

MCEV ANALYST & INVESTOR BRIEFING

4TH MARCH 2009

Operator

Please stand by, this is Premiere Global Services, we are about to begin. Good day ladies and gentlemen and welcome to today's MCEV Conference call. Today's conference is being recorded. At this time I would like to turn the conference over to Phillip Broadley, Group Financial Director. Please go ahead sir.

Phillip Broadley

Good afternoon ladies and gentlemen, it's Phillip Broadley. Apologies for starting the call a little bit late, there were a number of people who joined or joining the line just at half past and we wanted to make sure they could all be connected up before we got underway. For those of you who were present this morning or listening in to the main results presentation, as you will know this afternoon's briefing will focus on Old Mutual's supplementary Market Consistent Embedded Value or MCEV reporting. Sitting alongside me here in London is Andrew Birrell, Old Mutual's Group Chief Actuary.

Now before we start the MCEV presentation, I thought it would be a useful opportunity to use this call just to follow up on a couple of the points that were made on the main results meeting this morning, some of the questions to which we didn't have answers immediately available and thought it would be helpful to, as we had a chance to talk to you for a second time, to follow up on those. The first thing I would like to just confirm because it will be the subject of a number of questions at the meeting and subsequently is to be clear that the comments we've made today regarding the dividend for 2009 relates specifically and only to the ordinary issued equity capital or share capital of Old Mutual plc, ordinary share capital or common stock. In relation to the group's preferred shares and all of its debt instruments the dividend commentary is not applicable and the group will continue to meet dividend payments and coupons on all of the other outstanding instruments, I hope that clarifies that point. Then Andrew is going to deal with some of the other questions that were asked this morning.

Andrew Birrell

Thank you Phillip. There was a question about the percentage of RBC that we include in the calculation of the FGD and we include it at 150% so in other words anything in excess of 150% would be included in the FGD.

Secondly there was a question about the quality of the regulatory capital resource, the 4.1 billion and we can confirm that it is calculated as follows: we have £2.6 billion of Core Tier I capital, £0.6 billion of other Tier I, £2.4 billion of Tier II and from that you deduct £1.5 billion of inadmissible assets which are primarily in relation to deferred acquisition costs. Hopefully that also answers that question.

There was a question around the Q4 defaults that we experienced in 2008, the figures that I'm going to give are all in US dollars. The defaults in the Q4 itself were \$26 million and the defaults in Q3 were \$96 million. The total defaults experienced in the US Life bond portfolio 2008 were \$158 million and as you can see from that the defaults primarily occurred in the third quarter and were derived primarily in respect of the default of Lehman's, Washington Mutual, Kaupthing and Glitnir.

Phillip Broadley

Thank you very much. I hope you've had a chance to read the press release and have also been able to access the webcast of the presentation, details of which were in the release this morning. If you're looking at that presentation on the website addresses, the slides will advance automatically and so we won't draw attention to when the slides are changing. The presentation just to give you a sense of what we're going to cover, the presentation should

last about 40 minutes and then we will go into Q&A. I'll start with some introductory comments about the objectives and benefits of MCEV reporting and why we think it's a valuable source of information for assessing the performance of long term insurance business. Then Andrew will provide an overview of how we've made the transition from European Embedded Value or EEV reporting to MCEV reporting and the effect on our restated embedded value results for 2007.

Now Aviva led the way on 4th February with their 2007 MCEV restatement and I know a number of you will have attended that call but equally I'm aware that a number of our analysts and investors don't cover that stock and so we believe it is important to again focus on some of the key changes affecting the industry as a result of the introduction of MCEV reporting, so those of you who are getting comfortable with MCEV, I hope you don't mind us going over old ground, but I think that's important for everyone to have the same base of understanding. Andrew will then provide an overview of the MCEV results for 2008 and finally I will make some concluding remarks to bring an end to the formal part of the call after which we'll happily take any questions. So again just to sum up we'll give an introduction to MCEV, talk about the specifics of Old Mutual, each of those will last about 20 minutes and then we'll take your questions.

So why have we adopted MCEV Supplementary Reporting? The CFO Forum of European Finance Directors released a set of principles for MCEV in June 2008 and they set the formal adoption of those principles as compulsory for member companies from year end 2009. These principles set out market consistent framework reporting a shareholders' perspective of value for long term insurance business and that's defined as the present value of future cash flows available to shareholders adjusted for the risks of those cash flows.

Some time ago we chose to adopt MCEV Supplementary Reporting early in our report and accounts from the 2008 year end onwards including a restatement of our 2007 full year results from the EEV to MCEV basis. Our restated results for the half year 2008 will be published ahead of the half year one results and we are currently aiming to publish them as an adjunct to the release of our 2009 Q1 trading statement.

There are a number of reasons why we believe the principles will lead to improved consistency in embedded value reporting across the industry as well as improving transparency for users. First off they should lead to greater objectivity in setting assumptions, the market consistent allowance for financial risks and an explicit allowance for non financial risks, for example as part of the costs of any residual non-hedgeable risks. Secondly we believe that the increased minimum disclosure requirements, in particular the prescribed format of presentation of analysis of earnings and group MCEV and a greater number of mandatory sensitivities will make comparison across a range of companies easier; and lastly the principles require an external review of the methodology adopted, the assumptions made and the published results. Old Mutual already elected to do all of this under EEV reporting and although there's therefore limited effect for us, we believe this requirement will be a step forward and lead to greater consistency and approach across the industry.

Some of you may have heard me say before that consistency doesn't necessarily mean that every company will be reporting in precisely the same way. That is a consequence that member firms of the forum do have different business models, different geographies in which they operate and different product mixes and inevitably as a result of all of that there will be differences in the way we present but I think the analysis and in particular the sensitivities will make users' job easier in comparing published results.

The move to MCEV reporting has different effects depending on the type of products written and it therefore affects the different companies within the group in different ways. We will come on to talk about that but let me highlight up front that for our relatively capital light businesses in Europe, the UK and the Nordic region there's very little change to reported results under MCEV. In fact in many cases comparative results on an MCEV basis have increased slightly. For our South African business which is more capital intensive there's also not much change since the results were already produced on a basis that was very similar to MCEV and the investment guarantee reserve in place is able to absorb guarantee costs without these burning through to shareholders under most conditions. So under MCEV the

South African business continues to provide good returns. The company in the group most affected by the move to MCEV is US Life whereas you will see later the MCEV is down significantly due to the change in valuation basis.

Since there is little change in value in South Africa and Europe, much of the presentation focuses on the reason for the change in US Life. We believe that although the US Life MCEV has reduced significantly, the future profitability and returns for the US Life business will now be higher than under MCEV. The change from EEV to MCEV reporting does require investment of time for users, we acknowledge that, but we do hope that that time will be well spent in helping you understand the differences and make appropriate comparisons between companies and we hope this presentation from us will be a contribution to that process.

We'd like to point out that we are one of the small number of MCEV reporters at December 2008 in London and hence users must take care when comparing our MCEV results to results published by other companies which may be on a traditional embedded value basis in South Africa or an EEV basis in London.

The implementation of MCEV had been a major initiative for the Old Mutual Group but we have already seen benefits of it. The granularity of the allowance for risks improved our insight on a product level, in particular because MCEV fully captures the varying profiles of different products and also the risk profile of new business relative to in force business. As a result our new products sign-off procedures for all new products now includes MCEV metrics.

MCEV also provides a framework for ensuring greater consistency across our internal reporting measures such as economic capital and business planning as well as for external reporting such as the expected market consistent methodologies that we think will emerge under both Solvency II and the proposed IFRS Standard for insurers. While there are a number of differences between MCEV and these proposed measures, the concept of market consistency is common.

Like EEV, MCEV compliments IFRS reporting. The different reporting metrics and methodologies inherent within both provide various insights into the profitability of our business but we will continue to use EV as a key performance measure for the group's life business.

Finally let me point out that the European Embedded Value, Market Consistent Embedded Value and IFRS methodologies will all report the same total earnings over the life of a contract. The timing of recognition of earnings could be and usually is different between these approaches, but the difference in timing does not change the underlying fundamentals of the profitability or otherwise of business written.

I will now hand over to Andrew to take you first the key changes in methodology as a result of the move to MCEV and the effect it had on our 2007 results and then also to give you insight into the 2008 results.

Andrew Birrell

Thank you Philip and good afternoon everyone.

Old Mutual's MCEV approach, partly developed in conjunction with Deloitte LLP, does not constitute a complete overhaul to our EV reporting framework as we were already applying, to a great extent, many of the MCEV Principles under our previous EEV basis.. As a consequence the difference in results between the EEV and MCEV basis is not material for most of our businesses, although there are some fundamental changes for others which we will outline later in the presentation.

The major change in Old Mutual's is in the allowance for risks. Under MCEV a bottom-up allowance is made for financial risks:

Asset and liability cash flows are valued using risk discount rates consistent with those applied to similar cash flows in the capital markets, and financial options and guarantees are valued using market consistent models calibrated to observable market prices. For non-hedgeable risks, an explicit allowance is made for the cost of these risks in the covered business.

In contrast, under the old approach a top-down allowance was made for all risks by means of the risk margin included in the single risk discount rate applicable for each geography and in the value placed on financial options and guarantees. As Philip mentioned earlier, the new methodology therefore takes a more granular approach for the differences in the risk profile of different product lines and different generations of policies than the old methodology. Finally, under old methodology one capitalises credit, liquidity and equity risk premia which means that one's asset allocation can lead to a higher or lower Embedded Value, without adjustment for the risk inherent in this asset allocation. Under MCEV these risk premia emerge only in the years they are earned.

Any EV requires assumptions about the future, including economic assumptions. So what is market consistency then, in particular considering that no deep and liquid market exists for all insurance liabilities? It means that economic assumptions are set so that projected cash flows within the calculations are valued consistently with the prices of similar traded cash flows on the capital markets. In other words financial risks are reflected at current market prices and value cannot be created or destroyed simply by changing the investment strategy without any regard to extra risk being taken on. For example, the value attributed to £100 invested in bonds is equal to the value attributed £100 invested in equities. Under the EEV approach, £100 of equities would give rise to a greater value, since the equity risk premium is higher, although there would be no adjustment for the greater volatility in return.

Assets are valued at market value. In practice it is difficult to determine the discount rates to be applied to cash flows on individual assets, and so, in order to place a value on the covered business, we use a deterministic approach for products with no guarantees, referred to as the 'certainty equivalent' technique. This technique assumes that all future investment returns and discount rates are equal to that on a 'risk free' investment, calibrated with reference to swaps rates by the MCEV Principles. This is a mathematical valuation technique making the calculations easier, and does not remove the possibility over time to earn the risk premiums embedded in the actual assets held.

Where products contain financial options and guarantees a separate allowance is made for the time value of those options and guarantees using the same underlying assumptions and market option implied volatilities in a stochastic projection model.

So let's look at what this market consistent approach for economic assumptions means for typical products by means of some illustrative examples. The first product for consideration is an immediate annuity. Typically an insurer will hold corporate bonds to back these liabilities, and will price the product with reference to the yield available from these bonds, less an allowance for expenses and profit, referred to as the "spread". Under EEV the spread is capitalised within the EV. Under MCEV, the valuation is based on the risk free rate, and no allowance is made for the difference between the risk free rate and the portfolio yield. This difference only emerges in any year that it is earned. Hence cashflow projections assume lower future earned returns.

Slide - Example 1 – Immediate annuity earnings profile [9]

This MCEV approach is better aligned with the way profits from spread-based business are recognised under IFRS. Hence the profit signature of an immediate annuity contract can be significantly different under EEV and MCEV reporting with a delayed recognition of earnings under MCEV compared to EEV.

Under EEV greater earnings are recognised up-front at point of sale through capitalisation of the corporate bond risk premiums, whilst under MCEV an initial loss may be recognised at point of sale as spreads are not allowed for, but the pricing margins are locked into the valuation. Over time it is expected that risk premiums in excess of risk free rates will emerge

and these will contribute to MCEV earnings. Again, it is important to note that the total profit recognised over the lifetime of the contract will be equivalent under both the EEV and MCEV bases. Therefore under MCEV, products which rely on earning rates greater than risk free rates in order to be profitable can look unattractive at point of sale because the up-front recognition of corporate bond spreads is not permitted until realised, even though the spread is partially recognised in pricing. Although we have used an immediate annuity as an example, this principle applies equally to any other product where pricing, and hence profitability depend on being earning investment returns in excess of risk free rates.

Slide - Example 2 – Unit-linked savings plan earnings profile [11]

The second product we will consider is a unit-linked savings plan. For this type of contract, MCEV earnings might be recognised earlier in the life of the contract than EEV earnings.

Slide - Example 2 – Unit-linked savings plan [12]

Earnings in respect of unit linked plans are derived from fee-based income rather than investment spreads, per the immediate annuity example. Projected earnings under the MCEV basis are similar to EEV earnings, with the exception that the MCEV projections assume that we earn only risk free rates on unit fund reserves, and hence lower unit fund charges are projected under MCEV compared to EEV.

However, the effect of lower risk free discount rates in MCEV compared to EEV may lead to a modest increase in the new basis relative the old basis, at point of sale. We have outlined an illustrative example of the effect on a term assurance product in appendix A, but won't be discussing it further.

Slide - Examples summary [13]

As demonstrated by the illustrative examples, the direction and magnitude of change from EEV to MCEV depends on the type of product and the assumptions underlying the EEV and MCEV calculations. Under EEV, a weighted average risk discount rate was applied to all products within a specific geography, whereas under MCEV separate, explicit allowances are made for financial and non-financial risks for each product. In particular, the effect of adopting MCEV depends on how much financial risk is taken on behalf of the policyholder. The Embedded value of products which have high financial risk will tend to reduce under MCEV, whilst the opposite may be true for products where limited financial risk is being taken. In respect of the spread-based business that forms the bulk of our US portfolio, MCEV does not capture the Present Value of future expected investment returns in excess of risk free rates. Instead the entire corporate bond spread over risk free rates is treated as an implicit allowance for defaults. Additional investment returns will only be recognised in the MCEV earnings as and when they are realised.

Therefore, a low value of new business at the point of sale can still be expected to generate good returns over the lifetime of a contract. Similarly for our European and South African businesses, where a material part of policyholder funds is invested in equities, MCEV does not take credit for any future expected equity risk premiums in excess of risk free rates until such returns are realised.

The important thing to bear in mind is that the underlying profitability of any product does not change under MCEV. The total nominal earnings reported over the lifetime of any contract will be equivalent under IFRS, EEV and MCEV reporting, but the timing of recognition, and hence present value, of these earnings, is different under each reporting basis.

Slide - Non-financial risks [14]

In the illustrative product examples we covered the treatment of **financial** risks under a market consistent valuation. The Principles also make provision for allowance for non-financial risks in a number of ways. Non-economic projection assumptions for future experience, for example mortality, persistency and expenses, are determined using best estimate assumptions for those cash flows based on Old Mutual's own experience analyses

which are supplemented by industry data, where required. Furthermore, an explicit allowance is made under MCEV for the cost of residual non-hedgeable risks, which captures mainly non-financial risks, for example operational risks, by using a “cost of capital” approach. This component of MCEV allows for the potential effect on shareholder cash flows arising from uncertainty in setting the best estimate assumptions. Under the old EEV approach an implicit allowance was made for such risks in the determination of the risk discount rate. MCEV makes an explicit allowance for the frictional costs of required capital. These costs represent the actual costs that a shareholder incurs due to an investment via the structure of an insurance company. Such costs include investment management expenses and tax on investment returns on the assets backing the required capital, which can also be referred to as ‘locked-in’ shareholders’ funds since this capital facilitates the ongoing operation of risk assumption.

Slide - Summary of steps to move from EEV to MCEV [15]

The following steps are taken in moving from a top-down real-world EEV approach to the bottom-up MCEV approach. First, release the “cost of required capital” item under EEV. This step increases the value of in-force business or VIF. Second, apply market consistent economic assumptions. This consists of three components:

- replace the risk discount rate under EEV with risk free rates and thereby remove any risk margins in the EEV discount rate. This increases the VIF for profitable business as expected future earnings are discounted at lower rates.
- replace real-world EEV investment return assumptions with risk free rates and thereby remove capitalisation of any investment risk margins which instead emerge over time as part of the operating earnings. This reduces the VIF as expected future investment returns are projected at lower rates.
- allow for the time value of financial options and guarantees on a fully market consistent basis. This reduces the VIF, in instances where market implied volatilities are greater than historic realised volatilities. For example, the MCEV of the US life business is based on higher implied volatilities in current market conditions than the historic volatilities assumed under EEV.

The third and fourth steps introduce an allowance for frictional costs and a cost of residual non-hedgeable risks which both reduce the VIF.

Slide - Components of embedded value [16]

The following slide illustrates graphically how the components of MCEV differ from the components of EEV. MCEV consists of the following two components: First, the adjusted net worth, which consists of the sum of the free surplus and required capital; and Second, the VIF which consists of the Present Value of future profits less the time value of financial options and guarantees, cost of residual non hedgeable risks and frictional costs associated with holding required capital.

Slide - Treatment of unrealised corporate bond losses in US [17]

Apart from the more generic methodology changes that are required to move from EEV to MCEV, there is one further key methodology change to be implemented. As mentioned earlier, assets are valued at market value and any increase in corporate bond credit spreads will therefore be fully recognised in the market value of the asset portfolio.

Under the old basis any increase in credit spreads had a limited effect on the EV as only the assets backing the adjusted net worth, which in the past were largely cash assets, were marked to market. Assets backing statutory liabilities were valued at book value. Under MCEV, the investment return in the cash flow projection is set with reference to risk free rates, so any increase in credit spreads will have a direct effect on the EV to the extent that such unrealised losses cannot be passed onto policyholders through changes in future bonus or crediting rates over the remaining lifetime of the in-force policies.

So let’s look at how this MCEV treatment of corporate bond spreads is applied in practice by means of a few simplified examples.

Slide - US spread-based business – pricing methodology [18]

First, let's consider the pricing methodology that used for spread-based business backed by corporate bond assets. An assumption is made about the long term real-world returns that can be achieved on corporate bonds, net of expected defaults, and the difference between such returns and the investment returns or bonuses credited to policyholders provides a margin to cover expenses and deliver profits.

Slide - US spread-based business – MCEV projections in 'normal' markets [19]

One might expect that in normal market conditions risk free rates are greater than guaranteed rates that have been offered to policyholders and therefore such guarantees are "out of the money". Under MCEV we value business by reference to risk free rates and any corporate bond spreads are not recognised in the valuation. Therefore any market yields on such bonds in excess of risk free rates are implicitly assumed to be lost to default. Within the MCEV valuation projections, crediting rates to policyholder accounts are set by considering management's target shareholder margins throughout the contract lifetime. Projected crediting rates are set equal to the risk free rates less the anticipated margin to cover profit and expenses, subject to any guaranteed crediting rates (which would erode the shareholder margin).

Slide - US spread-based business – MCEV projections in current markets [20]

Current market conditions provide a completely different picture. The increase in corporate bond credit spreads has generated unrealised losses which are reflected in the market value of assets. This effect is coupled with reductions in risk free rates below the level of guarantees that have been offered to some policyholders. Because some policyholder guarantees are presently in the money, negative spreads lead to projected investment losses under MCEV. The value placed on spread-based business under MCEV is therefore also driven to a large extent by prevailing risk free rates, even though real-world expectations are that excess returns should be earned which will generate future profits. It can therefore be concluded that current economic factors have a negative effect on the MCEV for our US spread-based business.

Slide - Effect on FY07 results [21]

So let's take a look at the effect of the MCEV restatement on our EV results for 2007. The adjusted Group EV per share, which brings in the value of all non-covered business at the unadjusted IFRS net asset value, reduced by 4% to 166.3p on an MCEV basis. This is largely driven by a 7% reduction in the EV for covered business, although the effect on the adjusted Group EV per share was cushioned by the effect of marking external debt to market value. The majority of the reduction in the Embedded Value of the covered business is attributable to the reduction in the US spread-based business due to the non-capitalisation of corporate bond spreads and marking all assets to market value as discussed earlier. Similar considerations apply to the aggregate VNB and new business margins. The overall effect of the transition to MCEV is small for the other geographies. The adjusted Group operating earnings per share was largely unaffected by the transition to MCEV reporting although the operating earnings would have been 2p higher if the net positive effect of regulatory changes and taxation were not excluded from operating earnings under the new MCEV methodology. Under the EEV methodology these effects would have been included in embedded value operating earnings.

Slide - Restatement of EV for FY07 [22]

Slide 22 shows the different components of EEV and MCEV graphically and it can be seen that the Value of in force, for the covered business reduced from £4.5bn to £3.9bn as a result of the change in embedded value method.

Slide - Reconciliation of EEV to MCEV for FY07 [23]

Our next slide shows a regional analysis of the reconciliation of EEV to MCEV at the end of 2007.

The reasons for the 57% reduction in the EV for US business, largely attributable to changes in economic assumptions, have been covered in detail in the earlier part of the presentation and relate to both the effect of the reduction in swap rates, and the increase in corporate bond spreads, which reduced the margin between the projected investment return on the adjusted risk free rate, and the rate credited to policies. In some instances this would have been negative under MCEV at 31 December 2008.

Within the European and African businesses, the aggregate allowance for risks within the old and new approaches is broadly aligned and hence relatively minor effects are experienced on these businesses when moving from EEV to MCEV. As a result of the small effects for these businesses, the overall effect for the Group's total covered business is much more balanced and only reflects a reduction of 7% in EV.

We have provided reconciliations of the Value of New Business and the return on Embedded Value for 2007 from the old to the new basis in appendix B.

Slide – Agenda [24]

Now looking at the 2008 and 2007 comparatives on an MCEV basis and highlighting just the key items – there is more detail behind this in the Results statement.

Slide - Current dislocated markets - US spreads above government bonds [25]

Slide 25 shows how credit spread on corporate bonds have blown out towards the latter part of 2008.

The MCEV principles were designed in a period of relatively stable market conditions, and mandated the use of swap rates as a proxy for risk free rates, without allowance for liquidity premiums. We agree that swap rates can be reasonably assumed to be a suitable proxy for risk free returns under stable market conditions, since the additional return attributable to the liquidity premium is low enough not to significantly affect the MCEV results. Accordingly, in terms of the CFO Forum Principles, liquidity premiums, like equity and credit risk premiums should only be recognised in MCEV earnings in the period in which they are earned.

Slide - Are swaps appropriate risk free reference rates in current market conditions? [26]

However, swaps may not be appropriate risk free reference rates in current market conditions, which differ substantially from the conditions prevailing at the time of finalisation of the CFO Forum Principles. In December 2008 the CFO Forum announced that they were reviewing the MCEV Principles and Guidance on the application of these Principles, to address the notion of market consistency in the current severely dislocated credit market conditions. One of the areas under review is the recognition and determination of liquidity premiums. This is of course of great relevance to early adopters of MCEV such as Old Mutual, since we expect that amendments to the Principles will only be published later in the year.

Although we are actively participating in the CFO Forum discussions, we are setting out today our own view on an appropriate approach to recognising a liquidity premium in the current US credit market conditions. It is well known that corporate bond spreads increased to unprecedented levels in 2008, particularly in the US. For example, on the US Life bond portfolio, the spread between the market yield on our bond portfolio and the swap rate increased from 1.6% at YE07 to 6.9% at YE08, which implies a market default rate which is many orders of magnitude greater than anything ever seen before, if one assumes that all of the spread relates to credit default risk. One can express this in another way : it implies that 73% of potential future income is disregarded under our MCEV projections, which appears extreme when compared to any historic data, even that pertaining to the Great Depression of

the 1930's. We believe that interpreting this implied default rate as being only in relation to credit default risk overstates the risk of credit default and is not representative of a true market credit default expectation.

Slide - Liquidity adjustment for US onshore business [27]

Following an extensive review of a wide range of market data and literature (such as the calibration performed by Barrie+Hibbert at the 31st December 2008 on corporate bond spreads in the US and UK, and research published by the Bank of England, the Washington Fed and other sources), it is our view that the significant widening of corporate bond spreads during the recent financial market turmoil is partly a function of an increased liquidity premium rather than only heightened credit default risk, and that returns in excess of swap rates can be achieved, rather than entire corporate bond spreads being lost due to worsening credit default experience. Furthermore, it is misleading to completely ignore this now significant liquidity premium when valuing our US Life onshore portfolio, as such business is largely backed by investments in the bond market and the portfolio is managed to earn liquidity premiums by holding bonds to maturity. Over the course of the year we have further repositioned the portfolio by holding higher levels of cash, providing a strong defensive position against further market shocks. For the US Life onshore business we considered the currency, credit quality and duration of our actual corporate bond portfolio and we derived an adjustment to the risk free reference rate at 31 December 2008 of 300bps in respect of the liquidity premium. This adjusted risk free rate is used in the expected investment return and discounting assumptions, and reflects our estimate of the liquidity premium component embedded in current in corporate bond spreads that we expect to earn on our portfolio. We believe that the residual difference of 3.9% between the market yield on our US Life onshore bond portfolio of 9.5% and the adjusted risk free reference rate at 31 December 2008 of 5.6% provides a substantial implied margin for credit defaults. It is relevant to note that the book yield of the portfolio is 6.6%. When considering the liquidity premium we have adopted, it is important to note that we believe that we will be able to hold our bonds to maturity, hence will not have to sell at an inopportune time, for the following reasons :

- We have built up a buffer of cash in the portfolio, which combined with other cashflows (eg coupons and maturities) provides adequate liquidity under most scenarios
- The assets and liabilities are well matched in terms of duration. The duration of assets is 6 years, and duration of liabilities is 5.9 years

No liquidity adjustment is applied to risk free rates for any of the other geographies or for Old Mutual Bermuda. Our approach will be reviewed in respect of future reporting periods once further guidance has been provided by the CFO Forum. We do however note that many of the other parties that are publishing MCEV have already indicated a liquidity premium in their restatements and that certain of the other European insurers who have recently published have also incorporated liquidity spreads into their valuations.

Slide - MCEV FY08 results [28]

The adjusted Group Embedded Value per share reduced by 29% from the restated 166.3p at year-end 2007 to 117.6p at year-end 2008. The reduction was driven by the fall in equity markets, the reduction in global interest rates and a widening of corporate bond spreads which had an adverse effect on the EV of the covered business, offset by a reduction in the number of shares following the share buy-back program, and the effect of marking external debt to market. The value of this last adjustment increased substantially over the period. Adjusted Group operating earnings per share decreased from 17.0p for 2007 to 11.0p for 2008. The reduction is the net effect of:

Higher profits in the South African and European life businesses driven by higher expected existing business contribution in South Africa, the increase in the level of fee income assumed in the UK, lower debt costs and a reduction in the number of shares following the share buy-back program; offset by

A lower new business contribution, adverse persistency experience, higher guarantee costs, hedge losses and impairments in US Life, impairments in Nedbank and lower asset based charges in the asset management companies.

Slide - Adjusted Group embedded value per share [29]

When looking at a graphical presentation of the movement in the adjusted Group EV per share, it can be seen that:

- The positive net impact of profit flows and the impact of marking all our debt to market value was offset by
- negatives arising from adverse market movements
- the reduction in the share prices of Nedbank and Mutual&Federal over the period and,
- the dividend payments made to shareholders in May and November 2008.

The large impact from adverse market movements was largely experienced in US Life and arose primarily from:

- The large unrealised losses on the corporate bond portfolio
- The reduction in risk free yields, which as a consequence resulted in all guarantees being in the money to a greater extent, and
- Revised mortality assumption for SPIAs.

Slide - MCEV of covered business [30]

Slide 30 shows the different components of MCEV of the covered business graphically and it can be seen that the VIF for the covered business reduced from £3.9bn at the end of 2007 to £1.8bn at the end of 2008.

Slide - Financial summary FY08 – Group [31]

At a group level, the covered business contributed £133m of adjusted MCEV operating earnings, with an RoEV of 2.1% post the US Life impacts. We will unpack the regional performances later on.

Overall group VNB reduced by 54% to £105m. Although we saw strong growth in both the African and Nordic regions, sales were negatively impacted in the UK and ELAM due to the market conditions, and US Life VNB contracted due to the challenges faced by the business.

Turning next to our regional analysis.

Slide - Europe: UK [32]

APE reduced from £740m to £596m, driven by products with inherent guarantees indicating a lower customer appetite for equity based investments

Life VNB reduced accordingly, offset partially by positive variances in the International division due to a shift in product mix to higher margin products. Operating MCEV earnings increased by £29m during 2008 to £235m at FY08, driven to some extent by higher 1 year expected returns and fee income levels, offset by worse than expected maintenance cost experience, and a marginal worsening in persistency

Slide - Europe: Nordic [33]

Sweden delivered a very strong sales performance in the year, leading to a recovery in market share. New business margins are still below the level we think is achievable and sustainable.

The MCEV operating profit of £150m was driven by higher expected returns and the introduction of an earned currency spread in the modelling. The results were further boosted by positive assumption changes for the release of a provision set up to meet anticipated costs in the corporate line of business, partially offset by strengthened retention assumptions.

Slide - Europe: ELAM [34]

The MCEV operating profit reduced over the year, as a consequence of a lower new business contribution, negative experience variances due to expense and retention variances,

The main reasons for the decrease in PNVBP margin is the :

- Negative volume effect due to lower sales than in the previous year
- High acquisition expense overruns, and
- Changes in German legislation around policyholder profit-sharing

Slide – South Africa (OMSA) [35]

Sales volumes were substantially higher in the second half of the year than the first half, despite a tougher trading environment, leading to full year APE growth of 5%, primarily due to strong growth in Group single premium business. There were good contributions from Symmetry, and with-profit and term certain annuities. Increased sales led to higher VNB. Operating earnings benefited from higher expected 1 year returns, which we expect will reduce in 2009, overall neutral assumption changes in 2008 compared to significantly negative assumption changes in 2007, and better maintenance expense experience, partially offset by worse retention experience. RoEV of 14.4% was achieved. The asset allocation backing the Capital Adequacy Requirement changed over the year, to a lower exposure to equities. This resulted in a reduced capital adequacy requirement, offset by an increase in frictional costs due to the higher tax rate on interest earnings.

Slide – United States [36]

US Life sales reduced on the prior year as a consequence of the withdrawal of the OMB guaranteed variable annuity products. The reduced sales volumes, and increased assumed future hedging costs, had a severe impact on VNB and New business margins. The largest contributor to the reduction EV losses disclosed was the change in economic assumptions, arising from the drop of more than 200bps in swap rates and widening in corporate bond spreads over the year, discussed earlier.

Substantial Operating assumption changes were made, including a strengthening in Single Premium Immediate Annuity (“SPIA”) reserves totalling £151m (\$280m), relating to policies sold to “substandard” lives, where mortality experience was lower than anticipated. Note that the strengthening in SPIA reserves in 2007 was in respect of large case SPIA’s, and not substandard SPIA’s. The reduction in future assumed mortality has the impact of increasing projected life expectancy from 7 to 10.5 years, and when added to the attained age of 82 years, implies an average expected age at death of 93 years.

A provision was made in the VIF [of £157m] for anticipated expenses in excess of allowable expenses in the existing in force book, projected forward over the lifetime of contracts, based on current levels of overruns. Current management actions are focussed on reducing the cost base and this should lead to expense releases in future, based on current plans. Various adjustments were made in relation to the OMB VA’s, of which the largest were a strengthening of the Guaranteed Minimum Accumulation Benefit (“GMAB”) reserve which led to a reduction in Adjusted Net Worth (“ANW”) of £68m (\$126m), and an increase in assumed future hedge costs which reduced the VIF by £87m (\$161m)

Slide - Managing US embedded value [37]

MCEV does not change the ultimate profitability of the business, only the timing of recognition of earnings. We therefore believe that the US business is still economically viable despite the negative VIF under MCEV.

In respect of our bond portfolio, we have consistently managed to earn spreads in excess of the targeted spreads. Although current markets are volatile, we expect that once they settle we will continue this trend. The current impact on EV of recognising the present value of an additional 1% of spread on corporate bonds over and above the risk free reference rate over the lifetime of the liabilities (with credited rates and discount rates changing commensurately) amounts to £699m (after tax), or 13.2p per share. Given the current liquidity premia inherent in corporate bond spreads, we are confident that investment returns on the corporate bond portfolio in excess of the adjusted risk free rate are achievable and therefore we firmly believe that MCEV does not fully reflect the ultimate value generated by spread-based business. In addition, lessons learned from the MCEV implementation contributed to discontinuing some

unprofitable products.

Slide - Managing US embedded value [38]

Going forward, the RoEV for US business is expected to be higher on an MCEV basis than under an EEV basis for two reasons. First, it is measured off a lower starting base value compared to EEV. And second, other things being equal, operating earnings will emerge more positively than is currently projected under MCEV as unrecognized credit risk premia are earned in future reporting periods.

The value of deferred tax assets is only recognised under the MCEV to the extent that the tax assets are expected to be utilised in future by offsetting them against expected tax liabilities that are generated on expected profits emerging from the in-force business. In the current environment taxable profits are not projected in aggregate on an MCEV basis, thus these deferred tax assets are not recognised at present. We expect that we will earn returns greater than the adjusted risk free rate in future, hence will be able to offset tax payable against these deferred tax assets, which will give rise to unmodelled profits.

US Life has taken active steps to reduce its cost base by proactively managing expenses. Management actions include position elimination, office consolidation, reduction in consulting spend, renegotiation of vendor contracts, and rationalization of products and distribution arrangements. These actions are expected to increase the EV by \$120m over time as they take effect.

Thank you very much. We have covered a lot of ground in this presentation, and I will now hand you back to Philip.

Philip Broadley

Thank you, Andrew and thank you for covering so much ground very clearly.

To summarise briefly before taking questions, as you all gathered under the MCEV methodology we do expect great volatility in results, particularly where investment markets themselves are volatile but we do believe that MCEV will help users better understand value and risk associated with the Life business.

We'll be able to make better decisions regarding management of the business going forward.

As I mentioned at the outset of the presentation, changes due to MCEV do not necessarily imply changes to the fundamentals or strategy of the business. We are in the same business as other participants in the insurance industry. We take on risk and we'll continue to do so based on our understanding of the risks and expected returns, and provided that we believe that risk taking will provide an acceptable return to shareholders on a fully risk adjusted basis. Despite the effects of the transition to MCEV reporting on the US spread based business we continue to anticipate that additional earnings will emerge in future years as Andrew has explained and it's important once again to stress that the total earnings reported over the lifetime of a contract are equivalent under any of the different reporting measures. It's the timing of recognition that differs.

So when performing an evaluation of our long-term business it's important to include the value that's expected to emerge over time from the asset risk that's being taken on spread based business. So we do believe that in future there will be a greater focus required on total operating earnings rather than purely on the value of new business in assessing franchise value.

We've gained considerable insights from the implementation of MCEV and we've continued to embed the methodology into the way the business is managed. MCEV is a core part of our process to deliver the integrated management of risk, capital allocation, performance reporting and financial transformation. We'll continue to use embedded value as a financial

management tool to monitor the development of shareholder value created by the group's Life business and to enable management to determine efficient risk adjusted use of capital.

That concludes the formal part of the presentation this afternoon. I'm very conscious of the fact we've provided you with a great deal of information in a relatively short space of time to work on. We hope you have found it useful. We'd be very pleased to follow up with you later after this call as well as today taking your questions.

So operator, over to you now to open up the lines for questions please.

Operator

Thank you. If you'd like to ask a question please press *, or asterisk key followed by the digit 1 on your telephone keypad. Please ensure that the mute function on your telephone is switched off to allow your signal to reach our equipment. If you find that your question has been answered, you may remove yourself from the queue by pressing *2. Again please press *1 to ask a question. We'll pause for just a moment to allow everyone to signal for questions.

We'll take our first question from Risto Ketola. Please go ahead.

Risto Ketola, Ketola Research

Yes, hi, Andrew, it's Risto Ketola here.

Andrew Birrell

Hi Risto.

Risto Ketola

Just a couple of questions. Now firstly, I agree with what you have done on the liquidity premium. It just seems pretty high compared to for example the Aviva restatement. Now I know you're looking at December rather than June but do you feel your 300 basis points for the US is going to be the highest used by people in MCEV or do you think it's in line with what others will do?

Andrew Birrell

Risto, when we looked at the adjustment, obviously we looked at what the inferred liquidity premiums were at different credit rating categories and we have a lot of A and BBB corporate bonds in our portfolio. Now the BBBs in particular blew out very far at the end of December so I think that the liquidity premium that a company will use will depend on the segmentation of their portfolio into the different rating categories. I think also that Aviva has signalled that they will be using a higher liquidity premium at the full year end than they used at the half year because of the change in market conditions over the period and I think what you often need to do is I understand that some of the other companies that have published, for instance there was a publication from AXA who also used a liquidity premium which if you back it out is lower than ours but they used it across the global operations whereas we've applied it only to the US business. But to come back to your question will we be the highest? I'm not sure. I think that our total liquidity premium that we've used is 43% of the overall corporate bond spread.

We have seen evidence in the markets and in a number of papers that have been written on liquidity premia that they are in fact, or can be assumed to be, a higher proportion of the total spread than what we've taken into account, but I can't speak for other people in the market.

Risto Ketola

That's a very clear answer. Now I want to follow up on South Africa. We haven't seen annuity margins come down. Is that because the assets backing of annuities are mainly governments

so you don't have the same issue with credit spreads like you do on annuities in the UK or the US?

Andrew Birrell

That's correct. The corporate bond market is very small in South Africa relative to the US market and so most holdings will be in government bonds.

Risto Ketola

Ok. Then my last question is, before I delete my EV sheets, what other things are being discussed in the CFO Forum about the current MCEV standards? I think the liquidity thing is pretty irrelevant but what other things are likely to change when the next set of standards comes out?

Andrew Birrell

I think there are issues being discussed around should you use swap rates, should you use government rates? In fact there are some markets where at the end of the year treasury rates or government rates were higher than swap rates. There are discussions around the allowance to be made for CMHR and the final piece that's being discussed is volatility. Again some of the people publishing numbers which require assumptions around market volatility tend to use averages. We have in fact used market implied volatility and the answers that you get can be quite substantial. In AXA's disclosure that they published recently, they used 12 month average volatility. If you use a points based volatility like we did as at 31st of December 2008, firstly it seems to be a time when there is a relatively low level of trade happening so the market is quite thin; and secondly as was done at an extremely dislocated time in allmarkets, so that makes quite a big difference as well.

Philip Broadley

I think what the CFO Forum will want to do is to review the approaches that all the member companies take this year end. Each of us is having to deal with what I note from your comments you recognise are very difficult and unusual circumstances and we're all trying to come up with practical approaches to the present circumstances and I hope the forum will pull together the various ideas and hopefully we will be able to develop a common approach going forward.

Andrew Birrell

Very much from our side when we landed on our final liquidity number, it wasn't an arbitrary view and we were very strongly guided by the Barrie + Hibbert calibrations that we were provided with. We think that they are credible parties and they gave us a quantitative metric of what their models provided. So it certainly isn't an arbitrary number.

There's just one thing I would like to bring to all the listeners' attention and that is that in respect of our calibrations that we did for this valuation, we were unable to get a calibration at 31st December for US bonds which met the internal consistency checks. So we calibrated back to the set of data that met internal consistency checks and that was the calibration as of 30th September. I understand that we are not the only party who has this problem. The US data was very unusual for bonds as of 30 December or 31 December and I think that that's an important thing to know. Just also within that piece, don't be confused. We are using 30 September for the US onshore business for the bond market vols and for the equity vol that we use to value the Old Mutual Bermuda guarantees, those are based on 31-12-2008 equity market volatilities.

Risto Ketola

Thank you.

Philip Broadley

Thank you very much.

Operator

Our next question comes from Francois Du Toit from JP Morgan.

Francois Du Toit, JP Morgan

Hi, Andrew. You've just answered the main question, but the second question I've got here is the frictional costs on capital that you allow for, surely you also have to allow for some kind of a liquidity premium on capital as well as capital tends to be held into the life company for say 10, 15 years and as you know liquidity premiums are enormous at the moment so if you do want to do a proper mark to market value for that money that sits in the business rather than is held in the hands of investors then it should include some liquidity premium and potentially a control premium as well. That's question number one. Then the next question, on the mark to market bond losses that you've disclosed, relative to what was that? It doesn't seem to be swaps, it must also be to swaps plus some liquidity premium allowance there because for example if you take the sensitivities that you've disclosed just now in your presentation that a 1% additional spread profit allowance would boost your MCEV by £700 million, in other words a 300 bp allowance would boost your MCEV by nearly \$3 billion. In other words the mark to market loss must be more than \$3 billion, it must be closer to \$5-6 billion if swaps or risk free was your basis you were marking to.

Andrew Birrell

Francois, let's start on that question firstly. Obviously we take our adjusted risk free rate and we use that as a basis for future cash flow projection but from that we have to deduct expenses and we also have to deduct the spreads of the crediting rates that we have guaranteed to clients. If those are higher than the crediting rate that would be derived from a spread base, in other words you take your projected future rate and you take off your expected earned spread and just apply the balance to the clients. The instances where the guaranteed crediting rate is higher than that so you end up projecting an investment loss which would in present value leads to a loss in MCEV. The mark to market on the bonds is in fact the value that's implied in the market and just to be precise it was \$2.6 billion as at the end of December 2008.

When we talk about using the sensitivity that we gave around the 13.4p or the £700 billion, just one thing you have to be careful of is that that is not a linear sensitivity. As you expect a higher yield you will earn more profit on it because you're now covering or you're projecting a rate which is greater than many of the guaranteed rates. As you come down it would actually give you a bigger reduction in MCEV because you now have more guarantees that are biting. So it's a bit tricky to do an exact linear run off that. Your final point which I think is your first question that you started with was around should one be allowing for a liquidity adjustment because shareholder capital is locked up. I don't know on what basis we would make that. I think that the traditional approach or the MCEV approach which when it was debated had a fairly thorough airing determined that you accept that there's capital that is locked into the business that's regulatory capital that you need in order to write the business and that you can't release and you then look at the frictional costs being what taxes you have to pay and what investment management costs you have to pay on that locked-in capital. We certainly haven't thought before of a liquidity premium and I don't think it's part of the guidance either.

Francois Du Toit

Just to get clarification again, on the first question you can then confirm that your mark to treasuries loss in your US bond portfolios is 2.6 billion at 31 December to treasuries?

Andrew Birrell

Our mark to our investments portfolio, not just to treasuries, that's a mark to market so if we're holding corporate bonds it'll be a mark to the price of that corporate bond. If we were holding structured securities it would be in the price of that structured security.

Francois Du Toit

We'd always thought that mark to market means mark to [*phone line interference*] doesn't include any movements in the risk free.

Andrew Birrell

No, the assets are market value so basically we would take the mark to the actual bond instruments that we hold.

Francois Du Toit

Ok, so nominal pretty much.

Andrew Birrell

Just one comment to make there is that there are some that are marked to model if there's no price available and the IASB came up with some guidance on that late at the end of the year, around reclassifying certain bonds into the loans and receivable category if there was no evidence of trade in those.

Philip Broadley

It's a relatively small part of the portfolio where we have needed to do that and I think it relates to about 20 securities out of the 1,200 in the portfolio. My recollection is that's a nominal value of about \$2bn but otherwise and for the avoidance of doubt the accounting requirements for the available for sale portfolio which is the greater part of the corporate bonds in the US because they mark to market the traded market price of the individual security.

Francois Du Toit

Just one further quick question. Your own debt that you marked to the market, surely you can't use debt holders' valuation as the value to shareholders for that debt because that debt is a surety to shareholders. The debt needs to be paid and it will impact earnings and the cash flows therefore should be valued as a certainty rather than the way debt holders value it currently which is clearly not as a certainty.

Andrew Birrell

Francois, I think that the guidance again may say is that we have to mark it at the market value and that varies over time. If the price at which it's trading in the markets, we could potentially be a participant in buying it at that price presumably and so that is why that would be the value at which the shareholders would benefit from the debt.

Operator

The next question comes from Blair Stewart from Merrill Lynch. Please go ahead.

Blair Stewart, Merrill Lynch

Good afternoon, two quick questions. The first question is what was the effect of using the 300 basis points additional? I know you said it's not quite as simple as taking the 700 million multiplied by 3 so could you give us some guidance on that? Secondly, you talk about an implied default rate under MCEV of 6.9% of which you've very roughly taken 50/50 split between default and liquidity in your EV. If you're applying that to the spread widening that

you've seen in the US corporate bond portfolio it would suggest that the market's implying you should be losing about £900 million from that through defaults. Would you agree with that? That's it. Thanks.

Andrew Birrell

Thank you, Blair. I think firstly the 300 basis points that we've added is about 43% of the total spread, so just under the 50. We didn't come at it from a 50/50 split type of view. We came at it from a bottom-up view of the actual distribution of bonds in the different rating categories and then applied the market data that we had been able to find in respect of implied or inferred liquidity premiums at the different rating categories. In terms of your question around the £900 million default, I think at this stage that is very hard for us to determine or to tie back exactly what an expected default value in the market would be because of this dislocation in the markets. If you assume on a swap rate of 2.6%, if you add on that 6.9% to get to the market yield of 9.5% that's kind of implying that most of your income that you expect to get in future will no longer be received. That's precisely why we believe that the market was overstating the credit risk premium in respect of future credit defaults.

Blair Stewart

Sorry, could you answer the swap? What was the 300 basis point effect?

Andrew Birrell

The 300 basis points effect would have been roughly around about it's around about a billion dollars per 100 basis points. As I said it's not completely linear but you can average it out at that type of level.

Blair Stewart

So it's about 40p on the embedded value.

Andrew Birrell

The total, yes. If you wanted to take a very extreme view and assume that roughly three quarters of future income would not be received on the portfolio. I think it's also important to note that for most of our securities we are still receiving the income that was expected to be received, so they are servicing their debt. We're receiving the coupons and we don't need to sell them. We are not forced sellers of securities at these prices in order to pay out any benefits that are being claimed by clients. We do have a very adequate liquidity buffer and we do have a relatively well duration matched portfolio with liability duration of 5.9 years and asset duration of about 6 years.

Philip Broadley

We can look at it another way, Blair, I appreciate what you're seeking to do. But as Andrew explained in the presentation that under an old style, traditional or EV approach, the assets backing policyholder liabilities wouldn't be mark to market and therefore we would have been looking at an embedded value per share that's probably 30p the other way. I think what this just demonstrates is the challenge of trying to, if you will, make sense of what the market is telling us about corporate bonds and the returns that we might expect to get from them in the future it's for a US business.

Blair Stewart

I don't disagree with the introduction of liquidity premium, I'm just trying to make sense of the facts that you've given us and it seems like the 300 basis points has had...you know, if you hadn't have used that and followed MCEV to the letter, that would have be 40p lower and if the market is correct and there's a 57% default probability, 43% liquidity, sorry, a 57/43 split then the market's telling you that you'll lose more than 900 million of value from your corporate bond portfolio. That's correct, isn't it?

Andrew Birrell

If it said that that would be correct. But you would then have to work that back and compare that to the kind of default scenarios that have been seen in the past. That is many, many magnitudes greater and I think.

Blair Stewart

I'm saying that's what's being implied by market.

Philip Broadley

That is what is being implied by the market and our challenge is to try and make sense of that and report in a way that we consider meaningful. So between the range of outcomes between the one that you've asked us to describe and one of a traditional embedded value there is a 50p or 60p range.

Andrew Birrell

I think that's correct. If I can just add to that that if we had done – and we haven't done this and we haven't had it audited – but if we had done an EEV calculation at the end of December we probably would have ended up with an EEV in the range of somewhere around 150p per share. Now as analysts you have to try and work out whether we should have done that or whether you want to take off the liquidity premium that we added on, I guess that's your decision to make. But it does give you an idea of the range and I think it also gives you a sense of how difficult it's going to be to compare embedded value figures published at December '08 between the different London market participants and the South African companies for those that follow the companies there because there are people who have elected not to publish on a MCEV basis and have gone with EEV and you can't do a direct comparison between their value per share and ours.

Blair Stewart

Just one final observation from me. I think MCEV is fantastic for us actuarial nerds of which I'm one of them but for anyone else it's not something you can really understand and if you want your shareholder base in future – and this is a comment for the whole industry – to include anyone other than actuaries or people who are prepared to take the time to understand these things I think this whole thing needs to be completely re-thought and if you have got any input into the CFO Forum I suggest that's the way forward, have a market consistent valuation of the options and guarantees certainly but everything else just needs to be something that's far less volatile and much more easy to understand.

Andrew Birrell

Thank you, Blair.

Thank you for that. Again I think a number of participants on the call will likely know and we've discussed it before, I would genuinely welcome a shared view from you both on the buy and sell side around how we provide the understanding of the risks that you call for whilst on the other hand making the presentation simpler and I'm only too happy to feed that into the CFO Forum. I've been involved with the forum since its outset and continue to be.

Operator

Our next question comes from James Pearce from Cazenove.

James Pearce, Cazenove

Hi. First of all I agree with Blair and the question I have is why on earth have you adopted

MCEV? Secondly given that you have and we've got to put up with it, can I just clarify have you taken all of the gain on your own debt or just 43% of it and if you are taking all of it, why do you use 100% of your own debt but only 43% for other people's? How have you computed the 43%? Why 43%, not 50%, not 0%, not 10%, whatever? Could you also explain how you've computed the non-hedgeable risk provision of 370 million or so?

Andrew Birrell

Thank you James, if I can start on the liquidity premium. The liquidity premium is only applied in respect of our US Life onshore business. We did not adopt it for any of the other parts of the business and the reason why we specifically adopted it in respect to the US Life was because that book is primarily a spread based crediting book and it is very well duration matched. The assets and liabilities are very closely matched as you would have seen from the presentation this morning and now and so as a consequence we are able to hold the bonds to maturity. We are able to hold the bonds to maturity in order to earn the liquidity premium and we have adequate cash to deal with any expected outflows under a range of scenarios. So that is why we adopted it and we only adopted it in respect to the US. We did not adopt it in respect of the other territories in which we operate. Presumably if we had adopted it elsewhere it would also have led to an increase in embedded value.

James Pearce

My question was why on earth did you adopt MCEV full stop globally given that it's not very helpful as a communication tool particularly in current markets? It seems to be against your shareholder interests to do so.

Andrew Birrell

At the time that we started working on MCEV it was indicated that most of the London market participants would be adopting it at the end of December '08. We could have at the last minute chosen to release our results today recalculate the embedded value but we would not have had them on the European embedded value basis as of the same day as we have published the rest of our results because of the enormous amount of work involved to getting the calibrations right and to actually publishing the data.

The restatements for 2007 were done some time ago in order to get to this position to be able to publish today, so we've been doing a number of valuations. We've been through about four valuation cycles in the course of the last eight months so logistically it would have been highly problematic. You spoke earlier about how we determined the value of the liquidity premium and we determined that with respect to information and calibrations that we received from market experts on these matters, people like Barrie + Hibbert. We did not arbitrarily decide on a liquidity premium of 300bps.

James Pearce

Who are Barrie + Hibbert? I've never heard of them.

Andrew Birrell

Barrie + Hibbert are probably one of the best known providers of market calibration data and they provide calibration data for the US and the UK.

Philip Broadley

They started life James as professors at Heriot-Watt University and I'm surprised you say you haven't heard of them because we've certainly used them and I've referred to them in presentations at another place where they have provided us with mortality data, so perhaps you nodded off at that particular point.

Andrew Birrell

So basically we looked at the data that they provide which is by rating category and by market and we built up a bottom-up view of the liquidity premium which we then tested against other literature that has been published both within the public domain and also private research which one can subscribe to. That was how we determined the liquidity premium.

In respect to the cost of non-hedgeable risk, what we did there is we've applied a 2% charge to the capital required for the business every year, so we've projected for the capital every year, we've applied a 2% charge for that and we've discounted at the back and that's how we've arrived at that number.

Now I just want to point out

James Pearce

Then why have you chosen 2%? Why would I think that's the right way of providing?

Andrew Birrell

We chose 2% on the basis of the kind of industry loss data that we have seen across the insurance industry. When we chose the 2% we applied it to the undiversified capital base of each individual part of the group and in fact we do have a diversification benefit within the group so that actually grosses up to 3.25% on a group-wide basis. So we understand that our nominal 2% which is an effective 3.25% is actually at the high end of cost of non-hedgeable risk data. We understand for instance, I think that Aviva's equivalent to our 3.25 would be 2.5% and so we believe that if you look at the type of risks that we have been exposed to in the past around mortality and around the hedging issues, it is appropriate for us to have a higher allocation or allowance for non-hedgeable risk.

James Pearce

Given that you seem to have thrown the baby out with the bathwater on MCEV, at least as far as me and Blair are concerned, can you say how you're going to develop your IFRS disclosure so that we can sort of follow profit drivers through to earnings a bit more effectively than under the current disclosure?

Philip Broadley

I don't think I have an answer for that today and part of my anxiety around making further changes to our IFRS disclosure is it would be doing that in advance of what is still intended to be a Phase II standard that will have, whatever you might think of it, market consistent elements to it. Again we've spoken about this over the years and I'm keen that the framework should stabilise so I'm very happy to take ideas about how we develop our IFRS earnings and I think what I will seek to do over time working with Andrew is to look at how we can analyse further the movement of capital between net worth, free surplus and in-force. But again before someone else makes a comment about length of disclosure, all of that implies more when a number of you commented this morning about the volume and material that we're now providing. So I hope you at least have some sympathy with the challenge we have between providing all of the types of information that we're asked for and without adding greatly to the volume that we're already putting out.

James Pearce

Ok, thanks very much.

Andrew Birrell

Thanks, James.

Philip Broadley

Thank you, James.

Operator

Our next question comes from John Hocking from Morgan Stanley.

Philip Broadley

Good afternoon Jon.

Jon Hocking, Morgan Stanley

Good afternoon guys, I've got a few questions if I may. Firstly just going back to the liquidity premium point, can I assume from the conversation that effectively you're getting data from Barrie + Hibbert and that some things are done on a bottom-up basis and therefore that may not necessarily – I know that it's not going to reconcile exactly – but you're doing a separate bottom-up review of likelihood of defaults for your IFRS numbers. I just wonder if you've gone through any exercises in reconciling the view you're getting from Barrie + Hibbert on a sort of bond-by-bond basis or what you're assuming in the IFRS numbers. I know the basis is different but have there been any processes gone on to make sure that there are not glaring inconsistencies?

Then the second question is about the net worth. Can I just confirm the net worth in the CEV for the US business is effectively the US statutory capital? Then finally just as a consequence of all of this have you actually changed any of your sort of risk capital in terms of writing new business? How are you allocating capital? Are you looking at the MCEV numbers? Are you looking at the IRRs? What have you actually done in terms of managing the business?

Philip Broadley

Perhaps let me tell you the last one first. I think the MCEV analysis of product profitability was certainly one of the factors in the decisions that we've made about product rationalisation that's taken place in the US and that Chris Chapman referred to earlier. So we do take into account MCEV in determining what we write. Also linking back to the discussion I was just having with James, we'll continue to look at RoE on an IFRS basis as another measure. If you want me to kind of summarise it to what are the two things that are most important to me as I'm looking at the business, it will be those two measures.

Andrew Birrell

If I can pick up and good afternoon Jon the elements around the liquidity premium and the review of the bonds and the ANW on the US business. Firstly, we used the data from Barrie + Hibbert because we believed it was the best market data which actually deconstructed bond spreads into liquidity and credit components. We applied that to our portfolio to work out what the weighted overall liquidity premium was implied in our portfolio and that was the first indicator that we used for the size of the liquidity premium.

John Hocking

Is that effectively a similar methodology to Aviva where they've looked at sort of the negative basis trade where you can actually buy a corporate bond, take out the credit risk, the CDS and still have a residual spread? Is that how they're doing this or have they got another methodology?

They would be using some other methodology as I understand it. The next thing that we did is we actually cross-referenced that to other data that we could find around liquidity premiums. Now it was quite hard to find data which is precisely calibrated to 31st December but we did find other data which spoke about the proportion of a corporate bond spread that historically could be applied to liquidity premiums and also the movements. We looked at data that was

published by other research houses which unfortunately is not public data, which implied liquidity premiums could in fact have been higher than the one that we chose by a substantial margin, and we felt that the 300 was, given the nature of our bond portfolio, probably at the lower end of the range of acceptable liquidity premium assumptions. In respect of the work that's been done for IFRS every one of the holdings – and there's something like 1,200 different securities in this portfolio – every one of the holdings has been reviewed from the bottom up and it's been tested to determine what the likelihood of any losses or the likelihood of non-payment of any payments due, such as coupons, is when the final values were attributed to those portfolios and to those bonds and that work was actually checked and verified by the auditors and the audit process.

We've been through an extremely gruelling process because obviously there are a lot of things to check with MCEV and also given the current state of the market there's been a lot to check on the asset side of the balance sheet. But it didn't throw out any particular elements that would have given us cause for concern or inconsistency between the review of the individual bonds and the review of a global or overall liquidity spread. In respect of the adjusted net worth for the US, that is held on a US statutory basis, so it's a US statutory surplus but adjusted for mark to market value adjustments.

Jon Hocking

Ok, great. Thank you very much.

Philip Broadley

Thanks Jon.

Operator

The next question comes from Marcus Barnard from Oriel Securities.

Marcus Barnard, Oriel Securities

Good afternoon, gents. I'm not going to ask you too much about the liquidity premium. What I am going to ask is the figure you've quoted, the additional 1% spread would add about 13p to you or 699. Are you going to quote that figure on an ongoing basis in your future updates? Also can you quote the sensitivity of it because I know it's not linear but 1%, 2% because those of us that want to remain market inconsistent might want to add some of it back when we're valuing your company.

Andrew Birrell

I think we'll probably look at what the market implies at the time that we do our next publication Marcus. I think the other issue is that we've had to make some departure from the MCEV principles in respect to the US for December 2008. We would hope that by the time we next publish the CFO Forum principles are firmed up and finalised to take into account how you deal with dislocated markets; and at that stage we would hope to publish whatever is fully compliant with their principles and guidelines at that point in time. So I'm not quite sure what kind of sensitivities they would mandate. If we have the flexibility to publish this kind of information and it is material I would imagine that we would want to do so, but I don't want to pre-empt what the markets might look like at that stage.

Philip Broadley

I equally have sympathy for those people who want to be market inconsistent, as you put it, as well as those who want to be purists, so I think to try and accommodate both schools of thought we will aim to provide something of the type that we were talking about earlier, so you've got a sense of the range of outcomes depending upon what view you take.

Marcus Barnard

That's brilliant, thank you.

Philip Broadley

Thanks, Marcus.

Andrew Birrell

Thank you Marcus.

Operator

Our next question comes from Raghu Hariharan from Fox-Pitt Kelton. Please go ahead.

Raghu Hariharan, Fox-Pitt Kelton

Good afternoon gents, hi Andrew. I have two questions if I may please. Unfortunately the first one as you can imagine is on the liquidity premium. You guys started off your introduction by saying that the clear problem with the EEV is that you can take higher risk and therefore capitalise those spreads. I'm just left wondering that if you have a portfolio which is – I'm not saying it's you but in general – if you have a higher proportion of BBB bonds, BBB bonds have had the highest spreads, I can capitalise 50% of those premiums in terms of a liquidity premium and it gives me a higher EEV. I'm just wondering what cap, if any, is the CFO Forum considering in terms of liquidity premium because if you look at AXA they've used 100 bps in the US, Allianz use zero and you guys are using 300 bps. There are some similarities within the business that Allianz has and you have in the US.

The second component, when you say that you've done or you've got bottom-up analysis done, I'm just wondering, 25% or 30% of your portfolio is MBS or ABS securities and ratings have not proven to be a good guide to the ultimate default levels on this portfolio so I'm just intrigued as to how or what the analysis was which actually told you that you could have I guess a liquidity premium of 43%. So that's number one. The second question was on the free surplus within your MCEV. The free surplus is a negative, -128 million. If I look at your in a statutory capital position it seems to suggest there a \$2 billion surplus so I'm just wondering what's driving the difference? It definitely cannot be just the Mutual & Federal and Nedbank market value. I'm just wondering if you can help me understand the bridge there.

The third one was on the US book, what is the default allowance that you price into your products for bonds when you sell your fixed index annuity products? Thanks.

Andrew Birrell

Thank you Raghu. I just want to come back to your first question about holding BBBs and capitalisation of the liquidity spread. Of course if you just hold BBB's in this market you would find that your credit spread would have blown out quite severely anyway so there is some adjustments for the credit risk. I don't know what the CFO Forum will mandate finally but I think that it has to have whatever their mandate has to have reference to the actual duration matching position of our portfolio and also the level of liquidity that you will hold in that portfolio such that you won't have to sell bonds at an inopportune time and realise substantial market value losses. So I'm not quite sure how one would answer that question right now but I think those are the issues that you would use to reference the point of making that decision.

Just an interesting aside, I know you've referred to the AXA 100 basis points. That was in fact applied on all the assets outside of Europe and that was applied on an average, they've only got 50% of bonds roughly in those portfolios outside of Europe so you can gross that up and maybe effectively have got a 200 basis point liquidity premium which I think cross-refers quite well to ours, because we understand that they have a higher level of credit rated instruments,

a higher level of AAA top rated instruments in their portfolio. Now the ANW in OMSA doesn't reflect the full extent of the capital available to back required capital because it excludes Nedbank, Mutual & Federal and some other instruments as well. So actually that is I think where your level of confusion was coming in.

Raghu Hariharan

That's only on the default allowance that you use for bonds in the US book?

Andrew Birrell

The defaults allowance using for bonds, we price using a 16 to 20 basis points default assumption at this stage.

Raghu Hariharan

Is that what is there in your regulatory reserves as well for bond defaults?

Andrew Birrell

I'll have to get back to you on that Raghu for the exact figure in the regulatory reserves for bond defaults.

Raghu Hariharan

If I could just come back to you on liquidity premium. You were saying one of the issues is duration matching but I was just wondering about credit risk itself, when you have a higher proportion of BBBs or MBSs, ABSs. I'm just wondering as to how the bottom-up analysis kind of looks at the credit risk of ABSs and MBSs because that's been one of the major issues around this crisis.

Andrew Birrell

Yes. I think just a point on that and sorry I didn't pick it up earlier, Raghu, as far as I understand it we actually have a very low proportion of ABS and MBS type assets in our bond portfolio. The exact figure will be in the disclosures that we have published and I'm just trying to find it right now.

Philip Broadley

Fair value of our RMBS at the end of the year was just over \$1 billion., BMBS \$973 million and subprime £312 million. That's in the IFRS disclosures we gave today.

Raghu Hariharan

Ok. Thank you.

Philip Broadley

Ok, thanks

Operator

The next question comes from Larissa Van Deventer from Deutsche Bank. Please go ahead.

Larissa Van Deventer, Deutsche Bank

Thank you, hi, a couple of very quick questions I hope please. The first one, you are including your own debt at a rate less than nominal. Is that correct?

Andrew Birrell

That's correct. We've brought our own debt in at the market value of that debt which is per the CFO Forum MCEV guidelines.

Philip Broadley

Also consistent with IFRS where we bring that through not in the P&L but it's brought in as a net equity adjustment.

Larissa Van Deventer

Correct, ok. Could you indicate the benefit versus bringing that in at nominal? Do you know that number?

Andrew Birrell

The figure that we showed in the presentation was that there was 9.9p per share that came through as a consequence of including that number. That would be the movement from the prior year. The absolute figure is £645 million.

Larissa Van Deventer

£645 million, ok. Thank you, that's the first one. Then the second one. The value of goodwill in the asset management business as it came into this MCEV calculation, I couldn't find that in the slides.

Andrew Birrell

Larissa, we bring in the non-covered business at the IFRS value but there is a slide in the appendix that has that information.

Larissa Van Deventer

Oh, I'm so sorry if I looked over it.

Andrew Birrell

We're just... we're busy looking for it right now.

Philip Broadley

We're just busy turning pages if you hear sort of noises...

Larissa Van Deventer

Would you mind if I ask the next question while you're turning?

Philip Broadley

We may not be able to do both things at once

Andrew Birrell

Ok, the reference to US Life asset management is on page 51. It's in your packs that you received this morning and it comes just after the adjusted operating earnings per share waterfall which goes from 17p to 11p. It's called pro forma group MCEV.

Larissa Van Deventer

Sorry, hang on. Is this in the MCEV pack or the presentation pack from this morning, this slide?

Andrew Birrell

It's in the MCEV pack.

Larissa Van Deventer

Ok, it's slide 51.

Andrew Birrell

That's right, it's on page 51 and it's the fifth item from the top

Larissa Van Deventer

Ok, perfect, thank you. Then the last question, the impact of Nedbank and Mutual & Federal, is that the market value less the share of net assets, is that the number on slide 29 or is there another number we should be looking at? It's the waterfall chart and it's a 20.7 negative number that's labelled Nedbank and M&F market value adjustment.

Andrew Birrell

That will be the impact of the change in the market value of the shares or the holding in Nedbank and M&F in the period.

Larissa Van Deventer

Ok. Is there another disclosure that includes net assets or no?

Andrew Birrell

We were just having a look through it now but we'll get back to you in a moment.

Larissa Van Deventer

That's it from my side.

Andrew Birrell

Thank you, Larissa. Before we go to the next question, if you look at page 82, Larissa, of the big pack that you received this morning and it's in the one called Press Release, you'll see in page 82 we have all of that information, all those adjustments.

Larissa Van Deventer

Thank you.

Operator

The next question comes from Jacques Conradie from Peregrine Capital.

Jacques Conradie, Peregrine Capital

Hi Andrew and Philip. Just a question on the US Life business. On the fixed annuity business you're writing, what kind of crediting rates are you offering? Let's say I think on slide 36 you show a market yield of 9.5%. What kind of assumptions are you making for defaults and profits and commissions, so just an idea and also maybe if you can me the average crediting rate on existing business?

Andrew Birrell

Jacques, that's a difficult question to answer because there are a number of generations of products that we're talking about here so I'm going to try and see if I can try and get some

information for you. I think the best way of trying to have a look at this particular question or trying to answer it is firstly to tell you that we have actually earned a spread in excess of what we targeted in 2008 and 2007. The 2008 number was in fact included on one of the slides and I'm just going to get to the slide to refer you to it.

Jacques Conradie

I think you mentioned a spread of about 200 basis points or 185.

Andrew Birrell

That's right, and that is on page 37 of the pack, it's actually the second bullet point, the second sub-bullet. So we are actually achieving more than what we target on the spread but to tell you exactly what sits in the pricing basis would be quite complex for me given the different range of products.

Jacques Conradie

Ok. The reason I asked the question basically I was just kind of trying to get an idea of the type of default rate you guys realistically assume in new business and also if new business crediting rates for let's say 7% of existing business [*phone interference*] you think your [*phone interference*] or a competitor?

Andrew Birrell

Bear in mind that at the moment with yields being what they are in the US it's incredibly unlikely that crediting rates will be any higher now than they would have been in the past and in fact crediting rates both within our company and across the industry have reduced quite substantially over the course of 2008 and I presume will probably continue to reduce over 2009.

Jacques Conradie

Ok, so the crediting rates follows government bond yields more closely than corporate bond yields because the total corporate bond yields has probably gone up but obviously government bond deals have gone down, so you think crediting rates would have probably come down rather than gone up?

Philip Broadley

Crediting rates generally will follow government rates or if you like bank rates. Very often the choice of the customer has made historically when they've been investing in a fixed annuity or a fixed index annuity is around the choice between investing in a banking product CD versus an insurance product. So if you're a customer in the US that's currently sitting on a product that you might have bought in 2004, 2005, I think you might argue that product has potentially got some characteristics, albeit within it, that you would think carefully about holding as opposed to doing something else.

Jacques Conradie

Ok, and then just on your credit rating. I think you mentioned this morning that AM Best is obviously the vital one and that a two notch downgrade would be detrimental to new business. Do you think if a downgrade could happen would it be detrimental to existing business as well, i.e. would people try to lapse and go somewhere else or are people relatively locked into maturity on products?

Andrew Birrell

Well Jacques, I think it's hard to always predict customer behaviour but certainly rational behaviour would be, that for as long as there is a surrender type charge, you'd expect that lients wouldn't lapse, and there are surrender charge periods on these contracts. I think the

other issue that you've got to look at, is in the context of what's happening in the overall market. We are not in a situation that the Old Mutual US Life business is an island of bad performance within a sea of incredibly highly performing companies. In fact the whole sea is full of companies which are in the same trouble, as it were, or the same troubled waters. So we are, in terms of our bond portfolio, very much the same as any other life company in the US and therefore the bond portfolios with minor differences will be going through the same kind of stress that ours has been going through. So I think there's less chance of people lapsing their contracts, to take them up or to re-enter with other insurers, than they would have been if our company was the only one with a bond portfolio that looked like this.

Philip Broadley

As we commented this morning, we have significantly increased the amount of cash that we're holding in the portfolio which is a defensive measure against any number of different scenarios that might happen in the US.

Jacques Conradie

Ok, great. Thank you very much.

Andrew Birrell

Just a final issue for you to consider or to think about is that we do test resilience to increased withdrawals when we do our liquidity planning and when we consider stress scenarios, when we do our economic capital and in fact we do have a dynamic lapse model that we operate in our embedded value as well, our embedded value modelling. So the models are not static and they don't assume this continuation of behaviour. They look at a number of different scenarios in a combination of economic circumstances.

Jacques Conradie

Ok, great. Thanks.

Andrew Birrell

Thank you.

Operator

Next question comes from Greig Paterson from KBW.

Greig Paterson, KBW

Good afternoon, I thought I'd pushed the wrong button. Well done on this, I think it's a good effort. I want to ask you some theoretical questions, just three, one clarification and two questions on how you treat things. One is you mentioned the VNB. If you had used end of period assumptions, I wonder if you can just repeat that? I missed what you said, Andrew.

Andrew Birrell

Ok Greig. What I said is that if we'd used end of period assumptions we would expect the VNB in South Africa to be lower and we would expect the VNB elsewhere to be higher.

Greig Paterson

Do you mean to say elsewhere, Europe goes up or down, US goes up or down?

Andrew Birrell

US goes up and Europe goes up as well, Europe being the UK., ELAM, and Nordic.

Greig Paterson

All right. The second thing is, Aviva. In terms of how you're modelling assumptions for your discretionary credit rates from the US, Aviva's assuming that they keep their discretionary rate for three years and then it trends down to meeting the targeted spread or unless it's bouncing against the minimum 2.5% guarantee. What is your modelling approach for discretionary? Do you use a similar approach?

Andrew Birrell

Yes, we would have a similar approach Greig. We do target a spread in our approach unless we are hitting up against the guaranteed minimum rate. So if the net spread, in other words the projected return less the spread and the net rate thereafter, is lower than what the guaranteed rate would be on a contract, we would reset that to the guaranteed rate and effectively make a loss, an investment loss on that contract.

Greig Paterson

But what do you trend down? Is it flat for three years and trending down over 10 months? Did you start to straight away trending down or do you immediately set down? What's the approach?

Andrew Birrell

Greig, I think what we do is we assume that we will retain a spread going forward and if we find that the assumed spread, when you compare it to the guaranteed rate that we have guaranteed to credit to the client, if that assumed spread is negative we take the hit immediately.

Greig Paterson

All right. So there's no trending going on, it's an immediate hit?

Andrew Birrell

Yes.

Greig Paterson

All right. The second thing is, on your US book you do have a block of non-MVA guaranteed business and obviously that came to a put swaption and obviously there is a TVOG there. I was wondering if you've explicitly included that deduction in your TVOG and I wonder if you could just sort of quantify as a 100 million time value there, 50, 200, whatever?

Andrew Birrell

Greig, I'd have to get back to you on that detail but what I can confirm is that our TVOG in the US, as for any other territory, would fully cover any cost of options or guarantees that burn through to shareholders.

Greig Paterson

So it's not just maturity guarantees, you also have sort of immediate surrender guarantees that are factored into that modelling.

Andrew Birrell

Correct. Any guarantee that would burn through to shareholders would lie within the TVOG.

Greig Paterson

So in the US do you have a stochastic model on fixed interest security and what sort of model

would you be using? Does it include credit spreads as well?

Andrew Birrell

We use a stochastic model which will obviously take bond volatility to account in its future Projections, and we don't model the credit spreads explicitly, but they would be inherent in our starting point for the swaps plus the liquidity premium.

Greig Paterson

All right, excellent. Thanks very much.

Philip Broadley

I wasn't sure Greig how to take your comment at the start.

Greig Paterson

I was just saying every single question you've had is on liquidity. Maybe the audience needs to go and read a bit of theory before they ask the questions. Maybe it's just I'm a bit tired today!

Philip Broadley

We actually had a compliment from you which I was rather struck by.

Andrew Birrell

Just one thing I wanted to bring to your attention is, also in the modelling we do obviously in our cost of non-hedgeable risk allow for the risk of credit spreads moving and changing so that is already in the CNHR and I think in case...

Greig Paterson

You're saying in other words you've got a capital requirement before you apply the 2% includes credit spread RBC?

Andrew Birrell

That's correct. The credit spread is not done on an RBC basis, it's done on an economic capital basis.

Greig Paterson

Yes, I meant the economic level. So in other words on your non-hedgeable risk, you'd take everything that's non-market, but in this case you've included credit spreads. So instead of having assuming you had \$100 you've got \$150, the additional 50 for credit and you apply your 2% per annum.

Andrew Birrell

That's correct.

Greig Paterson

Great, thanks.

Philip Broadley

Thanks Greig.

Andrew Birrell

Greig, sorry, just one other thing and you'll be delighted to hear this.

Greig Paterson

You didn't answer my question right at the beginning about what was the realised losses on the US bond but I assume you're going to send me that later.

Andrew Birrell

I think I'll give the information to everyone on the call if you don't mind.

Greig Paterson

All right. No problem, that's good.

Andrew Birrell

Basically where we are is that in respect of the US, as at the half year 2008 the impairments that have been recognised were \$149 million and the realised losses were \$20 million. In Q3 we had impairments of \$380 million and we actually had a write-back on the realised losses because we'd impaired certain securities and then we were able to sell them at a better value. We had a \$280 million impairment hit but we had a write-back of \$9 million on realised losses so in fact we had realised profits: and in Q4 we had \$259 million of impairments and \$1 million of realised losses written back.

Greig Paterson

So the schedule in the third quarter which had £500 million I must ignore completely as an oversight.

Andrew Birrell

Yes please. What it does give rise to is overall impairment number for 2008 of \$768 million, realised losses of \$10 million and a total then of \$778 million across both items.

Greig Paterson

So the net is you haven't been trading this portfolio very aggressively at all?

Andrew Birrell

We haven't been trading it aggressively. We've been trading it on the margins. Bearing in mind that these numbers, the realised losses numbers will be pluses and minuses. So where we've been able to trade and it's been appropriate given the duration matching etc. Where we've believed that it is better to take a loss now than to have a bigger loss later we have done that too.

Greig Paterson

Alright, sure, that makes sense. What is your stock of unrealised gains? Do you have such a thing? I know you've got a net 2.6 but what's the stock of unrealised gains you have on that portfolio?

Philip Broadley

I think the closest we can do on that Greig is to refer you to the IFRS disclosures and page 14, the fair value gains and losses, there are some unrealised gains of 135 million against the unrealised losses that give you the net figure.

Greig Paterson

That's sterling, yes, 135 sterling?

Philip Broadley

That's sterling, yes. I think we are due to bring this call to a conclusion in five minutes and there are still some questioners on the line so I think we need to move onto the next question if I may. I think most people now are coming back for a second time. So let's move on quickly please to the next question.

Operator

We'll take a follow-up question from Risto Ketola. Please go ahead.

Risto Ketola, Ketola Research

Just very quickly now, you've spoken about the US withdrawals but you haven't put numbers to it. Last time I looked you had benefits at about \$600 million a quarter in the US. Now at that run rate can you meet that fully from cash flows or do you have to sell bonds to actually pay those benefits and at what quarterly run rate do you start realising losses at a level that starts impairing your US debt capital?

Andrew Birrell

Risto, I can't give you numbers of dollars per quarter because I don't have that picture in my mind but the sensitivities that I have looked at is that we have adequate liquidity to take a fairly severe worsening in our outflows and in that instance we may have to start realising some of the assets in about 18 months' time. That is what comes to mind for me. I don't have the dollar numbers but that is the shape of what the curve looks like.

Philip Broadley

That's assuming no sales and a significant increase in surrenders from what we're currently seeing and also an assumption that this is up at a higher than historic level of surrenders as products come out of the multi-year guarantee.

Andrew Birrell

That's right, so it's under a stress scenario. Bearing in mind we don't only hold zeros that start today, we hold a whole generation of different bonds in the portfolio which are being redeemed on an ongoing basis. We're receiving coupons on an ongoing basis so we actually have a fairly good match coming through on cash flow.

Risto Ketola

Just last thing, can you confirm that all the states you operate in, the annuitants are guaranteed up to \$100,000 from the state guarantee fund.

Andrew Birrell

Risto, I can't confirm that for you today, I'm sorry. I'd have to get back to you on that one.

Risto Ketola

I'm just wondering because you mentioned that the relative strength of mutual is probably pretty good in the US because everybody has had AM Best looking at their business model and so on. I'm just wondering whether the low average account balance at mutual is actually in your favour because most of your annuitants will probably be covered under the state plans.

Andrew Birrell

That's a very interesting observation, I think we'll probably take it forward but as of today I couldn't give you a confirmation of that, no.

Philip Broadley

Nor I'm afraid could I pass an exam on minimum guarantee levels by state. But you're right to make the comment that our average annuitants...certainly I think our average annuity balance would be somewhat less than \$100,000.

Risto Ketola

Thanks.

Operator

We'll take our next question from David Danilowitz from Merrill Lynch.

David Danilowitz, Merrill Lynch

Hi guys. In the interests of time I'll keep this one brief. Previously under EEV you incentivise in your policyholder funds to invest more in equities. When I say incentivise it really gave the policyholders a potential gross term but you've made a greater EEV. Now that's been taken away. Is there any reason...will it change your investment strategy on the policyholder side? Then I guess on the shareholder side...by the way that obviously doesn't relate necessarily just to the US. Then back to Francois's point probably about an hour and a half ago as regards to shareholders' funds versus policyholder funds, there definitively is inconsistency in the basis you're using to value the different assets. I understand as part of MCEV principles, do you believe that that is in any way going to be changing?

Andrew Birrell

David, if I can start with your comments about the EEV and the equity risk premium which used to be identified or capitalised there. I think a valuation basis shouldn't necessarily drive you away from things that are sensible, so if it is sensible to hold a heavy weighting in equities in certain contracts one will still continue to do so. I think it wouldn't be sensible to hold a heavy weighting in equities in contracts with very high levels of guarantees and that's typically why one would have bonds in those portfolios, so I think from an economic point of view MCEV won't make us do things which aren't in the economic interest ultimately of the clients or of the shareholders because in that way we would pretty quickly be in a situation that we weren't getting lots of new business and so there are competitive pressures. Now we're not doing it for the sake of new business volume, obviously we write new business in profitable terms but we wouldn't be changing our economic management of the company to the detriment of any parties. What we would do, and I think where MCEV has helped us, is identifying where we are taking on financial risks that we're not getting paid for. So if you are going to be taking on equity risk but at the same time making a guarantee to somebody, that's not a smart thing to do and I think that was very clear in the case of Bermuda. So I don't see a major change coming through there. In terms of your second question I wasn't quite sure what you were referring to...

David Danilowitz

Effectively Nedbank you hold at a market value but if you apply a discount rate to it and don't allow for excess premium, then by definition you don't back out the same value and I guess it's a circular reference but that's effectively what's happening on the policyholder fund. The question is do you believe there is any reason...I know you're taking a fictional cost basis but that certainly wouldn't allow for the equity risk premium gap.

Andrew Birrell

That's probably a discussion we would have that's going to take a bit longer than the time we've got available now...

David Danilowitz

My question is: is there anything changing? It sounds like that basis is going to be stable.

Andrew Birrell

I think that part of the basis would be stable, yes.

David Danilowitz

Ok, because there could be some inconsistencies between how you invest shareholder and policyholder funds on the back of that purely for embedded value representation purposes rather than economic.

Andrew Birrell

I'd like to have the discussion with you at some stage.

David Danilowitz

That would be fine. Great, thanks.

Operator

We'll take our next question from Marius Strydom from BJM. Please go ahead.

Marius Strydom, BJM

Hi there. Firstly I'd like to say that Greig Paterson, get a life and not be such a big nerd.

Philip Broadley

Thank you for that. We're not a Facebook site so we'll let you pass that on directly.

Marius Strydom

My question is that I was very surprised to the extent of the negative value of in force on the US Life business - despite the liquidity premium that you employed the value of in-force still came in at \$3.1 billion, which is quite a bit larger than the market value gap in the US Life business, i.e. the unrealised losses. It's difficult for me to understand why it was so large and so much larger than that mtm gap, but my question really is if that gap were to halve, if spreads were to come back and that gap were to halve, would the impact on value of in-force be more than the extent of the reduction in the gap?

Andrew Birrell

Two things happened in the US last year Marius. Firstly corporate bond spreads blew out and secondly swap rates dropped substantially. The swap rates dropping substantially, even when we add a liquidity premium onto that, still hurts you with guarantees that bite because you have to take some of that projected future return and apply it to expenses for instance. So you get a situation where in the current combination of circumstances, to coin a cliché, it's a perfect storm from a valuation point of view and I would hazard a guess that that is why some people who are expected to publish on an MCEV basis decided not to do so. I would also hazard a guess, notwithstanding the question we were asked earlier about why we proceeded with the MCEV, but if we'd published an EEV the market would have said to us "Well, hang on. You were supposed to have published an MCEV this time around so what was it?", so we were kind of in a bit of a tricky position from that point of view because I suspect if we

published EEV people would have asked us what the MCEV value was. In terms of the actual change in embedded value for the US I'd like to remind all the people on the call that when we refer to the US we are actually referring to two separate blocks of business or two separate entities. We refer firstly to the US Life onshore and it's onshore where we've had the issue with swap rates dropping to such an extent; and we've also had in onshore the adjustment to the SPIA mortality, which has also led to an embedded value hit. In respect of the offshore, it is also kept under the US Life banner, and that's why we try and be very careful in our notes and disclosures to tell you when we're talking about both of them or onshore only or offshore only, in the offshore we had the well publicised issue of the Old Mutual Bermuda variable annuity guarantees. We do still have guarantees going forward because contracts have not all run off and so we've had to assume higher hedging costs in future and we also, in respect of that book, in the course of the last year took the very well published hits on the hedge ineffectiveness in the first half of the year which improved substantially in the last quarter. So when you add all those factors together you get to the outcome that came from the MCEV calculation. I hope that answers your question Marius.

Marius Strydom

Are you saying that there are a number of impacts there and that if the spreads are to narrow then there would be a positive impact on the MCEV, if the swaps were to go up then there would also be a positive impact?

Andrew Birrell

Correct.

Marius Strydom

To the extent that you're not fully hedged in Bermuda, if markets go up you should also see a positive impact?

Andrew Birrell

I think it's dangerous to speculate or to look into a crystal ball, but what I would say is a relatively safe statement is that if swap rates revert back to the kind of rates that were customary before this global flight to government bonds and the subsequent huge issuing in places like the US of government instruments, if they reverted and if rates reverted back to the historical type of levels that one has seen, you would see a very large positive effect on embedded value. If spreads come down you will see a positive effect as well and I think that we would not anticipate a repeat of 2008 in future around issues like mortality for SPIA's and issues like hedging for Bermuda. So overall time I would expect those to come back. I think we probably will earn more profit in future from the existing book in the US than MCEV allows you to take credit for and when we earn that profit we will use deferred tax assets to offset part of the profits that we'll earn, so that will give us some upside. Finally the issue that I think we will benefit from is that we should earn more spreads, we've got the deferred tax assets and finally we expect that our expenses that we've allowed for in the embedded value which are based on the current run rate of expenses in a business where there has been a very substantial reorganisation - we've cut out a large number of product lines that were not profitable and we've also made a substantial change to the cost base in that business - so we should expect to see costs coming down and that will be positive for the embedded value. So I think that there are factors that would lead to a normalised embedded value earnings type figure being very different to what the embedded value earnings for those businesses were this year. And as far as a return on embedded value goes the MCEV opening base is very much lower so that really implies a higher RoEV in future but I think the R could be substantially higher too.

Marius Strydom

Just finally is it conceivable that the value of in-force to the US Life business could ever become positive?

Andrew Birrell

I think there are MCEV conditions under which that would become positive. Certainly it is marginally positive or positive on the calculations that we have done which are unaudited to try and understand what the movements were at the year end for 2008. That data is not audited and we have not been disclosing that but we did feel it was important to try and get a sense of where the major movements were and in fact I said earlier we've been through about four reporting cycles in six months and I think we've actually done about five or six valuations actually.

Marius Strydom

Thank you.

Andrew Birrell

Thank you Marius.

Operator

We'll take our last question from Blair Stewart from Merrill Lynch.

Blair Stewart, Merrill Lynch

Hi guys. I'm not going to ask my question, you've been extremely generous with your time today. Thank you very much for that. I think we've gone on long enough. I'll do my extra thing and work offline. Thank you very much.

Andrew Birrell

Thank you.

Philip Broadley

Thank you Blair and thank you everyone. There have been over 50 people on the line during the course of the afternoon so I'm grateful to everybody who therefore has spent upwards of 3½ hours with us today, this morning and this afternoon. I hope you've found it useful and I hope it has enabled you to delve into the results. Thank you for your questions and we look forward to talking to you next time. Thanks so much.

Operator

Thank you. That will conclude today's conference call. Thank you for your participation ladies and gentlemen, you may now disconnect.