PHOENIX GROUP

2019 Half Year Results

Wednesday, 7th August 2019

Clive Bannister, Group Chief Executive

Cash, Resilience, Growth - a Sustainable Phoenix. Good morning, ladies and gentlemen, and welcome to the Phoenix Group 2019 Interim Results presentation. I am joined on the podium today by Jim McConville, our Group CFO and Group Director, Scotland. Jim and I will take you through today's presentation. Then Andy Moss, CEO of Phoenix Life and Group Director of our Heritage business, and Susan McInnes, CEO of Standard Life Assurance and Group Director of our Open business, will join us at the end of the presentation for the difficult questions which you will put in their direction.

Phoenix has enjoyed a strong first half of the year. We have reported results today that are in line with, or slightly ahead of, the company compiled consensus across all our key performance indicators. This extends our track record of meeting or exceeding all of our publicly stated financial targets established since 2011. Our KPIs highlight Phoenix's ability to deliver dependable cash generation year after year, and the ongoing resilience of our regulatory capital position in this volatile world.

At our full year results in March, I set out Phoenix's strategic priorities for 2019, and Phoenix is delivering on these priorities. Jim will walk you through the financials in a moment. Meanwhile, let me comment on our transition programme. By bringing together the best of the legacy Phoenix and Standard Life Assurance businesses, we are building an operating platform that will service not only our existing business, but will meet our future growth aspirations. The programme is progressing well, and we are on track to deliver £1.2bn of synergy targets. In parallel, improving customer outcomes is essential to our mission. We have made good progress on customer initiatives and improving customer service.

Phoenix now has a range of growth opportunities, and is writing new business across both its Heritage and Open segments. New business written during the first half of 2019, has delivered £250m, £0.25bn, of additional long-term cash generation. This is incremental to our current cash generation targets, and brings more sustainability to Phoenix's dividend.

Finally, the M&A pipeline remains interesting. We are ready to take opportunities as they arise to deliver value accretive growth to the Group. As expected, the Board declared an interim dividend of 23.4 pence per share, which is consistent with the final 2018 dividend, and in line with our stable and sustainable dividend policy. Corporate transactions have been the trigger to review the level of our dividend. This has resulted in four dividend increases equivalent to circa 4.8% per annum over the last seven years.

I will now pass you on to Jim, who will take you through our financials.

Jim McConville, Group Finance Director and Group Director, Scotland

Thank you, Clive, and good morning everyone, good to see you. I will begin today by talking you through the Group's performance against its financial targets. As Clive said, we have had a strong first half of the year. I will take you through each of the key metrics in more detail shortly, but let me set out in summary our results.

Strong cash generation of £287m, an interim dividend of 23.4 pence per share, IFRS operating profit of £325m, New business contribution of £116m, PGH Group Solvency II surplus of £3bn, and a Shareholder Capital Coverage Ratio of 160%. Assets under administration of £245bn and finally, our leverage ratio of 23%, below our target range of 25-30%.

In March, we announced new cash generation targets that illustrate the long-term cash flow profile of the Group. These targets exclude any new business written after 31 December 2018, whether this is new business that arises through BPA in the Heritage segment, or through the Standard Life brand in the Open segment. They also exclude management actions in the post-2024 cash generation guidance. We are on track to meet these targets, which we will update at the full year to reflect the new business written during the year, assumption changes, and 2019 cash generation.

In the first six months of 2019, the insurance entities remitted £537m of cash to the Group. This included the first cash generation from Standard Life Assurance Limited, which we acquired last year. As expected, the Group injected £250m of cash into the Group's Irish domicile subsidiary, to appropriately capitalise it prior to the Part VII transfer of the Group's European branch businesses in March. This concluded the Group's Brexit preparations. As a result, we delivered cash generation of £287m in the first half of 2019, and we expect the second half of 2019 to deliver strong cash generation, and are therefore signalling today that we expect to be towards the upper end of the 2019 cash generation target of £600-700m.

This slide shows the sources and uses of cash for the Group over the next five years. As you can see, the uses of cash at the Group level remain small in number. These include the cost of maintaining our head office function, making contributions to the Pearl and Abbey Life pension schemes, servicing the interest on the debt outstanding, and paying a dividend of £338m per annum. There has been no material change to these sources and uses of cash during the period. Of note, the conclusion of discussions with all three of the Group's defined benefit pension schemes, following triennial valuations, has resulted in no change to our funding commitments. And after these uses of cash, we are left with an illustrative £1.3bn of cash at the holding companies as at 2023; and over the coming years this accumulation of cash balances will be used to support new BPA deals and future acquisitions that meet our acquisition criteria.

To demonstrate the resilience of our cash generation target, we have set out the sensitivity of this target to various stress events. As you will be aware, Phoenix has a low appetite to market risks and uses hedging to mitigate the majority of its exposure to equity, currency and interest rate risk. This translates into the low sensitivity to these risks we present today. Phoenix's main exposure continues to be to longevity risk on its annuity business, and here we model the impact of every annuitant living six months longer, and even in this unlikely scenario the Group will be able to service its debt obligations and continue to pay a dividend of £338m per annum. This resilience in our cash generation brings increased certainty to our dividend.

This slide follows on from the earlier one showing the position for the Group after 2023. Having repaid all outstanding borrowings, the Group expects to have £7bn of cash beyond 2023 available to meet future dividends, interest, expenses, and to fund growth. As previously stated, our cash generation targets will be increased by new business written through our BPA and open channels from the beginning of 2019.

Moving now to solvency. Phoenix maintains a strong capital position, with a Solvency II surplus of £3bn, and the Shareholder Capital Coverage Ratio of 160%. We continue to believe that Unrestricted Tier 1 Solvency II Shareholder Own Funds remains a reasonable proxy for shareholder value. We refer to this as UT1 and as at 30 June 2019 this amounted to £5.7bn. However, Solvency II own funds does not attribute value in a number of areas where shareholder value exists. These include contract boundaries, where a value of in-force on the unit linked business is restricted under Solvency II and the shareholders' share of our with-profit estate.

Adjusting for these items provides a better proxy to shareholder value for Phoenix at 30 June 2019, of £6.1bn, which equates to £8.46 pence per ordinary share. It is worth noting that this value proxy places no value on future new business from vesting annuities, BPA, or the open channels, or management actions, and also recognises the interim dividend payable in September.

During the period we saw the PGH Group surplus decreased slightly from £3.2bn, to £3bn. The main driver of this reduction was the capital dis-synergy arising from our Brexit preparations, where a loss of diversification and transitional benefits arose from the Part VII transfer of the Group's European branch businesses to Standard Life International Limited, because it is a standard formula company. The strain of £1bn from new business during the period, primarily relates to the cost of BPA and vesting annuities written in the Heritage segment, as new business written within the UK Open and European segments remains capital light.

Economic variances are reduced by the Group's hedging strategy for equity, currency, and interest rate risk, which brings resilience to the Group's solvency position. The figures presented assume a dynamic recalculation of transitionals, which dampens the impact of interest rate changes in the period. The Group has reviewed the assumptions used to value its £2.4bn ERM portfolio, to better reflect management's expectations of house price inflation and dilapidation provisions. This review resulted in a net strain of circa £40m. In the second half of 2019, we will conclude our annual review of assumptions, including longevity and property volatility.

Finally, Other includes a £0.1bn strain arising from the buying of the remaining £1.1bn PGL pension scheme liabilities, completed during the period. This strain is expected to reverse by the year end, once regulatory approval is received, to bring these liabilities into the matching adjustment fund.

Management actions added £350m to our Solvency II surplus in 2019, and included £115m of capital synergies on the Standard Life Assurance businesses. The Standard Life Assurance Limited capital synergies are principally driven from the benefits of a regulatory approved intra-group restructuring, which improved the capital efficiency of the Group. Other management actions included our ongoing investment in illiquid assets, completion of a further tranche of ERM securitisation, and matching adjustment fund optimisation.

Long-term illiquid assets return a higher yield for shareholders, and better match the duration of long-dated annuity liabilities. We therefore have an active programme of sourcing illiquid assets, including equity release mortgages, commercial real estate, and private placements.

At 30 June 2019 around 22% of our £19bn of shareholder assets backing annuities within non-profit funds were invested in illiquid assets. Our target is an upper limit of 40% allocation to these asset classes. And whilst we continue to be driven by value rather than volume, we expect to originate up to £1bn of illiquid assets per annum.

With over 90% of our illiquid asset portfolio having a credit rating of A or above we are comfortable that our exposure to credit risk remains within appetite. The sourcing of illiquid assets continues to be competitive, but we remain on track to meet our 2019 origination targets, with circa £500m of illiquid assets originated by June, through a combination of private placements and ERM funding. This volume delivered £80m of solvency benefit to the Group, comprising a £150m increase in own funds, offset by a £70m increase in the SCR.

Phoenix's capital position remains resilient to risk events. The sensitivities presented today are consistent with those disclosed previously, with the exception of property. A natural consequence of the growth of our ERM portfolio is an increase in our exposure to future property price growth. Our target Shareholder Capital Coverage Ratio range is 140% to 180%, and the sensitivities set out show that Phoenix remains well within this range under these scenarios.

We have delivered a strong set of IFRS results, with operating profit of £325m and a profit after tax of £39m. The increase compared to the prior year is primarily driven by the inclusion of Standard Life Assurance business in 2019. Investment return variances include net negative economic variances on hedging positions held across the Group during the period to protect the Group's Solvency II surplus and deliver resilience to cash generation. These losses have been partially offset by the positive impact of moving the asset portfolio towards a strategic asset allocation.

The first half of 2019 operating profit result includes the underlying expected returns from each of the life businesses segments, and was enhanced by profits from management actions, new business, experience variances and modelling and methodology changes.

New business profits primarily comprise profits in the UK Heritage segment from both BPA and vesting annuities. An operating loss has been recognised in respect of updates to actuarial assumptions, principally relating to the persistency of products with variable guarantees, and associated assumptions with regards to late returns.

Our second strategic priority for 2019 is to deliver the transition following the acquisition of Standard Life Assurance businesses. In March we increased the targets for cost and capital synergies arising from the transition to a combined £1.2bn target. Having generated a further £115m of capital synergies in the first half of 2019 we have now delivered 85% of the total target of £720m, and we expect the majority of the remaining capital synergies to emerge in 2021 following regulatory approval of our Internal Model harmonisation.

We have made good progress towards our cost synergy target, delivering circa 30% of the target reduction in the combined cost base in less than one year. And finally we have realised £17m of one-off cost synergies by removing duplication in the projects of the two legacy businesses.

In summary we are on track to deliver the £1.2bn combined synergy target for the acquisition in two to three years.

Our transition programme has three phases: Phase 1 will deliver the end state operating model for Head Office functions, and we are now well into the implementation stage of this phase and continue to make strong progress across all functions.

Phase 2 will deliver a multi-site financial and actuarial operating model and harmonise the Group's two Solvency II Internal Models. We continue to work closely with the PRA on Internal Model harmonisation, and are on track to submit our pre-application in December, with the formal application targeted to follow in quarter one of 2020. These timelines are challenging and subject to change, but we remain confident of delivering Phase 2, including the single harmonised Internal Model by the end of 2020.

In Phase 3 we will deliver our end state customer and technology operating model. It is extremely important to the long-term success of Phoenix that we get this operating model right. Phoenix is committed to the growth of its Open business, and our operating model must support this with a modernised platform that can respond quickly to the evolving market and provide enhanced customer service. The platform must be scalable to support future acquisitions and efficient to enable delivery of our cost synergy targets.

We will have a hybrid operating model, with a combination of both in-house operations and outsourced operations through our strategic partnerships. And implementation will take two to three years.

Finally, today I would like to take some time to talk about the new business that Phoenix has written in the period. Phoenix does not include new business in its long-term cash generation guidance. New business, whether through BPA or through the sale of Open products, is therefore incremental to cash generation and brings further sustainability to our dividend. During the first six months of 2019 Phoenix saw gross inflows of new business across its three business segments of £4bn. We estimate that this new business will generate £250m of incremental long-term cash generation, circa 1.5 times the interim dividend.

We continue to take a selective and proportionate approach to BPA, and look to allocate circa £100m of surplus capital to this growth area per annum. The BPA market was buoyant in the first half of 2019 and Phoenix competed well, completing our £0.5bn liability transaction with the trustees of the Marks and Spencer's pension scheme. The Day 1 capital allocated to this transaction of £32m is expected to generate long-term cash generation of circa £90m.

We completed a further £0.2bn BPA transaction at the start of August and expect to complete further value accretive transactions in the second half of the year.

The performance of our UK Open business segment was driven by strong Workplace gross inflows following the auto-enrolment increase from 5% to 8% in April 2019. The rise in total Workplace gross inflows year-on-year illustrates the cumulative effect of the auto-enrolment increases in 2018 and 2019.

The 2019 auto-enrolment increase is also the biggest driver of new business contribution, with circa £50m of the period total coming from this rise. We therefore expect 2019 new business contribution to be heavily loaded to the first half of the year.

It was a more challenging period for the Wrap and Retail product lines within UK Open. The reduction in new business gross inflows year-on-year is primarily driven by the sector-wide tail-off in defined benefit to defined contribution pension scheme transfers, but it is also due to Brexit-related market uncertainty which has been evidenced by reduced inflows across the industry.

Our European business has also suffered from the effects of customer uncertainty, with gross inflows of new business down from £622m in the first half of 2018 to £386m in the first half of 2019.

Our UK Open and European segments delivered £116m of new business contribution, an increase of £16m period-on-period. And this new business will add £160m of long-term organic cash generation.

I will now hand you back to Clive.

Clive Bannister

Thank you, Jim. Two sections left. This is about customer outcomes. Improving customer outcomes for our circa 10 million policyholders and customers continues to be central to our mission. This part of the presentation highlights the progress we have made to date.

We have enhanced our online proposition to improve customers' digital journeys. Working closely with Diligenta, our outsource partner, a further 1.2 million Phoenix Life customers were provided access to My Phoenix.

We also continued to improve the digital functionality available to our Standard Life Assurance branded customers, and as a result we see over 1 million app and dashboard logins every month. This is new good territory for Phoenix.

As part of our engaging the unengaged programme we have contacted 1 million Life and Protection customers to remind them of the cover they hold, and to date have reconnected a further 2,000 customers who had otherwise lost contact with their own policies.

Finally, Standard Life Assurance is one of the first providers to receive authorisation from the pension regulator for two master trust schemes. These comprise £5bn of assets under administration for over 240,000 clients, making them amongst the largest in the UK. This is a growing, modern business in which Standard Life Assurance is well-positioned to compete.

Customer service metrics comprise 25% of the performance measures within the corporate component of the Group's annual incentive plan. This weighting evidences the importance that Phoenix attaches to the delivery of high-quality service to our customers. During the period we have either met or exceeded all of our targets.

Let me turn to growth and the opportunities that lie ahead of Phoenix.

In our full-year results we set out a hypothesis that over time the incremental cash generated from new Open business could offset the run-off of our Heritage business, and thereby bring greater sustainability to the long-term cash generation for the Group.

To illustrate this hypothesis we used a graphic which we call the "wedge". Jim talked you through the new business figures for the first six months of this year, which resulted in incremental long-term cash generation of £250m. This level of cash generation would cover Phoenix's interim dividend 1.5 times. Only time will really tell whether the growth rate of the Open business will be sufficient to achieve a total offset of the run-off of our Heritage business. I would like investors not to focus on individual component parts nor on the gradients of various bits of the wedge. What is clear is that our new business is already delivering incremental cash generation to Phoenix that clearly strengthens our dividend paying capability. It remains early days but this is the fundamental change that will enable Phoenix to become an enduring corporation.

The drivers of further market consolidation remain compelling, and we believe that the potential market size of closed books has grown to circa £580bn, up from our previous estimate of circa £540bn. The growth in our estimates of the UK market have been driven by substantial players restructuring their UK businesses but we are also seeing more European opportunities.

One can argue about the actual size of the market but it is unarguably large and consolidating. As Europe's leading life consolidator we believe that Phoenix has a number of competitive advantages that position us well to benefit from future industry wide consolidation.

Our acquisition criteria are very clear: deals must be value accretive, support our dividend and maintain our investment grade rating. We will continue to maintain the price discipline that enabled us to acquire AXA Wealth, Abbey Life and the Standard Life Assurance businesses at less than 90% of own funds.

Funding is not an issue. Phoenix has a war chest of circa £1bn for acquisitions and we have a new £1.25bn revolving credit facility in place to provide funding flexibility. I have confidence that we have the management bandwidth to do further deals and we look forward to doing so. We are clearly open for business.

To conclude, cash remains king at Phoenix and we estimate at least £12bn of future cash generation from the business in force today which does not include the £0.25bn that Jim has referred to in new generation of cash in this first half.

The resilience of Phoenix is evidenced with a £3bn Solvency II surplus and a shareholder ratio of 160%. New business brings sustainability to our long-term cash generation and there will be growth through M&A as the UK and European insurance industry consolidates. We are building a more sustainable Phoenix.

Just before I end, there is a new date for your diary – we thought about October 31st, Halloween, but it appears that some of our stakeholders are a bit busy, so we've chosen instead 28th November, when we will be hosting a capital markets day and we look forward to meeting with you all again at that date.

So that is the end of the formal presentation, may I invite Andy and Susan to join us on the podium.

Q&A session

Question 1

Andy Sinclair, Bank of America Merrill Lynch

Three from me as usual if that's okay? Firstly Brexit - how has that affected your sellers in the UK M&A market? Are you seeing some shutting up shop until after the outcome or desire by others just to get out while they still can?

Secondly, you mentioned your discipline in doing less than 90% of own funds, before we have seen a transaction this week at 1.2 times own funds, do you think that changes the market at all or is it just a one-off quirk?

And, thirdly, just on BPAs - I think one of your peers today has talked about a five year payback period for BPAs, is that roughly similar for Phoenix? Thanks.

Clive Bannister. Group Chief Executive

So three questions there, I'll take the first two and Jim would you talk about the payback on the BPAs?

So the first question is whether Brexit has changed the motivation of vendors, and we talk now about a UK and a European market. The first observation to make is that we think the market has grown. So the statistics we gave you for the last two years were based on FSCRs of 2016 and now we base the market sizes on FSCRs of 2018 and we see a growth in the total markets up from £540bn to £580bn and we see activity in Germany, Ireland and in the United Kingdom.

And then the question is whether Brexit changes the gears to make people more motivated to sell their businesses and reconsolidate or whether less and I actually think Andy there's a different component. I think it's long-term interest rates. So across the world we see, for all the obvious reasons, macro negative headwinds, all the evident reasons and therefore monetarists are seeking ways to ensure that growth is delivered in their economies to sustain employment and therefore interest rates are going down.

And what interest rates do is they price capital in a different way. So the long-term reasons why our industry consolidates are that the old structure of asset management companies with insurance businesses, that's the first thing that isn't going to continue. And the second thing is within the insurance business, open business versus closed business, is restructuring because capital is being more accurately priced in a low interest rate environment. And that leaves businesses with trapped capital, stranded costs and not the skill set to deal with the administration of running off safely heritage books.

So I think those are long-term trends and so to answer your first exam question I see no change in people's strategic repositioning in their businesses because of Brexit, I think there will continue to be a forensic review on the returns on capital, particularly in a Solvency II environment which makes people motivated to restructure businesses. And you've seen no lack of acceleration, no deceleration.

Then your second question is a harder one. It is about whether the pricing has changed because there's been a transaction that has been advertised at 1.2 times own funds.

The first observation is that Phoenix retains its price discipline. You never get back what you pay at the wrong price going into a transaction and our evidence in the last three years of adhering to that price discipline so that we protect immediately cash accretive so that we can raise our dividend, something that protects our investment grade and you saw that by the extremely strong Fitch rating that we got of A+ and finally our capacity to pay our dividend. So those will remain irrespective of what we see going on in the outside.

So in transactions you get different shapes of books of business and it depends upon the rate at which cash emerges and that is very different according to each and every deal, so I am not going to comment on the deal that has just been announced in the marketplace, but I still think because cash has to be released that I do not see a systemic shift in an upward direction, I think that the transaction you are making reference to is more to do with the specifics, the speed of release of possible cash, rather than the market moving in itself.

Jim do you want to talk about the payback?

Jim McConville, Group Finance Director

Yes your question was in light of the comments from others this morning about a five year payback from BPA, our experience over the past couple of years we've not seen five years, we have seen slightly longer than that, probably up to nearer ten years in terms of a payback but clearly the payback varies from transaction to transaction and depends on the structure of the liabilities being taken on. But no we haven't hit five years yet.

Question 2

Jon Hocking, Morgan Stanley

I've got three questions please. Firstly on Europe could you comment a little bit about how you think about the European opportunities? You sound a little bit more upbeat about it than previously, and how you actually get over the conundrum of doing the first transaction in Europe given your price discipline because some of your private peers have already done several transactions, I just wonder how you get close to replicating the scale you've got in the UK on the Continent?

Secondly, looking at the synergy target, you're 85% of the way to the capital synergy target and you haven't yet harmonised the Internal Models which sounds very conservative. Could you talk a little bit generally about that harmonisation process? I guess it's not as easy as taking a company from standard formula to Internal Model. How should we think about that? Are you just being super-conservative or actually are you already pretty much aligned on the critical assumptions between the two companies?

And then just finally on the workplace business, given we've had the increase in the contribution rate in April I am just interested in whether you've had actually more people opting out or whether the very high opt in rate has continued that we've seen so far? Thank you.

Clive Bannister

Jon that turned into four questions, a 33% uplift there just so we get the maths right. Susan is going to answer the workplace question; Jim would you take the Internal Model harmonisation timetable, expected outcomes etc.? First time our friends at the PRA have ever actually had to manage two Internal Models coming together because Standard Life Assurance only had one. Then I will deal with your first two questions.

The first one is the nature of the European opportunities and the second question was how do you get into the game if your pricing is at a different point.

So I don't want to overcook Europe, you go fishing where you find the most fish and where you have the most relevant skills and so of that £580bn we believe £390bn is in the UK. That's not a surprise the UK has been Europe's largest insurance market and has the oldest annuities, with profits etc. businesses, so that is where we intend to fish first because we have the greatest relevant scale and it is easiest for us to transfer relevant capabilities.

When we go to Germany, Germany is the next largest market of about £160bn, so about 25% and Ireland is much smaller at about £30bn. So what we are seeing in Europe long-term interest rates, and you know what's happening in Germany, is that the regulators are seeking ways in which to restructure the business, you've seen it in Holland and you've mentioned private equity but there is evidence of regulators seeing consolidation as a way of repositioning the industry and the owners of those businesses. So we talk about foreign insurance companies, a French insurance company owning something in Germany or a German insurance company owning something in Italy, looking at their own capital returns.

And it's that lens which is driving owners who have businesses and trapped capital, stranded costs, low market shares, saying, is there a way out strategically?

So I don't want to overcook Europe. We think Europe is ten years behind where the United Kingdom is, so this is a slow burn but as Europe's leading life consolidator there is an optionality that we have today that we did not have a year ago.

Then the second question is how you get into something if prices seem to be done at a different price point? The deals in Europe are very different because the nature of what one could say is underfunding of capital positions. So instead of looking at greater capital synergies which we can generate in the UK through our own Internal Model, model harmonisation, we are looking at different asset backed strategies. You have a cost driven requirement so it is cost synergies and therefore you cannot do business in Europe unless you have a pre-existing asset, we have them in Ireland and in Germany, so again you have to be very cautious and that other people will pay X is going to never be a driver for Phoenix Group, we will pay what is right for us as and when those opportunities present themselves. Jim?

Jim McConville

Yes, your question was on the benefits from Internal Model harmonisation. So within the transition programme we have an overall synergy target of £1.2bn. Of that £720m relates to capital synergies and to date we have delivered £610m and we remain very confident about our ability to deliver that £720m. It's a very big programme but it's been going very well thus far.

We've said from the outset that that synergy target assumes a zero impact from combining the two independent Solvency II Internal Models, the old Phoenix model and the Standard Life model, and that remains the case in our thinking.

We are making good progress in terms of bringing those Internal Models together. We're working very collaboratively with the PRA. It's the first time it's been done in this country, first time for us and first time I think for the PRA. We've always felt it was prudent to assume a zero position on the basis that both models have already been approved by the PRA and therefore there is, theoretically, obviously a prospect capital requirements could go up but we hope that would be unlikely but it would be presumptuous of us to second guess the outcome of the discussions with the PRA. You would think on the face of it that it's not unreasonable to assume there will be a diversification benefit from bringing both businesses together, and we very much hope that will be the case. So we travel in hope, but we feel it prudent to assume zero at this stage.

Our plan, as I said earlier, was we are going to submit our pre-application before the end of this year into the PRA, with the formal application round about the end of quarter one. That gives them six months to review that, so in the second half of the year we would hope to have that result. That remains a very challenging timetable, but one in which we at this stage feel we can meet.

Susan McInnes

So your last question was about opt out rates for workplace and auto-enrolment, and just as a reminder, in '18 that rate went from 2% to 5%, and in '19 went from 5% to 8%. Our assumption was that we would have seen a slight increase in opt out when we moved to 8%, but we haven't seen that increase. To date it remains tracking at just less than 10% overall in terms of opt out, and that's kind of consistent across the industry. We will continue to watch it but as it stands just now we've not seen an increase.

Question 3

Ming Zhu, Panmure Gordon

Three questions please. First, on those deals that you didn't win recently, apart from pricing was something else in it we should be aware of? And if your competitors continue to be willing to pay more than you do going forward with other deals and opportunities in the market where does that leave Phoenix going forward?

And my second question is on Europe. What sort of deals are you willing to be looking at to test the water? And if you don't do anything in the next few years would you look at other strategic options such as disposing Europe and get your capital back to the Group centre?

And my third question is, based on your cash generation target guidance, under slide 32, the wedge diagram, what is stopping you paying a progressive dividend?

Clive Bannister

The P word. Not the S word: stable and sustainable. Gosh. So, Ming, thank you very much for your three questions. We never comment on transactions. Period. With regards to your first question, this has always been a competitive environment, and there are different buyers and different sellers, and so Phoenix's strategy and pricing strategy therein, transaction strategy and pricing strategy is not going to be governed by other people's activities, end of story.

Then your second question is more nuanced. I don't want to overcook Europe. We've said that Europe is ten years behind where we are in the UK, that you don't go out to bat unless you have a pre-existing asset in the territory where relevant. And going back to Jon's question, how do you test the water? Well, we'll find out when there is an opportunity that we think we're equipped to deliver safely for our shareholders.

The second part of your second question was, would over time, if the position changed, would we look at the strategic options of selling our European assets? Well, that's not on the table right now, because as Europe's leading life consolidator we believe that Europe has the opportunity. And there is a real difference between being a UK PLC, and the governance and the capital backing, versus being a private equity firm. And so we think that we bring to bear, as I said in my penultimate slide, that we bring a set of skills which are attractive to vendors and their regulators in Europe. But time will tell, and of course if the world changes, and of course there are a range of strategic options in terms of further acquisitions or divestments, but they are certainly not in our lens right now.

And then you asked about our dividend policy. So I'd make three observations. The first is that we've been very clear that it's stable and sustainable. That's what you'd expect from our business. We have given guidance that our SCCR ratio will be somewhere between 140% and 180%. We're bang on the money at 160%. North of 180% then it would be for the Board to review whether they would change their mind.

The third point is that we are at a very early stage in proving whether our cash generation will offset, dampen, the rate of runoff of our Heritage business, and so it would be far too early to move towards a progressive or a growth dividend. Those would be the three observations I'd make, and then as Jim pointed out, that if you take our dividend we have raised the dividend four times in seven years, that is equivalent to an annual increase of about 4.8%, and that has been principally triggered by corporate transactions. Restructuring our debt in 2013, and then three subsequent corporate transactions thereafter.

<u>Question 4</u>

Dominic O'Mahony, Exane BNP Paribas

Three questions, if that's all right. One very specific one. Jim, you mentioned in the management actions disclosures and benefit for the closure of the FCA investigations. I wonder if you could give us some ballpark indication of how important a contributor that was?

Secondly, sorry to go back to Europe, but in Germany, I was wondering if you saw any change in BaFin's attitude as a result, or following the closure of the Viridium/Generali deal? That's a market where transactions take a long, long, long time to get regulatory approval. I'd be interested to hear your views on whether anything's changed there.

And then a third question. In terms of M&A you always acquired books from other sort of primary insurers. Clearly another opportunity you could imagine would be acquiring other consolidators. Is there any consideration you would take into account in that sort of transaction that would differ, or would essentially evaluate that in terms of the same dynamics? And would there be any sort of other stumbling factors or bottlenecks for that sort of transaction? Thank you.

Jim McConville

So, the first question was about within the management actions, benefits, the impact of the closure of FCA investigations. What that refers to was the Abbey Life business, which as you know when we acquired that business, was an enforcement in relation to the annuities review, and an investigation into the legacy product review. These reviews are now complete and we've come out of them on the right side and we've been able to release some £20m of capital that's no longer required as a result of the completion of the reviews.

Clive Bannister

So, Dominic, your first two questions, first about Europe, and you went to Germany and BaFin. I am not going to overcook Europe, so I am going to say ten years behind and it represents a much smaller Germany. It's 25% of the total market compared to the UK 70%, and Ireland is 5%. So I always want to put that our priority remains in the UK.

So let's take Germany. I think transactions take a long time. Our conversations with BaFin and the CBI, the regulator in Ireland, are of course entirely private and will remain so, but what is clear is because of the cost dynamic, going back to the nature of the lack of available capital synergies in Germany becomes much more about cost. The regulator therefore is extremely focused, acutely focused, on customer outcomes so that there is no instability in the technology platform which delivers per policy administration at a lower cost and they have to ensure, quite right, that there's no detriment to customers. Customers have to be what we're about, and that's as true in Germany as it is in the UK.

So if you ask about our conversations with regulators, I am not surprised by their focus. They get the corporate finance aspects, and why people want to do deals, their focus is on enterprise stability when you're doing complex technological migrations and ensuring that there is no detriment to customer outcomes.

Then your third question was about if we were to buy another consolidator. Well, there are not an enormous number of consolidators in this space. And you asked whether we would use a different set of criteria, and the answer is no. Clearly, in in-sector deals you can look to greater cost consolidation because you've got two businesses doing the same thing. The capital synergies would be a function of Internal Models or standard formula, depending, but we would apply the same criteria to doing an in-sector deal, as to buying from a vendor.

<u>Question 5</u>

Gordon Aitkin, RBC

Three questions please. First on cash generation. Does the new upper end guidance include any mortality gain?

Second, on mortality, in slide ten you set out that a six month drop in life expectancy equates to £500m in cash generation, and the CMI 18 when those tables were published dropped life expectancy by six months. So we have, the maths is pretty easy, a £500m release and our consensus numbers don't have anything like that. And the argument that the release when you put that through won't be £500m is that your book is wealthier than the general population there, in the past your mortality releases have exceeded the releases that you would have reported if you had a slice of the general population, so why will the future be different to the past?

And just to finish, on the dividend yield. It's recently dropped below, let's say Legal & General, as you've got two different strategies there, and now it's quite a bit below, it's 70 basis points below. Now, your hedging is very tight, relative to your peers, but you could also say that the market's view of a back book consolidator's cost of equity is lower than it applies to an annuity business. So how does that feed into your view for your future annuity growth?

Clive Bannister

Fine. So would you take the first two, Jim, and I'll do the last?

Jim McConville

Yes. So in relation to cash generation, the target for 2019 is to £600m to £700m, and we've pointed you towards the upper end of that range. That £600m to £700m assumes no benefit from any mortality release and the statement we're saying at the upper end of the range, equally assumes no benefit from that mortality release.

I think as you say, Gordon, I wish it was that straightforward, that we could just take the CMI tables and just translate them straight through to get a simple answer, such as you've suggested, but it is a lot more complex than that, and therefore I don't think there is necessarily a direct read through to the £500m that you suggest. Standard Life and Phoenix, old Phoenix, are on two different bases or mortality tables, they both roughly come out to the same position in terms of reserving, but there's an awful lot of work that we're undertaking at the present time to harmonise the approach to longevity assumptions across the Group so it's on a common basis. That work will complete in the second half of the year and also pick up the impact of CMI 18.

So, I don't want to give a figure because that work's still underway at this stage, but clearly at the year-end results we'll update you on that position.

Clive Bannister

So, Gordon, thank you. The question had two parts actually. One was about the dividend and the yield, and then about capital and then backing in, if I heard it correctly, about where we ended up on annuity and capital backing, and our BPA strategy.

So let's take in a chunk. We've announced a dividend interim of 23.4 pence per share, unchanged, and on an annualised basis that's £338m worth of dividend payable in a calendar year. Our yield is a function of the underlying stock, and it is our investors who decide what the value of our stock is. So I make no comment other than that.

We agree with your observation that because we don't have a new business capital strain, we don't have, I am going to say, overseas subsidiaries in the same way that perhaps a Pru does, that a consolidator runs itself at an SCR at a lower level than the comparables, and I think it is worth looking at the gross inflows into our business that Jim talked about at £4bn and the capital charge was £37m. So that is why we said that we would run an open business differently, we don't own platforms, we don't own sales forces - what we do is underwrite and do policy administration.

Our shop window is run by Standard Life Aberdeen, for which we are immensely grateful, so we pursue an open business in a different way, and as we said two years ago or a year and a half ago when we announced the acquisition, that we would write it in a capital light manner, and that will continue to be the case so we don't have the capital strain that some of our peer group or competitors in the open business may have.

You also noticed the word resilience and hedging, we removed equity risk because we don't think that's the business we're in. That made us look really dim when equity markets were going up and makes us look a little less dim when equity markets are coming down, and we take appropriate hedging, but not to the same extent on interest rate and credit spreads.

So we run a resilient business where at the heart of it we protect solvency. Why? Because that solvency lake is the drawdown where we will generate cash for years to come which is currently the inforce business cash generation estimate. Without doing any more deals and any more open business, this stands at £12bn and there is not included in that £12bn the quarter of a billion that has been achieved in the first half of this year.

Then you've asked about BPA, and I think that's really interesting. For those of you who are keen eyed, we've done £460m of BPA. That was a capital commitment of £32m, and over time it will generate capital cash flows of £90m. That's an exceptional performance. It's a new business for us, and just outside the first half in July we closed a further £230m of BPA.

We committed to the market that we'd be very selective in the deals we do, but they would be proportionate for our size, and that we would fund it from our own money. So we expect to spend about £100m of capital this year, which will be about £750m to a billion pounds of liabilities. And what is instructive for me is last year at this stage we'd done about £470m of liabilities, £10m more, but it had cost us £62m worth of capital, rather than the £32m that we've spent in this half. So my colleagues, my able colleagues in the BPA team, are then going for value not volume, so we are looking very carefully at the liabilities we take onboard, thinking immensely hard about the illiquids that we put against them, position the cost of our money and the degree of reinsurance that we take.

And that is what you would want from our business. We never want to have a big market share, we're somewhere between 3% and 5% in the BPA market, and that is appropriate, so that's about a billion pounds a year, £100m of capital, and it's the value that we get out of it. So in that quarter of a billion pounds of new cash generation £90m comes from BPA, £145m from our UK business and £15m comes from our Irish business. And that gives us, I used the phrase carefully in my summary when I said about the wedge, it's not the gradient, it's not the individual components, we now have an optionality to drive the business forward in a way that gives us clearly a more sustainable dividend that we did not have 18 months ago.

Jim, have I left anything out on the capital aspect of the backing of what we're doing in the annuities business, and have I answered your question, Gordon?

Jim McConville

No, no, I think there's obviously a number of components when you're pricing a BPA deal. There's the price itself, but the way in which we think about reinsurance and the illiquid assets, and I think all that's come to play in driving the result we saw in the first half of the year.

Clive Bannister

Comfy?

<u>Question 6</u>

Steven Haywood, HSBC

Three questions please. Are you now more open to buying open businesses because of your open UK book? First question.

Second question: on the CMI tables, the CMI 18 has had a change in scope versus the CMI 17, how do you think about that and do you take that into consideration when you're thinking about adopting these new tables in the second half of this year? And I think the change in scope, if you did it on a like-for-like basis it would decrease life expectancy by two months rather than six months.

And then third question, a bit of a technical question on your Solvency II sensitivity to a fall in interest rates. An 80 basis points fall in interest rates leads to a negative £100m on the solvency surplus, but it leads to a five percentage points on the ratio. This five percentage points fall on the ratio has increased since the start of this year. Can you explain any sort of issues going on here and whether or not there's an overlay of convexity happening there, considering where the UK ten year rates have got to? And considering you target a 140% to 180% Solvency II ratio, rather than actually a solvency surplus, should we be focusing more on the Solvency II ratio forward if interest rates fall going forwards? Thank you.

Clive Bannister

So, three questions. Jim, you'll take the last one if you'd be so kind. Sorry, there are two questions on the CMI and the life releases, share it with Andy, and then the second one is on the solvency ratio. Perhaps, Andy, you want to comment.

So on the open business that you ask are we now more inclined to look broader in terms of the M&A, cast our net more widely? So let's go back to AXA. The first statement is we're in the business of solving vendors delivering on their strategic objectives. Vendors, when they're restructuring their business wish to move away from the track capital stranded cost skill set and hand that opportunity over to us, challenge for the vendor. And so if we go back to AXA in 2016, there was a small open business - Sun Life Direct. That has prospered, and so going back to 2016 we are open to that, and clearly Standard Life brings with it an enormous open business.

But we do pursue the open business in a different way, not being in a Marxian sense owning the means of production because those are owned by our friends at Standard Life Aberdeen, really reduces our exposure to mis-selling, sales costs, platform operation etc. So we're very clear that we are open to owning open businesses but they have to be repositioned and managed so that they are appropriate for a life consolidator such as ourselves. And we have been successful both with Standard Life and immensely proud of what is going on with our friends at Standard Life Aberdeen and what has been achieved by Standard Life Assurance. That's how I'd answer that question. Jim do you want to take the next one?

Jim McConville

So the second question was a very specific question about the CMI tables and their scope. Clearly we will take the scope of the CMI tables into account in determining the longevity release. It's not necessarily just a straight read across that happens, it's only one into the deliberations that go on to determine the most appropriate longevity assumptions. So the nature of the tables will be taken into account. But as I've said earlier it's too early to quote a figure for that.

Your third question was relating to the interest rate sensitivity, so the sensitivity against our capital position is that any UK bps fall would reduce the surplus by £0.1bn and 5% on the SCR. What we are concerned about is the absolute surplus, the amount, clearly the ratio is just a function of numbers but it's absolute pounds surplus that we seek to protect. The 5% is really just a function of how the component parts of the calculations work through between own funds and SCR. But what we're seeking to do at all times is protect the absolute level of surplus.

Clive Bannister

And Steve, I'd add to that that we've seen this movie before, 2016, so we started the year with a ten year swap rate, which is our referent grade at about 120 bps and it went down to 65 post-Brexit. There has not been an equivalent movement yet. I am not saying where it will end up to. We ended that year with a solvency I think at 140, 139 and that was a year when we did two transactions. So we've always hedged to protect solvency, we have management actions, we did £350m worth of management actions. The larger component of that, £240m, were protecting our own funds and that's what we would expect us to do in a low interest rate environment. But low interest environment absolutely crush our industry.

I hope you have three questions, so maintaining just go for it.

<u>Question 7</u>

Oliver Steel, Deutsche Bank

It's sort of one question and a request. To help us calculate our version of your wedge it would be useful, this is the request, to have a better timeline on the future cash flows beyond 2023. That's the request as I say on the existing forecasts you've given.

Talking about the extra £250m of cash flows that you've added in the first half you've given us some sort of guidance implicitly on the bulk annuity deal around the timing of future cash flows around that so I wonder if you can also give us timings around the remaining £160m of future cash flows or at least give us some sort of indication on the age group of the average customers contributing?

And actually, sorry this is the extra half question, the new business profit on the open business looks suspiciously close to the future cash flows so I just want to check what's going on there? The new business profit I assume includes all the future regular premiums you expect on new pension contributions but I am wondering what the future cash flows relate to? Do those capture all of the future regular premiums or just the regular premiums you've generated in the half year?

Clive Bannister

So Jim you're being tempted by Oliver, so just hold on to yourself here to go beyond 23 in terms of cash flow forecast, then an analysis, I put up the slide 29 on going through cash flows, and then Susan perhaps you may want to make a comment on the last one about the new business and the margins which I think are around 21 bps compared to the 8 bps in our heritage?

Jim McConville

So let me just come to them in reverse order. In terms of the new business profit that's written during the period if there was regular premium business where we'd take account of the future regular premiums. In terms of the £250m of cash generation that was the bulk annuities in response to Andy's question, I think we said we're seeing here a ten years as opposed to others five. I think the open business the payback period for that is longer so it's probably in the ten to 15 year mark.

And finally on the wedge we note your request for a better timeline beyond 2023. I think we did very well to give you very specific guidance out to 2023 but we'll give it due consideration.

Clive Bannister

Better note. I am sorry I shouldn't have said that, I do apologise but that's a translation.

Are there any more questions?

Concluding comments: Clive Bannister

So listen, we end today immensely proud of what Phoenix has achieved. These are strong, successful results for the first half and we very much look forward to seeing you, not on Halloween, but on Thursday 28th November. Take care. Thank you very much.