PHOENIX GROUP

Phoenix Group plc 2010 Full Year Results

Tuesday 29th March 2011

Ron Sandler: Chairman

Right, I think we have reached the appointed hour so can I say good morning and welcome. It's a great pleasure to see you all and thank you very much indeed for coming to hear the Phoenix 2010 results presentation. It is a particular pleasure to be introducing Clive Bannister to you today. Clive joined us, as I'm sure you will recall, back in February as Group CEO and we're also joined on the podium there by Jonathan Yates, our CFO. We have Mike Merrick and Chris Samuel with us as well. Mike and Chris are the CEOs of Phoenix Life and IGNIS respectively.

We're going to be reporting today on strong progress on a number of fronts. We've come a long way in recent years, we are now well advanced in our journey to build an extraordinary business; it's a business that rests on a platform of financial stability and it has a unique set of capabilities and infrastructure. The management of Phoenix, the Phoenix Way as we describe it, is all about bringing these to bear in the way we manage our assets and the way we manage risk in order to deliver value, both to shareholders and to policyholders.

The story of 2010, as you will hear in just a moment, is all about strong cash flow and growth in EV and it's also about de-gearing. And you will see that as we look forward to 2011 on this slide that these remain our areas of focus as we look to the future.

It's my pleasure to hand over to Clive and to Jonathan to take you through the detail of our 2010 results and after this we look forward to answering any questions that you may have. Thank you very much.

Clive Bannister: Group Chief Executive

Ron, thank you and good morning. Good morning everybody, it's a pleasure to be here to present the considerable progress that Phoenix has made in 2010, and to set out our financial objectives in 2011. And of course it's a pleasure that my first presentation should be to our investors and the analysts who cover our story.

2010 was a year of strong financial delivery, we generated target beating cashflows of £734 million, our IFRS profits remain strong at £373 million and we delivered significant MCEV growth to over £2.1 billion. This is the first time as a group we have published an MCEV number in excess of £2 billion. IGNIS assets under management grew to £67.5 billion and I'm able to report that we made prepayments of over £120 million to our bank debt bringing down our gearing level to 52%. All of this has allowed us to recommend with confidence a final dividend of 21 pence per share, giving 42 pence for the full year.

But 2010 was also a year of significant corporate delivery. We simplified our capital structure, successfully achieved the premium listing in July and gained our FTSE 250 Index inclusion in September. We also strengthened our corporate governance with a number of senior executive and non executive appointments and enhanced our risk management framework. This has created a platform for future success and we have already been rewarded by increased liquidity in our shares, broader analyst coverage and a more diversified investor base.

But the Phoenix Group is more than a balance sheet, it is a business and for the first time the CEOs of our core businesses, Mike Merrick and Chris Samuel, join us on the podium and I welcome them. Alongside our high profile corporate and financial attainments we have delivered notable business successes. Mike and his colleagues in Wythall in Phoenix Life have undertaken a number of important tasks which have resulted in improved customer service and has strengthened customer proposition. We improved our capital efficiency through the restructure of National Provident Life and the intra-group fund merger of Phoenix and London Assurance into the Phoenix Life Ltd. These achievements improve customer outcomes and build value for our shareholders.

We have also developed our outsourcing model. Our largest outsource partner, Diligenta, successfully introduced a new, modern server based administration platform to which we have already transferred over four million policyholders. IGNIS, the group fund manager, strengthened its team with important new executive appointments. It also completed the integration of two legacy businesses, and a signal of strength, we repatriated £5 billion of assets from third parties into the firm. IGNIS is genuinely a business on the move.

Our cash generation was strong, we delivered the £734 million beating our target which was set at a range between £625 million and £725 million. This is in addition to the £700 million that we delivered in cash flow in 2009. As you well know, one of the strongest measures of a closed life fund is its long term reliability and predictability of its cash flows, that is why we publish with confidence our cash flow targets. We strengthened cash flow in 2010 by managing the business better, through improved asset and liability matching, the de-risking of certain investment portfolios, fund restructurings and the successful resolution of some legacy tax issues. Cash is the most important measure for a closed life business, and this result without doubt proves and demonstrates our cash generative strengths. Management actions lie behind and accounted for the £242 million of cash flow out of a total of the £734 million I mentioned a minute ago.

To provide some colour and context to this, this slide has broken down management actions into three broad categories. Of the £242 million of accelerated cash flow the majority was developed and generated from improved risk management, £88 million came from operational management initiatives and the balance from restructurings and fund mergers. I repeat, cash remains the most important financial measure for a closed life business and our ability to accelerate £242 million of cash flows in 2010 demonstrates our cash generative strength in terms of both quantum and resilience. Simultaneously we improved the outcome for policyholders and added shareholder value.

The MCEV has performed remarkably well, growing by £277 million or 15% to over £2.1 billion. This included £296 million from management actions of which £157 million had been achieved at the time of our third quarter interim management statement in November. A further and powerful £139 million comes from the restructuring of the corporate loan portfolio which we announced last week. This translates into an MCEV per share of £12.27, up 11% from the £11 and nine pence per share which was where we were in 2009.

The message is that despite the runoff in our book we have been able to identify opportunities for operational synergy, integration and more efficient use of capital that enhances our MCEV. And as Jonathan will tell you in a few moments we see opportunity for more of this in the future.

MCEV management actions also increased the absolute quantum of embedded value within the group, creating tangible new shareholder value. The £269 million increase in MCEV in this slide was generated by leveraging the benefits of funds restricting and diversification, and £34 million of operational improvements. This is a very clear manifestation of the ability of Phoenix Life and Mike and his colleagues to improve customer outcomes and drive shareholder value. In 2010 we were able to reduce our gearing with prepayments of £122 million. As a result the group gearing came down from 58% to 52% and today we are setting a target to reduce that to below 50% in calendar year 2011 entirely funded from organic cash flows.

You will be very well aware that the group has complex banking relations. As a banker by background I understand and appreciate where our bankers are coming from. There has been much speculation in the market about what happens next with our banking facilities. As this slide shows no complete debt solution is being sought, nor is it necessary.

The quantum of our debt is not the primary issue, all other things being equal we would prefer to change some of the restrictive covenants including those that set a cap on our dividend payment. We have been exploring carefully options with our lenders with a view to resetting some of those covenants. However, you will also know from previous disclosures that we enjoy favourable interest margins, and I want to make it clear that we will only enter into new arrangements with our bankers on the right terms at the right time and things which will be of benefit to our shareholders. We continue to talk to our banks and will advise the market, if and when there is something to say, but I want to take this opportunity to thank our banks for their support for us and our business.

We're very pleased to recommend today a final dividend of 21 pence per share, taking the total dividend to 42 pence for the full year. This fulfils our 50/50 dividend policy which we intend to maintain for 2011. Under the terms of our existing banking arrangements in calendar year 2012 the dividend cap will rise from £58 million to £72 million. This will enable us to sustain a dividend of 42 pence per share giving the increased number of shares in issue following the interim scrip and placing. This increase will take place independent of any new arrangements that we might enter into with our lenders.

The story, as Ron said, of 2010 describes a record of delivery by the group, both operationally and financially. We are confident that we have proved that we can be relied upon to deliver in the future. I am convinced that we have everything that we need to be very successful. We will continue upon the critical tasks of delivering improved cash flow, improving and strengthening our capital position and continue de-gearing and building a stronger IGNIS fund management business. And I'm looking forward with confidence to the remaining part of 2011. And on that note I'd like to hand you over to Jonathan who will present our financial highlights. Jonathan, the floor is yours.

Jonathan Yates: Group Finance Director

Thank you, Clive, and good morning everybody. I'm delighted to be here to present what I hope you'll agree is a very strong set of results for Phoenix Group. In particular I'd like to draw your attention to cash generation of £734 million which is well ahead of the target that we set for the year of £625 million to £725 million, our solid IFRS operating profits, our group MCEV grew up to £2.1 billion which was up over 15% from the end of 2009. IGD surplus

remains strong at a billion and we're introducing a new KPI in the form of IGD excess capital and I'll come on to talk about that later on.

Despite the runoff nature of our business, assets under management grew to £68 billion and our financial indebtedness gearing fell by over 6% during the course of the year from 58% down to 52%. And finally, as Clive just said, we're recommending that the dividend be maintained at 42 pence a share. So I'll go on now to talk through these highlights in more detail.

The key feature of the Phoenix business model in financial terms is the emergence of cash from its operating subsidiaries, most noticeably Phoenix Life but also of course IGNIS. In 2009 we set a target for 2010 cash generation of £625 million to £725 million but in practice we're able to beat this and pass up £734 million to our UK holding companies. This total cash in the UK holding companies increased from £202 million at the start of the year up to £486 million by the end of 2010. This cash is now available to meet debt repayments and other group expenses and also to pass up to Phoenix Group Holdings, our ultimate holding company, to enable it to make dividend payments to shareholders.

Costs during the year increased, in part due to our now being a premium listed company on the London Stock Exchange which happened in the middle of last year. Debt interest and amortisation included £122 million of debt prepayment. As cash emerges strongly we fully expect to make further debt repayments ahead of the mandatory amortisation profile as we reduce our debt to below our target gearing level.

I've put this slide up to try and explain a little more clearly I hope how cash actually comes out of our life companies and how it ends up in the holding company. Within our life companies essentially what we hold is ICA which as a pillar two company represents the regulatory minimum capital that we're required in order to hold in order to meet liabilities to policyholders under stress conditions. In other words it already includes a margin in excess of what we would expect to have to pay on a best estimate basis. On top of this we also hold capital policies which are the quantification of our risk appetite for not breaching ICA, in other words they're the capital buffers.

Everything in excess of this we consider to be free surplus and in theory is available to be paid up to the UK holding company. In practice there are timing delays due to the time taken to carry out the valuation and in some instances we may hold back a margin as we seek to harmonise approaches across the group, for example in the calculation of capital policies. But as time goes by the business runs off and risks of future adverse outturn diminish which leads to a reduction in ICA and the capital policies and the release of this capital into free surplus. And to the extent that we're able, we use management actions to accelerate the release of this capital, for example by de-risking or better identification and quantification of risks.

So looking at this diagram as you can see at the end of 2009, the amount of capital within the life companies in excess of ICA plus capital policies was £464 million. By the end of the year this surplus had grown significantly up to £750 million but this was on top of the £708 million that was passed up to the group during the year. In other words, free surplus in total increased by a little under a billion over the course of 2010 and I think that number bears contrasting with our market cap at the end of 2010 which stood at a little over a billion.

So moving on to the emergence of free surplus and let's look at it in particular but the components of that billion what actually made it up. So IFRS operating profits, tax and economic variances together accounted for almost £400 million. Movements in capital requirements and capital policies accounted for another £400 million and as I described

earlier this reflects the runoff of the business together with the benefits of the management actions that we take to reduce risk, for example through fund mergers or better risk diversification. And finally, the valuation differences that exist between IFRS and the regulatory valuation basis give rise to another £200 million.

So turning to the IFRS operating profits, we delivered a solid operating profit for the year of £373 million and as we've just seen this included £388 million from Phoenix Life which was up 17% [1] on 2009 excluding exceptional items. IGNIS also produced a very satisfactory 35% increase in its operating profits to £46 million. The bottom line after tax for the year was £80 million [2] after nonrecurring items which included, as I mentioned earlier, the cost of the premium listing and other regulatory, restructuring, change and transformation costs.

This is a slide that we first used at the half year results last year and we're using it to try and better explain just how the operating profits across the group actually emerge, how they're generated, the lines of business that actually contribute to them. There's a lot of detail on this slide, I appreciate that, and it's really one more to take away and for people to read and I don't propose to go through it in detail here but would certainly be delighted to answer questions on it later on.

One of the pleasing things about it is the consistency that exists between 2009 and 2010 with a few exceptions, in particular the net margin on annuities fell but that was mostly due to a one off favourable change in longevity assumptions that was put through in 2009. The distressed with-profit funds, a relatively small driver of operating profit, in other words those funds which require internal capital support - there was a small reduction in the amount of profit driven principally by improved persistency, in other words guarantees biting on policies within those funds.

Moving on to IGNIS, a similar sort of breakdown here, again something we presented at the half year results but what we're trying to do is break it down between the different lines of business that IGNIS manages on behalf of its different clients. There are a few points I'd like to point out, firstly this slide helps to illustrate the disproportionate importance of our retail and institutional funds for revenue generation. Secondly, the margin earned on the management of the life funds increased quite significantly over the course of the year from 13 to 19 basis points. In the main this was due to increased performance fees and helps to show that we're not managing a static book in runoff but we're actually driving better returns, not just for shareholders but also for policyholders; most of this money is policy holder money. Of course this comes at a cost and IGNIS has invested substantially in its own staff and has recruited where it didn't have the talent necessary to sustain this outperformance going forward.

So turning now to MCEV, as I mentioned earlier on, this grew by 15% over the period. Operating earnings generated £247 million and management actions added a further £296 million which is comfortably ahead of our target for the year of £145 million. Economic and non operating variances was a small number but it actually masked some very large movements in both directions. The most notable of these were the growth in MCEV due to the performance of the equity market which was a substantial gain but that was offset almost entirely by the fact that short term interest rates were incredibly low. Our operating earnings make an assumption about long term interest rates in common with all companies reporting on an MCEV basis which is obviously a much higher number.

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[1] Editor's note: Speaker in webcast states 16%, but percentage is 17%

[2] Editor's note: Speaker in webcast states £76m, but figure is £80m

Finance costs reflect the interest that we paid on our debt but it doesn't include the deferred 2009 tier one coupon which you may recall, that's been included in 'other' where there's an equal and opposite offsetting item relating to the proceeds of the share issue that took place last year that we did to actually meet the terms of the payment of that interest under the alternative coupon satisfaction mechanism. And other than that, 'other' comprises a number of items most notably dividends to shareholders.

So moving on to solvency and in particular I mentioned this measure of sort of IGD excess capital, I thought it might be useful to try and just explain how we actually go from the capital that we have available in the group through to the reported IGD surplus and what happens along the way in what's actually a fairly convoluted and highly complex calculation. So IGD reported surplus at the end of December last year was a billion but it actually represents only a small part of the solvency capital that we have available to act as a buffer against adverse scenarios and doesn't properly reflect our resilience as a business. And we try to explain that a bit more clearly in this diagram.

So total available capital is £6.8 billion and against this we've set our regulatory required capital of £4 billion and this leads to excess solvency capital for the group of £2.8 billion which was the number that I mentioned earlier. However, in order to get from this number to what we report as IGD surplus, we've got to first deduct the surplus that's sitting in the with profit funds. The Phoenix Group doesn't count this due to these funds having been designated as closed to new business. When a fund is designated as closed to new business effectively any surplus capital within that fund is then treated for IGD purposes as being already allocated for distribution to with-profits policyholders and so is excluded from the IGD calculation. Obviously that makes a fairly material difference in that it reduces the apparent buffer within the group by 50% and as a with-profits company of course, or a largely with-profits company, with-profits being one of our major lines of business that's a very significant amount of capital that should be counted.

Beyond that we have another £400 billion of restrictions and a lot of it relates to the relatively complex legacy nature and the structure of Phoenix Group and various pockets of capital that are trapped around the group which aren't recognised for various reasons but which we are in the process of addressing through a range of different things, fund mergers and general discussions with the FSA about whether they should be treated as part of our capital. So if you look at our excess capital of £2.8 billion it's getting up towards three times what we actually report as our IGD surplus and we think this gives a far more meaningful basis for comparison with our peers.

So moving on to the assets under management, in spite of the fact that we are a runoff life business with an asset management company, group assets under management continued to grow over the course of 2010. Assets in the life company fell by £5.4 billion as we pay out claims, but this was more than offset by investment performance which again largely related to Phoenix Life itself. And it's very pleasing to see IGNIS generate net third party new business of £1.3 billion, much of which related to its highly successful liquidity and property funds.

So let's turn to the targets that we're going to set for 2011 and beyond. First of all cash generation. We set ourselves a new target range for cash generation for 2011 of £750 million to £850 million, in other words a fairly significant increase on the cash generation target that we set for 2010 of £625 million to £725 million. We've also raised the target for 2010 to 2014 by £300 million to £3 billion and we've now rolled this target forward to cover the period from 2011 to 2016 and we've set a target for that period of £3.2 billion. And that's a six year period which might sound a bit strange and the reason for that is that the period from today through to the end of 2016 is the period over which our existing bank facilities

actually pay down and we thought that that might be a useful period to have a cash generation target.

So secondly, gearing. We set a new target for gearing to reduce this to below 50% during 2011 and we expect to do this through organic cash generation. In the longer term we'd look to have access to the debt capital markets and clearly this would provide us with additional financial flexibility.

And finally, MCEV. Whilst our cash management actions focus on accelerating the cash generation profile, our last financial target is to enhance MCEV through management actions of £100 million per annum for every year between 2011 and 2014.

So just to add a little more clarity to those cash targets, we've tried to sort of set it out in a diagram. So our original target for 2010 to 2014 was £2.7 billion and to this we're adding £300 million of new management actions in 2011 that will take that target up to £3 billion. In 2010 we delivered £0.7 billion of cash generation which means our residual target for 2011 to 2014 becomes £2.3 million and to that £2.3 million we're going to add £900 million, 0.9 billion, of recurring cash flows between 2015 to 2016 which gives us the target that I mentioned earlier for that period of £3.2 billion.

The one point that I should stress is that these cash generation targets don't capture any benefits from management actions beyond 2011 but as our 2011 results demonstrate very clearly I hope, this is what the management of Phoenix Group is here to do and with that, I'll hand back to Clive. Thank you.

Clive Bannister

Thank you, Jonathan. Thank you very much. Let us look ahead to the journey in front. We have a simple and robust shareholder driven business model. Phoenix Life is responsible for the operational, financial and customer management of our life funds, it provides very specialist skills to deliver improved customer and policy holder outcomes. These in turn deliver significant value to our shareholders. And IGNIS, which in addition to managing the funds of the life companies, continues to successfully build a third party franchise which delivers significant profits to the group. Together they make an enormously powerful profits engine.

The reason why all of this works and why we have such confidence in our future is that we are not just the UK's largest specialist closed life fund consolidator with real scale in both of our operating businesses, but that we have developed and are developing what we call the Phoenix Way. The Phoenix Way characterises an approach and an infrastructure which is unique in the industry for the integration and management of closed funds; that is our business. The bottom line is that Phoenix Way will help us deliver value, it ensures that our advantages are scalable and repeatable. By applying consistent best practice within a framework of the Phoenix Way this reduces risk, complexity and cost whilst improving investment performance and improved customer service through effective working with our outsourcers. The inevitable outcome is enhanced MCEV and the release of capital to our shareholders. We are good at what we do and the Phoenix Way will make us better.

We're focused today on the business in hand but I recognise that we have to touch on M&A. The key message as we have shown throughout 2010 is that we drive improved shareholder value year on year without the need to do deals. Cash flow rewards our shareholders which is not dependent upon transactions. Whilst there are clearly a number of opportunities in the market any deal we do would have to be accretive to shareholder value and we are clear that any acquisition funding would have to take into consideration our current share price

and leverage. So we are very focused on continuing to develop our existing business. In due course we believe that this will put us in a position to take advantage of potential opportunities to acquire and integrate businesses in the future.

To help you measure our progress on the business in hand, and as Jonathan has already detailed, we have set ourselves four new very clear and challenging financial targets. A raised 2011 cash flow target range in between £750 and £850 million, a six year forecast for cash generation of £3.2 billion in total, further de-gearing to take us from where we are today to below 50% in the year 2011, and £100 million per annum contribution to MCEV every year until 2014.

I believe that this positions the Phoenix Group very well for the future. I was honoured to be given the opportunity to become the Group Chief Executive in February and since I arrived I've been impressed with the quality of the teams that we have in Phoenix Life, in IGNIS and in the group and the quality of the operating platforms that we work through with our customers. There are clear opportunities to grow and develop the business we have in hand today. We have a clear strategy and as a team we are focused on delivering shareholder value. We are, of course, on a journey, and it is a successful journey of strengthening cash flows, improved MCEV, and progressive de-gearing.

Thank you very much indeed for your attention. I'm going to now hand over to Ron, who will chair our question and answer session. Ron.

Question and Answer Session

Ron Sandler

Thank you Clive. And thank you all for your attention. We have some questions. You've got a microphone on its way.

Question 1

Greig Paterson – KBW

Good morning, Greig Paterson, KBW. Three questions. The first one is QIS5, the UK did very badly relative to the peers and there was a raw number and there was an adjusted number. And drilling down into the details there was a big improvement in the UK result as a function of sorting out offshore internal reinsurance arrangements. Now you guys have a big offshore internal reinsurance arrangement so I was just wondering how this impacts you, what your thinking in that regard is.

The second thing is you redirecting us towards looking at the inherited estate and adding the inherited estate to your capital measure. But if I'm not mistaken the FSA has just come out with proposals that if you're a closed fund you have to come up with a plan to distribute that inherited estate to policyholders, so I was wondering how fungible that exactly is, maybe you could make some comments about that.

And the third point is more sort of a strategic question. If you've got such a high yield, and you've got such a pressing debt problem, why don't you just halve your dividend and really refocus your cash flow on getting the debt down more aggressively than we've seen at this point.

Ron Sandler

Greig, thank you for all of that. I think we can spread those around the panel a bit here. If we start with QIS5, Mike, do you want to comment on that?

Answer: Mike Merrick

Yes. You're absolutely right, Greig, QIS5 did identify for the industry and for us that certain internal arrangements that had been put in place, that worked perfectly well under solvency I, caused some issues under Solvency II. That is something that we'll be taking into our restructuring activity that we look to complete in 2011. So fund merger activity and the like will bear in mind and reflect changes that will optimise the Solvency II balance sheet, as well as the Solvency I position. But we think we can do that at the same time as we're simplifying our business, because some of these inter-group reinsurance arrangements, whilst effective under Solvency I, did add complexity to our business, so it's a good simplification opportunity as well.

Further question

And the cost to do this?

Answer: Mike Merrick

There'll obviously be a reduced capital requirement under Solvency II but the cost will be manageable because we'll be able to implement it alongside restructuring we were planning to do anyway.

Ron Sadler

Jonathan, do you want to comment on the inherited estate, or the IGD measure, the Excess Capital.

Answer: Jonathan Yates

You're absolutely right, closed funds have to put in place a plan to distribute the estate to policyholders and that's exactly what we're doing. But it's not really about whether that money is allocated to policyholders or not, it's whether it's available to cope with stresses that hit the business. And the IGD surplus is very much a solvency measure, and if you're going to cover solvency then you should include the excess which exists within those funds. At the moment it's surplus to the actual guarantees to the policies, and is available to meet those stresses going forward.

Further question

I know that you must have had some discussion but I'm just trying to get a feel, is it distributed over the period, or do they want an accelerated plan?

Answer: Jonathan Yates

Distributed over the life of the policies, but that's common with all companies. Sorry, Mike, do you want to add something?

Further question

Because it's closed funds they're concerned about and you guys are the big example.

Answer: Mike Merrick

It is closed funds, but what we do is we take all of the free capital which is inside the with-profit funds and we add that to the asset share calculations that we do for our policies, which effectively increases the payouts to this year's maturities, but also future years' maturities. So whilst a small amount of the capital that we're adding is actually paid out to policyholders in any given year, the bulk of it, as Jonathan says, sits within the fund and is there and is available to deal with future risks that emerge within that fund and future risks to the business.

Answer: Ron Sandler

And, Greig, your final question was about de-gearing. You used the words 'debt problem'. We don't think we have a debt problem. We see ourselves very much on a path to de-gearing this business, as is set out in our financial targets. We are very concerned to ensure that shareholder value is maintained and enhanced in this business, and our policies towards such things as dividends will reflect that.

Further question

You made some statement about the 42p would remain. Was it 2011 and 2012, or was it just 2011 you were giving guidance on?

Answer: Ron Sandler

Well clearly ultimately what the dividends will be will be what the dividends will be. But the cash flows that we have will allow a maintenance of the dividend of 42 pence per share through 2011.

There's a question over here.

<u>Question 2</u>

Kevin Ryan - Investec

Thanks, it's Kevin Ryan, Investec. If I could ask a bit of Greig's question another way. You seem very confident in your increased cash flows and one thing that puzzles me is it seems to me that given that confidence and given that confidence going forward you could pay down a lot more of your debt and rid yourself of these restrictive covenants, which would give you as a management team a lot more flexibility. So my question is, what is stopping you?

Answer: Ron Sandler

I think as was said by both colleagues, and I'll allow each to comment, we are in constant dialogue with our lending banks, and this is a subject between us and has been such for some considerable time. We enjoy what we regard as a favourable set of interest rate arrangements on our existing debt, and any moves to restructure that debt have to take into account a range of considerations. If and when we feel that there is an arrangement to be struck with our banks which is attractive to our shareholders, we will do so. But there is no

pressing requirement to do that, and certainly not on a basis which we do not regard as favourable to our shareholders.

Clive, do you want to comment?

Answer: Clive Bannister

Ron, I think you've said it all, it's not the quantum of the debt that causes any concern, or our restrictive covenants, all things being equal, related to the dividend cap. We are in constant discussions with banks who have been extremely supportive, and as Ron has pointed out, we enjoy very favourable interest rates and interest margins which are to the benefit of our shareholders, and we have shown from the power of our cash flows that we can organically de-gear from 58% to 52, we set a target to be below 50% by the end of 2011, and this is part of a continuum and we will, as Ron absolutely accurately says, on the right terms, at the right time for our shareholders, make amendments and make changes in our banking arrangements, with our bankers' full support.

Question 3

James Pearce - UBS

Morning, James Pearce from UBS. A couple of things. First of all, your IGD surplus fell a bit during the year. Could you give us some of the reasons for that. And within that could you say how much of the four billion capital requirement relates to with-profits, so we can compare that to the with-profit capital?

Second, could you explain what the £1.2 billion loan portfolio restructuring actually was. You promised you were going to last week and I haven't seen it in the statement so far, and why was it included in 2010.

And finally the £100 million of management actions that you highlight for the next few years, will that include the eventual merger of Resolution and Pearl funds, or is that existing restructurings that you have in hand?

Ron Sandler

A good set of questions, thank you James. Jonathan, do you want to start on the IGD and the with-profit requirement?

Answer: Jonathan Yates

Yes, the IGD number fell over the course of the year from £1.2 billion down to £1 billion. The IGD goes down for all manner of reasons, the most obvious one in our case being the repayment of debt, and as we mentioned, we actually did prepay £122 million worth of debt in excess of what was scheduled to be paid, which was part of it. There are quite a number of things in there, though, that were driving that. The point I would make, is that whilst it was one billion at the end of last year, within a day or two it actually went up to £1.1 billion [3], when we merged the PALAL business into Phoenix Life.

Ron Sandler

And the with-profits component within the four billion?

[3] Editor's note: IGD remains at £1.0 billion on 1 January 2011

Answer: Jonathan Yates

Sorry, yes, the with-profits component. I'm afraid I don't know the answer to that. We'll have to come back and give you a response on that one. I mean obviously there's the 1.4, which is part of it, and whether it's anything more than that, I don't think so, but let's see. The alpha loans - as you point out, we did a restructuring of a structured asset that existed on our balance sheet a couple of weeks ago. That involved effectively taking a leveraged portfolio of corporate loans and eliminating the leverage, which was very much a de-risking action on our part. It was a highly volatile portfolio of assets, very highly performing, but actually didn't sit well in capital terms because of the risk capital we had to put up against it. But also because we weren't able to take credit for effectively the liquidity premium, or the illiquidity premium, within the margin on the corporate loans. So having restructured it we were able to take credit for that, and that's why it gave rise to a significant benefit, both in capital terms and also in embedded value terms.

Ron Sandler

And can you just comment on the fact that it was taken 2010.

Answer: Jonathan Yates

Yes, sorry Ron, very good point. It was actually something we'd been working on since last year, and therefore, because it was actually in train, we were able to anticipate it in our MCEV results, but because it hadn't actually happened by the end of last year we weren't able to take it into our IFRS results, or indeed our solvency results at the end of last year.

Clive Bannister

The final point was on management actions, the £100 million of MCEV for the next four years and will it be related to the fund mergers, or ultimate fund merger?

Ron Sandler

Across the two silos I think was the question.

Answer: Jonathan Yates

The fund mergers will be a contributory part of that.

Ron Sandler

But not across the two silos?

Answer: Mike Merrick

That's not necessary, to deliver the £100 million, but if that opportunity arose then it potentially would.

Ron Sandler

Yes, the message is that we have put that target out there, without consideration of having to merge across the two silos.

Answer: Jonathan Yates

I think the important thing to bear in mind is where we've been able to generate management actions in the past, which is very much a focus on the capital that sits within our business today against the risks that we have and the way in which we can better allocate that capital, either through de-risking or through just putting businesses together and getting better diversification of risk, and to that extent we're always looking to see what gains we can make. And the £100 million that we've set ourselves as a target for those four years, we think is very much achievable, based on the sorts of returns that we've achieved over the last few years, in particular, obviously, last year.

Ron Sandler

Other questions?

<u>Question 4</u>

Andrew Crean –Autonomous

Good morning, it's Andrew Crean at Autonomous. Could you give us a sense of the additional debt cost if you were to renegotiate your debt? Essentially what you're saying is you're bound by restrictive covenants, which you'd like to be released from, but there's a cost of doing that in terms of the debt interest. Could you give us some monetary estimate of what the differences would be?

Answer: Ron Sandler

No, I don't think we can. I think that if we decided or were able to conclude an arrangement with the banks we would only do so, as I said earlier, on favourable terms, and that requires a quite complicated calculus of all of the possible benefits against the incremental costs that the lending banks may seek to obtain through that process. I don't think it's worth speculating on what the outcome of such a process might be, or indeed whether such a process ever might take place. I just want to make sure that it is understood that we are very cognisant of our responsibilities to shareholders and we will not enter into any new arrangement unless we deem that to be on favourable terms.

Further question

So how would your shareholders be able to judge whether it was worthwhile doing? I mean some of these questions are suggesting that a different course might be possible and favourable.

Answer: Ron Sandler

Well I think our shareholders continue to have to judge across a whole measure of dimensions; how well the company is performing and whether the decisions that the management and the board is taking are sound and effective decisions, and that is reflected ultimately in the movement of the share price. If we were to do a transaction of any sort, or a restructuring of the debt with the banks, we would obviously expose to our shareholders any revised terms and our shareholders would form a judgement on the basis of that as to whether or not they thought it was a good or a not good deal.

Ron Sandler

There's a question over there.

Question 5

Marcus Barnard, Oriel Securities

Yeah, Marcus Barnard from Oriel Securities. Can you just explain your cash generation target in a bit more detail because I just need a bit more clarity here? If you're going to generate £750 million to £850 million in 2011 and then £3.2bn cumulative from 2011 to 2016 it looks like 2.4 in the last five years, 2012 to 2016, am I reading that right? Are there any one offs in 2011 that are boosting that number, because if I take the last five years it looks about £500 million a year which implies quite a steep runoff profile. Am I reading that wrongly?

Answer: Jonathan Yates

This is repeating old numbers if you like, but we've always said is that our regular sort of normal cash flow generation of the book, other things being equal, is in the range £400 million to £500 million per annum. Clearly over time that starts to go down. It starts higher, starts to go down over time. What we said was we are looking to deliver cash flow management actions in the order of about £300 million for 2011 which are included within the target of £750 million to £850 that we set so the £2.4 billion that you mentioned over the remaining five years is very much within that sort of four to five hundred range on average for that remaining period.

Further question

Right, so the £300 million is a one off effectively?

Answer: Jonathan Yates

It is, yes and to be clear the management of Phoenix Group is here to deliver management actions at the end of the day, not stand idly by whilst the cash emerges. So we will be looking to come up with new management action targets going forward, it's just that we haven't actually put any out there at this stage.

Question 6

Oliver Steel, Deutsche Bank

Oliver Steel at Deutsche Bank. Three questions and the first is just to sort of help us a bit more on the debt front, I mean there's a step up in the interest rate on quite a lot of the bank debt that comes through, I can't quite remember, in 2013 or 2014 or something like that. Can you just sort of remind us as to what the step up is, what you're paying at the moment, what you'll be paying after that? And I mean I'm assuming from what you say that actually there's really no point renegotiating the debt in its entirety in the first couple of years while you're paying very low rates of interest and it's only after that that it becomes more interesting. Anyway, whatever comments you've got on that would be interesting.

Secondly, in the light of your comments about the IGD, what is the solvency effect of paying down the bank debt over the next few years, are you actually generating enough cash to keep the solvency where it is?

And then finally, I know that the warrant exercise prices are sort of changed by the dividend payments, so do you have an updated set of warrant exercise prices?

Ron Sandler

Jonathan, can I throw those in your direction?

Answer: Jonathan Yates

Thank you, Ron. Yes, I think you make a really good point on the debt, the debt is very cheap, there is absolutely no question that the rates that we're paying on the debt at the moment are low, Ron's absolutely right to say we can't speculate on what refinancing the debt might actually cost but the debt cost that we have at the moment is very cheap and that certainly does mean that it lifts the pressure if you like in terms of having to do something. But of course the other side to that is if we are able to negotiate something which is overall attractive, there may be an increase in the cost of that debt and may be significantly less onerous covenants surrounding the debt going forward then obviously we would look to do that. But as both Clive and Ron said, we don't feel under any great pressure to go out there and do a deal at any cost, absolutely not.

Answer: Ron Sandler

I don't have to hand the step up of the interest cost but we have made that clear in the past, we can dig those numbers out again, I just don't have them at my fingertips.

Answer: Jonathan Yates

Yes, we can provide all that detail and it has been provided in previous presentations and nothing has changed there. And the step up in the interest rate is something that we've factored into all our modelling going forward in terms of how we look at the business and the step up does not take it from a level at which it's incredibly cheap to incredibly expensive, far from it.

In terms of the second item, which was if we start paying down debt what would be the impact on our solvency. The key solvency measure is obviously IGD - as we do start to pay down the debt the IGD surplus is affected, not exactly pound for pound because our group structure is anything but that simple, but clearly it starts to go down and that's one of the factors that we're very conscious of and it's an area that we need to sort of work with the FSA to make sure that we maintain a sensible buffer in excess of the required minimum. And as you can see in the figures that we've presented in the slides we've got a billion of excess IGD surplus, even on the basis of the FSA's current measure. So it's a reasonably solid amount there, but we are very mindful of making sure that we don't trip over thresholds as we start to pay down debt.

And your final question was about the warrant exercise prices, we went through a process last year of removing as much of the contingent capital within the group as we were able to do, as we felt sensible at that time, and therefore the amounts of warrants outstanding and the convertible shares has come down quite significantly. I can't give you the exact numbers I'm afraid off the top of my head, but all that information is available and will be made available.

Question 7

Ashik Musaddi – JP Morgan

Ashik Musaddi, JP Morgan, just two questions. One is on your IFRS operating profit drivers, it looks like you have changed the basis of the average net assets. Earlier you used some from FSA returns and now it's IFRS net asset. There's a huge difference between, especially for the annuities assets which used to be £10 billion and now it's five and a half. Can you please comment on that? And secondly, on the AuM, IGNIS asset management which looks like it fell in the second half, can you comment on that as well? Thanks.

Answer: Jonathan Yates

Sorry, what was your last question, sorry I couldn't hear it?

Ashik Musaddi

The IGNIS asset management AUM fell in the second half of 2010, I remember it was £62 billion for life funds and now it's £60 million. So thanks.

Answer: Ron Sandler

Jonathan, do you want to start and maybe we can bring Chris in on the AUM?

Answer: Jonathan Yates

Yes, okay. In terms of the profit drivers to be honest I'll have to come back to you on that. In terms of the assets then clearly we have a choice, you can either use the IFRS assets or you can use the FSA return assets. I'm not quite sure what the difference is so again I'll have to come back to you on that one I'm afraid. And finally the life fund, I think the way in which the assets fell is probably in line with the assets under management due to market movements combined with the fact that the business is of course running off over that period. I don't know if Chris has got anything to add perhaps?

Answer : Chris Samuel

No.

Ron Sandler

Grieg, a further question?

Question 8

Greig Paterson - KBW

Yes. I remember there used to be a restriction that the FSA put to you that you've got to have an IGD surplus including the WPICC in excess of 125% and then that went under review and they dropped those conditions so I was wondering if there's any issue, the fact that now it's breached that rule and you've actually dropped your rule there.

The second one is just in terms of these debt covenants, could you just confirm that some of the covenants prevent you from purchasing any closed books or are they just related to the level of dividends you can pay?

Ron Sandler

Mike, do you want to start on the 125% of the IGD?

Answer: Mike Merrick

Yes, sorry. Could I just clarify what the question was again?

Greig Paterson

Yes, when I saw that you changed your internal target from 125% down to 105% on the IGD the first thought that went through my mind was, wait a second, didn't the FSA insist on the 125%? And then I remembered that you were under review because of what had gone on before and they dropped it. So I was wondering are they happy with 125% now?

Answer: Mike Merrick

They absolutely are, I mean the issue was that the previous target just didn't behave in a rational way and there are some idiosyncrasies in the overall IGD calculation itself but the target itself was not operating in the way that FSA expected to or we expected it to. So it was definitely a dialogue with the FSA where we agreed that the formula we've moved to would be a more sensible and more appropriate headroom target to go to, so yeah, absolutely, fully engaged with the FSA on that.

Ron Sandler

Clive, do you want to comment on the debt covenants?

Answer: Clive Bannister

Greig, thanks for the question. The covenants as you can imagine with a large complex facility in two silos are numerous and linked but you could put them into three buckets and one bucket is to do with the dividend cap; one is to do with internal restructurings; and the third, which you alluded to, is the ability to do acquisitions and use cashflow for purposes outside the fund. There are others and I think it goes and plays exactly to what Jonathan said about not feeling impelled and therefore, doing something which is in the round of benefit to shareholders. There are many moving pieces and there are restrictions but all things being equal, we'd like to operate the business in a more flexible way and that does also include the legal structure. Would you add to that Jonathan?

Answer: Jonathan Yates

I think that expresses it perfectly.

Greig Paterson

The reason I'm asking the question I believe there's a few, and you alluded to it early on, close funds up for auctions or up for sale currently, I was wondering if you raised equity to buy them whether the covenants would prevent you from doing it? Or is it only if you make

use of the 700 that you release? I'm just trying to understand are your hands tied completely or if some very lucrative deal came along and you could motivate it to shareholders you could do it by raising equity?

Answer: Clive Bannister

As I said, we have these buckets, dividend cap, internal restructurings the way in which we use cashflow for acquisitions and our legal structuring so they're all linked. We are in constant and productive dialogue with our banks and under circumstances which were favourable to shareholders we would have a discussion with them. There is a congruence between our desire to run the business in a manner which progressively degears, as Jonathan said, towards an ability to fund in the capital markets and also the bank's desire to see us as very successful. But we would not look, as I said, to doing anything that was dilutive or non accretive to our shareholders for any forms of transactions.

Greig Paterson

A simple yes or no could you; if a deal came along could you arrange equity?

Answer: Jonathan Yates

Our structure is such that we have a holding company that sits at the top and then we have two silos underneath which hold the life companies and which relate to where the debt is raised. Our holding company could raise equity capital and could go and make an acquisition. However, there is no suggestion that we are even remotely thinking of doing that at the current share price we don't think that would necessarily be in our shareholders' best interest. We could use some of the cash within the silos that exist to go off and make acquisitions but that would require bank consent at any material level.

Answer: Ron Sandler

And I think we were quite explicit on that point about acquisition funding in the presentation I urge you to go back to some of the words that were used because they were quite carefully chosen.

We have a question at the back there.

<u>Question 9</u>

Andy Hughes - Exane BNP Paribas

Thank you very much. Just a quick question about the a hundred million you were talking about in terms of EV benefit. I think Jonathan mentioned that might be largely capital related. I'm just struggling how you could get such a large EV benefit from changing capital given the runoff for the business and the difference between the discount rate and the earned rate. It seems to suggest you're going to release an awful lot of capital to generate £100 million per annum of EV benefits. Are there other things such as reviewing the outsourcing arrangements or are they largely capital related? Thank you.

Answer: Jonathan Yates

It's a combination of all this. If you release capital the point there is you've actually released it a hell of a lot sooner therefore you don't suffer the discount on it, but as you say, you'd need to release a lot of capital to get that sort of measure of benefit. But there are other means of enhancing EV as well such as getting a better yield at a less risky basis on assets.

So there are a range of options that we can look, merging funds and those sorts of opportunities.

Andy Hughes

Thank you.

Answer: Ron Sandler

Are there any further questions? Are there questions from the web? Apparently not, I'm being advised or questions over the phones. No okay. There is a question from the front row however. Greig.

Question 10

Greig Paterson

When was this £1.2 billion loan portfolio when you removed the gearing structure over it you effectively reduce the risk and reduce the return and hence which would imply if you're using like a CFO Forum MCEV basis that would reduce the liquidity premium, that’s a point, and maybe you want to discuss why it went the other way?

And second of all is, the market consistent principles one pound of assets is one pound of assets whether you put it in cash or property or whatever. So I was just trying to figure out what sort of logic you apply to produce your liquidity premium because they're sort of in breach of the general certainty equivalent principle? And are you using the explicit CFO forum methodology which is at 40% plus the AAA minus 40 bps or are you using a more discretionary basis? You understand there's some oddity in the direction and there's some oddity in the behaviour.

Answer: Jonathan Yates

I think it's a fairly simple answer which is that we just weren't taking any credit for that liquidity premium before and we are now afterwards. In other words we weren't taking any benefit from holding these assets at all.

Greig Paterson

Yes but is it that explicit the CFO forum's latest thinking

Answer: Jonathan Yates

Entirely in line with our disclosed basis.

Greig Paterson

Yes but is it that explicit the CFO forum's latest thinking because I know people have moved to it?

Answer: Jonathan Yates

Yes.

Greig Paterson

All right, cool.

Ron Sandler

We have another question.

<u>Question 11</u>

Andy Hughes

Just a quick question on the loans portfolio, unleveraged loans portfolio you just described, are they at market value? How do you put them on the balance sheet, are they fair value or are they at face value?

Answer: Jonathan Yates

Are you talking about the debt on our balance sheet?

Answer: Ron Sandler

No this is the Alpha loans.

Andy Hughes

Are they at fair value or are they accounted for at face value ?

Answer: Jonathan Yates

They're marked to market.

Andy Hughes

And is there a market value for these? How do you assess them?

Answer: Jonathan Yates

Yes we're able to work out, they have a yield and we're able to work out a value based on upon the rating.

Andy Hughes

So how does that compare roughly to the face value of the lines, is it a lot higher given interest rate movements since then?

Answer: Jonathan Yates

I'm not sure of the answer to that to be honest, I don't know where. Do you know where they're standing relative to par?

Answer: Mike Merrick

No.

Andy Hughes

Okay. Right, thank you.

Answer: Jonathan Yates

I think they're probably slightly above par actually but I'd need to check up on that.

Ron Sandler

Are there any final questions? Apparently we don't have anything from the web or the phones, I'm just checking again at the back. We have one.

Jonathan Yates

On that last question can I just say actually they are standing at a discount to par. They're fairly illiquid assets so obviously they are standing at a sort of reasonable discount. Sorry I should have given that answer straight off.

Ron Sandler

Can we route the call through please?

Question 12

Marcus Rivaldi - Morgan Stanley

Thank you. Good morning. I was wondering if you could just explain or provide some more colour around please one of the risk factors that you flag up in the reporting this morning around distributions from the companies around Solvency II risk, around that please?

Ron Sandler

Mike can I look to you and Jonathan too on Solvency II?

Answer: Mike Merrick

There's still a considerable amount of uncertainty around where Solvency II will end. We have done our QIS5 results we're not disclosing the details of those, but very broadly the picture is not dissimilar to the picture that we see under our Pillar 2 results. So there's still a way to go though and it is does still remain a risk.

Marcus Rivaldi

And has there been any discussion that perhaps your current legal structure which has the Impala Holdings and then the bank debt sitting above that would get wrapped into the current IGD scope of Solvency?

Answer: Mike Merrick

I think our expectation is that the scope of IGD will remain the same so the IGD will be struck at the PLHL level rather than the PGH level, and that, therefore, those structures will remain in place as they are today, although we'll continuing keep our eye on the emerging regulations.

Marcus Rivaldi

Okay thank you.

Answer: Jonathan Yates

I think that's a fairly key point to make. We have no expectation that it will be, IGD will be struck anywhere other than at the level which is currently struck in terms of the UK holding companies. It won't be struck at the level of PGH which includes the debt. And that's a discussion that we have had with the regulators.

Marcus Rivaldi

Thanks very much.

Answer: Ron Sandler

If there are no further questions, I don't believe there are any, I think all that remains for me to do is to say thank you very much indeed for your time and your attention. And thank you, colleagues, for your contribution this morning. And we look forward to taking any further questions that you may have offline.

Thank you very much.