Phoenix Group Holdings

2015 Half Year Results

Thursday, 20 Aug 2015

Howard Davies, Chairman

Good morning ladies and gentlemen and welcome to the Phoenix 2015 interim results presentation. I'm joined on the podium by Clive Bannister, our CEO, Jim McConville CFO, and Andy Moss, CEO of the Phoenix Life Business. So the team is as it was the last time, but it will change next time because this is my last presentation. I take up position as Chair of RBS on 1 September.

The last three years since I've been here have been broadly a positive period for the Group, reflected in the progress of the share price, but also in a lot of financial restructuring and improved policyholder performance during that period as well. But there is more to do, and so I am delighted that we are today announcing the appointment of my successor, subject to final regulatory approval, that is Henry Staunton, who I think is an ideal appointment; has a lot of life insurance experience as Chair of the Legal & General audit committee for a number of years, and is also currently chairman of WH Smith. So next time you have a presentation there will be Twix bars, Walkers crisps and possibly scratch cards available for you.

I don't want to steal any of the thunder of my CEO, who is going to talk you through the financial progress of the Group over the last six months, so I'll pass over to Clive Bannister.

Clive Bannister, Chief Executive Officer.

Thank you Howard very much. Good morning ladies and gentlemen.

The first half of 2015 was another busy period for the Phoenix Group. A huge amount of effort went into the submission of our Solvency II internal model application at the end of June. This was the culmination of literally many years work, and we look forward to continuing to engage with the PRA as our application progresses through the remainder of this year.

Despite the uncertainties around Solvency II we were delighted that Fitch Ratings recently assigned to the Group an investment grade rating. This marks the achievement of an ambition set out last year and reflects the progress we have made over the past years in reducing leverage and simplifying the Group's structure. This work has continued with the Tier 1 bond exchange in January, as well as the further simplification of the Group's corporate structure following the unification of our banking silos in 2014.

These achievements are matched by strong financial performance, with Phoenix continuing to deliver cash generation and enhanced MCEV through management actions.

Lastly, we have today announced an interim dividend of 26.7 pence per share; unchanged from the 2014 interim dividend.

As the results presentation in March, we set ourselves cash generation and incremental MCEV targets. Our target range for cash generation for 2015 is £200m to £250m as we transition into the new Solvency II regime.

In the first half of 2015 we delivered £110m, putting us in a strong position to meet the target for the full year.

We also reiterate our longer term cash delivery target of £2.8bn between 2014 and 2019. And we have achieved a total of £1.1bn to date.

In March we set ourselves a new higher target of £400m of MCEV enhancements from management actions from 2014 to 2016, and by the end of June 2015 we had already delivered £345m towards this goal.

And last, we achieved our ambition of an investment grade rating, one benefit of which is a reduction in the cost of our senior bank debt by 50 bps. We will therefore manage our level of financial leverage in the future to ensure we maintain this rating.

2015 is an important year for the life insurance industry, given the regulatory changes from both a conduct and a capital perspective. The new pension freedoms have been effective from April this year. Phoenix has invested in our customer teams as well as new partnerships to provide a wide range of products for our customer base.

Second, we look forward to the conclusion of the FCA review into legacy customers, expected during the second half of this year.

We believe that our focus and specialist operational model makes us a strong custodian of closed life funds as we look to grow the business in the future.

Finally, with regards to Solvency II, we submitted our internal model application to the PRA in June and expect to be notified of the outcome in early December.

We continue to expect the Group's capital position to be in excess of the current PLHL ICA surplus, although this is obviously subject to final regulatory approval.

I will now pass you over to Jim who will take you through the financial results in detail.

Jim McConville, Group Finance Director

Thank you much Clive. Let me turn to the first half results.

We set out here the key numbers. As Clive mentioned earlier, we remain on track for our cash generation targets, and the achievement of an investment grade rating is a reflection of our track record and financial strength. We have maintained a robust solvency position and continue to deliver a range of management actions.

Of the £110m of total cash generation during the first half of the year, management actions accounted for £20m. We remain on track to achieve our 2015 cash generation target of between £200m and £250m. Debt interest costs, which include the Tier 1 coupon paid as part of the bond exchange in January reduced during the period as a result of lower overall debt levels. The bond coupon payments on the new £428m subordinated debt, as well as the £300m senior bond, will be paid in the second half of the year.

We have also repaid £60m of bank debt in the first half of the year. And we paid out £60m in respect of the 2014 final dividend of 26.7 pence per share. And at 30th June over £900m of cash remained in the holding companies.

Free surplus represents the excess capital over and above the strong capital policies in the life companies. We started 2015 with £196m of free surplus, and distributed £110m of cash to holding companies during the first six months. £315m of free surplus remains as at June. This is the free surplus under Solvency I, and is therefore not comparable to the position under Solvency II. However the improvement in free surplus does help demonstrate the enhancements achieved through management actions during the first half.

Phoenix Life operating profit was £135m at the half year, which includes £23m from management actions. Management actions under IFRS were lower than in previous year, which has impacted the headline number.

Below the operating profits line we incurred positive investment variances of £40m, partly driven by the acquisition of a portfolio of equity release mortgages, together with the impact of increased yields over the period.

We incurred £49m of finance costs which, despite overall lower debt levels, included a £12m impact from the accrual of the coupon on the new subordinated debt issued in January. The coupon on the previous Tier 1 bond was accounted for within a non-controlling interest, and therefore would not have been included in the analysis you can see on this slide. And finally, after tax, we generated a profit of £78m.

Now turning to look at MCEV. We set out here the material movements in MCEV over the year. For clarity we have shown the value generated from management actions separately.

So moving from left to right: we generated post-tax operating earnings of £40m, excluding management actions, which reflects expected returns on the life company embedded value at the long-term risk-free rate, plus assumptions of real-world returns. We delivered £84m of incremental value through a number of management actions which Andy will discuss in a moment. Below the line economic variances, non-recurring and other items totalled negative £52m, primarily reflecting the differences between the short and long-term rate assumptions and other market movements.

The increase in market value of the Group's listed bonds during the first half of the year has reduced MCEV by £22m. There has been a further approximate £35m increase in the market value of the bond since June, given the announcement of the Group's investment credit rating.

We incurred finance costs, including the accrued Tier 1 coupon, of £56m, and paid dividends of £60m.

Both the Group's pension schemes are in surplus under IFRS; but these surpluses are not included within the Group MCEV. Therefore future contributions will be a deduction from MCEV, and the post-tax contributions of £6m made in the first six months are shown here. The Pearl scheme contribution of £40m is made in the second half of the year.

As of the end of June the Group MCEV was £2.6bn, representing MCEV per share £11.43.

We have now achieved our ambition of an investment grade rating, with Fitch Ratings assigning an investment grade rating to both our senior and subordinated debt. This will reduce our bank debt cost by a further 50 bps, resulting in a facility margin of only 262.5 bps from 28 August. This compares to the 475 bps we were paying on the Impala bank facility two years ago.

The investment grade rating also provides broader access to the capital markets in the future. With a wider potential investor universe the Group now has greater flexibility in future debt issuance, both with regards to the type and maturity of instruments, and an improved ability to issue regulatory-compliant subordinated debt to support the Group’s capital position.

Achieving an investment grade rating also supports our position as the UK’s largest specialist closed life fund consolidator. It provides additional comfort to policyholders, regulators and vendors of closed life funds on the financial strength of the Group.

Moving on to Group capital. As a reminder, we look at our Group solvency position on two bases: IGD, which is a Pillar I assessment of the Group’s capital resources and requirements, and PLHL ICA, which is a Pillar II assessment. Both of these measures will be replaced when Solvency II comes into effect next year.

The IGD surplus at 30 June increased to £1.6bn during the first six months of 2015, mainly due to the benefit of a corporate restructuring. This restructure increased PLHL’s shareholding in Impala Holdings from 75% to 100%, allowing PLHL to include the entirety of the Impala subsidiary’s capital resources and requirements within the IGD calculation. This corporate simplification also provides a more appropriate Group structure for the Solvency II capital regime.

Our headroom over capital policy also increased to £0.8bn. And finally the position remains relatively insensitive to market conditions.

And now turning to look at the Pillar II position as measured by the PLHL ICA surplus. The PLHL ICA surplus and headroom remains unchanged over the period, and the metric also remains sensitive to some degrees to declines in yields.

We are still in the process of seeking approval for our internal model, and are therefore not in a position to provide any further details on our expected Solvency II position at this time. However, the next few slides provide a little more background on the new Solvency II regime and the approach Phoenix is taking.

In summary, the Solvency II puts in place new capital requirements for insurers, which are calculated either by standard formula or an internal model. And there are transitional measures that provide for a smooth transition to the new capital regime.

As I mentioned, Phoenix is following the Internal Model route, as we believe it is more appropriate for the management of the Group’s business and risks than the prescribed standard formula. The Capital Requirement, known as the Solvency Capital Requirement or SCR, is calibrated at a 1 in 200 year event.

There are a number of key differences for Phoenix between Solvency II and the current ICA regime under Solvency I.

From a life company technical provisions perspective, Solvency II includes a number of changes:

First, the inclusion of an explicit risk margin in excess of the best estimate liabilities.

Second, the use of a Swaps-based discount rate rather than gilts.

And third, replacing the use of illiquidity premiums with the matching adjustment methodology.

However, these changes to the calculation of technical provisions are offset by the use of transitional measures. These transitional benefits will run off over the prescribed 16 years and will reflect the run-off of our closed life business. However, the risk margin and other technical provisions will also run-off over this time and therefore mitigate the impact of the loss of transitional benefits over the period. Therefore, cash flows from the life companies over the longer term are broadly unchanged and we have reiterated today our £2.8bn longer term cash generation target.

From a life company capital perspective, we expect that the SCR under our Internal Model will be in excess of the current ICA. Therefore, there will be an increase in capital requirements for the life companies, which, as we discussed at the full year results, has reduced the 2015 cash generation. However, at the Group level, there is a positive impact from the treatment of the pension schemes and overall, the Group capital position under Solvency II is expected to be in excess of the current PLHL ICA surplus. This is obviously subject to regulatory approval, including the use of transitional measures.

We have set out here an updated version of what is probably a fairly familiar slide, setting out the illustrative sources and uses of cash over the period to the end of 2019, based on our existing six-year target of £2.8bn.

We begin with the current cash at the holding companies level of £0.9bn. The green bar to the right of this, of £1.7bn, represents the remaining cash generation expected to emerge over 2015 to 2019.

And continuing to the right, we show the various uses of that cash over the period to 2019, including around £0.5bn to fund an illustrative stable level of dividends at the current cost of £120m per annum over the next four and a half years.

After these uses of cash, we are left with an illustrative £1.1bn of cash at the holding companies. This demonstrates our confidence in a stable and sustainable dividend in the future.

Here we provide further information on cash generation expectations and the uses of that cash from 2020 onwards.

We expect there to be around £3.6bn released as cash to the holding companies after 2019, as represented by the green bar. Known uses of this cash include the remaining pension scheme contributions and outstanding shareholder borrowings. This leaves an estimated £3.2bn of cash at the holding companies available to fund interest costs, expenses and dividends.

Of course, this illustrative representation does not include the impact from any future acquisitions. Any acquisition we undertake, as set out before, would have to help us to sustain our dividend; be value-enhancing; and ensure leverage was at a level consistent with maintaining an investment grade rating.

I will now pass you over to Andy to cover the recent developments of Phoenix Life.

Andy Moss, Chief Executive Phoenix Life

Thank you Jim and good morning everyone.

During 2015, we continued to enhance the Phoenix Way - our approach to delivering shareholder and policyholder value. Our new actuarial modelling platform, MG-ALFA, is now fully in use to generate all of our financial measures and positions us well to meet the new Solvency II reporting requirements in an efficient manner.

We completed the fund merger of National Provident Life into Phoenix Life Assurance in the first half of this year, leaving only two remaining UK life companies. We also agreed the disposal of our small Irish subsidiary, SMI, which has only around 3,000 policy holders and therefore lacks the scale to operate efficiently.

The key event on the customer side has been the new pensions freedoms, which I will cover shortly. And we've also continued to take actions in our with-profit funds to enhance our policyholder returns.

We set ourselves a target of achieving £400m of incremental MCEV over the three-year period from 2014 to 2016. I am delighted that only 18 months into the target period, we have already achieved a total of £345m of incremental value. Specific management actions achieved in the first half include the acquisition of a portfolio of equity release mortgages and further benefits from the full implementation of the MG-ALFA system.

As can be seen in the right-hand chart, we also have a long track record of accelerating cash flows, on top of those that flow from the organic run-off of the Group's life policies. Over the past six years, Phoenix has generated a total of £1.6bn of cash from management actions.

Although we have only generated £20m of additional cash flows so far this year, as Jim mentioned, we have taken many actions that have enhanced the capital positions within the life companies, which in future will convert to cash flows.

Our expertise in identifying and executing management actions stands us in good stead as we move into a Solvency II world, and I am confident there remain further actions that we'll also be able to take to ensure we maximise our capital efficiency under the new regime.

There is a great deal of current activity from a regulatory, customer and product point of view, but we remain confident that Phoenix is well positioned to respond to these developments, given its past investment and track record in improving customer outcomes.

We are still awaiting the FCA review on legacy customers, and there are a number of other reviews and consultations ongoing, including an HM Treasury Consultation on pensions transfers and early exit charges.

We believe that with an average exit charge of only 1%, these charges are not acting as a significant barrier to our customers taking the actions they wish to do.

However, there is a focus on product governance and this will certainly continue into the future. Therefore, it is essential to have in place an operational model, such as Phoenix's, that can demonstrably add value for customers.

As I mentioned earlier, the introduction of the new pensions freedoms has been one of the main events during the first half of the year. There was a significant initial surge in customer calls in April and we have seen, along with our peers, an increase in full encashment for smaller pension pots. In the period to the 30 June, we have seen 15,000 customers requesting full encashment at an average pot size of £13,000. We have seen, from our customers, limited interest in alternative drawdown products.

We have also taken steps to offer a full range of products to our customer base to meet either investment needs or long-term income needs. This includes an extended partnership with Just Retirement that allows customers to access options, such as simplified financial advice, drawdown products and enhanced annuities.

Following the announcement of the merger between Just Retirement and Partnership Assurance, we have confirmed that this partnership will be unaffected.

In the first half of 2015, we wrote £208m of annuities, 79% of which had guaranteed rates. These policies provide attractive rates for customers, often twice the standard rate, at around 11%. We expect that the large majority of the guaranteed business for higher value pension pots will continue to be written, given the attractive nature of these rates.

Non-guaranteed annuity volumes written were down 47% on the same period a year earlier. However, we still see annuities being an attractive option for larger pension pots and believe that our assumptions with regard to take-up rates remain appropriate.

We continue to ensure delivery of the promises made to customers in their products and to provide high levels of security and service. We also look for possible ways to engage with customers and help them understand their policy benefits. This is particularly important given the new pensions freedoms.

We have dealt with a significant operational challenge to maintain our levels of customer service, given the increased volume and length of calls we have seen in the first half of the year, although we are now seeing call volumes starting to revert to their historic levels in recent weeks.

We have also continued our actions to prevent pensions fraud and have stopped a further £7m of potentially fraudulent transfers in the first half of this year.

The right-hand side of the slide sets out some of the key customer metrics and indicators that we track against. These take into account benchmarks that we see externally and we will continue to seek ways to improve and ensure that these levels are maintained.

I will now pass you back to Clive to wrap up.

Clive Bannister

Andy, thank you.

I'm delighted that we have made such good progress towards our financial targets. As a reminder, I set them out here:

We are on track to meet both our cash flow targets. We are confident in our ability to achieve our cumulative target of £400m of incremental MCEV in the three years to the end of 2016, and we will manage our leverage to a level consistent with maintaining our investment grade rating.

As I said at the start, we have maintained our interim dividend at 26.7 pence per share. Jim has provided further details on our existing cash flow generation, which supports this dividend pay-out, without the requirement for an acquisition, until 2019.

Solvency II is the clear focus for the remainder of 2015 and following our IMAP submission in June, we are expecting the PRA approval process to be completed in December.

As stated earlier, we expect to continue to be well capitalised under the new Solvency II regime, with the Group's capital position to be in excess of the current PLHL ICA surplus.

The work we have undertaken has clearly put the Group in a strong position to implement Solvency II.

Despite the impact on the 2015 cash flows from the transitions of Solvency II this year, we have reiterated today our £2.8bn longer-term cash generation target between 2014 and 2019. Beyond 2019, we anticipate a further £3.6bn of cash generation, demonstrating that the long-term cashflow profile of the Group remains a key strength.

You have heard from Andy about some of the changes that are occurring in our sector. The regulatory landscape is evolving and it is therefore essential to have an operational model that is specifically designed for the management of closed funds. In this regard, Phoenix is well positioned to benefit from those changes.

I remain convinced that there is a significant opportunity for Phoenix to generate further value from M&A. Once the uncertainties around Solvency II are resolved, the environment for transactions should improve, and the actions we have taken from a financial and operational standpoint put Phoenix in a strong position to play a leading role in the industry's future consolidation.

Finally, the first part of 2015 was another busy period for the Phoenix Group with a number of milestones achieved, including the submission of the Internal Model Application and the achievement of an investment grade rating.

The second half of the year will be focused on the upcoming Solvency II regime and working with the PRA on the Internal Model Application. Having an investment grade rating provides us with greater flexibility with regards to our own capital structure, as well as helping to finance the Group's future growth.

Just before I leave, this is my opportunity to thank Howard for the leadership that he has shown to Phoenix. Your intelligence, hard work and sense of humour has been ever present in the last three years and have been invaluable. Thank you very much indeed, Howard.

Howard Davies

Thank you, Clive, particularly for the last bit. That brings to an end the formal presentation, now we can move on to Q&A. Perhaps you could wait for the microphone to be brought to you, give us your name and the institution for which you work and we'll then answer the question, and there also may well be questions on the phone or on the internet, but we'll pick those up a bit later. So those who have made the effort to come should get first go. Who would like to kick off? Yes, the woman in the middle there.

<u>Question and Answer Session</u>

<u>Question 1</u>

Ming Zhu, Canaccord

Good morning, Ming Zhu three questions please. The first question - it's all on M&A, I'm afraid - the first question, could you please remind us of your timeline for M&A?

And second, there's been quite a lot of M&A activities going on in the UK insurance, what is holding back for Phoenix to do M&A? Is it more on the Phoenix side or maybe the vendor side?

And the third question, just on the M&A criteria, could you please remind us in terms of what's your preferred size of a deal please? Thank you.

Clive Bannister

Thank you very much indeed. Well Ming, thank you for the question. The first one is the timing of any corporate action for Phoenix. I said alongside Howard a year ago that we believed that there would be a period of hiatus in the industry awaiting a resolution and the clarification of Solvency II and I'm sure that we were right to say that then and it still pertains right now. It is extremely hard for a vendor to know the value of an asset, or indeed an acquirer to know what price to put on a target if you're not certain of the capital regime under which you will have to operate. That would be my general comment, and if you roll forward and you look into the future there is going to be much greater clarity by the end of this year and throughout 2016.

I would restate what I said earlier, that we believe that the tectonic plates of our industry are changing, we are the UK's largest closed life consolidator and we believe that the reasons that would motivate a vendor to put an asset up for sale remain true, those are the arguments that there is trapped capital in businesses that are no longer growing, a closed business like these are incredibly expensive businesses to run if you don't have an operational model like ourselves. It is obviously subject to increased regulatory scrutiny and there is a change in the economic profile of our industry because of the announcement and the implementation of the annuity changes. For those reasons we still believe that there will be continued consolidation in this industry.

Your second question said, well listen, there have been deals, Aviva and Partnership and Just Retirement, so what is holding us back? Those are different deals and the chief executives of those businesses will have to speak to them, so it is clearly possible to do deals, but in the closed life sector there has only been one very small deal which was the sale of a business out of Lloyds Bank, but so far in our space there has been a period of quiet or hiatus.

And then you asked the third question about our criteria. We're very clear about those criteria, and the first is it has to be value accretive, we have to serve our shareholders who have supported us. The second, we are determined to maintain our investment grade rating, that matters to us enormously, and third, we are absolutely determined to protect the dividend because that is one way of rewarding our shareholders.

A question about our MCEV, we are in terms of definition of what constitutes accretion, we go beyond just a definition of MCEV because we want to capture all the synergies that would come from doing a good deal and many of those synergies would be reflected in our service company and the profits that come out of that are not reflected in MCEV, and that's why we talk about value accretion, maintaining our investment grade rating and also ensuring that we can deliver the dividend. So we look forward to playing a leading role in the industry as it consolidates, as and when that happens.

Question 2

Andy Sinclair, Bank of America Merrill Lynch

Thanks very much and good morning. Three questions please. Firstly, you mentioned that your Solvency II position will be better than the ICA position. I just wanted to clarify, is that in terms of pounds or in terms of the surplus ratio or will it be both?

Secondly, how much headroom do you think you have to issue debt and maintain the investment grade rate credit rating which you made very clear that you want to maintain?

And thirdly, just looking at the £300bn market that you've cited for interest in M&A, looking at the spreads of foreign owned, bank owned, UK life, linked, with profits and non-profit, is there any particular area of that that you're looking to go for?

Howard Davies

Thank you. It's not obligatory to ask three questions by the way. I'm sure a combination of Clive and Jim will be able to answer those questions.

Clive Bannister

Well, Jim, do you want to take the first two which focus on Solvency II and then headroom for investment grade and then I'll deal with market size.

Jim McConville

So as we said at the full year and as we repeat today, we expect to be well capitalised under the Solvency II regime with our Solvency II surplus being higher than our existing ICA surplus, and by that we mean in pounds terms. So we expect the quantum of the surplus to be higher and what we are acutely aware of is the management of that surplus in pounds terms and the sensitivities to that surplus, and that will remain as much so under Solvency II as it was under the existing regime.

Your second question dealt with the headroom for the investment grade credit rating, I think I've said before that the level of leverage in a company is only one factor that the rating agencies look at when they consider a firm's credit rating. It was important for us to lower our level of leverage which we've done successfully over the years and obviously as is self-evident from the Fitch result that the level of our current leverage is within the parameters that they would consider for a successful investment grade rating and we will continue to see our debt fall as our amortising bank debt is repaid.

Clive Bannister

Andrew, your last question was I think related to this slide. I should say, talking about M&A, we don't have to do any deals to deliver the maths that you've seen today, it's extremely important that our £2.8bn which is the statement of our confidence in the business model and the Phoenix Group is deliverable in an organic way. So how did we come to the size of this market? So you'll see we've said it's over £300bn, this includes £185bn from the year end FSA returns and about £130bn from proprietary non-profit and unit linked. And that's where the maths come from.

Andrew, your question was did we have a predisposition for unit linked, with profits or non-profit? We will do any and all. It's extremely rare that when you look at a business, and that would be a whole business, that it wouldn't comprise one of any of those three products and probably all of them, and there are opportunities, we believe in the future, to look at books of business and therefore they may be specific books.

Now, far more important for us is not the size of the business, and not the underlying business because we can process and manage all of them, it's the opportunity that is presented for us to realise management actions on the business offered to us.

Question 3

Oliver Steel, Deutsche Bank

I was going to ask three questions but I'm now far too frightened to do that so I'm going to ask two. So following up from Andy's question on the Solvency II headroom over your target, you've said that the surplus will be greater than under the ICA surplus but you've also said that the capital requirement will be greater than under the current ICA capital requirement. So just so that we're not being misled at all, does that mean your headroom over a possible target will also be greater or will it be less? So that's the first question.

The second question is it looks as if your Solvency II is being measured at the PLHL level so your bank debt is being excluded, if you make an acquisition is there a chance that the PRA will then want to start measuring you at the Group level rather than at the PLHL level?

Jim McConville

Okay, so let me start with your second question first, Oliver. So you're right, our existing capital tests are measured at the PLHL level, that is the top entity for regulatory purposes and that is the measure that is used for all insurance groups. And we've set out in one of the slides in the appendix exactly how that capital management framework works.

Our Solvency II work has been based on a similar criteria that it would apply at the PLHL level and this has been the discussion that we've had with the PRA throughout our preparation for the Solvency II process. So it's been very clear throughout that that is the level at which we are applying the capital test. Clearly we're going through our IMAP applications and other applications as we speak and we will get the formal feedback from the PRA on that in December, but we don't anticipate any issues in respect to the level at which the capital is recognised.

In terms of your question on headroom, what we're saying is our Solvency II surplus is expected to be higher than our existing ICA surplus. We do show in the accounts the headrooms that we applied in both the IGD and the ICA test. As we go through the second half of the year we will be in discussions with the PRA on the equivalent headroom test that we have to apply for Solvency II but we don't again expect that to be a particular issue and we'd be seeking to get to a position where there'll be equivalent policyholder protection. So I don't think there'll be a windfall surplus or something going the other way in respect of the headroom.

Question 4

Kailesh Mistry, HSBC

A couple of questions, the first one is on the investment grade rating. Now you've got the rating, what next? Are there any Solvency or other benefits from, for example refinancing the bank debt or any other debt for that matter?

Secondly on the investment grade, is it possible to reconcile the leverage calculation, because I know you talk about a 35% leverage ratio, so on slide 47 you talk about your own leverage calculation, so I'm happy to take this offline if it's easier, but if you could just monitor that 35% leverage?

And then lastly, just on regulatory issues, I think they were on Andy's slides, what sort of outcomes are you now expecting from the legacy review and also the consultation on pension transfers on exit charges? Thanks.

Jim McConville

Okay, we've set out the leverage calculation that we applied in the presentation and the component parts of it, we're happy to take offline the more detailed queries on that, I'm sure Rash is in the audience and he'd be delighted to answer that one.

In terms of the investment grade rating your question was does that give us the opportunity I think to refinance some of the existing debt? It certainly probably helps in that discussion, in that we could, for example, take the bank debt and look at the opportunity to refinance that. There is a balance to be paid though because whilst we may have an expectation of interest rates lower than the current facility I'm sure our banker friends in the audience would have an expectation of fees to be paid in terms of that refinancing. So clearly we would look at opportunities as and when we think they arise and if it made sense to do so we would do so.

Andy Moss

So taking the legacy review point first, it's probably worth reminding ourselves, because it was a little while ago since the information came on as to what the legacy review was actually looking at. It's effectively looking at four things, in terms of back book strategy, performance of the back book products and particularly governance around investment management, looking at allocation of expenses between open business and closed business, and looking at customer communication. It specifically said, the FCA specifically said, it's not a retrospective review of sales practice and exit charges.

We think we're quite well positioned for all of those things, obviously we are a back book specialist in terms of expenses, we only have back book products in which to allocate our expenses so we think we're well positioned from that point of view. I think in terms of best practice I suspect there will be a number of best practice ideas coming out from that review when it comes out around customer communication, about how companies think about the overall product governance and the continued suitability of products for the people and I think we are looking forward to seeing that because we are continually looking at ways of enhancing policyholder outcomes.

In terms of the Treasury Review obviously that's a relatively new one, I think it was driven by quite a lot of press comment and quite a lot of experience from the early days of the pensions freedoms. So I think what they're looking to do really is to establish whether there are real barriers to exit in terms of people actioning those pensions freedoms. From our point of view our average exit charge is less than 1% across the book. We have not seen any significant complaints or issues from people in terms of having concerns about being able to exercise those pensions freedoms.

So I think the review needs to complete, the consultation needs to complete, we need to look at experience across the industry and we'll stay very close obviously to the review via the ABI and other firms as we discuss the potential findings coming out.

Clive Bannister

Can I just say Kailesh we see no evidence that our clients are negatively affected while taking a decision because of the current exist charges and as Andy has said they're 1% and that works out at about £150 and obviously there's an encouragement to take advice. So it's early days on that particular front and it would be a courageous CEO to talk about shareholder impact where there's no evidence of this.

<u>Question 5</u>

Ashik Musaddi, JP Morgan Cazenove

Just a couple of questions related to your costs. Earlier I remember you used to show how the cost is moving along with your run-off so can you just give us an update on that?

And secondly if you have to do an acquisition do you think that there is enough capacity with your current cost base to take additional book and not increase the cost? Thanks.

Andy Moss

So in terms of the run-off you're right we have put a slide up at year-end, we haven't done it for the half-year I mean I think what I can say is we are continuing to see our costs run down in line with our policy run-off, obviously it's only halfway through the year so we'd expect to show that information at the end of the year but given our variable cost model we expect that to continue.

Clive Bannister

So the second question is about acquisition. Ashik it's an impossible question thank you for asking it, you said on an acquisition could we inboard it and remain within our current cost environment? On inboarding we would look forward to taking, we have 5.2 million policyholders, we'd like to buy a business which has hundreds of thousands, if not millions of policyholders, the benefits of diversification are clear from an actuarial sense so that we could enhance our MCEV and cash flow, it is our variable cost model that will allow us to do that in a manner that ensures that those other two economic metrics which are key, it is a revenue driven model driven off close focus and attention on the cost but I can't answer it more specifically than that other than when we have a real opportunity. But we believe our operational model positions us very well to do exactly that.

Andy Moss

Sorry I'm just going to add one thing to it as we have developed our operating model we've very much looked to be able to scale the operating model both up and down so access to partners with a variable cost model is key to being able to take on extra books of business.

<u>Question 6</u>

Patrick Harrington, Baden Hill

I just wanted to ask did the board consider increasing the dividend as a result of the achievement of the investment grade credit rating because after all it does represent a pretty permanent increase in the dividend paying capacity of the group as a result of the lowered cost to debt capital?

Howard Davies

The board always looks carefully at the dividend but we decided we were comfortable staying with the commitment to a stable dividend at this point. As the team have pointed out there are still considerable uncertainties in the capital environment and we did not think it was a moment to reconsider the dividend at this stage.

Are there any questions in the ether? No, nothing so far. So any more for any more?

Good well thank you very much. Once again that you over the last three years for your assiduous attendance, I think the company's overall been served well by its analyst base. I read all your stuff and I think it's pretty good generally. Thank you.

Clive Bannister

In the headmaster's report in the school hall.

Howard Davies

Well we're allowed to comment on you occasionally as well as you commenting on us.

Clive Bannister

Howard, thank you very much indeed.