PHOENIX GROUP

Phoenix Group plc – 2012 Full Year Results

Friday 22 March 2013

Sir Howard Davies, Chairman

Good morning ladies and gentlemen, and welcome to the Phoenix Results Presentation. This is the first time I have done an Annual Results Presentation since I took over as Chair on the 1 October. Last year, though, of course, I think many of you were here for our re-terming presentation, which I also introduced. Let me just first briefly introduce our team. On the far end of the podium, on your right, Chris Samuel from Ignis, Mike Merrick, who runs the Life companies, Jim McConville, our Finance Director, and the one-armed man, Clive Bannister. I should point that Clive did not break his arm in a fight with any of our bankers, he fell of his bicycle when he was speeding. His wife took the points, of course, but he got the broken arm!

Now, the key concern that our shareholders voiced when I joined the Group last year, was the need to re-term our bank debt, that that was step one in any process which would deliver us a happier future, and we've achieved that. And in doing so, I think we have delivered longer term stability for the Group, which provides a platform for the next phase in our development. So I'm delighted to be here today, to announce a strong set of results for 2012, and to say that we look forward now with confidence to the Group's future. We're going to take you through the presentation now, and then we are all at your disposal to answer any questions you may have at the end. So, without further ado, I'm going to hand you over to Clive Bannister.

Clive Bannister, Group Chief Executive

Howard, thank you. The truth about my arm is of course far more sinister and it's the attitude a new chairman takes to people who don't show enough enthusiasm in the budgeting process! So we will move rapidly on, and I add my welcome to his, to hear about our 2012 results.

As Howard has already highlighted, our most important achievement has been the debt re-terming and equity raising which we announced in January. To recap, we set out the key details here. The transaction comprised two equally important components: first, an equity raising of £250 million at 500 pence per share; and second, a £450 million prepayment, and a re-terming of our Impala debt facility. At the EGM in February, 96% of our votes were cast in favour of the Board's recommendation, and 93% of our shareholders took up their entitlements. The key outcomes of this transaction, from a shareholder perspective, were as follows. First, the extension of a debt maturity from an average of 34 months to 78 months, e.g., ending in June 2019, and the elimination of bullet payments, which had previously posed a refinancing challenge. Second, a significant reduction in our mandatory amortisation, which better aligns our debt repayments to our longer-term cash flow profile, thereby improving our resilience during periods of stress. And finally, a 27% increase in the

recommended 2012 final dividend to 26.7 pence per share, and amended bank covenants, which allow for further dividend increases.

As the Chairman said, 2012 has been an important and successful year for the Phoenix Group, both from a financial and operational point of view. We've delivered cash generation at the top end of our target range, we've reduced our gearing and adopted a new methodology, which is consistent with the approach used by the world's leading rating agencies. Our Group solvency position has been strengthened through management actions, which increased the surplus and, at the same time, it reduced our exposure to external market stresses. And we've achieved a strong IFRS operating profits and maintained the embedded value in the business, despite the books run-off. All of these achievements have culminated in a proposed final dividend of 26.7 pence per share.

We set ourselves targets against our three financial metrics, and I am very pleased to report that we have met all of these targets in 2012. Our target range for cash generation for 2012 was £600 to £700 million, and it's good to report that we achieved cash generation of £690 million. In total, over the course of the last two years, we have achieved £1.5 billion of cash generation towards our six-year target of £3.3 billion between 2011 and 2016. MCEV is the second key metric against which we measure our performance. By the end of 2012, we had delivered £332 million of additional value towards our £400 million cumulative target from 2011 to 2014. And on our old gearing methodology, we achieved gearing of 42% at the end of 2012, against a target of 43% or below. Later on, I will describe the targets we are setting for ourselves in 2013 and beyond.

Operationally, we have made significant progress across the entire Group. Here we set out some of the key operational achievements in 2012. I am particularly pleased with the progress we have made in simplifying the Group structure, having gone from seven UK Life companies at the premium listing in July 2010, to just three UK Life companies by the end of 2012. In June we announced the transfer of £5 billion of annuity liabilities to Guardian Assurance, allowing the release of capital and the reduction by one third of our sensitivity to longevity risk. During 2012, £1.6 billion of our customers' pension policies vested, and from this we added £1 billion of annuities to our annuities portfolio. Our ability to write annuities in this way increases our annuities book and provides the opportunity to consider further annuity transfer transactions in the future. We transferred 780,000 in-force policies on to our new administration platform, and we now have over half of our six million policyholders on this efficient system.

Our policyholders remain a key focus of our business, and through distribution of the inherited estate, we have been able to continue to improve our customer proposition. Ignis continues to make good progress in building its third party business, with £1.6 billion of net third party assets secured, excluding the annuity transfer transaction. And Ignis' most important criteria, investment performance, continues to improve with 79% of assets outperforming their relevant benchmark or peer group, compared to 73% in the prior year. Ignis has also completed the outsourcing of certain of its back office functions to HSBC, and restructured its joint venture arrangements, allowing the company to focus more on its own clients. Now I'd like to hand you to Jim to take you through more of our maths. Jim.

Jim McConville, Finance Director

Thank you very much, Clive. Good morning everyone. For the benefit of everyone, I've got two hands!

OK, we've set out here our key numbers. Where relevant, we have shown the proforma position to reflect the impact of the debt re-terming and equity raising which we announced

in January. I will take you through each of the key metrics in more detail shortly, but in summary: cash generation was at the top end of our target range; IFRS operating profits were up 6% from last year; MCEV remained resilient and maintained at £2.1 billion, despite the natural run-off of the book. Our IGD and PLHL active positions have been strengthened, gearing has reduced, and assets under management were down slightly at £70.2 billion, after taking account of the remaining annuity transfer assets still to be received. And as Clive mentioned, we have announced a 27% increase in our final dividend.

Free surplus represents the excess capital, over and above the strong capital policies in the Life companies, which is available for distribution to the holding companies. I am very pleased to report free surplus generation during 2012 of £1.1 billion. By comparison, the 2011 position was adversely impacted by the effect of challenging market conditions.

Contributing to the free surplus generation was strong operating profits. The annuity transaction, which generated £252 million of free surplus, and our London Life and Phoenix Life Assurance funds merger, which completed in Q3 and generated £192 million of free surplus. Capital requirement run off of approximately £200 million also contributed to the overall movement. Of the £1.1 billion of free surplus generated in 2012, we distributed £661 million, or 62%, to the holding companies in the form of cash, to meet holding company outflows, including shareholder dividends. This left a closing free surplus in the Life companies of £514 million, in addition to the £1.1 billion of cash in the holding companies.

We generated £690 million of cash in 2012. Excluding management actions, the operating subsidiaries distributed £481 million of cash to the holding companies. Distributions from the operating companies are typically around £400 million per annum, but favourable market conditions, particularly narrowing credit spreads and rising equities, resulted in the 2012 distributions being higher. Operating expenses fell by 29% during 2012, reflecting the impact of cost management. The increase in pension costs is due to all contributions now being paid by the holding companies. Outflows in respect of debt interest, debt repayments, and shareholder dividends in 2012 relate to the previous bank facility agreements. And we finished 2012 with over £1 billion cash at the holding companies, and £239 million of this was used in February towards the £450 million debt repayment.

We generated IFRS operating profits of £410 million in 2012, a 6% increase on 2011, driven by our focus on management action, such as modelling improvements and policy harmonisations, which enhanced the Phoenix Life operating profit by £117 million, and Group costs, which reduced by £22 million, compared to 2011. We continue to amortise the acquired in-force intangible, which was recognised at the time of the Liberty transaction in 2009, in line with the run-off of the book. And following the transfer of £5 billion of annuities to Guardian, recurring operating profits generated by Phoenix Life are expected to be in the region of £250 million per annum. Of course this will trend down over time, but does not include any benefits which may arise from our on-going programme of management actions.

The annuity transaction resulted in a £177 million one-off gain under IFRS. The deal was priced on best estimate liabilities, whereas IFRS liabilities were valued on a prudent basis, so were recognised again under IRFS. This was offset by other regulatory change and systems transformation costs, totalling £28 million, and restructuring costs of £19 million. And after our finance costs and tax, we generated a profit of £409 million.

Ignis generated profits of £43 million in 2012, a slight dip versus 2011 and 2010, reflecting the restructuring of joint ventures and the impact of outsourcing administrative services to HSBC, offset by growth in the third party franchise. In addition, Ignis has invested in its fund management capability as it continues to grow its third party business. Overall, expenses remain flat, despite this investment. Since the end of 2009, and taking into account the

remaining £1.6 billion of assets relating to the annuity transaction, third party assets, as a proportion of total Group assets under management, has almost doubled to 19%. Having outsourced its back office functions to HSBC, and restructured Ignis' joint venture arrangements, so it can focus on its proprietary investment capabilities and on clients, Ignis is well placed to continue to grow its third party franchise.

After taking into account the remaining £1.6 billion of assets relating to the annuity transaction, Group assets under management fell slightly by £1.9 billion, or 2.8% during 2012, to £70.2 billion. £4.7 billion of natural life company asset run-off was offset, to a large extent, by net third party inflows of £1.6 billion, excluding the annuity transaction, and £2.7 billion of positive market movements. But the impact of joint venture restructuring and a net £0.4 billion reduction from the annuity transaction also contributed to this overall decrease.

Now turning to look at MCEV. We set out here the material movements in MCEV over the year. We have stripped out the value generated from management actions, from operating earnings and economic and non-operating variances, to provide a more meaningful analysis. We closed 2012 with MCEV at £2.1 billion. The MCEV has remained stable at this level for the last three years, demonstrating our real strength in delivering incremental value through management actions, which we have used to offset the natural run-off of the closed book.

So, moving from left to right: we generated post-tax operating earnings of £203 million, which reflects expected returns on the £3.8 billion of Life company value at the long-term risk free rate of 2.58%. In 2012 we delivered management actions of £167 million through modelling and policy harmonisations within Phoenix Life and the annuity transaction. And below the line economic variances and non-recurring items totalled negative £45 million in 2012, and included the impact of the increase in market value of the Tier 1 bonds during the year and various project related costs. We incurred finance costs of £123 million, and dividends of £73 million.

And the final impact we show here primarily relates to the change in the IFRS position of the Pearl Pension Scheme. During 2012 the Pearl Pension Scheme moved into an IAS19 deficit, and this was included in the closing MCEV reducing it by £0.1 billion.

At the end of 2012 the MCEV of £2.1 billion represented MCEV per share of £12.15. It is important to remember that the MCEV includes Ignis and the service companies at their net asset value of £0.2 billion. It does not include anything in respect of the value of future profits from these operating companies, which represents a significant source of additional value in the Group.

The debt reterming and equity raising increases the 31 December position to £2.3 billion on a proforma basis, representing MCEV per share of £10.39, after taking into the account the new shares issued during the equity raising.

Moving on to Group capital. As a reminder, we look at our Group solvency position on two bases: the PLHL ICA, which is an assessment on a Pillar 2 basis of the capital resources and requirements arising from the obligations and risks which exist outside the Life companies; and the IGD which is a Pillar 1 assessment of the Group's capital resources and requirements. And further details of the Group's capital management framework are set out in the appendix.

Since 30 June 2012 we have significantly strengthened the PLHL ICA position, increasing the surplus from £0.4 billion to £1 billion at the year end. This was largely a result of the agreement with the Pearl Pension Scheme Trustees, which improved the surplus by £0.3 billion and reduced the sensitivity of the calculation to external market stresses, and capital

generation of £0.4 billion including the transfer of the business form London Life to Pearl and positive market movements. The £450 million debt repayment made in February was partly funded by internal cash resources, and therefore the surplus is £0.2 billion lower at £0.8 billion on a pro forma basis.

Our IGD position remains robust, and continues to be relatively insensitive to market movements. The IGD surplus increased by £0.1 billion to £1.4 billion at the year end. The impact of entering into the insurance arrangement for the annuity transaction was relatively limited from an IGD perspective during 2012. However when the Part VII transfer takes place later this year, we would expect a significant benefit on an IGD basis of at least £0.2 billion. As with the PLHL ICA, the surplus would be £0.2 billion lower after the debt repayment made in February, bringing the surplus to £1.2 billion on a pro forma basis.

And finally turning to dividends. We have increased our final 2012 dividend by 27% compared to the 2011 final dividend to 26.7p per share. This represents a total cost of the 2012 final dividend of £60 million. The previous dividend restrictions have now been removed and we now have dividend capacity for 2013 of £125 million. And this capacity will increase by £10 million per annum.

Future dividends are met by strong and predictable cash generation from the operating companies. You will hear from Clive that we have increased our cash generation target from 2011 to 2016 to £3.5 billion. And after the £1.5 billion we have already delivered we have £2 billion to deliver over the next four years, giving average annual cash generation of £500 million. For reference we have set out the sensitivity of the £3.5 billion target to external market stresses in the appendix.

So, on this slide we show the various uses of that cash at the holding companies. So, moving from left to right: annual operating expenses in the holding companies are around £40 million; and then there's £80 million of illustrative average annual pension contributions reflecting £25 million of contributions into the PGL scheme, which was what we paid in 2012 under the existing funding plan; and on the Pearl side £70 million per annum in 2013 and 2014; and £40 million per annum in 2015 and 2016 under the new funding plan. So an average of £55 million per annum.

We have average debt interest costs of around £100 million on revised facilities, including the Tier 1 coupon.

And then the target debt repayments of £145 million being £120 million per annum on Impala and £25 million on Pearl, giving illustrative net cash available for additional debt repayments, dividends, and reinvestment of £135 million. This is of course in addition to the £0.8 billion of cash at the holding companies post the Impala debt repayment.

As we said this time last year, including 2011 and 2012, £9 billion of cash is expected to emerge from the existing business inherent future profits and capital releases. We remain confident in the business' strong and predictable cash generation and in our ability to deliver value to shareholders.

I'd now like to hand you over to Mike Merrick.

Mike Merrick, Chief Executive, Phoenix Life

Thanks, Jim. Good morning everyone. I'm very pleased to have the opportunity today to talk to you about the Phoenix Life operating model. We call this the Phoenix Way.

The Phoenix Way is our solution to the challenge of increasing value and generating cash flow for shareholders and for policyholders. Our operating environment is a complex one: we have a myriad of reporting bases and methodologies that Jim has just taken you through, and a book of business with various systems. Alongside that we have an ever-changing regulatory landscape and throughout we need to maintain a flexible cost base.

The Phoenix Way is our methodology for delivering value within this operating environment. The four boxes represent the categories in which we place all of our activity:

Restructuring represents activities such as funds and mergers. Operational management seeks to address legacy issues and standardise how we do things, such as dealing with and providing for outstanding claims. Outsourcing is all about simplifying our arrangements and helping to ensure our cost base reduces as the policies run off. And finally risk management focuses on taking risk in the right places and ensuring we have standardised controls to reduce operational risk.

We operate an efficient outsourced model, and have converted almost two-thirds of our Phoenix Life cost base from fixed to variable costs through our outsource arrangements. The costs paid to outsourcers for core administrative services has reduced by approximately 9% per annum over the last three years; while our policies run off at around 8% per annum. The simple scalable operating model which we've put in place helps to ensure the costs run off in line with our policies and can be applied to other closed funds in the future.

Our policyholders are central to everything that we do, and we are very focused on improving our customer proposition. We wrote £1 billion of new annuities from existing policyholders in 2012. Typically 99% of policyholders with guaranteed annuity rates choose to take those rates up. And in 2012 we also retained almost 75% of those policies that don't have these guarantees; the remaining 25% took their open market option. We will continue to write annuity business where it makes sense for customers and continues to be profitable.

Moving on to the inherited estate. Some of our healthy With-Profit funds have more assets than they need to cover their liabilities to policyholders; we call this the estate. During 2012 we distributed £109 million of the estate, of which £10 million was distributed to the shareholder fund. At the end of the year the estates in our With-Profit funds were worth £2.3 billion so there remains a significant opportunity to increase policy pay-outs in the future, benefiting both policy holders and shareholders.

We have real strength and expertise in managing closed life funds. As Jim has already mentioned, we have generated £332 million of incremental value over the last two years. And over the last three years we've also accelerated £0.8 billion of cash to the holding companies, which would have emerged from the business over a much longer period.

During 2012 improved actuarial modelling as a result of our actuarial systems transformation programme released £60 million of capital; and we were also able to release £22 million of capital held against operational risk. The management of our equity exposure and reduction of other market risks released £43 million of capital, and £29 million of capital release was accelerated through the harmonisation of accounting policies across the book.

Since we now have three UK Life companies there is less intercompany restructuring to do; but the aim remains to simplify the structure further to leave just one UK Life company. And within these three Life companies there still remain many funds, and opportunities exist to undertake restructuring between those funds which will add value and accelerate cash. Other areas of management action focus include: further annuity transfers, further data cleansing which will accelerate capital release and further risk management as we

rationalise and harmonise asset liability and management practices across the Group. We remain convinced that there is still a significant opportunity to generate value and accelerate cash from this business for the benefit of both policyholders and shareholders.

And with that I'd like to hand you back to Clive.

Clive Bannister

Mike, thank you very much. So I turn again to this familiar slide which sets out how we see the Phoenix Group journey continuing. This time last year I stood here and talked about how reterming our bank debt was our number one priority. This has now been achieved, and through the new terms we have been able to align our debt repayments more closely to our longer-term cash flows. We have now put in place a capital structure for the long-term that removes uncertainty and allows us to focus on the next stage of the journey as the UK's leading and largest consolidator of closed life funds.

In addition to the very many organic opportunities that Mike has just described, key to the next phase of the Group's journey are external opportunities for growth. We estimate that there are over £200 billion of assets sitting in closed or quasi closed life funds in the UK. These assets are owned by banks, other UK Life companies and other foreign owned Life companies based in the UK, which are either formally closed to new business or write so little new business in actuality that they are effectively closed. As the regulatory environment evolves these assets will become increasingly costly to administer for their current owners, are inherently capital intensive and are likely to come under increasing regulatory scrutiny to ensure that policyholders are treated fairly. Having delivered long-term capital stability through the debt reterming and equity raising, we now have a capital position and an operating platform which is scalable. We are well-positioned to take advantage of the opportunities for consolidation in this industry. It goes without saying that we would only do deals if they are good for all of our stakeholders and deliver reduced gearing to maintain the Group's financial stability and its target of 40% gearing by 2016.

We have a strong and predictable business which provides the confidence to set long-term targets for cash generation in addition to our shorter annual cash generation target. We have achieved or exceeded our annual cash generation target for the last three years and our ability to undertake management actions, as Mike has shown, to accelerate cash and increase value has allowed us to increase this long-term cash generation twice in the last 12 months.

This time last year we had a long-term cash generation target of £3.2 billion. At the time of our interim results we increased it by £100 million and I am delighted to announce a further increase of £200 million to £3.5 billion, demonstrating this business's real strength in cash generation.

I'm very pleased that we achieved all of our financial targets in 2012 and today we set new targets for 2013 and beyond. In addition to the long-term cash generation target I have just mentioned we set an annual cash generation target for 2013 of between £650 million and £750 million of cash flow.

Having already delivered £332 million of incremental embedded value in 2011 and 2012, we reiterate our MCEV management actions target of delivering £400 million of incremental embedded value by 2014.

Finally we have adopted a revised and more industry-consistent gearing methodology. At the end of 2012 and after taking account of the debt repayment made in February our gearing was 48%. We set a new target to reduce our gearing to 40% or below by the end of 2016.

To conclude we have delivered a strong set of results of which we are proud which demonstrate the resilience of the Phoenix Group. In 2012 we generated £1.1 billion of free surplus and a further £690 million of cash. We delivered £410 million of IFRS operating profits, and in the last two years we have generated £332 million of incremental MCEV value through management actions. We remain convinced of the inherent value of this business and have a clear strategy to deliver that value to all of our shareholders.

Our focus in 2013 and beyond is, first, to ensure we achieve the financial targets we have set ourselves in respect of cash generation, incremental MCEV and reduced gearing. Second, to continue building both on our operation achievements in Phoenix Life and in Ignis. And finally to pursue opportunities for growth through the consolidation of closed life funds in the UK.

This brings me to the end of the formal presentation and I will hand you over to our chairman

Sir Howard Davies, Chairman

Thanks very much Clive, Jim, Mike and we're now happy to take your questions. We'll take them in the hall first and maybe have some that appear over the airwaves but if you could wait for a microphone and then give your name. First in the second row here I think you've just about got in thanks.

Question & Answer session

<u>Question 1</u>

Kevin Ryan – Investec

Just a couple of questions please. Could you give us a feel for the timing of getting three life companies into one and also what sort of benefits we might expect to emerge from that?

And second how hot to trot are you in terms of looking for non-organic growth? And what sort of size of fund are you looking at or does that depend on the cash that might be extractable from it?

Sir Howard Davies

Mike do you want to deal with first and then Clive the second?

Answer: Mike Merrick

Yeah so getting three life companies into one I think that is a cross silo fund merger and therefore needs it to be effectively one banking silo so it will follow any change to the silo arrangements and I think we've said that it will generate capital synergies in the mid tens of millions.

Answer: Jim McConville

So I think in terms of timing if you thought of the repayment of the Pearl debt in 2016 that would be a time when we could contemplate putting the two main companies together.

Answer: Clive Bannister

Kevin, thank you for your question. Hot to trot – there's an interesting way of describing it. This Group's success for its shareholders is not predicated on doing any deals. The success of this organisation for its shareholders is doing more and better with what we have got, we deliberately asked Mike to go through in great detail the management actions that have been achieved to date and the more management actions that stand in front of us and in that respect shareholder value by announcing £650 million to £750 million cash flow increasing our 2016 target to £3.5 billion is to allay anybody's concerns that we have to do deals to make this business economically successful for our shareholders.

I would say that we do think that there are opportunities. I went through the size of the market at £200 billion, we think there is going to be a change, things in the Life business as we know evolve, slowly, so the tectonic plates are moving in the sense that there are businesses that are either closed or closing - they live in homes, let's say a foreign insurer, a bank in the UK where it becomes more costly to administer, there's a capital cost attached and there will be ever-increasing scrutiny on how policyholders are treated. So we think that with the way the markets have moved that there is the opportunity for deals to emerge.

I don't think it's like a set of red London buses and there are going to be a whole slew of them. As you know there was only one deal done, Cinven and there's been a period of quiet and I think a lot of that was associated with Solvency II. Vendors did not know what they were selling and acquirers did not know what they were really going to buy but with the evolving ICA Plus regime I think it makes it easier for both sides.

I would hasten to add that we are very clear that we would only do a transaction which was enhancing to our shareholder, delivering value to them. And we are categorically committed to de-gearing this business and we've given the target to be 40% or better by 2016. So any deal that we would contemplate would have to be done fulfilling those two criteria and that is very important for all of our shareholders.

So I end with where I began we do not need to be dependent upon doing deals to deliver to shareholders value and we are enormously committed to doing more and better with what we've got.

<u>Question 2</u>

Ben Cohen – Canaccord

I had two questions please. Firstly on Ignis I was just wondering if you could say something as to how you see the operating performance going forward. I don't know whether you saw the 2012 results as maybe a little bit disappointing but maybe you could just say more in terms of how you're going to take that business going forward?

And the second thing I wanted to ask was on Slide 25 you had a discussion of the inherited estate distribution. Could you just remind us in terms of the levers that you have there to increase the payouts to policyholders and then to shareholders? Thank you.

Chris Samuel, Chief Executive, Ignis Asset Management

Yes Ben thank you. I suppose two things: first of all we certainly don't see Ignis' results as disappointing. Just to give you the overview we reported 46 last year, there are some quite big changes to the business model – we've ceased to provide administration services to the Life company on the back of the outsourcing and also restructured the JVs which means that we're foregoing a revenue share now in return for a capital gain we hope in the future. So that's quite a significant restructuring of the business.

Against that of course you've got the Life company assets running off and we feel that we've done well to win third party business that has brought us back from that adjusted number back up to 43. I think it's worth saying what we've said in the past as well which is that we have a significant element of performance fees in here which are a tad down from last year but there will always be that variability.

In terms of going forward it's business as usual for us. I think we've set out our stall very clearly that what we want to do is have a broad business and to develop each of those and I think we've said publicly, certainly I've said publicly that we're extremely pleased with how our fixed income business, our multi-manager business, our real estate businesses are going. We feel we've got a bit more work to do on the equity side so we will be focusing on pushing that forward.

Answer: Mike Merrick

So in terms of the inherited estate I'll refer you back to Slide 25 where we have the picture there on the right hand side of the broad balance sheet of the With-Profit Fund so the totality is the assets and the assets back either liabilities, the ICA or the Estate. The more we can convert, the bigger we can get that excess estate figure then we can therefore release that extra capital confidently to policyholders. So it's either by directly increasing the estate through similar kinds of management actions that we talk about in the shareholder world. We're doing the same kinds of things for policyholders but also risk reduction. So if we can actually reduce risk for policyholders through better asset liability management or risk transfer then the ICA will come down and as the ICA comes down the excess assets goes up and you distribute more to policyholders. So it's a very similar picture to what we go through in terms of releasing capital for shareholders.

<u>Question 3</u>

Jon Hocking – Morgan Stanley

I've got two questions please. Slide 45 where you give the maturity profile of the cash flows you can see the impact of management actions in terms of accelerating those cash flows. How do you think of the dividend policy in the light of that chart? If you're growing the dividend obviously the cash flows in the medium term are that much lower than they would have been had you not put through the management actions. That's the first question.

The second question on the annuity transfers, given that you're looking at external opportunities what is the judgement call between actually retaining those annuities and using that as part of the growth strategy rather than actually looking at inorganic opportunities? Thank you.

Answer: Jim McConville

Yes thank you so as you quite rightly observe Jon clearly our cash profile of the business and MCEV generation has been enhanced by management actions and you see the maturity profile of the business from the MCEV of going out in outer years. Now that analysis will not

have within it the management actions that could be delivered in the outer years because, by definition, we haven't got to that point where we identify them. We have a continual programme for looking at management actions, it's regularly refreshed and monitored on a very regular basis and typically looks forward two or three years and as we keep going we see further opportunities arise that will hopefully benefit future cash flows and capital releases.

Answer: Clive Bannister

Jon, thank you for your question and it was shown on Slide 25. Last year the annuities had £1.6 billion being written and invested and retained for us was £1 billion. We're proud of that number, it makes us a top five player and this is profitable business for our shareholders. Mike also alluded to the fact that in the range of management actions we can consider we clearly have future opportunities as we did for transfer last year in June, so those type of transactions can be conceived and we will do that in thinking through the priorities to release cash, accelerate cash, that is one of our options.

You then link that, Jon, to a question about which is preferential to retain it for the reasons that make sense or to accelerate further releases to be able to better finance or pursue non-organic growth, i.e. do transactions. That's a sort of counter-factual it's a 'what if' and I think with any transaction you would ask, or the Board would ask itself four questions: what is the size of the transaction? What is the quantity of synergies that could be generated? What is the timeframe for it to be completed; one next Wednesday or in four years' time because of our balance sheet position where we would be. And then also in any financing what financing structure would be dependent on the quantity of equity or quantity of debt which would depend in part of the nature of the balance sheet of that which we might acquire.

And so I can't answer your second question other than say you've got multiple variables which would have to be considered at the time of transaction but I go back to saying that our primary role is to do more and better with what we've got. This Company's success is not deal-dependent and any deal has to add value to shareholders and at the same time de-gear this business. And why we are mono-manic on getting to 40% or better is because we are determined to get to an investment grade so that we have access to the subordinated debt market, that's in all of our stakeholders' interest and to be able to refinance in an appropriate way our senior debt.

<u>Question 4</u>

James Pearce, UBS

I imagine you've got a pretty good line into what the PRA and the FSA are thinking. What do they think about you doing M&A? I can see why it's good for getting your gearing down but for the target company's policyholders they'd be exposed to a very geared capital structure, what implications does that have for the funding? For the acquired company's policyholder base it exposes them to a much more geared owner, presumably, what are they thinking about the funding that you would need to put in place? Is it purely equity or could you fund it in other ways?

Secondly something strange seems to have happened to your MCEV basis costs in the second half of the year which I reckon were positive can you just elaborate on what happened there? I think you did 29 of costs in the first half of head office operating costs and it was 25 in the full year so what was behind that?

Answer: Jim McConville

I deal with the second point. The answer is what we have for MCEV costs in 2012 was £25 million and in 2011 £54 million, so you see the fall in costs for two main reasons, the first was a fall in Group costs of £10 million which related to really cost management activity, we continually seek to drive down costs and that is a pressure that we will be under forever, so I'm very keen that we continue on that journey. And secondly in 2011 there was a net interest charge included within that figure because the Pearl pension scheme was in deficit and that amounted to £14 million but that was not repeated in 2012.

I think part of the reason James you're looking at the half year results and going forward you will also note in the detailed commentary in the accounts that we've restated £23 million of costs from the previous year from operating earnings to OCI. So again these are related to pension schemes. And we've adopted a treatment which is consistent with others in showing those costs within the OCI element of the statement, but it's only a line switch and there's no impact on the total MCV, and I think that's maybe why you're looking at the numbers quite oddly.

Answer: Clive Bannister

It's not my job to speak for the FSA, but let's take the observations you've made, a priori you've said is it a good idea to take policyholders out of a less leveraged business and is it in their interests to put them in a more leveraged business. I don't think that stacks up. In any part so and so the FSA would be party to any transaction because of the change in control requirement, and as you know in Part VII's you have to have expert advice ensuring that the policyholders are not diminished, and that's on both sides of the fence.

We are completely committed to doing the deleveraging. If we look at the maths, if you go back to 2009 on the new gearing methodology we had a leverage level of 63%, at the closing of last year having done the refinancing it had gone down to 48%, so that's a 15% decline in our gearing in three years, and therefore we have the ambition of going down from 48% to 40% and we have four years to do that. So one of the asks for our investors is for them to rely on us to achieve that. We don't need to do deals, we're going to do more and better with what we've got and that is how I would answer your question.

<u>Question 5</u>

Andy Hughes – Exane BNP Paribas

Hi, it's Andy Hughes from Exane BNP Paribas, I've got three questions if I could. The first one is about the plus bit - obviously you mentioned the regime - the first bit is about the plus bit, so the first bit you mentioned was you're on an ICA Plus basis, all of the disclosure we've got here is on the ICA, particularly I'm thinking about the Group pension scheme, because I can see quite a big ICA surplus at the holding company on an ICA basis, but I'm a bit worried that on an ICG basis it would look very different because you'd include the funding deficit, the pension scheme, which is about £500 million.

The second thing is, I'll just come back on James' question about the new regulator, but my concern is somewhat different. Over the past the Group have quite successfully taken management actions and merged Pillar 1 and Pillar 2 firms together to release capital from these businesses, yet the agreed basis of capitalisation is unchanged, presumably you're still holding 125% of your ICA and yet the new regulator's probably going to step up and re-look at the capital management plans for what is a business which has substantially lower ICA but presumably a large degree of the same risks. Is there a danger they're going to come back and say, well you need to hold much higher capital because the business has changed substantially over the last five years?

And the final bit was on Mike's presentation on the annuities, I think he said that 99% of the guaranteed annuity rate policies are staying internally, presumably that's net of the 25% tax free cash and has that changed at all, given interest rates are very low and what's the sensitivity to that? Thank you.

Answer: Mike Merrick

Yes, so 99% is after 25% more or less has gone out in cash and that we do in the kind of stress scenarios we're looking at, we assume that that 25% actually declines as interest rates fall, but actually policy holder value doesn't actually change very much, people tend to take the cash.

Answer: Jim McConville

So, ICA Plus, I mean the ICA Plus regime obviously is new, we've obviously just introduced the ICA last year, so the discussions we've had with the FSA on how the PLHA ICA works are fairly recent and so we're not anticipating in the ICA Plus regime changes in terms of the mechanics of that calculation.

And on your second question, clearly we are very aware of the Pillar 1 and Pillar 2 requirements and they're monitored, both on a very careful basis. Again, Mike may want to comment further, but in thinking of our management actions we do consider both bases and we don't see any worsening of opportunity there as we go forward.

Answer: Mike Merrick

I think you also asked about the capital policy and whether that might change, I think you quoted us as 125% of ICA capital policy, it's actually nearer 140%. And I think that puts us toward the upper end of the range of capital policy, so I think there's less a risk now of that.

<u>Question 6</u>

Oliver Steele – Deutsche Bank

A couple of questions, the first is about the three and a half billion target. So if I take the midpoint of your target for 2013 you've got a bit over £430 million of gross cash flow built into your target per annum for 2014, '15 and '16. You made £481 million clean in 2012. Is that 433 your estimate of what the average underlying cash flow should be of the business, because that sounds quite low for those three years, or are you being conservative?

And then the second question I've got is, I mean you've tended to beat your underlying cash flow projects by a good £200 million, even £300 million a year, per annum, over the last four years or three years, I can't remember which. You seem to be targeting the same sort of beat in 2013. Hypothetically, if you like, how does the chairman view the choices between paying down debt faster and increasing the dividend capacity, versus organically funded acquisitions?

And I'm sorry, I've got one more question, which is you said that the benefit from the equity raised was £211 million net, that sounds quite a low figure compared to the 250, so I'm just wondering what went into that calculation.

Answer: Sir Howard Davies

Well, let me deal with my question first. I think that the board has debated this at some length and our view is very clear that the targets and priorities that have been set out today are the ones we support. We believe that we have to get the gearing down, as we explained in the re-terming and in this presentation, in fact the language is the same, and that that is the number one priority for the Group at this point.

Once you get to that point you begin to have some more flexibility and at that point we can look at it again in the light of opportunities that are available to us. But I wouldn't want to prejudge how we would go beyond that point.

Answer: Clive Bannister

May I deal with the first question and I'm going to turn to that slide there which comes from Mike, our cash generation, how do we do the maths and are we erring on the side of caution? Well, you'll see on the top left hand side three years ago it was £734 million, then it was £810 million, last year £690 million and we're forecasting for this year a number between £650 million and £750 million. On the left hand side you'll see the organic cash flows and that would be of a winding down and the run-off, an actual run-off, and above that in the blue you see the management actions.

This is a business where the horizon over week which we choose to forecast and the quantities we forecast for management actions has to be thought about very carefully, we want the market to be very clear about what we genuinely believe and see and can do in the immediate 365 days, and then we've given them a longer term to give people confidence about what is possible, coterminous with our debt repayments, substantial debt repayments, and the reterming of the debt in 2016; and as Jim said when he was speaking, we expect cash in total of circa £9 billion to emerge over time and that's a longer time period to the maturity of our policies. To date we've taken £1.5 billion out of that £9 billion.

So what's going to happen this year, and the maths that you did, Oliver, was and here I would go back to 21, is that £500 million was of course the division, we've put out a target of £3.5 billion, we've paid down £1.5 billion, you've got £2 billion left in four years and you divide it by four and you get the £500 million.

Your maths suggests circa £700 million in cash flow that would mean in the remaining three years £433 million. I can't fault your maths, but I'm going to go back to orthodoxy, and I sound like a broken record, that we err on the side of caution because we would far prefer to under promise and over deliver, and that is what we have achieved to date. But there are many variables, to remind you of last year, we achieved no cash flow virtually in the first half of the year and it all happened in the second half. So we have to give you counsel, both about the quantity and also timing, and there's a lumpiness to our business, depending on Part VII's and things beyond our control, judicial processes, but what we want to communicate is the sustainability of the cash flow in one year over until 2016 and in the context of our overall book.

Answer: Jim McConville

The final question I guess, Oliver, which was on the fees related to the equity transaction which included the £250 million equity raising and the net £201 million, I think the thing to remember it was both an equity raising and a debt reterming, so that difference does include the bank consent fees, which were approximately £21 million and then there was a spread of £18 million related to both the professional fees and underwriting fees for both the equity transaction and the bank reterming. So you have to look at it in the context of a £2 billion bank reterming, and the £250 million capital raising.

Question 7

Colin Simpson – Goldman Sachs

Hi, it's Colin Simpson from Goldman Sachs. Could you give us a sense of the quantum of capital that might be sitting in With-Profits funds backing non-profit business that could be released if you were to move that non-profit business out of the With-Profit funds?

And the second question is maybe somewhat theoretical, but I notice that your MCEV growth metric has the same value as cash flow in management remuneration and one of the easiest ways to improve MCEV might be through annuity transfers. But the market's almost telling you that the MCEV of an annuity book is not its true market value, because the market's willing to pay more than that. I just wonder, just maybe a bit of colour on why MCEV is so important to the Group?

Sir Howard Davies

The first one, do you want to deal with that, Mike and then Clive on the second one?

Answer: Mike Merrick

So the question was, is there capital tied up in the with profits fund that could be released by transferring non-profit business out of the with profit fund? There is, I can't tell you the quantum, but in any event it would fall to policyholders and not to shareholders, so it's mainly, going back to the point earlier, it would enable estate distribution to happen. And there is shareholder capital backing some of the With-Profit funds and that is something that we seek to try and reduce and is part of the management actions that we look at, but that wouldn't necessarily be directly affected by transferring non-profit business out.

Answer: Clive Bannister

I'll give you an un-technical answer and then I'm going to look for Jim to give us the technical answer. Positioning the firm three years ago there was a challenge as to whether a run-off fund just inexorably runs off, and the DCF models that many analysts use needed to see if that break was accelerating or could be arrested. So it was very important for us to put clear metrics in the public domain that people could track and then believe in as we reliably delivered. And they were cash flow, MCEV enhancement and de-gearing.

So the MC enhancement, if we were to do nothing there would be a capital unwind of circa 5% to 8% per annum, so it was important to show that we could do, not just capital acceleration, cash flow acceleration, but we could add real value through restructuring as has been mentioned today, tax enhancement etc. And therefore we gave ourselves the target of £400 million incremental MCEV between '11 and '14. We're proud that we are more than two thirds, 75%, ahead of that, and that gives us confidence that we can add value by actively managing the assets that we have. So that's my non-technical answer and I'm sure there's a better technical answer, which is going to come from Jim.

Answer: Jim McConville

Well, I think the important thing to remember is we've got a range of different measures, MCEV is a value measure and in relation to the annuity transactions that you're alluding to, if you think what happened in 2012 the annuity transaction resulted in a small incremental benefit to MCEV, so it was value enhancing, but it delivered a very significant increase in the

ICA surplus, which will turn itself into cash. So there was a disconnect between the size of the cash benefit versus the size of the value generation on an MCEV basis. So different activities do have different impacts across the different measures, and I think what we're trying to get is that basket of measures within the remuneration structure.

Question 8

Alan Devlin – Barclays

Just a question on page 37 on your sensitivity to the cash flows. First of all, you say a movement of 75 basis points increase on interest rates has basically no impact on the £3.5 billion of cash, so I was wondering why is that the case, and what actually does that £3.5 billion assume? Does that assume interest rates stay at this level for the next four or five years?

And then secondly on the impact of the 20% for the equity markets, is the reverse true if markets increase by 20%, does that add £100 million to your cash flow targets?

Answer: Jim McConville

Okay, thank you for that one, Alan. I do love you! So, what these cash sensitivities show is the base case is obviously the cash generation over the period 2011 to 2016, but clearly we're part of the way through that period, so the sensitivity movement is applied from 31 December 2012, through to '16.

So that's how you get a relatively small impact in terms of the measures. In terms of, I think the second part of your question was would a 20% increase in equity markets improve the position by roughly an equivalent amount. The Life companies are broadly hedged in terms of equities and so there would be a small uptake in terms of a 20% increase, but it wouldn't be a huge number.

Concluding Comments – Sir Howard Davies

Do we have any questions that have appeared from anywhere else? No, we don't, so speak now or forever - well, until the half year - hold your peace. Okay, thank you very much to the team, thank you for some interesting questions and particularly, thanks for coming.