AVIVA - interim results

Capital

Q.

I'd like to start with capital, which of course is at the forefront of everyone's minds with the fall in equity markets. Do you have sufficient capital to grow the business, or will you have to consider a rights issue?

A.

What we've shown to the market today in very clear form is that people have underestimated the capital strength of the group. First of all, taking it all in the round, we've got a whole panoply of really strong businesses. You can start with our UK Life business and we've talked about the financial strength of the with profit fund - a 14.1 per cent excess solvency margin - one of the strongest in the marketplace. But we've gone on to point out that outside that fund, the group as a whole has these excellent other businesses including our GI businesses, including our overseas businesses. And if you take those businesses then on the most stringent solvency test, the EU solvency test, we have around about £1.5bn of excess capital available within those businesses as a whole. Put those together you make a very strong group. Put those together, you've also got a cash generative business, not least from the GI business, adding to that capital strength. Then finally, just yesterday, we had Standard & Poors confirming our AA rating right at the lowest point in the market place in terms of recent ratings and coming back with that independent confirmation of our position.

Q.

Were you relieved by that decision?

A.

No. I mean we knew what our internal situation was. What we've done today is to explain more clearly the information that has sat behind that rating.

Q.

So just to be clear, are you telling me that you're ruling out a rights issue?

A.

We're showing you that our capital base is strong and very adequate to support our current business. We're showing you that we're in a cash generative situation and therefore there is no need for a rights issue to support our organic growth.

Q.

Turning to UK Life with profits, what happened to your free asset ratio in the first half?

A.

The free asset ratio at the 30th June is the 14.1 per cent. We've made it clear that if you don't use implicit items, then you get the 10.1 per cent and that's a very resilient position compared with our end of last year numbers.

Q.

Of course we're in a very dynamic situation, so what is the position as of today?

A.

We're not talking about disclosing today's position. We monitor those things internally and we take them very seriously. But with a position as strong as that at 14 or so per cent compared with a minimum requirement of 4 per cent, we're able to take a long-term view of what is the best thing to do inside that fund for our investors. And so it isn't a matter of day-to-day discussion or day-to-day disclosure.

Q.

Have you been selling equities?

A.

You can see in fact from our disclosure of equity proportion of our fund that that hasn't been the case. We started the year with around about 54 per cent in UK equities. We're now at 49 per cent and of course in that time the fall in equity prices has been the prime cause for any reduction in that change. Now we're not a forced-seller of equities. Of course we make trading decisions. We make decisions between the UK or the rest of the world as equity marketplaces.

Q.

But you can't be comfortable with the amount of equity that you hold?

A.

No I think the other way round. It would not be the right time on behalf of our customers to be out there selling large volumes of equities. I don't believe that is in their interest. We sold them a product with the expectation that they would have around about two-thirds of their exposure to the equity and the property market. That's what we're providing and we believe in the long-term, that that's what we will deliver – the best benefit for our customers.

Q.

To what level would the market have to fall for you to stop writing new business, capital intensive business?

A.

You've seen that we're not particularly susceptible to market falls in terms of the strength of our fund and its resilience. There are many other levers that you could pull in terms of adjustment before you would be in that situation. So quite frankly that's not an issue that's on the agenda.

Q.

Help me understand this then. If your capital position is so strong, was it justified to cut the dividend?

A.

The dividend cut and the capital position are not essentially related. We said when we cut the dividend that we were not doing this because of any immediate shortage of capital, but we were doing it to bring the group's financing division into balance. You can see that what we now have is that the current dividend level we are in a cash generative situation. We're able to finance our future growth from our retained earnings and those numbers are there in our business. So there's that capability to deliver organic growth and be cash positive.

Q.

But given current circumstances, is the growth really out there?

A.

It can be dangerous to make a judgement on a last six months situation. There is growth in our marketplace. We've actually, even in the last six months, delivered double-digit increase in our Life and Pensions business with 11 per cent APE. Of course, single premiums have been subdued. People are not making big lump sum investments into today's marketplace. The very level of the market shows you that. We have done very well at attracting regular premium business but the underlying tide, the demography if you like, the need to provide for retirement and long-term savings, is still running equally strongly in all the markets we operate in. You're still seeing governments taking action to encourage further savings.

Results and outlook

Q.

What were sales and margins like in the first half?

A.

In general they were pretty well maintained. We saw different effects in different marketplaces. For example, in places like Spain we saw an increase in the volume going through, they are hitting really high numbers - excellent margins there, where we're growing in that particular marketplace from our distribution. Here in the UK, one of our biggest businesses, we saw an improvement in margin in the second quarter compared with the first quarter. A modest decline on this time last year. Most of those effects have been driven by the type of product we've been selling during those periods.

Q.

Now you've set yourself quite an ambitious target in long-term savings. You want to have a 15 per cent market share in Life and Pensions. So where are you on that?

A.

We’re talking market share UK here. First quarter - we can't measure for first half because we don’t have rest of the market data - but first quarter we were bang on target. Up to 12.5 per cent market share there. So we’re making exactly the progress we hoped.

Q.

On the face of it though, profits were flat weren't they?

A.

Yes profits were flat. There was an underlying story there. General Insurance profits up 13 per cent, a really excellent record distinguishing us from our competitors. On the Life side, we saw an increase in new business added value by about 6 per cent. But the profits from the in-force business are turned, are reduced because of the poor effects of the investment marketplace. They're also, in comparative terms, reduced because in the same period last year there was just over £50m of special one-offs went through that account. So overall, as you say, a flat position if measuring the achieved profits, a modest increase in statutory profits.

Q.

So what's the outlook on sales?

A.

I think the outlook for the market as a whole is mixed. Whilst investor confidence remains low, that’s having a dragging effect on people’s willingness to commit single premiums particularly to equity products increasing a preference for bond-based fixed interest type products. For us as a group, it is somewhat more encouraging because we have a wide range of products so we do pick up those bond-based sales. We pick things up from the strength of our brand, and we pick up benefit from that increased distribution capability we have. It’s difficult to predict exactly how those two effects will balance off over the next six months.

Q.

Turning to General Insurance, the results look good. But is this basically because you're at the top of the pricing cycle?

A.

I don’t think that’s the case. Our results are ahead of our competitors. We know that we've achieved them through very disciplined underwriting, through very efficient systems, through our willingness to see policy accounts reduced in order to write the kind of business we prefer. We have continued to invest in that efficiency process for our systems. We've continued to invest in claims' management and we believe we've set up a model that is going to enable us to maintain our promise of a 102 combined operating ratio across the cycle.

Q.

So you're telling me that your position is sustainable here?

A.

We’re telling you exactly that. It is sustainable and we have always planned to build a sustainable machine.

UK Life - regulatory reviews

Q.

There have been a lot of regulatory proposals over the last six months. But what's your view on how these will affect growth in margin levels in the UK?

A.

First of all the regulatory proposals are intended to grow the long-term savings market. That’s the core aim. Secondly I think the whole thrust of those proposals favours a highly efficient large distributor with a strong brand name and that’s exactly where we see ourselves in the marketplace.

What Mr Sandler in particular has proposed is the suggestion that for a set of extended stakeholder products there is a trade-off between enormously reduced regulation at point of sale and a relatively prescribed product with fixed features and obviously with a fixed cost. Now at the moment we don’t know enough about that to assess exactly how it will work out. We will produce some products in that range when we have those definitions and when we can assess the fact that they are economic and viable from a shareholder perspective.

Q.

But can you make money in a 1 per cent world?

A.

That's exactly what we will be assessing. We will produce those products, and market those products to the customers where they are viable, and produce the appropriate return on capital so that shareholders can commit their capital to that type of product. And that's a decision which we will make as we see the proposals go through and be produced in more concrete form as they go through the consultation process with the FSA.

Q.

But what about Sandler's proposals for the with profit structure?

A.

Perhaps the proposal that's attracting most attention is the suggestion of a 100/0 fund. I think I should make it clear that inside the group we know how to run that business. We have considerable experience at it, and our existing stakeholder pension product already operates on that basis. Interestingly he also suggested that in moving more business to this format it would be appropriate to have an orphan estate reattribution exercise and, as we've already discussed, our orphan estate is around some £4.7bn. So that would also be an important exercise and we expect to begin work on that with a view to being able to complete it towards the end of 2004.