OLD MUTUAL

Q3 2008 Analyst Call

6 November 2008

Presenters
Julian Roberts, Chief Executive

In attendance
Jonathan Nicholls, Group Finance Director
Andrew Birrell, Group Chief Actuary
Don Hope, Chief Executive of Bermuda

Operator

Thank you for standing by and welcome to analyst call. At this time all participants are in a listen-only mode. There will be a presentation followed by a question and answer session at which time if you wish to ask a question you will need to press *1 on your telephone. I must advise you all that this conference is being recorded today, Thursday 6th November 2008. I would now like to hand the conference over to your speaker today, Mr Julian Roberts. Please go ahead sir.

Julian Roberts

Thank you very much. Good morning everyone and welcome to our conference call for our quarter three interim management statement. With me here this morning is Jonathan Nicholls; Andrew Birrell, our Chief Actuary; and Don Hope, Chief Executive of Bermuda. Historically we have used these calls to talk to our sales and trading performance on a business by business basis and I'll give some headlines on that, but I'd also like to spend a bit of time giving an update on what we're doing to fix US Life and I'll also make some comments on capital and liquidity.

It's just two months since the Board asked me to become Chief Executive, and what a two months it's been for any financial services company; extreme movements in equity markets and currency, continued bank failures and government bailouts, regulatory pressures, interest rate changes and general acceptance that the world is moving into or already is in a global slowdown.

The market just keeps throwing challenges at us, but it also gives us opportunities. Against this background the Group is trading well. Strong life sales in the Nordic region and South Africa were offset by the UK and the US and overall life sales for the Group were down 4% on the previous year. Mutual fund sales were down by 23%, but once again Nordic and South Africa performed strongly, being offset by declines in the UK, ELAM and the US.

Value of new business was down by 10% year to date. We have excluded

the US Life, we're not showing a figure for that, because as part of the ongoing product review we're likely to change the assumptions which underlie the VNB calculation and I didn't want our reporting to be misleading. Net client cash flows for the Group are neutral for the nine months, but this hides good performance in the UK and Europe. Overall Group funds under management are down just 9% on the opening figure at the start of the year. This compares favourably with the much more severe falls in equity markets and reflects continuing strong investment performance on a relative basis.

Our Financial Groups Directive, our FGD surplus, was 1.1 billion at 30 September, above the 750 million, which in current markets we consider to be a sufficient buffer and as you know the 750 is our target. Each of our businesses has sufficient capital and liquidity to support regulatory and operational needs and here I highlight both OMSA and Nedbank who have very strong capital positions.

So let's look across the Group. In Europe we achieved a turnaround in sales in Nordic in late 2007 and this has continued, reflecting our market position and the strength of the brand in that region. Market conditions in the UK are tough and inevitably sales and the value of new business were down on the previous year, but net client cash flows were positive for the nine months to September and I believe that our offering, which supports both mutual funds and bonds, is well positioned for when investor confidence returns. Across our European business overall net client cash flows remain strongly positive for the nine months at 5% of opening funds under management, which in the current climate is a strong performance.

South Africa continued to be a strong contributor to the Group. Sales growth is very encouraging, demonstrating the benefits of the increased sales force and once again the strength of our brand in the region. Net client cash flows were considerably better than in 2007, but we still saw an overall net outflow, largely due to the higher bonuses declared in 2007 and earlier this year; and also higher withdrawal from pension funds.

In the US our investment performance track record positioned us well relative to our peers. A number of our affiliates, including Acadian, Rogge, Heitman, Ashfield, reported strong positive net client cash flows. Overall, excluding the outflows, which resulted from Dwight suspending its low margin securities lending business, net client cash flows for the nine months would have been over $4 billion, which I think is a superb performance in the current market and reflects the strength of our asset management business.

In general our businesses are holding up well. This performance in challenging times gives me some confidence of what this Group will be capable of once we move into a more favourable macroeconomic environment, which we're clearly not in yet.

Now, moving on from our nine months trading I'd like to give an update on my first 60 days as Chief Executive. When the Board appointed me, they accepted my requirement to be given a mandate for change. I started by addressing what I saw as the three highest short term priorities:
- firstly, taking action which will enable us to draw a line under Bermuda;
- secondly, taking action which will enable us to fix the remainder of US Life; and
- thirdly, forming the management team that will work with me to take the Group forward.

Let me take these in order, firstly starting with Bermuda. Since we last spoke to you we've experienced considerable market volatility and a significant strengthening of the US Dollar. These effects have led to substantial increases in the costs associated with the guarantees provided on the Universal Investment Plan product. As a result we've put a total of $582 million of capital into this business: the 300 we told you about at the half year; the additional 250 million we told you about in September, on September 10; and in addition a further $32 million. However, we've taken a number of actions to limit our exposure on these guarantees, including withdrawing products, introducing currency hedging and improving fund mapping to reduce basis risk. These actions are on top of the formation of the oversight team that we talked about earlier.

We have made a considerable amount of progress. We're now hedging more elements than we were previously and as a consequence our hedging has become significantly more effective, making us less exposed to future market volatility. We've also learned lessons for future product development and pricing and the team in absolutely no doubt that I expect them to work on those lessons.

In addition, in order to reduce our overall exposure, we've made an offer to our direct Bermuda clients. We call this the Accelerated Universal Guarantee Option, which we launched yesterday and are making available in a two-week window. Under the offer we give clients the chance to take a top-up to 85% of their original investment now in exchange for them giving up the future guarantee. For those clients who have seen significant falls in the value of their plans since inception we believe this is a compelling offer allowing them to increase their exposure to the market in anticipation of a recovery without having cash or, giving them a chance to release cash,

improve their liquidity by realising their investment now at a much higher level than would otherwise have been possible.

The benefit for us is obvious; it helps us to de-risk the book, reduce the uncertainty and release the guarantee reserves in respect of those clients that take up the offer. We won't know what the take up will be until we get to the end of the offer period. As markets continue to move it changes the relative attractiveness of the offer as well as impacting the amount by which we have to top up the plans. Once the offer period has closed and the applications have been processed we will come back in due course to the market to confirm the financial impact. So for Bermuda my summary would be we understand the book much better now than we did before, we're hedging more effectively and we've made an offer which will reduce the uncertainties on our exposure.

Let me move to the onshore part of US Life. September was an unprecedented period of fall out from the financial services sector and we, like our peers, were substantially hit by impairments, some $381 million in the third quarter. Although the Fed plan has helped to calm the situation down we're left with an exposure as a result of the market value of the portfolio being below the book value. Again, our peers have the same issue.

Looking in detail at the US Life business, my assessment is that the crux of the problem is that we've been selling too broad a range of products with a focus on volume rather than returns. My initial action was to change the management and bring in Chris Chapman as CEO with a clear brief to act quickly to get this business into better shape. Chris has delivered a turnaround plan and is already getting on top of the issues, which will include reducing the number of product lines, reducing the run rate of expenses, changing the internal focus to fewer but more profitable sales and rationalising the distribution channels to focus on those that are the most efficient and profitable. Chris's mandate is clear; to create a business which runs efficiently and delivers an appropriate return on equity. Across both onshore and offshore US Life we've also beefed up the risk management team and processes with better oversight from the centre.

Let me move onto the third of my immediate priorities: shaping the management team. I've already mentioned Chris Chapman whose appointment we announced at the end of September. Chris is a turnaround specialist with considerable experience in the life sector and I'm very pleased to have him on board.

I'm also pleased that Bob Head has agreed to take over my previous role

heading up the Skandia branded businesses in Europe with effect from the 1st January 2009. With Bob's experience and skills I know that he is the right person to continue the work that I started in developing those businesses to ensure that they capitalise on their strengths and realise their potential.

And finally, we're delighted to have secured the appointment of Philip Broadly as Finance Director, replacing Jonathan who as you will have seen from our announcement this morning has decided that the world of embedded value is no longer for him. I'd like to put on record my thanks to Jonathan for the contribution he's made to the Group and wish him well for the future. In terms of Philip, he brings considerable experience of the sector and I imagine that many of you will know him already. He joins us on Monday and I am very much looking forward to working with him.

Let me say a few words about capital and liquidity. As I've already said at 30th September our surplus was £1.1 billion. Our gearing is in line with the level targeted to support a single A credit rating. We maintain a close dialogue with the rating agencies and we'll be working with them as they undertake their forthcoming reviews. The factors which most impact our FGD surplus are the Rand/Sterling exchange rate, the Dollar/Sterling exchange rate and the movement in the JSE. We remain focussed on proactive and prudent management of our key exposures and we've developed a risk appetite model which we're in the process of embedding with the business.

Turning now to the question of liquidity. Fundamentally, our businesses are generating cash and I can confirm that we are comfortable with our liquidity position. This has been an unprecedented period in terms of the amount of liquidity we've had to put into our US business. The fact that we've been able to do this and still have sufficient to cover our expected needs for the foreseeable future is evidence of the strength of our position.

So far, as I've said, I've been focussing on the immediate priorities, but with the action of those underway I'm now turning my attention to how we take the Old Mutual Group forward. I obviously have some views on things I'd like to change, but I'm not going to say any more this morning. I think it's right that over the next few months I take a fresh and objective look at all parts of the Group and my intention is to give more of an update with our preliminary results presentation in March.

So in summary, against the market background overall Group performance has held up well, with particularly strong contributions from our established brand franchises in Nordic and South Africa. We've taken major steps

towards de-risking the US Life business. We now understand the issues in the onshore and offshore businesses and are dealing with them. Across our businesses we maintain sufficient capital and liquidity to support our regulatory and operational needs for the foreseeable future. We expect market conditions to remain difficult in the balance of the year, but I'm confident the Group as a whole remains resilient and our businesses are well positioned to deal with the challenges.

At this point I'm going to stop and the team here with me are happy to take your questions.

Operator

We will now begin the question and answer session. If you wish to ask a question please press *1 on your telephone and wait for your name to be announced. If you wish to cancel your request please press the # key. Your first question comes from Michael Christelis from UBS, Johannesburg. Please ask your question.

Michael Christelis, UBS

Morning guys. I've got four questions, if I can just run through them quickly. Firstly, on your FGD surplus can you just elaborate on the impact or just confirm for me that the full stakes in Nedbank and Mutual & Federal is accounted for on the asset side of that surplus. In other words a sale of Mutual & Federal or perhaps even Nedbank one day wouldn't boost your FGD surplus in any way, that's the first question. Second question; what percentage of your Bermuda sales, VA sales, are direct? You mentioned that you've made this offer to direct clients only, can you just give us an indication of what percentage of the sales are direct? A third one, you spoke about the US Life business being refocused and delivering ROE as an acceptable ROE, I mean are you changing your ROE targets or what are the ROE targets for that business going forward? And then just the last question, in terms of your level of gearing being sufficient for an A rating, etc, if we are at the end of the year in a position where your impairments on the US bond portfolio are down at say, 2.3 billion where you've quoted them as a current date, what does that do to your gearing levels then, because clearly that goes directly to equity if I'm understanding that correctly?

Julian Roberts

Ok Jonathan

Jonathan Nicholls

I'll pick up the FGD one. The Nedbank question is academic in terms of the

sale, clearly it's part of the Group, but the M&F business if we do sell it will impact and improve the FGD. ROE or onshore, as you know we do have an ROE target for all of our businesses in the northern hemisphere, which is 15%, so from that point of view that is what we're aiming for. Clearly, we've got some way to go with that business; as you know we've been in single digit ROE territory for the last few years, so that is the target we're aiming for. We've no reason not to have that target there in terms of that going forward.

The single A rating in terms of onshore US Life, it's actually a little bit more complicated. I mean the rating is ultimately for onshore, predominantly the important rating agency is AM Best and they look at that business on a stand-alone basis, but also look very much at the support from the Group and the rest of the Group businesses, so it's more than just simply what does the onshore balance sheet look like.

But you're right; in terms of the impairments, the impairments at the end of September were 2.3 billion. Clearly the longer those impairments remain on the books, the more chance there is that there is an event that causes us to impair the offside mark-to-market position but we do need actually actions to incur before they are impaired and therefore come through either through our equity or our stat capital. So it's a bit hard at the moment to predict where we are going forward. We've given you the information for the quarter on the actual impairments that we suffered in the quarter, which is $381 million. Hopefully Q4 will not repeat Q3 as Julian said in his text, Q3 was pretty unique one hopes in terms of market disruption but there are still significant spread widenings which we are recognising through the mark-to-market process along with our peers elsewhere in the UK, but also in the US as well. So it's clearly a watching brief; we're monitoring the book very closely and the impact on capital we'll have to report when we get to our full year numbers in March.

Julian Roberts

Just the other question you asked, that offer percentage of Bermuda sales are direct; I actually think that that's the wrong way to look at it. If we look at it from assets rather than sales roughly two-thirds of the assets are direct, so that is the proportion of assets we've made the offer to. But also being open with you that the one-third that we are making the offer to at the current time is probably the more problematic area, but by assets the offer is for two-thirds.

Michael Christelis, UBS

Ok, thanks guys.

Operator

Your next question comes from Marius Strydom from EJM. Please ask your question.

Marius Strydom, BJM

Hi there, it's from BJM, but anyway. My question relates to US Life onshore surrenders. That's in my opinion a very, very scary part of the business right now. The spreads on corporate bonds have widened meaningfully since 31st September and just rough calculations would show us that market value to book value gap is probably over $3 billion right now and it also as a percentage of book value is probably something like 82% or 83%, which means that that gap is a great deal wider than the typical minimum surrender value that you can pay to your policyholders on these contracts. Now, in my opinion the big risk here is that you experience surrenders, I mean for increase in surrenders, because there's a huge opportunity for policyholders now to select against the company and my question is have you started to experience an increase in surrender rates; what available resources do you have to pay surrenders from cash resources as opposed to having to liquidate the portfolio; and then thirdly if you have a meaningful doubling, trebling, quadrupling of surrenders what strategy are you going to follow? Are you going to pay from cash resources which would probably imply injecting more capital? Are you going to liquidate the portfolio? Or are you going to consider freezing surrender payments?

Julian Roberts

Look I think the first thing to say is let's get to the facts. So the average annual surrender rate for that business was around 12% but varies by type of product. So overall we've seen a decline in surrenders as compared to the same period last year, due primarily to reduction in annuity surrenders. Mortgage term products are showing an increase in surrenders particularly in early duration.

So there is no sign at the moment in that portfolio that we have a surrender issue. And you know it's one of the things that we have to gauge moving forward and Chris will be looking at, to look at our overall policy. So again we're very conscious of the rating of this business, and having sufficient capital in the business. So therefore there are no grounds for people to surrender. So we haven't Marius seen any signs of it and as part of Chris's work there is a project team to work through at the moment what we do if the surrenders do start to pick up.

Marius Strydom, BJM

And but as it stands at the moment are you paying surrenders from cash resources or are you liquidating certain bonds at sub-book valuation?

Andrew Birrell

Marius hi it's Andrew Birrell here, just to get back to your previous point. At this stage bearing in mind as well that most of the US insurers would be in a similar position to us with respect to market values and book values on their bond portfolio. I think it's fair to say in the current situation with respect to the current exits we have not been in a position where we've had to liquidate at this stage.

Marius Strydom, BJM

Thank you.

Operator

Your next question comes from Jon Hocking from Morgan Stanley please ask your question.

Jon Hocking, Morgan Stanley

Morning everyone. I've just got one question, previously you've given a sort of rough rule of thumb for the hedge effectiveness in the Bermuda book, it's broadly 50-60%. Given the sort of fine tuning of the hedge programme that you've done in the last few weeks, can you update that figure for us please?

Jonathon Nicholls

Morning, yes I mean we have improved the hedge. In terms of overall I'd say it's now approach 70%. With some of the pieces it's actually higher than that but it has improved over the last three months. That is encouraging, because of the initiatives that Julian mentioned in this call.

Jon Hocking, Morgan Stanley

Excellent thank you.

Operator

Your next question comes from Greig Paterson from KBW, please ask your question

Greig Paterson, KBW

Morning gentlemen. Three questions, one is one of the reasons why you've gotten this problem in the US is that you are sub-scale in your fixed annuity

book and your cost structure is high and therefore in order to bore your accounts you've had more risky asset base so that you can cover the higher expense structure. I mean all these conditions still exist; you are sub-scale, I can't see that changing, why not just sell the book? That's the question one.

The second one is if you look at the other UK insurers have made extremely strong statements about liquidity and quantified it showing that they are five to 10 times the ability to cover the current liquidity requirements. And you've only made a statement about comfortable. To me that's a very high relative risk factor. I wonder if you could throw some numbers around that to give us some comfort.

And then the third point obviously from your comments at a Group level and also with the US rating agencies looking up at a Group level, it's your fixed charge cover that seems to be under pressure. I wonder if you could tell us what that is and tell us what the range is required for your single A, so we can actually gauge when you'll breach that rule and potentially expose to a downgrade.

Julian Roberts

Let me answer the first one Greig. The work that Chris has been doing recently has turned round and shown to us that this business has been run for sales. And it has not been run for profitability. You know that, you've been looking at the business for a while, and our IRRs on these products are pretty low.

The initial work that Chris has been doing has been turning around and saying that we do believe that we can sustain significantly reduced expenses, and keep our MGA distribution happy by selling products with a much higher IRR. So you will see moving forward that we will have lower sales but they will be more profitable, and we do believe that we can cut back the expenses to hit our IRR targets.

Jonathan Nicholls

Let me answer the questions on liquidity and ratings Greig. Firstly in terms of liquidity, we do have a large facility which is largely undrawn. And that remains the case. In terms of our liquidity management, as with our peers I'm sure you can imagine we have been monitoring that very closely as we have capital over the last two months that the market has disrupted.

And it's also important to do that in the context of our plans going forward and we are currently in the middle of our planning process, well towards the

end of our planning process in terms of the three year plan process that we run, a key part of which is obviously looking at the capital draws and the liquidity draws from each of those businesses.

Around the world we do have very strong cash generating businesses. I mean the South African businesses go without saying, they are the key driver of cash for us. But also of course the Skandia businesses are now very cash generative in their own right, both Nordic and UK. So from that point of view we're generating significant cash for our own purposes from internal resources.

So when we say that we're comfortable, we are comfortable; we've done plenty of work to look at the sensitivities the market movemenst that may or may not impact that. And looking forward as an organisation we feel very comfortable with where we are in terms of our liquidity sitting here today.

The rating agencies, I mean clearly we are in not continual dialogue with them but we have regular dialogue with them as normal when it comes to quarter three update. We are talking to them not as we speak but we have meetings with them over the next week or so, couple of weeks where we'll take them through the numbers. But also importantly we'll take them through our estimate of the forecast for the year end and also the business plans.

So in terms of cover, gearing no problem at all. Interest cover broadly in line over the time of the plan. But I think the key issue for them will be obviously the outlook in terms of firstly the individual business's margin performance as we project that going forward compared to track record. And also exactly what we're going to be doing with Bermuda and onshore US Life because those are two key businesses that they'll be looking at closely and have been looking at closely.

So I'm afraid at this point in time it's a bit difficult for me, and obviously I can't anticipate what the rating agencies will do but all I can say is that we are fully involving them in our debates and we're having very proactive debates with them.

Greig Paterson, KBW

So for liquidity if you can give us some numbers; I mean how much cash you've got at the head office, what was the third quarter cash flow, and what's the size of the facility? So we've got some kind of gauge of if we throw another billion of impairments is that going to kill you off? That's what we're trying to figure out.

Jonathan Nicholls

Greig we don't disclose those numbers externally. All I can repeat is the information we've given on the statement, but we are comfortable with our liquidity and our capital position.

Greig Paterson, KBW

Alright thanks very much cheers.

Operator

Your next question comes from Blair Stewart from Merrill Lynch, please ask your question.

Blair Stewart, Merrill Lynch

Good morning everyone it's Blair Stewart here. I've got a couple of questions: with regards to the offshore business can you talk about the issues that you've got with putting out an offer to the Hong Kong customers? Presumably there's some issues with your distribution partner there and how confident are you in your ability to make an offer in the near future and perhaps give us an idea of timing on that?

The second question is can you comment on the net flows that you're seeing for the onshore US Life business? Just relating back to the question about surrenders that would be useful.

And thirdly just on the future for US Life, I know you're going to be talking about this in detail later, but it seems that the sales are going to be perhaps as much as half the peak levels in future. And the comments you're making about operating on a lower cost base, you know obviously that's necessary given the problem with unit costs creeping up, but it seems very challenging to me for a very competitive market to be expecting to increase the profitability on a per-product basis to make up for that change. I just wonder if you could perhaps put a little bit more flesh on it.

Julian Roberts

Yes sure; I mean let me go with the on the Bermuda book and the Hong Kong book. That arrangement, that one third of assets is effectively a re-insurance that we had. So we're in discussions with the people that we re-insure. We would like them to make the offer to their clients but of course that's up to them whether they do that or not. So we're not in control of that process, and you know that's, so we're going ahead with the book that we've got and we'll keep on talking to them.

I think I'll go for Jonathon or someone else on the net flows on the US Life business. On the future of US Life, I think the factor here of the work that Chris and the team have done is that we do have a very wide range of products in the US Life business, many of which we realise are unprofitable. And therefore the view that the team has done in this period of time is that we can cut out those unprofitable lines.

Those lines have volume but no profit and therefore we also believe that we can scale back our expenses quite significantly and therefore produce a decent return. So our view is we get this business into shape, it's going to take us a period of time to get it into shape, and that's what our focus of attention is right now. I'll pass onto somebody else for the current net flows in US Life, I think Jonathon's about to answer that.

Jonathon Nicholls

Blair I'm not sure if you're asking that from a capital point of view or net client cash flow point of view. But from a capital point of view we said in the update which I think is probably more where you're focused that we've actually injected another 100 million invested in this to maintain our RBC ratios. Those RBC ratios are currently around 275%. We have a commitment to keep it around that sort of range going forward but obviously that's a debate for the rating agencies.

In terms of net client cash flows for the period, we had a small outflow in the period of around $370-odd million for the quarter. And year to date, sorry I'm just reading this here, for onshore you're interested in yes $369 million USD.

Blair Stewart, Merrill Lynch

Outflow in Q3 yes that's what I was referring to. Just coming back to the first point Julian, how confident are you that your distribution partner will be interested in making the offer?

Julian Roberts

Look I can't actually turn round and say, I don't know, we've had a number of discussions. The Hong Kong market is a pretty rough market at the moment. It's totally their call. You know I don't know what the answer is. So we're just honing in right at this current time of looking at the offer that we're making to the distributor business. That will significantly reduce our exposure just of itself.

Blair Stewart, Merrill Lynch

And will you also give details of the strategic direction of US Life with the prelims in March?

Julian Roberts

I will come back and talk about the Group in general in March yes.

Blair Stewart, Merrill Lynch

Ok thank you.

Operator

Your next question comes from Raghu Hariharan from Fox Pitt Kelton, please ask your question.

Raghu Hariharan, FPK

Morning gentlemen, Raghu Hariharan, FPK, I had three questions if I may please. The first question was on your SGD surplus and the buffer. Now you mentioned that the 750 million Sterling is a sufficient buffer; I was just wondering what would be the impact of reaching this buffer? Is there a rating agency impact; is there a capital raising impact? Can you give us a sense of what the 750 million actually refers to?

The second question I think I just wanted to follow up with Jonathan on the RBC ratio in the US, is that you guys have a 275% RBC, I was just wondering what margin does that give you about a single A rating level? And if you can give us the, if you have it to hand a dollar amount of the excess I guess of the 275% level.

The third thing was on the US Life offshore business. The first kind of clarification I want was, is this, are the guarantees now fully hedged? You're referring to currency hedging and fund mapping; I just want to check whether these guarantees are fully hedged. I think at the half year stage you said it was hedged 60%.

And the second one was on the acceptance levels of the new offer that you're rolling out to customers; I'm just wondering could you give us the sensitivity of the gearing of the reserve position to acceptance levels? For example I'm assuming that today your guarantee reserves are sufficient to cover 100% acceptance levels, but what happens if you have let's say 50% acceptance levels? Can you give us some a sanity check if you will around the sensitivity of the reserves to acceptance levels please thank you?

Jonathan Nicholls

Right let me pick up the first couple of I may. FGD is an internal buffer. To be honest the rating agencies, I mean once they look at FGD they're more interested actually in ratios in relation to gearing interest cover and EPS and margins. So for our purposes we have a buffer simply as if you like an early warning. We have it there to ensure that we have sufficient FGD obviously for regulatory purposes through the cycles.

But I think really though from our point of view we do look at the individual capital that we have in each of the businesses case by case as being obviously fundamental and we ensure that each of our businesses are appropriately capitalised to ensure that we can ride through the cycles. So while FGD is obviously important, from a rating agency point of view it's actually less so.

RBC ratios, generally we run at a sort of range of 275-300-ish. We are as I said earlier in debate with the rating agencies; I mean clearly the markets are in a fairly unique situation at the moment. So from our point of view it's not firm as to where we'll actually end up there but clearly the intention is to maintain the single A rating and that's an important objective for us in terms of the conversations we've already been having in terms of the stability of the business going forward.

But in terms of a 10% movement in RBC it's about $25 million of capital so it's not a huge amount.

Julian Roberts

I think I'll ask Don to answer the hedging of what we hedge and what we don't hedge.

Don Hope

Hi, we hedge the exposure to the major Asian indices as well as the European, US and UK stock markets. We hedge interest rates, we now hedge Sterling, Euro, Korean Won, we're in the process of hedging the Japanese Yen. And when that is done, 35% of our currency exposure will be fully hedged.

There are some of the more esoteric markets where we have small exposures, for instance the Brazilian stock market where we don't have a hedge, we don't hedge volatility, and we wouldn't be surprised at volatility at these very high levels.

Raghu Hariharan, FPK

And sensitivity to acceptance levels, would you in terms of your de-risking offer to policy holders?

Don Hope

Well the book that we have extended the offer on, we think that around 50% of customers in that book would find the offer very attractive, either in terms of gaining liquidity or increasing their exposure to the markets in the event that if they think the market is going to begin to recover.

And I think I would regard success in terms of the offer on that book which is by far the more stable book and the easier book for us to hedge, I would regard success as being acceptances in the range of 25-35%.

Raghu Hariharan, FPK

Ok thank you.

Operator

Your next question comes from James Pearce from Cazenove, please ask your question.

James Pearce, Cazenove

Morning everybody; on the hedging issue, my impression from the conference call at the beginning of September was that you would be looking to achieve certainty on the options. Is it right to say that you're now sort of taking a view that with volatility at current levels you're willing to just take a bet on I assume the market going back up? And I just want to understand whether you're leaving an open ended liability potentially if it doesn’t go your way?

Secondly on solvency, I mean it seems likely that it’s going to cost you money to get out of this position in Bermuda. One would assume reinsurance costs, loss on disposal, that kind of thing, and possibly further hedging losses based on the trends of the last couple of quarters, and that would take you below the 750 – what is your take on the dividend given the likelihood of breaching the 750. Thirdly, could you give us some more insighst on the US profitability? I am surprised you have chosen not to disclose your profitability in the US and I would like you just to explain what you think the underlying trends are?

Don Hope

Just on the Bermuda piece to start, we aren’t taking a bet and we haven't

taken a naked exposure, hoping the markets are going to recover. We are actively hedging using dynamic hedging techniques. The vast majority of the exposures that we have in that book there are – we are linked with some basis risk given the wide range of funds which investors have chosen and selected under the programme and the one significant exposure that we have chosen not to hedge is volatility because we believe that volatility at these extraordinarily high levels is not something that we would be an active buyer of so I think we are very comfortable that we have got the vast majority of the risks hedged and are managing that on a daily basis.

James Pearce, Cazenove

I thought you said the hedging effectiveness was still only 70% which leaves 30% unhedged.

Don Hope

The hedge effectiveness or the overall book as of the end of September was around 70-76,75% sort of area; since then we have continued to put on the currency hedges which we did not previously have hedged – or the parts which are now hedged we are getting a hedge effectiveness of close to 90%. And it is a relatively small piece which we remain exposed to and we will continue to review our options to reduce our exposure and improve our hedging around those as we go forward.

Julian Roberts

And James, the policy on dividend is the same as it always has been; we will wait to close off the accounts at the end of the year and then the Board will consider the dividend.

Andrew Birrell

Julian, if I can just speak about the cost of closing out the offer – at this stage we have provided guarantee reserves against the guarantees in full, and we believe that the level at which we have made the offer is one where the cost of making the offer with top ups to clients would be offset by releases from the guarantee reserves, so there will not be in an additional cost over and above, obviously it depends on the exact market conditions on the date that you are closing it out, but we think that they will be broadly equivalent on that level. So there won't be an additional cost in terms of making the offer and closing out the guarantee in respect of clients who take it out.

James Pearce, Cazenove

So you are saying from the 31st October there will be no further costs of exiting the Bermudan guarantees, am I right in saying that?

Andrew Birrell

What I am saying is that in respect of clients who take up the offer there should not be an additional cost to us over and above the guarantee reserves that we have already set up.

James Pearce, Cazenove

Ok, so what about the rest? I mean you are hoping for take up of what is it – 25, 30%.

Andrew Birrell

At whatever the take-up rate is we should have adequate guarantee reserves which we can release for the clients who take up the offer which will fully cover the cost of us making the offer to the clients.

James Pearce, Cazenove

So either way the point EUIGD surplus should not be affected, is that right?

Andrew Birrell

Not as a consequence of this offer, no.

James Pearce, Cazenove

But if volatility spikes further it could be, or some such further market change.

Andrew Birrell

It is possible, but just to put that into context – if you look at markets and indices over the last month, at the point of 27th October which was around about a time and data point that we were using when we were modelling the data, just about any index in the world hit a low, a recent low, and just about any currency in the world was at a low against the dollar as well - that is fairly strong data point at which to have been setting up guarantee reserves.

Julian Roberts

Let me pick up the last point on profitability because I know it has annoyed some of you and thanks for raising it James – about why we haven't shown margins on the US Life. I have just come in, Chris has just come in and taken over the role and therefore we are doing a very heavy review as I said

before of this business with some quite significant changes and I believe Jonathan, the team here believes that it would have just been misleading to have shown any margins on that business. We could have just carried on with exactly the same model, and we just thought that was wrong. We are doing an assumption review as part of this work.

James Pearce, Cazenove

Thank you very much.

Operator

Your next question comes from Francois du Toit from JP Morgan. Please ask your question.

Francois du Toit, JP Morgan

I have got a question on your FGD surplus level – is your FGD surplus level net of the November dividend – if it was 0.8 billion at the end of October then, and I think it is at about the same level now looking at the market, etc. It's probably in danger of breaching your own 750 million estimate because I estimate the cost of the dividend to be about £150 million because of the exchange rates at which it was set, which was obviously not very favourable at the time that was set.

Then, a further question also – the FGD surplus sensitivities that you have given indicates a very, very sensitive – big sensitivity to the dollar and it implies that your FGD surplus in the US is negative $3 billion. Can you please explain that to me and whether you can hedge that sensitivity or whether you believe there is a need to hedge that? Those are the only questions that I have got at this point in time.

Jonathan Nicholls

Let me just respond to that – you are right the dividend has come out, the number you have got actually is too high, but I should also point out of course that we continue to make profit throughout the rest of the Group which will come in to support that FGD surplus as we go forward. And our projections for FGD surplus continue to be reasonably solid. You are right there in terms of the exposure on currency, and the issue actually was in one of your recent notes was that we have Rand-Dollar exposure in particular on FGD, because we have a negative in the US. The reason for the negative in the US predominantly relates to this liability of intangibles to the US business we have over there and the dollar debt that we run offsetting obviously the significant surpluses we have elsewhere but particularly in South Africa.

In terms of hedging, it is not something we have done up to now – it is something though that we are considering, because clearly there is the potential for volatility on that, and it is something that we would consider going forward.

Francois du Toit, JP Morgan

Thank you.

Operator

Your next question comes from Jacques Conradie from Peregrine Capital. Please ask your question.

Jacques Conradie, Peregrine Capital

Good morning everyone, Jacques here. I just have two questions – one regarding the US Life Onshore business. In your management statement you state that one of your goals for the year would be management corporate bond portfolio to reduce weightings in the financial and banking sectors and relative risk of losses. Now, would that mean realising these bonds and basically selling them and buy other bonds and would that cause you to realise the losses and how would that influence your capital position. The second question would just be – can you just confirm – I just missed the part that you answered the previous question on whether your FGD surplus of £800 million – is that gross of the dividend, so the dividend that goes ex on the 5th starts to be deducted from that? Thank you.

Jonathan Nicholls

Hi, Jonathan again. Let me just answer your first question again in relation to managing the book – clearly going forward what we don't want to do is to unnecessarily realise losses because it does have an impact obviously on our profitability going forward. With the book where it is – in terms of some of the questions we have had already people have already identified as have the rest of the market that spreads have widened subsequent to the end of September; actually we are relatively restricted in what we can do in terms of proactively managing the book now. Having said that, we are looking at the book and we do obviously continue to monitor it very, very closely for specific rating items or actions which may cause us to have to recognise an impairment from an asset that is on our watch list of below 80% of market to book.

In addition we continue to monitor the developments in the US; I mean obviously the US Government has been active in terms of supporting the

banking community in America. As yet whilst there are rumours that they are going to do something similar to the insurance industry and no doubt some of the insurance industry results announcements last week will be encouraging them to look at that more closely than perhaps they might have done. At this stage though there is no specific news, but we continue to engage with the appropriate people to ensure that we are fully up to speed with that if and when something does come out of the US Treasury.

Yes as I said earlier, in terms of the surplus, obviously that number was September as before; the dividend payment and we continue to make profits as a Group, so going forward we are comfortable that the FGD number that we have is ok and comfortable in terms of our outlook.

Jacques Conradie, Peregrine Capital

So effectively the situation with the bonds trading below book kind of does restrict you in a sense to trade out of bonds that you don't like because of the fact that you have to realise the losses, so in the end you will only trade out on rare circumstance – would that be correct?

Jonathan Nicholls

That is right. At the end of the day you have got to realise –the markets are disrupted and if you look back to June 2007 when the book was onside we have seen a fundamental re-pricing of credit spreads, but the bonds themselves are still being serviced in the vast majority of cases. Interest is still being paid, maturities are still occurring.

Clearly, though, what we have got to do is continue to monitor that portfolio because of specific impairments or specific insolvencies or rating downgrades, or items which would cause us to have to recognise an impairment from the watch list. Just in that context it is just worth recording that for the year-to-date of the total impairments that we have recognised which now total over $500 million we have only actually incurred $21 million through insolvency. So that gives you some idea of the fact that it has more to do with accounting rules rather than specific insolvencies or businesses going bust, or whatever – it is just about accounting rules at this point in time.

Jacques Conradie, Peregrine Capital

Great, thank you very much.

Operator

Your next question comes from Tiargo Parente from Fidelity. Please ask

your question.

Tiargo Parente, Fidelity

Good morning, just a fixed income question if I may. Your hybrid debt, your prefs contain basically clauses to defer the coupons that are on a pure management discretion basis. Could you give us an idea of what your approach is likely to be if any different from what it has been regarding the coupons on the prefs in light of perhaps the view to conserve capital at this delicate stage?

Jonathan Nicholls

Yes, I think just a couple of points on that – I think from our point of view you are quite right that is in there, I think that would be part of a broader debate in terms of the outlook for the business when we finish the year end results and when we are considering dividend and prefs and coupons on that; clearly far too early for us to be able to give any guidance on that at this stage.
[This question was answered in light of the Group Equity Dividend. The response should have made clear that for regulatory purposes, we are unable to guarantee payment of any discretionary coupon of our hybrid debt instruments but at this stage we are confident that coupons will be paid when due.]

Tiargo Parente, Fidelity

Thank you.

Operator

Your next question comes from David Danilowitz from Merrill Lynch. Please ask your question.

David Danilowitz, Merrill Lynch

Thanks very much. Good morning – almost afternoon here – two questions – first of all clearly the FGD surplus is the difference between two numbers, capital and then required capital – you discussed actions you have taken with regards liquidity. Could you give us a feel for what actions you could take with regards to reducing your required capital – I guess in your case that relates primarily to DAC and upfront costs?

Jonathan Nicholls

As I said earlier we actually tend to look more specifically at the capital draw of each of our business, so obviously as you will know we have been for example driving OMSA away from the capital heavy to a capital light

business. Chris Chapman is focusing specifically on that in terms of the products that he is looking at going forward where we are trying to reduce the amount of capital that each of our product lines absorb. In that context, that is obviously very – not surprisingly proactive management to ensure that we are maximising the return available for our capital that we have.

In relation to other issues that we have got, I mean you mentioned DAC there – in terms of our businesses in the US as Julian mentioned in his speech that we are looking at all assumptions for that business. And clearly it is too early yet to be able to conclude as to where we will come out on that, but that undoubtedly will have an impact for example on the VNB which is one of the reasons why we haven't disclosed that and no doubt elsewhere within our balance sheet as well, so we do need to continue that work, complete the exercise and we will update you just as soon as we can.

David Danilowitz, Merrill Lynch

Thanks. The second question comes back to the net client cash flow with regards to, as in clients money moving – just referring back to your '04 accounts where sales on Onshore US Life were particularly strong and I guess my question I am referring to is what type of maturity profile – we are all focused on surrenders right now, but clearly realising of assets is a critical issue as well. Could you give us a feel for what the maturity profile looks like? Are most of the products five-for-five or have you got shorter term duration products in there as well?

Julian Roberts

The average duration is around six years.

Andrew Birrell

What we do David is we also do cash flow matching on the bond portfolio so that we have cash flows coming out of those portfolios that is matched roughly when we expect maturity and the expected surrender proceeds to be paid, so that doesn't change much with changing market conditions and again that underscores the fact that provided we don't have substantial unexpected defaults in that bond portfolio we have got cash flows coming out of the portfolio to support the cash outflows and policies. And to underscore the point that we made earlier, around 21 million of defaults thus far in the portfolio is notwithstanding the quantum of impairments that we have had to recognise.

David Danilowitz, Merrill Lynch

If I could just jump on that a little bit – if I were to roughly just to sum back

the maths calcs of your book about the 20 billion of book value let's say you could achieve very high type of yields of 10% - you could be coming out with 2 billion of interest and payments whereas your flows are significantly higher than that, so clearly – would you be inferring that you are adequately covered from pure interest only or you clearly would need to be realising assets?

Andrew Birrell

I think in the – obviously you don't hold assets only with one maturity, so there is a range of maturities coming out of the portfolio too. The interest flows plus the maturity flows are adequate to cover the liability outflows.

David Danilowitz, Merrill Lynch

Great thanks.

Operator

Your next question comes from Marius Strydom from BJM. Please ask your question.

Marius Strydom, BJM

Hi there, me again, I have three quick questions. The first one is just a theoretical hypothetical question. If your shareholding in Nedbank were to reduce below the 50% level would that mean an increase in the FGD surplus, would you be able to count the shareholding in Nedbank as a portfolio investment for FGD surplus purposes. Second question is – the Chinese Asset Management acquisition that you announced a couple of months ago, has that reduced your FGD surplus to date and has the cash already been paid for that acquisition and if not what do you see the timeline on that, at which stage do you actually see that cash flow reducing both your cash position and your FGD surplus position? And then I guess the final question is just to confirm again, you don't consider the final dividend payment to be sacrosanct I mean if you are in a position of liquidity difficulty I assume that you would feel comfortable to cut that dividend if it means that it affects the situation for the company.

Jonathan Nicholls

I will pick up a couple of those – as you quite rightly say, the discussion on Nedbank is hypothetical, clearly if we didn't have it then we would have more surplus, so as I said it's totally hypothetical. In terms of dividend Julian answered the question, I have answered the question – at the end of the day we will run through the year end process, we will complete our

business then as normal in that context going forward we will decide what the dividend will be.

Julian Roberts

If I come back to the Chinese deal; that hasn't completed. If you can probably understand the difficulty we are having at the moment – ABN Amro, the asset manager was owned by ABN Amro who was then owned by Fortis, and now Fortis is split into two, so we are at the moment not too sure that who we are buying this business from and therefore we are certainly not too sure who is going to give us the reps and warranties from it, so I think it will be several months yet before that deal is consummated.

Marius Strydom, BJM

Thank you.

Operator

Your next question comes from Risto Ketola from Deutsche Bank. Please ask your question.

Risto Ketola, Deutsche Bank

Yes hi it's Risto here, just following up on somebody asked about the preference dividends being suspended, don't you need to actually suspend the ordinary dividend first to be able to enforce that?

Don Hope

If we were not to pay on the preference share then you're correct then we could not and following I think twelve months pay an ordinary dividend that is correct.

Risto Ketola, Deutsche Bank

And the second question is, in the US you used third party administrators and underwriters to rent scale and I'm wondering if you narrow the product range will you still be able to get the third party services at the current rates, or would that scale issue become a real problem then?

Julian Roberts

Yes we have a great deal of flexibility; several years ago we had very little flexibility with the outsourcer, we certainly have significant flexibility now. We don't have long notice periods at all and therefore we're very confident we can negotiate costs down quite significantly. There are competition as well that are giving significantly cheaper rates than our current provider as

well.

Risto Ketola, Deutsche Bank

A question for Andrew really is that let's say the market falls from here, so the top up amount on the non-fronted book increases am I right that because you're so far up the money it becomes almost like delta one in that whatever the additional top up would be, would be a reserve addition anyway?

Andrew Birrell

That's right.

Risto Ketola, Deutsche Bank

So even if the market falls further effectively you're damned if you do, damned if you don't; the top up is the same as the guaranteed reserve movement?

Andrew Birrell

Yes that's roughly right Risto and remember when we set the level at which we could do the top up we had to look at the situation not just that hopefully markets improve, but also that markets get worse. And so the level at which we are doing the top up made some provision for that too.

Risto Ketola, Deutsche Bank

And the last question on this is that you saying you not hedging volatility, but obviously volatility is a huge input into your reserve as you setting it up over time. But as you get to maturity it becomes a delta play rather than volatility so I'm just wondering here is that shouldn't you maybe wait out for the volatility to normalise before you proceed with the offer?

Andrew Birrell

Well I think that would be taking a view on market timing and given that markets have been acting in very unusual ways it will be quite hard to predict how long to wait out. But this time we feel we have adequately reserved for the guarantees if we do any form of top up and people accelerate it then there is no more guarantee on the policy so there is no volatility that can affect the cost of the guarantee. In fact clients who take the acceleration can also then invest in any fund they like so we will no longer have restricted funds for those clients. So there are a number of positive reasons not just for us, but also for clients, why the offer makes sense.

Risto Ketola, Deutsche Bank

Yes and the last question it's pretty straightforward I just want to double check this is for 100 basis point increase in impairments the FGD impact that is simply 100 basis points times the bond portfolio, less the small release of RBC, so the net effect is maybe 95 basis points?

Andrew Birrell

Probably yes.

Risto Ketola, Deutsche Bank

Ok so it is that straightforward.

Andrew Birrell

Pretty much yes.

Julian Roberts

Operator I think we're running out of time, so I think we have probably only got time for another couple of questions we have already overrun.

Operator

The next question comes from Greig Paterson from KBW, please ask your question.

Greig Paterson, KBW

Morning lads, lucky I got in at the tail end. One is a request and then two points for clarification. The first one is there is a lot of information risk associated with your stock. And you're proposing to give the '07 prior years numbers of market consistent at the same time you do the '08 numbers so therefore nobody can really do a forecast for the '08 numbers. Can I suggest like the other companies who targets of January to give the '07 comparable so that we can nail down the risks there earlier and therefore have list risk associated with the stock.

The second point is a question; I wonder if you could actually tell us what for this US VA book what the unit account is, what the actual degree of the guarantee is so we can work out the degree of money. And just a clarification, I was listening to all the commentary and it was a bit confusing. You're exposed to the Brazilian index, you're exposed to the Yen, I wondered can you just be specific about the indices or currencies or issues that you are exposed to.

And a third thing is my understanding, you have been speaking too some of the local asset managers in South Africa saying that you would look at a break up if the stock price didn't recover. I wonder if you could put a time frame on that and what would be the catalysts to make you decide that a break up would be a value enhancing proposition or alternatively if it would not be.

Julian Roberts

Let me answer that last one first Greig. What is very clear to me is that the Group has to change and my role here has to deliver that uplift in value to the Group. We can't carry on trading as we have done for many years and it's worse over the last period of time with such a discount to the sum of the parts. That's why I'm moving on to do the work that I have said I'm going to do and I'll come back with more to say in March. But I'm going to look at the options that I think gives the best shareholder value.

Andrew Birrell

Let me just pick up some of the other points. Grieg look we debated at length the timing of the announcement for MCEV and unfortunately we're just not going to be able to go in January. We're going to have to do it with the full year results, so apologies for that, but hopefully we'll provide sufficient analysis and sufficient time to process for you to be able to dig into the numbers. In terms of the exposures that we have within the Bermuda book, we haven't actually given out specific exposures currency by currency or index by index; but I think probably the best thing to do is that once we have been through the process with the offer we can then consider whether or not we get specific exposure detail of that.

Greig Paterson, KBW

I'm just looking what is; forget about the detail, what is the aggregate unit account exposure you have got that 105% guarantee of five years, what is that actual amount? So we know the degree of the moneyness. And then you mentioned Bermuda am I correct in saying that you mentioned Japanese Yen, the Yen's exposure, just clarify what you have said, those two numbers I think are crucial the first two and just clarify exactly what you said during the call on what are the specific exposures?

Don Hope

I think in terms of the different exposures we do map across a whole range of indices and markets with associated currency exposures. And those change on a regular basis because our clients are permitted to switch

funds, the asset managers have obviously actively managing their investment portfolios. So that is something that we need to monitor and track on a regular basis, I don't think it's going to be particularly useful information to give you the current exposures because they are changing all of the time.

Greig Paterson, KBW

But you did mention the Yen and the Brazilian index security.

Don Hope

Yes there was a small amount of exposure to the Brazilian index and I said that we don't cover that it's pretty trivial.

Greig Paterson, KBW

You said it's trivial.

Don Hope

The Yen is one of the four major currency exposures that we believe would be coming through on this book and once we have the Yen covered along with the Euro, the Sterling and the Korean Won which is the other major currency exposures that we have, we believe that we will have around 75% of the currency exposure hedged, we do obviously have exposure to the Hong Kong Dollar as well, but that is hedged against the US dollar.

Greig Paterson, KBW

So the Yen is hedged at this point?

Don Hope

The Yen is in the process of being hedged over the next week or so but we have actually been benefiting from Yen strength.

Greig Paterson, KBW

And what is the unit account total and the 105 guaranteed total?

Don Hope

I don't think we have given that information.

Greig Paterson, KBW

But you're asking investors to invest in the stock and you talk about a risk exposure and we have got no idea what the actual quantum is?

Don Hope

We have got the position hedged and we have provided the reserves against that liability.

Greig Paterson, KBW

Ok I think I will take this offline, thanks very much.

Julian Roberts

Ok operator is there one last question?

Operator

Your next question comes from Jon Hocking from Morgan Stanley please ask your question.

John Hocking, Morgan Stanley

Hi I just wanted to confirm that the currency hedging is restricted to the Bermuda block rather than the IGD cash flows or the IGD currency exposures rather?

Jonathan Nicholls

That is right.

Jon Hocking, Morgan Stanley

Ok thank you.

Operator

Unfortunately we have run out of time for any further questions I would now like to hand the conference back to Mr Roberts.

Julian Roberts

I would just like to say thanks for everybody joining I'm sure there will be a lot of follow up calls, but we have run out of time to do so. I know we haven't talked about trading but I think it's quite fair capital and liquidity we spent time on the issues, but I do want to go back and say fundamentally the Group has solid capital in its subsidiaries and is trading well in this environment. So thanks very much indeed for your time.

Operator

That does conclude or conference for today for those of you wishing to

review this conference the replay facility can be accessed by dialling within the UK on 0845 245 5205 or alternatively on country code +44 145 255 0000 the reservation number is 67635029. Thank you for participating.