Phoenix Group Capital Markets Day 2020 presentation transcript

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Introduction – Nicholas Lyons, Chairman

Good Afternoon, and welcome to Phoenix's 2020 capital markets day. 2020 has been a year of change for Phoenix as we welcomed Andy Briggs as our new CEO and completed the acquisition of ReAssure, making Phoenix, the UK's largest long-term savings and retirement business.

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Under Andy's leadership, Phoenix is evolving from being a Financial Consolidator to a purpose led business with a clear role in society. The Board recognises that Phoenix has a pivotal role to play as the country navigates the shifting pensions and savings landscape and is committed to putting sustainability at the heart of all that it does.

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You'll hear much more about this shortly. Andy has rebuilt and enlarged the executive team that will help him deliver this new vision for the Group. His team brings together the strengths of our legacy businesses with internal promotions being augmented by new colleagues from ReAssure and external appointments, bringing market leading experience to meet the skillsets required to deliver our strategy.

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Phoenix's transition is one of evolution and not revolution. We're building on our market leading capabilities in managing Heritage businesses, and undertaking M&A and integration both to consolidate that and to grow a thriving Open business, that supports customer retention and customer acquisition. As ever, Phoenix continues to be focused on cash, resilience and growth.

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This morning's trading update is evidence of our ongoing delivery, with 2020 cash generation complete and above the upper end of our target range. A strong and resilient capital position and on-target growth delivered by our Open business.

I'm also delighted that we have today announced, our commitment to achieving net-zero carbon emissions by 2025 across our operations and by 2050 across our investment portfolio.

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In addition to the change we had planned for 2020, we have also of course been dealing with the challenging results from the COVID-19 pandemic. Throughout this period, our priorities have been to protect our customers, and colleagues, and to support the communities in which we operate.

The Board is extremely grateful for the enormous commitment shown by our colleagues during this difficult time, we continue to monitor the physical and mental health of our colleagues as they juggle working from home with their other personal commitments.

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Due to the current restrictions, our Capital Markets Day takes a different format from previous years. Andy and his team will be presenting today from our Wythall office where our premises are sufficiently large to enable our presenters to comply with social distancing rules. Andy and Rakesh will lead off today and provide an overview of our strategy and of the financial framework that underpins its delivery.

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We will then move into a series of deep dives into the core building blocks of our business. Which will begin with a more detailed look at our approach to sustainability. We will then conclude with Q&A, thank you for joining us today and for the work that you do covering Phoenix and the sector. Stay safe and I hope that you manage to spend some time with your families this Christmas. I look forward to speaking to you again at our full year results announcement in March.

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Strategy – Andy Briggs, Group Chief Executive Officer

Thank you Nick and good afternoon. Phoenix is the UK's largest long-term savings and retirement business. We are a unique business, with a clear strategy. We do three things. Heritage is the bedrock of our business and with the market leader. Distinctive capabilities built from two decades of consolidation, and further strengthened in July with the acquisition of ReAssure.

Our Open business has strong foundations and delivers growth, enjoys unique advantages from operating alongside Heritage, and we're the market leaders in M&A and integration where our specialist skills and scalable operating model underpin a differentiated capability.

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This clear strategy delivers the three parts of our financial framework. The first is Cash, which is dependable, long-term and supports our dividend. Second is Resilience, from our unique approach to risk management. This is fundamentally different to other insurers. And third, Growth, with our clear capital allocation framework to ensure we're only allocating capital where we will get strong returns.

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So today, we'll spend time looking at each area of our UK strategy in more detail. And we'll explain why Phoenix is well placed to take advantage of the drivers of change across the long-term savings and retirement market and how we will win in each market.

So, I want to start, as all good businesses do, with our customers, and the key macro trends that are driving profound change.

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We've all grown up with people moving predictably from learning, to earning, to retirement. These day's societal change means the world is no longer linear. Now, we all know we live in an ageing society, with more people than ever benefiting from a longer, healthier life.

But increased longevity brings its own complexities and the need to take the right decisions throughout our lifetimes to ensure our futures are fulfilling.

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At the same time, the world of pensions has radically shifted. Define Benefits schemes that guarantee a fixed income in retirement are vanishingly rare. And we've seen strong growth in auto-enrolment, tripling the contributions into workplace schemes.

People, rather than governments, are now expected to take the lead in planning for their future.

Financial uncertainty is forcing people not simply to live for today, but to look further ahead, but they find it complex and most just aren't doing enough.

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And then, digital is becoming the normal method of interaction and interest in sustainability is increasingly shaping decisions. People want their money put to good use.

As a result, what we're seeing, is that customer needs are changing as they move through the changes of the life savings cycle. In early life they're typically in the accumulation phase, where they're most likely to be saving through workplace pensions, and looking to protect their family income.

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In midlife, customers will start to consolidate their pension pots and begin to prepare for retirement.

Moving into later life, customer wealth will be decumulating as they draw income for their retirement and provide for social care. And the customer need for guidance also changes across the life savings cycle.

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This need for guidance is also stronger than ever, as people struggle with the complexity of having multiple pension pots and navigating through the choices offered by pensions freedoms.

So, here at Phoenix, we have a clear role to play in society, to address these needs and to help people journey to and through retirement.

That's why our new purpose is: Helping People Secure a Life of Possibilities.

This means providing our customers with the right guidance and products, at the right time, to support the right choices.

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Our new purpose sits at the heart of Phoenix and acts as our North Star. It starts with being customer obsessed and being focused on the outcomes that matter to our customers.

It drives our strategy, ensuring we allocate resources to the most attractive opportunities where we have competitive advantage and so will further enhance our returns for investors.

And our people are absolutely fundamental. We all know, winning businesses have the best people, with superior skills and capabilities who are diverse and highly engaged. As Nick's already covered, this is a real strength throughout Phoenix.

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Our focus on purpose and our culture, has led to a 20 basis point rise in colleague pride and advocacy this year. And what this means is that in the pandemic, our people have been determined to be there for our customers in spite of the move to work from home.

As a result, our call answer rates and customer satisfaction scores have remained above 90%. This is a great example of this virtuous circle. I passionately believe that businesses with the best people, focused on their purpose and their role in society, deliver better customer outcomes and, in turn, stronger returns for shareholders.

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And we see sustainability being at the core of our new purpose and a key enabler of our strategy. Our sustainability strategy focusses on delivering for our 14 million customers and investing our £323 billion of assets in a sustainable manner, making a meaningful difference to society.

We fully embed this into our business activities. We are committed to reducing our environmental impact, investing in our people and culture, supporting our communities and working ethically with our suppliers.

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Claire will talk in more detail about our sustainability strategy later but I'm delighted that today Phoenix has announced its commitment for our operations to be net-zero carbon by 2025 and for our investment portfolio to achieve net-zero carbon by 2050.

So, what I want to do now is talk about the sector, our position within it, and then go on to set out our strategy. So, first the sector.

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This exhibit takes the customer life savings cycle, which I covered earlier, and overlays the various markets for long-term savings and retirement products. It illustrates the large size of the life insurance asset pool as a whole at £1.8 trillion with good growth at 7% per annum, and covers the size of each market within that.

Here, we overlay Phoenix's position within these markets. With £300 billion of UK assets under administration. We have a 17% share of the total market. This includes Heritage, where we are the market leader.

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Our scale is valuable as it drives our strong, dependable cash generation. It also shows the strong foundations and hence significant potential for growth we have across our Open businesses. We're a top 3 player in Workplace with an 11% market share.

Our Customer Savings and Investment business covers both individual savings and pensions draw down where we have a 16% market share. And our retirement solutions business covers annuities, where I see our lower market share relative to peers as a positive, as it means our balance sheet has much lower exposure to credit risk.

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Now the final build of this slide is to look at the major market trends and hence the significant growth opportunities.

We continue to see insurers consolidating their legacy books of business, to release trapped capital and avoid the inefficiencies caused by running these old-style products on legacy systems.

This represents a £440 billion M&A opportunity to our Heritage business in the UK market alone.

We're also seeing strong growth in the Workplace market with annual flows of £40 billion per annum, driven by auto-enrolment and growing rapidly with the ageing population and the move from Define Benefit.

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There are also annual flows of £30 billion as individuals prepare for retirement and move into decumulation products.

And finally, corporates are de-risking. Offloading Defined Benefit schemes to insurance companies. Flows here are in excess of £40 billion per annum and this understanding of the stocks and flows in the long-term savings and retirement market underpins Phoenix's strategy, and ensures we are well positioned to take full advantage of these industry trends.

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So, onto strategy. Phoenix has a clear strategy focused on three key priorities. Leveraging our leading share of in-force, and the major market trends that I've covered on the last couple of slides.

Our first priority is optimising what we already have, our in-force business, across both Heritage and Open customers. Our risk management framework ensures we improve customer outcomes and deliver resilient cash generation.

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Integral to this is the delivery of both management actions and integration activities including cost and capital efficiencies. So, delivering the Standard Life transition and ReAssure integration are top priorities.

Then our second priority is deepening customer relationships. So, engaging them and offering them the right products and services to meet their needs across the life savings cycle.

This means they'll stay with us and consolidate towards us as they journey to and through retirement.

And our third priority is customer acquisition. Here, we'll leverage the other industry drivers of change and grow our in-force business by acquiring Workplace and BPA customers through new business, and Heritage customers through M&A.

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This strategy delivers cash, resilience and growth. So, we have a clear strategy that is aligned to the industry drivers of change. But to win, we also need distinctive, competitive advantages across Heritage, Open and M&A. So, let me cover each of these in turn.

Phoenix is the market leader in managing Heritage businesses and it remains the bedrock of our business. Here, our strategy is to deliver customer outcomes and manage the in-force business for cash and resilience.

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Andy Moss will take you through the deep dive later and explain how our scalable operating model and our ongoing delivery of management actions delivers value.

Our track record of improving customer outcomes and maintaining excellent customer satisfaction are unquestionable. As is the value we create for investors, with £2.5 billion of cash generation from management actions in the last 10 years.

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Our competitive advantages in this area are truly market leading by far the best that I've seen in my 33 years in the sector.

Phoenix's Open businesses have strong foundations and are central to our purpose of helping people secure a life of possibilities. Here, we're focused on deepening customer relationships and customer acquisition.

And we have unique competitive advantages from operating alongside our Heritage business.

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Andy Curran's deep dive will focus on the 3 of our 5 Open businesses, where we see the biggest growth potential. So, in Workplace, our advantages are our scale and our market leading cost efficiency from leveraging the substantial Heritage relationship with Tata Consulting Services.

And our priorities are accelerating our investment in our proposition, to benefit from the shift to Master Trust.

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In Customer Savings and Investment, our advantage is our 14 million customers, where we want to help them journey to and through retirement.

And in BPA our priority is improving capital efficiency, where we should be ahead of peers due to our diversification with Heritage, in order to grow our market share. Hence, I'm confident we can deliver attractive, profitable growth here.

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Phoenix has an excellent track record of M&A and integration. Our recent transaction history speaks for itself and has seen us grow to a company which is currently ranked 67th in the FTSE.

Cash generation from acquisitions is a multiple of the price paid and as Phoenix has grown and built scale, these multiples have increased. Our integration capabilities are market leading and have been further strengthened through the ReAssure business, which provides us with additional talent and creates the bandwidth to run multiple integrations in parallel.

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And again, we have distinctive capabilities and are set up to win. We provide deal certainty to the vendors with strong access to capital markets, proven Part VII capabilities and strong regulatory relationships.

We also have a scalable operating model with modern, cost efficient technology and our broad range of existing business enables us to access greater capital synergies.

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And finally, we have specialist skills, which enable us to deliver management actions and complex migrations.

We continue to see M&A as a core driver of our growth and we're ready to do the next deal. We estimate the Heritage market opportunity to be £440 billion in the UK, with a further £190 billion in Germany and Ireland where our European businesses are based.

The UK continues to be our primary focus for M&A as the market we understand the best, have a proven track record in, and has the greatest near-term opportunities.

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And whilst our focus is acquiring Heritage books, we will consider buying Open books where they have a good strategic fit and bring complimentary capabilities to our strategy.

With £323 billion of assets, I think it's essential that Phoenix creates a single Asset Management team and I'm delighted to have Mike Eakins in the role of Chief Investment Officer to build this.

You'll hear more from Mike later about our ambition to be a best-in-class asset manager focused on customer centricity, leveraging best-in-class strategic partnerships with an integrated approach to responsible investment.

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Our Asset Management team is an enabler to our strategy focusing on managing asset risk for resilience through the hedging of equity and interest rate risk and the proactive management of our credit portfolio. Mike's team are also integral to our ambitions to grow our Open business through the origination of illiquid assets to support BPA.

Moving now to our financial framework which Rakesh will cover in more detail shortly. Cash is King at Phoenix and I have inherited an enviable ten-year track record of meeting or exceeding all cash generation targets and it's very much my plan to continue this.

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We've delivered cash generation this year of £1.7 billion, ahead of our target. And we're on track for just under £6 billion of cash generation over the next 4 years, and £19 billion over the life of our business. This cash generation significantly exceeds our uses and excess cash will be reinvested into value accretive growth.

Long-term, dependable cash generation that brings certainty to our dividend.

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Resilience is a critical differentiator of Phoenix, our unique approach to risk management is the key driver here, where we use an extensive hedging program to manage unrewarded risks, like interest rates and equity. And active, defensive, portfolio management to manage rewarded risks such as credit. This means our financial performance is significantly less volatile than other insurance businesses as evidenced in this exhibit, which plots our sensitivity to market risks.

The chart speaks for itself and brings certainty to our stable and sustainable dividend.

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And finally, we want to deliver growth in cash, to make cash sustainable and ideally growing into the longer term. This simple diagram that we fondly call the "wedge" illustrates this. The wedge highlights that cash generation is typically two thirds organic cash generation and one third management actions.

Over time, we expect the composition of organic cash generation between Heritage and Open to change, but we expect our long track record of delivering management actions to continue, with or without M&A.

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Rakesh will talk in more detail about how much new business we need each year to offset the run off of our Heritage business.

Once we exceed this offset and organic cash generation is growing, we can consider growing our dividend without M&A.

But M&A remains a core part of our strategy and if we can deliver this on top of everything else, it starts to get really exciting.

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Dependable cash generation and a resilient capital position drive our dividend. Our dividend policy is stable and sustainable but M&A has enabled us to make 4 dividend increases in the last 4 years and our dividend has grown at a CAGR of about 4% over the last ten years.

Proving the wedge and further M&A provide further opportunities for dividend growth.

Our dividend growth is broadly in line with the FTSE 100 pre-COVID, something many would not have expected from Phoenix.

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But the resilience of our business is clearly demonstrated in the post-COVID period. Our dividend has continued to be rock solid. This is a dramatic out performance of the FTSE 100 and as a result we expect to be the 24th largest dividend payer in the FTSE this year.

So, let me summarise. Phoenix is a sustainable and growing business. Helping people secure a life of possibilities. Our strategy delivers unique advantages. Our approach to risk management differentiates us from our peers, delivering resilience to our in-force business. We deliver high levels of long-term, dependable cash generation which supports our stable and sustainable dividend for many years, and our business generates excess cash to invest in a range of growth options aligned to the industry drivers of change.

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And at Phoenix the whole is much greater than the sum of the parts. Our history of cost discipline drives market leading, cost efficiency across both our Heritage and Open businesses, a unique advantage over peers for our Workplace business.

Our broad diversified range of products give us capital efficiencies that benefit both our Heritage and Open businesses, a unique advantage over our peers for our BPA business. And finally, as the UK's largest long-term savings and retirement provider, we have 14 million customers and are therefore best placed to help them journey too and through retirement.

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A unique advantage for our Customer Savings and Investment business.

And it's for all these reasons that I am very confident about our future here at Phoenix. And now, I'll hand you over to Rakesh who will expand on our financial framework, Rakesh.

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Financial framework - Rakesh Thakrar, Group Chief Financial Officer

Thank you Andy.

This morning we provided a trading update on our Q3 performance demonstrating further progress in our three key attributes: Cash; Resilience; and Growth. These evidenced Phoenix's ability to continue to deliver across all key metrics, despite the enormous challenges posed by the COVID-19 pandemic.

Year to date the operating companies of Phoenix and ReAssure have delivered just over £1.7 billion of cash generation on a proforma basis.

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2020 cash generation for the Group is now complete and has exceeded the revised target we set back in August of £1.5-1.6 billion. Our capital position has strengthened materially, increasing from a Combined Group proforma surplus of £4.4 billion at 30th June to £5.0 billion at 30th September, this equates to a Shareholder Capital Coverage Ratio of 159%, right in the middle of our target range of 140-180%.

We have also achieved strong growth. By the end of September, our Open business had delivered £472 million of incremental long-term cash generation, already in line with the full year 2019 new business long-term cash generation of £483 million.

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At our half year results, I signalled that we expected our solvency position to strengthen from the proforma 30th June balance sheets results presented. The end September position reported today reflects the benefits of the completed Part VII transfer of the L&G mature savings business to ReAssure, and the delivery of additional equity hedging and integration synergies.

We have also completed the annual review of longevity assumptions. Whilst it remains too early to make any changes to our long-term assumptions around longevity rates from the pandemic, we have updated our assumptions to the CMA 2019 longevity tables. As a result we have seen a £0.2 billion release of longevity reserves.

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We remain on track to deliver a number of further management actions in Q4 and expect our full year solvency position to be broadly consistent with the Q3 position, having made provision for the 2020 final dividend.

Finally, I want to draw your attention to the economic variances we experienced in the 9 months to end September. The waterfall presented on this slide is on a Combined Group basis and shows that our economic variances were a strain of only £0.2 billion, which was

partially offset by the higher management actions from the credit trades, demonstrating the resilience that our approach to managing market risk delivers.

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Phoenix has a clear financial framework in place to support us in delivering the strategy that Andy has just outlined. This slide summaries this framework and we will spend time today exploring each component part in more detail. Our in-force business is cash generative and as you know, Cash is King at Phoenix. The risk management framework is designed to deliver resilience and we manage our business within clear target ranges for capital, leverage and liquidity.

Resilience brings dependability to the timing of cash generation, and certainty to our ability to pay a stable and sustainable dividend to shareholders.

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Our in-force business is generating surplus cash and capital and we have a robust framework for allocating surplus capital to our range of growth options.

Growth delivers incremental cash generation and replenishes our in-force business. This is the “wedge” hypothesis and if growth can more than offset the in-force run off, we will be able to consider increasing our current dividend.

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As I said, Cash is King at Phoenix, and our in-force business delivers long-term, predictable cash generation. We set annual cash generation targets, which we frame in the context of a 4 or 5 year target. Since listing in 2010 we have met or exceeded every financial target we have set. These targets are for our in-force business only and therefore exclude any new BPA, other new business and future M&A, and only include management actions up to 2023. It therefore acts as a base case for cash generation. We are in the process of finalising our first full annual operating planning process as an enlarged Group and will therefore provide an update on targets with our 2020 full year results in March.

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Over the life of our in-force business, we have estimated that our Group will deliver £19 billion of cash generation. £14.4 billion of this cash generation comes from the natural run-off of the in-force business. In 2020, this organic cash generation was £800 million and we would typically see this reduce at around 6% per annum.

It is worth noting that this level of organic cash generation includes a drag from the transitionals associated with Solvency II. When these run out in 2032, we will see a circa £250 million kicker to annual organic cash generation, which will reduce by 6% thereafter.

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We expect management actions including integration synergies to deliver £2 billion of cash generation. With £2.5 billion of cash generation delivered from management actions over the last 10 years, they form a dependable source of cash generation, even without any M&A, and typically comprise around one third of annual cash generation.

We also carry a level of Solvency II free surplus in our operating companies which will be released over time and enhances the dependability of cash generation.

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This slide will be familiar to you. It sets out HoldCo uses of cash generation over the 4 years to 2023, and illustrates how secure our dividend is over that period.

It also highlights the significant amount of surplus cash that will be generated over this period that will be available either for growth or for special returns to shareholders, subject to operating well within the leverage range of 25-30%.

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Looking further ahead, our in-force cash generation supports a stable and sustainable dividend over the long-term. But it is important to remember that this exhibit assumes no new business, no further M&A, and no management actions beyond 2023. We therefore plan to do much better.

To improve the clarity of our reporting, we are introducing an additional new metric called "long-term free cash". This will quantify the amount of cash within the Group that will become available for growth and shareholder returns. As a Group wide metric, it therefore has the advantage of netting out the impact of moving cash from the Operating Company to the Holding Company.

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It also excludes shareholder debt and therefore provides a quantification of the total cash available to meet Group costs and shareholder returns. We will report on this new metric at each reporting period.

Moving on now to Resilience. Phoenix has a disciplined approach to balance sheet management, which is articulated through our risk management framework. This framework is unchanged from my presentation at our Capital Markets Day last year. We continue to manage capital within a target solvency ratio range of 140-180%, to manage Fitch leverage within a target range of 25-30%, and to manage liquidity by ensuring that we maintain an appropriate buffer.

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Turning first to capital. We manage our risk in accordance with our risk appetite, which is approved by our Board. We have a particularly low appetite to equity, currency and interest rate risk which we see as unrewarded. We therefore have a comprehensive and dynamic hedging program in place, which hedges 80-90% of the shareholders' exposure to equity risk and uses swaps and swaptions to protect the Group's Solvency II surplus to changes in interest rates. We see credit risk as rewarded and actively manage our portfolio to ensure that it remains high quality and diversified and operates within our risk appetite.

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We also manage our longevity risk through reinsurance. Mike will talk in more detail later about our approach to managing market risk.

This differentiated approach to risk management means that we are more resilient to market risk than our peers, this is evidenced in this exhibit which shows the impact of movements in equity rates, credit spreads and interest rates on the solvency ratio of Phoenix and a number of our main UK and European Life peers.

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It is this resilience that has driven the very low £0.2 billion economic variants during the year that I explained earlier and which sets us apart from other insurance companies.

Our target solvency range is 140-180% and we are happy to operate at any point within this range. Our priority is always to ensure our policyholders are extremely well protected but we do not want to hold excess capital in the business for long periods of time. This becomes particularly relevant when we think about funding M&A, where it is important that we do not overcapitalise transactions. An integral part of our M&A due diligence processes is building a view of how Group solvency will develop over time.

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Typically, we therefore see our solvency ratio reduce at completion as we aim to utilise own funds to minimise the amount and mix of capital being raised, and increase as organic surplus and synergies begin to immerge from the acquired business.

This slide shows how we use the full 140-180% target range to efficiently fund recent acquisitions. As noted earlier, we have seen this play out for the ReAssure transaction, with the Group ratio increasing by 9 basis points, since the low of 150% immediately upon completion at 30th June, to 159% at the end of Q3, the midpoint of our range.

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We adopt a similar approach with leverage, where we seek to utilise the full Fitch leverage target range of 25-30% when considering the funding mix for each acquisition. The ReAssure acquisition has seen Group leverage increase to 28%, similar to the levels following the AXA and Abbey acquisitions back in 2016.

We expect leverage to reduce over time, as synergies emerge and as we utilise surplus cash and capital to repay debt to operate well within our range.

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We have a rigorous capital allocation framework which we use to allocate surplus capital first to growth and in the absence of growth, as a return of capital.

It is worth noting that other than BPA, our Open business is capital light and is therefore not subject to an allocation of capital. We also fund internal vestings from in-force organic cash generation, therefore our capital allocation framework applies to the allocation of surplus capital to BPA and M&A.

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We are looking for deals that are value accretive, support the dividend, and maintain our investment grade rating. As Andy explained earlier, we are also looking for M&A that provides a good strategic fit to the Group and supports our aspirations for growth, across both our Heritage and Open businesses.

Our BPA business is growing and is in the capable hands of Andy Curran who will talk more about this business later. My success criteria for the BPA business are crystal clear, and our approach to this business continues to be selective and proportionate.

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Currently, we are achieving a capital strain on BPA business of 8% which we measure inclusive of an allowance of capital management policy. Andy is focused on reducing this to 5%. At these levels of strain, we will allocate between £150-200 million of surplus capital to

BPA per annum, and expect £150 million capital investment to deliver circa £600 million of incremental long-term cash generation.

This slide illustrates how we evaluate M&A opportunities. Essentially, we identify the cash generation that the acquisition will deliver, this cash generation will be a combination of organic cash generation, as the business runs off, together with the incremental cash generation that will be delivered from both integration activities and wider management actions.

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Analysing the cash generation in this way, enables us to determine the IRR and payback of the deal.

It also enables us to identify whether the acquisition supports an increase in the quantum of our dividend and enhances dividend sustainability.

Finally, I want to talk to you about growth and the wedge. I first presented the concept of the wedge at our Capital Markets Day back in 2018, a simple hypothesis that the growth of the Open business can offset the run-off of the in-force business and bring sustainability to organic cash generation.

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This hypothesis is unchanged. Before we talk in more detail about how the hypothesis translates into actual numbers, I wanted to set out the possible outcomes of the wedge hypothesis.

The first thing to remember is that the wedge hypothesis focuses on growth. It is therefore looking at cash generation that is incremental to the £19 billion we expect our in-force business to generate, which I have already illustrated can support our dividend at the current stable and sustainable level out to 2040.

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So even if the growth of our Open business is less than needed to achieve an offset to organic cash generation, it will extend the ability of the Group to pay its current level of dividend for more years. If a perfect offset were to be achieved, this would mean that we would pay our current stable and sustainable dividend in perpetuity. But if we were to over achieve the offset and organic cash generation is growing over time rather than staying flat or decreasing, Phoenix can consider growing its dividend.

And please remember there is always the expectation that M&A will create further upside and remains core to our strategy.

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We always get asked lots of questions about the maths that sits behind the wedge and how the acquisition of ReAssure and our evolving strategy has changed this maths. I'm therefore going to spend time today running you through how we model the wedge internally.

The wedge hypothesis continues to be focused on organic cash generation only, management actions and M&A are additional to this and it does not include free surplus. I explained earlier that we expect our in-force business to generate circa £14 billion of long-term organic cash generation.

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In 2020 we will see £800 million of this organic cash generation emerge and we expect this level of organic cash generation to reduce at around 6% per annum as the in-force business runs off. This slide shows the gap that the Open business needs to fill through growth to maintain £800 million of organic cash generation each year.

When we write new business, we quantify on Day 1 the amount of incremental long-term cash generation that it delivers over the lifetime of the business, the emergence of this cash generation over time, is driven by the type of business being written.

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With BPA now integral to our Open business, and expected to be a material proportion of new business each year, our wedge illustration assumes that 6% of the cash generation emerges in year 1, and this amount runs off at 6% per annum consistent with the assumptions that we're using for our Heritage business. You can see therefore that if we delivered £800 million of long-term cash generation from new business, this would immerge as £48 million of incremental organic cash generation in 2021, running off at 6% per annum thereafter.

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Modelling this forward over consecutive years shows that the wedge hypothesis is proven if our Open business can deliver £800 million of incremental long-term cash generation each year. Delivering less than £800 million of long-term cash generation is still additive to cash generation but it will not achieve a full offset in the in-force business run-off, and delivering more than £800 million will more than offset the in-force run-off and would satisfy one of the two criteria needed for us to consider growing the dividend.

So, the next question is, whether £800 million of incremental long-term cash generation from new business is achievable. The simple answer is yes.

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Andy Curran will talk through our Open business in more detail later but by reducing the capital strain on BPA, and increasing the capital we are allocating to BPA to £150 million we expect to generate £600 million of long-term cash generation per year. And by investing in our Workplace proposition and supporting our customers as they journey to and through retirement, we can build on the solid foundations of our existing workplace and CS&I businesses, and deliver in excess of £800 million of long-term cash generation from new business.

0:47:01.9

Earlier I explained that we will be introducing a new cash metric. Long-term Free Cash. This is a Group level metric that quantifies the amount of cash available in the business for growth, and returns to shareholders. Each year, we will report to you on how the amount of long-term free cash has changed. Increases will be driven by the sources of long-term cash, i.e. new business and over delivery of management actions.

And decreases will reflect the uses of cash at HoldCo level including expenses, interest and dividends. This reconciliation will highlight whether the Group is replenishing the cash that it uses year on year.

0:47:45.9

It is not exactly the same as proving the wedge as it does not focus solely on organic cash generation, however it will evidence whether the business is growing, and in conjunction with growing organic cash generation will be the criteria for determining whether the business supports a growing dividend.

Before I conclude, I wanted to share with you one final exhibit. I'm often asked, whether we would turn away further Heritage M&A, because it weakens the wedge hypothesis and undermines our desire to deliver growth. This could not be further from the truth. This slide shows how M&A has delivered significant growth to both organic cash generation and to our dividend.

0:48:34.1

Heritage M&A will increase how much incremental cash generation we need the Open business to deliver each year to offset the in-force run-off. But Heritage M&A also provides the surplus capital needed to fund that growth enabling us to become a growth compounder. Our financial framework is supported by a clear set of reporting metrics aligned to our key attributes of Cash, Resilience and Growth.

We are supplementing the metrics with the addition of a new long-term free cash metric and we will reconcile the movements in this year on year, to illustrate whether our business is growing or not.

0:49:20.2

To conclude, Cash, Resilience and Growth remain at the core of Phoenix's financial framework. Phoenix's resilient cash generation from the current in-force business supports the dividend for many years. We have a clear criteria for allocating surplus capital to growth through BPA and M&A, and to enhance shareholder returns in the absence of growth opportunities. New reporting metrics within Phoenix's financial framework will allow us to track the businesses' growth and proving the wedge alongside growing long-term free cash would allow us to consider dividend growth.

I will now hand over to Claire who will talk to you about sustainability.

0:50:09.5

Sustainability - Claire Hawkins, Director of Corporate Affairs and Investor Relations

Thank you, Rakesh, and welcome to the first of today's deep dive sessions.

Phoenix published its first sustainability report in March, and set out its vision of "committing to a sustainable future".

We have made significant progress against the broad range of commitments set out in this report, and are on track to complete all 2020 actions on time.

0:50:33.7

However, the world we operate in and the needs of our stakeholders are changing and, as a result, our sustainability strategy is evolving at pace.

It addresses the critical trends impacting our industry, including the aging population and the responsibility to address global environmental challenges.

Our strategy focuses on delivering for our 14 million customers, and investing our £323 billion of assets under administration, in a sustainable manner.

0:51:09.6

It is fully embedded into our business activities, integral to how we interact with our stakeholders and underpinned by good governance, and risk management.

As Andy explained, we see sustainability as being at the core of our new purpose of helping people secure a life of possibilities, and a key enabler of our strategy, and by meeting the needs of our stakeholders, we will attract more customers, retain and attract the best talent and deliver better returns to investors.

0:51:45.0

The impact of climate change is one of the biggest global issues and Phoenix is committed to supporting the goals of the Paris Agreement.

Today, we have announced our commitment to becoming net-zero carbon by 2050, using science-based techniques.

Our commitment has two key components.

0:52:05.3

The first, relates to the impact of our operations, where we are setting a target of being net-zero carbon by 2025.

The second, relates to our investment portfolio, where we are setting an overarching target of being net-zero carbon by 2050.

We recognise that there are many considerations in delivering this investment target, and our immediate focus will be on our equity and liquid credit portfolios, which comprise around one third of our total assets under administration.

0:52:39.2

Our strategy for decarbonisation will focus on:

- Reducing the carbon intensity of our portfolios;
- Increasing investment in 'climate solutions', such as renewable energy, and energy efficient technologies; and
- Paris-Aligned Stewardship, to influence investee companies to transition to a low carbon economy.

Having set these commitments, we will focus on developing interim targets which will be reported in due course.

0:53:11.3

As you have heard, our enterprise strategy focuses on deepening our relationship with our existing customers, and acquiring new customers by meeting needs across the savings life-cycle.

Our sustainability strategy aligns fully to this, and is focused on helping close the growing pensions savings gap.

To achieve this, we will focus on product innovation and promoting financial inclusion and education across demographics, with particular focus on supporting vulnerable customer groups.

0:53:45.2

We are in the process of concluding a customer research project, aimed at better understanding the needs of our existing customers in relation to sustainability.

This research will support the ongoing development of a range of ESG products across the savings life-cycle, with the go-live of our Workplace ESG passive default fund on the 15th of December.

We already support customers in the run up to retirement through telephony, digital, face to face events and webinars. We will broaden and extend the reach of our financial wellness offering in the future, across life stages and needs.

0:54:26.5

Finally, Andy Moss and Andy Curran will talk later about our investment in digital across both our Heritage and Open businesses.

We will be increasingly focused on driving forward our digital strategy, with the aim of increasing education and engagement, and promoting financial wellbeing.

As an asset owner, we act on behalf of our customers to invest responsibly and with a long-term view.

Mike will talk later about how it is essential for us to factor sustainability considerations into our investment decisions.

0:55:05.6

Our net-zero commitment demonstrates our focus on decarbonising our portfolios.

Through our membership of the IIGCC, we were one of five insurers who took part in a pilot to build and test Paris aligned portfolios. This has provided valuable insight into how we will implement our net-zero commitment.

In 2019, we set out our philosophy for responsible investment.

Clearly, this requires a different approach, for those assets where we have the ability to directly influence investment decisions and those assets which remain at the sole discretion of our customers.

0:55:45.6

We are committed to establishing robust policies and procedures for understanding and addressing the ESG risks across all portfolios.

Active stewardship is critical to the delivery of our ambitions and to meeting our net-zero carbon commitment.

So, we are working in partnership with our asset managers to include sustainability considerations within their mandates.

And this will enable an integrated approach to ESG management and investment decision making.

0:56:18.5

We continue to make good progress towards reducing the environmental impact of our operations, and believe our commitment to achieve net-zero carbon by 2025 is market leading.

We are preparing a challenging emission reduction plan, in line with science-based techniques, to form our route to Net-zero.

Which begins from a base line of emissions from all 22 occupied premises within the Group.

0:56:48.4

Our focus will be to reduce carbon emissions before we engage with any offsetting.

We have started our journey by supplying our Phoenix UK sites with electricity contracts that are 100% renewable energy, and we will bring all of our occupied premises online during 2021.

Where renewable energy is not available, we will use offsetting projects. These are already in place for Phoenix UK sites and will soon be extended to cover all sites, making sure that the programmes we choose are impactful, certified and focussed on carbon removal.

0:57:27.0

Similarly, for waste, we will be working to eliminate waste to landfill across all sites through 2021.

And having already removed single use plastics for some of our UK catering facilities, we will continue the work to cover all UK sites next year.

We are committed to making Phoenix the best place our colleagues have ever worked. To achieve this, we want to be an organisation where diversity of thought and perspective is genuinely embraced.

0:58:00.2

We have made strong progress across each of our five areas of focus and our wide range of pledges and accreditations across social mobility, race, disability, mental health and gender, evidences our commitment.

As ways of working change, we are committed to adapting quickly, and providing solutions in the best interests of all colleagues.

We have seen this aspiration tested during the pandemic, when our priorities have been to protect colleagues and customers. Whilst our offices have remained open, we continue to have around 90% of our colleagues working from home.

0:58:41.0

And we are in the process of conducting a Group-wide employee engagement exercise to determine our future ways of working.

2020 has clearly been a difficult year for our colleagues and we are extremely grateful to them for the hard work and commitment they have shown.

Despite these challenges, we have been delighted that the recent annual engagement survey reported an increase of 10% in overall engagement year on year.

We remain deeply committed to supporting our communities, and continue to have a comprehensive community engagement programme.

0:59:19.7

At the heart of this programme are our colleagues, who continue to commit both their time and their skills to making a difference.

These programmes have needed to flex during COVID, embracing remote volunteering and fundraising.

Moving forwards, our colleagues will be voting to form a new partnership with a UK-wide mental health charity.

And we will be focused on better understanding the needs of the different communities in which we are based, ensuring that we prioritise our activities by measuring the social value that each initiative delivers.

0:59:55.8

Working ethically with our supply chain is integral to our sustainability strategy.

Our supply chain management framework takes a multifaceted approach to assessing and managing sustainability risk.

Using this framework, we will work in partnership with our suppliers to focus on the issues which we see as key.

These will include the environmental impact of our supply chain, including decarbonisation and health and safety.

1:00:27.5

This work will be done in a phased approach during 2021, based on the importance of each supplier to the Group and our assessment of the risk that each supplier poses to the supply chain.

Our sustainability strategy is underpinned by good governance, and sustainability risk is fully integrated into our risk management framework. In recognition of the importance of sustainability to the long-term success of the Group, the Phoenix Group Board have established a new Sustainability sub-committee, Chaired by Karen Green, and comprised solely of non-executive directors, this committee will be responsible for the review, challenge and oversight of the Group's sustainability strategy.

1:01:15.0

I am really looking forward to being an executive attendee of this committee. I believe it will provide the challenge needed to ensure our sustainability strategy creates value for stakeholders.

And our increased commitment to sustainability is translating into improvements in our ESG ratings, with recent upgrades from MSCI and the Dow Jones Sustainability Index.

Whilst these improvements are encouraging, we still have a long way to travel, and expect our ratings to improve further, upon delivery of the ambitions I have shared today.

1:01:52.3

To conclude. Sustainability is integral to Phoenix's purpose, of helping people secure a life of possibilities. Our strategy is focused on delivering for customers, and fostering responsible investment.

And we are committed to becoming net-zero carbon by 2050, targeting the significantly earlier date of 2025 for our operations.

The newly created Board Sustainability Committee will provide oversight of our ambitions, and by closely aligning our sustainability strategy to our enterprise strategy, I am confident that we will deliver value to all stakeholders.

I will now hand you over to Andy Moss, who will talk to you about our Heritage business.

1:02:42.1

Heritage business - Andy Moss, Heritage Chief Executive Officer

Thank you very much Claire, and good afternoon everyone. Phoenix is the market leader in managing Heritage businesses. We have a number of competitive advantages driven from the optimised operating model we have developed over a number of years.

The business covers a broad range of unit-linked, with profits and protection products that are no longer actively marketed to new customers and comprises circa 50% of our in-force book, with 8.3 million policies and £162 billion of assets under administration.

Our strategy here is unchanged. To deliver customer outcomes and manage our in-force business for cash and resilience.

1:03:29.6

The unique and distinctive nature of our Heritage strategy positions us to outperform.

At the heart of our in-force business is our optimised operating model. This model comprises:

- A core, digitally enabled, customer administration platform;
- A single set of actuarial and accounting processes and platforms including a single internal model;
- A harmonised approach to risk management which delivers resilience to the business; and
- A single investment strategy.

As a team, our time is therefore focused on further optimising this operating model which we do by delivering for customers, executing management actions and integrating the businesses that we acquire.

1:04:15.1

As a result of this we deliver improved customer outcomes and cost and capital efficiencies.

This strategy delivers cash, resilience and growth and supports three of the key components of our wedge illustration being Heritage, management actions and the integration synergies which are realised from M&A.

As Claire explained, delivering for our customers is central to our sustainability strategy and is fully aligned to our purpose of helping people secure a life of possibilities.

1:04:49.0

By putting customers at the heart of all that we do in our Heritage business we have developed a long track record of improving customer outcomes, consistently delivering high quality customer service, and by investing in our digital proposition we have improved the ease of interaction for customers.

Turning to our track record of improving customer outcomes. Our actions here are wide ranging and show the breadth of our customer service activities. Not only have we delivered strong value for money for customers by reducing charges and investment management fees on their policies, we have also traced and repatriated policyholders with unclaimed life insurance policies.

1:05:31.5

I am particularly pleased that we have taken a proactive role in preventing pensions fraud and continue to take an active role with government and industry influencers on topics that matter most to our customers – like the pensions dashboard.

We have also demonstrated that we are a safe pair of hands in the remediation of legacy reviews – for example, Abbey Life which was a business we acquired whilst it was under FCA enforcement.

We continue to target a 90% level of customer satisfaction and have been delighted to have delivered ahead of this target for a number of years.

1:06:09.7

This has been particularly pleasing this year when we have proactively managed the many challenges arising from COVID-19.

In responding to the pandemic, we contacted 1.2 million customers, encouraging them to move to digital interactions and delivered over 80 online enhancements. We introduced COVID-19 dedicated customer support and help pages online and kept our call centres open at all times. In addition, we encouraged annuitants to accept bank transfers rather than their traditional method of receiving a cheque, and offered premium flexibility to support those suffering from financial hardship.

Phoenix has been investing in the development of its digital platform for Heritage customers. Our focus to date has been on improving availability and convenience whilst expanding the journeys that can be completed online.

1:07:04.2

All legacy Phoenix customers can now access our website which provides information, help and education to support decision making.

We have also developed the logged in environment "MyPhoenix" where our priority has been the introduction of digital journeys for the convenience of our customers.

Moving forward we will continue to expand this offering with our focus being to provide a service to meet our customers' needs, to engage more easily with customers and to improve efficiency.

We are excited about the future opportunities that this presents to both the Group and our customers.

1:07:38.6

Moving now to management actions - the bedrock of Phoenix's Heritage capabilities.

The majority of our cash generation comes from the emergence of surplus as our in-force business runs off over time and capital unwinds. We call this "organic" cash generation.

However, at Phoenix we also deliver management actions which are incremental to the organic unwind. These actions either increase own funds and therefore increase the overall cash flows from the business, or reduce risk capital and therefore accelerate the timing of cash flows.

1:08:16.7

Our track record of delivering management actions is unique. We have delivered £2.5 billion of additional cash generation from management actions between 2010 and 2019 with a further £0.6 billion of Solvency II surplus generated by the end of Q3.

Typically, management actions comprise a third of cash generation and our long track record illustrates their dependable nature. Management actions are lumpy and we do typically see more delivered in the period immediately following M&A as we integrate businesses together. But they are not dependent on M&A as our long track record illustrates.

1:09:00.9

Our 2020 management actions also evidence this point, with a wide range of items including illiquid asset origination, credit management, asset restructuring and equity risk hedging. Equity hedging is the only action directly attributable to M&A.

I wanted to spend a few minutes looking at a couple of management actions in detail to better explain how we deliver value.

The first example examines the Solvency II benefit driven by illiquid asset origination.

We calculate the present value of our annuity liabilities using a discount rate derived from the yield on the assets that are cash-flow matching the liability.

1:09:46.3

Long dated, or "illiquid" assets better match the long-dated nature of our liabilities and typically have a higher yield to reflect an illiquidity premium.

Replacing liquid assets with illiquid assets therefore increases the discount rate and reduces the present value of our annuity liabilities. This is the matching adjustment benefit.

Against these assets, we prudently hold additional risk capital which will unwind over time.

This year we have seen a £265 million increase in own funds from the £1.4 billion of illiquid assets originated. Mike will talk later about our appetite for illiquid assets. But we do expect to deliver significant, further value in future years as we move from 24% to 40% of illiquid assets against our £39 billion annuity book.

1:10:41.3

The second management action explores the benefit delivered by hedging ReAssure's equity risk.

Phoenix views equity risk as an unrewarded risk and uses hedging to manage its exposure. It is therefore commonplace for Phoenix to extend its approach to hedging across future acquisitions from the date of announcement.

In the case of ReAssure, we took out hedges to increase the hedging of ReAssure equity risk from 40% to 80%. These hedges were initially held at the Phoenix Group level but have subsequently been passed down to ReAssure.

By hedging this exposure, £120 million of equity risk capital has been released.

1:11:37.2

Looking to the future, our £5.9 billion cash generation target for 2020 to 2023 includes £2.0 billion of management actions. We continue to have a strong pipeline of actions that underpin our confidence in this target including longevity reinsurance, illiquid asset origination, Part VII transfers and further operational efficiencies.

We only place value on management actions out to 2023, however, we expect there to be opportunities for management actions over the life of our in-force business.

New opportunities for management actions also arise as our environment changes. Future M&A is an obvious example of an opportunity for cost and capital synergies, but we also see regulatory change, digitalisation and our macro-economic environment as potential sources of value generation.

1:12:33.1

Turning finally to our integration capabilities. Phoenix and ReAssure have been leaders in the consolidation market, with six acquisitions split evenly between us over recent years prior to the businesses coming together in July.

ReAssure bring additional skills to the Group which complement our own, and additional capacity which means we will be ready to undertake further M&A more quickly.

Whilst our legacy businesses are different, our approach to integration is consistent. Both Groups have focused on accessing cost efficiencies, by delivering scale to their operating model and unlocking capital efficiencies through accessing diversification benefits and applying a harmonised approach to risk management.

1:13:19.7

In addition, we have both sought to optimise investment returns through a single investment strategy and prioritised delivering improved customer outcomes.

Whilst our operating models are different – Phoenix favouring an outsourced model for customer administration using the TCS Diligenta Bancs platform and ReAssure having an insourced model using the Alpha platform, we have both driven cost efficiencies by migrating policies onto a single platform and utilised reinsurance and Part VII transfers to access capital synergies.

1:13:54.9

The similarities in approach are highlighted through this case study of ReAssure's acquisition of the Old Mutual Wealth business.

For those of you who remember our 2018 capital markets day, this case study is extremely similar to that of Phoenix's acquisition of the AXA wealth business.

ReAssure paid £446 million for the business. It had own funds, measured in accordance with the Old Mutual underlying assumptions, of £411 million and a surplus of £167 million.

1:14:31.9

By harmonising assumptions for the business to those of ReAssure and in particular, reflecting the reduced per policy cost of administration from migrating policies onto the ALPHA administration platform, additional own funds were created.

Further synergies were accessed by reinsuring the business into ReAssure and applying the Group's hedging policy. These Day 1 management actions increased the acquired own funds to £584 million and increased the surplus to £442 million, supporting a cash release of £290 million. Thus, a deal that looked like it was being conducted at 109% of own funds, became a transaction at 76% of own funds and illustrates the value that can be created by specialist consolidators of Heritage books.

1:15:24.4

Part VII transfers are a key value enabler to consolidators. By moving policies into a single legal entity, we deliver economies of scale and ensure that customers are serviced from the most efficient and optimised operating model.

However, Part VII transfers require both regulatory and High Court approval and therefore require significant expertise to execute successfully.

The Part VII of the L&G mature savings business completed in September. This was an extremely complex transaction, migrating 1.1 million customers, £33 billion of assets under administration, from 5 L&G retained platforms and with over 60 different policy types.

1:16:14.0

Migrations of this nature are extremely difficult to deliver successfully. The ability of the ALPHA platform to perform this extraction of policies evidences our ability to manage both complexity and uncertainty and deliver value for customers and investors.

Our integration approach has three phases, which are approached sequentially, so when one integration is complete, capacity is created for the next integration to start.

Phase 3, the migration of customer policies onto our administration platforms, is the hardest and longest phase of any integration as shown in the timeline and can be the biggest barrier to being ready to undertake further M&A.

1:16:58.8

Having two administration platforms in the form of ALPHA and BaNCS is therefore an enabler to the faster integration of acquired businesses.

This slide illustrates that we have the capacity to consider further M&A opportunities now. Phoenix is very much open for business.

To summarise;

Phoenix is the market leader in managing Heritage businesses, driven from our distinctive operating model and unique competitive advantages.

1:17:30.6

Our strategy places customers at the heart of all that we do and we are focused on improving customer outcomes.

We have a strong track record of delivering management actions, with £2.5 billion over the last 10 years and will continue to deliver management actions into the future.

Phoenix is also a market leader in M&A and integrations, delivering value by integrating businesses onto our optimised operating model.

And finally, ReAssure strengthens our capabilities, both in the management of Heritage businesses, and for M&A and integration where they bring complementary skills and additional capacity.

Thank you for your attention. I will now pass you over to Andy Curran, who has been unable to travel due to COVID restrictions and joins us today from Glasgow.

1:18:26.6

Open business - Andy Curran, Chief Executive Officer, Savings & Retirement UK & Europe

Thank you Andy. I joined Phoenix this summer and took up the role of CEO of our Savings and Retirement Business in October. This has given me a great opportunity to really understand the Open business and assess our opportunities to deliver growth.

It is clear to me that our Open business has strong foundations and is central to our purpose of helping people secure a life of possibilities. The Open business covers 5 business units and compromises of around half of our in-force book, with approximately 5.6 million policies and £161 billion of assets under administration.

1:19:11.7

My focus today is on the 3 business units which we expect to be our major drivers of growth. I will share with you how we are thinking about our Workplace, Customer Savings and Investment and Retirement Solutions business units.

All of which, give us a great opportunity to grow. We have the chance to leverage the competitive advantages we have today but I do recognise we have work to do to realise these opportunities and we have set ourselves clear strategic priorities to achieve our ambition.

1:19:49.4

Speaking of ambition, Rakesh has outlined the maths that underpins the wedge. To offset the run-off of our in-force book, I'm bringing sustainability to our organic cash generation, our Open business must deliver over £800 million of incremental long-term cash per annum. This target is ambitious but it is also achievable. In the first 9 months of this year, the Open business delivered £472 million of incremental cash generation from new business.

While this is lower than the £800 million level needed, we expect to be able to close this gap in future years by increasing the capital allocated to BPA while at the same time reducing the capital strain and by growing our Workplace and CS&I businesses through our investment in products, proposition and people.

1:20:52.0

Three of the key drivers of growth in the long-term savings and retirement industry will help to drive growth in our Open business. Growth in workplace is driven by auto enrolment, the ageing population and the move from DB to DC.

We currently have an 11% share of the Workplace market and our strategy here is to protect and grow naturally as the UK population ages, more and more people will be on a journey to and through retirement. We estimate annual flows of around £30 billion into products supporting this stage of the saving cycle, which aligns to our CS&I business.

Currently, we have less than 5% of the flows today. We do however have approximately 14 million customers.

1:21:43.5

The strategy here is to engage and develop relationships with these customers, with ambition, that they will consolidate towards us, and stay with Phoenix for longer.

And finally, corporates are de-risking with around £40 billion of DB scheme liabilities, transferring to the insurance sector each year. We currently have a 5% market share and our strategy here is to grow and expand. A deep understanding of how each of these markets work will be critical to our success, and of course we will only allocate resources where they will deliver strong returns.

1:22:25.4

Delivering a similar share of flows to our share of stocks will drive significant growth. Looking at these markets in a bit more detail, I will know turn to Workplace.

The Workplace market will become the main vehicle for retirement savings in the UK and is forecast to grow from around £400 million to £1 trillion over the next decade.

Within this market there will also be a major shift to Master Trust, driven by a raft of changes in pension legislation. This presents a fantastic opportunity for Phoenix to pick up existing and new pension schemes.

1:23:08.2

To be successful you first must have a deep understanding of how this market operates. You need a strong, modern proposition, you need excellent customer engagement, you will also need leading cost efficiency, all underpinned by commitment to the longer term.

As you will already be aware, we will operate in the corporate market under the Standard Life brand. We are already a skilled player with over £41 billion of assets under administration. In this capital light thin margin market, scale and ongoing propositional investment are key attributes to being successful.

1:23:50.6

Our commitment here is evidenced by a rapid propositional development, over the last year, which we will continue to accelerate into 2021.

Our proposition now offers a wide range of investment solutions across active and passive funds, our digital platforms, interactive tools, our automated member communications all ensure excellent employer, employee advisor and trustee experience.

Our reputation in the market for excellent customer service is well-deserved.

1:24:27.8

And, our relationship with TCS will help us deliver market leading cost efficiencies without compromising on service levels. Our strategy is to protect and grow our Workplace business from these strong foundations.

As I've just mentioned, our proposition has improved considerably, and we will not stop there. Up and coming enhancements include retirement income focus funds, providing a digitally enabled retirement advice service, and a salary deductible ISA.

As a whole, it is clear that our proposition today stands in comparison with any other in the corporate market.

1:25:12.2

Claire set out the sustainability strategy earlier, which puts customers right at its heart. Aligned to this strategy we have made great progress in expanding our range of ESG investment solutions.

Our new ESG passive default fund launches this month. The fund has been designed to deliver good member outcomes at retirement. Using a blend of approaches including exclusions, targeting and influence. On top of this, we are also launching a range of ESG themed active funds, these funds will help support Phoenix in meeting our net-zero carbon target commitment.

1:25:56.1

Pricing in the Workplace market is competitive, so efficiency is crucial. Here we have substantial advantages from operating our Open business alongside our Heritage business, and through our unique partnership with TCS we will migrate to the digitally enabled BaNCS platform which will help futureproof our business.

It will deliver a modern flexible platform and supports our continued excellent customer service and gives us important market leading cost efficiency.

1:26:35.9

To summarise, we are already a skilled player in the corporate market, and we are well positioned to deliver, our "protect and grow" strategy.

Moving on to our CS&I business unit. There are a number of key trends driving change across the long-term savings and retirement industry, in particular pension freedoms have given consumers significantly more choice. With more choice, the industry has found it hard to strike the right balance for the consumer on the need for more education, information and advice when making important financial decisions.

1:27:15.8

At Phoenix, we will build on our existing capabilities and become an organisation that gives the consumer the support it so badly needs. As an example, retirement is no longer a single event. It's a more complex transaction for which responsibility has shifted to the individual.

Our customers tell us that they find the journey to and through retirement confusing and that advice is often too expensive for their needs, and while a digital journey may get the ball rolling, many would value guidance to help them understand their options and validate their own thinking.

1:27:57.4

Few players are capable of engaging customers and providing holistic solutions to help customers secure their income in retirement.

Our CS&I business includes what we have previously referred to as a Retail Business and Wrap SIPP, for Wrap SIPP we provide an insurance wrapper to the Standard Life Aberdeen platform, this is high volume, thin margin business for Phoenix. We also have drill down products, individual SIPP and bonds within this business unit.

Whilst Phoenix's market share is currently modest, it is an area of significant potential growth, with around 40 million customers, Phoenix has a unique opportunity to deepen our understanding of customer needs and respond to those needs with innovative solutions throughout the retirement life cycle.

1:28:55.7

Our strategy here is to engage and develop. We will achieve this by focusing on the needs of our customers across the 4 stages of engagement. This begins with the need for financial awareness, moves to consideration, where customers need clarity on the options they have, then onto support, where help is needed to validate thinking. And finally, to transaction.

We will engage with our customers by helping them bring consolidation onto our platform simple and straightforward, by developing more innovative solutions as customers move to and through retirement and where complex decisions need to be made directing them to advisors.

1:29:44.0

Andy Moss spoke about the strength of our digital capability in our Heritage business. The same very much applies to our Open business. We have introduced new app features, implemented priority functionality for NHS staff and launched a new investment hub.

Encouragingly we have seen increased usage of our digital drawdown solution with over 21,000 customers using online retirement journey by the end of October. This year, we've seen 15 million logins so far, 50% of which have been through the app and we are on track to achieve £1 billion of new cash through digital channels this year.

1:30:31.2

In summary, the Customer Savings and Investment market is very large and through improved customer engagement and product development we see this as a significant growth opportunity for Phoenix.

And finally, turning to Retirement Solutions. This includes both vesting annuities and BPA with total assets under administration of £38 billion, there are £2 trillion of DB pension liabilities in the UK and it is estimated that £1.2 trillion of these liabilities are sufficiently well funded for a buy-out or a buy-in.

1:31:12.5

We expect to continue to see demand for DB de-risking remain strong, as CEOs and Finance Directors of corporates continue to look to focus on their business, rather than their company pension scheme.

Having entered the external BPA market in 2018, Phoenix is now an established player, having written £5.7,billion of liabilities across both internal buy-ins and external BPA.

Our market share is currently circa 5%. Our ambition here is to grow and expand this business unit. We will fund BPA from own resource and we will allocate £150 million-£200 million of surplus capital per annum, subject of course to meeting at Rakesh's expectations around returns on capital.

1:32:10.5

And we will target deals in the £100 million - £1 billion range, however we will continue to be selective and proportionate, focused on the value not volume and ensuring that annuities do not become an overly dominant proportion of the Group's total product mix.

While our deal economics continue to improve, we are still seeing a capital strain of 8%, inclusive of our capital management policy. Our focus is on reducing this capital strain from 8% to 5%, which will be achieved by optimising capital within the framework of the harmonised internal model, a best-in-class approach to the sourcing and allocation of illiquid assets and by optimising our approach to reinsurance.

1:33:05.2

With these deal economics, £150 million of capital investment will generate around £600 million of incremental long-term cash generation. A significant step on our way to proving the wedge.

To grow our BPA business, we must strengthen our capabilities, and Mike will talk next about his plans to build a best-in-class asset management capability that will support our growth strategy.

We will also be looking to expand our proposition, develop our operating model and build de-risking partnerships. And, we look forward to welcoming Tom Ground as Managing Director of this business in January.

1:33:51.2

Before I conclude, I thought I'd share with you an example of how our ability to build long standing relationships, facilitates follow on transactions.

Our first external BPA was with the M&S Scheme back in March 2018, this is a scheme which uses umbrella contracts to undertake a rolling program of buy-in tranches.

Phoenix applied a solutions-focused approach to work with the Trustees, recognising the Scheme's commitment to reduce longevity risk over time by working collaboratively with advisors and Trustees and reinsurers who were able to improve transaction efficiency.

1:34:36.2

This approach also allowed us to provide attractive pricing. We have now completed three transactions and insured £1.3 billion of liabilities with the M&S Scheme, covering 30% of pension liabilities.

So, to summarise, our Open business is central to our purpose of helping people secure a life of possibilities. We have strong foundations and are aligned to the industry drivers of change. We are a top 3 Workplace provider and are accelerating our investment in propositions to protect and grow in this market.

By deepening our customer relationships, we will retain our customers and they will consolidate towards us, as well as helping them journey to the through retirement.

1:35:35.5

We are an established player in the BPA market and are focused on improving our capital efficiency to ensure the capital we allocate delivers strong returns.

Through the delivery of the strategic priorities, I am confident that delivering £800 million of incremental cash generation from new business is achievable. We can prove the wedge.

I will now hand over the Mike who will take you through our approach to Asset Management.

1:36:10.5

Asset Management - Mike Eakins, Chief Investment Officer

Thank you Andy and good afternoon.

I joined the Group in July this year, when Phoenix's acquisition of ReAssure completed, having held the role of CIO at ReAssure for just over 12 months. I am super excited about the shared vision that Andy Briggs and I have for in-house Asset Management at Phoenix and that it is, to be, best in class.

The Phoenix Asset Management team brings together all investment activities, across both Shareholder and Policyholder Assets and across both Heritage and Open businesses.

1:36:38.1

Our Asset Management strategy has three clear priorities:

1. To manage our Asset Risk for Solvency II balance sheet resilience.
2. To source assets that support our growth aspirations and deliver management actions; and
3. To embed the principles of Responsible Investment into all that we do.

Our ambition of being a centre of excellence, will be delivered by our people and our operating platform. My team has dedicated Shareholder and Policyholder teams who are supported by specialist teams focused on: Internal Ratings, ALM, Sustainability, Quantitative Strategists, Operations and Manager Oversight.

1:37:13.0

I am fortunate to have been able to recruit some of the best and most experienced talent available, within the Asset Management and Insurance Sectors, to ensure we have in-house expertise across liquid credit, illiquid assets and interest rate markets.

We are also investing in our operating model, using the latest technology to implement a leading investment platform and risk management system across the Group.

Phoenix Asset Management operates as a shared service. We are there to provide investment solutions across the Group.

1:37:41.1

So, put simply, my priorities are the priorities of Andy Moss and Andy Curran, and therefore totally aligned to the Group purpose of helping people secure a life of possibilities.

But our real competitive advantage comes from our Global Strategic Partnerships, which we can leverage to deliver optimal investment outcomes. Aberdeen Standard Investments, or

ASI as we refer to them, are our core strategic asset management partner. The strategic partnership fosters collaborative working, and I have been extremely impressed with the level of support we have received from all levels of engagement with ASI, on a day-to-day basis.

1:38:15.4

We also use a wide and increasingly large range of other Asset Management partners, and this network is becoming truly global to ensure that we deliver best in class performance across all asset classes and geographies.

For example, as it relates to Infrastructure Debt, we also partner with Macquarie and BlackRock. The flexibility that this network affords us, ensures we can leverage the very best experience available. Now as Claire set out earlier, Responsible Investment is at the core of our investment strategy and will deliver benefits to policyholders, investors and society.

1:38:53.2

In 2019, we published our Responsible Investment Philosophy, representing a step change in our approach to integrating ESG into our investment strategy. Our philosophy is based on the principles of the UN PRI and I am delighted to confirm that we have recently became members of the UN PRI.

Our commitment to decarbonise our investment portfolio and be net-zero carbon by 2050 is integral to this, but we recognise that commitments are not enough on their own.

Delivery is key and delivery will be contingent on the integration of ESG factors into our investment making decisions and will be dependent upon high quality data and reporting.

1:39:34.4

Key areas of focus for us right now.

We also recognise our stewardship responsibilities and will adopt an “engagement first” approach with the objective of using our position of influence to bring about change.

In-activity will, however, ultimately lead to divestment.

Having explained our approach to Asset Management, I wanted to spend some time explaining how our Asset Management strategy delivers resilience through proactive risk management and building on some of the management actions discussed by Rakesh.

1:40:04.0

We decompose shareholder market risks into two categories:

1. Those that we view as unrewarded, such as interest rates, inflation, FX and equity. All of which, are managed within risk appetite through systematic hedging.
2. And those that we see as rewarded, like credit and property, which we manage within risk appetite through disciplined investment.

As a result of our approach to risk management, just over 40% of our residual shareholder risk is driven by market risk.

This approach to the setting and management of market risk appetite is different to our peers and translates into the low sensitivities presented here.

1:40:40.1

Many of you will be familiar with this exhibit. It sets out the impact on both our Solvency II surplus and Coverage Ratio of risk events occurring as at 30 September, and shows that we remain within our target coverage ratio range under all scenarios.

You will note that the sensitivity of our Solvency II surplus to the unrewarded risks of equity and interest rates is negligible, and that our proactive management of risks such as credit and property, means our sensitivity to these risks is also small.

But I wanted us to explain how we achieve these low sensitivities, starting first with Equity Risk.

Here the Shareholder's exposure is an indirect exposure it has to the With-Profit and Unit Linked funds.

1:41:21.7

This exposure is largest in the Unit Linked funds, where a decline in equity markets erodes the value of Unit Linked funds and therefore reduces the present value of future profits or "VIF".

In total, we carry £4.9 billion of VIF on our balance sheet, and hedge between 80% and 90% of this exposure through a rolling programme of options, futures and forward contracts.

The chart on the right-hand side shows how our sensitivity would change if we didn't hedge equity risk. A 20% fall in equity markets would increase the strain on Solvency II surplus from a negligible amount to £0.5 billion.

1:41:58.0

Moving now to interest rates where the Shareholder exposure is driven primarily from the annuity book. Our objective is to reduce our exposure to interest rates and bring resilience to the Solvency II surplus.

We do this initially through cash flow matching in our annuity funds, and then use swaps and swaptions to hedge the remainder of our interest rate exposure.

We have hedged over 85% of our interest rate risk, representing approximately £13 million per basis point movement in interest rates.

1:42:28.2

This hedging strategy brings significant protection to shareholder value and without it, our sensitivity to an 88bps fall in interest rates would increase from a £0.2 billion reduction in Solvency II surplus to a £1.2 billion reduction.

Our exposure to the rewarded risks of credit and property are driven from our £46 billion shareholder asset portfolio. The assets backing our annuity liabilities represent £39 billion, with the remaining £7 billion representing assets backing Protection business and other Shareholder capital.

1:43:00.7

The shareholder portfolio includes a range of liquid and illiquid assets and is diversified across ratings, sectors and geographies.

Our shareholder assets includes a £35 billion debt portfolio comprising of Gilts and Supras, Corporate bonds, Illiquid credit - excluding Commercial Real Estate Debt and Equity Release Mortgages.

We have a dedicated in-house team of market leading credit experts who proactively manage this portfolio on a daily basis. The portfolio is defensively positioned, with minimal exposure to companies most impacted by COVID-19 in sectors such as airlines, hotel, leisure and traditional retail.

1:43:42.7

The Group's debt portfolio is high quality with 98% at investment grade. And only 2% of the portfolio sitting at BBB-.

Historically, ReAssure's exposure to BBB was significantly higher than that of Phoenix, and we have been proactively reducing the exposure to BBB throughout the year.

On a combined basis, the BBB and below exposure, as a percentage of our debt portfolio, was at 23.5% at the half year.

Through the delivery of management actions, including rotation into US dollar Investment Grade credit, this exposure had been reduced to 19.7% at the 20th November.

1:44:23.6

The material reduction in BBB exposure has, in a large part, been delivered through Portfolio Block Trades. Not only do these block trades help improve our credit quality, but they have supported our ambition to diversify into US dollar Investment Grade Credit and have been a value creating management action.

These trades are only possible because of the expertise within the Phoenix Asset Management function. Portfolios are constructed in accordance with clear investment criteria and their impact assessed on the aggregate balance sheet, prior to execution.

1:45:01.3

We then execute these block trades with the help and support of our Asset Management and and bank partners. To give you an example of a recent block trade, in September, Phoenix Asset Management rotated £210 million out of sterling credit into USD credit, generating Solvency II surplus.

It should be noted that all dollar bonds are hedged back to sterling, by using cross-currency swaps, matching the term of the bonds.

The outcome of this management action is limited downgrade experience. This chart shows that the average credit rating of each sector within our debt portfolio has been maintained.

1:45:38.2

As at the 30th September, only £1.6 billion or 4.5% of bonds in our debt portfolio had been subject to a full letter downgrade, and only £148 million or 0.4% from our debt portfolio were to sub-investment grade.

99.3% of all cashflows have been paid on our illiquid bonds and 99.9% have been paid on our liquid bonds. This performance is directly driven by Phoenix's approach to managing credit risk and the high-quality team we have in place.

Phoenix's exposure to property risk is primarily driven by our £3.3 billion Equity Release Mortgage portfolio. This portfolio is highly resilient and well diversified.

1:46:20.6

We have clearly defined risk appetite parameters for this investment class and our selective approach to origination imposes hurdle criteria on rating, duration and diversification. We monitor the portfolio on an ongoing basis through stress and scenario testing and will continue to evaluate the use of no-negative equity guarantee hedging.

Annuity liabilities are long dated and it is therefore optimal to put long dated, or illiquid assets against our annuity liabilities, to achieve cash flow matching.

Our current £9.3 billion illiquid portfolio is well diversified across asset types and sub-sectors. In addition to our Equity Release Mortgage portfolio, our illiquid portfolio comprises of

- Private Placements,

- UK Local Authority Loans,

- Commercial Real Estate and Infrastructure Debt.

1:47:12.3

The portfolio has a high credit quality with around 75% of the portfolio rated single A or above. As Andy Curran explained earlier, BPA is a driver of growth for Phoenix and appropriate illiquid asset sourcing is a key enabler to reducing the capital strain we incur from the current level of 8% to the target of 5%.

To meet the expected growth of our BPA business. And achieve our 40% target strategic asset allocation, we aim, subject to prevailing market conditions, to source £3 billion of illiquid assets per annum.

1:47:47.9

However, we will continue to be driven by value and not volume, quality and not quantity.

As a reference point, over the course of the third quarter of 2020, of the potential illiquid asset investments screened, only 12.5% were invested.

We will achieve this increased origination target by expansion of our investment strategies across new assets and geographies, with fully integrated sustainability objectives.

In 2020, we have originated £1.4 billion of illiquid assets across a range of durations, with an average credit rating of single A.

1:48:27.3

Illiquid asset origination continues to be one of our key management actions, delivering a £0.1 billion increase in Solvency II surplus. On a going forward basis, we'll be expanding our ability to originate direction with borrowers so that we can augment the origination through our Asset Management partners.

It is in our illiquid asset sourcing that we can most easily see the impact of our commitment to responsible investing, with 50% of our illiquid asset origination this year being into ESG assets.

And integral to this illiquid asset origination is our programme of helping Build Back Britain Better. I have included on this slide two great examples of this programme in action.

1:49:12.1

The first, Project Albion is a renewable energy portfolio. Across onshore wind, hydro and solar power, with investments in England, Scotland, Wales and Northern Ireland.

The second, Project TunTum is a community-based housing association with a BAME focus. Based in the East Midlands, it has approximately 1,400 homes providing affordable housing to over 3,000 people.

We really look forward to playing a key role in society over the coming years, putting our assets to good use and supporting our Group purpose of helping people secure a life of possibilities.

1:49:47.1

So, to conclude, Phoenix is building a best in class in-house Asset Management team, which has the unique advantage of being able to partner global asset managers and ASI as our core strategic asset management partner.

Sustainable Investing is integral to our investment strategy and aligned to the Group's purpose. Integral to this is our commitment for our investment portfolio to be net-zero carbon by 2050.

A key priority is managing market risk. We deliver resilience by hedging unrewarded risks like equity, interest rates and FX, and proactively manage rewarded risks like credit through a well-diversified, high quality, defensively positioned portfolio.

1:50:35.0

Illiquid assets provide great matching for annuity liabilities and our ability to originate high quality illiquid assets supports the growth of our BPA business and drives capital efficiency.

I am now going to hand back to Andy Briggs to summarise.

1:50:50.8

Summary - Andy Briggs, Group Chief Executive Officer

Thank you Mike. I am incredibly excited about the creation of Phoenix asset management.

The combination of the right team, and the right strategy, means we're very confident of the impact Mike and his team will have on our broader strategic delivery.

We've run through a lot of detail today, and there's been much to absorb. Before we move to Q&A, I wanted to try to pull it all together.

1:51:18.3

Therefore, if there were three things I'd urge you to take away from today, they would be:

First – our strength of purpose. As the UK's largest long-term savings and retirement business, Phoenix has a clear role to play in society, and that is what underpins our new purpose: helping people secure a life of possibilities. With sustainability at our core. I passionately believe that the best businesses, have the best people, are customer obsessed and focused on their core social purpose, to in turn, drive superior returns for shareholders. A virtuous circle and that's what we're doing here at Phoenix.

1:52:06.3

Second – our clear strategy. This starts by leveraging our market leading share of in-force business, in the UK long-term savings and retirement market. And then we're extremely well placed, to take advantage of the major market trends. Both deepening our existing customer relationships, across our 14 million customers. And acquiring new customers, through new Workplace and BPA business, and through M&A.

And third – we will win, because we have unique advantages. Our resilience, our dependable cash, and our excess cash to invest in growth. All of which we've evidenced over a long time period, including most recently, through the challenges of the pandemic.

And because at Phoenix, the whole is greater than the sum of the parts. Our Open businesses have unique advantages, from operating alongside Heritage.

1:53:13.2

And given the scale of our Heritage and Open businesses, we can deliver higher synergies, and hence more value, from M&A. All in all, a unique combination of dependable resilience and exciting growth opportunities.

Thank you, and with that we'll move to Q&A, so for the sell-side of analysts, now's the time to dial into the telephone conference so you are able to ask your questions live into the room here, while you're doing that, we also have questions coming through on the webcast, so Vicki could we have the first question from the webcast please?

1:53:57.1

Q&A

Question 1 - Vicki Hayes, Phoenix Investor Relations Finance Manager

Yes, thank you Andy, so the first question, when do you expect to be ready to undertake your next M&A deal and would you consider buying a 100% Open business?

Andy Briggs

Ok thanks for that Vicki, so much as Andy Moss covered, we're ready to do the next deal now because we're well advanced in the first phase of the integration of Phoenix and ReAssure which is bringing the head offices together. But were we to do another do deal now we would need to wait a while before we're ready to do the second and third phases, so Finance and Actuarial and the Operations in IT, and as a result of that we're not currently pounding the streets desperately looking for our next deal but we are optimistic about the opportunities for M&A in the UK market and if the right opportunity came along we would be in a position to do it.

1:54:50.0

In terms of the types of deal there's probably two observations I would make. One is that I often hear people say Phoenix can only do a massive deal and that a smaller deal just wouldn't work but that's just not the case at all from my perspective yes, we'd be interested in larger deals but I think Andy Moss gave a great example of the ReAssure deal for Old Mutual Wealth where there was well over £200 million of day one synergy benefits delivered on that deal. So, and if you think now the Combined Group, we've got seven and a half thousand people, we can have a small group of people doing a smaller bolt on deal every

year and if each of those was generating a couple of hundred million of value that's really significant in the scheme of an annual cost of dividend of £480 million.

1:55:32.8

And then the final part of the question would we consider a hundred percent open business? So, our priority remains heritage businesses, we think that's where the biggest opportunity lies but we would consider a 100% open business. Two criteria for that, the first is strategic alignment so is it going to support the strategic direction we're going in as an organization bringing new capabilities that will be valuable to us. And then secondly that the clear criteria that Rakesh set out so it needs to be value accretive, it needs to support cash generation for the dividend, and we need to maintain our investment grade rating. Those three criteria will continue to apply.

Okay. So, Jess is our operator here today. Jess, do we have any questions yet from the analyst team?

Operator

1:56:16.6

Yes, we have a few questions in the queue. The first question comes from the line of Andrew Sinclair from Bank of America, please go ahead.

Question 2 - Andrew Sinclair, Bank of America

Thanks and good afternoon everyone. Three from me if that's okay.

Firstly, you mentioned that you can optimize the capital efficiency for BPA business and that should be better than peers given diversification of Heritage. Just really wondered if you could give some context around that. What level of diversification benefit advantage do you think can be achieved? And given the 5% strain target remains higher than some peers how low can this go?

1:55:57.7

That’s question one, question two, I know you've talked about partnerships for Asset Management but with your in-house expertise building do you have any interest in in-sourcing some of the Asset Management services currently outsourced how much can be done without the partners?

And third was just on Europe, I'm going to try not to ask you something you can't answer but you've talked about strategic optionality. I'm just really interested what would you do with any proceeds if you were to dispose of, of Europe or anything else for that fact, bulks or future M&A to get back to shareholders, interested in your thoughts there, thanks.

1:57:40.4

Andy Briggs

Okay, thanks very much Andy. So I'm going to get Rakesh to answer your first question around BPA capital efficiency and diversification with the rest of the book of business. I'll get Mike to answer the second question on Asset Management Partnerships and in-house, and I'll pick up your third question. I'll do that first if I may on Europe.

So, we've got a significant presence in Europe - established businesses a geographic focus obviously being Germany and Ireland. I've always said that I think that gives us, you know,

potential strategic optionality whereby we can take unique M&A capability that we've deployed in the UK and move it internationally.

1:58:20.7

But we have had a number of approaches for those businesses and have concluded the right thing to do is just to stand back and think about our strategic options. Very early stages. No decisions made on which option we might pursue and certainly it's far too early to be thinking about what we may or may not look to do with any proceeds if that was the conclusion we came to. Needless to say, we will update you as when there's anything more to say. Rakesh do you want to pick up Andy's first question?

1:58:50.5

Rakesh Thakrar

Yes, thanks Andy. So, your question Andy was around the potential capital efficiency between Open and Heritage? And, you know, both myself and Andy Curran have explained what we're trying to do is get that 8% BPA strain down through to 5%. And one of the ways to do that is looking at our capital efficiency on our internal model.

So currently as you know, we've got two internal models. We've got an approved legacy Phoenix one and we've got approved legacy Standard Life one. So you can imagine the Standard Life one is the Open business mostly with the Workplace and Customer Savings & Investments within that Standard Life internal model, and within the legacy Phoenix one you've got primarily the Heritage business which includes the BPA business. At the moment what we do is really the sum of the parts, so we're not taking any benefit because it's really just adding the two together.

1:59:46.6

What we're hoping to do with our internal model harmonization program is really offset those risks that are dominant in each of those two different models. So, for example, within the legacy Phoenix you have longevity and credit given what we're talking about in terms of BPA but in the Workplace you have persistency risks. And when you bring those two risks together you get diversification and that is the benefit of having a Heritage and an Open business.

2:00:16.8

Andy Briggs

Thanks Rakesh. Mike do you want to pick up the second question?

Mike Eakins

Thanks Andy. And the question was around our use of partnerships and the fact that we're expanding our expertise in-house. Well look, in response to that, ASI are our absolute core Strategic Asset Manager and we do a number of great things with them and we've got a real structural advantage because we can partner with organizations like ASI but also, we can go anywhere else in the world and partner with other asset managers to tap into their expertise. And that's particularly important when we're focused on illiquid assets. It's also critically important whether we want to be best in class in terms of sustainability?

2:00:54.9

So, using partnering with asset managers will absolutely be the core but what I would say is, and I referenced this in my presentation, we will build out our illiquid asset origination by doing so directly and having relationships directly with borrowers. But that will really augment the illiquid asset origination that we do with our Asset Management partners.

2:01:14.9

Andy Briggs

Thanks Mike.

So just to be clear, you know, we will do some direct illiquid asset origination, there's no plans for any direct asset management beyond that consideration. Jess next question please?

2:01:28.5

Operator

Yes, certainly. So, the next question comes from the line of Greig Patterson from KBW, please go ahead.

Question 3 - Greig Patterson, KBW

Afternoon gentlemen? Can you hear me ladies and gentlemen?

Andy Briggs

Yes, we can. Greig, how are you? Good afternoon.

2:01:43.7

Greig Patterson

Good thanks, surviving, I hope everyone is well and safe. I'll do the traditional three questions.

The first one is, you talk about £440 billion of the UK opportunity, I would like you to explicitly name the top five companies that contribute to that £440 billion please?

The second thing is on Workplace pensions in terms of the third quarter ignoring the new business element, I wonder if you could update us on what the inflow item was and the upflow item. I'm just trying to get a sense of the COVID-19 headwind on Workplace pensions net flows ex new business.

And the third one just in terms of the presentation, is it fair to say this is the first time that you are explicitly dropping your M&A criteria that the price of a deal had to really below own funds. I note the examples cited in slide 75 about Old Mutual Wealth? So, I just want to know if you’re formerly dropping that criteria, thank you.

2:03:00.0

Andy Briggs

Okay, thanks, Greig. So, we have Andy Curran with us in lockdown in Tier 4 in Glasgow, they don't let him out, so I’ll get him to take the second question in a moment. I wasn't aware we had a criteria that says that M&A would be below own funds but I'll get Rakesh to answer that one because he'll have the history of what we've said historically probably better than I do. And let me answer the first one in terms of the £440 billion opportunity.

So, what we covered in our slides today was to say that kind of roughly half of that opportunity is books of business over about £50 billion and roughly half of it is below £50 billion. I kind of judgment working this out is we're basically looking at with-profit books of business and we're looking at things like unit-linked bonds or old legacy personal pensions that aren't actively marketed for new business, aren't open for new business coming into them.

2:03:54.9

I'm not going to name specific competitors here Greig, but that's our kind of criteria that leads us to come up with the £440 billion as a whole. And it is a combination of some larger ones and lots of smaller books as well.

Andy do you want to pick up the workplace question please?

2:04:11.7

Andy Curran

Yes of course, I think I heard the question correctly.

We currently Greig, we have around 11% market share of the Workplace market at the moment and we expect that to grow. As I said in my presentation from, basically, we expect the market to go from £400 million to over a trillion pounds over the next 10 years.

Really important dynamic going on in the market, which is that transfer from Own Trust to Master Trust which we think is really important.

If your question is underlined by how does our long-term cash generation compare with last year? Last year's numbers were slightly inflated through the change in contribution rates, significant change in contribution rates, for auto-enrolled schemes where the base level went up to 5% from 3%. This year we expect to have another solid year in the Workplace. As I said in the presentation very, very bullish about the proposition going forward. A whole series of interesting developments in that Workplace market and we feel really positive about it going forward.

Andy that's the best I could do I couldn't quite hear the question.

2:05:33.1

Andy Briggs

I think the other point that Greig was asking is what impact has COVID had on the flows in our Workplace pensions book?

2:05:40.4

Andy Curran

Yeah, not very high. At the moment from what we've seen is contribution rates have dropped by about 7%.

Andy Briggs

Yeah, and that's probably pretty much a market-wide impact, you know, basically the impact, a combination of some level of unemployment, but also a lot of schemes where people have gone onto furlough. Although in furlough, the furlough will cover the auto-enrolment contribution, it only covers the minimum 8% level. So, schemes are paying at a higher level

than that, we've seen the level come down. So, the net effect is about 7% impact so financially on us is pretty insignificant. Rakesh, M&A criteria.

2:06:23.9

Rakesh Thakrar

So, M&A criteria, just a reminder. So, the M&A criteria that we have, so one, it has to be the strategic fit to the rest of the Group. Second, is value accretion, third is investment grade rating maintaining, the investment grade rating and fourth is maintaining our stable and sustainable dividend.

Now Greig, as I understand your question was around value accretion. Now, usually when we look at value accretion, you know, one measure is looking at the discount to own funds. But what I highlighted today in my presentation is the way we actually look at M&A internally and then look at the output of that and see, what does that mean in terms of the percentage of own funds.

2:07:05.4

So, you would have seen that when we look at that calculation, we look at the organic cash generation that the target will bring, we will then look at the incremental cash generation from the synergies and management actions will have on top of that, and then using a discount rate, that weighted average cost of capital and the risk premium on top of that, which will define the uncertainty and the return we want, we will then calculate that IRR.

And if it meets our hurdle rates we will then do it, and you saw from Andy Moss's presentation an example of why you could get a situation, when you apply that scenario where with the Old Mutual Wealth example where, although initially it was above own funds in terms of the price paid, by the time you did all those management actions and synergies and bringing it onto your own platform and getting the benefit from a lower expense cost of policy, you end up in a scenario where you’re actually having paid 76% of own funds.

2:08:07.3

So, I'm not saying we were dropping that own funds as a metric, what we keeping is value accretion and there's a number of ways to look at that.

Andy Briggs

And I guess another good example of that in practice has been the way that in the three months since half year, our solvency ratios gone from 150% to 159%. So, when we do these M&A deals, we're able to move rapidly in terms of both cash generation and capital synergies and hence it improves our capital position.

Jess, next question please.

2:08:36.0

Operator

The next question comes from the line of Steven Haywood from HSBC, please go ahead.

Question 4 - Steven Haywood, HSBC

Good afternoon, thank you very much. On your UK M&A opportunities can you give us an idea of what your potential firepower is here without coming to the equity markets? And also,

what the competition is for back books, especially now that you've taken out your biggest competitor?

Second question is on the BPA environment, and again on the competitive landscape here. What is the situation? And also, how are the discussions or the consultation process with the regulator going on potential changes to the risk margin and the matching adjustment? What could that mean to your new business strain or potential ability to do more BPA in the future?

And then finally, from this new long-term free cash generation. I assume it's an undiscounted basis, but I think you've given it at the end of 2019. But surely at the third quarter 2020 stage, this £14.1 billion is maybe a billion higher already due to the cash generation throughout this year. Thank you.

2:09:58.6

Andy Briggs

Okay, thanks very much Steven.

So, I'm going to ask Andy Curran in a moment to talk about the BPA environment, but I'll ask Rakesh to pick up the, you managed to get five questions in there, I think which is a good effort Steven, very impressive, to pick up the regulatory risk margin elements of that.

Rakesh will also pick up the long-term free cash generation point. On the UK M&A I'll ask Rakesh to talk about the firepower we have. I'll just quickly touch on the competition point.

2:10:31.2

So, it is fair to say that previously the two main players in this would have been Phoenix and ReAssure and obviously now we've combined together. But there is a lot of private equity interest in the UK insurance market at the moment. Generally, that focus will probably be at the smaller end rather than the larger end, so I'd expect the smaller end would be relatively competitive. At the larger end of deals I think, you know, we'd feel like we're pretty well-placed, and I really would emphasize the things we talked about in the presentation, the kind of strength of our credibility as a partner, our track record of doing deals, our access to funding, our strong track record of doing Part VIIs, it does make us very attractive counter policies to people within this.

Rakesh do you want to pick out the firepower points, the regulatory risk margin type environment and the long-term free cash? And then I'll come around for the BPA competitive landscape.

2:11:28.8

Rakesh Thakrar

Yeah, so let me pick up the firepower once. So, I think in one of the slides Steven, you would have seen how much cash we'll have at the end of 2023 and that was £1.8 billion. Now, when you're looking at the context of any M&A, you know, you've got to look at what the target is, what the target's leverage ratio is, what its Solvency II surplus is. But based on what we think will happen over the next 6-12 months, our firepower, assuming it's in line with our expectations, we could have up to £1-1.5 billion to spend on an acquisition.

2:12:06.4

But as I said, it depends on the target and the characteristics based on the Solvency II surplus, the ratio and its leverage ratio.

So, then moving on to the risk margin landscape. So, clearly, we're onset of Brexit and we really welcome the Treasury's call for evidence on Solvency II and the framework. Now, we don't expect any changes immediately, this will take time. But certainly, as many of us in the industry will be saying, the risk margin is currently at 6% and its high relative to our interest rates today and the fact that it has a double impact also on your SCR when you get that movement in interest rates.

2:12:48.9

So certainly, what we would be looking for is potentially a reduction in the risk margin which will then help the industry and also help the BPA market, because it means that new business would mean the capital cost of that would be that much lower, and then Steven just on that final question about the long-term free cash.

Yes, absolutely right it is undiscounted and I think the points you are making is that when there's the cash generation should that £14 billion number that we indicated at the start of this year, the £14.1 billion, would that go up? And the reason is it doesn't, the answer is it doesn't go up, and the reason is because what we've got in that calculation is that £19 billion of cash and we've got the holding company cash as well.

2:13:37.8

So, really what's happening is you just get a transfer of cash from that £19 billion to the holding company Group cash. So overall, there should be no change. The drivers of that long-term cash will be when you write new business or when we over-deliver on management actions and create value accretive management actions, that's not in the original £19 billion and then the uses of that as I said in my presentation will be the debt interest, the dividends, the Group expenses etc…

2:14:11.7

Andy Briggs

Thanks Rakesh. So, the way Steven I look at it is that there is a slide in Rakesh's deck which effectively shows, although it hasn't got numbers on the bars, that's the slide we will fill in in our full year results in March. So, it shows you the different components that might move.

Andy I'm conscious you probably didn't hear the last question particularly well there in Glasgow. But Steven's question was basically, in terms of the BPA environment what was the competitive environment like around the BPA market at the moment?

2:14:38.3

Andy Curran

Yeah, I think it's healthy, Steven, we expect the market demand to remain strong. We assess around about £2 trillion of liabilities, about £1.2 trillion of which are ready for buy-out or buy-in so we're feeling pretty positive about the market and the prospects of the market.

As I mentioned we're looking to allocate about £150-£200 million of surplus capital per annum in this market. We'll always look at value not volume, so this will not be a market share gain for us and we'll always be selective and proportionate.

But overall, our sense is that this market has many years to go before we see any significant contraction I imagine.

2:15:29.1

Andy Briggs

Thanks Andy, thanks Steven. Jess next question please?

Operator

The next question comes from the line of Louise Miles from Morgan Stanley. Please go ahead.

2:15:43.1

Question 5 - Louise Miles, Morgan Stanley

Hi everyone, I hope you are all doing well. Three questions from me as well please. So, my first one is on the bulks. So, I think you previously said that you want have about 10% of your assets under management in annuities and it looks like from one of the slides you're aiming to write about £3 billion of bulks per year, and that looks like it's more than the run-off of the current annuity book as you'll seeing the annuity books running off at 6%.

So, I'm curious is that 10% figure still relevant? And I know you said that you don't want, annuities to become too dominant part of your business mix, but can you help us to kind of quantify the optimum proportion of annuities within the books? That’s my first question.

2:16:24.0

And then on the same topic, looking at your Solvency II sensitivities, should we expect the credit migration and credit spread sensitivities to change as you increase your exposure to annuities and credit risk? And then finally my final question is, from one of the slides you said that you reinsure 50% to 60% of the longevity risk to external counter parties. Can you give us a bit of an overview of how it differs across the new business that you're writing and then the back book? And then on slide 72, it says that one of the management actions you're going to do is for longevity reinsurance, and does that mean you're intending to increase the percentage of longevity reinsurance across the entire book? Thank you.

2:17:05.2

Andy Briggs

Thanks very much Louise.

Yeah, we're all doing very good here in socially distanced Wythall, so I'm going to ask Rakesh to answer the second question on the credit sensitivities.

I'll ask Andy Moss to pick up the third question on reinsurance of longevity and management actions around reinsurance. In terms of the first one, so I have said I've talked about the fact that annuities, got £38 billion or so of annuities, circa 10% of our total balance sheet and we don't want to become overly dependent on annuities.

What really matters is actually the proportion of credit risk as a proportion of our total risk in the SCR and one of Rakesh's slides talked about that being 19%. So that is significantly less than a lot of our major competitors.

2:17:54.3

And it's fine if that goes up a bit because it's still a relatively small proportion of the balance sheet, we just wouldn't want it to end up being a much larger proportion than that.

Broadly the kind of flows here is if the £38 billion of in-force annuities will go down by the circa 6% a year, and then, so what that's maths, about £2 billion off and then we're adding £3 billion back on again.

So, you can kind of see that given that our total assets ought to grow as we grow our Workplace business and investment returns on the portfolio as a whole, you can see how we wouldn't expect annuities to move massively as a proportion based on the selective and proportionate approach that we're taking.

Rakesh do you want to pick out how the other sensitivities might move over time?

2:18:37.8

Rakesh Thakrar

Yeah, absolutely Andy.

So, I mean what you've seen in that sensitivity slide which was within Mike's section was that the credit sensitivities, and there were two that we showed, credit spreads widening and also a 20% downgrade across our annuity portfolio.

Now, all other things being equal you would expect if we are writing more annuity business and if the total proportion of credits go up, you would expect that sensitivity to increase.

But I would make two points on that. One is, as you know, we're also looking at investing a lot of our, credit, from credit into illiquid assets which Mike has already spoken about which you are well aware of.

2:19:20.9

And second is Mike and his team actively manage this credit portfolio, they will do whatever it takes to make sure any risk to that is minimized, and the sensitivities we actually disclose, do not allow for any management actions, it is a purely formulaic calculation that says, if the spreads widen by this much this will be the impact, but we know in reality there's action we can take to reduce that exposure.

2:19:48.3

Andy Briggs

Thanks for Rakesh and Andy our king of management actions over there, who's done this £2.5 billion over the last 10 years. With or without M&A, all good stuff, tell us a bit about the reinsurance management actions.

2:19:58.3

Andy Moss

Thanks a lot great introduction Andy. So, Louise thanks for the question, so what we've got on our slide there as you quite rightly point out, we've got an action around looking at our longevity reinsurance next year. That will be related to the ReAssure book which is at a lower percentage than we have across the rest of our Phoenix book, so we are absolutely planning to increase that reinsurance.

Obviously, as we do that, we'll look at the optimal levels balancing off the risk and the value that we can get from those reinsurance deals.

2:20:30.2

Andy Briggs

Thanks Andy. Jess, we go to our next question but I'm conscious we do have a hard stop at 4:30pm so I might ask if people could ask their two most important questions. We'll get through more people's questions that way, if that's okay. Jess who's next?

Operator

Next question comes from the line of Trevor Moss from Agency Partners please go ahead.

2:20:51.4

Question 6 – Trevor Moss, Agency Partners

Hi Andy. My two questions then, although I'm afraid that they do overlap slightly with other people. You talk about your Open business and wanting to build complimentary capabilities, which I totally get. What would you say are your top three complimentary capabilities that you would like to build i.e. are they asset origination, different product sets, what are your top things you'd like?

The second thing is relating to one of Steve's questions actually. In terms of the competitive environment of deals, when I used to be covering resolution back in the day, Clive always used to say to me that it was always very helpful to have at least two bidders sitting around the table because it gave Boards the comfort that they were getting the right price for the deal and the right sort of deal. But having taken out ReAssure, at the larger end you haven't really got anyone competing with you even if you've got PE down at the bottom end. So, I mean how do you address that do you think?

2:21:58.3

Andy Briggs

Okay, thanks, Trevor.

So, I'll maybe ask Andy to comment more broadly on capabilities, but if the question related to Open business was around, what Open business M&A might we think about? Probably the way I'd look at it is to look at that customer life savings cycle kind of diagram we looked at so for example, in the early life stage we said that the customer needs are starting to save in accumulating towards retirement, typically done through Workplace pensions as our top three player in that market we're well set. But the other need was around protecting their family income and health and wellbeing. So, a group protection business might be attractive as I think today would also diversify well with the rest of our Group.

Or potentially in the later life stage one of the key needs was how might people release equity from their property to meet their needs in retirement, be that social care or a higher level of retirement income. So that might be another example which again would also support the illiquid asset origination of the BPA business.

2:23:02.2

In terms of looking at deals and the two bidders. I think where things have moved on from a decade or so ago, is there has been lots of these deals that have happened in the market, and that does then give a sense of what market pricing might look like, and so ultimately, I think my view would be that the strategic desire to offload the back book and refocus any particular group on what it wants to do going forward - they can calibrate the value in pricing

relative to other deals that have been done in the market elsewhere and therefore satisfy a Board accordingly.

And so, on balance, my judgment will be, it won't stop people from taking action on the larger books if that's strategically what they want to do.

Andy, the other part of Trevor's question, just reference what are some of the kind of capability builds that you're focused on in terms of in terms of the Open business? I know you've got great capability already in the team but you are bringing more people in a number of areas, yeah?

2:24:09.5

Andy Curran

Yeah, on capabilities, as Andy says we already have excellent capabilities, you don't to where you are already and be pretty successful without great capability.

But we have a significant ambition as we've discussed and one of the things that I've found in my experience of working in this market, similar to Andy for well on 30 years now, is that if you really understand the subtleties of each of the markets really well, and are able to join up those particular dots, from your Brexit to Master Trust to what the FCA are thinking about it around, you know, a stronger nudge for people who are looking for advice and guidance.

All of that sort of thing and that sort of real depth of knowledge is really important to us and it's something that we'll continue to build out on, and I'll just echo Andy's points about the adjacencies from a business perspective.

2:25:10.4

Andy Briggs

Thanks Andy, thank you, Trevor. Jess next question please?

Operator

The next question comes from the line of Oliver Steel from Deutsche Bank please go ahead.

Question 7 – Oliver Steel, Deutsche Bank

Hi Andy, hi everyone, I've just squeaked in it looks like. I'm going to keep it to one or one and a half questions. Which is, can you talk a little bit more about the assumptions within the £800 million of new cash being generated and particularly the bulk annuity 5% strain figure. So, are you expecting to get to this £800 million figure as early as next year? And secondly on the bulk strain figure, can you achieve that as early as next year or when does the new internal model come through? And finally does that 5% include a full 40% allocation in new business to illiquids?

2:26:06.2

Andy Briggs

Great Oliver. Thank you nice to hear from and Rakesh do you want to pick those ones up please?

Rakesh Thakrar

Yeah, so let me start with the £800 million from our Open business. So, you would have seen from the analysis, in order to offset the organic generation run-off which in 2020, we

said is about £800 million, we would need £800 million of new long-term cash generation, and that long-term cash generation we believe will be done from a combination of targeting that BPA strain from currently the 8% to the 5%, add together with improving our proposition on Workplace and CS&I to really get to above that £800 million. You know, that is going to be something that we will look to do over the next short term to medium term and then certainly is on Andy Curran's agenda as is, our agenda, Andy's and I, agenda as well.

2:27:08.8

In terms of the 5% strain, in order to get to that position, as you saw in one of Andy's slides it's a combination of a number of things.

So, today we were at 8%, you've got a capital efficiency, you've also got the investment in talent and capability and proposition, the restructuring, the reinsurance, and you've also got the investment in the illiquid assets and making sure we have the right assets to back those liabilities. So, it's a combination of all those three that will get us from the 8% to the 5%.

2:27:44.5

And then I think just finishing off on the internal model harmonization. This is something we're absolutely working on, it's a complex program. It's bringing two as I said approved internal models together and we're the first in industry to do it.

We're making sure it's absolutely right and it really recognises the benefit of bringing the Heritage and Open business together, and we're hoping that application will go in in Q1 and therefore allow us to use it later on in 2021 to really support Andy and Tom Ground in that BPA space as well as the wider organisation in delivering our strategy.

2:28:27.8

Andy Briggs

So I Oliver, I guess I'll very quickly add, so we're not putting timescales on when we'll get to this £800 million long-term new business cash, or indeed on when we'll get to the BPA strain, just because this is an active competitive market and we will make objective decisions about recycling our substantial excess cash based on where it will be value accretive, and therefore if the market moves around and different things happen, we will be disciplined, we will put value over volume.

Which is why, if we've got an integration we're doing, it's in our control so we can say here's when we're going to do it by and we'll do it by then. When it comes to Open businesses you're in a competitive external market, we're not going to commit targets and timeframes there because we want to be able to be free to make the right commercial decisions in the best interest of shareholders over time. Jess, we've probably got time for one final question please.

2:29:20.7

Operator

The next question comes from the line of Larissa van Deventer from Barclays. Please go ahead.

Question 8 - Larissa van Deventer, Barclays

Thank you very much. Just wanted to build on the illiquid asset generation. My first question was actually going to be by when, but I believe you just answered that.

The second question is whether you are finding that there are sufficient deals that can meet your hurdle rates or are you struggling to find deals with appropriate returns in the market? And at what rate do you see them coming available for investment?

2:29:53.1

Andy Briggs

Okay thanks so much Larissa.

Mike do you want to pick that one up?

2:29:57.9

Mike Eakins

Sure, thanks Andy, thanks for the question, Larissa.

So, look as it relates to illiquid asset origination, as we said we have very strict criteria over the investment criteria that we apply and we have many hurdle rates in terms of capital, in terms of pickup versus the assets that we sell, and that's actually the important point just to focus on.

When we invest in an illiquid asset, we are selling an existing asset and typically we're selling corporate bonds which have an unsecured exposure.

So, we can sell a corporate bond, invest it in illiquid assets, get a spread pickup, get a greater security and a higher rating.

2:30:33.5

Now, in terms of your question in terms of deal flow, we are seeing significant deal flow. As I mentioned in my slides, we saw several hundred deals shown to us over the course of Q3 2020, we only allocated to 12.5% of that. So, it is really, it’s a numbers game in terms of making sure that we see the deal flow and that's why we're building out our capabilities in illiquid asset origination, working in tandem with our Asset Management partners and building out our ability to do it direct.

2:31:01.2

Andy Briggs

I think it also feeds very strongly into our sustainability focus so of the just over £1.5 billion we've invested in illiquid assets this year, half of that has been into ESG based assets, so really does support that sustainability focus that we've got.

Look, that's us out of time but thanks very much everyone for joining us today, it's been great to have you with us.

For those of you on the sell-side if you have any further questions don't hesitate to get in touch with Claire and the team and they'll be able to handle those, and then for those on the buy-side, Rakesh and I are out on the virtual road next week, so from our living rooms we've got time put aside for buy-side investor meetings. So, if anyone wants to follow up on anything we'd be delighted to do so. But in the meantime, thank you very much for joining us here today and we'll catch up soon.

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