2018 Half Year Results

Thursday, 23rd August 2018

Clive Bannister, Group Chief Executive

Ladies and gentlemen, good morning and welcome to Phoenix's first half interim results presentation. I'm joined on the podium today by Jim McConville, our Group CFO, whose additional role is reflected in his new title, Group Finance Director and Group Director, Scotland. And Andy Moss, CEO of Phoenix Life and Group Director, Heritage Business.

Now, before we start today I would like to take the time to express my gratitude and that of my colleagues to Henry Staunton, who announced his intention not to seek another three-year term as our Chairman back in May. Phoenix has benefited from his significant expertise and judgement during a time of immense growth which has seen us complete the acquisition of AXA Wealth and Abbey Life in 2016 and most recently the announced Standard Life Assurance deal in 2018. Henry leaves Phoenix stronger and more confident than it has ever been and my colleagues and I, plus the entire Board, thank him for his leadership and guidance.

We welcome Nicholas Lyons who, subject to regulatory approval, will replace Henry as our Chairman. Nicholas brings a wealth of experience from the life insurance sector and the Board looks forward to working with him in the future.

So, turning to my presentation. Phoenix has had a very successful first half of the year from both a strategic and a financial point of view. The Group delivers today a strong set of financial results with cash generation of £349m and it is clearly on track to exceed the upper end of its 2017 to2018 target range of £1bn to £1.2bn. As expected the Board declared an interim dividend of 22.6 pence per share, which is consistent with the final 2017 dividend per share rebased for the rights issue in July.

The Group has improved its capital resilience with our Solvency II surplus up by £500m to £2.3bn, delivering a shareholder capital coverage ratio of 180%. The strong financial position of the Group was underscored by Fitch's affirmation in July of their ratings of A+ with a stable outlook for both of our life assurance subsidiaries.

On the customer side, Phoenix has undertaken the important initiative to cap charges on non-workplace pensions, which Andy will detail later.

Turning to our strategic priorities. We have completed the integrations of AXA Wealth and Abbey Life, delivering cost synergy benefits of £27m per annum, that's £10m ahead of target.

Cumulative cashflows from those businesses acquired now total £768m, circa 60% of the acquisition price delivered in less than two years.

In May we announced our first external BPA transaction with Marks & Spencer's pension scheme. This has increased our long-term cash generation target by £200m.

We anticipate the completion of the acquisition of Standard Life Assurance on August 31st. Our investors were very supportive of the transaction with 99.98% of shareholders voting in favour of the deal.

Our acquisition financing is in place through the issuance of a £500m Restricted Tier 1 bond in April, and the £950m rights issue completed in July. The take-up rate of the rights issue was 96.25%, and the rump placing was 2.25 times oversubscribed.

Our expected post completion annualised dividend of £338m equates to 3.5% uplift in dividend per share, a slight increase from the expected 3% signalled at our announcement.

A new leadership team is in place. We look forward to welcoming two Standard Life Aberdeen non-executive directors to our Group Board: Barry O'Dwyer, the last CEO of Standard Life Assurance, and Campbell Fleming who is in charge of institutional asset sales in Aberdeen Standard Investments. Mike Urmston, Chairman of our life company, will chair both the Standard Life Assurance and Phoenix Life companies, with a unified Board including two Standard Life Assurance Directors.

I have expanded my executive committee to ensure that we are ready to drive forward the Combined Group. Completion is imminent and we are putting the finishing touches to our Day 1 preparations. This deal is transformational for Phoenix and I will talk at the end of today's presentation about how Phoenix is an institution that is forever changed for the better as a consequence.

I will now hand you over to Jim who will take you through the financials.

Jim McConville, Group Finance Director and Group Director, Scotland

Thank you, Clive, and good morning everybody. As Clive said we have had a strong first half of the year. I will take you through each of the key metrics in more detail shortly, but let me set out in summary the key results.

Strong cash generation of £349m, with holding company cash as at the end of June in excess of £1bn. PGH Group Solvency II surplus of £2.3bn, and a Shareholder Capital coverage ratio of 180%. IFRS operating profit of £216m, and an interim dividend of 22.6 pence per share, in line with the 2017 final dividend which has been rebased for the recent rights issue.

Whilst we do not report a leverage ratio we have been clear that we seek to maintain a ratio within a 25% to 30% range, which protects our Fitch investment grade rating. At 30th June our leverage ratio was within this target range, but following the July rights issue and the completion of the Standard Life Assurance acquisition we expect it to be below this range. This, therefore, provides us with a good opportunity to fund future growth through debt issue without any need to return to the equity markets.

The cash generation in the first half was £349m. The principal driver behind this good result was £250m of cash receipts from Abbey Life, bringing the total cash generated from this acquisition to £486m.

With regards to uses of cash, pension scheme contributions are significantly lower in 2018 following one-off contributions made during 2017. And we expect to see a consistent level of pension scheme contributions over the next few years.

Non-recurring outflows include £92m associated with hedging equity and currency risk across both Phoenix and Standard Life Assurance, and £30m related to acquisition and integration costs.

A £62m capital injection was provided to Phoenix Life Limited to fund the £470m BPA transaction with the Marks & Spencer's pension scheme. This capital contribution was based on a conservative asset mix of cash and gilts and will reduce following a shift in these holdings into higher yielding, more illiquid asset classes.

With the addition of the £494m net proceeds from the restricted Tier 1 bond issue in April this results in a holding company closing cash position of just over £1bn.

Moving onto the PGH Solvency II position. As at the start of 2018 the surplus at PGH was £1.8bn. This surplus increased at the half year to £2.3bn. The Shareholder Capital coverage ratio is 180% as at the half year, a 16% increase over the period. This solvency position is on a full internal model basis, following approval to bring Abbey Life within Phoenix's Internal Model. It also anticipates the interim 2018 dividend of £163m payable in October.

Following completion of the Standard Life Assurance acquisition the Shareholder Capital coverage ratio will fall. We have previously advised a 31st December 2017 proforma ratio of 147%.

This slide provides more detail on how the Solvency II surplus has changed over the period. The increase in the surplus has been driven by the positive impacts of management actions and the Restricted Tier 1 bond issue. Andy will take you through the management actions later.

Economic and other variances led to a reduction in surplus of £0.3bn. This principally comprises the day one strain of the BPA transaction, the cost of introducing fee caps on non-workplace pensions and the cost of equity hedging for the Standard Life Assurance acquisition which I will explain shortly.

The Group's Solvency II position remains resilient. This is in part a result of the £0.9bn additional surpluses within the strong with-profit funds and the PGL pension scheme, together with the hedging actions that we carry out, designed to protect the Group's solvency position and, therefore, our future cash generation.

The Group's most significant sensitivities are to increased longevity on our annuity portfolio and a widening of credit spreads. It is important to note that we see broadly similar impacts on our expected cashflows; any detrimental impact on our life company Solvency II position directly reduces the free surplus that is available to distribute up to the holding companies as cash. Therefore there is a direct and immediate impact on the cash generation from these stress scenarios.

We have set out in the appendices the proforma Combined Group FY2017 sensitivities. The key sensitivities remain as set out in this slide and overall the position for the combined Group remains resilient.

The majority of our shareholder equity risk arises from the Value in Force of Annual Management Charges in unit-linked funds. The shareholder is also exposed to equity risk on the value of shareholder transfers from with-profit funds. Currently the Group's exposure to equity risk is circa £1bn, but this increases to approximately £2.8bn on completion of the Standard Life Assurance acquisition.

Phoenix has a low appetite to this risk and hedges at least 90% of the exposure using short forward positions and options. The result of this hedging activity is to increase solvency resilience and therefore protect cash generation. However the approach does introduce volatility to the IFRS result.

It is important to note that the customer retains upside and downside exposure for funds with equity holdings which is not affected by this hedging strategy.

On 23rd February 2018 Phoenix hedged circa 90% of the shareholder equity exposure of Standard Life Assurance. This was identified as a key source of capital synergies associated with the acquisition, and we expected to deliver circa £300m of our capital synergy target.

In the period prior to completion Phoenix is exposed to movements in this hedged position without the offsetting movements in the value of the Standard Life Assurance Value in Force. As equity markets have risen in the period this has resulted in us recognising a loss of £105m on an IFRS basis and a solvency strain of £137m in our half year results. The Standard Life Assurance Value in Force has seen the opposite impact since the announcement, and we would expect Phoenix's losses to offset against gains in Standard Life Assurance on completion.

Moving on to IFRS, the Group's operating profit was £216m for the half year, in line with the first half of 2017. The Phoenix Life operating profit of £228m has been enhanced by management actions and positive experience variances. The impact of changes in assumptions for the period was small.

We will consider the adequacy of our longevity assumptions in the second half alongside the review of all our assumptions.

Investment return variances and economic assumptions include the negative impacts of losses on the Group's derivative positions, including the £105m loss on the Standard Life positions.

Other non-operating items were also negative and primarily relate to acquisition and integration projects, together with the impact of capping charges on non-workplace pensions, which have been partially offset by cost savings from process improvements and continued investment in digitalisation of the customer journey.

Phoenix has continued to deliver strong cash generation in the period, with just over £1bn in 2017 and the first half of 2018. This means that we have already met the lower end of the two-year cash generation target we set ourselves for 2017 and 2018. We expect the second half of 2018 to deliver cash generation in the range of £200m to £300m, and are therefore signalling today that we expect to exceed the £1.2bn upper end of the 2017 to 2018 cash generation target.

The strong cash generation reflects the success of the integrations of the AXA and Abbey Life acquisitions.

We do not expect any cash generation from Standard Life Assurance in 2018.

Moving now to future cash generation. In March we set a new five-year cash generation target for the Phoenix business for 2018 to 2022 of £2.5bn, and guided to a cash generation beyond this period of £3.8bn. The successful BPA transaction increases this long-term cash generation by £0.2bn to £4bn.

Total cashflows of £5.5bn are expected to be generated from Standard Life Assurance's in-force book, which will increase the Combined Group cash generation to £12bn. As you will note the cash generation profile of the Standard Life Assurance business is more long-dated than that of the legacy book. This is in part driven by the fact that the Standard Life Assurance book has continued to be open to business and therefore the duration of the acquired cashflows is longer than that of Phoenix.

We also expect to incur £250m of capital dis-synergies in 2019 as we move the Irish and German business of Standard Life from branches to a subsidiary through a Part VII transfer in readiness for Brexit. This cost is reflected in the numbers shown on this slide. These plans are well-advanced and have the effect of delaying an element of cash generation from earlier to later years.

We have set out here an updated version of the slide showing the sources and uses of cash for the Combined Group over the period to the end of 2022. This slide deals first with the cashflows associated with the acquisition of Standard Life Assurance.

On 31st August we will transfer £2bn of cash to Standard Life Aberdeen. This, together with a 19.99% equity stake in Phoenix, represents the full £2.9bn consideration for the acquisition. The half year 2018 holding company cash position of £1bn already includes £0.5bn of acquisition finance proceeds from the Restricted Tier 1 issue.

In July we raised £950m through the rights issue, and the rest of the cash consideration will be drawn down on the Group's existing revolving credit facility. We will consider options to refinance this drawdown through a hybrid capital issue moving forward.

After the acquisition completes, holding company cash will return to a more business as usual level of £0.5bn. The £3.2bn green bar on the slide represents the remaining cash generation expected to emerge over the period, and includes the £1.0bn cash generation we expect to deliver from the Standard Life Assurance business.

Moving to the right, we show the various uses of cash at the holding company level. These include our funding commitments to the Pearl and Abbey Life pension schemes, which remain unchanged. It also assumes that the dividend is increased from the time of the 2018 final dividend to an annualised amount of £338m. After these uses of cash, we are left with an illustrative £1.1bn of cash at the holding companies as at 2022. Over the coming years this accumulation of cash balances positions the Group to potentially deploy more of its own resources for future acquisitions, or to support BPA transactions.

There is significant expected cashflow over the longer-term with the acquisition adding £4.5bn to Phoenix's existing expectations of £4.0bn. These long-term cashflows from Standard Life Assurance provide additional durability to the dividend, and supports our stated stable and sustainable dividend policy. These longer-term cashflows do not assume any management actions, nor do they assume any value from new business generated

through the strategic partnership with Standard Life Aberdeen, or through BPA transactions. We therefore would expect these to increase as management actions are identified and new business is written.

To summarise, Phoenix's financial strength has been further enhanced during the first half of 2018. We are on track to exceed our short-term cash generation target, having completed the integrations of the AXA and Abbey acquisitions, and delivered benefits ahead of plan. With our acquisition finance in place we are ready to complete the acquisition of Standard Life Assurance, and I look forward to reporting our full year 2018 results as an enlarged Group.

I will now pass you on to Andy who will talk more about Phoenix Life.

Andy Moss, Chief Executive, Phoenix Life and Group Director, Heritage Business

Thank you, Jim, and good morning everyone.

2018 has already been another year of significant delivery for Phoenix Life. Management actions have added £384m to the Solvency II surplus, and we have increased our holding of illiquid assets to 20% of shareholder assets backing annuity liabilities. The AXA and Abbey Life integrations are now complete, delivering cost synergies of £27m per annum and cash generation of £768m, both ahead of target.

We are fully committed to improving customer outcomes, and the announcement today of the introduction of charge caps on non-workplace pensions will benefit around 250,000 customers. We continue to invest in digitalisation to improve customer communication and engagement, and to source actions that will reduce costs and/or improve returns to customers.

Management actions broadly fall into two categories under Solvency II. Those that increase Solvency II Own Funds and therefore increase the total quantum of cashflows emerging from the business, and those that reduce capital requirements and hence allow an acceleration of cash that would otherwise have been expected to emerge over time. Management actions added a total of £384m to our Solvency II surplus in the first half of 2018.

Those management actions that have primarily driven an increase in own funds, include the benefit from investing in illiquid assets and from investment fee reductions. We have also seen savings arising from our joint investment with outsourcers in the digitalisation of the customer journey. Finally, the £54m of management actions that accelerated cashflows included the Abbey Life Internal Model approval, modelling enhancements, and credit and matching adjustment optimisation.

Long-term illiquid assets return a higher yield for shareholders and better match the duration of long-dated annuity liabilities. We therefore have an active programme of sourcing illiquid assets including equity release mortgages, commercial real estate and private placements. At half year 2018, 20% of our £11bn of shareholder assets backing annuities were invested in illiquid assets. We are currently looking to originate up to £1bn of illiquid assets per annum as we move towards our target of an upper limit of 40% allocation to these asset classes, and have continued to expand our in-house team dedicated to these actions.

By the end of June we had originated £0.8bn of illiquid assets in 2018, including private placements and equity release mortgages sourced both through back book purchases and origination through established partnerships. We see the delivery of this asset allocation target as a key management action over the coming years, which supports our strategy of

growth through BPA, and will contribute to the Standard Life Assurance acquisition capital synergies.

ERM is an important asset class for Phoenix with a cashflow profile more closely aligned to those of our annuity liabilities. Phoenix Life holds £1.8bn worth of ERM, 16% of total shareholder assets backing annuity liabilities. These have been sourced two-thirds through back book purchases and one-third through origination with established partnerships. The high average age of 79 years reflects the maturity of our back book deals, and this together with an average current loan to value of 33%, demonstrates the conservative nature of our portfolio.

In July, the PRA released a consultation paper, CP13/18, which proposes a strengthening of the valuation of guarantees on ERM and the associated matching adjustment benefits. The potential impacts of this consultation paper for Phoenix are largely driven by the requirement for a risk neutral valuation approach to be applied in the calculation of transitionals. Our initial conservative estimate of the impact of these proposals, is an immediate reduction of approximately £175m in the PGH Group Solvency II surplus. These changes, if introduced, would lead to an increased level of prudence in the Solvency II balance sheet, which will unwind over time as the assets mature. It does not change the economic value of these assets. As a result, we do not expect the introduction of CP13/18 to cause us to revise our cash generation targets, and we continue to see this asset class as an integral part of our shareholder investment strategy.

Moving now to customers. Phoenix is committed to an appropriate charging structure which aims to improve customer outcomes. Phoenix’s non-workplace pension book contains predominantly older more complex products, some of which offer benefits that are often not seen in the products sold today. These benefits include guaranteed returns and annuity rates, protection benefits such as waiver of contribution, and specific bonuses linked to policy age. 75% of Phoenix’s circa one million non-workplace pensions already have ongoing charges of less than 1.5% per annum.

But we are today announcing the introduction of caps on ongoing charges on non-workplace pensions as follows. A 1.5% per annum cap on ongoing product charges for policies with a value over £5,000, and a 3.0% per annum cap on ongoing charges, and the full removal of exit charges on policies valued at less than £5,000.

The higher charge cap for the smallest pots reflects the minimum cost to administer any policy, but we believe the removal of exit charges could facilitate small pot consolidation for the benefit of these customers. A one-off cost of £68m has been recognised in the half year results for the impact of this change, which will benefit circa 250,000 policies and take effect in 2019. Following these changes, the average ongoing charge for non-workplace pension policies will be 1.1%.

Phoenix Life continues to drive forward actions which seek to improve customer outcomes. In the period we have continued our review of investment strategy by asset class to improve customer returns and reduce costs, which has been reinvested in reduced customer charges. We have also launched an initiative to enable customers to retrospectively benefit from the choices offered by pPnsions Freedom, by buying back small value annuities in payment which commenced before these freedoms were introduced.

We continue to invest in the expansion of our digital journey and now allow more customers to encash their policies online, and have recently started to provide digital annuity quotations. These initiatives lower our costs and provide a more convenient, faster and improved service to customers.

During the period we have migrated circa one million customers to our more modern administration systems to enable more digital interaction, improved services and reduced costs. As you may have read in the press, a very small number of customers, circa 0.1%, experienced some service disruption during this migration. We would like to take this opportunity to apologise for any inconvenience caused, and you will note from the slide that the service complaints metric is at the upper end of the target. All of our other customer metrics are within our target range.

I will now pass you back to Clive.

Clive Bannister

Thank you, Andy. Phoenix is delighted to announce that we anticipate completing the acquisition of Standard Life Assurance on 31st August. It is a transformational transaction for both Phoenix and our colleagues and our customers, and it is strategically and financially compelling. It is value accretive, giving us £5.5bn of additional cash generation, which clearly enhances the Group's dividend's future sustainability. Standard Life brings scale in a business that rewards size. This scale will enable us to deliver net costs and capital synergies of £720m.

We have new future opportunities, first in the form of asset growth generated from our strategic partnership; and second, we can consider for the first time growth opportunities in Europe. Our strategic partnership between the two companies is embedded through their 19.99% strategic stake in Phoenix. We welcome that.

Our transition programme is being led by Jim and has a clear set of milestones. We have the rest of our leadership team in place, most notably Susan McInnes our new CEO of Standard Life Assurance and Group Director, Open Business, who will be based in Edinburgh.

Today we are operationally ready for Day 1, and I would like to take this opportunity to thank my colleagues for all their hard work in helping us achieve that milestone. We now target delivering the deal synergies in three years, not the two to four years that we advertised in February. On 29th November we will hold a Capital Markets Day. This will be our early opportunity to update you on our progress post-completion. Our full year results in early March 2019 will be our first as an enlarged Group. At this date, we will revise our Group cash and synergy targets based on that first Combined Group operating plan.

The acquisition of Standard Life is a pivotal moment in the Phoenix Group history. To date, Phoenix has comprised businesses which have been closed to new customers. So although we haven't actively marketed products to customers, we have always written annuities for existing policyholders upon vesting, and we have a small successful business with Sun Life Direct.

Standard Life Assurance contains a very significant closed business, but it also actively markets to customers, and is therefore open to new customers. As a result, Phoenix will no longer be a pure "closed" player. What we call Phoenix "Redefined" will contain both closed, or as we call it "Heritage" and "Open" business. But, and it is a big but, our centre of gravity remains firmly fixed on our Heritage business.

Two thirds of our assets, £160bn out of £240bn under administration are Heritage assets. Thus Phoenix continues to be predominantly a Heritage business.

The compelling aspect of Phoenix's business going forward, is that our new business capabilities will offset, or dampen the natural rate of run-off of our Heritage book.

This is good news for all of our shareholders.

Thus, Phoenix now has a broader range of opportunities to grow both organically and inorganically, which together extends the duration of our business and enhances future cash generation. Our primary focus remains growth through closed life consolidation. This is clearly our biggest growth avenue. The closed life markets in the UK, Germany and Ireland total £540bn, a remarkable opportunity. The BPA market in 2018 we estimate to be worth circa £18bn, and we will continue to participate, as Jim said, selectively.

Our organic growth through new business across both our Heritage and Open books will dampen the run-off of our in-force business. This may total somewhere between £6.0bn and £7.0bn per annum, approximately 2.5% of our current assets under administration.

Under the strategic partnership, Standard Life Aberdeen will own the customer and the sales process, e.g., doing what they do best. Whilst Phoenix, doing what we do best, will provide the capital to underwrite on a "white label" basis the "capital light" products, which are sold by Standard Life. And we will also do the management of policy administration using our enhanced scale, to get better value for the benefits of shareholders and customers.

Looking to the broader market, the reshaping of the UK and European life insurance industry continues apace. It is clear that the bifurcation of the sector into those willing to commit capital to underwrite risks and be "capital heavy" firms, and those looking to move the other way and become "capital light", delivering fee-generated products, is accelerating. The Standard Life transaction is testament to this industry shift, and we believe others will follow. It is our vision in time to be Europe's Leading Life Consolidator.

To end. Phoenix has a clear set of strategic priorities for 2018. Cash generation continues to be our key metric as it underpins our stable and sustainable dividend. We have announced today that we are on track to exceed the upper end of the £1.0bn to £1.2bn target for 2017 and 2018. The completion of the acquisition of Standard Life Assurance is imminent, and we look forward to working with our future colleagues to deliver the capital and cost synergy targets that we have announced and also to embed the new strategic partnership.

We will also continue to focus on improving customer outcomes, which includes their digital journey. The work to simplify our Group structure is on-going, and we hope to complete the final stages of on-shoring in the fourth quarter of 2018. And finally, we are "open for business". We will examine further M&A opportunities that meet our stated criteria of being value accretive.

The Standard Life acquisition is an enormous stepping stone on our consolidation journey, but it isn't the final destination, and we remain focused on doing more transactions. As I have said in public, we were two firms, we will be one firm, with one future, and we are clearly better together. Thank you very much indeed.

So, ladies and gentlemen, that brings us to the end of the formal part of the presentation. Thank you for your engagement. Please ask questions. Can you wait for the microphone to arrive, Juliane will bring it to you, and perhaps if you could give us your name and the institution for whom you work? I'll do the easy questions, Jim does the difficult questions, and the impossible ones get sent to Andy. Thank you.

Q&A session

Question 1

Ashik Musaddi, J.P. Morgan

This is Ashik Musaddi from J.P. Morgan. I don't know if it's an easy question or not, and I think it could be a bit early to ask this, but I'll still ask it. Let's say you come across a new M&A prospect which would be a multibillion dollar deal in the next one month, would you consider that, or would you say that at the moment you're too busy with the Standard Life integration? That's the first one.

Secondly, it's an interesting position you have got into, it does have a bit of open book as well, so can you shed some light as to what your expectations are? I mean, Standard Life has delivered consistent net inflows in the pensions business and the bulk annuity market is a big market as well; so do you think you will be able to continue to do similar flows, or do you think that because your focus is not that much on that part of the business it will come down versus the past?

And the last would be on management actions. I'm more interested in the increasing cashflow thing rather than acceleration of cashflow. You have done £330m for the first half, it's a pretty punchy number…

Clive Bannister

£384m.

Ashik Musaddi

No, I'm just talking about the increase in the cashflow, rather than the acceleration of cashflow. The £330m is a pretty big number, so what shall we expect going forward on an annual basis? Say a five year view or something like that. Thank you.

Clive Bannister

Jim, and then perhaps Andy, do you want, Jim, to just take the last part first and I'll deal with the other two? So, management actions.

Jim McConville

Yes, so you're right to say, Ashik, that management actions have contributed significantly in this half year, and indeed in 2017. I think we always signalled that with the AXA and Abbey acquisitions the contribution from management actions would be more significant as a proportion of the overall cash generation in that initial period. We would expect going forward the level of management actions to be between roughly 35% to 40% of total cash generation. As I've explained before, we run a dynamic approach to the identification and management of management actions and the teams are still pretty busy. We see management actions going forward and they're incorporated into the targets that we've set.

Clive Bannister

Ashik, let me deal with your second question which had two parts, one of which is the sources of growth going forward, open. And the second is whether we expect the current levels of work with Standard Life to continue.

So, first of all we're enormously excited. I've put this slide up deliberately. Our first largest source of growth for this firm remains inorganic, which has been doing transactions, going to

Ashik's first question, but let's deal with the second one. You see that we now have alternatives for how to grow our business organically.

We are enormously excited, we think there is a complete alignment between what will build Standard Life Aberdeen going forward -Aberdeen Standard Investments. They do what they do best, which is managing B2C. They take responsibility for channel, brand, customer engagement and product. We do what we do best, which is "white label" underwriting on capital light products, which we'll make money on, and then we also do the policy administration. They bring more scale, more policies to us and we get better value from our outsourcers. They're interested in building that business so that they can get the fees as a world class investment company.

And then you talk about ongoing volumes. They did about £6bn in 2017. This is in three product areas, SIPP, workplace pensions and drawdown; drawdown being about £4bn, and workplace pension being about £2bn. They had very significant market share and they are leaders in those products with entrenched and fine relationships with the IFAs.

So it's conjectural, but our view is that this is a source of value add to our family because they will continue to sell the volumes and be the successful company they are. As Jim said in his presentation, we have attached no value to this in our future cashflows because we have to wait and see. But that is the synchronicity or the alignment between their commercial ambitions in the UK and our capabilities as a "white label" underwriter and policy administration.

Then your first question is about whether we are back on the playing field to undertake transactions, and the answer is resolutely yes. The challenge is in any case when you're looking at a transaction is bandwidth; can management take something on? Can it be financed? And are we going to get regulatory support for doing something else?

Our first objective is clearly to land safely, and we have not yet closed on Standard Life Assurance, so never ignore the pennies at your feet for the sixpences in the sky - an Irish grandmother that I've referred to before - so we are very focused on closing and making a success of Standard Life. But we think the £540bn market opportunity, £380bn in the UK, £140bn in Germany and £20bn in Ireland, is inevitably going to happen. There is a train here where the repositioning of capital in our industry is inexorable, "capital light" and "capital heavy" firms, they take different skillsets, and the motivation of vendors is becoming more acute in my mind rather than less acute, because companies do not like having trapped capital, stranded costs, increased regulatory oversights and businesses from which they can't get added value and they require specialist skills in terms of administering heritage business.

So to answer the question directly, scale is not what drives it, it's about management bandwidth, it's about the ability to finance and obtain regulatory support, and I would put a yes in each of those boxes. We clearly have the management capability and our colleagues in Scotland add to and they do not detract from that capability. They bring skills in Ireland and Germany that we never had before, and their skill sets in Scotland.

Secondly, we can clearly finance. Financing is not an issue for this firm at the moment if it's done properly as we have shown in the past, and absolutely if we do the right sorts of transactions I am certain that we will get regulatory support.

<u>Question 2</u>

Andy Sinclair, Bank of America Merrill Lynch

It's Andy Sinclair from Bank of AmericaMerrill Lynch. Three from me please. Firstly, the cash generation guidance for full year 18 has been upgraded and you're likely to get some cash as well from the bulk annuity transaction over the next few years. I just wondered why the 2018 to 2022 guidance hasn't also been revised at the same time as the longer-term guidance. Is there some upside there?

Secondly, just on equity release mortgages. You've given some good colour on solvency, much appreciated. I just wondered on your cash generation metrics what assumptions do you have there? Can you give us any more colour on the assumptions built in there for property price growth etc?

And thirdly, now that you're aiming to be Europe's leading consolidator, rather than just the UK's, how do you prioritise the UK versus Continental Europe on capital deployment? Thanks.

Clive Bannister

So three questions, great questions. Jim, you'll deal with the cash generation and how its improved longer-term, but what happens between 2018 and 2022. Perhaps, Andy, you would think about ERM and our views on the property and its impact on cash. And then finally I'll deal with Europe and the other options.

Jim McConville

Yes. Well, Andy, we've said we do expect to exceed the short-term cash target, 2017 to 2018 by £200m to £300m in the second half of the year, taking us above the £1.2bn upper range, and that's because we've successfully delivered management actions. And that gives us increasing confidence in the ability to meet the target out to 2022. We have not revised that target, as Clive said, we will revise the targets in March next year and give you a target for the combined business. But you can take it that we have increasing confidence in our ability to meet that target and our track record of meeting and exceeding targets in the past has been very good.

Andy Moss

So on the ERM side, we are currently seeing property price increase at RPI plus one. It's probably interesting to look at the sensitivity though because a 10% property fall has an impact of just above £10m.

Clive Bannister

Then the question was prioritisation, so deals or transactions have to go through three filters. They have to be accretive, and that for us is predominantly absolute cash delivery, that's the metric by which this firm works. The second is that it has to support the dividend we pay our shareholders. It's interesting, we're occasionally accused of not raising dividends. In the seven years I've been chief executive we've raised it four times and we've raised the dividend three times in the last three years. So we honour that metric. And most importantly, any transaction has to protect our investment rating and therefore we operate between the leverage ranges that Jim has identified between 25% and 30%. So those are the filters.

We actually have a very interesting job as a management group now. Do we put a dollar of capital, more than a dollar of capital behind BPA, or behind our vesting annuities? How we

deal with the growth in Sun Life behind the joint venture, and also we now have European opportunities for consolidation.

I don't want to overcook the pace at which things take place, the last deal that was done in Germany took nearly two and a half years, that was the Viridium and Generali deal, so this takes time. Mark Twain used the phrase, "molasses in winter, they don't move", but it is evolving. There have been in Germany eight deals in five years, totalling about €65bn. In Ireland we have had seven deals in six years totalling about €65bn. That includes Great West's with Irish Life which was a very substantial component. So what we see is there are opportunities and we now have a broader bandwidth.

Heretofore, Phoenix was constrained by looking at closed opportunities in the UK, we now have organic growth opportunities that can be funded, and you mentioned BPA which has worked well, and I thank my colleagues for the M&S transaction, but we can also look geographically more broadly and include those businesses that have an open component that under our model we turn into a closed and shareholder profitable and accretive business. So we will prioritise against those three filters against the opportunities that may occur in the future.

<u>Question 3</u>

Andrew Crean, Autonomous

It's Andrew Crean at Autonomous. Three questions please. Firstly, once you've done the Standard Life deal what is your internal capacity for deals, both equity or liquidity on balance sheet and debt?

Secondly, either now or hopefully in the investor day could you give us the cash generation profile off the back of that new business which you've got up on the slides, so that we can get a sense in cash terms which is what you measure as to what an annual rate of new business might do?

And then thirdly, you say that your target is 40% of the £11bn of annuity reserves backed by illiquids. Moving from 20% to 40% what would that do to cash generation and solvency coverage? I'm slightly surprised that your management actions actually in the first half, didn't have anything from the hedging strategy, I would have thought that would have helped. The equity hedging strategy, I would have thought that would have helped you.

Clive Bannister

Okay. So, Jim, I think let's do those questions one at a time. Jim, you're being asked about your war chest. How much money do you have? And this is how I embarrass Jim, so asked about our capabilities in terms of equity and debt. So your war chest, Jim?

Jim McConville

Okay, so as I said in the presentation, Andrew, we expect our leverage on completion of the Standard Life deal to be slightly below our stated target range of 25% to 30%. If we were to assume that leveraged increased to the top of that range that would give us capacity from the debt markets of some £700m. And that is an increase from the £500m that we spoke of at the last time we presented in front of you.

In terms of liquidity, we don't have any issues there, we've obviously got substantial cash resources on the balance sheet. As you will have seen we have currently an undrawn revolving credit facility and we also have an acquisition facility which is in place for some considerable time on top of that. So there is no issue with liquidity whatsoever.

Clive Bannister

And on the equity side, Jim?

Jim McConville

On the equity side, clearly the previous transactions that we've done in terms of raising equity for the AXA deal, the Abbey Life deal and now the Standard Life deal, we've seen extremely strong support from our shareholder base. They've taken to the strategic fit of all these transactions and the take up of the rights issue and the pricing and discount on the rights issues has been very good. So we see continuing support from all of our main shareholders.

Clive Bannister

And I would add to that, Andrew. Our market cap will be circa £5bn. A share placement of 10% raises you a lot of money overnight. The last time we did that which was the funding in the spring of 2016, early summer, we did that placement at a price above the closing price the night before. So the only time we've had to do a placement it's been done at a price effective for our shareholders and we are now covered by 12 analysts in a way that we weren't three years ago. And there is more liquidity in our stocks. So that's the equity to substantiate what Jim said on the debt.

The second part of Andrew's question was, Jim, at what point will you describe the economics and the cashflow generated from our open business versus our heritage business? And then give guidance on the fact that we are a biped and what comes on there.

Jim McConville

Yes, we'll look to do that in the capital markets day at the end of November.

Clive Bannister

And then, Andy, maybe you'd take the annuity target and what it means.

Andy Moss

Yes, I mean obviously moving forward it would be impossible to give you an exact total because clearly it depends on the yields and what we get on those assets, but just to give you an indication of this year, so the £0.8bn that we've achieved this year has given us about £80m improvement in our overall solvency position.

Clive Bannister

And there's a question for Jim. Why did the equity hedge not come through in management actions? Andrew, that was your question wasn't it?

Jim McConville

Well, we have the hedge on our books but the benefit of the Value of in Force in the Standard Life books, we haven't acquired them yet, so it is asymmetrical at the present time. But from a capital position once we have completed the transaction that capital strain from the hedge that we've incurred in the first half of the year will reverse.

Clive Bannister

Oliver?

Question 4

Oliver Steel, Deutsche Bank

First on the £62m of new business strain on the bulk annuity. Can you just give us the sort of definition of that? Is it gross or net of reinsurance? What assumptions does that make about the capital requirement? I assume it builds in the SCR on that, but is it net or gross of any diversification benefits?

Just as an aside on that… Well actually no, I'll ask my second question. By the end of this year what do you expect to be the net strain on that bulk annuity? And as an aside on that, I'm sort of a little uncomfortable with the way you've presented it because some of the uplift in your headline cashflow includes the management actions which you're taking to improve the asset portfolio, but then you're shoving the £62m below the line. So I wonder if in future you could perhaps put a bit more emphasis not just on headline cashflow but also the net cashflow, particularly if you're going to write more new business?

And then finally, I'm a little confused I suppose between the management actions which Andy talks about and how much of that has actually come through into the headline cashflow. It doesn't look as if much of that has come through, except on Abbey Life, so I wonder if you can just sort of reconcile between Andy's management actions and what's come through?

Clive Bannister

Okay, Jim, so I think we've got three questions there, but I'm intrigued by the one about taking £62m including it in the £349m and then putting it down. So let's just deal with structurally why we do that, and then let's go back to the BPA and then talk about management.

Jim McConville

Okay. So as we've said, in projecting forward our cashflows that you see that assumes no BPA transactions. Now what you've seen, we've always said that as surplus cash resources build up over the five year period that we would use a proportion of that to fund BPA business, and therefore what you see is from a Group sense the funding of that BPA business, but at the same time we've increased the cash that will come out of the book to recognise that business as being written. So I think it's an entirely consistent way to present information and if more transparent than if we had netted it off.

The £62m is the day one position and it is the impact on our free surplus; so it includes the capital requirements, plus the capital management policy associated with those requirements. And it assumes a conservative asset mix that we acquired of cash and gilts

but clearly we have built up illiquid assets that we almost immediately then transformed the structure of those assets once we've completed that deal.

You asked what that £62m would drop to after that that capital conversion, and it's in the low 40s of millions, so it will reduce from £62m by approximately £20m.

Clive Bannister

And the third part of the question, Jim or Andy, it was about the management actions and how they flow through to the gross cashflow announced.

Andy Moss

Yes, and what you'll see, I think we disclosed the free life surplus, then obviously some of those have contributed towards the extra surplus within the life companies. So some of it we have not paid up yet for various reasons, and obviously that will partly generate some of the cash flow in the second half of the year.

Clive Bannister

And the free life surplus increased from £700m to £800m?

Andy Moss

Yes.

Clive Bannister

Money in the departure lounge as I call it, and on the detailed stuff about reinsurance and capital treatment on SCR I see Simon True standing at the back, and Oliver, do talk through the BPA with him. We're very comfortable with what we've done and we have described it today on the most conservative basis.

Any other questions?

<u>Question 5</u>

Abilash P T, HSBC

It's Abilash P T from HSBC. Just one quick question from me. On the non-workplace pensions you have taken a charge on your book. Do you anticipate, given that Standard Life has a sizeable book partly of heritage pensions as well, that you'd have to take a charge here to make it consistent with what you've done in your own book once you've acquired it?

Clive Bannister

Can I ask Andy to answer that question?

Andy Moss

Yes. So we think that's very unlikely. Obviously Standard Life has remained open to new business, so many of the products are a lot more modern and a number of the older policies have been switched into those newer products. The average charge in Standard Life is

round about 1% on the older products. What we will do is apply and roll out our governance approach. So what we do is look at cohorts of policyholders to look at the customer outcomes, we will do exactly the same on the Standard Life side, but we think it's very unlikely that there'll be any charges to take on Standard Life.

Question 6

Ashik Musaddi

Hi, Ashik Musaddi again. I just have one follow up question on equity release mortgages. Now, if I look at your book you mentioned 33% LTV and 79 years average age of the customer, that sounds pretty conservative compared to, I would say, what the industry average would be for the equity release book. I mean, on the other hand the PRA recently flagged that the underwriting standards of equity release mortgages is getting worse every day, I mean the LTVs are going up and average age is going down. So how do you see your book evolving because you plan to move a lot into illiquid assets? So do you think that you will maintain that same quality of ERM book or will you relax a bit of standard as well on that? So that would be one.

Clive Bannister

Ashik, thank you. Great question. First of all this is always proportionate, so this is one of our alternative assets, this is measured and we'd have a target which is set out over five years, so we're not betting the farm on any single asset class, but if you want to go through those very specific points, Andy?

Andy Moss

Yes, I mean I think the key is obviously everybody's annuity liabilities will sit in different timescales. Obviously the ERM we've been focussing on is designed to match the cashflow profile of our annuity books. We will absolutely maintain our underwriting standards, so on the books we've acquired we've got quite a high threshold in terms of due diligence and then equally on the amounts that we're writing with our partners, which does tend to be slightly longer-term to match some of our longer dated liabilities. Equally we have set various underwriting standards which we'd expect.

So I think doing this as Clive says, in a proportionate way, that manages our risk, and keeps a reasonably comfortable loan to value in terms of the roll up of interest, then we will continue to do that.**Clive Bannister**

And, Ashik, we originate in two ways. We have done secondary transactions which have a different profile and we originate through two business partners. And that again gives us an optionality to balance the book of ERM that we end up with.

Clive Bannister: concluding comments

The witching hour has been reached, we've been at it over an hour. All of us should be on holiday, that's my sense, so I want to end by thanking you for your time and engagement. It's been a strong set of financial results, and as we said right at the start, this is a pivotal moment in our history as a Group with the Standard Life acquisition prospect. Thank you very much indeed.