strong performance in the first half of the year we have also delivered an improvement in the quality of the balance sheet. Throughout the period we have maintained a robust capital position and at the end of June our IGD surplus stood at 3.4 billion, equivalent to a coverage ratio of 270%. Our liquidity position at the centre remains strong with over 1 billion of central cash resources and untapped facilities of 2.2 billion. We continue to de-risk the balance sheet during the period. We reduced our overall holdings of bank hybrid debt, more specifically Jackson reduced their exposure in EU and US regional banks by $850 million and the UK shareholder business sold nearly 400 million Sterling of financial debt. We also improved the quality of Jackson's corporate credit book by targeting a range of securities including sub-investment grade corporate bonds and non-agency RMBS. The programme size was $1 billion and as a result only 5% of Jackson securities are now below investment grade compared to 9% a year ago. Jackson has reinvested these proceeds and has directed a proportion of new inflows into Government securities and at 30 June held approximately $4 billion of US treasury bills.

Our credit position has also improved. The 1.8 billion of unrealised losses that we had on our US debt securities from 12 months ago has now gone full circle and is now sitting as a 1.2 billion unrealised gain. Impairment levels have slowed dramatically in the last six months now running at 2007 levels at approximately 50 million per quarter. We have suffered no defaults in the UK. We have maintained our practice of rolling up any unused default positions into our reserves which at 30 June stood at 1.7 billion for our shareholder backed annuity business.

In summary, we have delivered broad based profitability, improvements across all parts of our business and on all metrics. We have continued our strong focus on value and capital, significantly increasing our new business profits while consuming broadly the same amount of capital. The good work that has been done over the last few years in this area is now emerging in our EEV and IFRS results and is improving the balance and the quantity of our earnings. Our free-surplus generation has accelerated in the period and this has enabled us to maintain a robust capital position throughout the first half. I hope you will agree that these results demonstrate that management has safely led the company through the financial crisis and the associated downturn in markets and is now capitalising on the opportunities that are emerging. Thank you for your attention. I would now like to hand you back to Tidjane.

Tidjane Thiam:

In summary, the Group has delivered a strong first half 2010. All of our businesses, Asia, the US, the UK, M&G, Asset Management Asia are performing well and I expect that to continue. Our strategy, as I said, is sound and we will continue to pursue it with the operating discipline that has delivered excellent results on all measures over a sustained period. We have significant opportunities for profitable growth and we have a financial strength to take advantage of those opportunities. We are cautious about the outlook for the Western economies. However, our Asian business gives us a material and powerful presence in the most attractive market in our industry and one that will continue to underpin our growth. We give the rest of the year with confidence given the momentum we have seen in the first half of the year. As we look further ahead beyond the [unclear] half we are well positioned to continue to deliver strong growth and generate strong returns for our shareholders thanks to our operational focus and strong market positions. Finally, and before getting to questions please date for your diaries on 30th November and 1st December we will hold an investor and analyst event in London for a more detailed look at our businesses across the Group, so US, UK, Asia and asset management. We would intend this to become an annual event, so thank you and over to you now for questions.

Greig and I'll go from right to left.

Greig Paterson:

Good morning to you, Greig from KBW, three questions. One is in the light of Mark Tucker going to AIA, could you just remind us when the Standard Chartered distribution deal comes up for re-negotiation? The second question is on the US; you mentioned a while back that at some point your margins in the VA will come under pressure as their competitors get back on their feet, I was wondering if you are seeing any evidence of that in the Third Quarter? The third question is, you have a pretty low dividend yield, you're growing your dividend at 5% per annum, you've spent 18 months, I suppose convincing the market that you've actually got very, very strong cash flow. If the dividend carries on growing at 5%, how does one actually suggest that you invest in the stock, can we expect some kind of upgrade in the future?

Tidjane Thiam:

Thank you Greig. AIA – the first thing I'd like to say is that we wish Mark well, he was CEO of Prudential for many years and we wish him well at AIA.

Barry Stowe:

On Standard Chartered we don't disclose the specific terms, but it does have years to run and the relationship is obviously very strong and the results are going very well.

Tidjane Thiam:

Hong Kong has recovered very nicely.

Barry Stowe:

Hong Kong has recovered very nicely and you'll see in the First Half Results, that bank is up 42%, so it's outpacing the broader regional growth. SCB obviously is a material part of that. So we wouldn't have any particular concerns about that Greg.

Tidjane Thiam:

Absolutely. You've seen that something like UOB also diversifies our presence, they did 11 million of APE in five months for an agreement that's just starting and they're already comparing interestingly with other positions we have in the region. We're also going to continue to grow that and diversify that.

Margins in the US. Clark, do you want to talk about that.

Clark Manning:

As far as…your question on re-emergence of competition in the US. Six months ago I'd have said there was very little competition in the US, except for a couple of targeted large players. You're starting to see some re-emergence now of people coming back into the market and where pricing had almost over-corrected, where it's becoming more competitive now. None of it is problematic, none of it is anywhere near the line of what I consider to be the irrational competition that we saw in the past, but you're seeing people wander back into the market, yes.

Tidjane Thiam:

The third one was the dividend, which is probably a question we'll get a lot this morning. I have two key points here. The first one is really, the opportunities we have in the business. We always say that we'll re-invest with IRRs at both 20%, paid back around two or three years in Asia. We believe it's very, very attractive and it's possibly a discussion for November/December when we have that invested, but we can drill down into the IRRs and explain to you why we believe that the first destination of those surpluses should be re-investment into the business. We have extraordinary investment opportunities and provided they come back fast, it is a short payback, they should be rewarding for the shareholders.

The second one is that we really stress test our dividend, it's something I insisted on when I was here before and I think Nick is continuing that. 5% is a sustainable increase, at a sustainable pace. What it means is that you adopt a pace that, it doesn't insulate you, but protects you against the volatility of the world economy and that's what we try to achieve and that's very important. So when you see us putting out an increased rate, it's really robust. The dividend policy is a two times cover, but we really work very hard to ensure that the dividend is progressive and remains so. So it only goes one way, not the other way.

So I think that explains possibly some of the gap between what you were expecting and what we have delivered. It's the desire to make sure that the balance between growing the business and making sure that the dividend can continue to progress is right. That being said, it's a place where I think there is an upside, but we are cautious and there is still a lack of visibility over the next 12 months and you've just seen what's been announced yesterday, we will see the news. It's better to be cautious, that's the stance we've taken.

Tony Silverman:

Tony Silverman, Standard & Poor's Equity Research. Just a couple of questions on Asia. I wonder if you could talk a bit about the background in India and the Regulatory changes that have happened in recent months or what the outlook means, for you and the market? Secondly, I would be interested to hear a bit more, what you can say, you mentioned that China is, there's a bit of China if you like implicitly included in some of the South-East Asian territories, I haven't heard a lot said about that, other than such remarks. I would be interested to hear what more you can say? Finally on slide 55, there's an 'others' line. Just a small question really, but it seems odd to me that it appears to include Singapore which is your second largest market, or as least it's not mentioned separately on slide 55. I don't know if that's just an oddity, but perhaps you could comment? Thanks.

Tidjane Thiam:

Alright, India, we are very happy with recovering volumes, I think we were 56% in volume in India and that's welcome. The Regulatory environment effectively is challenging in a market where margins are still relatively low. So with that introduction Barry, I'll let you talk about it.

Barry Stowe:

It's a lot of Regulatory change all at once, so it's kind of a shock and our approach to making Regulatory change in normally things like this are sort of drip fed, but the changes that they're proposing, certainly will have an impact on all of the players there, particularly the multi nationals, the foreign JVs.

In the long term I think the changes are positive, in that they are focused on trying to drive a market which has been very, very investment orientated, with very little feature of protection. They're trying to move it towards protection. That's a good thing, that's something we've been trying to do for a couple of years, singlehandedly in our own way, with some effect but not dramatic effect. Ultimately, as Tidjane says, the margins in India are amongst the lowest in the world and the way you drive up the margins are by changing the product mix and offering people more protection. The fact of the matter is, consumers there need the protection as well, because there's not a social safety net. For all the reasons we write protection in other places, it works in India too. It's just none of the companies have ever really focused on it significantly.

In the long run, the changes are good. In the short term they will be challenging to get them implemented. They will require re-engineering in how you distribute the products. You'll tend to see smaller distribution forces but more productive distribution forces. Again, the evolution from point A to point B, will be complicated, but once you get to point B that's a good place to be.

We're actually optimistic and we're particularly optimistic about it, because we think that given the planning that we've done already to respond to this and we have a full operational plan in place to deal with these changes when they arise here in the next couple of months, that what's really going to help is having scale, the largest players will be the most advantaged players in terms of dealing with this. The players like us, we're perhaps the only foreign JV that's actually in a breakeven position now; we generated our first net profit in India for the fiscal year ending March 31. So we're in a much stronger and a much more advantaged position to deal with these changes than our competitors.

I think it's fair to assume that you will see, within the marketplace, you'll see new business volumes taper off some, for a period of time, but in the long run I think it's good for the market.

Tony Silverman:

Noise around it, do you think influenced the sales profile in recent months?

Barry Stowe:

No, not really, there's been some noise around it, but it's really sort of happened rather suddenly and I don't think people had a clear view into what it was actually going to mean, so I don't think it's had a significant impact over the last few months. Our momentum has been fairly steady over the last 9-12 months.

Tony Silverman:

Why don't you disclose the Singapore margins?

Barry Stowe:

Well there's just certain markets where we disclose margins and certain where we historically haven't. That's something I guess we could always re-look at.

Tidjane Thiam:

It's well spotted.

Barry Stowe:

The 'others' includes everything else [laughing].

Tidjane Thiam:

You can tell, between the former CFO and the CEO of Asia, is a very lively debate on this issue, it's well rehearsed, we've talked about it many times, but I'm confident, having some influence on the debate that we'll get to more open communication of this in the future, but it's well spotted.

Tony Silverman:

The China connection, yes.

Tidjane Thiam:

Well that's a very interesting point, because you have this debate on intra-Asia trade and the integration of the Asian economy is to China. Often people talk about China and the rest of Asia and something the Japanese understand very well, they link themselves into China very smartly. If you look at a country like Vietnam, economically it operates as an additional Chinese profit. If you look at the degree of integration between a lot of these economies and the work that the Asian countries have done, the nature of the trade flows is completely different. 65% of the trade now is intra-region.

If you run a regression, you'll see that the GDP of the other South-East Asian nations is very highly correlated with the GDP of China. Many observers still haven't really understood that. We are in places where we are getting very good growth, we're benefiting from China and we have no problem extracting dividends and capital flows etcetera, so maybe it's not such a stupid strategy. That's all I was trying to say.

John Hocking:

John Hocking from Morgan Stanley. I've got three questions please. Can you explain how you get a two year payback in the US. Just in simple terms, what cash is going out in terms of the commission, locked up capital etc and what fees are you earning in the products in two years, because it seems a very, very short payback? Secondly, on the bancassurance in Asia. Long run, is that a threat to margins. How do you see the margins on bancassurance versus the proprietary channels? Then just a final question; I may have this wrong, but I think from memory, you had £1.6 billion at the Holdco at year end, now you've got just over a billion, obviously the AIA fees have come out etc, and the divi has come out, where do you think that cash position will be at year end?

Tidjane Thiam:

Okay, thank you, very good. Payback of two years. I'm going to go to Clark, but how much time do we give you Clark [laughing]?

Clark Manning:

We'll do 30 seconds here and more later. At a high level, commission on the product is 7.5%. The initial surrender charge on the product is 8.5%. We get an expense allowance under US Regulatory accounting, not to exceed the surrender charge on the product. So that and some of the Regulatory required capital in the RBC formula unwinding after the first year of the contract, causes the VAs to payback very quickly. The aggregate fee structure is about 180 basis points on that, so the fee structure is healthy as well, but I'd say the dominant feature is just that the expense allowance that we get is healthy, because the surrender charge is healthy and it's supportable by the fee structure, so we're allowed to take it.

John Hocking:

Effectively, you can basically cover the commission from the deductions on day one, from the product?

Clark Manning:

Yes, you can, and you pay for it out of the fees and your Regulatory accounting.

Tidjane Thiam:

Or it wouldn't work from a cash perspective.

John Hocking:

Where do you think VA payback periods were back in 07/08 to the market, because that two years just seems very, very short?

Clark Manning:

For us they've always been relatively short. We increased our surrender charges at one point in time, to shorten them, in order to have better recoverability of the acquisition costs, but variable annuities have never been that capital intensive. Really what has impacted the capital intensity of the US business, is the shift from the general account products which have much longer paybacks to the variable annuities, where the variable annuities are now 75% of our writings. That's what you're seeing.

Tidjane Thiam:

Bancassurance margins. Effectively, if you look at margins, bancassurance looks lower, but the returns on capital are good and that's really what we look at. So, look it's a discussion we're also having internally and I think we will need probably again in November, to give you a better sense of that, value creating business there's no doubt about it. Optically it looks lower margin than agency, but it's still good business and it's creating value, it's covering its cost of capital.

Barry Stowe:

Important to remember too. The definition of success is absolutely NBP not necessarily margin. We work very hard to keep margins high and to drive the business as hard as we can, but it's absolute NBP. The bank business is growing faster, but margins still go up because…also important to remember when you look at our bank business, it's a little distinctive compared to what most people do, which is almost purely deposit stripping through bank staff. A huge chunk of our business comes from our own staff embedded in the branches, who are selling recurring premium, unit linked life product with riders. So that supports the margins. That means that while our margins for bank are lower than they are for agency, they're higher than most other competitors margins are for bank. I would infer from your question, you're assuming that bank will overtake agency as a distribution channel. While it's coming on very strong in some markets, don't count agency out yet, it's got a long way to run and it's still also growing very fast, but bank is growing a little faster, but it's not a big difference.

Tidjane Thiam:

Our projections, it was 37/42 the first month, 37% agency, 42% bank assurance. It's going to be like that. So the 37% in the global world of insurance, we,ll take that agency growth in Asia. So both will grow with one growing faster than the other, but agency has many good years ahead of it. Cash, yes, 1.6 billion, yes, we've paid the dividend, we've paid UB, we've paid the AIA costs. It's gone down, but we're confident that it's going to rebuild. Nic you can give more colour if you wish.

Nic Nicandrou:

The central cash position at the start of the year wasn't quite 1.6, it was just shy of 1.5. It had increased last year because of the issuance of hybrid debt, which we said we raised to support the IGD position during the crisis. The full reconciliation is given in your packs. It's now sitting at just over a billion, as I said in my presentation, we're not uncomfortable with that level, historically we've managed it in the range of below a billion to around 1.5, but we're comfortable with that position.

Tidjane Thiam:

Next question from Blair.

Blair Stewart:

Thanks very much, Blair Stewart, BofA Merrill. Two questions. One for Clarke and one for, on Asia for Barry. On Asia, given AIA is going to be a listed company, in all likelihood under a new CEO, how should we assess the risk of management or agent drift from PCA to AIA, what protections are in place, particularly on the agent side? In the US for Clarke, we've seen a couple of your competitors taking charges because the hedge costs are above what they're able to get in fees and we've seen some [VAT] current locking as well. Just wonder how you can avoid that. You said that your price more or less stays the same, when clearly the price of the hedging is going up. Just if you can talk around that, how you've avoided those losses and what the hedging costs are doing at the moment?

Clark Manning:

It's more complicated than what was in the chart, we've got a whole lot of information there under one chart. Hedge costs are part of it, but the benefits or rather the fees charged for the benefits is part of it, but the benefits that you're providing for those fees, is the other part of it. What we've been doing is, we didn't take charges up, because we think when the costs of these benefits goes above 100 basis points, the saleability of them goes way down. Instead, what we've done, is taken the benefits in, reduced the richness of the benefits as the hedge costs have gone up. So we've been doing that in order to keep the benefits hedgeable within that cost.

If you charge an adequate fee, you can afford to hedge the economics and we've always been very focused on charging an adequate fee. So that we're able to hedge the economics.

On the DAC, as you know we're outside of the corridor. So DAC moves around with the market, our current sensitivity is about $9 million worth of DAC per 1% move in the equity markets. So I think we took a hit yesterday, but we'll stay outside of the corridor for some period of time, so that will be our DAC sensitivity and it's really, it's just as simple as that on the DAC.

We're not anywhere near any recoverability issues, our K-factor on our variable annuities is 63%. So we're nowhere near a recoverability issue, where we've actually had to take a DAC charge other than the normal equity market movements.

Tidjane Thiam:

But I think we disclosed the number. If we eliminated the mean reversion.

Clark Manning:

Yes, mean reversion would be the other question, the natural follow-on. If we eliminated it, it's a $160 million charge to book value, so it's just not that materially effective, it has potential to smooth the DAC period-to-period.

Blair Stewart:

That's great. Can you give an example of, can you give an example of how the benefits have come down in the VA product?

Clark Manning:

Yes, I can, we've taken our…we used to have for our roll-ups, when people aren't accessing benefits, we used to do a 7% simple interest 10-year roll-up and we reduced that to a 6% simple interest 10-year roll-up. Also we had on one of our more popular benefits, although this change really applied across most of the book, where you could access 5% of the money per annum, beginning at age 45, that's now at age 65; these benefits are more expensive at the older issue ages. We reduced commissions at some of the older issue ages to increase margin or make the sale at those ages less attractive. So this would be some of the tangible things that we've done.

Tidjane Thiam:

There was a question for Barry on AIA and agent retention?

Barry Stowe:

The downside of fast growth and success and so forth, is that people are always crawling all over our team. I think our team is widely viewed as being the strongest in the region. So our guys get phone calls all the time. If it wasn't AIA it would be AXA or Manulife or pick a name. I think AIA's listing doesn't necessarily given them, that doesn't transform thing and make it easier for them to recruit. I think again, it's always somebody and it's almost constant. Yet, we have always been a net importer, certainly of agent talent and we've not lost any senior people to a competitor, people that we felt were strategically important to the business in years. So, it's something that we certainly take seriously. Again, it's the downside of success, so it's something you have to watch very closely.

Our compensation systems are…there's a big element of our compensation systems historically that have been focused on retention, those remain in place, but a lot of it is actually about the environment as opposed to compensation. There's a reason why we've been able to attract the people that we've been able to attract; and it's because of the sort of empowered culture that we have, the success of the organisation, the energy and ambition of the organisation. I don't see those things fundamentally changing. So we'll certainly watch it and as we always have and we'll watch it even more closely in the future, but it's not something that I think we need to be unduly concerned about.

Tidjane Thiam:

I think one of our most effective protection is our growth. As long as agents are successful with a company, they are pretty good at NPV calculations and they understand where the economics are. Then when you see Hong Kong up 37%, India 56%, Indonesia 54%, Malaysia 48%, Philippines 131%, Singapore 45%, Thailand 59%, that's how we keep our agents. They are successful, successful and they make a lot of money, they're happy.

Andrew Crean:

Good morning it's Andrew Crean from Autonomous Research. Three questions. Firstly, could you comment on your relationships with the FSA and how seriously you might consider re-domicile to Hong Kong, either for an easier capital regime or a better rating? Secondly, could you talk about, instead of IGD, your internal capital models and how those are fairing, particularly in relationship to low interest rates? As an adjunct to that, could you talk a bit about guaranteed annuity options and the crediting rate on your US variable annuities? What are the key sensitivities, is it to do with allocations between equity and fixed interest buckets, or what are the key factors?

Tidjane Thiam:

The FSA, we have a good relationship. Clearly it was a factor during the AIA transaction, but to be open the issue there was more I think the complexity of the transaction and the issues that had to be resolved, rather than a relationship issue between the FSA and us. We have a good relationship. Operationally I speak every two weeks, we have a call which is minuted, between myself and the lead regulator and the FSA. I actually do the same thing with the Hong Kong regulator and with others. Overall the relationship is good and you can imagine the number of issues we discuss at any point in time, it is very large and it is a good dialogue.

The domicile is an important question from a shareholder value perspective. It is something that the Board looks at regularly. We look at the issue very closely, we invest resources in it. So far I have got a review as always, concluded that London was the right location for the Group and it is something that we review regularly.

IGD in terms of capital models, I am looking at a combination. Maybe we will take GAOs because that is specific. Clark if you want to talk about the GAOs and the impact of lower rates and then we can talk about the internal capital model between them.

Clark Manning:

The impact of lower rates and you're asking with regard to the VA Book and the VA General Accounts. We have moved VA General Accounts to the NAICs floating interest rate minimum calculation which in periods of low interest rates like what we have right now, if you have structured your products to comply with those; that is like around 1.5% or something like that right now. We are crediting at or close to those guarantees. We have got between 10 and 15% of our VA money in the general account right now to trade off between the cost of the money and that general account, and the positive impacts it has on the volatility of the accounts due to the reduced equity component. We have got around 20% of the money right now flowing into those accounts, but some of that Dollar cost averages out. It is all in there, it impacted our margins, because we're making obviously much less margin on that general account business than we were previously, and that was one of the big aggravators in being able to hold our aggregate variable annuity margins where they are at present.

Nic Nicandrou:

The other place we have guaranteed annuity options are in the UK, those are in the with-profit fund and the estate which we put up on the slide of 5.9 billion, is effectively acting as an effective buffer in terms of absorbing any additional guarantee costs which have increased as interest rates have fallen.

Tidjane Thiam:

On the internal capital models, you want to know where we are in developing them or what their…

Andrew Crean:

I just wanted to know how great is your coverage on your own internal capital models and how that has moved since interest rates came down.

Nic Nicandrou:

Our coverage remains healthy. We haven't published information, so we aren’t required to do that and therefore that is to come. The point I would though make is that this goes back to the point I was making during my presentation, when you look at the improvement in the balance sheet. The much greater component that comes from pure risk business, acts as a diversifier to some of the risks that are associated with low interest rates on our spread business. It is just to bring that into the equation.

Tidjane Thiam:

We have also seen the flexibility we have in crediting rates in places like the US which has been a big factor I think and I showed that the sensitivity is actually less than people really think.

Andy Hughes:

Andy Hughes, Exane BNP Paribas. A couple of questions if I could. First one on that point to do with the US General Account spread business. It stayed about the same amount of money in US Dollar terms for the last five years or so. It sounds a bit like you're increasing the liquidity in the asset portfolio behind it and reducing the crediting rates. Is the idea to shrink the spread business in the US and where are we now with crediting rates on the fixed annuity book etc?

The second question was on new business strain in Asia. Obviously it is quite a lot lower than possibly you might have expected given the switch towards bancassurance. Is bancassurance in Asia a lower strain product than the other products that you sell. Could you give us some background as to why the new business strain is so much lower as a percentage of the premium in Asia this time around.

Tidjane Thiam:

Do you want to take the fixed annuity business in the US Clark?

Clark Manning:

General account in the US has been flat for quite some time, and that was by design. It wasn’t an explicit target to keep it flat, but an explicit target to grow our fee based business at the expense of the general account business. We’re not trying to get it into negative cash flow or anything. If you look at net flows on the general account products they're about flat. I think if it stays about where it is that would be a comfortable range. I wouldn’t want it to go into net cash outflow, despite the gain in the portfolio. I think we’re comfortable. If you're balancing the risks in the US business you want to keep some spread component there, because you're more resilient from a capital standpoint, you're more resilient from a cash flow standpoint; you need the general account to help finance the acquisition costs of the fee based businesses. People that have tried to go straight separate account without general account have run into problems in that regard because you're dependent on the securitisation market for the variable annuity fees and we don't want to get to that. Not a target to drive it down really from where it is today. You would like to maintain spread income about where it is and then grow the fee income, so that we get a better balance that way.

Tidjane Thiam:

We're always looking for that balance between spread fee and underwriting. I think that is absolutely right. New business strain in Asia, do you want to take that between Barry and Nic.

Barry Stowe:

Let me make a comment and then Nic can comment as well. On the bank issue specifically, again you have to remember what it is we're writing through banks. Most people that are focused heavily on bank business are writing deposit stripping, two-pay, three-pay, five year endowment with a guarantee and they're chewing up a lot of capital in doing that kind of business. A majority of the business that we write through banks is not deposit stripping product, it is regular premium, recurring premium unit linked with riders. That is why our margins are higher and that is why our strain is lower in the bank channels. There is bank and then there is bank and we just do it a little differently than most, and that is why our numbers look a little different than most.

Nic Nicandrou:

Just to expand on that, there will be differences in strain to reflect if you like the size and the shape of the commission payment, but to Barry's point that is the biggest driver, or the biggest influence to the total amount is mix.

In terms of the reduction in the absolute amount of new business strain, some of that has to do literally with stopping writing business in Japan. That was consuming a lot of our capital, and slowing down the business that we have been writing in Korea, which was also a large strain on that particular metric. It just goes back to being absolutely clear about where we can deliver the most profit using the least capital in Asia. It is linked to that philosophy and the operating principles that Tidjane described earlier in this presentation.

Andy Hughes:

Is there some way of working out where the underlying new business strain has moved from last year excluding the fact that it was in Korea and Japan.

Tidjane Thiam:

I think we can help you with that, I think offline, but I think the point is really important. For me this whole thing about discipline, it is really binary. Like in some places it hurts you very much. All we have done on the IFRS; I was shocked when I saw -40 just from India. Locking that down, stopping Japan, I think it is absolutely vital. Korea is IFRS positive at I believe for the first time this half year, but to discipline we are enforcing it; and China. When you do that you can see…always focus on the big things but often it is the small things if you don’t get them right and if you let them go who really kill you and hurt your numbers. It is really about discipline across the board that produces these results.

Oliver Steel:

Oliver Steel Deutsche Bank. It is really a question about the fungibility of cash flows and capital. I know that you remit to the centre only as much as you need to cover the central costs and dividend, but I mean to what extent would you be able to raise that remittance? What changes have you seen over the last say 6 or 12 months in local restrictions on capital and cash transfers.

Tidjane Thiam:

It is a very important question. I think in the short term the way we run the Group is the way you described it. You bring to the centre just what you need to cover your costs, central cash costs, dividend etc. That is not difficult. No real impediments to that. When you try to move more capital, our experience frankly is that it is doable, but it takes more time. My personal belief is that over time the medium term capital is very fungible. In the very short term frankly it is not, because you need to get into conversations with the regulators to pay a dividend from here or there, but generally those conversations are sensible and get resolved. We got a 400 million dividend out of Singapore, a special dividend last year, 400 million pounds that is a big amount. It shows what we do. You have to have a good relationship with the regulator, explain what you want to do, and if you're not weakening the business and if you're not threatening the solvency of the business, generally you can move the capital, but it is not automatic. It is not like pressing a button, but overall I think that free surplus generation; that underlying free surplus generations gives you a good sense of the true capital generation, and that capital is mobile. Over a horizon of 12-18 months, it is mobile. Over a horizon of 3-6 months, no it is not.

Nic Nicandrou:

There are no regulatory restrictions in the same way as there were in place when we talked to you about the AIA transaction. Beyond ensuring that you have an appropriate risk capital for the business that you are writing; and that capital is what we’re reflecting in the determination of our embedded value and the cost of capital that is associated with it.

Tidjane Thiam:

But it is fascinating, because we’re not talking abut Asia. What we found in ’08, ’09 at the worst times of the crisis is that we had no tension and no issue with the payment of dividends. We have always been able to upstream the dividends with no real threat or difficulty. That is not a major concern I think.

Duncan Russell:

Duncan Russell from JP Morgan. Just coming back onto the VA margins, you said that about a third of it was driven by higher take up of guarantees, and a third was driven by lower use of those guarantees. I was just wondering how comfortable you were with that assumption which seems slightly contradictory that people are buying more of the products and using less of it. Could you talk about policyholder behaviour and that assumption you have got embedded in your pricing I guess. Please.

Clark Manning:

What we have done which doesn't appear to have been the predominant practice in the US when these things were new, was we set our accounting assumptions for utilisation very conservatively, because we hadn't seen experience in the tails and now we have seen and been accumulating experience in what we hope were the tails of the tails. What you get is relatively inefficient utilisation of the benefit from an economic standpoint. From a customer standpoint, they're trying to provide for their retirement income and provide some stability. The patterns you see are reasonable, from a customer standpoint, but as far as maximising the value of the options, it doesn't tend to maximise the value of the options. They don't start taking the withdrawal benefits as soon as the value is maximised. They take it when they start to need the money. They don't necessarily, if they have a 5% benefit they don't take a 5% benefit, they take the money that they need. A lot of them, at this point in time aren't taking anything at all.

What we did in our assumptions was start to reflect some of that. We didn't reflect all of it, but we moved from what we would assume was quite efficient utilisation of the benefits to something that was between what we were seeing and where we had been before. We're quite comfortable with those assumptions and look at that experience pretty carefully.

Tidjane Thiam:

Thank you Duncan.

Raghu Hariharan:

Raghu Hariharan from Citi. Just three questions and two on the US really. The first one was if you could give us a simple kind of benchmark? Your US peers for example tell us what S&P 500 levels do they think when the market reaches, when they have either DAC unlocking or guarantee costs economically being much higher, and that starts affecting either your earnings or your capital. If you can give us a benchmark as to what levels S&P need to reach when you start seeing losses.

Secondly just trying to go a bit deeper on the VA guarantees. You said you charge about 180 bps or AMC, how much of that would be for the guarantees? How much of that would be for the assets? Say if you charge 180 bps, how have the guarantees performed against the charges that you have taken for the guarantees, since you have seen higher take up and a lower utilisation.

The last one was really on Asia. You're seeing a lot of regulatory risk coming through in Asia. I was wondering how well prepared are you for regulatory risk changes or regulatory changes across South East Asia, in terms of product mix, in terms of agent retention, and just in terms of how scalable your products are?

Tidjane Thiam:

So we start with US, maybe Clark again.

Clark Manning:

As far as at what point drop on the S&P 500, I know we put some IGD sensitivities out there and defer to those in terms of the impact of the guarantees on IGD Capital. From a DAC recoverability standpoint, you have got two DAC things going on, one for the 9 million per 1%. The second part of that question would really be what is the point where you hit recoverability issues. There we have got a 63% k-factor, so we're nowhere near it.

Raghu Hariharan:

There would be no basis risk from hedging either?

Tidjane Thiam:

No basis risk on the hedging.

Clark Manning:

From a standpoint of the 180 basis points that I reference; that would be 115 basis points for the M&E charge, the standard base M&E charge. That would be about 10 basis point for other administrative charges. That would be about 55 basis points for our share of the asset management fees. That wouldn't include anything for the cost of the guaranteed benefits. That is the cost of the wrapper.

Tidjane Thiam:

You know Chad is in charge of all our hedging and risk management in the US. If you want to talk to him after this meeting, I am sure you will benefit from that.

Regulatory change in Asia, I think maybe I will make an opening comment and let Barry continue. We actually really have very, very solid, very good relationships with the regulators in Asia, and that got verified during the AIA transaction at various points, where they actually agreed to speed up the process work for us, were extremely cooperative. That is an asset for us. As you said, yes sometimes it is positive, sometimes it is negative. but we find the environment in Asia reasonably benign, particularly vis-à-vis our industry. We are viewed favourably because we contribute to collect savings. What we do is something every Minister of Finance likes is to really go into the society and collect all the savings and then transform them into productive investment in the economy, because we go and buy corporate bonds or equity or investment bonds. We deepen their financial market, we're long term investors. When you think about FDI, you're trying to attract foreign direct investment as a further country. People who actually raise capital domestically and reinvest it are seen very favourably. We have never really perceived any fundamental tension, and most issues we find are resolved. On the Asian front we are helpful, because really most of the time they don't like poaching, so they contribute to professionalise the industry and this is something we support. We are seen as a good player who is easy to regulate, and plays by the rules. Barry you're closer to that so you should comment.

Barry Stowe:

I think Tidjane has covered most of the important points. The diversity is important. We don't see anything on the horizon that we think is really punitive towards us. In fact a lot of this stuff, sometimes there is some complexity in dealing with regulatory changes. It tends to be far less complex for us and far less impactful for us, than it is for our local competitors who don't operate to the same standard we do. If they come out and say well agents now have to complete 'total needs analysis' forms and that has to be turned in with the application before they can sell a policy and so on and so forth, we already do that. That is not difficult for us but that is a hurdle that local companies tend not to place on their agents. It actually works to our benefit because it slows our competitors down. We operate generally speaking to a standard that is higher than what is required or what is considered locally accepted practice. Regulatory changes tend actually in the long run to help us, not to hurt us.

Tidjane Thiam:

The FSA comes over here and reviews our operations in Asia; they did their last review in January 2010. One of the conclusions they gave in writing was that we operate in every single market ahead of the local regulatory requirements. That is the positioning we have taken deliberately and that protects us.

Nic Nicandrou:

The impact on numbers, clearly there can be changes. The impact of changes can be both ways, negative and positive, but the general trend has been one of releasing excessive prudence into reserving. Clearly you saw that very clearly last year with a release in profits in Malaysia from the RBC change. That tends to be the general trend from a financial impact perspective, but it can be positive and negative.

Tidjane Thiam:

We will take one last question. Sorry, back there, I think you have tried several times. One more question and then we will close. Unfortunately we have got more commitments today.

Craig Bourke:

Craig Bourke from MF Global. A couple of questions. Just on the step change down in the transfer from the with-profit fund. I know we had the bonus cut in 2009. Is there anything else going on there that we should be looking at, change in mix or change in volumes and maturities coming off there that we should look at on that?

Secondly on the persistency in Asia, I know the persistency is now fairly modest. What are we looking at now? Are we looking at customer behaviour or sales retention issues there?

Tidjane Thiam:

I will start with Asia and then we will go to the UK. As you see the numbers compared to the embedded value are relatively modest, but they exist, they are real. One of the things that happened clearly, something we saw in the UK earlier, especially when you're talking about unit linked; often when the market goes down they don't sell. It is often once you get a recovery that you see the customer selling some of their position. Part of it is just customer behaviour, the classical thing. They hold onto their shares and often when you have a recovery in equity market levels and people are back where they were, the retail market tends then to sell and get out. I think that has been a large part of that, you have seen there an underlying issue. It is manageable. It would concern us if it was really localised at one country. As you saw Korea last year, this year you saw a mixture of Indonesia and Malaysia and a bit of Korea etc. It is something that will happen in the large portfolio over time, but it is not of concern today.

The UK, Rob do you want to…

Rob Devey:

I will pick up on the with-profits transfer; it is entirely driven by the bonus changes in 2009. It is nothing on the underlying flows or size of the portfolio. Indeed the with-profits transfer is slightly higher than we planned for this year, because of our performance in 2009 reflected in the 2010 bonuses. A very strong performance in terms of the underlying investment returns on the with-profits fund in '09 led to higher bonuses than we were expecting. Actually it is recovering in terms of a long term trend faster than we anticipated.

Tidjane Thiam:

Thank you very much. We will see you at Q3 at then at the investor day in November which we are looking forward to. Thank you.

Operator:

Thank you. Ladies and gentlemen the recording of this teleconference will be available shortly. To access the replay please dial 0044 207 769 6425 security code 333 26 97#. Once again to access the recording please dial

0044 207 769 6425 security code 333 26 97#. Ladies and gentlemen this concludes today's conference. Thank you for participating. You may now disconnect.