PHOENIX GROUP

Phoenix Group plc 2012 Q3 Interim Management Statement

Wednesday 31st October 2012

Clive Bannister, Group Chief Executive

Good morning everybody. Thank you for attending today's call. I am Clive Bannister, Chief Executive of the Phoenix Group, and I welcome you to our third quarter interim management statement call. I'm joined here today by Jim McConville, our Group Finance Director, and Katherine Jones, Head of Investor Relations.

Jim and I will be very happy to answer your questions in a few minutes, but first I would like to take you through the highlights of our quarter three announcement, which we released this morning.

I am pleased to report that the Group has generated a total of £517 million of cash from the operating companies by the end of October 2012, and that we remain on track to meet all of the financial targets we set for 2012, in terms of cash generation, MCEV uplift and organic de-leveraging.

I would just like to take you through the key financials we have reported on today. First, cash generation. Cash generated by the operating companies is the key metric which we use to judge our performance, and the one which we think is most useful in helping investors understand the long term value and predictability of our business. In the first nine months to 30th September, we distributed £299 million of cash from the operating businesses to the holding companies. And after our normal cash outflows in the first nine months, this resulted in the group having £835 million of cash at the holding companies as at 30th September. This compares to £710 million of cash at the holding companies at the half year.

A further £218 million of cash was distributed to the holding companies during October, following the completion of a funds merger of London Life and Pearl; so in total, cash generation in the year to date amounts to £517 million, and I am confident that we remain well on track to meet our 2012 cash generation target of between £600 and £700 million, which you will remember we increased by £100 million at the first half.

I would also like to take the opportunity to reconfirm our longer term cash generation targets of £3.3 billion between 2011 and 2016.

Now, turning to capital, since the first half of 2012, we have reported our Group solvency position on two bases; the first and the one which will be most familiar to you is IGD. This is our Pillar 1 calculation of the Group's solvency position. Our IGD surplus and IGD headroom, which is the excess over the IGD capital policy, have both increased by £200 million since 30th June 2012, to £1.4 billion and £600 million respectively at the 30th September. These increases have been driven primarily by the completion of the London Life and Pearl Funds merger, which received Court approval at the end of September.

Our second group solvency metric is the PLHL ICA. We reported this for the first time at our interim results. It represents a risk-based Pillar 2 assessment of the Group's solvency position.

At the 30th June, our PLHL ICA surplus was £400 million, and as we aim to hold a surplus of £150 million, we had headroom over that policy as of 30th June of £250 million. As a result of the London Life and Pearl Funds merger, and to a lesser extent positive market movements, the PLHL ICA surplus has increased to £614 million as of 30th September, and the PLHL ICA headroom has risen to £464 million.

We continue to make good progress on management actions, particularly in respect of the pension fund, which in due course we would expect will strengthen this position further and reduce the sensitivity of the calculation to external market stresses. One key component of a PLHL ICA calculation is the free surplus in the life companies, which represent the excess capital over and above the life companies' own strong capital policies. I am pleased to report that the free surplus increased from £566 million as of 30th June to £692 million as of 30th September for the reasons I have stated. This is an increase of £126 million.

And finally Ignis, our fund manager. Ignis generated net new business from third parties of £2.9 billion in the nine months to 30th September. This includes the £1.5 billion of assets which have been transferred to Guardian as part of the annuity transfer transaction. In total £5 billion of assets were transferred to Guardian, the remaining £3.5 billion are currently still subject to transitional investment management arrangements, and the majority of these will have been transferred back to Ignis for the investment management purposes by year end. I think we could just call this round tripping.

Net new third party inflows were £927 million in the first half of the year, on a like-for-like basis this increased to £1.4 billion by the end of September. This means that Ignis raised £473 million of net third party money in the third quarter, excluding the Guardian assets, which is a very creditable performance. Overall, Group assets under management were £67.9 billion as of 30th September, the decrease since the 30th June is largely due to the £3.5 billion of Guardian assets which have not yet transferred back to Ignis, but this is obviously just a timing issue, which as I have said before we have a target for completion by year end.

And operationally we continue to make good progress. I have already mentioned the London Life / Pearl Funds merger, which received Court approval on 24th September, which means we now have just three life companies, down from seven at the time of the premium listing in July 2010. We have also continued to make great strides on our administrative system migration program and now have 3 million policies out of a total of 6.1 million policies on our new modern system. This is good news for policy holders.

So to conclude, I am delighted by the progress we have made since our interims, particularly in respect of cash generation and Group solvency, and I remain confident of our ability to meet all of our financial targets in 2012 and beyond. At this point I'd like to stop, and if we may, Dan, can we now move on to Question and Answer session and thank you very much for helping us with the call.

Question and Answer session

Question 1

Jon Hocking – Morgan Stanley

Morning, everybody. I've just got one question. Could you possibly talk a little bit about the headroom over the capital policies, and how you think that going forward this might change? You've obviously done the fund merger in 3Q and I am particularly interested in…at the moment it seems like the IGD is the constraint. At what point do you think that will change? Or will you have to wait for Solvency 2 and is there a sort of flip over point where you can actually release the ICA headroom and you're no longer constrained by the IGD?

Clive Bannister

Jon, that's a fine and fair question. I'm going to hand it over to Jim. Jim?

Answer: Jim McConville, Group Finance Director

Jon, thank you for the question. I think you are right to observe that the headroom on the Pillar 2 calculation and the Pillar 1 calculation are moving to a position where they're reasonably close. You will have heard at our half year announcement, when we talked about the PLHL ICA, we noted that the sensitivities for that were larger than the IGD sensitivities, so whilst the numbers may be roughly similar, the ICA remains the more sensitive calculation. We do, however, have plans in hand that will improve the resilience of the PLHL ICA calculation to stress, so as we go forward I think we would see that that stress would reduce to nearer the stress within the IGD calculation.

Further question

And are those initiatives restricted to the pension scheme? Or there are other things you are looking at doing as well?

Answer: Jim McConville

They are substantially related to the pension schemes, because that remains one of the key risks within the PLHL ICA calculation.

Question 2

James Pearce – UBS

Morning, everybody. I was wondering if you could please give us a bit more colour about the banking discussions, I mean, this is not the first time that you've told us that you're optimistic about getting things done and then in the next quarter or six months we see no progress that's visible from the outside, so could you just give us some sort of colour as to why you are optimistic, and whether this time you really are on the verge of getting it across the line?

Answer: Clive Bannister

We remain confident, and I've said before, and James thank you for your question, it would be very strange if it were not asked, and I do understand the frustration that must be created to be on your side of the fence. We continue to have cordial and productive discussions with the Banking Group. There are a number of stakeholders who are necessarily involved in these discussions. We have more financial flexibility, given the quality of the numbers that we announced today, and that is one reason for remaining confident about our ability to achieve a deal which is sensible for all of our stakeholders. I have said before that we will do the right deal rather than the rapid deal. At the moment our capital structure is well served by well priced debt, and therefore I am not capable, or not prepared, to give a timetable. I never have. But I remain very confident that this reterming will take place in the fullness of time, and this is an issue which is at the forefront of our mind.

Question 3

Ming Zhu – Canaccord

First, you've got £218 million cash generation in October. Could you tell us what's the main contribution behind this number?

And second, on the asset management inflow, third party inflow, your Q3 was about £470 million, and compared with what you had in Q1, Q2, which is £390 million and about £540 million in Q2, what kind of trend shall we expect in the third party net inflow?

And on asset under management, you've got £67.9 billion at the end of nine months, compared with the £71.6 billion, now there's £3.5 billion is the Guardian deal, which has not been included. So if I add that back on, that gives £70.4 billion. The difference is £200 million compared with H1, and I want to know whether you can tell us how much of this £200 million is the run rate from the life book and how much is from the market performance?

And my last question is, you have another 180,000 policies moving onto a new system by Q1 2013, and what kind of benefits would you guide on this transfer? Thank you.

Answer: Clive Bannister

Well, Ming, thank you very much, I'm going to answer those in reverse order if I may and thank you for covering the company. You're very welcome. Right, the 180,000. We've invested in something called the AST platform. And that provides us both with better management capability, but particularly financial capability of managing and modelling the way in which we look after our policyholders. In previous calls we have commented on the fact that we have this new system, and it allows us to be more accurate, and we get to scrub the data and do better modelling, and that has allowed for capital releases. So that is a clear shareholder benefit. But more importantly we can be more accurate about the way in which we manage and look after our policyholders' assets. And so in that respect that is good news for policy holders and good news for shareholders, and we intend to continue using our AST platform as it gets completely implemented over the coming months, between here and the first quarter.

Your second question was then about asset management. And you asked two questions there. And the first one is the difference between £67.9 billion and £71.6 billion is in effect that we have not fully taken account for the returning funds from the annuity transfer. There is a delta there of £200 million, and that can be ascribed to some market movements, and it's, I'm not going to say it's neither one way or another, but that is we can come back to you with greater detail on that, but in the fullness when we do our full year accounts that will be much clearer. I think it's, I'm not going to say a rounding error, but that £200 million is relatively modest.

Then your other question about asset management was you said, "Okay, you've done £473 more genuine net new money coming in", that's come from a variety of products. The products I would draw your attention to are our liquidity funds and ARGBF, which is the Absolute Return Government Bond Fund, but there are a spread of activities, you know, and some have gone up and some have gone down, but I think the headline to focus on is there's £473 million more in our business, in a world where it's very hard to generate net new money.

Then your first question was about how did we get £218 million out between 30th September and where we are today? Jim, do you want to go through that?

Answer: Jim McConville

Yes, Ming, thank you. That £218 million was received during October, and was by way of a dividend from the life companies, which primarily recognised that we'd completed the Scheme B transaction.

<u>Question 4</u>

Oliver Steele – Deutsche Bank

Morning, Clive. Two questions; the first is looking at the PLHL ICA, I mean, you've said in the past that £150 million is the minimum that you want to hold there. But it is now up at £600-odd million, so I guess I'm sort of asking you what would a sort of perfect level be rather than just the bare minimum?

And then the second question is - this sort of breaks down into three - but what are you doing on the pension fund to improve the ICA position? Is this linked with the £43 million injection into the pension fund which you made in the first nine months, which actually seems to be a slightly higher rate in the third quarter? And what effect will your actions have on the ICA when you've finished them?

Answer: Clive Bannister

I'm going to let Jim take the second question. I'll answer the first one. And first of all, Oliver, thank you very much for your note which came out earlier today. It's a fair question and I'm going to give you not a very satisfactory answer. Capital policies are decided within the Group, and it's done on a determination of where we find the company and how we see external environments. So we've set a minimum there, and that gets reviewed as part of a risk process which is done on a semi-annual basis and confirmed by our Board, and so this is actually something we've been doing right now and we reconfirmed the £150 million, which is a number we're comfortable at. It could go up, it could go down, as you know we run this in a very prudent manner and so comfortable at £150. Jim, do you want to go through the pension stuff?

Answer: Jim McConville

Thank you very much, Oliver. First, dealing with your question about the £43 million, and you'll have noted that is a higher number than shown in the comparable period last year. In fact there has not been an increase in the pension scheme contributions, they remain at the same level, but there has been a change in where they have been paid from in the Group. In the past certainly the contributions into one of the schemes was paid from the service companies, and these contributions are now paid by the holding companies. So the comparison that you see looks quite odd, but there has been no change in the level of contributions.

In terms of the impact on the PLHL ICA, there are a number of things we are looking at on the pension scheme, which we believe once we've agreed the position with the Trustees for some of them will lead to an increase in the ICA position, so it's primarily around the investment mix of the assets within the pension scheme, and various hedging strategies in relation to those assets to deal with stress situations, which would give rise to capital benefits.

Further question

By implication you're not going to give me a number of what that outcome might be?

Answer: Jim McConville

No. I'm not going to give your number at this stage certainly, Oliver, but we are very pleased with the progress we've made since the half year, and we will give you a further update, obviously, at the full year.

Further question

Can I just follow up with how much…what sort of injections out of the holding company into the pension fund would you be expecting now in future years?

Answer: Jim McConville

The projections would be consistent with what we've assumed within the PLHL ICA calculation at present.

<u>Question 5</u>

Ashik Musaddi – JP Morgan

Thank you and good morning, Clive and Jim. Just one question; in the past you have made prepayment of your debt basically, given that you had excess capital, and right now the excess capital has gone up even higher, like £450 million on the ICA IGD headroom of £600 million. So why are you not doing any prepayment at the moment? Can you give us some colour on that?

Answer: Clive Bannister

Thank you very much for your question, and thank you for your note earlier today. Prepayments would serve a role in a broader reterming. And so as you know our mandatories are £150 million a year, and any further prepayments would be part of a broader restructuring of the capital, and the debt structure of the Group, and so there's nothing untoward or sinister. As I said a few minutes ago, we have greater flexibility now because of the performance of the firm in the last quarter, and that gives us, as I said, the confidence about the reterming and any prepayment would be part of a broader reterming exercise.

<u>Question 6</u>

Alan Devlin – Barclays Capital

Thank you very much. Just a follow up from James's question on the debt refinancing. You know, on the one hand you're better waiting as long as possible to refinance the debt, given the very attractive terms the current debt is on. On the other hand, the debt refinancing is a significant overhang on the stock, and shareholders would like you to do it as soon as possible. How do you kind of balance those two conflicts in your thinking?

Answer: Clive Bannister

It's not a conflict, Alan, and thank you for your question. It is our priority to do a successful reterming, and we aren't trading here in a manner which is cynical, we wish to do something which serves all of our stakeholders and there are obvious trade-offs between those stakeholders. So we are well served with our current debt pricing, but we wish to achieve a reterming as soon as reasonably possible for something which is the right deal, because obviously we have to live with it for many years. This is not a set of clothing we can take on and take off easily. We are finding a structure which works for all of our stakeholders. So you have correctly gauged the advantageous nature of that debt, but this is a part of our thinking, but it doesn't drive the overall thinking. Our primary move is to get a reterming done as sensibly and as quickly as possible.

<u>Question 7</u>

Matthew Preston – Berenberg

Morning everyone. Just a quick question on the Guardian transaction; clearly you've taken the £25 million to the IGD surplus. I was just wondering whether there was any update on the progress of the Part VII transfers. You know, clearly you've guided to 2013, but is this going to be a first half or a second half event? And also what sort of quantum can we expect? Thank you.

Answer: Clive Bannister

We can't give guidance on that. It is other than that which we said, because that would be making estimations about something which we are not in control of in terms of a Part VII. So I think we've said what we've said on that subject.

Concluding comments: Clive Bannister

Dan, thank you very much for helping us this morning and I thank everybody for attending the call and then the good questions. Thank you very much indeed.