

Friends Provident plc UK Market Workshop



Ben Gunn
CEO
FP Life & Pensions

Title slide – Ben Gunn

Good morning to you all. I'm Ben Gunn, chief executive of Friends Provident's life and pensions operations, and it's my pleasure to welcome you here this morning. Thank you for coming.

Agenda

The main purpose of today's presentations is to set out our plans to accelerate growth in the UK life and pensions arena. I will set the scene and then hand over to Simon Clamp, to give us more details about our strategy and why we can have confidence in it.

Philip Moore will then run through some of the financial implications, before James Ward talks about Wraps and the investment market. Finally, Philip Moore will return, this time in his capacity as Group CEO-elect, to close the formal presentations.

There will be ample opportunity for questions at the close of today's presentations, so can I suggest that we hold these back until that time.


After that, I very much hope that you will be able to stay for a bite to eat, and take the opportunity to speak with any of us individually on what you've heard this morning. You can also see some of our systems demonstrated. Amongst the other senior people here today are Keith Satchell, our Group Chief Executive, Jane Stevens, MD of Operations, Rocco Sepe, MD of the International businesses, Paul Tunnicliffe, Director of Friends Provident International, and Kevin Watkins, Director of UK Sales.

Let me first briefly highlight our 3rd quarter new business figures announced this morning.

2006 new business (Jan-Sep)

With total new business for the first nine months of the year up by 39% on the same period last year, there is no doubting the genuine and growing momentum in our business.





Looking at the breakdown between our UK and International operations, both are showing excellent growth, with the UK up by 34% and International up just over 50%.

Both our international operations are building their businesses with energy. At this point last year, FPI new business was up 26%, compared with 31% this year, and Lombard was up 11% compared with 68% this year, although Lombard's numbers are potentially more volatile due to the impact that large cases can have in any quarter, and please remember that very large cases tend to be lower margin.

There is also a one-off territorial effect in Lombard's figures, primarily resulting from proposed tax changes announced by the new coalition government in Italy. The proportion of Lombard's new business produced in Italy this year is significantly higher than for the first nine months of 2005, but this may be exceptional, as these tax changes are still being debated.

The pattern of new business for Lombard remains strongly skewed towards the fourth quarter, and the broader indicators for future success are clearly positive.

You may recall that we hosted a similar meeting to this in June to focus on our International developments. On that occasion, we shared with you how we intend to leverage growth in largely untapped markets of huge potential and higher margins, developing primarily the very good distribution relationships that already exist, but also strengthening our reach through the opening of new offices in Switzerland and Singapore.

Benefit from these new developments is likely to impact new business positively over the second half of next year.


2006 new business (Jan-Sep), split by product segment

Turning back to the UK, group pensions continues to take the lead in terms of volumes. We showed at interims how this is profitable business for us, how our use of technology enables us to handle increasing volumes cost-effectively and how our excellent service is not compromised despite the very significant growth. This means that schemes placed with us tend to stay with us. Simon will cover this later.

For individual pensions, the percentage rise of 98% is flattered by the timing this year of DWP payments coming through, but stripping these out, underlying growth is still up by more than 60%, primarily comprising the more profitable single premium business which we target.

Investment growth remains steady, but of course the big future factor here is our entry into Wraps, which will be covered in more detail by James a little later.

Protection business continues to be lifted by the effects of some of the many distribution agreements in place now being felt, and we remain confident of growing our share of this segment over the next few quarters. Whilst the 9 month growth figure was 8%, third quarter growth over quarter three 2005 was 37%.



So the results as a whole indicate continued success and growing momentum, both here and abroad. Today, we turn our focus onto the UK market, which is a market we know well and which we believe holds out significant opportunities for accelerated and profitable growth.

H1 Market share

Our share of this market is steadily advancing, from just under 5% last year to nearly 6% at the half year stage, double where we were when we listed just five years ago. In fact, our Q2 market share is up to 6.9%, compared with 4.7% for the same quarter last year, which is a very significant increase indeed over just twelve months.

You can see that we currently hold strong positions in protection and group pensions. This reflects the success of our strategy of re-engineering the business processes in certain segments, and then developing them. The investment market is the next segment in our sights.

For individual pensions, we continue to target only the more profitable single premium business, and Simon will comment on SIPPs in his presentation. As you know, we currently do not focus on annuity business. However, the wider retirement market is attractive and we are evaluating how we can target this segment.

We are of course firmly in the top ten for UK new business as a whole, and the evidence points to these top ten companies continuing to attract the lion's share, currently some 75% of new sales compared to 50% about a decade ago, according to recent reports. We expect that concentration trend to continue.

We have also said before that, because of the way IFAs and the major multi-ties demand choice, there will always be a number of significant players. Whether it be five, six, seven or eight - we confidently expect to remain one of that number.

Life & Pensions strategy


Our approach to building our position, segment by segment, is to deliver unrivalled levels of service, enabled by leading-edge technology applications.

It is this combination of service and technology that underpins the relationships we have with distributors, which we value. The feedback coming from those in our business who daily present what we can offer distributors, in terms of building customer relationships and introducing operating efficiencies, is that people like what they see.

The latest development is our prospective partnership with John Lewis. This moves us into a new league and is a hugely encouraging development for us. It will be another important step in our diversification of distribution streams, as well as a further endorsement of our attractiveness to potential partners.

We remain confident that more agreements will be secured in the coming months.

Incidentally, the technological strengths we have in the UK market are exportable. Earlier this year, we completed the transfer of FPI business onto our UK platform, and off the back of that, we have just launched pension products into the German market.



This is the latest example of how we take opportunities that are aligned with our capabilities, looking for ways to transfer our UK expertise to match the needs of consumers or distributors in foreign markets, offering service excellence beyond the reach of those without the IT know-how that we have.

As you know, our focus is on the more profitable, lower risk market segments, and we continually review our reward versus risk appetite. For example, we continue to review a wide range of options to maximise the value, and reduce the risk, of our annuity book.

So I am positive about the market generally, and particularly about our strategic position in it, and excited about the opportunities we have to move up a gear in building on the significant progress already achieved.

Investing in opportunities to accelerate growth

So what does moving up a gear look like?

Over the next couple of years, we intend to lift our investment in the UK market to between £30-40 million per annum. This will bring the total development spend including our international businesses to £40-50 million per annum, from £25 million in 2005 and a shade over that in 2006.

In the UK, we will be developing further our existing strengths in protection and pensions, and becoming one of the handful of successful providers of Wrap platforms. In all of these, our established strength of great service for our customers, supported by strong technology, will continue to be a source of competitive advantage.

And what are we aiming to get for this investment? Our aim is to triple the value of new UK life and pensions business, from the 2005 level of £64 million, hitting a target in the range of £180 - £200 million by the end of 2008. This is a stretching target, and is set against the expectation of the UK market growing by something like 15% this year, trending down to nearer 7 or 8% in 2008.

The opportunity is now

The time is right to exploit our leading capability in IT and service.

Consumers and advisors are being increasingly drawn to the web and this trend will continue. They expect instant service, or as near to it as technology allows. They also want to be in the driving seat when it comes to control. This plays to our strengths.

We can also be trusted to deliver.

We've already delivered on an expansion of our international business, delivered on group pensions and increasingly in the protection market too. Just what we promised in our flotation prospectus.

And now we believe that, just as stakeholder proved a catalyst for change in the pensions market, Wraps - for a relatively small investment - has the potential to be a similar driver of major change in the way that individual customers manage and hold their assets, and our strengths are those needed to succeed.

We have the financial and the operational ability to deliver on our promises, and I am confident that we will. I'd now like to hand over to Simon to take us forward.



Simon Clamp
Managing Director
Marketing & UK Distribution

Title slide – Simon Clamp

Thanks Ben and good morning ladies and gentlemen.

Ben has outlined our vision of accelerated growth for the UK business, which is to triple the Value of New Business by 2008.

My aim now is to describe in more detail why we feel very confident about achieving this growth.

Agenda

I'll update you on our UK strategy – how we are delivering on this, how it positions us in the market, and how we are positioned with respect to changes in that market.

I'll then cover the main product areas – including for the first time the margin per product segment; our distribution strategy, and why we believe our market proposition is both compelling and differentiated.

Delivering on our strategy


Our core UK strategy is clear and in fact remains largely unchanged since listing.

We've developed service excellence and leading products to create a positive customer experience. We've moved from 2-star service in 2001 to a sustained 5 star service today; the only life provider to have a 5 star rating for both life and asset management businesses. We'll develop this lead further with our 6 –star programme – more on that later.

I will show today how we intend to build on our leading market positions in group pensions and protection. Investments have been less of a focus for us in recent years, but I will outline our plan to move to a leading position in this market as well.

We have built strong and reliable distribution relationships.

We have regularly updated the market on our success in developing our distribution relationships, and this will be familiar to you. We are on most of the major distributor panels and have announced recently large deals with several building societies and banks including Barclays. We have also benefited from other relationships, including Countrywide and Hargreaves Lansdown.



Our technology is widely regarded as market leading – we are the Financial Adviser ‘e-commerce provider of the year’, and we have a triple-E rating for all our protection and pensions propositions. This technology has enabled a substantial reduction in our unit costs, as we’ll see later.

We’ve made great progress in developing our people and culture over recent years, and our success here underpins the excellent service results we have had.

Every year we survey our staff engagement which is a measure of how committed our people are to achieving our business goals. In the demanding market conditions of 2006, we’re delighted that the engagement level now stands at 76%. In the area of people satisfaction alone, we are 10% points ahead of the benchmark for financial services industry.

Benefiting from market changes

Our core strategy has positioned us well to take advantage of a number of changes in the marketplace.

We anticipated the shifts arising from depolarisation, and have benefited as advisors moved from single tie to multi tie. Today, we are on most panels.

We have seen some expected consolidation in the IFA marketplace - Thinc and Destini for instance.

We have also recently seen Berkeley Berry Birch advisors moving to Tenet, and Millfield advisors to the Moneyportal. Our strategy has ensured that we have very strong relationships with the consolidators in the marketplace.

We have seen some providers taking control of distributors – Aegon, Skandia, and Axa all now have ownership of some significant distribution, although each operates an open architecture business model.

The vertical integration we have seen has not changed the significant share of business we get from these owned distributors.

Our own strategy of taking stakes in distributors has until now focused on minority stakes, and has ensured a broad base of relationships across the larger players in the intermediary sector.

Another key change has been concentration amongst the top 10 providers.

The top 2 companies have declined, but the next 5 – including us - have considerably outpaced market growth.

We also anticipated the increased activity in group pensions business, and the opportunities for players with a leading proposition to capture marketshare.

The move from DB schemes to DC , from trust to contract-based plans, plus the high profile which pensions issues get today, all benefit our business.



Growing in profitable product areas

Before turning to individual product areas, I'd like to comment on the UK portfolio as a whole.

Our focus is to maximise the value of new business, subject to an overall double digit hurdle rate for Internal Rate of Return.

We do have an eye to margins, but we prioritise maximising the value of our new business.

As mentioned, we are disclosing margins in the UK product segments for the first time.

We have positive margins on all our products – including group pensions which are shown here after full allocated expenses have been deducted.

Clearly with 8.8%, protection is the highest margin product, but our group pensions business has contributed substantially to an increase in total margins, as you'll see in a moment.

All in all, what you see here is an impressive growth in VNB since listing.

We have had experience variances and changes in operating assumptions each year, however, the total of these variances comes back to near zero – minus £1m in fact. This demonstrates that while VNB is an estimate of future profitability of business sold, our estimates are accurate and credible.

Operational Gearing – delivering increased profitability

Let's turn now to operational gearing, which we highlighted at interims results.

This has been delivered by writing a significant volume of business, and leveraging our market-leading technology on a flat cost base.

The growth in volume has been largely in group pensions this year, however the overall impact of this volume is not to decrease margins by this move to a lower margin product, but actually to increase overall margins. In fact, margins on all products increased – by spreading fixed costs over a higher volume of business.

Protection: sustainable profitability


Turning now to the review of our product areas – starting with protection.

At a margin of 8.8%, protection is our most profitable product area.

There are several drivers of this profitability:

We have cost advantage derived from our leading-edge systems, which deliver a paperless straight-through process, including underwriting for the majority of cases. This reduces the cost by at least a third over a paper system.

Our systems not only deliver a cost advantage – they generate a real service differentiator for intermediaries in areas that really matter, like knowing that their client can get life cover within 20 minutes.



We also offer responsive and competitive pricing – although we will not always be the cheapest.

Continuing to grow our protection business

Looking ahead, the housing market outlook – a key indicator for protection sales – is reasonably positive.

We have distribution deals on protection in place, and expect increasing volumes in the next few years.

We are continuing to develop systems, and our development spend will be increased to this end. We are developing our system to 'B2B2C' branding requirements, enabling the use of external branding on our system.

We are converting some of our distribution partners not currently using the e-select system, onto this system, reducing our costs and making it easier for them to promote our products. By the way, if you haven't seen e-select, then do take a look at the demonstration in the lobby later.

We are developing a business protection proposition, which will begin to impact from 2008 onwards, and we are developing new systems to support and increase our group income protection share.

We will also develop and launch a group life product, which again will increase volumes by 2008.

These systems give us a cost advantage – which builds a barrier to entry for new players – as a very significant investment in systems is now required to make a profit in this market.

Pensions profitability – market backdrop


Turning to pensions, I want to first acknowledge recent market challenges with regard to pension business, and in particular on pensions profitability. These statements have challenged the quality of this business, on the basis that the business is not new, but is recycled or churned between providers, and that persistency is so bad that, taken together with the long payback period, the business is not profitable. Taking the market as a whole, there is some truth in these statements.

However industry experience in this area differs greatly between providers. Pensions is an area which now only a few can make truly profitable, and we're one of them.

Our pensions business is profitable

Our pensions business is profitable, with positive margins of 1.6% for both group and individual business after overheads. We've already seen today how growth in our pensions business increased not only the value of new business, but also overall margins - the impact of putting a high volume of profitable business on a flat cost base.

Let's look at what lies behind these numbers.



Most of our business is group pensions - Individual pensions dynamics are different from group. Much of the criticism of profitability in the market is more true for individual than for Group schemes. We are very selective in our participation in the individual market, and target the larger single premium end of the market.

Within group pensions, our business is moving away from full initial commission. Clearly, full indemnity commission creates more cash strain and persistency risk than a fee-based scheme.

Within commission-paying business, intermediaries are increasingly taking advantage of the flexibility offered to take reduced initial commission with higher trail. What you see here is that even the commission-paying segment is creating less strain and risk than in previous years.

For group pensions, we target high-quality schemes, monitor intermediaries for high lapses, recognise industries with lower staff turnover, and check employers' financial ratings. We price on a scheme-specific basis.

The key driver of profitability for Group pensions business, however, is persistency.

There are two types.


The first is where individual members take advantage of flexibility within the scheme to reduce or stop premiums, and it is this type of persistency hit that led to a small charge at interims and which we indicated would lead to a modest assumption change at the year end. The cost of this is likely to be in the low double digit range.

The second type of persistency hit is where whole schemes are lost..

Our actual scheme lapses to-date total approximately half of one per cent over five years. This figure applies for the period since demutualization and through the A-day period and represents scheme funds which have been removed to go to another provider or through corporate activity. This would be expected to worsen in time as the book matures, but to date this is an outstanding result.

This persistency is the result of a compelling and market-leading proposition – delivering operational excellence – combining class leading service backed with class-leading technology – we give employers absolutely every reason to want to stick with our schemes.

And just to touch on the issue of scheme churn – we have a relatively new back book, and so have been the net beneficiary of any churn – we suffer few losses, but pick up a considerable share of switched business. Our growing assets under management from these schemes - shown here - shows a position of rapid net increase year on year.



The other driver of pensions profitability is costs. Prior to 2001 our member to administrator ratio for Group Personal Pension Schemes was around 400:1. You can see from the chart how this has been affected by the significant technology advances that have been introduced, through the development of our award winning pension systems - which we call NGP, in order to accommodate the introduction of stakeholder style pensions. The changes we have employed have led over time to a 10 fold increase in efficiency to a ratio of well over 4000:1 by the end of 2005. This is at the same time as improving the quality of our service.

Growth in pensions: building on our leading position

Turning to the future, how will we build on our leading position?

In the shorter term, our view of the market is that the massive growth we saw in Q2 of this year is a spike from A day which we cannot expect to continue – however, ignoring this spike, we expect to continue to build our Group pensions business.

The accelerating trend from defined benefit to defined contribution schemes will, we believe, continue, and those recently opened defined contribution schemes will generate a steady increase of new incremental business.


Do we believe that SIPP is a big opportunity? The answer is yes, and we have a defined strategy for this market – and we are investing in it - but to understand the nature of that opportunity we need to take a closer look at the SIPP market.

A SIPP is essentially a personal pension with an extended fund range and the ability to invest in other assets.

For that additional investment flexibility there is an additional charge – and this will be appropriate only for the higher end of the mass affluent, as well as the high net worth market. There are few true SIPP products of this type being sold today, although we think the market will grow in the coming years – in fact we believe that half of all wrap assets in the future will be these SIPP products.

This is a market segment generally for customers who have a pension pot in the hundreds rather than tens of thousands. However we believe that this will be a profitable market segment, and our strategy is to tap this market through the development of a leading wrap platform - which James Ward will talk about shortly.

Many of the SIPP offerings being sold in the market today are actually individual or group personal pensions with a SIPP option. There is no additional charge until the option is used and most people with a SIPP option will in likelihood never use it. However, we recognise that this option will become a hygiene factor in the years to come, and so our standard group and individual pension products will in future include this option – the launch of these developments is targeted for mid 2007 for the group option, and later in 2007 for the individual option.



Developing SIPP offerings is not the only new work we are doing in pensions. We are working on improving our employer and member experience of us by improving our on line interactions – this should improve retention of schemes still further. We are working on our drawdown facility – this too will aid the reinvestment of policyholder money in Friends on the vesting of policies.

We are improving our ability to customise and bespoke our offering – this is key to attracting the very largest schemes.

Touching briefly on the question of the implications of the NPSS. The government's proposals in our view are either neutral for us – as the target audience for this are non savers, at the lower end of the market where we do not play. Or this could be an opportunity – if the government opens the administration of the scheme to the private sector – an administration function which FP's leading systems would be ideally placed to offer – should we so choose.

We plan to develop a significant presence in retail investments

Investments is one of our 3 core areas – it is profitable, with margins of 1.7%, but our current market share at 2.6% is below where we want to be.

We do think that Wraps will drive change in the investment market and provide considerable opportunity for those with proven technology expertise to work with intermediaries helping them sell a wider range of products for a variety of customer needs. Our proven technology leadership leaves us ideally placed to capitalise on this opportunity.

Therefore we think that the time is right for us to grow our ambitions in the retail investment space. We are developing a significant wealth management capability, at the core of which is our compelling wrap offering.

Wrap itself will probably not be a significant contributor to our 2008 target – most of the growth will, we suspect, be after this. We will, however, use the wrap technology to launch additional flexible packaged investment products, which will contribute to our 2008 target.

Winning and widening distribution


We have been consistently winning distribution deals – benefits of this are now starting to come through, our success in getting onto panels, and our recent successes in gaining bank and building society deals, are well documented.

The recent announcement of our partnership with John Lewis shows another development of our distribution strategy.

This “B2B2C” distribution is a new area for us. Along with the planned movement into the retail investment space, this marks the beginnings of a new relationship with our customers.

Our distribution investment strategy: delivering close relationships

I have briefly mentioned our distributor investment strategy – to take stakes in those leading intermediaries we see as being potential consolidators in the market. The strategy was conceived to help consolidation and infrastructure-build in a fragmented sector.



But it was also a move to develop strong relationships with those intermediaries. As a pure investment strategy it has not been a great ride – the sector has not performed well since 2001. However, this strategy has played its part in our transformational success in building the UK business – and continues to do so.

Originally, stakes in distributors were limited to less than 10%, but with regulatory restrictions now abolished, we have taken stakes in some distributors to around 20%, and we remain open to taking larger stakes in the future.

The Friends experience: sustainable differentiation

Underlying all our success is a clear differentiation – based on operational excellence. This combination of technology and real service culture has won Friends Provident numerous awards, including Life Insurer of the year at the 2006 British Insurance Awards.

I should emphasise that much of our success in service is not just down to technology, but critically to our people. We have focused on developing our people, and have high quality engaged workforce with a customer focused service culture. This is a real differentiator and one that is not easy to replicate.

The Friends experience: developing our consumer brand

As I have outlined, our strategy has been focused on intermediated distribution, and the building of our brand to date has mostly focused in this area. As a result of the changes I have described today – the growth in, and developments of, our current propositions, the move into retail investments and the developing B2B2C strategy - we believe now is the right time to start to increase our spending on our consumer brand, starting small but building up over the next three years.

Our target market for this brand development will be the mass affluent, and those engaged in making decisions around pension schemes.

This fits well with our move into Wraps and SIPP's and will engage with a higher net worth group of customers.


Keeping ahead: continued development

In order to secure this growth, as Ben has mentioned, we are intending to increase the level of development spend. We intend to invest some £40-50m each year of 2007-08, of which some £30-40m annually will be in the UK.

I have already highlighted the key developments on this slide. I do want to emphasise, however, our 5-star service – the highest rating there is. Underlying our strategy is a commitment to retain and improve that lead – and our internal 6 star programme is designed to do just that, a continued investment in service and technology.

Excellent prospects

In summary then we have excellent prospects for the future.



We are

- Investing for further growth in protection and pensions
- Developing a leading wealth management proposition with a larger market share in retail investments
- our distribution is widening, and we will continue to focus on profitable growth by differentiation through people, service and technology.

I hope that's given you a real insight into our UK strategy; James will go into further detail on wraps shortly, but first I will now hand over to Philip to explain how this growth in the UK is to be managed.



Philip Moore
Group Finance Director
Friends Provident plc

Agenda

Thank you Simon, and good morning to you all.

You have heard from Ben and Simon about the exciting opportunities we see in the UK Life and Pensions market and the ambitious growth target we have set ourselves.

In this session I will demonstrate that we can fund this UK growth whilst maintaining the dividend policy.

In short it is about capital and cashflow.

Strong, stable capital position

Starting with capital, this is no longer an issue

The balance sheet is the strongest it has ever been

Our ratings are improving

We have more than enough capital to support the growth outlined today.

Further, we have the skills to raise high quality, inexpensive non-equity capital to fund further organic growth, should we need it.

And we continue to reduce capital requirements by active risk management; for example as you have heard already we are looking at our annuity book

2005 was cash positive with some one-offs

Turning to cash, this is a reminder of our position for 2005. The slide is in the format of our cash disclosure used in recent results (and the numbers are the same!).

In that year we were cash positive, although we did benefit from a tax credit of just over £100 million, which was exceptional.


So 2005 was cash positive, what do we expect for 2006?

We expect to be cash neutral in 2006

As you can see on the slide, in 2006 we expect to be cash neutral or even mildly positive.

These indicative 2006 numbers include our understanding of what CP06/16 (that is the FSA's proposals for more realistic reserving for non-profit business) might do.

You will see we have also assumed a £40m re-payment of outstanding Fin Re.



The cash position before payment of the dividend or receipt from F&C is a surplus of about £150m – in excess of the net dividend cost in 2005.

We also expect significant additional releases from the new rules in 2007, once detailed guidance is released.

Limited use of monetisation to remain cash neutral 2006-2008

Now, we know there are one or two cash bears in the audience, so for you we have estimated our cash position over the three years 2006-8.

This is based amongst other things on:

- our understanding of CP06/16;
- projections of investment returns;
- and the growth plans we have outlined.

The turquoise boxes are for the UK only, the orange boxes for the group – with 2006-8 compared to 2005.

You will see we are projecting a neutral cash position – requiring just 150m of new securitisation or Fin Re. and after allowing the existing £70m Financial Reinsurance to fully run off.

The amount of new monetisation, be it securitisation or Fin Re at £150m, is very modest and can be easily flexed to meet the actual outturn. To give this amount further context, it is broadly the same as the amount expected to have been paid back on our 2004 securitisation by April 2007.

Securitisation is cost-effective and available

So, lets talk about securitisation. Why do we keep mentioning it, and why has no one else done one since ours?

First let's look at the growth of mortgage securitisation in the banking sector – through the 80s it was exotic and seldom used – now it is vanilla, the norm. The point is, after a slow start it's now huge. I am sure this will be the case in the life sector.


The main stumbling block for others is the challenge of how to ringfence a sufficiently diverse block of business. Our 2004 issue made use of the ringfencing we had to do for our demutualisation, but the experience we gained is invaluable, and I'm sure we can construct another suitably diversified and ringfenced book.

In summary, we know how to do it, and we know it works. It is good quality capital and it is cheap. In 2004 we raised £380 million at a cost of about 5.5%. Further, there have been no downside surprises for investors, so we are confident we can do another.

Projected distributable reserves are stable over the period

Whilst cash emergence is key, dividends are paid from distributable reserves.

At the end of 2005 our distributable reserves were over four times the cost of the 2005 dividend.



Further, we expect to generate sufficient distributable profits over 2006-8 so those reserves remain broadly stable - despite the growth we expect and while maintaining our dividend policy.

So we have a considerable buffer from which to pay the dividend.

Strong, affordable growth

In conclusion:

- Our capital position is strong
- We can fund the exciting growth we have talked about; and
- we can generate the cash and distributable profits required to pay the dividend.

Thank you. And now let me hand over to James, who will shed more light on to one of the most significant planks of our growth plans – our entry into the Wrap market.



James Ward
Director of Marketing
FP Life & Pensions

Title slide – James Ward

Thank you Philip and good morning to everyone.

I'm just going to take a few minutes to talk to you about our wrap development, which is a very exciting move for us, and a key part of the accelerated growth strategy that you have heard about from Ben and Simon.

Agenda

I'll start by giving some background to the wraps market.

I'll then talk in a bit more detail about the wrap platform that we will be launching next year.

And finally I'll explain why we see FRIENDS being one of the winners in this space, and how we'll be making money from wraps.

What is a Wrap?

A wrap is not a product, but a service offering that manages a client's investments on a single online platform.

At the front end, you have a web interface that gives access to a consolidated statement and a range of advice tools that support asset allocation, risk profiling and tax planning.

At the other end is a very wide range of investment choices that include cash, collectives, insured funds, stocks & shares, and perhaps in the longer term property and other valuable assets.

In the middle is a range of product 'wrappers' which may include life bonds, SIPPs, ISAs and the option of direct investment.

So what you get is a complete wealth management platform for the customer and adviser, that allows them to see their whole portfolio in one place, and get a "helicopter view" of their investments.

I'll just show you now a few screenshots of what a wrap platform might look like in practice, so you have a real sense of what it can do.

We'll have a fuller demonstration running in the lobby over lunch, so I hope you will be able to stay and look at it then.



Sample Associates

For the customer, the most important thing is that consolidated “helicopter view” – and the ability to see their portfolio value reported online, either on their adviser’s laptop or directly over the Internet, on a real-time basis.

As you can see, this also enables them to break down their portfolio by product, by underlying fund, and by asset class – so for example I can see how much money I would make if the bond market rose by 10%. At present this information could take weeks to collate, with endless calls backwards and forwards between their adviser and a series of life companies, fund managers and stockbrokers – by which time the information would be out of date. The wrap platform provides it immediately.

Of course this information would be of little use if they couldn’t do anything with it. But the wrap also provides the ability, through an online interface, to very easily switch money between different funds, asset classes and products. It thereby enables much more active management of the client’s portfolio, with the potential to gain better investment returns.

And finally the platform also enables better analysis of the client’s risk appetite, investment goals and tax status, so that the adviser can ensure that the portfolio they have accurately matches their financial needs and future plans.

Why use a Wrap?

So hopefully the benefits for customers are very clear.

But what does it do for the adviser? Well by taking time and effort out of their back office, the wrap enables them to spend more time with the client, undertaking regular reviews of their portfolio and advising on investment switches. As well as potentially generating revenue, this also means lower costs for the adviser and easier compliance (through use of the wrap’s advice tools).

In addition, by enabling a shift to a business model that places greater emphasis on fees and renewal commission, the wrap enables the adviser to build up embedded value in their own business. This also helps us, by reducing the cash strain and persistency risks that inevitably arise from business with high initial commissions.


Lessons from Australia

To see where this market might go, it is helpful to look at the experience in Australia, which has been several years ahead of the UK in developing the wrap concept, and where volumes have grown rapidly in recent years – to the extent that platforms now account for around 80% of retail investment flows

Lessons from Australia

There have been multiple waves of development aimed at different segments of the market, all the way from full wrap platforms for higher-net-worth customers, down to “mini” or “baby” wraps, which provide a cut-down service at lower cost, with restricted investment choice, to a broader marketplace.

This market has been competitive, with a large number of platforms competing for business. But assets have now begun to concentrate with a few successful platforms.



Gross margins have also been compressed, although as platform volumes have grown, profitability has actually improved, as the costs grow much less quickly than the revenues.

Some platforms have used white-labelling as a route to accumulate scale. However this is no guarantee of profits – if you tailor the proposition too much for each white-labelling deal, you never achieve the economies of scale.

The good news for us is that the real success factors that have distinguished the winners from the losers in the Australian market have been technology, service and distribution.

The UK experience to date

In the UK, the experience so far has been a little different. Until recently, growth in platform assets has been very slow.

Part of this has been driven by poor service quality on the existing platforms and problems with the technology, which have deterred advisers from being “early adopters”.

More fundamentally, the platforms have only really worked for new business – it has proved extremely difficult to transfer legacy assets onto the platforms, or to obtain online valuations for products that the customer does not want to move. Having an overview of only half of your portfolio is not much use for investment planning.

As a result, advisers have been very slow to move onto a wrap model, despite a high level of interest in the concept. This has not been helped by uncertainty around the regulatory position – in particular whether wraps would be treated as a regulated product.

The Right Time to Enter

So, given that rather depressing background, why has FRIENDS chosen this moment to enter the wraps market?

Well for a start, the market is now showing signs of the take-off that has long been predicted. A number of the established platforms have seen 100% growth in assets in the last year.

In addition, the distributors are starting to move. There are a lot of informal conversations underway and formal tender processes starting up, and we believe that over the course of the next 12-18 months, most of the big distributor groups will fix their wrap strategies. The research we have suggests that most IFA groups will initially choose to work with 3 or 4 platforms – and then work out over time which ones work best, and where they should therefore concentrate their business.

A big factor for us was the availability of technology platforms from the Australian market. By buying this in, we will be able to get to market in under a year, and significantly reduce our upfront costs – as well as leapfrogging our competitors by starting out with 3rd generation technology.

Plus, the regulatory environment is starting to clarify, with the FSA’s paper released a few months ago setting out their position.



The Right Time to Enter

So putting all that together, we are expecting strong growth in this market over the next few years. Of course, volume will take time to build on the platform, but we believe this is the absolutely the right time to enter, while the market is still evolving, and while distributors have yet to form their strategies or select the partners they want to work with. We have had very strong positive feedback from the market, with a number of groups keen to work with us in shaping the development of the platform.

An Opportunity for FRIENDS

For FRIENDS, this is very much a strategic opportunity. For other companies with a large share of the existing wealth management market, wrap is a threat that requires a defensive response to maintain volume and margins. But not for us - at present we have about a 2.5% market share for single premium investments, and less than 2% for individual pensions – so clearly there’s a lot of upside before we reach the kind of market share we enjoy for group pensions and protection. And in fact the individual wealth management market is bigger than either of those markets – and we expect an rapidly increasing proportion of these products to be sold via wrap platforms over the next few years.

So we are looking at a large market where we currently have low market share, about to go through a transition to a new business model, where the critical success factors will be technology, service and distribution.

An Opportunity for FRIENDS

Which are exactly the core strengths that have driven our success in the protection and Group Pension markets.

As Ben noted before, the introduction of stakeholder products in the Pensions market was the catalyst for us entering with a technology-led proposition with low costs and high service quality. 6 or 7 years down the track we can see the results, with us now in a market-leading position (from a very low base before) and making significant profits.


Our ambition is to do the same in the wraps market, and be able to look back in 6 years time with us being one of the winners in that market. We’ve done it twice before, and we firmly believe we can do it again.

Perhaps more importantly, so do our distributors. Our market testing of the proposition showed that they had every confidence in our ability to translate our strong e-commerce track record from Group Pensions and Protection into the wraps market.

The FRIENDS Wrap

So what will the FRIENDS wrap actually do?

We have already announced that we will launch the platform around the middle of next year, and our project is on track to hit that timeframe. The initial launch will be with a small group of founding partners, and we will then open up the platform to a wider audience later in the year.



The primary target market will be high net worth and mass affluent customers with significant portfolios of investible assets, and the advisers who serve them. As noted before, we see potential in the longer term for “mini wrap” propositions that provide cut-down functionality, at reduced cost, to a wider market.

We will have a full range of products on the platform – including cash, collectives, SIPPs, ISAs and life bonds, both onshore and offshore. There will also be a wide range of investment choices underneath that.

Finally, we will be offering flexible charging and commission structures to the adviser.

How will we be different?

Those are really the “hygiene factors” of what you need for a credible wrap offering. But what will make the FRIENDS wrap stand out in a crowded market?

The first and most important thing will be the quality of service we provide. Many existing platforms have struggled to live up to the promise of a true straight-through online process, with a lot of manual workarounds. Consequently advisers and customers have had to deal with processing errors and lengthy delays. We will be building our platform from the start to deliver a true end-to-end online process – applying the experience we have from our Group Pensions and Protection platforms into this market.


We will also be deploying best-of-breed technology. We’re using the Bravura system from Australia to provide the core admin functions, and the web front end to the wrap. In addition we are extending our relationship with Distribution Technologies, who already provide advice tools for our bond products, to deliver a new range of tools for the wrap platform. Buying the technology is one thing. The real skill, and much of the investment, is in integrating this with our proprietary and market-leading e-commerce infrastructure to deliver a seamless user experience for the customer and the adviser – just as we’ve done many times before with other software packages.

We will also be providing connectivity between the wrap and the IFA’s back office systems, which is key to achieving penetration in this market. Further, we will be providing significant support to assist IFAs with transferring legacy assets onto the platform, and we will look to build links with other providers to gain online valuations for their legacy products – at the same time as providing valuations for our own legacy to other providers’ platforms. In this way, the wrap industry will be able to get over the hurdle of legacy asset visibility that has held it back to date.

Finally, we will be providing a range of branding models, to suit different distributors. The combination of these features will, we believe, make the FRIENDS wrap the market-leading platform when it is launched next year.

How to Make Money from Wraps

I’m sure uppermost in many of your minds will be the question: how can you make money from wraps? There certainly isn’t much sign of large profits being made in the UK wrap market today. But looking at the Australian experience, and picking up from the Group Pensions market which has similar dynamics, we can see very clearly the route to financial success in the wrap market.



First, it's important to keep upfront costs low. If you spend £40m or more on a series of failed developments before getting it right, it will take a very long time to pay back. We shall not do that. Instead, we have bought in proven technology from the Australian market, and will be using a number of specialist partners to provide elements of the operational process – such as settlement of equities and collectives. It also means adopting a risk-sharing approach with our key suppliers, where they share in the success of the platform, and reduce our upfront costs as a result. Our development, therefore, will cost much less than some of our competitors – around £15-20m in total, spread over 3 years. This figure is included in the overall investment spend that Ben and Simon described earlier.

Secondly, scale is important. We expect volumes to grow relatively slowly in the early years, as advisers take their time in deciding to move onto wraps, and then in transferring client assets onto the platform. But we do expect things to take off in the latter part of the decade, reaching critical mass about 3-4 years after launch. At this point, the “operational gearing” that we've seen on Group Pensions starts to kick in – enabling us to take on more volume at relatively little cost, and so generate significant profits.

However, it's important to keep a focus on margins as well as scale. There are players in the Australian market with large volume, but low profits, because they have either given business away, or allowed their costs to balloon through tailoring of the platform for different distributors. Our Pensions experience again provides the model: pricing selectively to ensure that we grow volume profitably, and attract high-quality business. Overall, we expect wrap margins (including charges for using the platform, as well as product margins) to be similar to our current pensions and investment business. This is not a high-margin business. But with sufficient scale and active cost management we believe substantial profits can be made.

In addition, the cash and capital strain arising from wrap business will be much less than for traditional packaged products, given the expected trends towards fees and renewal commissions.


Which brings me to the final point – persistency. As with pensions, retaining assets on the platform will be key to maintaining profitability. And the key driver of persistency will be service quality, combined with the ongoing strength of the proposition. With the wrap, money can move around between different funds and products – provided that it remains on the platform, we will continue to earn our margin on it. And that's how we will make money from wraps.

A Recipe for Success

So, to sum up: we believe we have a significant strategic opportunity here to capture share in a market which is about to undergo a major transition.

We are entering at a time when the market is still evolving, and the major distributors have yet to fix their strategies and their selection of partners.

The critical success factors in this market will be technology, service, and distributor relationships – all areas where we have proven strengths, and can leverage our success in the Pensions and Protection markets.



Learning from that experience, we are also building our platform to deliver high service quality at low cost, right from the start. Which is the key to ensuring that growth in volume delivers real growth in profits.

And that's why we are confident the FRIENDS wrap will be highly successful, and a strong driver of shareholder value in the years to come.

And I'll now hand back to Philip for his closing remarks.



Philip Moore
Group Finance Director
Friends Provident plc

Title slide – Philip Moore

Thank you James.

In closing the formal proceedings, let me just bring the key points to front of mind again, before opening up the floor to questions.

Excellent prospects for growth

The headline message is that we intend to increase significantly the pace of new business profit growth in UK life and pensions over the period 05 to 08. Ben pointed to the real momentum we have in sales, which gives us the confidence to give an ambitious new target, which is broadly to triple the 2005 value of new UK business by the end of 2008.

So it's not just growth but profitable growth that we are targeting.

Keith will leave with many positive legacies. One of these is that we are a company that does what it says it will do. We've delivered on transforming our international operations, and on building a significant presence in pensions and protection. We have shown our strengths in these areas, and have the opportunity, ability and determination to go further.

This new growth strategy has been developed by the senior team together, so I can assure you that it will not be changed when I become CEO in the new year. And of course the benefits of it will shape our growth well beyond 2008.

Excellent prospects for growth

Let me summarise what we are doing. Simon outlined the UK market opportunities for us to continue to build our positions in pensions and protection while, at the same time, target significant growth in investment business. I want to emphasise this.

Although we have majored this morning on our plans to develop Wraps, we are also devoting significant time, talent and money to enhance our propositions for pensions, protection and non-wrap investment business.

Additionally, we are investing in the 6 Star programme's initiatives, to lift our service still higher, and in raising consumer awareness of our brand.

This renewed push in the UK market sits alongside the plans for growing our international business, outlined back in June. Both markets will deliver significant profitable growth for us.



The opportunity is now

The time is right for us.

As Ben explained the things companies need to be successful in the UK market today are the very things that we excel at:–

- e-commerce strength in depth
- excellent customer service
- and building distributor relationships that work for all parties.

And Simon covered how difficult it is for other players now to get a foothold without very significant investment in systems. And even then, we are committing strong investment capital to maintain our lead.

So our prospects for significant growth are genuine and exciting, and we can achieve this value growth without putting pressure on our dividend policy.

I hope you have found this morning both informative and exciting. I'm sure you have some questions so if you could wait for a mike, we would be pleased to take them.