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Corporatefile.com.au - Open Briefing with AMP CEO Andrew Mohl

AMP Limited
Level 24, 33 Alfred Street
Sydney NSW 2000 Australia
ABN 49 079 354 519

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Lodgement of Open Briefing

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AMP Limited
Level 20
33 Alfred Street
Sydney, NSW 2000

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AMP Limited yesterday announced a dividend of 7 cents per share for the first half ended June 2003, down from 26 cents for the previous corresponding period. How did you determine the dividend level given underlying earnings of $305 million, down from $555 million in the previous comparable period, and write-downs totalling $2.0 billion?

CEO Andrew Mohl
We obviously took into account the fact that we had a substantial loss. We've said previously that for New AMP, we'd be looking at a payout of around 60 percent of earnings going forward. We had an eye to that, although we haven't applied it precisely, in setting the dividend at 7 cents. We're also conscious of the fact that at the current time our dividend will effectively be funded by the issue of shares through the dividend investment plan under-writing. That was another reason to be conservative in setting the dividend.

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Can you also provide further guidance on the dividend policy for New Henderson?

CEO Andrew Mohl
What we said in the demerger announcement on May 1, was that New AMP would be targeting a payout of around 60 percent of earnings and on New Henderson, that we didn't expect dividends to flow in the initial period given its financial position.

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In the demerger announcement, you indicated "steady state" operating margins for New AMP of $470 million and New Henderson of $140 million, collectively $610 million for a full year. To what extent is the "steady state" estimate a useful guide to earnings?

CEO Andrew Mohl
The "steady state" pro-formas we put out on May 1 were to give an insight into the two new entities at that point in time. We haven't updated them but we're going to be providing very detailed information on both entities in the demerger explanatory memorandum. There'll be forecasts available for New AMP in 2003, and outlook statements for both entities in 2004.

People can also look at the new entities' half yearly results, in the case of New AMP by adding up the results of AFS, Henderson South and discontinued business, which come to $236 million for the half, an annualised $472 million. The New Henderson half-year result was lower than "steady state" but the Henderson business is cyclically down and the life businesses are going through a transition with the expectation that underlying earnings will improve. So we believe there's enough information available to investors to determine the outlook for both entities without us having to formally update the pro-forma statements.

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Controllable costs were down 20 percent to $1.0 billion compared with the previous period. What cost reductions are yet to be realised?

CEO Andrew Mohl
In the UK, there are going to be further substantial cost reductions going forward as we transition to a closed business, and that's consistent with the expectation we can get the service company to break even in 2004. Across the rest of the group, it's a matter of continuing to work on doing things smarter, being more focused. We've looked at where we create value and where we don't, and the runs are on the board.

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What evidence supports your faith in the ongoing strength of the AMP brand or franchise?

CEO Andrew Mohl
The half-year result is very powerful evidence. The result in AFS, a fall of just 9 percent in operating margins, which were in fact significantly higher than the second half of last year. The fact that if you look at industry figures, AFS net cash flows rank second or third among the top five managers by AUM. Outflows have been held to a 10 percent rise, despite the worst market we've seen in over a decade. Planner force numbers were 3 percent higher than a year ago. And we've reported that in the first six or seven weeks of the current second half, net cash flow has improved noticeably from previous trends. All of that indicates we're weathering the storm. It's been a difficult period but we're coming through and the outlook's quite positive.

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Due to the reduction of equity risk of the UK life insurance funds, the FTSE index will have much less relevance to AMP's earnings. What factors will dominate future profit outcomes for New AMP and New Henderson?

CEO Andrew Mohl
In New AMP, the exposure to markets will be similar to what it's always been. Assets under management levels obviously reflect markets and that drives revenues. And market sentiment and confidence drive fund flows and obviously our competitive positioning. So the AFS and Henderson South business will be strongly impacted.

There's also some moderate reduction of equity risk going on in Australian shareholder capital. We're managing our shareholder capital exposure more carefully here as well as in the UK. So our holding of growth assets in Australia was down further in the first half, to 28 percent from 37 percent in December and 45 percent a year ago.

In the UK, Henderson is very cyclically sensitive to markets and we've seen the effect a declining market has. We'll see a recovery as markets continue to improve. For the UK life businesses, we won't see a lot of impact from market levels, although we'd benefit from higher markets in some areas. We still have a book of investment-linked products that would benefit. Generally, the industry environment and the value perceived in our business will also be enhanced in a stronger market environment.

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Henderson North's results were disappointing in the first half, with a margin of $28 million, down 52 percent year on year. What undermined the margin and what's the outlook given an improving equity market?

CEO Andrew Mohl
There have been reports that a third of the asset managers in the UK are losing money at the moment. So Henderson North's cost ratio of 83 percent and 20 percent return on equity show it's a very good business. But, it's cyclically sensitive and the business has certainly turned down relative to a year ago. We've managed costs tightly, so if markets improve, revenues will respond strongly and that will come through to the bottom line. The analysis we've given the market shows the effects of the poorer market and forex movements were the main factors that drove earnings down between the first half of last year and first half of this year.

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The persistency rate in your UK Financial Services business fell to 85 percent in the first half, down from 88 percent in the previous comparable period. What impact would a further deterioration have on the short and long term cash flows and value of the business?

CEO Andrew Mohl
That's difficult to answer. We have books of business where there are no profit margins and a rapid run-off is positive because it will release capital more quickly. There are other books that are profitable and we can't proactively go about managing down the unprofitable products, but we can certainly pay particular attention to customers or product lines where we want to protect our margins and steps are being taken in that regard.

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Why did the free asset ratios in your UK businesses decline by over half when markets finished higher at June 30 compared with December 2002?

CEO Andrew Mohl
There were a range of forces. We were selling equities in the initial part of the half-year, so we didn't get the benefit on those assets of the rising equity market in the last three months. Pearl was also impacted by its equity exposure to London Life and NPL and the effective support it provides them. While the solvency ratios are low, they've been far more stable since the initiatives we took in the reduction of equity risk.

And it's important to say that the free asset ratios we disclose are the ratios above the required minimum margin of 4 percent, which in the case of Pearl is about GBP600 million. We also have over GBP600 million of assets in Pearl that aren't admissible for solvency purposes.

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In yesterday's announcement, you said that if the proposed demerger proceeds, the net assets of the UK operations will be de-merged from AMP Limited at fair market value. Can you explain the accounting and valuation impacts associated with this?

CEO Andrew Mohl
As required by accounting standards, we currently use a combination of historical cost and market value accounting principles. For a business separation of this type, at the time of demerger we'll have to value the net assets at fair market value. Any adjustment difference between market value and carrying value will be booked at December 31 in AMP's accounts. It's really an accounting entry to record a book value adjustment.

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You've disclosed provisions totalling GBP1.2 billion in the UK Financial Services business. Can you provide a breakdown of these provisions?

CEO Andrew Mohl
There are three or four major items that underpin those provisions. There's about GBP400 million in guaranteed annuity option provisions, GBP300 million for pensions mis-selling, GBP195 million for the mortgage endowment "promise", GBP19 million pounds for mortgage endowment mis-selling and another GBP80 to 90 million for property that's no longer required.

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Many of your competitors in the UK have recently increased their provisions for mortgage endowment mis-selling. Are you satisfied with the adequacy of this provision and how has it changed from the prior period?

CEO Andrew Mohl
Yes we're satisfied. We provisioned for this some time ago and after being reviewed it's come down slightly in this accounting period, in the light of the experience we've had.

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AMP recently flagged that discussions with regulators regarding the demerger are "well underway" (with APRA in Australia and the FSA in the UK). Is APRA focusing on the capital adequacy of the Australian licensed company, that is, AMP Life, or on the corporate entity, that is, AMP Limited, or is it focused on both?

CEO Andrew Mohl
It's focused on both but the demerger proposal has no real effect on AMP Life, which has a solid credit rating of A+. The real issue is AMP Limited and the impact on it of the various steps we're taking to relieve the UK of the debt on its balance sheet, and in the context of asset sales that are yet to be concluded.

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Yesterday, you flagged the introduction of "modified embedded values" for Australian Financial Services and UK Financial Services. How will this differ from the embedded values you've historically provided and what's the likely valuation impact of adopting the new methodology?

CEO Andrew Mohl
It's a far more sophisticated measure of value, particularly in the case of the UK, where there are guarantees and options embedded in the various contracts. These are directly valued through stochastic modelling. At the moment, investors usually take a traditional EV and apply a discount margin to the derived figure on a deterministic basis and then a further discount above that for risk and uncertainty.

The new methodology provides simulations of literally hundreds of potential outcomes and presents the results on a distribution curve of likely outcomes and probabilities. So a lot of the uncertainty in terms of probable value would be taken out as a result of providing this information to the market. Modified EV will have much less impact in Australia than in the UK because the impact of guarantees and options is relatively insignificant here.

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AMP's capital includes eliminations of $1.4 billion relating to inter business unit holdings associated with your UK operations. How will these eliminations be accounted for post demerger?

CEO Andrew Mohl
Going through the items individually: there's the relationship between Pearl and Henderson, and that's in the process of changing; the relationship between Pearl

and Virgin, which isn't likely to change; the loan between AMP Life and Henderson, which will be repaid; and then the loan to the corporate office from Gordian - that will probably remain in place.

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You've indicated that you're looking to achieve majority ownership of Henderson North, which is currently owned by Pearl. Can you explain the rationale behind the proposed change?

CEO Andrew Mohl
In the current configuration there's a special class of shares which allows any uplift value in Henderson above book value to flow through to the holding company but to all intents and purposes, Henderson is owned by Pearl shareholders' fund. That means Henderson's earnings flow into Pearl and aren't available in a cash flow sense to the parent, given Pearl's operating on a relatively low solvency buffer at the current time. We believe it's important for the investment case of New Henderson that AMP UK has majority ownership of Henderson Asset Management so that it can directly access its cash flows and determine its future. AMP's website will contain a proposed structure diagram for New Henderson.

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When you announced the demerger plan your presentation said "no further equity capital raising is required to facilitate the demerger." Yet yesterday you said a refinancing of the AMP reset preference shares (RPS) is "both necessary and likely" if the demerger proceeds. Doesn't that contradict your earlier statement about no further equity capital raisings?

CEO Andrew Mohl
What we said on May 1 was that in order to achieve the demerger, we wouldn't need to do a further equity capital raising for additional capital. What we said yesterday was that while $11.5 billion of total capital resources would be enough to effect the demerger, what we don't have is the right mix of capital. And given the discussions we've had with regulators in shaping the structure of New Henderson, it's become clear that the RPS will lose their regulatory, credit and tax efficiencies in the new structure. For that reason we're proposing a refinancing of the RPS.

We're looking at a range of alternatives that will involve equity and/or Tier 1 instruments. The combination of equity and other Tier 1 instruments will depend in part on asset sales that are yet to be completed. But we do expect the refinancing into other equity instruments to be up to the full amount of the RPS. The net effect is no change in the total capital resources of group, but the mix will change.

When we've determined the best way in which to replace the RPS with other capital instruments and when we've agreed with regulators on the capital structures of the de-merged entities, we intend to make full disclosure to the market.

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Why did you revalue the Australian distribution subsidiaries by $250 million?

CEO Andrew Mohl
We'd previously carried these businesses on a very conservative basis, largely historical cost as a proxy for market value. Under the new tax consolidation regime, we have to revalue to market value. If you look at AFS excluding banking, it has a book value of $3.8 billion including the revaluation, and its first-half earnings were at an annual rate of around $532 million, around 7 times earnings.

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Thank you Andrew.

For more information about AMP, visit www.ampgroup.com