PHOENIX GROUP

Q1 Interim Management Statement
Friday 24th April 2015

Clive Bannister – Group Chief Executive Officer

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

I'm pleased to report the Group has generated a total of £87m of cash from the operating companies in the first quarter and that we remain on track to meet all of the financial targets we set ourselves for 2015 and beyond.

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

First, cash generation. Cash generated by the operating companies continues to be the metric which we think is most useful in helping investors understand the long-term value and predictability of our business. In the three months to 31st March we distributed £87m of cash to the holding companies. As we described in our full-year results 2015 is a transition year as we move into the Solvency II regime, and the 2015 cash generation is therefore impacted by the retention of capital in the life companies in the short term. However the cash generation of £87m is in the context of our target for the full year of £200m to £250m which we are on track to meet.

We reiterate our longer-term cash generation target of £2.8bn between 2014 – 2019. We have also over £1bn of cash at the holding company level as of 31st March.

Second, turning to capital. We report our Group solvency basis on two bases: IGD and PLHL ICA. Our IGD surplus and IGD headroom, which is the excess of the IGD capital policy, are both unchanged since year end at £1.2bn and £0.5bn respectively as at 31st March. In addition our PLHL ICA surplus and headroom are also unchanged since year end at £0.7bn and £0.6bn respectively as at 31st March.

And from an individual life company perspective we report the Phoenix Life free surplus. Following the distribution of cash into the holding companies the free surplus was £271m as at 31st March, which represented the excess capital over and above the life companies' own strong capital policies on a Solvency I basis. This has risen from £196m at the year end, with the increase being due to the acquisition of a £300m equity release portfolio which we completed in the first quarter, as well as positive market movements.

Third, the latest with regard to Solvency II. The PRA has provided additional clarity recently with regards to matching adjustments and transitional provisions, and the Group expects to formally apply for regulatory approval of the Group's internal model by the end of June.

The Group expects to be well capitalised under the Solvency II capital regime, with the Group position expected to be in excess of the current PLHL ICA surplus, subject to regulatory approval. This is as we said at year end.

And finally an update on the impact so far with regards to the new pension freedoms. It is still very early days in relation to the new pension freedoms, but the investment we have made in terms of operational capacity has allowed us to manage the process without any material administrative issues, despite a doubling of the number of incoming customer calls immediately after 6th April to close to 3,000 calls per day.

We won't see any firm trends in terms of customer behaviour for the next few months; but initial indications are in line with our planning assumptions. As we stated last month, we had revised our assumptions on future take-up rates of GAR, guaranteed annuities, and non-GAR annuities at the time of our full-year results. As expected, we have seen some customers interested in full encashment of their pension savings, particularly for smaller pots. However, the tax implications of full encashment are not well understood by many customers, and Phoenix Life is therefore providing detailed information to customers on their options, as well as promoting the availability of the government's PensionWise service. In addition customers are clearly informed that if they have guaranteed annuity rates as part of their products there is a further requirement for customers to take up financial advice before foregoing guaranteed annuity rates on pension pots with a value above £30,000.

In order to ensure customers that Phoenix Life customers have access to the wider range of options available under the new pension freedoms, Phoenix Life has agreed a wider partnership arrangement with Just Retirement. This provides customers with a wider range of products, including the ability to 'shop around' for standard and enhanced annuities, as well as offering a drawdown pension product. The new partnership also offers customers the ability to access financial advice as they plan for their retirement.

We are delighted that we have managed the transition to the new pension freedoms so smoothly; and will continue to adopt our 'test and learn' strategy as we track changes to customer behaviour in the coming months.

So to conclude: we have made continued progress since year end and remain confident of our ability to meet all of our financial targets for 2015 and beyond. We have also continued our work to achieve an investment-grade rating, and expect that we will be able to complete the process during 2015.

At this point I would like to finish and move on to a question and answer session. Thank you very much.

Q&A

Question 1

Oliver Steele – Deutsche Bank

Good morning Clive. I just wanted to follow up with the movement in the free surplus and how much of that, I don't know if you're able to do it, but whether you would be prepared to breakdown the element that comes from the equity release purchase and how that works.

Clive Bannister

Okay Oliver good morning, thank you. Jim, do you want to go through, because there are various components in the free surplus, and then perhaps address the specificity of the amount related to ERM?

Jim McConville

Okay thank you, good morning Oliver. So the free surplus rose from £196m at the end of 2014 to £271m at the end of the first quarter. The negative impacts within that were largely the dividends from the life companies that come up through into the Group, which you'll have seen in the cash generation. But it was more than offset by management actions, which included the investment in equity release mortgages and certain de-risking on other activities and positive market movements. So, of the offset which would be around about £70m in total, I would say more than half than that was as a result of the management actions. And the largest management action was the equity release mortgage.

Oliver Steele

Just to make it clear then: if we strip out the £87m dividends paid up and the £70m of other bits, as it were, then the rest of it is the underlying free surplus generation is that right?

Jim McConville

Yes.

Question 2

Max Bossino – Morgan Stanley

Hi, good morning. Just a couple of questions from me please. The first is on your progress on obtaining an investment grade rating. I just wondered if you could give an indication of what kinds of metrics the rating agencies are indicating for the achievement of an IG rating.

My second question was on the consolidation in the UK market. I was just wondering if you could give an update on what you're seeing in this space and if you have any plans for further transactions? Thank you.

Clive Bannister

Max, thank you for your question, Jim will take the investment grade rating, our progress there and the metrics which are being asked for. But why don't I deal first with consolidation in the UK market?

As we have said before, I think there is a period of hiatus, and this is largely around the regulatory environment, principally to do with Solvency II, but also we're waiting for the legacy industry review from the FCA, which we expect to come out at the end of June.

But there is no doubt that the uncertainty regarding the capital structures that this industry will operate under, which will be clear I think by the end of the fourth quarter of this year going into the spring of next year, has meant that there has been, on both sides, both vendors and acquirers, a hesitancy regarding what might take place.

We remain extremely confident that there is a very sizeable market. We have said that this is over £250bn of closed life business in the UK, and this is owned by three groups of players: UK banks; UK insurance companies; and foreign insurance companies in the UK, and that our view that the reasons why they may become and are motivated or will become more motivated sellers, remain true. This is because of trapped capital, the expense of running this business, the regulatory uncertainty, oversight and scrutiny which is taking place, and also the change in the economics as a result of the change in annuities' legislation or environment going back a year.

So those four reasons still, we think, will act as a backdrop in an industry which will undergo further consolidation, but this is currently – and let me use the phrase – 'on hold'. So that is how I would answer your second question. My other point is that we remain extremely well positioned to take advantage of this and we would like to be in the forefront as the UK's largest consolidator. So Jim, do you want to talk about our journey on investment grade?

Jim McConville

As I discussed at the year-end results process, we have a three phase process thinking about our application for an investment grade rating. The first phase, which has been completed, was an internal investigation just to make sure that we believe we're in a position to go forward.

The second phase, which we remain in but are nearing the end of, is a series of informal discussions with each of the rating agencies to better understand their approach to ratings and to start introducing Phoenix to them.

That will be followed, if we decide to proceed, with a third phase which will be the formal application process with one or more of the rating agencies. As we stand today, we are progressing well with that work and we anticipate going forward with the investment grade rating process during 2015. The timing remains a little uncertain because of some of the uncertainty around the Solvency II position.

The second part of your question was in relation to what are the key metrics that the rating agencies look at. We all have a slightly different range of metrics to look at. For us of importance I would point obviously financial leverage and interest cover. I think that would be for most applicants. We are slightly different in that we don't have new business and therefore market share in terms of industry positioning, so what's important to the agencies is understanding our strategy for acquisitions and our readiness for acquisitions. And obviously risk management frameworks remain very important and the way in which we manage the balance sheet. So these are key factors that will be in our discussions with agencies as we go forward.

<u>Question 3</u>

Ming Zhu, Canaccord

Good morning everyone. Just a follow-up question from Oliver's question on the free surplus. I took the difference between the beginning of the year and the quarter end, then add back how much is net to the group centre, and that suggests about £162m underlying the actual free surplus being generated at Phoenix Life. And I just want to clarify out of this £162m how much of that is from management actions and how much is from market movements only?

Clive Bannister

So Ming good morning. So you want a split up of that £162m as you've calculated between management actions versus market movements. Have I understood your question?

Ming Zhu

Yes.

Clive Bannister

Right, well I'm looking across at Jim.

Jim McConville

Okay I don't have that readily to hand, Ming. Can we get that breakdown back to you after this call?

Ming Zhu

Okay. It's fine, thank you.

CLOSING REMARKS

Clive Bannister

I thank everybody who has participated today. In summary, I would comment on the fact that we've delivered £87m worth of cash in the first quarter, and that, as we've said, we remain on track to meet all of our financial targets for 2015 and beyond. This is steady and sure as it goes. So thank you very much indeed.