PHOENIX GROUP

2013 Full Year Results

Wednesday 26th March 2014

Sir Howard Davies, Chairman

Good morning ladies and gentlemen and welcome to Phoenix Group's 2013 results presentation. As you know, at these presentations the Chairman's role is normally limited to ensuring that the Chief Executive's tie is straight, but I did want briefly to say something about what we're going to present to you this morning, because it is quite a lot of material. We've achieved a great deal in 2013, we have delivered, as you will see, a very strong set of results. We raised £250 million of capital and re-termed our bank debt, and we believe we are now in a better position to explore M&A opportunities in the closed life sector, which is where we see our mission.

You will all have seen the press coverage over the last couple of days about our disposal of Ignis, our fund manager to Standard Life, which we formally announced this morning. I need to say, of course, that it is subject to regulatory approval. The transaction brings significant financial and strategic benefits to us, which my colleagues will expand on shortly. We'll take you through a detailed presentation on our results and on the sale of Ignis, and we'll also, of course, cover a subject given a lot of coverage in the last week, which is the impact of the Chancellor's budget announcements last week on Phoenix.

I am joined on the podium today by exactly the same team as last year, we've had a very stable position at the top of the Group recently: Clive Bannister, Chief Executive, Jim McConville, the CFO, Mike Merrick, the CEO of Phoenix Life, and Chris Samuel, the CEO of Ignis, and they, particularly Clive and Jim, will take you through the presentation now, and of course we will answer all your questions at the end, both from the room and also questions that may come through to us on the web. So let me hand over now to the Chief Executive, Clive.

Clive Bannister, Group Chief Executive

Howard, thank you very much. You've set a low bar; I think my tie is straight, so I meet the first of the requirements today! Thank you and you're most welcome, ladies and gentlemen, to our 2013 results presentation.

I have four messages today. First, a very strong set of results. Second, the description of the divestment of Ignis and commencement of a strategic alliance with Standard Life. Third, a set of new financial targets for 2014 and beyond. And finally, how collectively these strengthen Phoenix's position as we pursue future closed life transactions.

So 2013 has been an outstanding year of progress for the Phoenix Group and we have delivered a very strong set of results. We've delivered cash generation above the top end of our target range. We've significantly exceeded our target for incremental MCEV a year ahead of target. We've reduced our gearing by 11 percentage points since December 2012. Ignis has achieved its best ever profitability, driven by good investment performance and strong third party inflows. And on the back of these very strong results, I'm happy to confirm our final dividend of 26.7 pence per share, delivering 53.4 pence per share for the full year.

As Howard noted, we have agreed, subject to regulatory approval, the sale of Ignis and the creation of a new strategic asset management alliance with Standard Life, which I will come to shortly.

We set ourselves targets against three financial metrics, and I am very pleased to report that we have met or exceeded all of these targets during 2013. Our target range for cash generation for 2013 was £650 to £750 million. I am very pleased that we have generated £817 million, almost 10% above the top end of our target range. In total, over the course of the last three years, we have achieved £2.3 billion of cash generation towards our six year target of £3.5 billion between 2011 and 2016. Put simply, two thirds of our target in half the time.

MCEV is the second key metric against which we measure our performance. By the end of 2013 we had delivered £502 million of additional value since 2011, significantly beating our £400 million cumulative target from 2011 to 2014 a year ahead of plan. Again, put simply, 125% of delivery against target MCEV delivered in three quarters of the time. And during 2013 we reduced our gearing by 11 percentage points to 44%, reducing the senior bank debt by almost £700 million, very much on track towards our long-term target of 40% or better.

Our core competence is driving value for shareholders and policyholders from the consolidation and management of closed life funds. The divestment of Ignis allows us to focus exclusively on the efficient management of closed life funds and the delivery of management actions which enhance MCEV and accelerate the release of cash. The divestment strengthens the Group's balance sheet, allows for further debt repayment, and increases our MCEV. The reduction in gearing will accelerate our access to the wider debt capital markets and strengthens our position as an acquirer of closed life funds, as Howard said a few minutes ago. In addition, we have agreed a strategic alliance with Standard Life Investments. This strategic alliance will provide us with additional value if they manage any assets that we acquire as a function of a closed life fund transaction. This ensures that we will benefit from any asset management synergies as we grow our core business.

In summary, we are very excited about the prospects of our new relationship with Standard Life Investments. We have extensive experience of ensuring that strategic relationships generate value for all parties, and I am very motivated about how we can work together with Standard Life in the future.

On this slide we have provided some further details on the proposed transaction. The cash consideration is £390 million. The creation of the long-term strategic alliance with Standard Life Investments will ensure the continued delivery of top-class asset management for our policyholders. Their investment track record and expertise in managing life company assets will support our continued vision to be the saver-friendly solution for the safe, innovative and profitable management of closed life funds. In addition, as I said a few minutes ago,

the agreement to share value from any future transfer of assets to Standard Life as a result of completing closed life transactions will help to position us fully to capture synergies of future transactions.

Finally, subject to achieving regulatory approval, we anticipate this transaction will complete in the first half of 2014.

The transaction has a compelling financial rationale. As we hold Ignis at its net asset value within our MCEV, the proceeds from the divestment will add an additional £237 million to the Group's MCEV as at the year end; broadly representing the difference between the net proceeds and the value of Ignis within the MCEV. This represents an additional £1.05 per share. This increase in MCEV, combined with the £250 million debt repayment, will reduce our senior bank debt to £1.4 billion, and will reduce gearing to 39%. Our stronger balance sheet will accelerate our ability, as I said a moment ago, to get to an investment grade rating and access the wider debt capital markets, with the benefit of long-term simplification and diversification away from senior bank debt of our capital structure. The strengthened financial position of the Group, both in terms of MCEV and gearing, is for the benefit of both policyholders and shareholders and will allow Phoenix to execute its consolidation strategy with greater confidence.

I now wish to talk about the targets going forward. Today, we set targets for 2014 and beyond, which take into account the impact of a planned divestment. Our original long-term cash generation target was set from 2011 to 2016, to be coterminous with the maturity of the previous Impala facility. As part of the January 2013 re-terming, the Impala facility was extended to 2019, and so today we set a new long-term cash generation target, from 2014 to 2019, of £2.8 billion. This includes the proceeds from the divestment. Clearly, this long-term target spans the period during which Solvency II will be implemented. Consequently, our targets are set based on the assumption that the Solvency II regulations will operate in a way in which we envisage. We also set an annual cash generation target for 2014 of between £500 and £550 million. The proceeds of a divestment will be in addition to the annual target.

We have already more than delivered our incremental MCEV target of £400 million between 2011 and 2014. There are many more management actions we believe we can undertake to generate incremental value, and so today we set a new incremental target of £300 million to be delivered between 2014 and 2016. Assuming the divestment of Ignis and subsequent debt prepayment is completed as planned, we will achieve our 40% gearing target two years ahead of plan. Our aim is to maintain or improve on that gearing position in the future.

To achieve these targets we will continue to undertake management actions in the same four areas: namely, restructuring, risk management, operational management and outsourcing, in all of which we have a proven track record of delivery. We have an extensive menu of management actions which gives us confidence in our ability to meet the targets we have set out today, which will allow us to continue to deliver value for shareholders and policyholders alike.

Operationally, we have made progress across the Group and we have continued to enhance our customer proposition. Here I set out some of the key operational achievements in 2013.

We formally completed the transfer of £5 billion of annuity liabilities to Guardian Assurance. We completed the migration of policies on to our new administration platform, and we now

have over half our policies on this system. Our policyholders remain a key focus for our business. We have reduced the average time taken to handle claims from 12.8 days down to 10.1 days, and we have also distributed over £157 million of our inherited estate to about 115,000 of our policyholders. Ignis continues to make good progress in building its third party business, and its investment performance continued with 85% of assets outperforming their relevant benchmark or peer group in 2013. Good news for the Group, and also for our policyholders.

I hope you will all agree, from this brief review, that this is a thriving business, managing the savings of millions of policyholders efficiently and effectively. I'd now like to hand you over to Jim for the detailed maths. Jim.

Jim McConville, Finance Director

Thank you very much, Clive. Good morning everyone. We show here the actual and pro forma 2013 numbers, with the pro forma position reflecting the divestment of Ignis and subsequent debt prepayment. I'll take you through each of the key metrics in more detail shortly, but let me set out in summary the key results.

Cash generation of £817 million, ahead of our stated target for 2013. MCEV of £2.4 billion, the highest level of MCEV we have ever reported. Gearing reduced to 44% through a combination of the higher MCEV and further debt repayments.

IFRS operating profit of £439 million, a slight improvement on 2012. Stable assets under management of £68.6 billion. A continued strong group capital position. And total 2013 dividends of 53.4 pence per share, which includes a recommended final dividend in respect of 2013 of 26.7 pence per share, reflecting the strong financial position of the Group.

Free surplus represents the excess capital over and above the strong capital policies in the life companies. It is the amount which is available for distribution to the holding companies. We started 2013 with £514m of surplus and I am pleased to report free surplus generation during the year of £809m. This broadly falls into three areas: IFRS operating profits net of tax after the impact of economic variances and non-recurrings totalling £346m. The run off of capital requirements as well as the impact of increasing yields which reduced the capital requirements and policy by £371m, and a further £92m of valuation differences reflecting the differing treatment of reserves under IFRS and free surplus.

It should be noted that the £1.1bn of surplus generation achieved in 2012 benefitted from a large one off factor being the transfer of £5bn of annuities to Guardian.

We distributed £794m of cash to the holding companies during the year leaving £529m of free surplus in the life companies which will support the new long term cash generation targets which Clive mentioned earlier.

Now turning to cash generation. Phoenix Life generated £794m of cash and with Ignis providing a further £23m during the year total cash generation was £817m. This exceeded our 2013 cash generation target of between £650m and £750m and was also ahead of 2012. The net proceeds of the 2013 capital raising of £211m are in addition to these numbers. In terms of uses of cash the payments to the two group pension schemes reflect the new contribution schedules agreed with the trustees in 2012 and 2013. The current level of scheduled contributions reduce to £55m from 2015 onwards.

Debt interest costs, which include the Tier 1 coupon, increased during the period primarily as a result of the out of the money interest rate swaps on the Group's bank debt which have now expired.

We have reduced our bank debt by almost £700m over the course of the year. This includes the £450m Impala prepayment, £120m amortisation on the Impala facility and an annual amortisation of £25m on the Pearl facility. In addition there was a further £100m prepayment of the Impala facility in December.

We paid out £120m in dividends and despite this increased dividend payment and the significant debt pay down during the year almost £1bn of cash remained at the holding companies.

Cash generation arises from the organic cashflows from the business in the ordinary course and delivery of management actions which either accelerate and/or increase the cash generation.

As can be seen in the left hand chart we have continued to be successful in generating additional cash through management actions, on top of those that flow from the organic run off of the Group's life policies. Over the past four years Phoenix has generated a total of £1.1bn of cash from management actions. The key management action that contributed to cash generation in 2013 was the transfer of annuities to Guardian. This transaction released £252m of capital into free surplus during 2012, and this was distributed to the holding companies in 2013. We also increased cash generation by £47m through our focus on asset and liability matching and a further £33m from a number of other smaller management actions.

As well as accelerating cash generation from management actions we have also successfully added incremental MCEV. A large number of actions were completed during the year, which were mainly operations-based or driven by improvements in risk management. We set ourselves a target of achieving £400m of incremental MCEV over the four year period to 2014, and I am delighted to announce that we have, as at the end of 2013, achieved a total of over £500m of incremental value, beating our target with a year to spare.

The wide range of management actions completed during 2013 is testament to the work undertaken by Phoenix Life and includes improved credit investment strategy for annuities, the continued accrual of benefits from investing in our actuarial systems, and the release of legacy provisions following balance sheet reviews.

As Clive has discussed earlier we still believe there is further value to be derived from future management actions and we have set ourselves a new target of achieving an additional £300m of MCEV enhancements over the next three years, not including the impact of the Ignis divestment.

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 2013 with MCEV of £2.4bn, the highest level we have ever reported.So, moving from left to right from the pro forma position at the beginning of the year. We generated post-tax operating earnings of £222m which reflects expected returns on the life company embedded value at the long term risk free rate. We delivered management actions of £170m as I explained on the previous slide. Below the line economic variances and non-recurring

items totalled a positive £48m in 2013. This was offset by the negative impact of the increase in the market value of the Tier 1 and the Tier 2 bonds during the year. We incurred finance costs of £143m including the Tier 1 coupon and dividends of £120m. So at the end of 2013 the MCEV of £2.4bn represented MCEV per share of £10.58.

On a pro forma basis the divestment of Ignis is expected to benefit the MCEV by £237m thereby increasing the MCEV to £2.6bn and increasing MCEV per share to £11.63.

Our gearing methodology is a factor of both our MCEV and the level of outstanding debt. We have sharply reduced our gearing over the course of 2013, helped in part by the capital raising and debt re-terming we announced at the start of the year. However we have also paid down further debt over the course of the year including an additional £100m of Impala debt in December. This, combined with the higher MCEV position of the Group has reduced our gearing to 44%.

Including the divestment of Ignis and planned £250m prepayment we have reduced our senior bank debt by £945m in the last 12 months. Our gearing is expected to reduce further by a further five percentage points to 39%, thereby allowing us to achieve our target gearing ratio of 40% two years early.

Now moving on to IFRS. In 2013 Phoenix Life operating profit was £414m which included £98m from management actions, such as modelling improvements and the release of legacy provisions following the harmonisation of policies across the business and balance sheet reviews. The increase in operating profits compared with last year is particularly pleasing as the 2012 results also benefited from significant management actions with regard to the annuity portfolio.

Below the operating profits line there were positive investment variances of £33m and we incurred £126m of finance costs, reflecting the amended Impala facilities and the cost of the interest rate swaps which have now expired. Non-recurring items were a small negative whereas the 2012 comparable numbers reflect a gain on the annuity transfer transaction. And finally after tax we generated a profit of £207m. And going forward we would expect underlying recurring Phoenix Life operating profits to be in the region of £250m.

Ignis has had a highly successful year, increasing operating profits by 14% to £49m, driven by an improvement in investment performance combined with strong third party net inflows. Net inflows from third parties increased to £1.9bn, the majority of which were into the non-liquidity asset classes, in particular Ignis' Absolute Return Government Bond Fund or ARGBF for short.

Third party assets have grown to 22% of group assets under management and are on a significantly higher fee basis than the current life company assets.

We have continued to see significant net inflows into ARGBF in the early part of 2014 contributing to over £1bn of net new third party assets year to date, excluding liquidity. This continued success provides Ignis with a strong platform going into 2014.

Moving on to group capital. The IGD is currently the banking group solvency calculation, but our IGD position remains robust and continues to be relatively insensitive to market movements. At 31st December 2013 the IGD surplus in headroom were £1.2bn and £0.5bn respectively. The surplus was flat over 2013 with capital generation and management actions offsetting the payment of shareholder dividends, bank debt repayments and other outgoings at the holding companies. However our headroom over capital policy increased

slightly from 2012 to £0.5bn helped by the completion of the transfer of the annuity portfolio to Guardian.

In terms of the divestment impact - we have agreed a debt prepayment which minimises the impact on the IGD position and therefore expect to maintain a robust IGD surplus on headroom post-completion of the Ignis transaction.

Any now turning to look at the Pillar 2 position. The PLHL ICA remains strong with £1.2bn of surplus and £1.1bn of headroom above our capital policy. During 2013 the surplus position improved by £0.4bn. This includes £0.9bn of improvements in the capital position, both within the life company free surplus, which I mentioned earlier, and in respect of the pension scheme derisking which has allowed capital to be released. This was offset by £0.5bn of external payments at the holding companies in respect of bank debt, the Tier 1 coupon and shareholder dividends.

The divestment of Ignis and subsequent debt repayment is expected to reduce the PLHL ICA surplus by £0.1bn, representing the difference between the net proceeds and the current value of Ignis within the PLHL ICA, offset by the debt prepayment. The position remains relatively insensitive to market movements.

In terms of Solvency II as you would expect we are working with the PRA during the pre-application period of our internal model and expect to make an application to the PRA in due course. We currently anticipate the solvency position of the Group to be largely unchanged provided the Solvency II regulations operate as we expect. We also expect the group solvency will continue to be measured at PLHL under the new regime.

Turning to dividends we have proposed a 2013 final dividend of 26.7p per share giving a total dividend per share of 53.4p per share, supported by the strong financial performance and outlook for the Group.

As Clive mentioned earlier we have today provided new cashflow targets to take into account the extension of the maturity of the Impala facility. Having already met £2.3bn of the original 2011 to 2016 target of £3.5bn we have set ourselves a new goal to achieve £2.8bn over the period 2014 to 2019, including the proceeds of the Ignis divestment. The specific target for 2014 is £500m to £550m in addition to the proceeds from the divestment. This new cash target includes an assumption of further management actions over the period. Looking beyond 2019 there is still at least £3.6bn of potential cash flow that will be released over time, demonstrating the long term cash generation of the Group.

Moving on to look at the cash inflows and outflows on an annual basis we set out here the average sources and uses of cash over the six year period to 2019. This is a slide we presented at our investor day last year which we have refreshed to take into account the new targets set today. The green bar in the centre of £470m represents the average annual cash receipts we expect at the holding companies from 2014 to 2019 based on our new six year target of £2.8bn. And to the left we show the various uses of that cash. £35m of operating expenses, £55m of pension scheme contributions, average debt servicing costs of around £90m and finally £160m of average debt repayments, this includes the remaining annual target and mandatory amortisation of Impala and Pearl, including the £300m Pearl bullet, in the six years to 2019.

After these uses of cash we are left with an average of £130m for dividends which currently cost £120m, additional debt repayments and reinvestment. This is of course in addition to the £1bn of cash which we're currently holding as a buffer in the holding companies.

Given the recent budget proposals on annuities I wanted to speak for a few minutes about how we see this impacting Phoenix. The only new business we write is annuities which we offer to our existing pension policyholders when they reach retirement. In 2013 we wrote almost £800m of annuities of which almost two thirds have guaranteed annuity rates. The policies with guarantees provide attractive rates to policyholders. They typically pay twice the standard rate, for example, currently a 65 year old male typically receives an 11% annuity. And so we do not believe the recent budget proposals are likely to have a material impact on this component of our annuity business. This is particularly the case if the proposals around free guidance for policyholders are implemented, as we believe policyholders will continue to make rational financial decisions and will choose to take up those valuable rates rather than seek an alternative product.

Even for those customers who do not have guarantees, we believe lifelong certainty of income provided by an annuity will mean these products will continue to provide an attractive retirement option for some policyholders. In terms of the financial metrics relevant for our investing annuity business an IFRS of operating profits in 2013 included £36m from new business written in the year. Of that £20m was from policies with guaranteed rates and the remaining £16m was non-guaranteed business representing less than 5% of our operating profits.

On MCEV we included the expected future value from guaranteed annuities within the Group MCEV, on the basis that we expect policyholders to take up the valuable rates. The value of this was £191m at the end of 2013 which we do not believe is at risk for the reasons I've already mentioned. However, we fully reserve for policies with guarantees, and so to the extent fewer policyholders choose to take up their guaranteed rates than we expect there is the potential for positive experience variances to benefit the MCEV in future.

On the non-guaranteed annuities we don't make any assumptions around the proportion who will choose to take an annuity in the future as this is less certain, and so we recognise this as new business each year in the MCEV. In 2013 the contribution to MCEV post tax operating profits from writing non-guaranteed annuities was £18m.

And finally, we do not believe the financial targets that we have said today will be materially impacted by any of the budget proposals. I'd now like to hand you back to Clive.

Clive Bannister

Jim, thank you. Just in case you hadn't been listening it's my job to recap and we set out here today our new targets for 2014 and beyond.

Long term cash generation targets from 2014 to 2019 of £2.8bn, including the proceeds from the divestment of Ignis. 2014 cash generation of £500m to £550m in addition to the Ignis sale proceeds, £300 of incremental MCEV between 2014 and 2017. And we have reiterated our gearing target of 40% for completeness which we expect to achieve through the divestment of Ignis and the subsequent debt prepayment. Our aim is to maintain or improve on that gearing position in the future.

I return to the four messages I set out at the start of this morning's presentation. First, we have delivered a very strong set of results for the year 2013. Second, we have announced the divestment of Ignis bringing compelling financial benefits and allowing us to harness the potential future asset management value from M&A opportunities through the commencement of our strategic alliance with Standard Life. Third, we have announced new financial targets for 2014 and beyond as we look to generate value through the efficient and effective management of our existing closed life funds. And then finally fourth, we believe

that collectively these factors strengthen our position as we pursue the value accretive M&A opportunities.

I'd now like to hand you back to Howard for the Q&A. Howard.

Howard Davies

Thank you, Clive. Well as I warned at the beginning there's quite a lot of material that we've presented this morning, we hope it's comprehensible to you but no doubt there'll be some questions. But before we begin the session I just have one other point to draw to your attention that we also announced this morning, that Mike Merrick, the Phoenix Life Chief Executive, will retire at the end of June. We conducted an extensive search internally and externally and we're delighted to announce he'll be exceeded by Andy Moss who is on the front row here who is currently the Finance Director of Phoenix Life.

Mike has been Chief Executive since 2009, having joined Britannic, one of the component parts of the Group back in 2000, and under his leadership Phoenix Life has delivered a constant stream of management actions, as you will have seen, and operational improvements which have brought substantial cash generation to the Group, but also many improvements in the returns and the service for our millions of customers and he will be greatly missed and on behalf of myself and all of my Phoenix colleagues we'd like to wish him a happy retirement, the length of which we hope will be entirely consistent with our mortality assumptions.

Now we move on to the Q&A, if you could wait for the microphone and then let us know your name and institution, so we'll take questions from the room first and then we may have some that emerge online. So over to you.

<u>Question and Answer Session</u>

<u>Question 1</u>

Andy Sinclair, Bank of America, Merrill Lynch

Good morning, it's Andy Sinclair from Bank of America, Merrill Lynch. I just wanted to ask a couple of questions, firstly on the Standard Life tie-up and then one other. So firstly on the synergy sharing arrangement, I just wondered if you'd tell us a bit more about this. Firstly why payments from SLI are being made to Impala rather than to Phoenix on an annual basis.

And just secondly if you could give us any details on charge limits and what the charge levels will be for the fund management.

And the third question effectively, on the annuity market impacts with the changes in the Budget, what do you think that will mean for effectively the back book markets, do you think that there is going to be some of your competitors that are changing business model, there might be more competition in that part of the market and equally if there's going to be more capital to be deployed if people aren't using that for annuities.

Answer: Clive Bannister

Andy, I'm going to do that in reverse order, so let me just take the annuities. First of all as Jim has explained we regard the consequences of the budget on our business as more of a

tremor than an earthquake, as Jim explained the impact of the annuity changes, even if all of the annuitants are non-guaranteed but not to take up their vesting annuities, that would have less than a 3.5% impact on our current IFRS profitability. So in the context of this business the annuity changes as I say, are shaken but not stirred.

In terms of the industrial landscape for insurance, clearly this will have an effect, it's been overstated the demise of annuities, they will have a role to play in people's financial planning as they go forward to retirement, but it will clearly change. If you remove a source of income from an insurance company, which annuities clearly are for many insurance companies, then that will challenge the management of those insurance companies to think about how they are applying their capital, and that may lead them to reach a conclusion that those books of business may be closed. Our primary purpose in life is to manage and to consolidate closed life businesses so we believe that possible changes going forward as I said in the industrial landscape of insurance will provide us with opportunities.

So that's what I would say to the second part of your question, the first part of your question was to do with our synergy sharing agreement with Standard Life. Our Standard Life strategic alliance has two components. The first component is that they will be managing the lifeco funds for a ten year basis and that's immensely important for us and our policy holders. Their remarkably good investment performance will be augmented and added to by the talent that they are receiving from Ignis, which as we described, has had a remarkably good year. So that's one part of the strategic alliance.

The second part that you referred to was the synergy sharing arrangement. That is in two five year bits, so it's five years and then five years optionality and at both sides. And how it works is that, I was going to say if, but when we do a closed life transaction, if those assets are managed by Standard Life and for the duration that they are managed we will get a 15% or 20% of the gross revenues generated from those assets managed by Standard Life. The difference between 15% and 20% is if it's less than £5bn transferred it's 15% and if it's more than £5bn of assets it's 20%. So that is how I would answer your question. And then there was a question about Impala.

Answer: Jim McConville

Yes, so the question was why do the synergy sharing fees go to Impala Holdings Ltd. Impala Holdings Ltd is a subsidiary of the Group and the Ignis company was held within the Impala silo, so from a Group perspective it's the natural place for those funds to be received.

<u>Question 2</u>

James Taylor, USS

James Taylor from USS. Just to clarify something, I know you've got these very high guaranteed annuities of 11% but if people didn't take those up, just to clarify, would the reserve release be larger than the £191m currently in the MCEV, i.e. would the MCEV net go up, or would the £191m in there for future vesting, which would evaporate, would that mean the MCEV went down?

Answer: Jim McConville

I think Mike can deal with the detail. But certainly these policies are fully reserved, and if the policyholder decided not to take up his annuity option there would be a release of reserve. So, you are correct in that statement, James.

In terms of the context relative to the MCEV, Mike?

Mike Merrick, Chief Executive, Phoenix Life

I would just say first that we will be working quite hard to make sure that our policyholders recognise the value of these guarantees. A guarantee that effectively doubles your money is not one that should be given up very lightly. And therefore we would not expect to see the guarantees do anything other than come into payment for customers.

But we think the release of reserves would have an effect on the EV which would be less than the value that you see on the balance sheet. So the EV would reduce if guarantees come into payment. And it would be in the order of half of the number that you see on the slide.

Question 3

Ashik Musaddi, JP Morgan

Just a couple of questions. First of all on your external debt can you give us some clarity? I mean reducing prepayment of external debt how does that help in doing M&A in the future? Is it from the regulatory discussion perspective that regulators will have a better discussion with the regulators to do M&A? Or is it that you may look to go into the capital market to raise debt to do M&A? So how should we think about that? That's the first one.

Secondly, on slide 27 you have given a waterfall of the cashflows. Within that there is £160m annual debt repayment. Does that annual debt repayment include the £250m that is expected to be paid from Ignis proceeds? So, how should we think about that because it looks like the £250m, there's £160m that is there in that slide is just the planned amortisation?

Answer: Clive Bannister

So, the question, Ashik, which you partly answered yourself, which is how does reducing our leverage make us more compelling or more effective in doing transactions going forward, I think there are three answers. You also asked whether the regulators had any involvement in this. No, this is a deal that has been struck principally and primarily because it fulfils our strategic logic of being the UK's leading closed life consolidator.

The way in which deleverage helps and makes us more credible as a counterparty is threefold. First of all there is the self-evident strengthening of our entire balance sheet. The second is it provides us with more cash resources. And, fourth and finally, I think it also acts as a signal for policyholder stability in terms of our whole enterprise stability which makes us more attractive as a counterparty. So those would be the three reasons I would give.

Jim, you may wish to go into the second part of that question.

Answer: Jim McConville

The £160m you referred to on slide 27 is the average over the period to 2019. And if we make the £250m prepayment that would reduce that amount.

Question 4

Barry Cornes, Panmure Gordon

Just one question. Could you give a bit more colour on the sale process of Ignis and perhaps comment on competition for the business please?

Answer: Clive Bannister

Thank you very much. We received an unsolicited approach just before Christmas from Standard Life, which after discussions convinced us there was a compelling proposition – because as I said a few minutes ago, it has allowed us to pursue our stated strategy of being the UK's leading consolidator. So that was the mechanical process.

The Board considered very carefully the alternative ways of completing the transaction. And they came for three positive reasons the idea of going an exclusive with Standard Life: The first was the nature of a price consideration at £390m of cash; the second is that we are extremely convinced by our new partnership and the strategic alliance that we have with the synergy sharing, so we retain all the benefits in any future M&A transaction to have in effect a carry from the synergies that would be derived from asset management. And the third is we believe they are a very able asset management firm; very compelling again with regards to our policyholders and looking after their outcomes. Those are the three positive reasons.

The negative reasons which are equally powerful for not going into a broader process, which is I think behind your point, is that actually I don't think we would have done our shareholders any favours whatsoever. This is an asset which is wholly dependent upon human capital. We've seen other transactions which have taken an attenuated period, that destabilises individuals and importantly it destabilises the third party assets which Chris and his colleagues have so successfully generated. So we are very happy to be into a contractual arrangement and head towards completion. As we said, we are seeking to do that before the end of the first half of this year.

<u>Question 5</u>

Oliver Steele, Deutsche Bank

Three questions. The first is going back to that slide 27. I see that leaves you with £130m a year available for dividend or extra debt pay down. Dividend cost is £120m; does that mean you are effectively capped at £130m of dividend pay out over the next six years, unless you can do deals or unless you can find extra management actions?

Question two is: it still looks like your IGD headroom is the binding constraint at half a billion pounds; what could you do to improve that?

Question three is: are there any funds within SLI that could enable you to reduce your capital requirement or improve your solvency, perhaps more specifically, or improve your MCEV if you were to be invested in this?

Answer: Clive Bannister

Oliver, thank you very much indeed. I think what you've just eluded to is an avenue – so your question was whether we have thought about things that we could do with Standard Life related to types of funds and capital and so on. That is an avenue for thought which we have not yet entertained. But that may be one of the benefits of working more closely with Standard Life.

Answer: Jim McConville

So turning to slide 27. So you're right to say that the dividend, as you know, has a ratchet mechanism within it. But this slide shows that we have an average of £130m per annum left to source the dividend and other matters. There are a number of things to make relevant here. First of all our track record in the past of delivery of management actions and delivery of our targets we have I think we have a very good track record of over-delivering against our targets. And whilst we have included some management actions in setting our cash targets, we believe we've included them on a prudent basis and we will be doing our very best to outperform those targets.

Secondly, once we pay down the £250m prepayment we'd expect the interest costs to fall by roughly £10m per annum, so that will further increase the headroom that you see in that slide.

And thirdly, as we develop our strategy and diversify away from senior bank debt we'd expect to see some bond debt which would be non-amortising in the future, which again would further reduce the cash outflows.

Clive Bannister

Oliver, you had a second question which was about IGD. It remains our biting constraint, and we are working at management actions to allow us to give us more headroom over our capital policies.

Jim McConville

When you look at management actions, Oliver, we look against the basket of different measures that we have to work within; and IGD is clearly one of them. So we are very mindful of seeking to identify those management actions which will improve the position.

<u>Question 6</u>

Ming Zhu, Canaccord

Two questions please. Previously you mentioned you see £200bn opportunities in the UK closed life market. Now post the budget 2014 do you expect this number to change going forward?

Also previously one of your criteria in the M&A was to lower gearing, and now your gearing level is at 39% proforma Ignis. Is there any gearing target in terms of future M&A?

Clive Bannister

Ming, you're absolutely correct, we said last year that we thought that the UK market had £200bn worth of closed life business. There were three owners of that type of business, they were either UK banks, UK insurance companies or foreign insurance companies operating in the UK. We think that we have seen already movement in the marketplace in terms of people thinking about transactions, and vendors may be motivated by the concept of tracked capital, the cost of administration and of course regulatory scrutiny and oversight which gets ever more complex. So those vendors are motivated I believe already.

And then your question is whether the events of last week will create more opportunity. And I think they will. I think that the industrial structure of the insurance industry, as I said a few minutes ago, is going to change. Annuities will not carry on going forward providing the revenue to the people who have been providers. We do not write open market annuities, we write vesting annuities. For those players who no longer have that source of income they will be looking at those books of business and the capital committed, and they may choose to close those businesses. We are in the business of closed life consolidation.

So a yes with a degree of caution because we still don't know how the events in 2014 will play out.

Howard Davies

I think it's right. I think that directionally is very likely to be correct. We are still in week one of the post budget announcement, and I think a lot of companies are thinking hard about what kind of products they're going to need in the future, where they will be written. And I think we're wise to sit and watch how that process pans out before we conclude very firmly about the size of the opportunity, of the increased opportunity.

Jim McConville

Your question was why have we left the target at 40% basically. Obviously the transaction has yet to complete; so it's only once we receive the regulatory approval that we'd know we were definitely down below that 40%. So, we thought it best just to leave the target as stated before the transaction completes. We've always said that we expect our business to be able to operate with a higher level of gearing than those businesses which are open to new business; because of the more predictability of our cash flows we still believe that is the case. And we would expect our gearing to reduce further; but our long-term gearing range is probably in the mid-30s I would say.

<u>Question 7</u>

Rupert Harcus, Guy Butler

You can correct me if I'm wrong, but I thought that you were trying to target an investment grade credit rating by 2016. So as a result of the transaction – I accept it hasn't completed yet – can you bring forward that target to mid-2014?

As a second question, you eluded to the fact that you'd like to move away from a model in which a large proportion of your borrowings are bank debt, perhaps towards bonds. I accept you perhaps can't talk about exactly what you plan to do, but if you could give a broad brush view of what financing you might be doing. I note there are a number of your assurance peer group, London Victoria, Lloyds, Royal London, have refinanced perpetual Tier 1s in recent times with long-dated lower Tier 2s, 30-year notes; and I just wondered if that was something that would be on the horizon for Phoenix with regard to your Tier 1 instrument?

Jim McConville

You're right to say we've said in the past that our ambition is to reduce the level of gearing. That has been one of the key priorities that the company and the Board have agreed. We have, and we have said getting to a target of 40% was consistent in terms of getting us to the range of gearing that the rating agencies would find acceptable for investment grade. So

that obviously, as you know, is only one of the factors that rating agencies look at but is an important metric that they do look at.

So the achievement of the 40% two years earlier, you're right in saying, probably brings forward the point at which that element of the rating agency consideration is met, and it means that we can start discussions probably with the rating agencies sooner rather than later. Now, these things take time so I wouldn't like you to read into that that we'll definitely get a rating this year, but we're in the range of gearing where it makes sense for us to start thinking seriously about going for that investment grade rating.

In terms of the bank of the debt structure, we're very heavily obviously dominated by bank debt, and it's our ambition to achieve a more diversified debt structure, and that would be used, as I referred earlier, to probably some bond type instruments. In terms of the Tier 1 instruments, they're obviously regulated capital instruments so it would be not be right for me to state what we are going to do with these in terms of the call when that comes up, but we're very aware of our market expectations in relation to those instruments and we will deal with those instruments as and when the time arises.

Question 8

Marcus Barnard, Oriel Securities

Can I just get some clarity on the phrase you used underlying the current Phoenix Life operating profit expected to be in the region of £250m. I'm assuming that's the sort of spread and fee based income from the books and that excludes capital releases. Maybe can you illustrate what that would have been in 2013 and 2012, because also when I try and square it with the organic cash flows you show on Slide 17 obviously they are post-tax and include some element of capital release. I just wondered if you could put some figures around that to help us modelling going forward? Thank you.

Answer: Jim McConville

The operating profit is £250m per annum. They exclude economic variances and the like, so they assume the normalised return for the business. The cash releases, as you say, also include that element of the release that would come from capital surplus arising from business as it matures. So you're right in what you say, Marcus.

Marcus Barnard

((1:02:10.4?)) inaudible

Jim McConville

In terms of the cash generation?

Marcus Barnard

The difference between the ((1:02:14.4?)) inaudible

Jim McConville

Yes.

Marcus Barnard

((1:02:17.2?)) Guardian ((1:02:21.1?))) inaudible

Jim McConville

In terms of IFRS operating profits, I think going back in time prior to the Guardian transaction it was probably nearer £300m than £250m.

Question 9

Kieran Singh, Keefe, Bruyette & Woods

Their webcast question is, what is the duration of the IMAs with Ignis and how would this change this acquisition?

Their second question is, are there any break fees on the IMAs that you will need to pay after that acquisition?

Their third question is, does the LDI capability of Phoenix sit in the life company or with Ignis, and will this be transferred to SLI as part of the arrangement?

Answer: Clive Bannister

Sorry, I heard the first two questions, you'll have to repeat the third I'm afraid. We are in a 10 year arrangement in terms of Standard Life looking after our asset management. We have rolling 3 year IMAs and so they roll, they don't come to an abrupt end. And there is no change in the fee proposals as they currently exist. So in effect actually upon completion Standard Life will inherit the pre-existing IMAs, which are all slightly different according to the asset class that the life company has arranged. And then your second question is, is there a break fee related to changing those IMAs, and the answer is no. If there is an issue there is a restitution process and they will operate as they are currently structured. I didn't understand or I did not hear properly the third part of that question.

Sir Howard Davies

Can you give us the third question again?

Operator

The third question is, does the LDI capability of Phoenix…

Clive Bannister

Does the what, sorry?

Sir Howard Davies

LDI.

Clive Bannister

Carry on.

Operator

... sit with the life company or with Ignis, and will this be transferred to the SLI as part of the arrangement?

Sir Howard Davies

Okay. Does it is sit within Ignis or Phoenix, and will it go to SLI.

Answer: Clive Bannister

The LDI investment management capability sits within Ignis, and that capability will be transferred and is part of a value-add to our friends in Standard Life, it's one of our core capabilities, and as I said this is a talent motivated acquisition by Standard Life and they will be getting that capability.

<u>Question 10</u>

Samir Patel, Lazard Capital Markets

Good morning gentlemen. Just a follow-up on how you are planning to address your capital structure in the future. I know you gave some colour about how you are thinking about towards reaching an investment grade rating maybe next year; but one big theme is how capital structure actually fits in with Solvency II, and what your thoughts are on how you could possibly address Solvency II, and also your migration towards having more bond debt rather than bank debt. If you can elucidate more on that, that would be helpful.

Then on your Tier 1s the Solvency II big debate is whether they would be eligible for Tier 1, which they don't. That moves you onto the debate whether they would be eligible for Tier 2. So there's a big question mark given that your Group structure is quite complicated and you could use Solvency II and its motive for addressing capital structure to address those issues quite forcefully. What are your thoughts on this?

Sir Howard Davies

I'm going to ask Jim to comment, but I think it is fair to say that we all as an industry still await some clarification on the details of Solvency II. Although the broad lines of the deal have been agreed a lot of the detailed implementation measures have not. So with that caveat Jim.

Answer: Jim McConville

Okay. One of the first points I'd make is, as we evolve our debt strategy one of our ambitions is I think to try and simplify the company structure, so very much bear that in mind as the journey goes forward. In terms of the Solvency II requirements, clearly as Howard said some are still being formulated, but we are very mindful of the Solvency II position in determining what is the optimal debt strategy. So you can rest assured we will not do anything that from a Solvency II perspective doesn't make sense.

In terms of the Tier 1 bonds, it is possible we may have to do some internal restructuring in terms of where the Tier 1 bonds sit within the corporate structure to make them Solvency II

compliant, but we've a reasonable understanding of what needs to be done and we don't think it's a material thing to do.

Samir Patel

Just to follow up on that last point, internal restructure would maybe address this issue, but: 1) how would you expect bond holders to agree to this; and 2) would you rule out the possibility that these non-Solvency II compliant Tier 2 ((1:08:51.0? inaudiable)) an exchange offer or a buy-back to a new Tier 2 Solvency II compliant instrument?

Answer: Jim McConville

Well clearly in relation to anything we do do with the Tier 1s we would have to consult with bond holders as you would expect, and that we would do. In relation to the Tier 2, sorry could you repeat your question?

Samir Patel

I was saying what could be a possibility is that if you are intending to issue more bond debt in the future you could issue much more cleaner Solvency II compliant capital, and then as part of that process you address these Tier 1s via exchange or buy-back offer.

Jim McConville

Well that clearly is one option available to us, but I wouldn't like you to read into that that that is a definite thing that we would do, but clearly that's one of the options.

Concluding comments: Sir Howard Davies

One final call to anybody in the room who has thought of anything else? Thank you very much. Can I just end by thanking you all for coming, but also we haven't had any direct questions to Chris Samuel, but this is an opportunity for me to thank him and his colleagues for their cooperation through the sales process. Always very difficult of course when you're engaging in that kind of corporate restructuring, but we are very pleased by cooperation we have had from our colleagues in Ignis. So thanks to Chris, but if you could thank your colleagues on behalf of the Group.

So thank you all for coming and we look forward to reading what you write. Thank you.