PHOENIX GROUP

2014 Full Year Results

Wednesday 18th March 2015

Sir Howard Davies – Chairman

Good morning ladies and gentlemen, and welcome to our 2014 Results presentation. When we chose 18th March we chose it because we thought there'd be nothing much else on, on the day, but it wasn't a great tribute to our forecasting! Welcome to these modest surroundings, and thanks to J.P. Morgan for hosting us. I think this hall is not so much too big to fail as too big to fill, but we'll do our best to engage you.

As you already know, this will be my last presentation as Chairman of Phoenix Group before I take up my new responsibilities at RBS on 1st September. But I don't take over there until 1st September and until then remain very firmly focused on Phoenix, and I'm delighted to say, as a headline for this morning, that I will be leaving the Group in robust health. I am also personally in robust health, in case any of you are anxious, but both the Group and I, I think, are in good shape.

In 2014 we delivered a strong set of financial results. We significantly reduced our level of gearing, and we achieved a comprehensive debt restructuring. You will hear the detail of that from my colleagues this morning, Clive Bannister, Group CEO whom you've met many times, Jim McConville, the CFO, as well as Andy Moss, the CEO of Phoenix Life.

In the last three years we have consistently met our financial targets, we've diversified the Group's debt structure, and significantly, I think, the shareholder base has been normalised with the exit of many of the original private equity investors. So we now have a more normalised financial structure, a more normalised shareholder base, such that you would expect for a company of this kind, and a streamlined Board as the original PE investors have left us and we have a conventional and very high quality, I should say, Board for a public company, which is well placed to lead the Group into the future.

Lastly from me, I should say, that the Board recommended, after its discussion yesterday, a final dividend of 26.7p per share, in line with the 2013 final dividend, and consistent with the stable and sustainable dividend policy which the Board endorsed at its meeting earlier this week.

I would now like to hand you over to Clive and the rest of the team. We expect this presentation to last about 35 minutes, and then there'll be an opportunity for you to question the team. Thank you, and I'll hand over to Clive.

Clive Bannister – Group Chief Executive

Howard, thank you. I feel quite nervous coming back to a headmaster's hall, it brings back a whole set of memories that I could do without! And clearly I hope I am not going to be acoustically challenged because these results are terrific. It's been a transformational year for the Group, and that is supported by very strong financial performance. The year has also seen significant regulatory changes which will continue to develop during the rest of 2015. I

believe that the work we have undertaken in the past 12 months has now positioned Phoenix to face this new environment with great confidence.

2014 was exceptionally busy. In March we announced the divestment of Ignis Asset Management to Standard Life. This was completed at the start of July. We have re-engaged with the debt capital markets, successfully raising £300m with the issuance of a 7 year senior bond. This was closely followed by the refinancing of the Group's remaining senior bank facility and associated debt into a single £900m bank facility.

Finally, in January this year we saw the successful exchange of 99% of our Tier 1 bonds into new subordinated notes with a maturity of 2025. This comprehensive debt refinancing has reduced gearing and interest costs, extended the term of the debt, and will allow us to continue to simplify the Group's corporate structure. It also supports our ambition to achieve an investment grade rating and to acquire more closed life businesses in the future.

Turning to the maths. Since 2011 we have set ourselves three financial targets: cash generation; incremental MCEV; and gearing. Our target range for cash generation for 2014 was £500m to £550m, which we have exceeded, with total cash generation of £567m in 2014. We also made a good start towards our longer-term cash delivery target of £2.8bn between 2014 and 2019, by the delivery of £957m assisted by the £390m received upon completion of the Ignis divestment.

In March 2014 we set ourselves a new target of £300m of MCEV enhancements from management actions from 2014 to2016. By the end of 2014 we had already delivered £261m, a huge step forward towards this goal in only a single year.

And last, we reduced our gearing ratio to 34%, surpassing our 40% target. I am pleased to report that the reduction in gearing will also result in a 37.5 basis point reduction in the bank facility margin, from 350 basis points to 312.5 basis points on the entire £840m outstanding facility.

In 2009 the Group was heavily indebted and dependent upon short-dated bank facilities. Since then we have sought to strengthen the balance sheet through the delivery of management actions and progressive reduction of our debt. The reduction in the level of gearing culminated in the comprehensive debt refinancing achieved in 2014. This work has continued into 2015 with the successful Tier 1 bond exchange, and we now look forward to achieving our aim of an investment grade rating.

Having exceeded our 2014 gearing ratio target, we will now aim for a leverage level that is consistent with this ambition. The bank facility margin would fall by an additional 50 basis points on achievement of an investment grade rating, a good goal for us in 2015.

2015 will be an important year for the life industry given the upcoming regulatory changes from both a capital and a conduct perspective. Although there remain a number of uncertainties, as time progresses we are getting more comfort on the expected outcome of Solvency II. We continue to work on our Internal Model application, currently planned for June. We expect to be well capitalised under the new Solvency II regime, and expect the Group's capital position to be in excess of the current PLHL ICA surplus, although this is subject to regulatory approval and clarification of further outstanding issues.

Second, we have been preparing for the new pension freedoms that will take effect from April this year. This includes investment in our customer teams and new partnerships to provide a wider range of products for our customer base. We also continue to take steps to

ensure that our customers remain aware of their benefits, and we look forward to the conclusion of the FCA review into legacy customers, expected at the end of the first half of the year.

Finally, I remain convinced that there is a significant opportunity to generate further value from M&A. Once the uncertainties around Solvency II and the FCA review are resolved, the environment for transactions should improve. The actions we have taken from a financial and operational standpoint put Phoenix in a strong position to play a leading role in the industry's future consolidation.

I will now pass you across to Jim, who will take you through the financial results in greater detail.

Jim McConville – Group Finance Director

Thank you, Clive. Good morning everyone. I'll take you through each of the key metrics in more detail shortly, but let me set out in summary the key results.

Cash generation of £567m, ahead of our stated target range for 2014, and with a further £390m of cash from the divestment of Ignis. Total holding company cash of £988m at the end of 2014. IFRS operating profit of £483m, an improvement on 2013 despite the Ignis divestment halfway through the year. MCEV of £2.6bn, a significant increase on 2013. Gearing reduced to 34% through a combination of the higher MCEV and further debt repayments. The Group's solid capital position has been maintained. And total 2014 dividends of 53.4p per share, which includes a recommended final dividend in respect of 2014 of 26.7p per share.

Cash generation in 2014 amounted to £957m, of which £390m was from the completion of the sale of Ignis. Of the remaining £567m, £180m arose from the delivery of management actions, and Andy will talk about this in more detail shortly. The operating expenses of the Group have reduced through continued strong cost management. The payments to the two Group pension schemes reflect the contribution schedules agreed with the Trustees, and the contributions will fall further to £55m in 2015, in line with those agreements. And we have repaid over £600m of debt in 2014, and a total of £1.3bn over the past two years. Although there were significant one-off costs in relation to our debt restructuring over the course of the year, debt interest costs reduced sharply during the period as a result of the lower overall debt levels, and the expiry of the out of the money interest rate swaps on the bank debt at the end of 2013. And lastly, we paid out £120m in dividends, in line with 2013.

Free surplus represents the excess capital over and above the strong capital policies in the life companies. We started 2014 with £529m of free surplus, and following distributions to the holding companies during the year, £196m of free surplus remains as at year end under the current Solvency I regulations. As previously announced, in the first half of 2014 we strengthened our ICA stress assumptions related to longevity, credit and correlations, which impacted the free surplus generation by £0.2bn. This has resulted in a lower free surplus as at the end of 2014. But in addition to the free surplus held at Phoenix Life, almost £1bn of cash is held at the holding companies.

The following slides recap on the progress we have made regarding the Group's debt structure. The equity raise and debt re-terming that we achieved at the start of 2013 has been built on over the past 12 months. The sale of Ignis to Standard Life led to increased MCEV, and a substantial debt repayment resulting in a significant reduction in our gearing level. We then accessed the debt capital markets last summer with the issuance of a £300m

senior bond. This allowed us to reduce the quantum of our senior bank debt, and refinance the two existing debt silos into a single new facility, reducing the interest margin and lifting a number of restrictions on the Group.

More recently, we have taken two further actions with regard to the Group's subordinated debt. First, a consent solicitation for the Tier 2 bonds issued by Phoenix Life Limited to ensure that the bonds could be grandfathered as capital under Solvency II. And second, a highly successful exchange of the Group's Tier 1 bonds, which have a call date in April 2016, into new £428m 10 year subordinated notes maturing in 2025. The terms of these new notes meet the requirements of Tier 2 capital under Solvency II.

Taken together we have radically simplified our debt structure in preparation for Solvency II. Our proven ability to access the debt capital markets positions us well as we seek to grow the business going forward.

The debt restructuring has also allowed us to match our amortisation profile more closely to our long-term cash flows.

At the start of 2013 we faced a number of sizeable, senior bank debt repayments over the period 2014 to 2016. Over the past two years we have been able to both repay a significant quantum of debt and smooth the amortisation profile of the remainder through the issuance of bonds in the debt capital markets and the refinancing of the legacy bank silos. And as can be seen by the bottom chart, we now have a range of debt maturities with no significant repayments in the near term, and there remain further opportunities for debt capital market issuance in the future.

In addition to extending and smoothing the maturity profile of the debt we have also been successful in accessing different sources of funding. We now have a more balanced mix of funding sources, moving from the bank markets towards the debt capital markets. We have also been successful in moving the mix of funding towards a greater proportion of subordinated debt rather than a reliance on senior debt. And we will continue to look at opportunities to further diversify our funding away from senior bank debt.

Now our senior bank debt borrowing has interest costs pegged to our financial leverage ratio: as this falls, interest costs will fall. The reduction in the gearing level achieved in 2014 has meant that we have triggered the first of these reductions in the bank margin, lowering the cost of debt by 37.5bps.

We continue to make good progress towards our ambition of achieving an investment grade rating. We have started discussions with each of the main rating agencies, on an informal basis, to better understand their approach to ratings for closed life businesses. We have also taken forward our internal programme of preparing for a formal ratings application and we continue to aim to complete the ratings process during the course of this year. If we achieve an investment grade rating our bank debt costs will fall further by 50bps.

Clearly the quicker we are able to gain final clarity of Solvency II the better; but the actions we have taken over the past 12 months have significantly enhanced the Group’s credit story.

The successful Tier 1 bond exchange has provided an opportunity to align our reported gearing methodology with that used for the bank facility margin reductions. The current methodology, which we announced at the start of 2013, accounted for the Tier 1 bonds at 50% of their value, reflecting their hybrid nature and the methodology of the rating agencies

at that time. Given the Tier 1 bond exchange this is no longer a relevant consideration and the pro forma impact of the exchange is an increase in the gearing ratio to 38%.

In order to simplify our reporting we will now report a Financial Leverage ratio aligned to the definition used in the bank facility documentation. Our gearing under this Financial Leverage methodology was 39% as at the end of 2014. The 1% difference arises due to the switch from using the IFRS value of debt, to the face value of debt, in the calculation. Therefore this change in methodology does not have any impact on either the overall level of debt the Group holds or on how we expect the rating agencies will perceive our credit story and financial standing of the Group. We will continue to manage our gearing at a level consistent with the achievement of an investment grade rating.

We set out here the material movements in MCEV over the year. For clarity we have shown the value generated from management actions separately.

So, moving from left to right: we generated post-tax operating earnings of £148m, excluding management actions. We delivered £261m of incremental value through a number of management actions that Andy will discuss in a moment. The divestment of Ignis added £248m to Group MCEV.

During 2014 we incurred costs in relation to regulatory and legislative changes, which we announced with our half-year results. These included a £15m impact for a reduction in our take-up rate assumption for guaranteed rate annuities following the pension reforms announced in the Budget; and a £20m anticipated reduction in future profits with regard to the cap on workplace pension charges. We have therefore halved the original £40m provision relating to the workplace pensions cap that we made at the half year as the expected impact is now less onerous than we first predicted. We have also prudently allowed for the anticipated cost of the PensionWise guidance, introduced alongside the new pension freedoms.

Economic variances, non-recurring and other items, totalled negative £39m, primarily reflecting the difference between the short and long-term rate assumptions and other market movements.

The increase in the market value of the Group’s listed bonds reduced MCEV by £68m, demonstrating the significant improvement in the market’s view of the Group’s credit standing.

And finally we incurred finance costs, including the Tier 1 coupon, of £90m, and paid dividends of £120m. And at the end of 2014 the Group MCEV was £2.6bn, representing MCEV per share of £11.76.

Now turning to look at IFRS. In 2014 Phoenix Life operating profit was £487m, which includes £165m from management actions. The increase in operating profits compared with the previous year is particularly pleasing as the 2013 results included a full year’s profit from Ignis; whereas 2014 only included the half year result of £17m.

There were positive non-recurring items due to a gain on the disposal of Ignis of £107m, and a £68m benefit from the restructure of the PGL pension scheme longevity arrangements. We incurred £88m of finance costs, a significant decline from 2013. And finally, after tax we generated a profit of £406m.

Moving on to Group capital. As a reminder, we look at our Group solvency position on two bases: IGD, which is a Pillar I assessment of the Group's capital resources and requirements; and PLHL ICA, which is a Pillar II assessment. Clearly both these Group capital metrics will be replaced by Solvency II when it comes into force at the beginning of next year.

At 31 December 2014, the IGD surplus and headroom were £1.2bn and £0.5bn respectively. The IGD position remains the Group's biting regulatory constraint. The surplus and headroom were unchanged over the year, with capital generation, management actions and the divestment of Ignis offsetting the bank debt repayments and other outgoings from the holding companies. Our IGD position remains robust, and continues to be relatively insensitive to market movements.

And now turning to look at the Pillar II position. The PLHL ICA surplus was £0.7bn as at the end of 2014, with £0.6bn of headroom above our capital policy. The reduction over the year primarily reflects the bank debt repayments, together with the £0.2bn strengthening of ICA stress assumptions related to longevity, credit and correlations, which is shown in the graph as a negative impact on capital generation. In addition, the decline in yields seen during the final quarter of 2014 has also had a negative impact on the PLHL ICA surplus and the metric remains sensitive to further declines in risk-free rates.

We have previously stated that we expect the capital position of the Group under Solvency II to remain broadly aligned to the PLHL ICA surplus. Although we are unable to give specific figures at this time, based on our current expectations of the Solvency II regulations we now believe the Solvency II surplus capital position will be in excess of the current PLHL ICA surplus.

This slide sets out the cash generation going forward. 2014 was another successful year with target-beating cash generation. The blue box relates to the organic cash flows and the green box relates to £180m of cash flows generated from management actions.

As for many of our peers, 2015 will be a year of transition as we position the Group in readiness for the new capital regime. Our cash generation targets are based on actual remittances from the operating companies to the holding companies and therefore 2015 is impacted by the remaining Solvency II uncertainties.

Today we set a 2015 cash generation target range of £200m to £250m due to the retention of capital in the life companies in the short term. We will of course update you on this target as Solvency II becomes clearer during the course of the year.

Although the 2015 target is impacted by this one-off transition to Solvency II it should be noted that the longer term target of £2.8bn remains unchanged, with cash generation targeted to return to an average of around £400m over the remaining four years of our forecast period.

Furthermore, I said at the time of the half-year presentation, we expected further cash generation post 2019 of £3.3bn. We have now increased the expected cash flows after 2019 to £3.6bn, in large part due to the increase in expected future management actions. This is a clear demonstration of how we continue to add value to shareholders from the existing book of business.

Given our long-term cash flow generation target we have reiterated here the illustrative sources and uses of cash over the 5 year period to the end of 2019.

We begin with our current cash at the holding companies' level of £1.0bn. And the green bar to the right of this of £1.8bn represents the remaining cash generation expected to emerge over 2014 to 2019 based on our existing 6 year target of £2.8bn. And continuing to the right we show the various uses of that cash over the period to 2019, including £0.6bn 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. This demonstrates our confidence in a stable and sustainable dividend in the future.

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

As I mentioned, we expect there to be around £3.6bn released as cash to the holding companies after 2019. This is represented by the green bar, and is £0.3bn increase since the half year results, helped largely by the higher level of future management actions. Known uses of this cash include the remaining pension scheme contributions and outstanding shareholder borrowings. And this leaves an estimated £3.2bn 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 acquisition we undertake, as set out before, would have to help to sustain our dividend, be value enhancing and ensure leverage was at a level consistent with achieving and maintaining and an investment grade rating.

I will now pass you over to Andy to cover the recent developments at Phoenix Life.

Andy Moss – Chief Executive, Phoenix Life

Thank you Jim and good morning everyone.

During 2014 we continued to enhance the Phoenix Way, our approach to delivering Shareholder and Policyholder value.

Our new actuarial modelling platform, MG-ALFA, is now fully in use to generate all our financial measures and positions us well to meet the new Solvency II reporting requirements in an efficient manner. We completed the transition of investment fund accounting and custody from multiple providers to HSBC and have established new operating procedures with Standard Life, following their acquisition of Ignis, and are well on the way to moving to the Standard Life operating platform. All of this has enabled us to improve the effectiveness of our operation and has assisted us to continue to run down cost in line with policy count, despite increased requirements arising from regulation.

On the customer side, we've increased the distributable estate in our with-profits funds by £184m through management actions including de-risking and enhanced modelling. We have also been proactive in publicising the risk of pension fraud and have played a key industry role in building awareness of this issue, especially in the lead up to pension freedom in April, where consumers face an increasing threat from fraudsters. For our own customers, we've already prevented £22m of pension scams. Finally, we've also improved customer experience on a number of measures, particularly around claims experience.

We set ourselves a target of achieving £300m of incremental MCEV over the 3 year period from 2014 to 2016. I'm delighted that only one year into the target period, we have already achieved a total of £261m of incremental value. This good performance is testament to the work undertaken by my colleagues and includes: a restructuring of the longevity risk within the PGL Pension Scheme; improvements from the standardisation of methodologies across funds as a result of moving to our newly developed MG-ALFA actuarial model; and the successful resolution of historic tax legacy issues.

As can be seen in the right-hand chart, we've also continued to be successful in generating additional cash through management actions, on top of those that flow from the organic run-off of the Group's life policies. Over the past 6 years, Phoenix has generated a total of £1.6bn of cash from management actions.

Our expertise in identifying and executing management actions stands us in good stead as we move into a Solvency II world and I am confident there remain further actions that we'll be able to take to ensure we maximise our capital efficiency under the new regime.

One of the big challenges for closed book consolidators is to have an operating model that is scalable both upwards and downwards. This was a key topic at our Investor Day in November. The table above shows that we continue to be successful in being able to run down our cost base in line with our policy run-off. This is underpinned by the variable cost nature of our outsourced relationships. And we've also undertaken a number of initiatives to reduce our retained cost base. Most notably, simplifying our legacy actuarial modelling platforms, reducing costs and improving the management of risks within the business.

All of this demonstrates cost efficiency, and the development of our operating models means that it is also scalable upwards, allowing us to on-board further closed funds in an efficient manner.

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 promises made to customers in their products and to provide high levels of security and service.

Customer engagement in financial services products remains a challenge for the insurance industry. We continue to look for all possible ways to encourage customers to connect with their policies and have recently undertaken more research to help us understand what we can do to make our communications as helpful as possible in encouraging this re-engagement. Thus, we have reinforced a programme of improving our communications to give our customers progress updates on their policies, but also to remind them of the key features and benefits of their products.

The right-hand side of the slide sets out some of the key customer metrics and indicators that we track against. These are the same targets we showed you previously and take into account benchmarks that we see externally. For the year to date, we have beaten all of the targets and will continue to seek ways to improve and ensure that these levels are maintained.

Clearly, significant work has been going in to getting ready for April 6th. We expect more contact from our customers once the new freedoms come into force. We have made available additional resource and are building and delivering training programmes to equip ourselves to deal with this anticipated spike in activity. Our plans are well advanced and we will be encouraging our customers to make full use of the new government guidance service, PensionWise.

It is difficult to know how customers will react to the new freedoms, but we continue to believe that annuities remain a good solution for a number of our customers, especially those with valuable guaranteed benefits which are a significant improvement on any rates that would be available in the open market today. As a result, we will continue to write annuities for our existing customers post April 6th.

We've also amended all of our systems to allow full encashment, should that be what our customers want, and have increased flexibility for some products. Where the product does not support flexibility, we will continue with our model of having partners in place who will help our customers source more sophisticated options.

We anticipate ongoing development in the area of pensions, as evidenced by the recent announcement on our possible "secondary market" in annuities. Therefore, this is undoubtedly a confusing time for customers as we see the most radical change to pensions legislation in the last 50 years. Our focus remains on doing everything possible to help them make informed decisions.

I will now pass you back to Clive.

Clive Bannister

Andy, thank you.

I am delighted that we have made such good progress in 2014 and this has allowed us to revise some of our financial targets upwards.

We reiterate our long term cash generation target from 2014 to 2019 of £2.8bn. Given the transition to Solvency II, we are targeting between £200m and £250m of cash in 2015.

We have already delivered a large portion of our incremental MCEV target of £300m between 2014 and 2016, and we believe we can generate additional incremental value, and so today, we have increased the target by 33%, or £100m, to £400m between 2014 and 2016.

As Jim mentioned, having achieved our gearing target, we are now focused on achieving an investment grade credit rating during 2015. We will therefore manage our leverage in line with this ambition.

To conclude, Phoenix's business model is about generating predictable cash flows 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 £1.8bn. 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 bringing both financial and structural benefits to the Group.

Altogether, these actions will help the Group as it transitions to the Solvency II regime, as well as enhance its position in the debt capital markets and facilitate our strategy of creating significant value through future M&A.

We believe that the achievements of the past 3 years have now positioned us to be a leading participant in the next wave of consolidation of the UK closed life fund market.

Now despite it being 6 months before Howard "lays down the seals" of office at Phoenix, I would like to take this public opportunity to acknowledge his very great contribution to Phoenix. He has been a model Chairman to the Board, with my senior colleagues and to me. His efforts have helped us rebuild Phoenix, and whilst, of course, wishing him well at RBS, we will miss him. Howard, thank you.

Sir Howard Davies – Chairman

Thank you very much Clive.

That brings us to the end of the formal presentation and thank you for staying with us for that, and we'll now move on to questions and answers. Perhaps you could wait for a microphone to be brought to you, which is on its way. If you could give us your name and institution and we'll answer the question. And we may have questions on the internet and we'll take those later.

Q&A

Question 1

Ming Zhu – Canaccord

Good morning, three questions please.

The first question is that you have £196m free surplus at the Life Company level and that's under Solvency I. What is the equivalent number under Solvency II and how much do you need under Solvency II at a Life Company level?

And the second question is, you've delivered good cash generation in 2014 and prior years, so why is the target for 2015 £200m to £250m? That seems very low, and how conservative is that? And because you have kept your £2.8bn long term target unchanged, why couldn't you smooth this out by management actions, and/or, given that you have £1bon cash at the Holding Companies?

And that leads to my third question. Given the £1bn cash you have at the Holding Companies, how much conservatism or buffer have you built around that, or are you holding some of that for M&A? Thank you.

Sir Howard Davies

Thank you. I think Clive might kick off.

Clive Bannister

So there are three questions there, Ming, and as always, welcome, very good.

Let's start with the second question, which was about our cash flow, and then I'll ask Jim to deal in greater detail with that, and also with the free Life Company surplus of £196m on Solvency I versus Solvency II, and then we'll wrap up on what we do. We have £1bn of cash at the holding company, £988m, and we'll talk about that. So I'm going to make some general points.

First of all, Ming, this is a transition year. What we have described today is it doesn't affect MCEV at all, it therefore doesn't affect value. It is all about timing, and you, of all people, will understand that.

It was extremely important that we reconfirmed the £2.8bn, in addition to which Jim gave us further sight, past 2020, raising what had been a £3.3bn number of cash to £3.6bn. We generated £567m of cash flow last year. You know that we have a very good track record of meeting and exceeding our targets, and we have also reconfirmed the dividend.

Put in the round, that is our best way of explaining – and I go back to what I said right at the beginning – this doesn't affect our MCEV, this is all about timing and it's the prudence that we're taking in positioning ourselves for the successful navigation of Solvency II.

So Jim, I don't know if you want to talk about the details of that?

Jim McConville

Thank you Clive, as usual, you steal most of my thunder.

Solvency II, we have said, is a transition year and I think you will have seen many companies refer to the continuing uncertainty around many of the items affecting Solvency II. And in our case, notably the transitional arrangements and how they work, and the matching adjustment and how that will play through. So we have that uncertainty along with others. However, based on our current understanding of the Solvency II regulations, we expect that our surplus at a Group level would be in excess of the PLHL ICA surplus, the Pillar II surplus that we have today, so that is good news.

What is affecting the timing of the cash coming up in 2015 is that although the surplus is going to be higher than the PLHL ICA surplus, there is a rebasing between the Group companies and the Life companies. We have more surplus at the Group level and slightly less at the Life Company level, which would impact the 2015 number, and therefore, we're taking a cautious view of that 2015 release. However, what we do see, again looking at the Solvency II regulations as we interpret them today, we still will be able to meet the £2.8bn target which means that the remaining years between 2016 and 2019 will have to deliver an average of £400m compared to what would have been £370m under the old regime, so a slight uptick, but we're confident that that £2.8bn target is achievable.

Sir Howard Davies

Thank you. Anyone got any slightly easier questions? Yes?

<u>Question 2</u>

Kailesh Mistry – HSBC

Just on that – Solvency II surplus being higher than the ICA – will the surplus only add to the headroom or both to the capital policy and the headroom, firstly?

And secondly is there any major change in management's view on the M&A outlook since you last addressed us or are we still in a holding pattern until some of the regulatory issues disappear?

Sir Howard Davies

Thanks. Maybe Clive could deal with the second and then Jim the first, yes?

Clive Bannister

Certainly. I've used the word 'hiatus', you've used the word 'holding pattern', I think both are well chosen. There are four factors which are going to drive change and in our opinion will increase the opportunity for us – there will be more deals in the future. Those four factors are: this is an extremely expensive business to run if you're in a run-off business and you don't have the advantages of our variable cost platform through outsourcing; it is a business that is attracting ever increasing regulatory scrutiny; capital is trapped and, as some other people have shown, the capital returns in the business have been declining or have not been comparable to other business lines; and the annuity changes announced by the Chancellor a year ago have clearly changed the tectonic plates and the economics of much of our business. This means that without doubt there will be deals taking place.

The holding pattern and hiatus that we've made reference to before is a function of two factors in my opinion. The first is, under Solvency II it is extremely hard for a vendor to know the worth of what is being sold and it's virtually impossible, for the reasons that Jim has gone through a few minutes ago, for us to understand the capital value of something that we're acquiring. On top of that you would put the second reason – the FCA legacy review. I think there's an overhang related to that – it will finish in June, that is what we're led to understand – but there is still a worry that some new shareholders would be in-boarding problems of the past and I think we have to wait for Solvency II to go further down the track and the FCA legacy review to reach its conclusion.

Jim McConville

I think on your first question, Kailesh, what we're saying today is that the expected Solvency II position is expected to be in excess of the surplus on ICA position. We're not giving any indication yet on the headroom over the capital policy. These will be matters that we will need to resolve as a Board and in discussion with the regulators in due course as the final regulations emerge and the clarity comes through.

<u>Question 3</u>

Ashik Musaddi – J.P. Morgan

Just a couple of questions. In the past you have done a big longevity swap deal with Guardian, do you look to do any such deal going forward given you're just ahead of Solvency II or are you comfortable with your longevity risk at the moment? That's the first one.

Secondly, Clive, would you mind giving us an update on the FCA thematic review and the annuities review? Do you see any risk for Phoenix going into that review in June/July? I remember that you have mentioned that the risk is pretty low for Phoenix but just if you can remind us, what's an update on that at the moment? Thank you.

Sir Howard Davies

Again Clive, do you want to deal with that one and then perhaps Jim with the other?

Clive Bannister

Ashik, thank you. So just let me remind the audience about a year ago that the thematic review was announced. This is a review which will reach its conclusions, we're still led to understand, or led to believe, by the end of June. There were three broad areas of investigation: the first was looking at the quality of communication with policy holders; the second was for strategy of management of back books and open books, a question mark about the degree of cross-subsidisation; and the third was the obstacles that we might put between ourselves and our policyholders in terms of exit charges. I've used the phrase before that I think that this will be more of an earth tremor than an earthquake, particularly for Phoenix, and let me go through those three sequentially.

The first is we can always do better in the communication with our clients. You've heard powerfully from Andy today how hard he is working, and our colleagues, in terms of improving that communication before vesting and during the process of vesting, the quality of our website, the speed of ORIGO transfers etc… and those things, so we can always do better but we pay a lot of attention to it.

The second is the degree of cross-subsidisation between open and closed book. We don't have an open book, so all of our costs and all of our energies are focused upon our closed activities, that is a challenge maybe for other firms but it's not a challenge for us.

And then finally, what are the exit charges that we may put between a policy holder and exiting with their funds? This particularly and substantially addresses only our unit linked business. We have about £11bn, about a fifth of our business is unit linked, our average customer has around £14,000 of investments and the average exit charge is 1%, so it's about £135 to £150. We do not believe that that is a causus belli between us and the conduct review that is taking place but we have to wait the outcome of that, and so I go back to my phraseology about being a tremor rather than an earthquake.

Jim McConville

Okay, on the second question, Ashik, it was around any further planned annuity sales. As you quite rightly referenced, in 2012 we did a £5bn annuity transaction with Guardian and followed that up with a smaller transaction in 2014 involving with-profits funds and Guardian.

So in relation to annuity risk – we are happy with our longevity risk at the moment. We are within our longevity risk appetite but as ever we continue to look at a range of management actions as we go forward. So as we stand today we look at a pipeline of management actions which is quite healthy. If you refer to slide 23 which was the 5 year cash generation slide that I spoke of, we have within there an assumption broadly of about 15% of cash generation from management actions over that period which is prudent compared to what we've achieved in the past few years.

So we will continue to look at a range of management actions and that may include longevity transactions if we feel it gives us the right metrics and results. So we wouldn't rule it out but there's nothing specific on the immediate horizon.

Question 4

Barrie Cornes – Panmure Gordon

Just one question if I may. Concerning M&A, I do understand what you're saying about Solvency II leading to uncertainty but can you give some colour on sort of valuations being offered in the closed life market and what you think you might be able to acquire at? Perhaps a discount to EV or something along those lines please.

Clive Bannister

Barrie, thank you for your question. It's very opaque on pricing so I'll give you a view. These deals have happened very infrequently, let's put the elephant of Aviva and Friends to one side which you know was done publicly, just at book. The three previous deals that have taken place: there's been a small one with Direct Line; one with Ark Life and they were done reputedly at somewhere around 80% of EV but it's never been disclosed because those were private transactions. The third deal was the sale of a pensions book by HSBC, relatively small, to Admin Re and that was never put into the public domain.

We're trading at 73% of EV, Jim's already commented on the EV per share of £11.76, that's a pound up and it's an 11% increase from where we were at the end of 2013. We are very confident that we have a share price which is trading at an appropriate level to allow us to do value accretive deals if the market price is circa 80%. In addition to which, the restructuring that my colleagues have done in Treasury and with Jim now gives us access to the public market for lower price debt, longer dated debt, which gives us flexibility in the financing of those transactions.

<u>Question 5</u>

Alan Devlin – Barclays

A couple of questions. Given it's the transition year for Solvency II does that limit your ability to do management actions, at least in 2015, particularly the merging of funds or will you go ahead and do them? And also you're increasing your management actions by £100m – how much of that was related to the purchase of the equity release mortgages and is there more you can do on re-risking the investment portfolio? Thanks.

Jim McConville

Thank you, Alan. As I said earlier, as we stand today we have a very healthy pipeline of management actions, both Solvency II related and, if you like, "business as usual" impacts, so we don't see any diminution in terms of our ability to do management actions because of Solvency II. Clearly in looking at management actions, we have to look through to their impact in a Solvency II world to make sure they make sense, but we don't think it's stopping us doing anything in particular.

In relation to equity release mortgages it is our intention to make changes to our strategic allocation and that includes going into equity release mortgages and we have done a transaction which is small in tens of millions of benefit.

Sir Howard Davies

I've got something online.

Question 6

Webcast question 1 – Rupert Harcus, Guy Butler

Thank you for the presentation. Why do you envisage the gearing ratio rising to 40% and also why do debt repayment and dividends impact ICA by £800m but only £600m for IGD? Many thanks.

Jim McConville

So the gearing relates to a change in definition so there are two things I would draw attention to. Firstly, under the old basis of gearing at the end of 2014, we had a gearing ratio of 34%. That took account of an equity credit of 50% for our Tier 1 debt which was held at that time. After the year end we did a debt exchange and swapped that Tier 1 debt into Tier 2 debt which does not carry the same equity credit and that resulted in an increase in the gearing from 34% to 38%, although the actual amount of debt on the books remained exactly the same.

That brought us very close to a definition of gearing used in our bank facility documentation and to simplify things going forward we've moved to that one single measure of financial leverage – the bank definition – and that resulted in an increase from 38% to 39% and the reason for that is it uses a slightly different measure of debt, it compares the face value of debt as opposed to the IFRS value.

Question 7

Webcast question 2 – Atif Ali

Do you have any plans to issue further senior or subordinated debt this year?

Jim McConville

Thank you. As I said in the presentation it remains our intention to further diversify our debt away from senior bank debt and if we are successful in gaining an investment grade status that will give us further opportunity to look at different types of debt. We are not giving any prediction on the timing of these transactions, that will be dependent on market conditions and the financial position of the Company at the time.

Question 8

Trevor Moss – Berenberg Bank

I understand 2015 is obviously the transition year and you're leaving more money in the UK Life Companies, other people have referred to that as well through this result season. Implicit in 2016 and beyond is that the UK regulator takes a benign view once we're into Solvency II regime and therefore things effectively return to normal – it seems to be implicit in your numbers. What risks do you see to that as a view? From a regulatory perspective I would have thought a bedding down process over Solvency II for at least a year or two, then maybe taking a much more cautious line on dividends out of UK life companies or surplus generation within UK life companies and their ability to upstream that to holding companies. I wondered what you might have as a view on that?

Sir Howard Davies

One general point I would make is that once you're on an Internal Model under Solvency II the discretion for individual regulators to adjust that is much reduced. I won't say it's nil because I'm sure regulators will always be imaginative enough to find some method of doing it, but the point of Solvency II, at a high level, was a common regime model based across the European Union. So in theory once you're in a Solvency II regime the scope for individual manipulation of ratios should be significantly reduced and we'll have to see if that's the way things work out.

So at the high level I would say that it's this transitional year whilst you get to your model regime when you may see the most caution exhibited by the regulators, because once they've got into the new regime their ability to put add-ons to it is much reduced.

Clive Bannister

Howard you said the two things: one is the capacity to intervene, or intervention once it's model based should be diminished; the second is that you normally expect a continued prudence in the bedding down process. So Trevor I think you used the right word. And then I don't want to steal Jim's thunder but we believe there will be a new environment for doing more management actions, Solvency II based and focused management actions which is one of the reasons today. So it's the counterbalance to what you have suggested or your caution Trevor, and that is why today we've announced an increase of £100m in our incremental MCEV target to £400m because we think there will be an environment where we can exercise more judgement to deliver better management actions.

Jim McConville

I think the other thing I would add Trevor is I think the funnel of doubt which remains with Solvency II will narrow over the course of 2015 obviously. I mean, we will see the final guidance on transitions coming out very shortly. We will get at least industry-wide feedback, if not specific feedback but certainly industry-wide feedback, on matching adjustments we think in Q1 and there remain other consultation papers we'll get clarified into final statements over the next few months.

So I think as you go through the year the doubt will be significantly reduced and therefore once you step into 2016, as Howard says, the ability of the regulators to impose add-ons is much reduced.

<u>**Question 9**</u>

Webcast question 3 – Tom Jenkins

In terms of potential new debt issues, obviously market rating and timing dependent, would you expect to focus more on issuing senior or subordinated debt in the capital markets?

Jim McConville

That is something we will look at, at the time, I don't want to give any quotations on that at this stage.

Clive Bannister

I see the bankers smiling in our audience here.

Jim McConville

They're queuing up for mandates obviously.

Clive Bannister

I can see them taking avid notes at that question.

Sir Howard Davies

Any more or are we through? I think we probably are so thank you very much for coming, on what I know is a busy day, and we're grateful for your continued engagement with the Group. Thank you.

Clive Bannister

Thank you very much.