

# Capital, cash and profits



2 July 2010



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# Capital, cash and profits

Andrew Moss

Group Chief Executive

## **Our challenge**

- to simplify and clarify how we make money and our cash generating ability

## **Three core themes to the presentation**

- key drivers of IFRS profits demonstrate the resilience of Aviva's results even in tough economic conditions
- capital generation is significant, resilient and will grow
- disciplined allocation of capital will fund profitable growth

# Capital, cash and profits

Patrick Regan

Chief Financial Officer

## We aim to explain

- How we make money
- What drives our IFRS result
- How this converts to capital
- How capital is turned into cash
- How we use the cash

## 1. Overview

## 2. Capital generation and utilisation

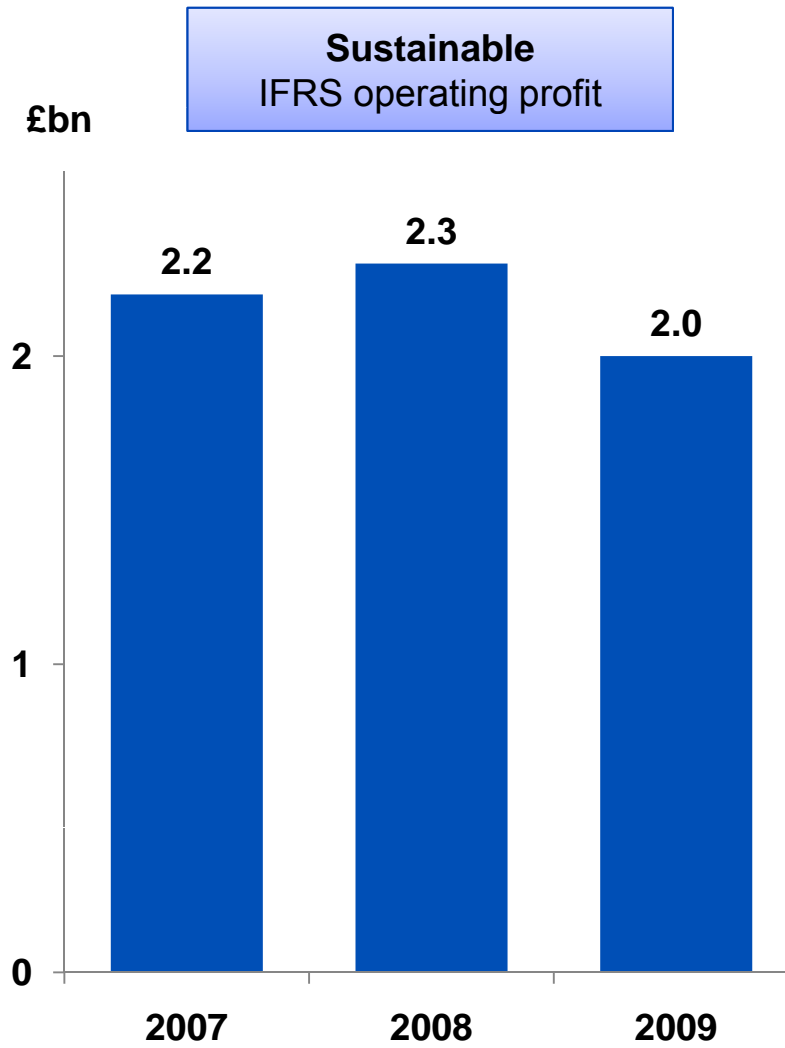
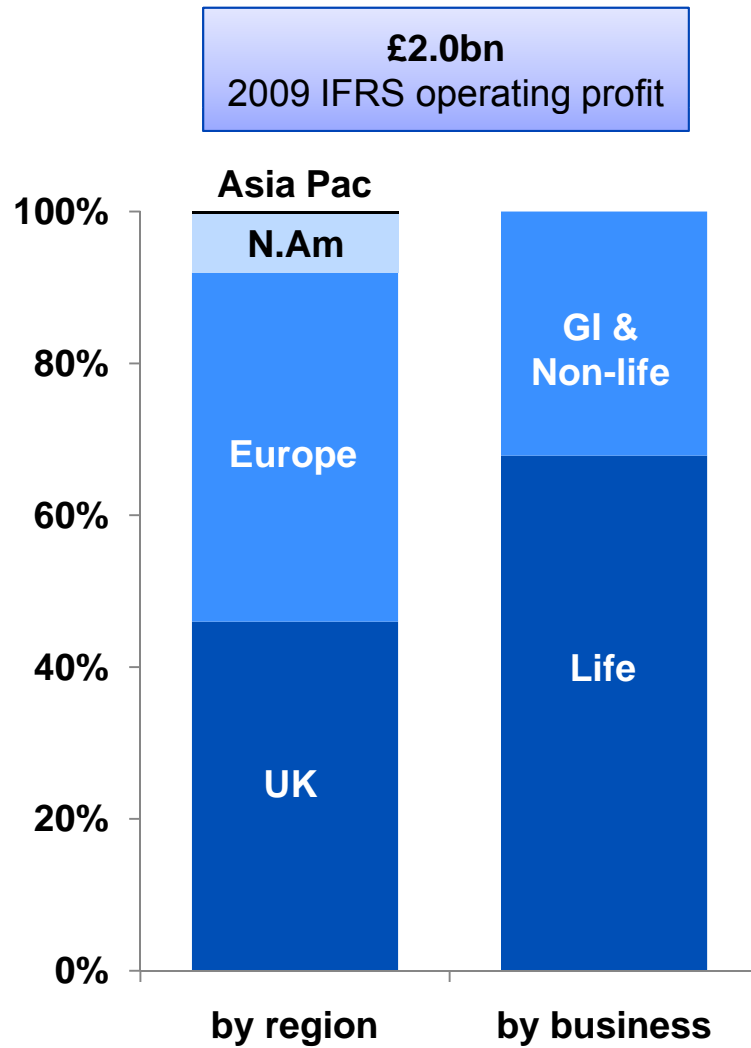
- Source and resilience of Life, GI & Non-life capital
- Disciplined capital investment to generate profitable new business
- Converting capital to dividends

## 3. Embedded value reporting

## 4. IFRS profit drivers

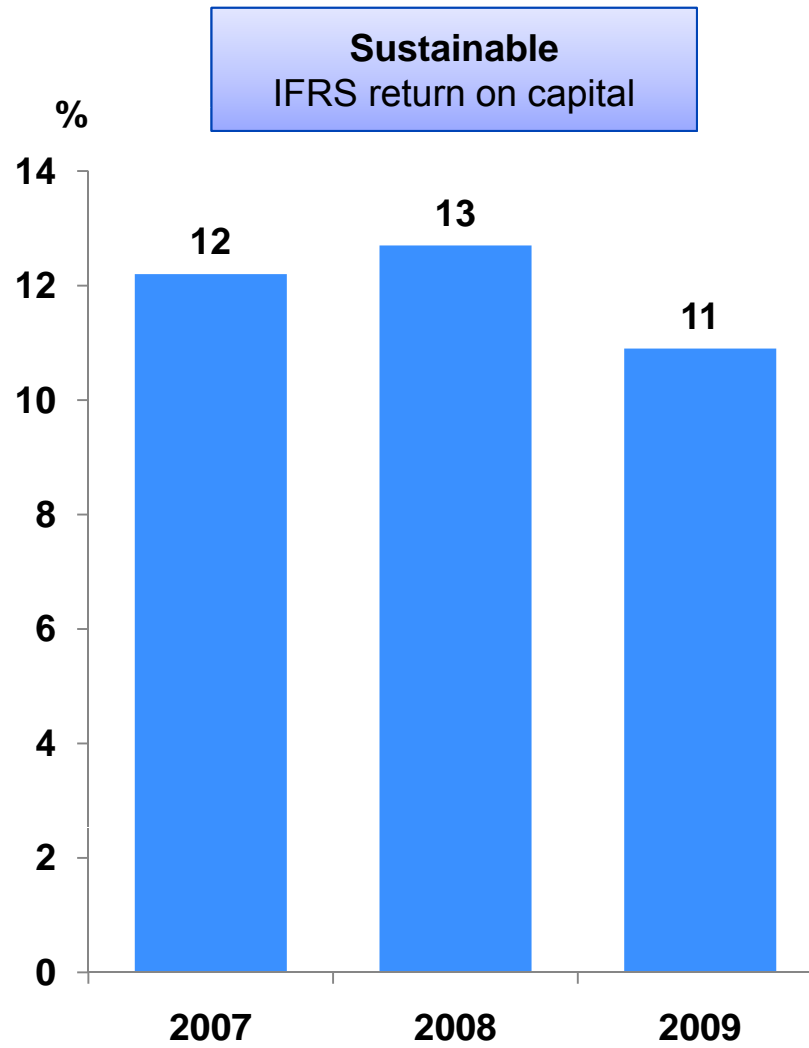
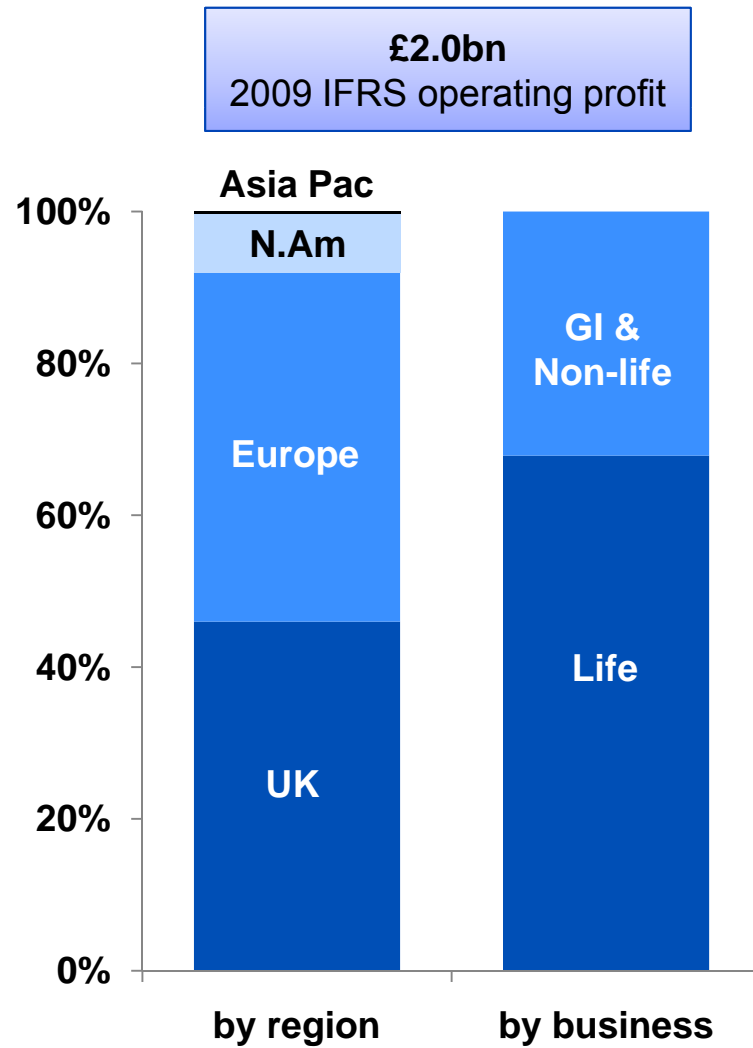
- Life profit drivers
- GI & Fund Management profit drivers
- Linking expenses to the profit driver analysis

# A diversified portfolio – with resilient profits

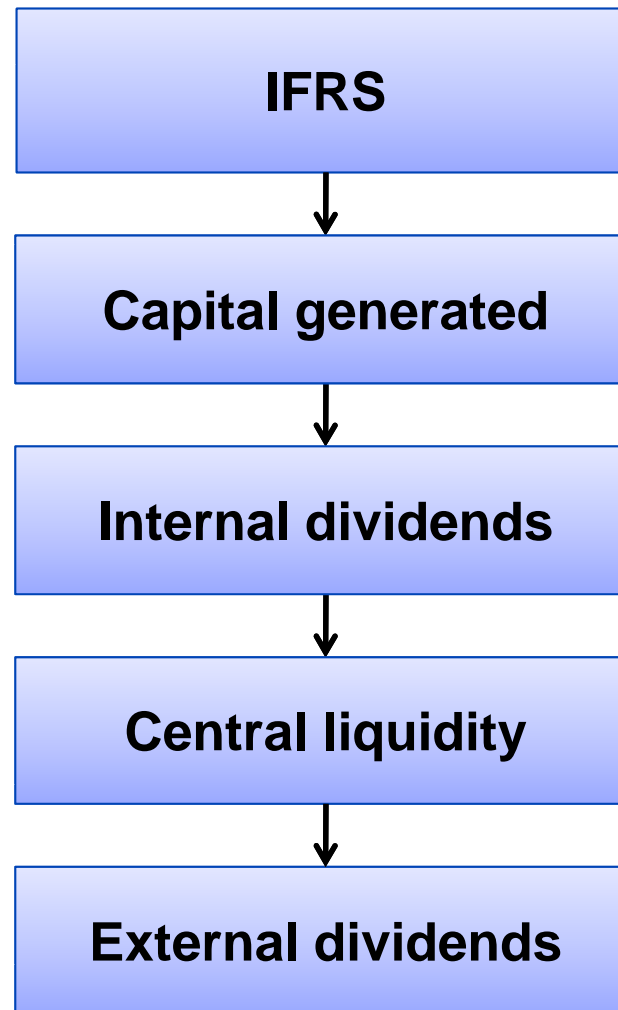




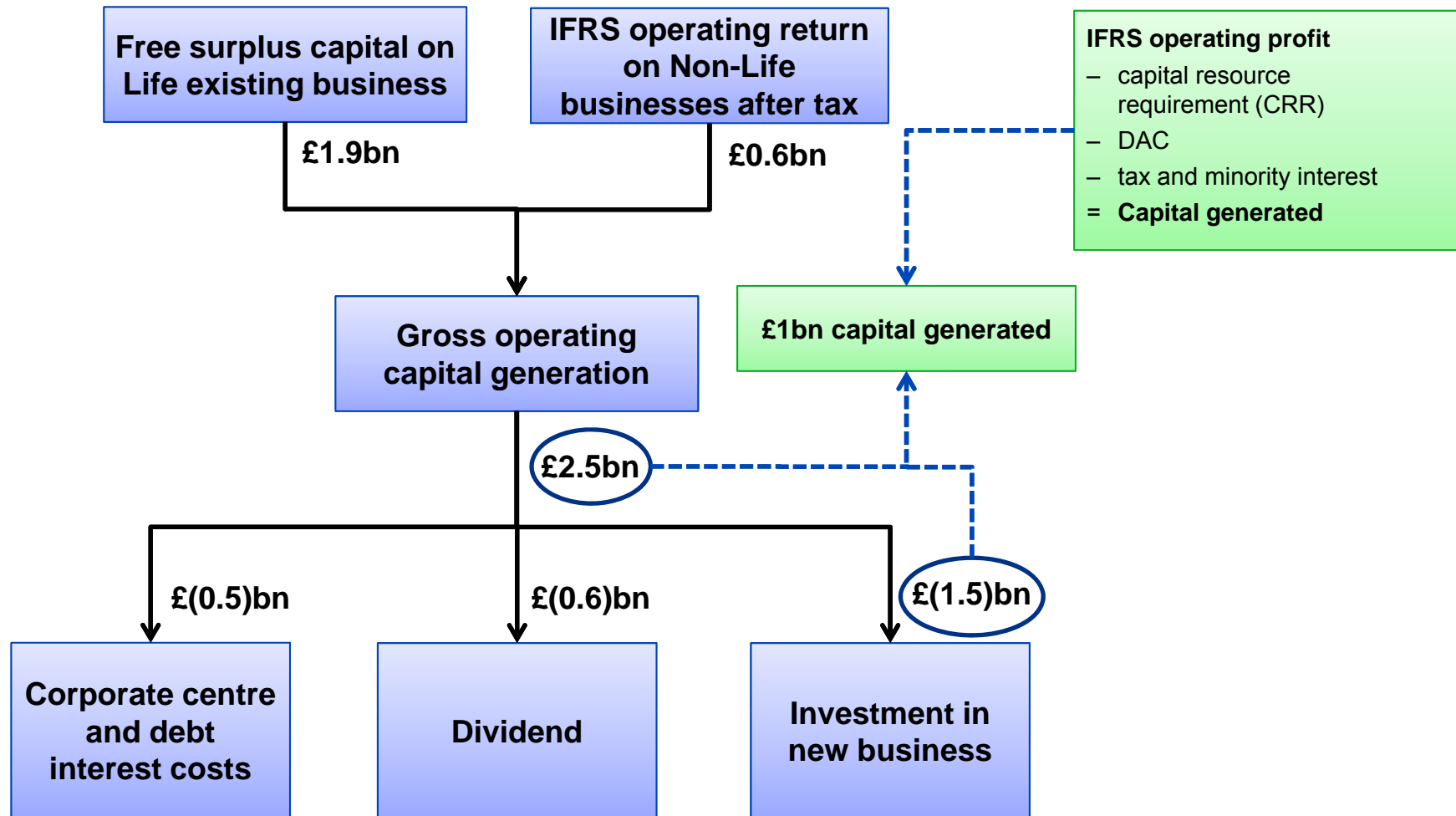
# A diversified portfolio – and a strong return on capital



Note: IFRS return on capital based on operating profit post-tax and MI



# Defining capital generation at Aviva



Operating profits use an assumed long term investment return

Note: 2009 numbers net of tax and minorities

Overview

Capital

EV

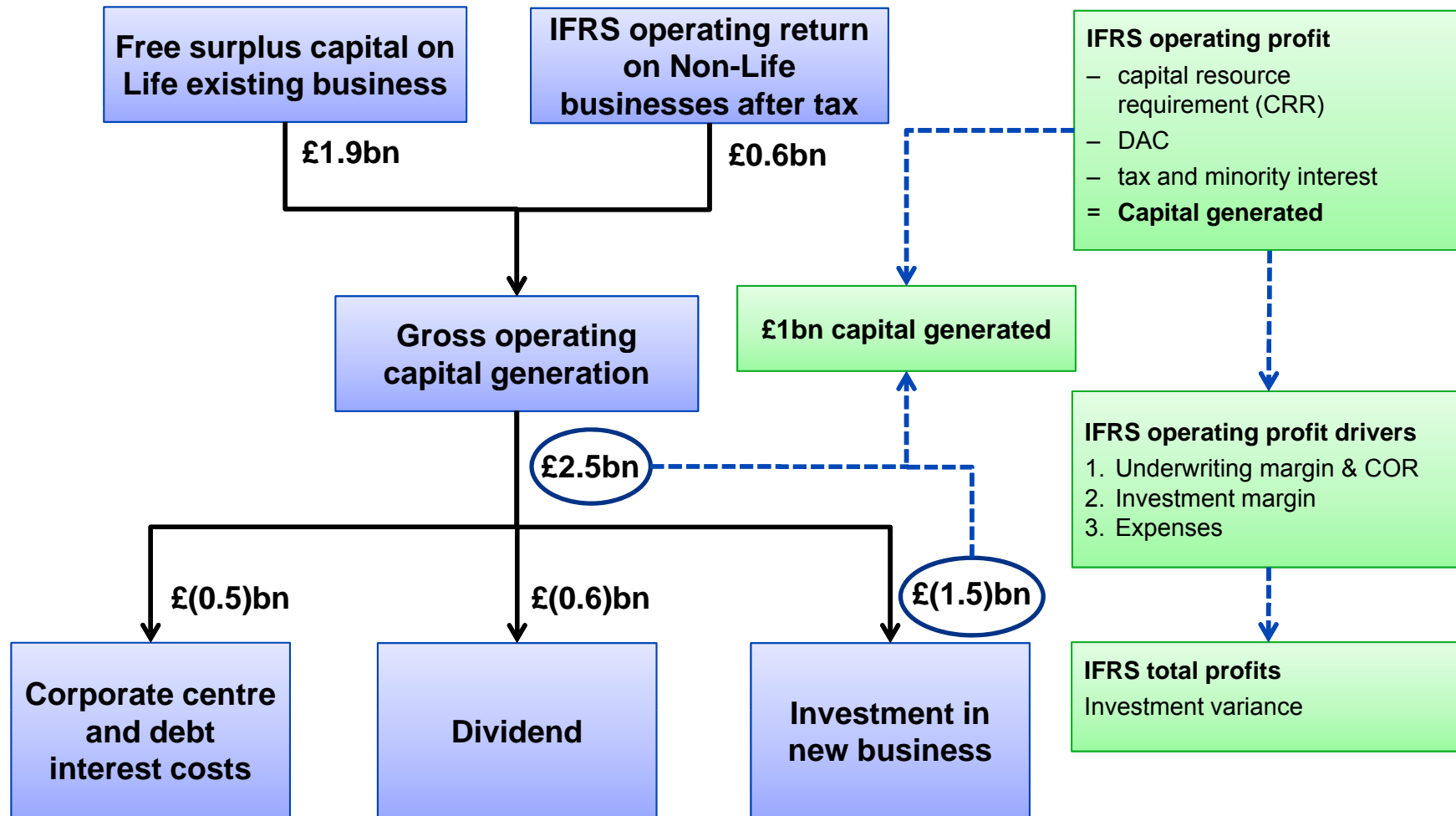
IFRS

# Reconciliation of IFRS to net capital generation



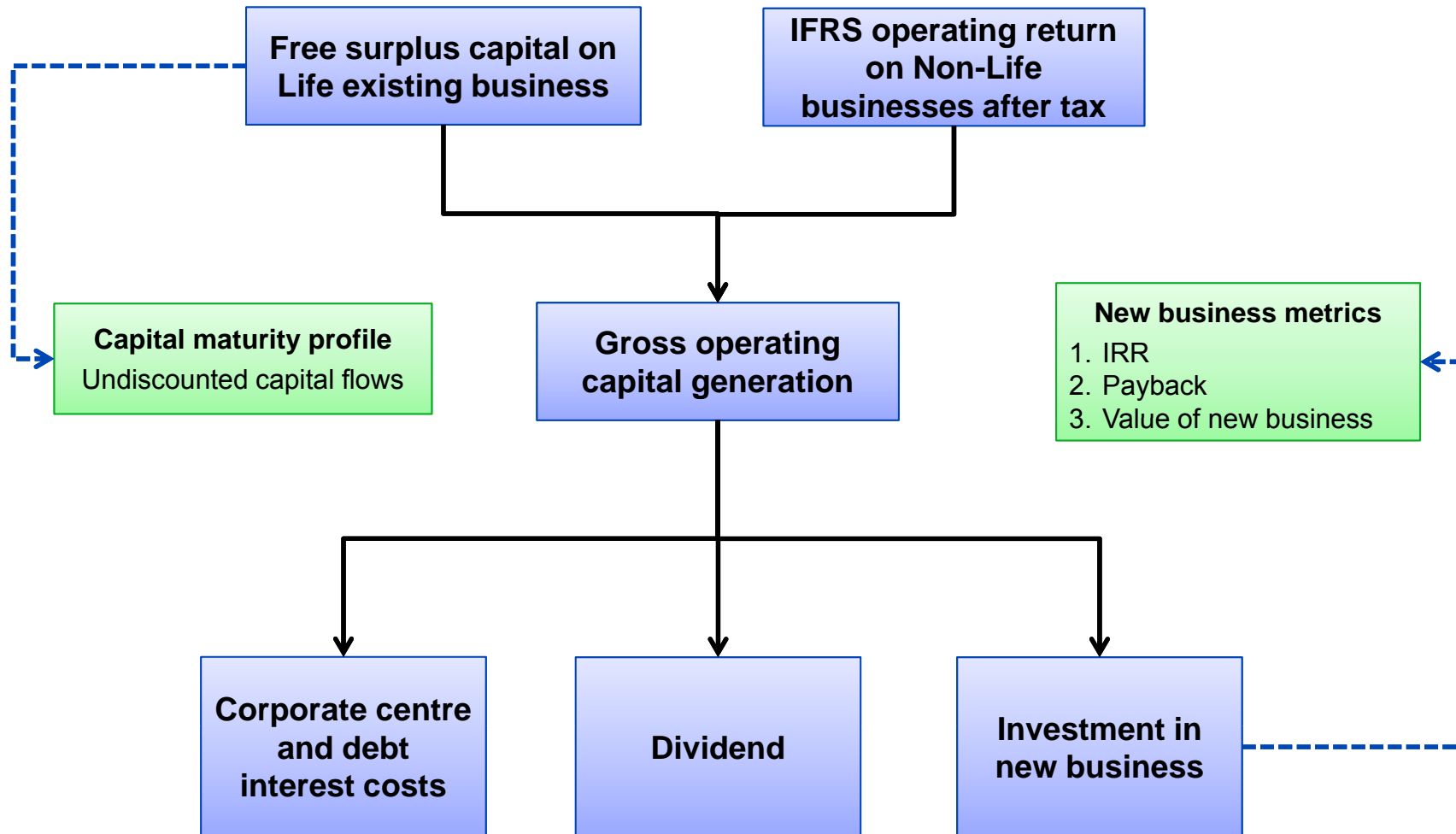
<b>2009 £bn</b>	<b>Total</b>
<b>IFRS operating profit before corporate costs and interest</b>	<b>2.8</b>
Less tax and minorities	(0.9)
Net increase in required capital	(0.4)
DAC and other	(0.5)
<b>Operational capital after investment in new business</b>	<b>1.0</b>

# Defining capital generation at Aviva

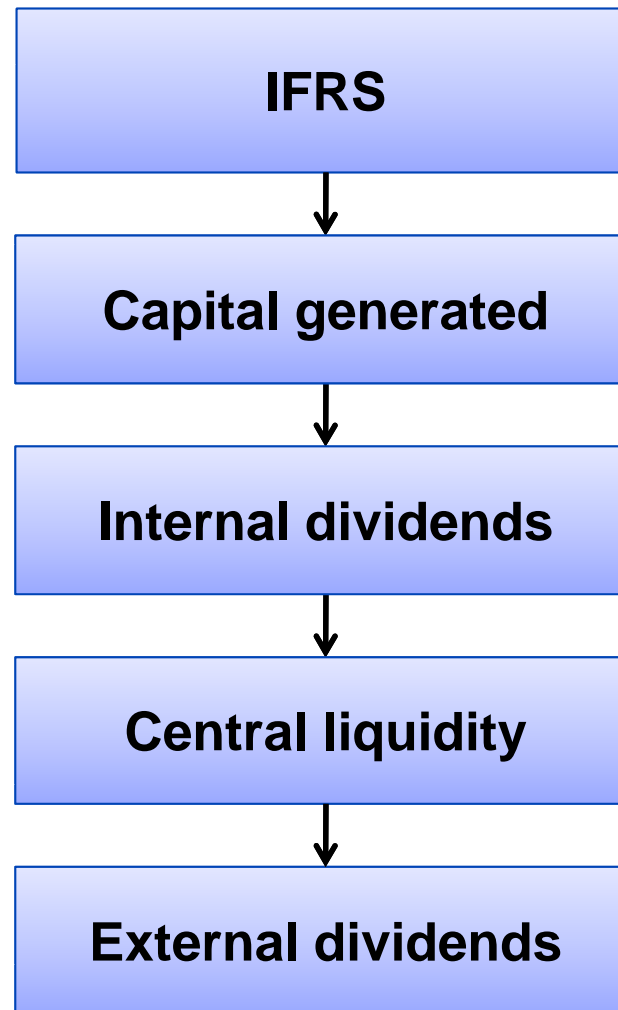


Operating profits use an assumed long term investment return

# Analysis of capital generation and utilisation



Operating profits use an assumed long term investment return



# Converting capital to cash

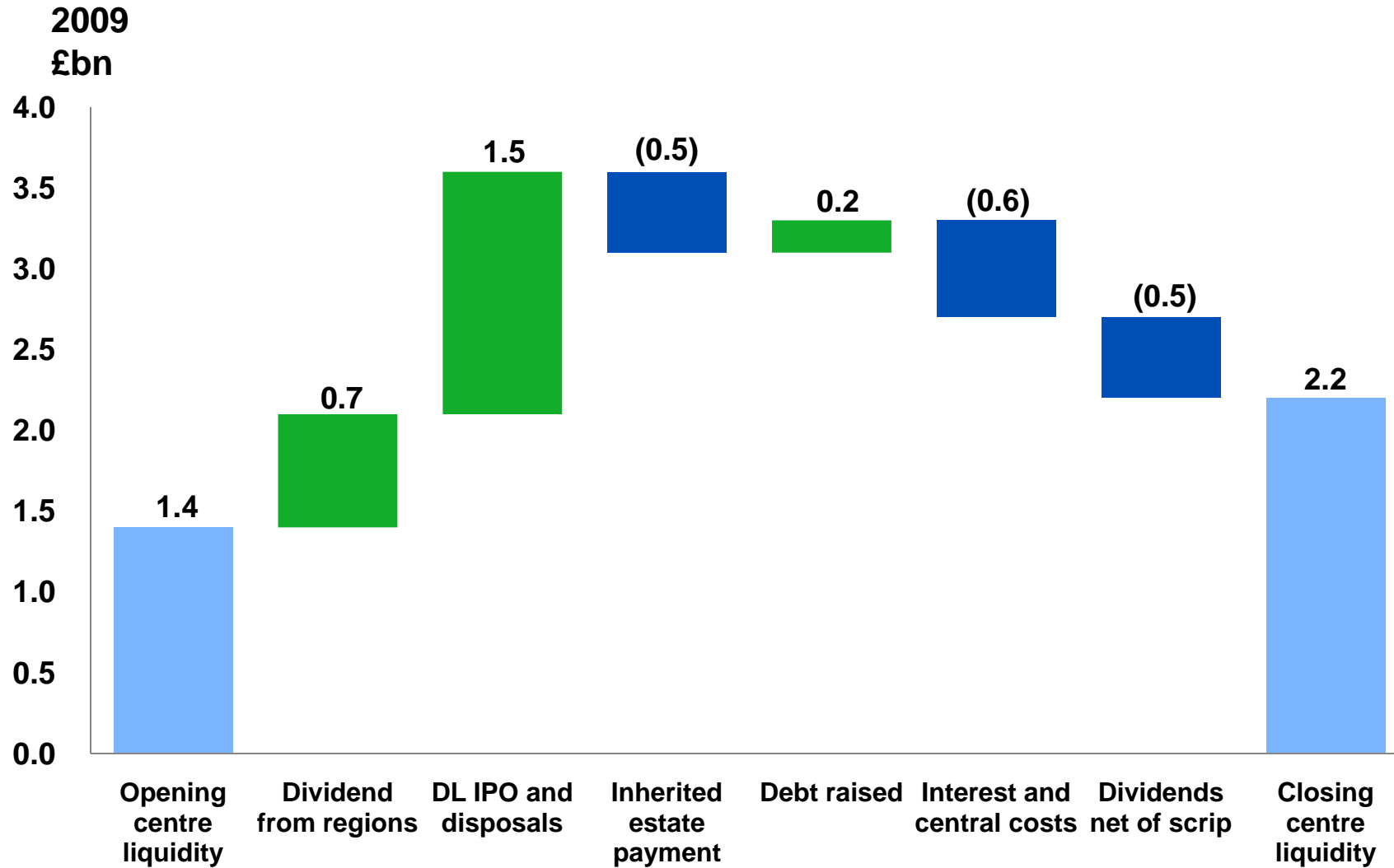


Dividends paid in year	2005	2006	2007	2008	2009
UK	✓	✓	✓	✓	✗ (Reattribution)
France	✓	✓	✓	✓	✓
Ireland	✓	✓	✓	✓	✓
Italy	✗	✓	✓	✓	✓
Poland	✓	✓	✓	✓	✓
Spain	✓	✓	✓	✓	✓
Canada	✓	✓	✓	✓	✓
Delta Lloyd	✓	✓	✓	✓	✗ (IPO)
<b>Total (£m)</b>	<b>950</b>	<b>1,200</b>	<b>1,100</b>	<b>900</b>	<b>700</b>

Over 2005-9 the regions paid an average yearly dividend of £1bn to Centre



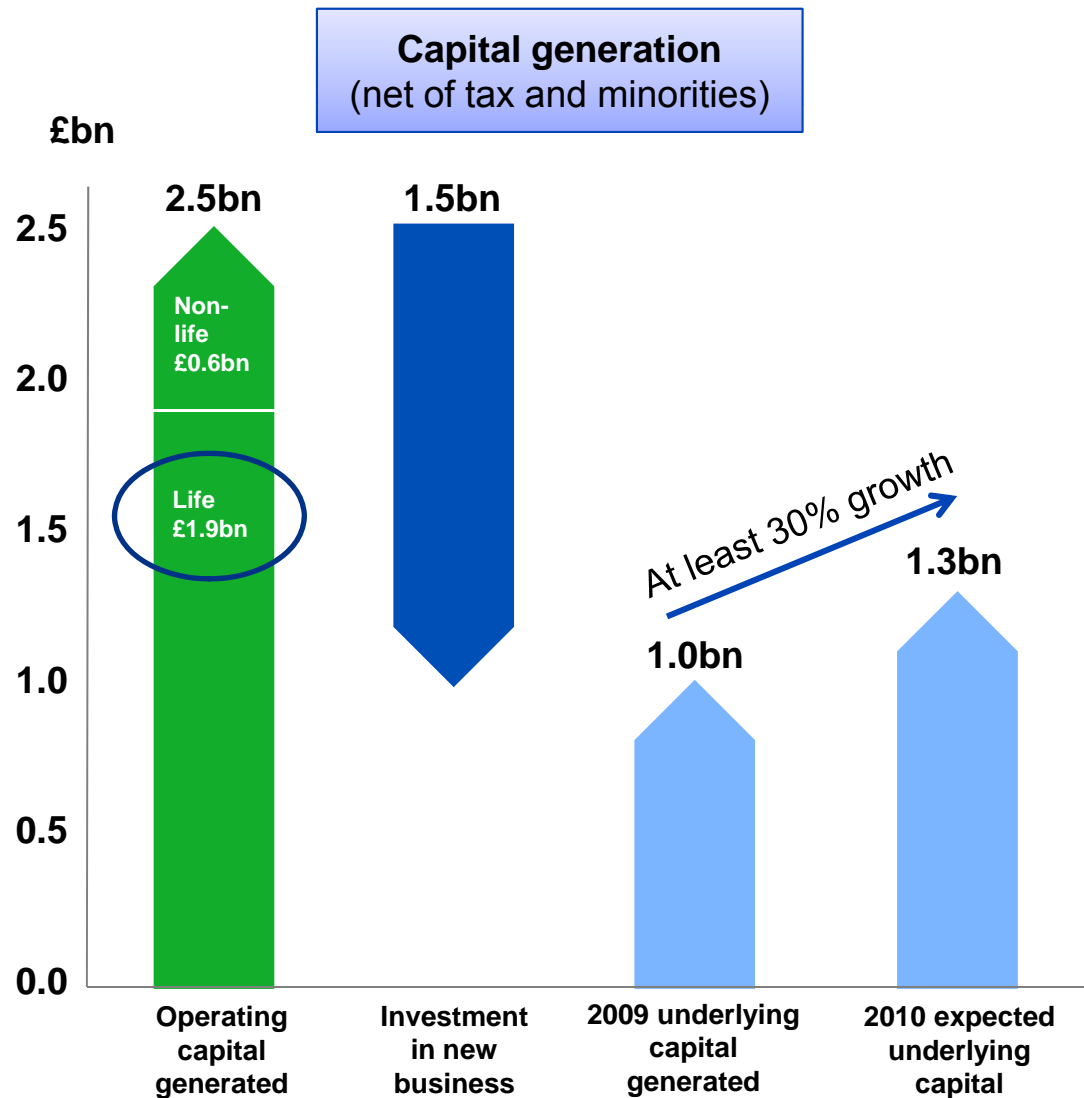
# Central liquidity



# Capital generation & utilisation



# Focused on generation and disciplined allocation of capital



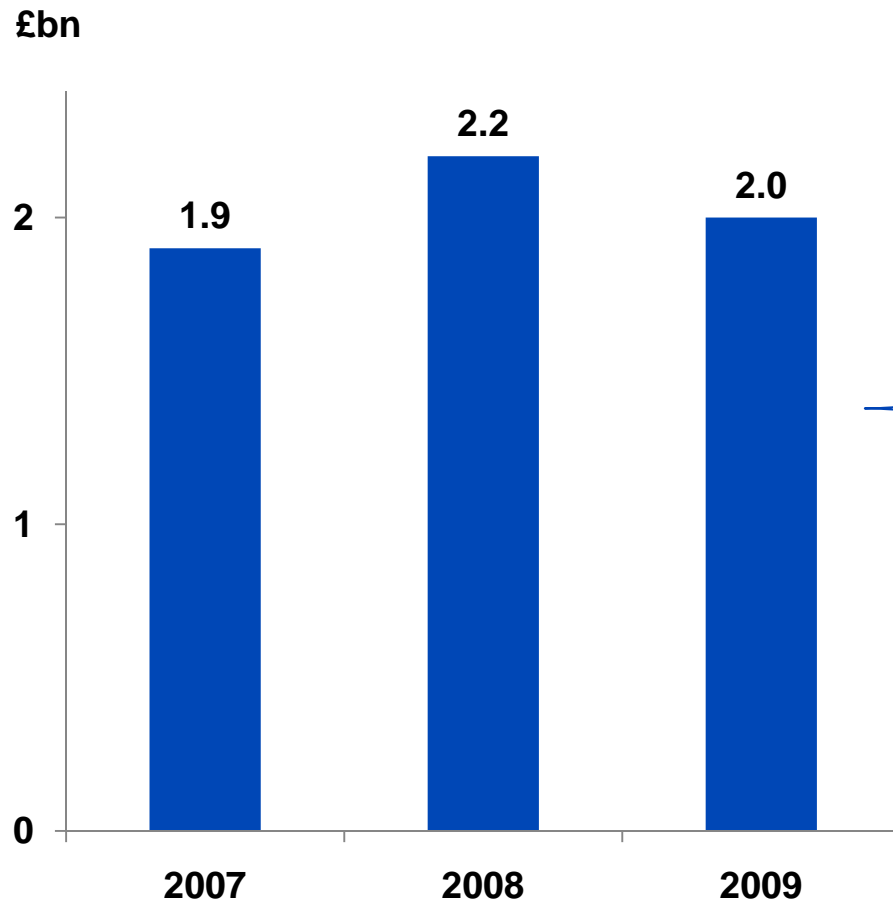
**A diversified range of life and GI businesses with 53 million customers**

- Generating material and predictable capital flows
- With an effective franchise to profitably attract and generate further capital

**Key levers for growth:**

- Increasing in-force capital generation
- Increasing GI profits
- More efficient capital investment

# Strong historic life capital generation



	2009 £bn
UK	0.4
Europe	0.7
North America	0.2
Asia Pacific	0.1
Delta Lloyd	0.3
US capital for year 1 only	0.3
<b>Underlying generation</b>	<b>2.0</b>
Other	(0.1)
<b>Total</b>	<b>1.9</b>

# Resilience and improvement of capital generation



## Managing expenses

- Continuing focus on cost savings, £500 million target achieved one year early
- Consultation around closure of UK final salary pension scheme

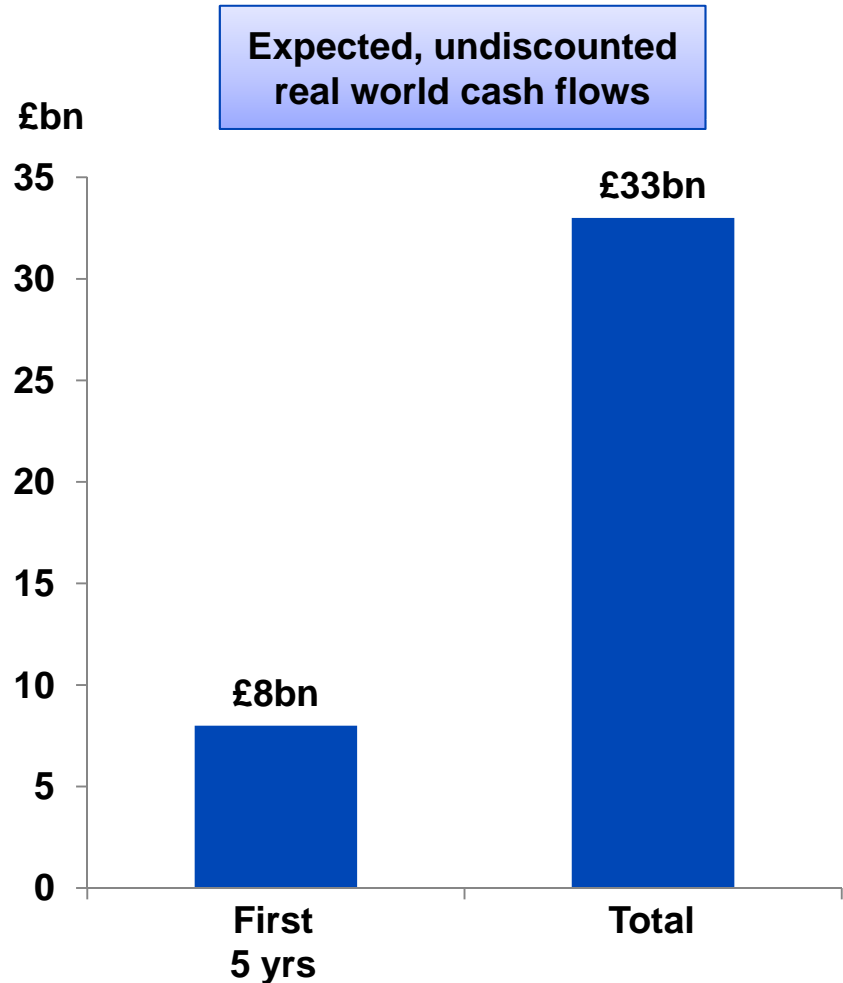
## Keeping our customers

- UK targeting pension, with profits and endowments customers
- Pan-European retention centre of excellence established in France

## Maintaining a strong balance sheet

- Reduced shareholder equity exposure
- Asset and liability duration matching limits impact of interest rate changes
- Limited losses on debt and mortgage book

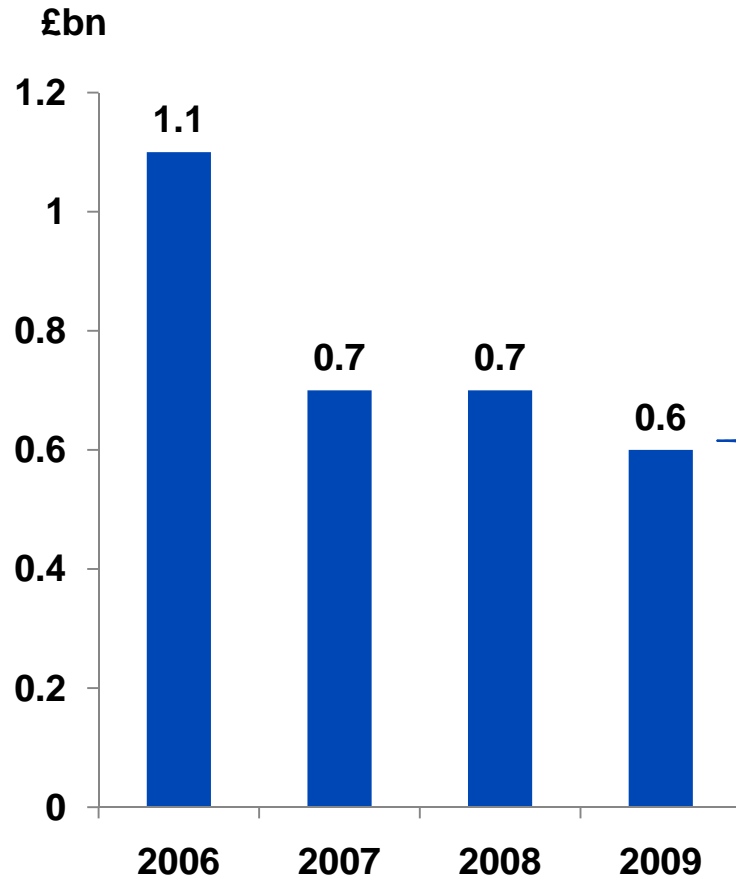
# Strong future life capital generation



- c. £8 billion undiscounted real world cash flows to emerge over next 5 years from existing book
- £33 billion to emerge over the life of the book
- 2010 cash flows expected to be in line with the £1.9 billion generated in 2009
- Actual free surplus will be boosted by:
  - new business written over the period
  - Actions to improve value of the existing book

Future presentation to provide breakdown of 1-5 year profile

# Opportunity to grow non-life capital generation

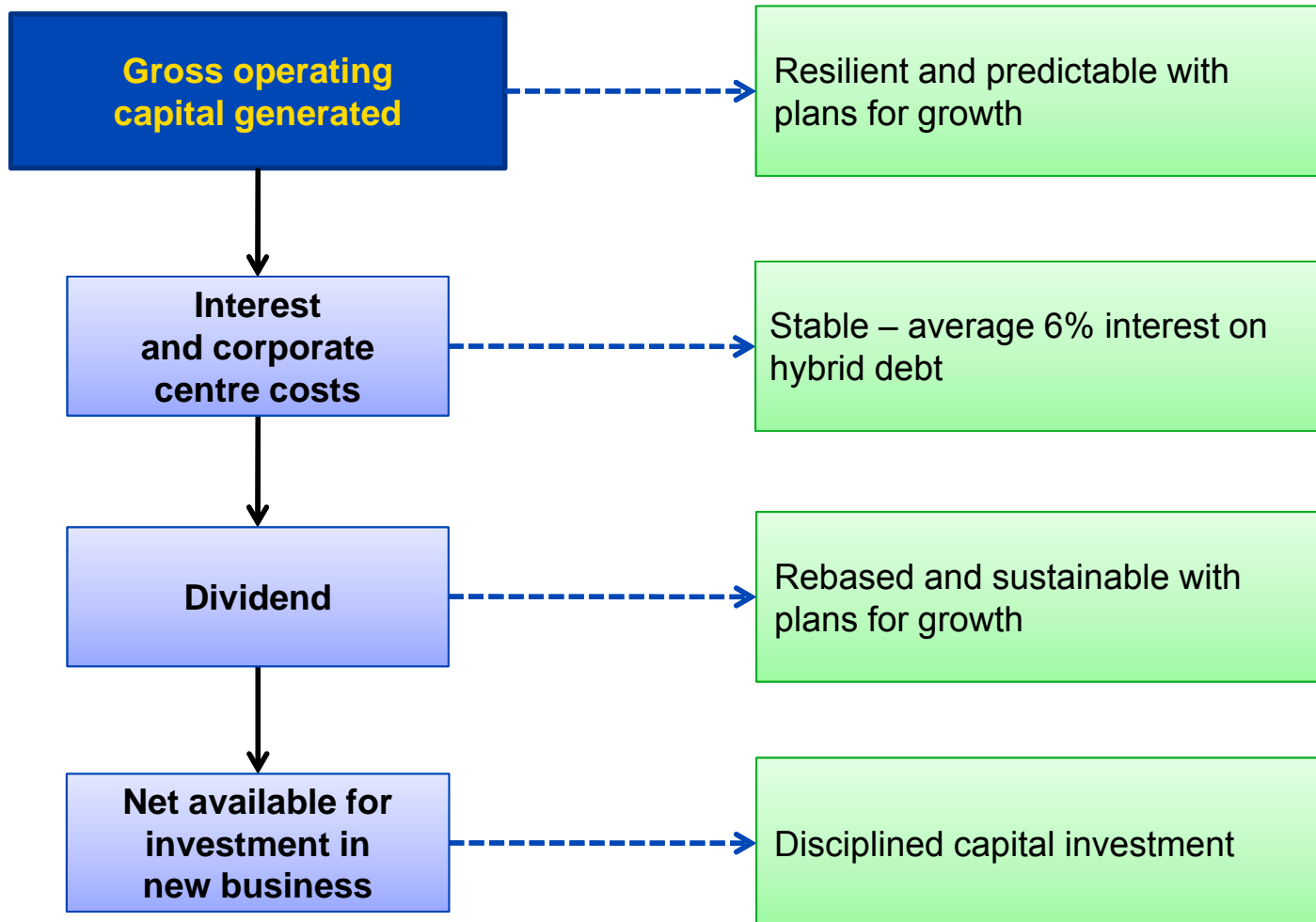


COR	2006	2007	2008	2009
	94%	100%	98%	99%

	2009 £bn
UK GI	0.4
Europe GI	0.1
DL GI	0.1
North America GI	0.1
Other non-life	(0.1)
<b>Total</b>	<b>0.6</b>

- Underwriting expertise**
- Ongoing GI pricing action across all regions contributes to 98% COR target
  - Focus on pricing and risk selection
- Operational improvements**
- UK GI turning the corner into profitable growth
  - European market penetration
  - Continuing improvement in Canadian profitability
  - Continuing focus on cost savings, £350 million savings achieved in the UK since 2007
- Aviva Investors**
- Continuing drive for external FUM

# Capital generation enables sustained and growing dividend payments





# Disciplined investment in new business



Unlevered IRR of AT LEAST 12% based on full capital allocation

Payback period less than 10 years

Improving trend of new business value per £1 capital invested

# 2009 actual performance



2009 £bn	Sales PVNBP	Capital invested in life	IRR	Payback period
<b>UK</b>	8.9	0.2	14%	8 years
<b>Europe</b>	13.5	0.5	13%	7 years
<b>North America</b>	4.5	0.3	7%	14 years
<b>Asia Pacific</b>	1.4	0.1	8%	20 years
<b>Delta Lloyd</b>	3.7	0.2	6%	33 years
<b>US Capital for yr 1 only</b>	-	0.2		
<b>Total</b>	<b>32.0</b>	<b>1.5</b>		

# Actions taken for improvement



<b>UK</b>	<ul style="list-style-type: none"><li>• Reattribution of the inherited estate provides access to additional £650m of capital for new business over next 5 years</li><li>• UK life product mix shift towards annuity and term assurance sales</li></ul>
<b>Europe</b>	<ul style="list-style-type: none"><li>• Targeting shift towards unit linked business in Europe</li></ul>
<b>North America</b>	<ul style="list-style-type: none"><li>• Pricing actions on annuity business</li><li>• AXXX reinsurance deal in the USA</li></ul>
<b>Asia Pacific</b>	<ul style="list-style-type: none"><li>• Growing businesses with aim to establish scale</li><li>• Asia Pacific exit from capital intensive products in Hong Kong, Malaysia and Taiwan</li></ul>
<b>Delta Lloyd</b>	<ul style="list-style-type: none"><li>• Partial IPO of Delta Lloyd</li><li>• Delta Lloyd ceased writing new business in Germany</li></ul>

# Returns in line with assumptions



	Operating variances and assumption changes £m
<b>2005*</b>	(22)
<b>2006*</b>	(6)
<b>2007</b>	(135)
<b>2008</b>	(84)
<b>2009</b>	239
<b>Total</b>	<b>(8)</b>

\* 2005-6 on an EEV basis

# Embedded Value reporting

## **MCEV:**

- is a useful tool for risk management
- underpins Solvency II

## **‘Real World’ EV:**

- is a better measure of value
- is comparable with other UK insurance companies

# IFRS profit drivers

# Summary life profit drivers

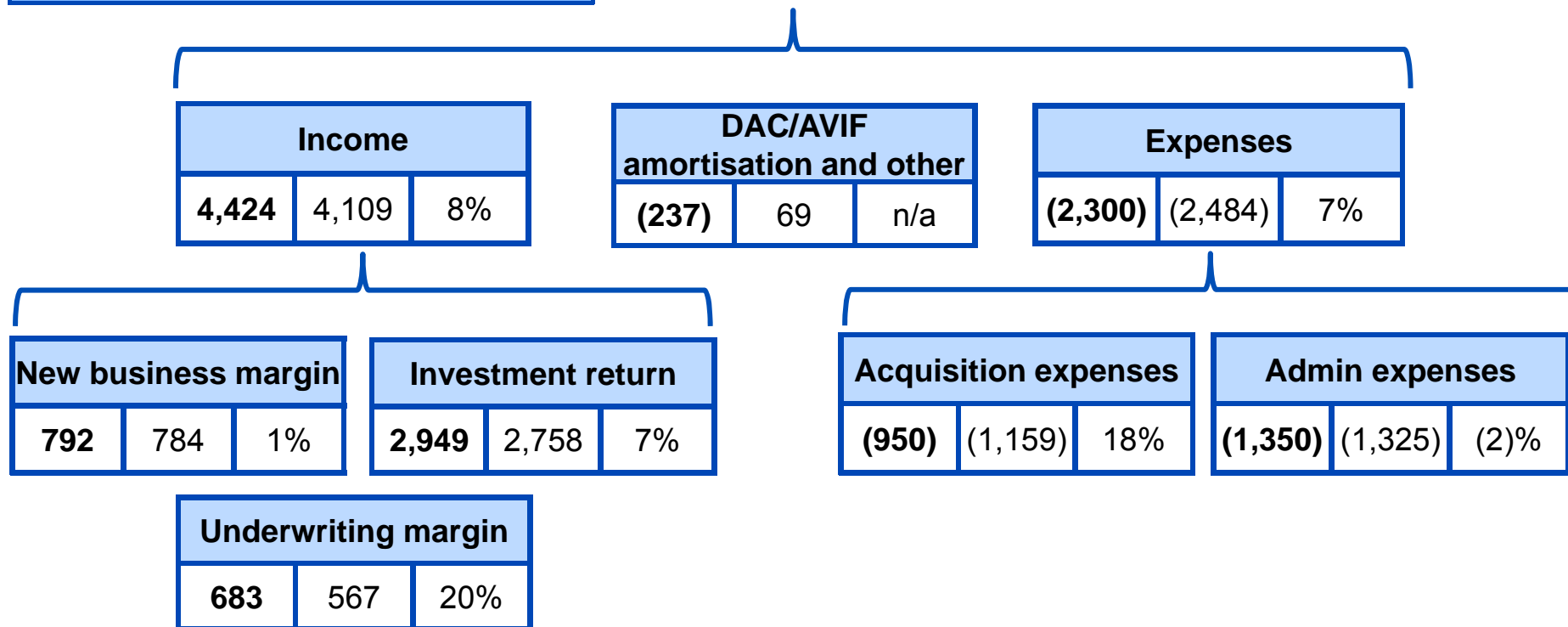


£ million	2009	2008
Life	1,887	1,694
GI	960	1,198
Fund Management	133	123
Other, non insurance	(214)	(198)
Central costs and debt	(744)	(520)
<b>Operating profit</b>	<b>2,022</b>	<b>2,297</b>

Key:

Driver		
2009	2008	Variance to 2008

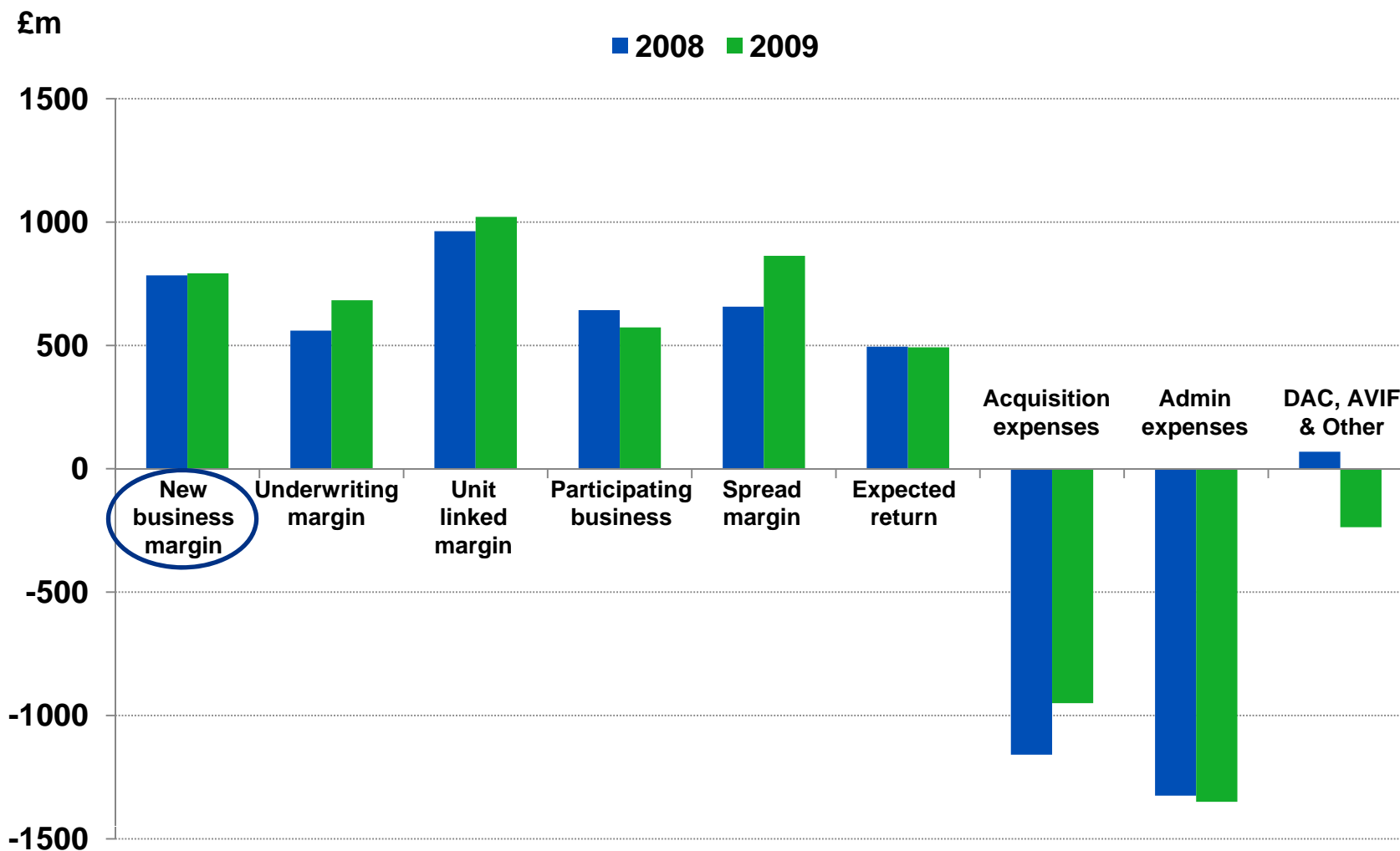
Pre-tax operating profit		
1,887	1,694	11%



Note: There is a positive FX contribution of £100m included in the 2009 IFRS operating profit result



# Diversified range of life profits contributes to resilience



# New business margin



Key:

Driver		
2009	2008	Variance to 2008

New business margin		
792	784	1%



<b>APE</b>	<b>3,745</b>	<b>4,277</b>	<b>(12)%</b>
<b>Margin</b>	<b>21%</b>	<b>18%</b>	<b>3ppt</b>

Lower APE reflects a disciplined approach to writing new business across the group in difficult market conditions

Improved new business margin on APE due to pricing actions particularly in UK, US and Asia

New business margin reflects premiums less initial capital reserves

# Underwriting margins



Underwriting margin		
683	567	20%



<b>Expenses</b>	<b>263</b>	135	95%
<b>Mortality &amp; longevity</b>	<b>381</b>	382	-
<b>Persistency</b>	<b>39</b>	50	(21)%

Mortality and persistency margins reflect conservative reserving for unit linked, risk and spread business

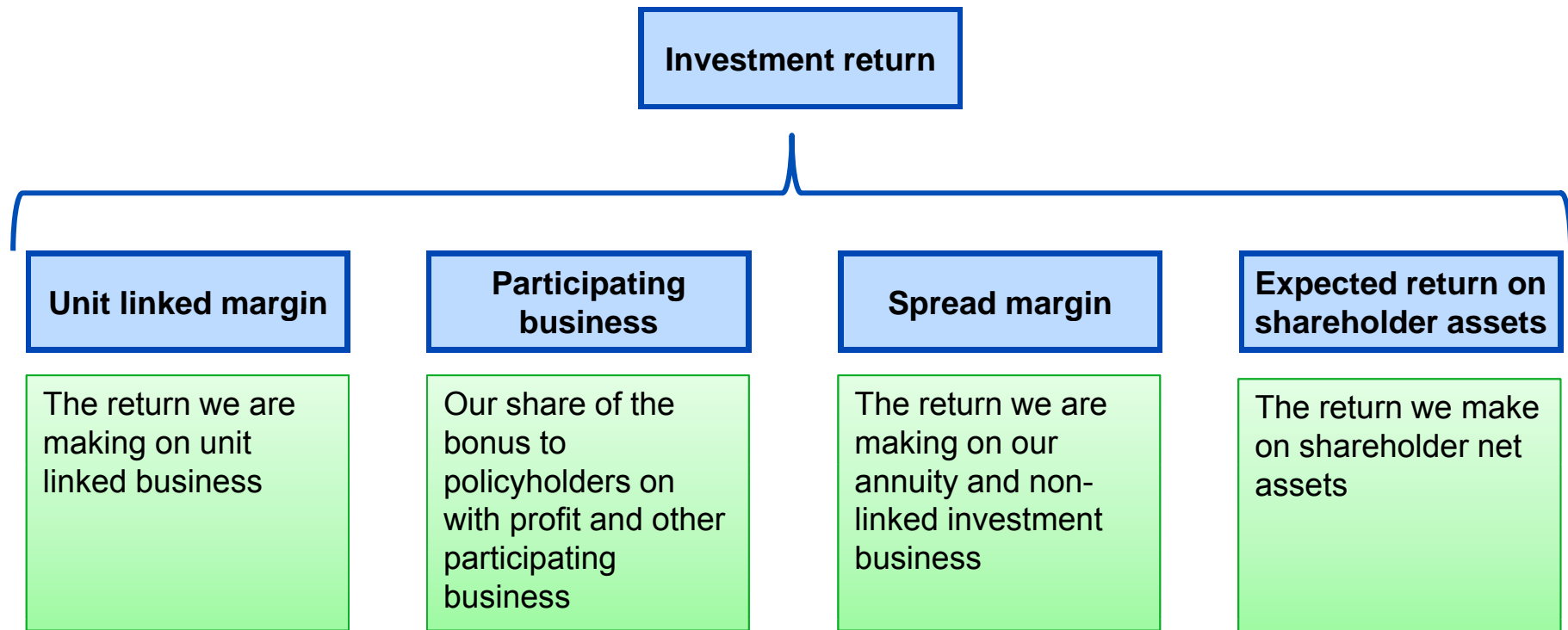
Expense margin represents unwind of annual expense allowance on risk business and assumption changes

Key:

Driver		
2009	2008	Variance to 2008

Underwriting margin improvement reflects:

- DL expense savings
- stable risk portfolios
- good mortality profits



# Investment return



Key:

Driver		
2009	2008	Variance to 2008

Investment return		
2,949	2,758	7%



Unit linked margin		
1,021	963	6%

Participating business		
573	643	(11)%

Spread margin		
863	657	31%

Expected return on shareholder assets		
492	495	(1)%

AMC (bps)	115	109	6
Average reserves (£bn)	89.1	88.4	1%

Annual management charge increase reflecting business mix in UK and Europe

Bonus (bps)	49	58	(9)
Average reserves (£bn)	117.1	111.0	6%

Lower regular and special UK with-profits bonus  
Reserves increased mainly due to AFER in France

Spread (bps)	126	112	14
Average reserves (£bn)	68.4	58.6	17%

Increase due to pricing action in the US  
Reserves increase due to growth in annuity business in UK and US

Equity	7.3%	8.3%	(1.0) ppt
Property	5.8%	6.8%	(1.0) ppt
Bonds	4.7%	5.0%	(0.3) ppt

# Expenses



Key:

Driver		
2009	2008	Variance to 2008

Acquisition expenses		
(950)	(1,159)	18%



APE	3,745	4,277	(12)%
Acquisition expense ratio	25%	27%	2 ppt

Acquisition expenses including commission incurred in writing new business less deferred costs

Admin expenses		
(1,350)	(1,325)	(2)%



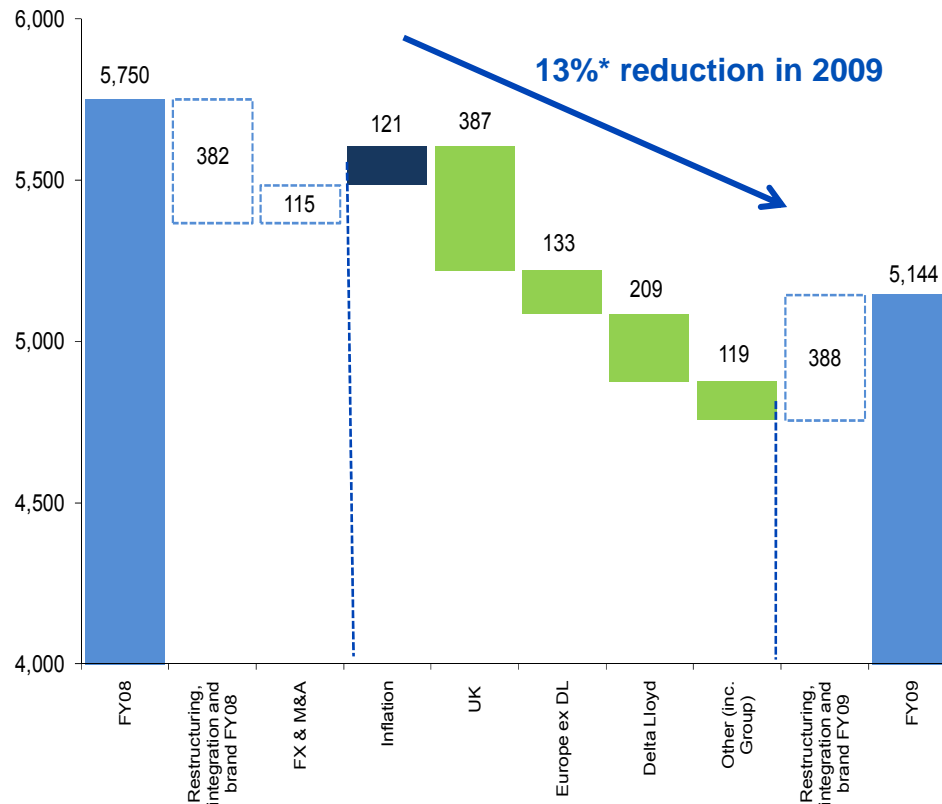
Existing expense ratio (bps)	49	51	2
Average reserves (£bn)	274.6	258.0	(6)%

Expenses and renewal commissions incurred on managing the existing book

# Linking expenses to the profit driver analysis



**Analysis of Operational Cost Base (by Region)**



£m	2009	2008	Var.
Life acquisition and admin expenses per profit drivers	2,300	2,484	(7)%
Excluding commissions DAC and other items	(282)	(323)	13%
<b>Life operational expenses</b>	<b>2,018</b>	<b>2,161</b>	<b>(7)%</b>
GI & Health expenses	1,628	1,909	(15)%
FM expenses	373	351	6%
Other non-life expenses	737	947	(22)%
<b>Operational expenses</b>	<b>4,756</b>	<b>5,368</b>	<b>(11)%</b>
Restructuring, integration and brand	388	382	2%
<b>Total expense base</b>	<b>5,144</b>	<b>5,750</b>	<b>(11)%</b>

**£500m cost reduction target exceeded one year ahead of schedule**

Note: After adjusting for FX and M&A

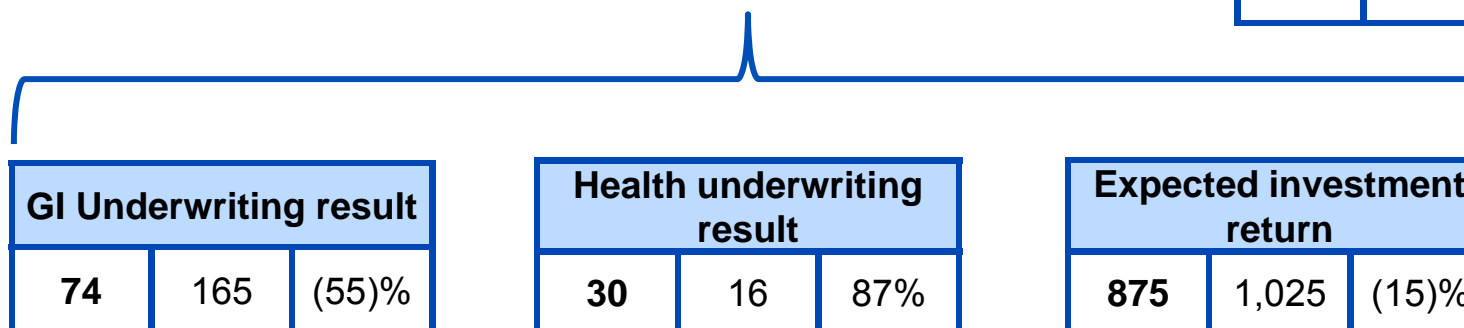
# GI & Health profit drivers



Pre-tax operating profit		
960	1,198	(20)%

Key:

Driver		
2009	2008	Variance to 2008



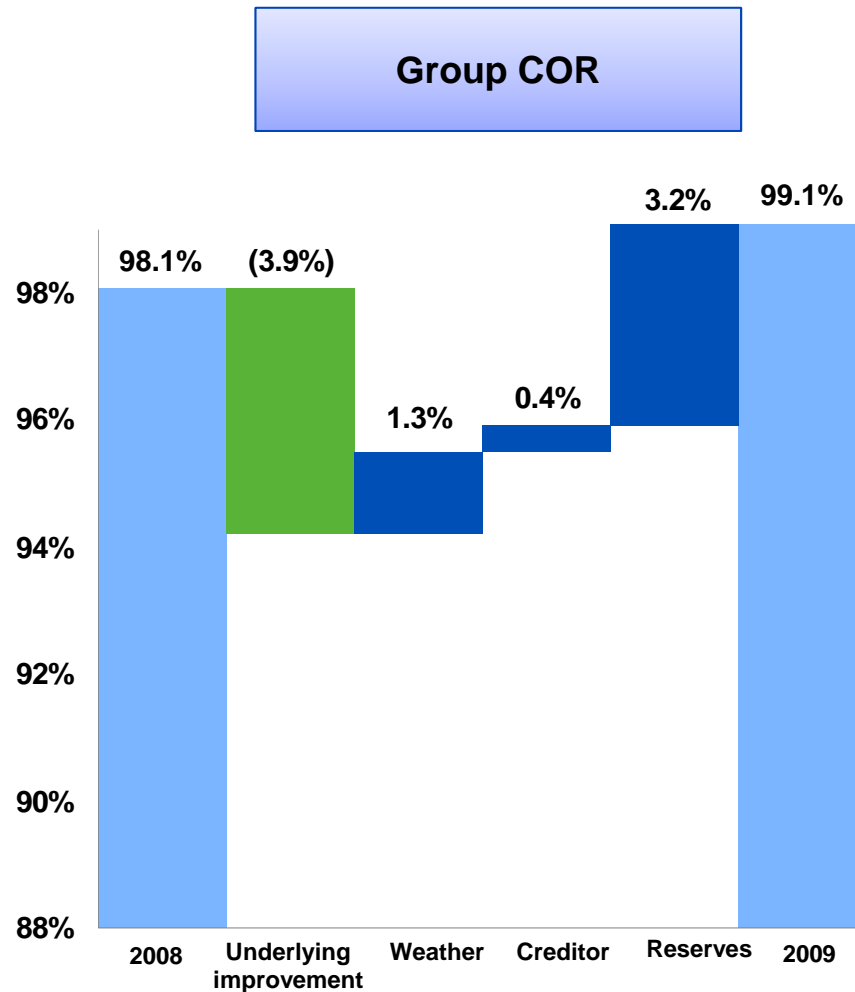
Net written premiums	8,492	9,248	(8)%
Claims ratio	66.7%	62.6%	(4.1) ppt
Commission ratio	19.7%	22.0%	2.3 ppt
Expense ratio	12.6%	13.4%	0.8 ppt
COR	99%	98%	(1.0) ppt

Average rate	4.6%	5.4%	(0.8) ppt
Average assets £bn	19.1	18.9	1%

Note: Operating profit includes £(19)m resulting from unwind of discount (2008: £(8)m)



# Improved underlying General Insurance combined operating ratio



## Expense ratio

- UK: Cost savings target of £350 million achieved
- 27 operational sites reduced to 9
- Europe: Further cost savings to come through Quantum Leap

## Claims ratio

- Rate increases across the group
- UK: enhanced risk selection
- Europe: pan-European claims programme
- North America: improvements to motor pricing model

# Fund management profit drivers – Aviva Investors

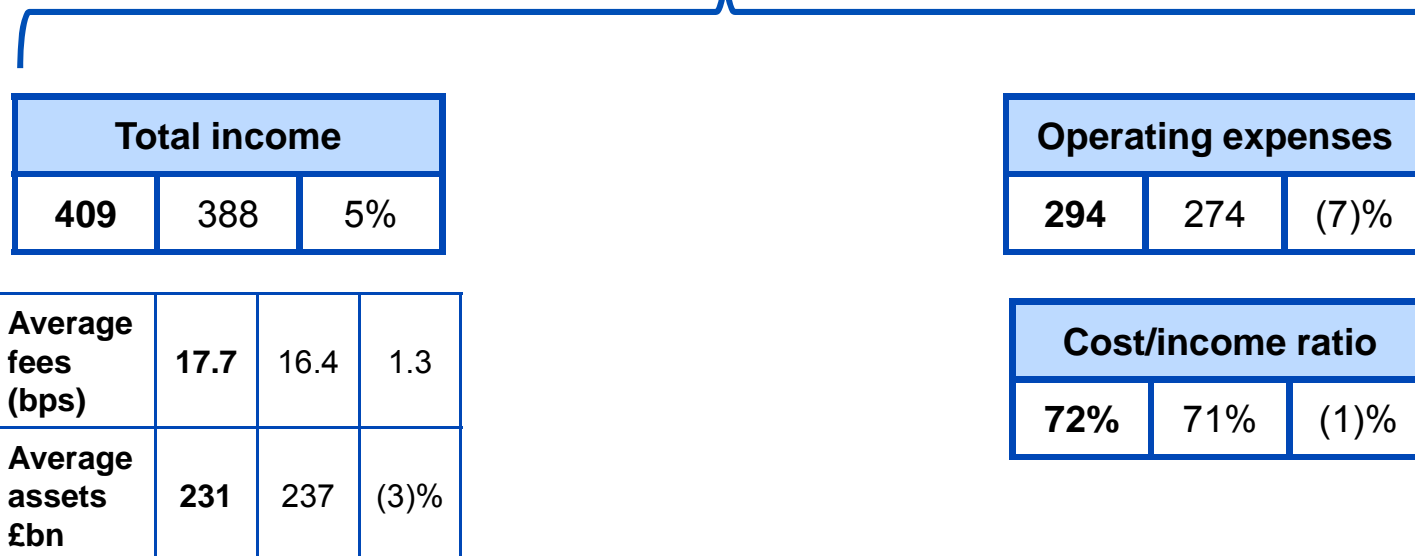


£m	2009	2008
Aviva investors	115	114
Other	18	9
Fund Management	133	123

Key:

Driver		
2009	2008	Variance to 2008

Pre-tax operating profit		
115	114	1%



## **Confidence in capital generation**

- Strong and sustainable life profits and cash flows
- Combined with GI profits currently at cyclical low

**A growing franchise with disciplined capital investment**

# Capital, cash and profits

Q&A

# Appendix

# Inherited estate reattribution



## Operational Capital

### Gross capital generation

- Assets and the return earned on those assets is held in required capital
- No benefit to gross capital generation until restrictions lifted in c. 6 years' time

### Capital invested in new business

- Access to £650 million held in required capital over 5 year period
- Therefore less free surplus is used so capital invested in new business will reduce
- Benefit of c. £100m in 2010

## IFRS

### Operating profit

- Earn expected return on:
  - Assets backing estate c. £45m pa;
  - Assets backing non-profit business held in NWPSF to extent not offset by movement in liabilities;
  - Assets backing guarantees to extent not hedged
- Also recognise financial unwind of guarantee costs

### Non-operating profit

- Impact of investment variances on above

## MCEV

### Operating profit

- New business margins and IRRs are not impacted
- Earn expected return on:
  - Assets backing estate c. £30m pa;
  - Assets backing non-profit business held in NWPSF to extent not offset by movement in liabilities;
  - Assets backing guarantees to extent not hedged
- Also recognise financial unwind of guarantee costs

### Non-operating profit

- Impact of investment variances on above

# Life IFRS profit drivers – income



Income	U/L	Spread	Protection	Par	Unallocated	
New business margin	✓	✓	✓	✓		New business cash flows (excluding acquisition expenses) based on actual volumes Premiums less initial reserves. Includes expected investment return to end of year Excludes variances in operating experience or assumptions
Underwriting margin						
Expenses			✓			Protection - Allowance in valuation basis for expenses
Mortality	✓	✓	✓			Protection - Allowance in valuation basis for mortality less actual claims & benefits UL - Charges made to policyholders less actual claims & benefits Expected change in liability for any guarantees or options subject to mortality risk
Persistency	✓	✓	✓			All - Actual reserves released less surrender benefits paid
AMC	✓					Annual management charges on unit linked business (based on expected investment returns) Excludes risk charges and costs Expected change in liability for any guarantees or options that depend on investment return
Participating business				✓		UK/Ireland- shareholders' share of actual bonus declared Continental participating shareholders' share US - closed block profits
Spread margin		✓	✓			Spread - Expected investment return less unwind of liability/amounts credited to policyholders Excludes risk charges and costs Protection - Expected investment return less valuation discount rate applied to opening liability Expected change in liability for any guarantees or option that depend on investment return
Expected return					✓	Return on assets covering solvency margin and additional surplus Based on longer term rates of return applied to expected average funds under management updated for fund flows and out flows

# Life IFRS profit drivers – expenses



Expenses	U/L	Spread	Protection	Par	Unallocated	
Acquisition expenses	✓	✓	✓	✓		New business acquisition commission and expenses less deferred costs
Admin expenses	✓	✓	✓	✓	✓	Maintenance expenses and renewal commission on existing business
DAC/AVIF amortisation and other	✓	✓	✓	✓		Amortisation of DAC, AVIF and impact of regulatory changes, reserving methodology changes or other one-off items
<b>IFRS life operating profit</b>						
Investment variances and economic assumption changes	✓	✓	✓	✓	✓	AMCs based on actual investment return less AMCs based on expected returns Spread based on actual investment return less spread based on expected returns Variance in current actual and assumed future investment return less expected investment return
<b>Total IFRS life profit</b>						



# 2009 IFRS result



Income statement	2009	2008
<b>Operating profit</b>	<b>2,022</b>	<b>2,297</b>
Investment return variances and assumption changes on long term business		
UK provisions for credit default	-	(550)
Unit-linked provisions in DL and France	-	(260)
Spain: Write back/(write-off) of UDS	160	(220)
Other	(235)	(601)
<b>Total</b>	<b>(75)</b>	<b>(1,631)</b>
Short term fluctuations and assumption changes on non-long term business	152	(913)
Impairment and amortisation of goodwill and intangibles	(206)	(183)
Profit on disposal of subsidiaries and associates	153	7
Integration / restructuring costs	(286)	(326)
Exceptional items	45	(551)
<b>Profit / Loss before tax</b>	<b>1,805</b>	<b>(1,300)</b>
Tax	(490)	415
<b>Profit / Loss for the year</b>	<b>1,315</b>	<b>(885)</b>