2014 Half Year Results

Thursday 21 August 2014

Clive Bannister - Group Chief Executive Officer

Good morning ladies and gentlemen, and welcome to our 2014 interim results presentation. It has been a transformational period for the Group supported by strong financial performance. I am joined today on the podium by Jim McConville, our Group Finance Director, and I'm delighted to introduce for the very first time Andy Moss, the Chief Executive of Phoenix Life.

Given all the activity in the first half, today's presentation may be slightly longer than our usual interim results presentation, so please be patient. And that is the only health warning that you're going to get today!

The first half of 2014 was exceptionally busy for the Phoenix Group. In March we announced the divestment of Ignis Asset Management to Standard Life Investments. This was completed at the start of July. We have also re-engaged with the debt capital markets, successfully raising £300m through the issuance of a seven year senior bond. Finally, we agreed the re-financing of the Group's remaining senior bank and associated debt into a single £900m bank facility. This has reduced gearing and will allow us to simplify the Group's corporate structure. It also supports our ambition to achieve an investment grade rating in the future.

The comprehensive debit refinancing has been achieved alongside strong financial performance, with Phoenix continuing to deliver cash generation and enhanced MCEV through management actions. Also, we have today announced an interim dividend of 26.7p per share, in line with the 2013 interim dividend.

The Ignis divestment had a compelling financial and strategic rationale. It increased our MCEV and allowed a £250m debt repayment. In addition, we have entered into a strategic alliance with Standard Life Investments, which will provide us with additional value if they manage assets that we acquire as a function of a closed life transaction. This ensures that we will benefit from any asset management synergies as we grow our core business. Our future relationship with Standard Life Investments is important. I believe it will be beneficial for both our policyholders and the Phoenix Group shareholders.

We signalled at the year-end results in March our intention to diversify our funding structure via the debt capital markets. Having been too reliant on the banking market, we raised a £300m seven year senior bond in July, allowing us to both extend the maturity of our debt and achieve a lower interest margin than the existing Impala facility. This was highly successful as a return to the debt markets for the Phoenix Group and offers a source of financing for future transactions.

Following the issuance of a senior bond, we were also able to agree a new unsecured single bank facility with a core group of lending banks, including three new banks. We are now well positioned to move to the next stage of Phoenix's development as we seek to lead the consolidation of the UK closed life fund market.

The divestment of Ignis, issuance of a senior bond and refinancing of the bank debt all completed in July, and we were not able to fully reflect these in our results of 30 June. We have therefore shown the impact of these transactions on a pro forma basis. The Ignis divestment had a significant impact on our MCEV, which is now at an all time high of £2.6bn, the equivalent of £11.57p per share. The transactions also resulted in net debt reductions of over £450m.

Our intention is to obtain an investment grade rating in due course. This will allow us access to a deeper and wider pool of investors and finance, and possibly at lower margins. Preparations towards achieving this will commence during the second half of this year.

Jim will go through the details of our capital position in a few minutes. However, in summary, our pro forma capital position remains strong and provides a solid base from which to move forward in our strategy of undertaking further closed life fund acquisitions.

Let's look back a bit in history. In 2009, our focus was to improve our financial position through the delivery of management actions which would allow us to accelerate debt repayments and reduce gearing. This chart illustrates the progress that has been made. MCEV has increased from £1.8bn to £2.6bn, whilst total shareholder debt has reduced from £3.5bn to £1.8bn. As a result, our gearing has fallen over the period by 28 percentage points to 35%. I can confidently say that the historic issues around leverage are now very much in the rear view mirror and Phoenix's financial position has been transformed.

Moving on to 2014, we set ourselves targets against three financial metrics: cash generation; incremental MCEV; and gearing. Our target range for cash generation for 2014 is between £500-£550m. In the first half of 2014 we delivered £332m, this puts us in a strong position to meet our target for the full year. We also made a good start towards our long-term cash delivery target of £2.8bn between 2014 and 2019, and together with the £390m we received from the Ignis divestment completed in July, we have achieved a total of £722m in the first half of this year.

In March, we set ourselves a new target of £300m of MCEV enhancements from management actions from 2014 to 2016, and by the end of June we had delivered £153m, a huge step towards this goal. And last, we have reduced our gearing to 35% on a pro forma basis, surpassing the 40% target 18 months earlier than originally scheduled.

I will now pass you onto Jim who will take you through the new debt structure and our financial results in greater detail.

Jim McConville - Group Finance Director

Thank you very much Clive. Good morning everyone. Over the past few months we have taken significant steps towards implementing our debt strategy. Our strategy involves a reduction in gearing to levels commensurate with achieving investment grade status; the diversification of our debt structure to reduce the reliance on senior bank debt; the smoothing of our maturity profile of our debt to better match cashflows from the business; and lowering the cost of debt.

At the start of last year we raised equity and re-termed the Impala bank debt. This year, through a combination of the divestment of Ignis, the senior bond issue and the bank debt refinancing, we have taken further steps to meet these objectives. In turn this has given us more financial flexibility, making us better placed to pursue our growth strategy.

I have set out on this slide some further detail on the £300m seven year senior bond. The bond was issued by PGH Capital Limited, a new financing subsidiary of Phoenix Group Holdings, from which we intend to issue all future debt. The transaction was over-subscribed, allowing us to price at a coupon of 5.75%, which was at the low end of our target range. We were also delighted to attract a wide range of investors for what was an unrated issue. This strong interest bodes well for the future as we continue to look to diversify our debt structure and undertake acquisitions.

As you will recall, our old senior bank debt was held in two banking silos, Impala and Pearl, with separate terms and conditions. These complex arrangements encumbered our ability to move cash and capital within the Group, and placed restrictions on dividends and the ability of the Group to acquire. Our new banking arrangement is much more simple. A new unsecured facility, held at PGH Capital, has been provided by a group of nine relationship banks, three of which are new to the Group. The facility ranks pari passu with the senior bond issue.

This new £900m facility, consisting of a term loan facility of £450m and a revolving credit facility of a further £450m, is at a margin of 350 basis points above Libor, cheaper than the re-termed Impala facility agreed at the start of 2013. In addition, the associated debt repayment of £206m also lowered the overall gearing of the Group and supports our ambition to achieve an investment grade rating.

At 31 December we had bank debt totalling £1.5bn held in the Impala and Pearl silos. These facilities had annual amortisation payments of £145m, with bullet repayments in 2016 and 2019. In addition, we held PIK notes totalling a further £200m which matured in 2019 and 2024. All of the bank debt and the PIK notes have been repaid and replaced by the new bond and the new facility, which together total £1.2bn.

Together, the new bond and bank debt arrangements smooth and extend the amortisation profile. The £450m term loan facility has an annual amortisation of £120m. The Pearl bullet in 2016 has been removed, and the 2019 bullet under the new facility is lower than the previous Impala bullet. The senior bond matures in 2021. This helps us repay our debt in line with the emergence of cashflows whilst obviously retaining the ability to refinance the bank debt in the debt capital markets.

The Group now benefits from a long-term lower margin debt structure. The average cost of the previous debt structure would have increased significantly as we repaid the cheaper Pearl debt in 2016 and incurred the step-up in coupon on the Impala debt from 2018. As you can see from the slide, the new debt structure is marginally lower cost at the outset, but expected to be considerably cheaper in the future. We will continue to examine options to manage our interest costs lower as we progress towards our aim of an investment grade rating and further diversify our debt structure.

Let me now turn to the first half results. We set out here the key numbers. As Clive mentioned earlier, the divestment of Ignis, the issue of the senior bond, and refinancing of the bank debt all completed in July and were not fully reflected in the results to 30 June. Therefore we have shown the impact of these transactions on a pro forma basis.

Of the £332m of total cash generation during the first half of the year, management actions accounted for £149m. We also received £32m of cash from Ignis, which is in addition to the £390m of consideration received in July. We remain on track to achieve our 2014 cash generation target of between £500m - £550m, and the proceeds of the divestment of Ignis of £390m are of course in addition to this target.

Debt interest costs, which include the Tier 1 coupon, reduced during the period as a result of lower overall debt levels and the expiry of the out-of-the-money interest rate swaps on the bank debt at the end of last year. And on a pro forma basis we have reduced our senior debt by £541m since the end of 2013 to £1.2bn. This includes the £250m pre-payment in respect of the Ignis divestment, £206m pre-payment on drawdown of our new bank facility as previously described, £60m of amortisation on the old Impala facility, and the annual amortisation of £25m on the old Pearl facility.

We paid out £60m in respect of the 2013 final dividend of 26.7p per share, and after all that at 30 June, after allowing for pro forma adjustments, almost £1bn of cash remained at the holding companies.

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 and supports our ability to meet our targets. We started 2014 with £529m of free surplus, and distributed £211m of cash to holding companies during the first six months.

We have included a prudent £0.2bn of strengthening of assumptions related to longevity, credit and correlations during the first half of the year. £379m of free surplus remains as at June, and this supports our cash target for 2014. And in addition to the free surplus held at Phoenix Life, on a pro forma basis we have almost £1bn of cash held at the holding companies.

In the first half of 2014, Phoenix Life operating profit was £256m, which includes £114m from management actions, including: modelling improvements from our new actuarial system, MG-ALFA, allowing policyholders to cash in small annuities-in-payment, and improvements to our modelling to more accurately calculate credit defaults to remove unintended prudence. This rise in operating profits compared with last year reflects the higher level of management actions on an IRFS basis versus 2013.

Below the operating profits line we incurred positive investment variances of £59m.

Non-recurring items include a management action that we undertook in the interests of both policyholders and shareholders, and this was a restructure of the PGL pension scheme longevity arrangements, which I will describe in more detail shortly.

And we incurred £48m of finance costs, down on last year, reflecting the lower debt levels and expiry of the out-of-the-money interest rate swaps, and after tax we generated a profit of £191m.

Now turning to look at MCEV. We set out here the material movements for MCEV over the year. For clarity, we are showing the value generated from management actions separately. So moving from left to right, we generated post-tax operating earnings of £107m, excluding management actions, which reflect expected returns on the life company embedded value at the long term risk-free rate. We delivered £153m of incremental value through a number of management actions that I will discuss in a moment.

On the announcement of the divestment of Ignis in March, we estimated that the impact on MCEV would be an increase of £237m. The impact of the divestment has been reflected partly in the actual results to 30 June, and partly as a pro forma adjustment.

The results to 30 June include the anticipated VAT costs of future investment management expenses now that Ignis is no longer part of the Group, together with the impact on our tax position of the debt repayment and other transaction costs.

The sales proceeds are shown separately as a pro forma adjustment. Together they total £238m, similar to that previously reported.

The negative impact of regulatory actions during the first half of the year have been provided for. These are £40m for the anticipated reduction of future profits with regard to the cap on workplace pension charges, and £17m impact for a reduction in the take-up rate assumption for guaranteed rate annuities following the pension reforms announced in the Budget.

Below the line economic variances, non-recurring and other items totalled negative £52m, primarily reflecting the differences between the short and long term rate assumptions and other market movements.

The increase in market value of the Tier 1 and Tier 2 bonds during the first half of the year has reduced MCEV by £45m, and finally we incurred finance costs, including the Tier 1 coupon, of £62m and paid dividends of £60m.

At the end of June, the Group MCEV was £2.3bn, representing MCEV per share of £10.35, and on a pro forma basis, MCEV has increased by £0.3bn to £2.6bn, representing MCEV per share of £11.57.

As well as accelerating cash generation from management actions, we have also successfully added incremental MCEV. We set ourselves a target of achieving £300m of incremental MCEV over the three-year period from 2014 to 2016. I am delighted to announce that only six months into the target period we have achieved a total of £153m of incremental value, halfway towards our overall target.

This good performance is testament to the work undertaken by Phoenix Life and includes: a restructuring of the longevity risk within the PGL pension scheme, which included a buy-out of an existing longevity indemnity provided by a certain Group with-profit funds, and a longevity swap between the scheme and Phoenix Life Limited; improvements from the standardisation of processes across funds as a result of moving to our newly developed MG-ALFA actuarial model; and improvements to our modelling to more accurately calculate credit defaults and remove unintended prudence.

Moving on to capital. As a reminder, we look at group solvency on two bases; IGD, which is a Pillar 1 assessment of the Group's capital resources and requirements, and PLHL ICA, which is a Pillar 2 assessment. The IGD is currently the Group's biting solvency calculation.

The surplus at 30 June increased slightly to £1.3bn during the first six months of 2014, due to the benefit of management actions, IAS19 pension scheme revaluations, and the sale of BA(GI), partially offset by the payment of shareholder dividends, bank debt repayments, and other outgoings from the holding companies. Our headroom over capital policy increased to £0.6bn.

Both the IGD surplus and the headroom are reduced by £0.2bn on a pro forma basis, primarily resulting from the additional debt repayment on drawdown of the new bank facility. Therefore, at 30 June, on a pro forma basis, for the divestment of Ignis, the bond issue, the senior debt refinancing and associated debt prepayments, the IGD surplus and headroom were £1.1bn and £0.4bn respectively.

Finally, the position remains relatively insensitive to market conditions.

I'm now turning to look at the Pillar 2 position. The reduction in the period since the year-end primarily reflects the £0.2bn strengthening of assumptions related to longevity, credit and correlations. Taking into account the Ignis divestment and bank refinancing, there is a further reduction of £0.3bn on a pro forma basis. However, the PLHL ICA position remains strong, with £0.7bn of surplus and £0.6bn of headroom above our capital policy as at 30 June on a pro forma basis.

The UK industry is still awaiting clarification from regulatory authorities on the specific details in relation to the implementation of Solvency II. However, provided that the regulations are in line with our expectations, and subject to regulatory approval, it is Phoenix's view that the capital position of the Group will remain broadly aligned to the PLHL ICA surplus.

And moving on to look at the cash inflows and outflows over time. We set out here the illustrative sources and uses of cash over the five and a half year period to 2019. This is an adaptation of a slide we presented at our 2013 full year results announced in March, which we have refreshed to take into account the debt refinancing.

We begin with our current cash at the holding company level of £1.0bn today. The green bar to the right of this, of £2.1bn, represents the remaining cash generation to emerge over 2014 to 2019 based on our existing six year target of £2.8bn.

And continuing to the right, we show the various uses of that cash over the same six-year period: £0.2bn of operating expenses; £0.3bn of pension scheme contributions; estimated debt servicing costs of around £0.4bn, assuming a 5% average interest cost; and expected debt repayment of £0.5bn representing the repayment of the new term facility; and finally, £0.7bn to fund an illustrative stable level of dividends at the current cost of £120m per annum. After these uses of cash we are left with an illustrative £1.1bn of cash at the holding companies, £0.1bn higher than at the outset.

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

We expect there to be around £3.3bn of capital still to be released as cash to the holding companies after 2019, as further illustrated in Appendix 9. This is represented by the green bar and takes into account the revised assumptions with regard to the take-up rates on both GAR and non-GAR annuities.

Known uses of this cash include £0.1bn of remaining pension scheme contributions, and £1.4bn of outstanding shareholding borrowings. This leaves an estimated £2.9bn of cash at the holding companies available to fund interest costs, expenses and dividends.

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

Following the conclusion of the divestment of Ignis and our comprehensive debt refinancing, we are now positioned to concentrate on our core business of managing and consolidating closed life businesses.

I will now hand over to Andy Moss, Phoenix Life Chief Executive, who will take you through the Phoenix Life business model in more detail.

Andy Moss – Phoenix Life Chief Executive

Thank you Jim and good morning everyone. I thought it would be worthwhile starting with a high level overview of Phoenix Life.

Phoenix Life as it is today has its history in over 100 original life companies. Over the past few years we have focused on further reducing the number of life companies to produce value and security for policyholders and shareholders alike. We now have just four life companies: three UK and one Irish – reducing from ten at the start of 2009. Within these there are 15 separate with-profit funds and over five million policyholders.

As I will discuss shortly, our aim continues to be to ensure that the £57bn of assets are managed effectively and securely in order to maximise policyholder and shareholder value. This we call "The Phoenix Way".

A key part of The Phoenix Way is our operating model. Within this we use outsourcers to leverage scale and to enable us to invest and benefit from modern and scalable platforms and processes. We then have additional in-house expertise in respect of financial and risk management.

The Phoenix Way is our solution to the challenge of increasing value for policyholders and shareholders, and for providing security and high levels of service to our customers.

The four boxes on the right represent the categories in which we place all of our activity and this framework enables us to deliver in a complex and highly regulated environment.

This framework also enables us to deliver management actions to increase value and cashflows. And as Jim has shown, we have a long track record of doing this. Clearly there is always concern that there is not an endless supply of management actions. However, we still have many actions on our to-do list, including further funds mergers; seeking new asset classes to enhance our risk adjusted returns; with profit run-off actions; and addressing legacy issues. Thus there do remain opportunities to continue to drive value out of the existing business without a further acquisition.

Moving away from shareholder benefits it is important to remember that a huge part of Phoenix Life is dedicated to our customers. Our aim is to ensure delivery of the product promises made and to provide high levels of security and service; and also to try and ensure that customers are getting the most from their policies. To help this we regularly and proactively review the historic product suite and look for opportunities to help our customers make the most of their products.

As an example: we were the first insurer to offer customers the opportunity to commute small annuities-in-payment to a cash lump sum. These types of initiatives add value to customers and shareholders alike.

A key challenge for us in the management of the with-profit funds is their orderly rundown, and ensuring that cohorts of policyholders get the maximum value they can. Thus distributing the estate so that all policyholders benefit is a key measure to us. We are also proactive in trying to reunite customers with policies that they have forgotten about – an issue for the whole of the industry.

The right-hand side of the slide sets out some of the key customer metrics and indicators that we track against. The targets take into account benchmarks that we see externally. For the year to date we are inside all of the targets; but nevertheless we continue to seek ways to improve and ensure these levels are maintained.

One of the big challenges for closed book consolidators is to have in place an operating model that is scalable both upwards and downwards. The table shows that we've been successful in being able to rundown our cost base in line with the policy of run-off. This is partly due to our use of outsourcers, who have the scale, common processes and platforms to provide a per policy charging structure. In addition these contracts are written on a long-term basis, which allows for long-term investment from our partners, whilst our in-house oversight expertise enables us to manage the outsourcers and limit the risks to Phoenix.

Furthermore we have also undertaken a number of initiatives to reduce our retained cost base. Most notably we have simplified our legacy actuarial modelling platforms, reducing costs and improving the management of risk within the business.

All of this demonstrates cost efficiency. But the development of our operating model means that it is also scalable upwards, and would allow us to on-board further closed funds in an efficient manner using the existing internal and external resources that we already have in place.

There have been a number of recent regulatory announcements, perfectly timed with my appointment in my new role, that will have major impacts on the UK life industry and that I wanted to briefly cover.

Firstly, there was the Budget where it was announced that compulsory annuitisation would be scrapped in 2015 and that the total value of a pension could be taken in cash. Annuities are the only new businesses that we write within Phoenix, and we only do so for own vesting pension policyholders.

In the first half of 2014 we wrote £284m worth of annuities, over two thirds on guaranteed rates. These policies provide attractive rates for customers, often twice the standard rate at about 11%.

Under the new arrangements we expect that the vast majority of guaranteed business for higher value pension pots will continue to be written given the attractive nature of the rates. However, we do expect an increase in cash being taken for lower value pension pots. Whilst it's still too early to draw firm conclusions we have assumed a 20% across the board fall in take-up rates, which has impacted MCEV by £17m.

With regard to non-guaranteed annuities again it is still too early to ascertain long term behaviour, though volumes written in the first half of 2014 were down 50% on the same period a year earlier as policyholders either commuted small pots or deferred making decisions with regards to their pensions.

Our longer-term expectation for planning purposes is that the across the board take-up rates will fall by two thirds. Our first half MCEV contribution from writing these annuities was £7m compared to £10m in the first half of 2013.

We are currently looking at offering alternative products to our customer base to meet either investment needs or long term income needs. We are well placed with existing partnership arrangements which can offer our customers alternative products, but we are also exploring the opportunity to widen that with additional products and/or partners.

With regards to the workplace pensions cap of 75 bps on new auto-enrolment pensions this is not a market that Phoenix is actively engaged in. However we have assessed the impact of applying the cap to our historic workplace pension schemes should they wish to use them as qualifying schemes. This has an impact of £40m on MCEV and full provision for this has been taken in our half-year numbers.

Therefore these two key changes do not have a significant financial impact on Phoenix. However, they do represent a key change for our policyholder base and we will be focusing on assisting our customers to understand the changes and the new options available to them.

The FCA's thematic review on the treatment of legacy customers has commenced with initial data gathering. We are comforted by the FCA's clarification that the review will not consider the suitability of historic advice, nor will it require a review of individual policies. The FCA has confirmed the scope of the review as looking at: the firm's back book strategy; the performance of back book products and governance around asset management; allocation of expenses to the back book; customer communication; and the level of exit charges.

Given our closed book nature we can demonstrate a strong focus on our back book strategy and do not have the same conflicts around expenses that an open book would have. We can also demonstrate ongoing governance of our products and consideration of poor customer outcomes. For example, trivialising small annuity pots and reminding customers proactively of their benefits. We expect that the review will conclude in the first half of 2015. Overall we believe we are well positioned for the review and look forward to further best practice ideas emerging.

Whilst the industry enters a period of significant and rapid change with Solvency II and the new customer initiatives, Phoenix Life continues to deliver strongly in all areas, and is well-positioned to assimilate future acquisitions and respond to the changes foreseen.

I look forward to talking more about these at our Investor Day in November. In the meantime I will hand back to Clive.

Clive Bannister

Thank you. We are now going to the final furlong.

I'm delighted that we have made such good progress towards our financial targets for 2014. As a reminder I set them out here.

We are on track to meet both our cashflow targets, annual and longer term. We are very confident about our ability to achieve our incremental target of £300m of incremental MCEV in three years to the end of 2016. And we have achieved our target to reduce our gearing to 40% or better 18 months ahead of schedule. Going forward, we will manage our leverage, as Jim has said, to a level consistent with our ambition to achieve and maintain an investment grade rating.

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

Given the long-term run-off nature of the Group's business the Board believes it is prudent to maintain a stable, sustainable dividend whilst we build financial flexibility to execute our growth strategy, and we will keep the dividend under review.

To conclude: Phoenix's business model is about generating predictable cashflows over the long term. We have consistently met or exceeded our targets and furthermore enhanced the value of the business as measured by MCEV.

Our balance sheet has been transformed, with total debt repayments since 2009 of £1.7bn. This has allowed us to re-establish our relationship with the debt capital markets and has culminated in the achievement of a single bank silo, which brings both financial and structural benefits to the entire Group.

Altogether these actions will help the Group to deliver further simplification of the business as well as facilitate its strategy of creating a significant value through further M&A.

We believe that the achievements of the past three years have now positioned us to be at the forefront of the next wave of consolidation in the UK closed life fund market.

Finally, as Andy said a few minutes ago, we will be hosting an Investor Day later this year on 25 November, and we very much look forward to seeing you there.

Let's move on to Q&A. That brings us to the end of the formal presentation. Thank you for your engagement.

<u>Question 1</u>

Jon Hocking – Morgan Stanley

I've got three questions please.

Firstly, on the credit comments that Jim made. You seem to be releasing excess prudence from the default assumptions on an IFRS basis, but adding to them on an ICA basis. I just wonder if you could clarify what's going on there, please.

Second question: You mention asset re-risking; I think Andy mentioned asset re-risking as a potential opportunity. I just wondered whether you felt you had sufficient ICA surplus to execute that asset re-risking at the moment; or is that something that is going to come down the track?

Final question just on the investment grade rating: Do you think you've achieved enough in terms of the balance sheet to get that now or are you going to have to make further progress in terms of improving maybe the quality of capital before you get the investment grade rating?

Clive Bannister

Can I answer the investment grade rating, and then Jim will you do the asset re-risking and our ICA surplus? And then the first part of the question was about credit and the default assumptions. So, we'll do it in reverse order.

Getting an investment grade rating is immensely important to this Group, and that is why we make it a clear target. The reason for that is self-evident: it allows us access to a wider pool of investors. There are only a certain number of investors could buy unrated paper; a wider pool can buy rated paper. It will give us access we believe to cheaper debt. We know it will reduce the cost of our senior debt by 50bps because that is what we have agreed in the senior facilities.

It will also give us longer maturities, access to longer maturities. And clearly gives us flexibility as we go into a Solvency II world; we don't know what the regulatory capital environment will look like fully, but we want regulatory capital friendly debt issuance and longer term maturities – and that is what we will be more able to get to when we get to an investment grade rating.

Your question is: is 35% a good enough leverage or do we have to go lower. There is both art and science in getting an investment grade, and you can decide in your mind which is the more important, the art or the science. The science is that we believe that there is a range, and a number of 35% leverage puts us entirely and comfortably in that range. But the rating agencies, of which there are three, have different ways of approaching things, and when I was much younger it was just the maths; now it is much more than the maths: it's enterprise risk; it is the quality of the management; it's governance, the way in which we run ourselves. It is our ambition to engage with the rating agencies shortly, and I think we have a target of trying to make the achievement of getting an investment grade rating in the first half of next year.

This is a journey. There isn't the certainty of outcome that you can ever predict; but it is a journey that we are better positioned for than ever before. And in answer to your question, 35% appears to be absolutely in the zone, which makes it very possible.

Jim, is there any more on that?

Jim McConville

No, I think that's covered it.

So, ICA. Your question, Jon, I think, is if we move into different asset classes how will that impact through into the ICA position. We have had a project ongoing for some time looking at our strategic asset allocation and that has explored the use of different asset classes. We are well advanced with our progress towards equity release mortgages, and would see us in a measured way moving into the equity rielease mortgage asset class, starting in the second half of this year and building up. And we are reasonably well progressed with other asset classes, but they will come in the future.

Clearly in making those judgements and the timing of the move into those asset classes we are very mindful of the capital impact. And as I said earlier, it is a measured approach into those asset classes. And therefore we are very confident that we can manage the ICA impacts from those shifts in asset allocation.

So I think Andy, you were going to pick up on the credit question.

Andy Moss

Yes, on the credit side, I think we've done two slightly different things. So in respect of IFRS, effectively IFRS is reflecting our best estimate assumptions on credit. What I think our modelling platform has enabled us to do is to more accurately reflect that assumption, and to take out, as we said earlier, some unintended prudence in some of the calculations across some of the funds.

Whereas obviously on the ICA side we're looking at the situation in a stressed environment and we've made some strengthening based on various market movements, and also actually separating out some of the individual credit asset classes. So I think they are perfectly fine to do separately.

<u>Question 2</u>

Ashik Mussaddi – JP Morgan

Yeah, hi, good morning, Ashik Musaddi from JP Morgan. Now the first thing on your dividend; can you just remind us if there is any sort of restriction from the current debt arrangements on the dividend? That you can pay only 120 or like that?

And any thoughts on the growth in dividend at any point? What will trigger that growth in the dividend?

And thirdly; any update on M&A? I mean is there any discussion going on at the moment or is it just too early given that you have been a bit busy tied up in sorting out the bank debt deal at the moment? Thank you.

Clive Bannister

Four questions there, Ashik thank you very much. Jim, do you want to just go through the covenants now that relate to the dividend?

Jim McConville

Yes. So if you recall under the previous banking arrangements, we were restricted in our ability to move cash up and across the group because of the banking arrangements. And within the holding company we had a ratchet mechanism, which limited the shift in the dividend that we could make. All of that has fallen away under the new banking restrictions.

In general terms we have moved towards an investment grade style banking arrangement and that has one simple dividend restriction in it, in that if we do not pay our target repayments, there is a dividend stopper, which is perfectly normal in these circumstances.

Clive Bannister

Your second question was about our dividend policy and dividend growth, so I would make four observations; the first of which is let's remind ourselves of history. So 18 months' ago we rebased our dividend very significantly. We moved it by 25% from 21p per share to the current 26.7p and that was a substantial change. I think supported by management, the board's thinking is that it behoves us to husband our resources, to give ourselves greater financial flexibility in an M&A environment. We've always said we'd only do a transaction which protected that dividend. That's a very key requirement. We'd only do an acquisition which was value accretive overall. And we believe one of the best ways of adding value to our shareholders is having those resources, as I said, to give us strategic flexibility.

The third observation is that we are a run-off company. So it's counterintuitive, but until one has done a transaction to refill the well that's when we do move away from a policy that has been described accurately as stable and sustainable.

And the fourth observation are the very good numbers which are on pages 25 and 26 of the presentation. And this just underpins the maths on why we believe our dividend to be stable and sustainable. The first page demonstrates an illustrative source as an application over the next five years, between now and 2019, and demonstrates how we can have monies available for the dividend, and then the latter page says that between where we are now and going forward, there's a further £3.3bn of organic capital unwind, which will be available for shareholders over time, post 2020.

So that is the way I would deal with what we think is a very plausible and appropriate dividend. Of course it is the board's responsibility not mine to review dividend policy, which they will do periodically as you would expect.

Your third question was about M&A, and first of all we should remind ourselves that none of the maths that Jim has gone through today has been dependent upon doing a transaction. We are open for business and that is our ambition as the UK's largest closed life consolidator. That is what we're designed to do; to go out and do transactions. But we don't have to do a transaction to deliver any of the maths that we have showed today. I said a few minutes ago we'd only do a deal which added demonstrable value and protected the dividend as one part of that, so something that was value accretive.

I think in the environment we look at, I use the word in the RNS which is "hiatus". And therefore there are currents, you can argue that there are accelerants, why deals may be more rapidly be coming down the track, and those would be, we think, the annuities change announcement by the Chancellor in the Budget will change forever the landscape over the UK insurance industry and that means over time there will be more closed books available for sale.

We also think that the cost of administration, the arguments of trapped capital and the increased costs of regulatory oversight all argue for why people may be more motivated to sell in an accelerated way.

The de-accelerants are, well, the overhang of an FCA review, which will be with us between now and summer next year, not a threat in the way that Andy has described. We're not complacent, and there is of course a degree of conjecture, but then these are not threats to the body politic of Phoenix as we know it today, but that is a de-accelerant, why people may put the brakes on doing deals. Likewise the unknown capital positions from both vendors and acquirers in a Solvency II world as that evolves. So, Ashik, you can argue reasons for why there will be deals and why there may not be deals.

Then you asked us whether we are in discussions. I make no comment on that. What we said a year ago is that we were opened and positioned better than ever before to consider transactions where a more eligible counter-party, I draw your attention to the strategic alliance we have with Standard Life Investments; they help us when we go to bat to market, because of the arrangements we have with them, and we carry on doing our thinking actively in this space.

<u>Question 3</u>

Andrew Crean – Autonomous

Two questions; could you expand on that last point about M&A? I think there will be a gathering number of people coming down the track who want to exit the market; would you be more interested in bigger deals or would you look at smaller deals in the initial phases?

And secondly on the FCA review, I just wanted to get a sense in terms of your embedded value of what proportion of it belongs to 2000 and prior policies and what proportion of your MCEV is subject to exit charges which is an area which the FCA might like to look at?

Clive Bannister

Okay, so three questions there. I'll let Jim and Andy deal with the percentage of EV and the exit charges. Let me deal with your first question, which is about a transaction. There is that phrase, "Never make the perfect the enemy of the good". I don't think size is the relevant criteria. Last year it was in the public domain that we were discussing a relatively large transaction. The important thing for our shareholders is that they are value accretive. So the transactions that would advertise themselves to us are ones where we can bring specific skills. We would do to a new venture what we have been doing so successfully in the last five years in terms of generating cash and enhancing EV.

So you look at opportunities where you can restructure, which means merging funds. Where you can de-risk. Do better asset and liability management, where we're able to use our outsourcing capability to lower the operational costs, and of course lowering costs themselves by playing advantages to scale. And in an operational sense and in an actuarial sense, the benefits of diversification.

We also have three additional sources of value; and that is the way we manage debt, we now have the opportunity to bring debt to bear, a year ago when we entered into discussions we had a leverage debt rate which was 48% now we're at 35%, and we can talk about using debt as part of consideration. That gives us more flexibility.

We have a tax shield, which is a way of also adding value, and then the final way is in asset management. We have entered into a strategic sharing arrangement, or partnership, with Standard Life. If we generate net assets through an acquisition, we would benefit directly, either at 20% or 15% of revenue, by passing those assets on to Standard Life, and at the revenue level that money would come back to us. So we would retain the synergistic upside from the component of asset management, even though we're no longer owning an asset manager.

So I don't think it's size. It's type of assets. We're very good at with profits. We also do unit linked. So those and then our ability to deliver against those various ways of getting synergistic value. So that's how I would answer the question. Jim, do you want to talk about the EV and the exit charges?

Jim McConville

No, it gives me great delight to pass that one to Andy, actually.

Andy Moss

So I think the first thing to say on exit charges, I mean, the FCA have said that they are not intending to challenge exit charges. So where exit charges were compliant at the time of selling a policy, they're not intending to revisit that. I think the key thing is, and their focus is going to be, around the communication around that so making sure that policy holders have understood what exit charges are in place and why those exit charges are actually in place.

I mean, in terms of exit charges, for us, it largely applies to our unit-linked policies which are around about 20% of our total assets under management. And then that further splits down where for those which were single premium, there are no exit charges in place, for those that are regular premium, which is probably around half of that, then there will on some occasions be exit penalties in place usually linked to periods of time where there have been higher initial allocations. Of that business, the majority of it is pre-2000. So as time goes on, those exit penalties will obviously get less.

<u>Question 4</u>

Alan Devlin – Barclays

A couple of questions please; first of all on capital, post the Ignis and the debt refinancing, which is your biting constraint? Is it the IGD surplus or the ICA? Has that changed at all?

And secondly, could you use any of that excess capital to help fund M&A deals? Small M&A deals if they came along?

And then just secondly on your guaranteed annuities; you've assumed that the guarantees are for 20%? Is that what you've seen since the Budget?

And can you remind us what the uplift and the guarantee is on the annuities?

Clive Bannister

So, Jim, why don't you deal with the biting constraint on the capital and then also, you know, how some of those funds i.e. our headroom above capital policy could be used in an M&A situation?

And then perhaps, Andy, if you would answer in terms of the guaranteed annuities 20% to date, what's been our experience?

Jim McConville

Okay. So IGD surplus is our biting constraint, and was our biting constraint since certainly I've come on the board and reported. So, I mean, I think we see that as the biting constraint for the foreseeable future. So in terms of the headroom that's available over that constraint, you're correct, those funds would be available for use in an acquisition, if that's what we chose to do.

Now I think one of the important things to reflect on is the improvements we've made to the financial flexibility of the company over the past year or so have given us much more options in terms of how we think about financing a deal. So this time last year, given where the leverage was, it would be inconceivable for us to have furthered a deal structure which would have added us bringing in debt into a deal financing structure. I think there with our dealing at 35% we have that greater flexibility. And certainly in the larger deals you would see a combination of equity and debt and perhaps some of the cash resources being used, so I think, you know, the steps we've taken have placed us in a much better position.

Andy Moss

So on the GAR side, obviously at the moment there are still restrictions in terms of the size of the pot that can be commuted to cash. For those we have seen for the lower value ones, about 40 to 50% fall. For those above that, obviously, we've not seen any great change to date. What we are seeing, though, is a number of annuitants deferring their decision until next year obviously waiting for the full regulations to be in place.

But the most important thing to us with the guaranteed rates is that the customers understand the values of those guaranteed rates, and with the interface with the guidance procedure, we believe that the majority will still take those guaranteed rates, because effectively they can get almost a doubling up of their annuity compared to market rates. So we think certainly for the larger parts there should be very little impact, if all of the guidance and our guidance is working well.

Clive Bannister

I think in your presentation, Andy, you said it was about 11% our guaranteed annuitants received.

Andy Moss

Which is clearly double the market rate.

Clive Bannister

Historically the retention rates have been about 99%.

<u>Question 5</u>

Oliver Steele – Deutsche Bank

Three questions. The first is can you remind us of the nature of the threshold that you set for your IGD headroom because if that is the binting constraint I'm assuming you can't or you won't want to use all of that £400m that's there at the moment?

The second question, actually linked to that, is what happens to the IGD headroom biting in the new Solvency II regime? Should we be looking at an ICA style of headroom? I'm not sure I think that counts as two questions so again I'll ask two more.

The third is debt. You seem to be talking about using debt potentially for bolt-on acquisitions and I can see one way in which that will work if the target is not highly leveraged but are you still sticking to the commitment of any acquisition must be debt leverage reducing overall?

And then finally Clive you talked about the tax shield. I thought your tax shield was in your EV already so I'm just wondering do you have extra tax shield available on an acquisition that would add to the embedded value?

Clive Bannister

Okay I'm going to do those in reverse order so I'll talk about the tax and I'll mention about the debt in an acquisition environment and then Jim will go through the headroom in Solvency II and the IGD headroom and the use thereof.

So in thinking about an acquisition I was saying that of the corridors of thought for synergistic benefit one is thinking about tax management. We've done it well in the past, I'm not suggesting that there is more or less capacity, it entirely depends on the nature of the acquisition, the point in time of where we are in that shape. It's just one of the avenues that one thinks about alongside a reduction in risk, restructuring of capital etc. So I didn't want to set hares running in the wrong direction.

On your third, or your penultimate question about debt and acquisitions I think Jim was terribly clear any acquisition we would do, any future debt thoughts will be dependent upon getting, gaining and maintaining an investment grade rating. That is the overriding moniker. We had previously said 40% or better by 2016, having hit 35% our new target is to maintain our leverage at a level which allows us to get, and then maintain an investment grade rating. And as Jim said a few minutes ago because we are now at 35%, depending on the target and the type of acquisition, if the target had no debt whatsoever it would be conceivable to then use debt as part of a consideration. It's not a necessary but whereas it was almost inconceivable last year when our leverage was at 35% and we had specifically said any acquisition would have lowered our leverage we are now at that point so that avenue of thinking is at least open to us.

Jim do you want to go through that uncharted territory for what happens to IGD and the Solvency II role?

Jim McConville

In a Solvency II world our belief is the IGD calculation falls away and will be replaced by a Solvency II calculation which is obviously an economic-based calculation and more akin to the approach we adopt in our ICA basis.

And in terms of establishing the headroom for our IGD position that is based on our risk appetite which is reviewed regularly by the board to ensure that it remains appropriate.

<u>Question 6</u>

Ming Zhu – Canaccord

I have two questions please. The first is the free surplus generated in Phoenix Life in H1, that was about £661m and you distributed £211m to the group so that's because you had about £150m from the opening free surplus at the Life Company. And your closing surplus I just want to know on Slide 20, going forward what's the minimum you need to hold for your free surplus at the Phoenix Life Company level?

My second question is on the cash generation target for the full year. That £500m to £550m excludes the £390m Ignis but your £2.8bn for 2015 to 2019 that includes the £390m Ignis so if I just round it up for this year and say if you have £900m in total including Ignis that leaves you about £1.9bn for the next five years.

That gives an average about £380m a year does this seem a little bit conservative or would you look to review that target at the full year?

Clive Bannister

I think Jim they both are in your bailiwick. A treatment of the free surplus and then would you go through, and obviously I'll go to the slides where you talk about our future cash flows in the context of what we have done with the £722m.

Jim McConville

Let me deal with the cash question first. So you're quite right Ming in that our current year target is £500m to £550m and our long-term target does include the proceeds from the sale of Ignis so if you do the maths, as you've done, you're left with the remaining amount. And if you go back to the slide before that you see there the £2.1bn is the remaining cash generation that has to be achieved to the end of 2019.

Now in setting the cash generation target and the timeframes we have always said that there is an element of lumpiness about the recognition of cash generation because it does rely on management actions in addition to just the normal cash generation that would come if we sat back and did nothing.

Historically the benefit from cash management actions has been roughly about a third of the cash generation and if we look forward into that target for 2019 we prudently assumed about half of that so about 15% of that target relates to management actions. So you're right that it is stated on hopefully a prudent basis.

Now as we've done from time to time we have, as you know, revised our long-term cash generation in the past as time has gone on and we've gained more sight as to what is possible we will review our targets as we do on a very regular basis and as soon as we need to revise them we will revise them.

Clive Bannister

And then on the free cash surplus Jim and just where we started and where we finished.

Jim McConville

Right so we started obviously the year at £529m and have paid out dividends up into the holding company and resulted in a closing position of £379m.

Now part of that movement reflects the strengthening of the longevity credit and correlation assumptions which in total are about £0.2bn so there's a significant impact from that strengthening but it's also impacted by the achievement of management actions and the like.

In terms of the minimum surplus that we need to hold, in theory you could take that number down to £1 and remain with a sufficient free surplus number. And if you look back on that chart you will see at the end of 2011 it was a relatively low number.

Now clearly we try to look at things and manage it on a prudent basis so I'm not suggesting that we would take it down £1 but there is quite significant headroom available there.

Andy do you want to add anything on the free surplus?

Andy Moss

No I think we've covered it and I think the key thing to remember the free surplus is the surplus above our capital policies. So it is additional and as Jim says, in theory it is available to distribute, albeit obviously at a life company level we would want to make sure we were distributing that in a prudent way.

Closing Comments - Clive Bannister

So first of all thank you for your engagement. This is a strong set of results. I'm not sure how the maths could have been any better. I think it has buried any demons that may have existed in the past about our debt, its size and type, and it positions us very well to be at the forefront of consolidation in this industry that we care so much about.

Thank you very much indeed.