Phoenix Group Holdings

Proposed Acquisition of Abbey Life

Wednesday 28 September 2016

Clive Bannister, Group Chief Executive

Welcome, and thank you for being here on what is an important and good day for Phoenix. Before I get into the formal presentation I'd just like to make some summary comments.

This is obviously a very important transaction for Phoenix. It is a sensible deal that you would expect us to do because it's on message. We believe it is attractively priced. As a result of doing the deal it will make us a stronger company, our leverage comes down, our solvency improves. It gives us great pride to be able to improve returns to our shareholders who have supported us by increasing the dividend, and we believe we're creating a platform for future growth which emphasises our role as Phoenix as the UK's largest consolidator.

So without further ado, I now intend to go through a formal presentation of which you have a copy in front of you. I am joined unsurprisingly by my colleague, Jim. I will say a few words, and then he will go through the details of the presentation after me.

The proposed £935m acquisition of Abbey Life reinforces Phoenix's position as the UK's leading closed life fund consolidator, offering a compelling strategic rationale and significant financial benefits. It is the second acquisition we have announced this year following AXA's Wealth acquisition announcement in May. The AXA acquisition offers significant capital synergies over the short term, whereas Abbey Life is a more mature closed book generating a stream of longer-term cash flows.

Before we go into further details on the following slides, I would like to summarise the key benefits of this transaction.

First, an attractive acquisition price with a total consideration of £935m. Second, a significant increase in the Group's long-term cash generation, up by £1.6bn. Third, a strengthened Group solvency. And finally, a modest immediate reduction in leverage. We also propose a further 5% increase in our dividend per share which, when including the impact from the AXA Wealth acquisition, will result in an overall 10% uplift in dividends. We will also deliver benefits for Abbey Life's policyholders who will become part of a well-capitalised and focused closed life fund business. We look forward to welcoming Abbey Life's policyholders into the Phoenix family.

Turning now to a quick overview of the Abbey Life business which was founded by Mark Weinberg in 1961. Phoenix will acquire an additional £10bn of assets under management, with 735,000 policyholders and 45 employees. The business was closed to new business in the year 2000. The business covers a broad range of products, 60% comprising mature unit linked, 35% annuities, and two small with-profit funds; hence Abbey Life business includes all of the main product types that Phoenix currently manages. Furthermore, the simplicity and similarity of Abbey Life's outsourced operating model with Capita matches Phoenix's, which will facilitate a straightforward separation and integration process which will be run in parallel with the integration of AXA Wealth.

The consideration is £935m, which represents 89% of own funds on an Abbey Life basis. For those of you like me often thinking in old money, the price is 77% of MCEV. However, cash generation remains our key metric and we expect to generate cash flows from the acquisition of £1.6bn.

Importantly, we have also put in place contractual protections against possible outcomes of FCA investigations. The cash consideration and estimated expenses will be financed with a mix of new equity and debt. £735m will be financed from the net proceeds of a fully underwritten rights issue, which has been announced today, which will increase our market capitalisation from approximately £2.1bn to close to £3bn. The remaining £250m will be financed by a new debt facility at an initial margin of 85 basis points. The financing mix is in-line with our acquisition criterion of maintaining an investment grade rating, and is expected to result in a modest immediate reduction in the Fitch leverage metric.

Our disciplined approach to M&A has been well advertised. It means that any acquisition needs to meet these specific criteria. The proposed transaction achieves all of these. Abbey Life is a UK closed life business, and the acquisition confirms our leadership in this space in the UK. We expect to generate capital and cost synergies and expected total cash flows of £1.6bn, as I said before, from the transaction, with cash generation up to £500m from now until 2020, and beyond 2021 of £1.1bn. The transaction also supports a further uplift of 5% in the proposed 2017 interim dividend, in addition to the existing proposed 5% dividend increase announced at the time of the AXA acquisition. We will maintain our stable and sustainable dividend policy at this enhanced level.

Furthermore, the acquisition will strengthen our balance sheet, with shareholder capital coverage ratio expected to increase from 144% to 151%. That is equivalent to £400m, an increase from £1.1bn to £1.5bn. And there will also be a modest immediate reduction in the Fitch leverage metric. The enhanced scale strengthens the Group's capacity to create shareholder value, to the opportunity for additional management actions, and also including through future value accretive acquisitions.

A key benefit of the Abbey Life business is that it follows a similar operating model to that of Phoenix's. This allows the integration to be run in parallel with AXA. The AXA transaction is on track to complete in November, and we have already reiterated the expected cash flows and synergies from the acquisition. Phoenix Life has been busy designing the integration, and therefore there is a plan in place once we receive the necessary regulatory approvals. Abbey Life is very much a standalone business, and we do not envisage any material separation issues from the vendor. We will in-board the new book and apply our “Phoenix Way”, thereby limiting additional costs.

I would now like to pass you over to Jim, who will take you through more details of the transaction.

Jim McConville, Group Finance Director

Thank you, Clive, and good morning everyone. Here is a brief snapshot of the impact of the AXA and Abbey Life transactions on some of our key metrics. The acquisitions increase both cash generation and the scale of Phoenix's business. Including the two acquisitions would result in £2.8bn of cash generation over the years 2016 to 2020, up from £2bn from the standalone Phoenix business today. Cash generation from 2021 onwards increases to £4.4bn, up from £3.1bn today. We do not assume any management actions within the cash generation from 2021. We will become a significantly larger business with total assets of £74bn, and over six million policyholders.

Cash generation remains the Group's primary key financial indicator. In total we expect £1.6bn of cash flows from Abbey Life, and these include the expected benefits of management actions up to 2020. As you can see, the proposed acquisition provides a significant uplift in the Group's future cash generation. As we discussed at the interim results, the Group intends to put in place a new UK registered Topco. The proposed acquisition supports this process given the positive impact on the Group's solvency.

Phoenix also continues to examine opportunities to issue longer-term subordinated debt to refinance existing senior bank debt. The increased cash generation and reduced leverage of the Group is also supportive of this aim.

Phoenix expects to generate capital and cost benefits through a series of management actions. These will include the application of Phoenix's strategic asset allocation to Abbey Life's annuity book. The proposed acquisition offers benefits from economies of scale including head office synergies, and overall we anticipate annual cost savings of £7m per annum. Furthermore, Abbey Life's already existing outsourcing contracts will further consolidate our relationship with Capita, one of our key outsourcing partners. And additionally, the integration with Phoenix's customer and governance model will strengthen oversight of the acquired business.

Our internal model is a key component of our toolkit for assessing acquisitions, and it is envisaged that we will apply in the second half of next year for the acquired business to be incorporated into our internal model. There are possible future synergies to be derived from the adoption of Phoenix's asset strategy to the annuity book, and of matching adjustment measures subject to regulatory approval. We will also be applying our hedging strategies to the acquired book.

With regards to the Group's Solvency II surplus, the transaction will increase the surplus by £0.4bn, from £1.1bn to £1.5bn post acquisition. This will increase the shareholder coverage ratio to 151%, from 144% at the half year. This analysis excludes the impact of the AXA transaction, which you will remember from our previous presentation in May will have a small positive impact on the surplus.

One of our key criteria for an acquisition is that the level of dividend per share should be at least sustained. The cash generation from today's acquisition has allowed us to announce a 5% equivalent increase in the dividend per share from the time of the interim 2017 dividend. This is in addition to the proposed 5% increase in the final 2016 dividend following the AXA Wealth acquisition. So the total dividend uplift from 2015 would amount to 10%. Despite this step up in dividend the dividend policy remains stable and sustainable; and as shown on the next slide, the new higher level of dividend payments is supported by the Group's expected cash generation.

Including the impact of the AXA and Abbey Life acquisitions would result in a total of £2.8bn of cash generation between 2016 and 2020, of which £147m was achieved in the first half. In terms of the additional uses of cash over the next five years, the two main changes are the assumed repayment of the new Abbey Life acquisition debt facility of £250m, and the higher level of dividend payments in future. As can be seen from the chart, even assuming the repayment of the entirety of the existing revolving credit facility and both of the acquisition facilities, the cash generation from the acquired business can support the higher level of dividends with room to spare.

Clearly, given the strength and credit profile of the Group this is a conservative assumption, and as I mentioned we will continue to look to refinance some of this bank debt into longer-term subordinated debt. This will extend the maturities of the debt to more closely match the emerging cash flows, as well as support the onshoring process while still maintaining an appropriate level of gearing in the future.

Here we provide further information on cash generation expectations, and the uses of that cash from 2021 onwards. With the AXA acquisitions there would be around £4.4bn released as cash to the holding companies after 2020, as represented by the green bar. It is important to note that this does not assume any further management actions. Known uses of this cash include the remaining pension scheme contributions and the outstanding debt, and this leaves an estimated £4.3bn of cash that would be available to fund dividends together with any interest costs and expenses.

As part of the contractual arrangements we have agreed protection against potential outcomes from ongoing FCA investigations. This includes the legacy review where Abbey Life is one of two firms whom the FCA will investigate as to whether it contravened regulatory requirements. We have undertaken detailed due diligence to understand the level of potential risk using our expertise and understanding of the regulatory review process. As a result, in order to mitigate the risk of negative outcomes, the vendor has agreed to indemnify Phoenix for losses arising from any enforcement action with the indemnity capped at £175m. Within that cap the vendor will bear the full cost of any regulatory fines, and we have agreed a risk sharing mechanism in respect of any losses incurred as a result of policyholder remediation. Furthermore, Phoenix's valuation and pricing of Abbey incorporates our view of the expected residual cost under the risk sharing mechanics of the indemnity.

Notwithstanding the ongoing FCA investigations, the acquisition delivers clear benefits for Abbey Life policyholders who will become part of a specialist closed life fund business with a significant scale and track record of delivering value. Phoenix has a clear customer strategy with a strong emphasis on the fair treatment of customers, and we will apply our customer model and product governance to Abbey Life with the improvement of customer outcomes as a priority. Abbey Life customers will benefit from the expertise of Phoenix's well-resourced customer team. The Group will focus on improving communications, product reviews and actions on tracking down customers who may have lost contact with their policies, so called 'gone aways'.

Finally, on the expected timetable over the next few months. We expect to publish the circular and prospectus early in October, with the shareholder vote later this month. As Clive said earlier, we are currently expecting the AXA acquisition to close in November, and we are targeting closing the Abbey transaction around the year end. However, both acquisitions are subject to regulatory approvals.

I will now pass you back to Clive for the wrap up.

Clive Bannister

Thank you, Jim. I have often talked about the future opportunities from consolidation in the UK closed life fund market; today’s proposed acquisition of Abbey Life reinforces Phoenix’s position as the UK's leading closed life fund consolidator. The Phoenix Board unanimously recommends the proposed transaction to its shareholders. The acquisition provides significant cash flows, a stronger balance sheet and increased dividends for its shareholders. In addition, the Phoenix customer model offers clear benefits for Abbey Life's policy holders.

The two acquisitions we have announced this year are transformational for the Group, making Phoenix both bigger and, much more importantly, better. Our focus now is to deliver the benefits of both the AXA and the Abbey Life acquisitions. The resulting Group will have increased its overall cash generation by 41% to £7.2bn, its assets up by 42% to £74bn and its policyholder numbers from 4.5 to 6.1 million policy holders, an increase of over 36%. This business growth will fuel in time the increase of the dividend per share by 10%.

Last November a number of you attended the Pensions Institute talk on the report we sponsored entitled 'The Meaning of Life'. Their main conclusion was that the traditional life assurance model was under threat and that mid-tier players would struggle with market and regulatory changes, leading to a process of further consolidation. This would result in a UK industry that would become dominated by a smaller number of players that had true economies of scale, relevance to clients and an economic proposition for their shareholders.

The proposed Abbey Life transaction is, in our opinion, a continued demonstration of this fundamental shift in the UK life market. Phoenix is well positioned to benefit from the pressure on existing players to manage both their costs and their capital in this very tough environment.

The Group provides a scalable and efficient platform to manage legacy books of business for the benefit of its shareholders and policyholders, and we expect further consolidation in future years. A transformed Phoenix looks forward to this future with confidence.

We would now be delighted to take any questions. The normal rules: the difficult ones for Jim and the easy ones for me. If you could please wait until the microphone comes to you and then give us your name and the institution for whom you work and then we will answer your question. At the end of this session we will answer any questions that may be on the phone or the internet. So why don't we start? Craig.

Question and Answer Session

<u>Question 1</u>

Craig Bourke, Whitman Howard

Three questions if I may. First of all on the dividend policy and the dividend increase, the increase is comparable to the AXA acquisition but the cash flow, particularly after 2020 is significantly higher. I'm wondering if you could just expand a bit on your thinking on the relationship between the two.

Secondly, the management actions for the cash flow up to 2020. Does this acquisition represent any significant shift in the mix of management actions than what you've indicated so far?

And just finally on the appetite. Given the platform synergy as you've said with your existing platform, how should we think about your appetite for acquisitions in the near term or should we now expect a pause while these two integrations are underway?

Clive Bannister

So, three questions there. Jim, cash flow and its relationship to our dividend policy. Management actions, are we doing anything new or more of the same? And then our appetite. Let me deal with the last one first and then I'll hand it over to Jim. What's the definition of short term, Craig?

Craig Bourke

Well, short term is the last one I guess.

Clive Bannister

Okay, short one last, so that makes my answer easier. We're taking a breath. I ended my presentation by saying our duty today is to focus on the issues and the opportunities we have at hand that we have announced. We have to safely in-board the AXA transaction and we expect that to close in November and then focus all our efforts on closing and safely in-boarding the Abbey Life transaction. Therefore I would say for the next six months or so, six to nine months, that is what we're focused on. Now, our doors are never shut, you know that these transactions take a long time to evolve, but right now our obligation to the key stakeholders, namely our policyholders, our regulators and our shareholders, are to deal with the business that we have in hand. So we're taking a breath. Jim?

Jim McConville

Okay, thank you Craig. First of all on your question on the dividend increase, as you rightly say this transaction gives us a 5% increase along with the AXA transaction and we've reiterated our policy of stable and sustainable. I think we've shown on this slide that shows the waterfall to 2020 that that increased dividend is more than covered with the costs that we expect and the cash generation that we expect over that period; that will be extended were we to refinance the senior bank debt into the future as we would hope to do.

Now, the important thing I think in thinking of the Abbey transaction is that the cash flows are very evenly spread over the life of the book for some considerable time and therefore they do support and reinforce the resilience of the dividend beyond 2020. So, whilst we've only shown the period up to 2020 it is supportive of the period beyond that.

In terms of your second question in relation to management actions, there are a number of management actions that we plan to undertake over the course of the coming near term which all improve capital efficiency and will result in cash generation. And we spoke about the strategic asset allocation, so that is moving the Abbey annuity book onto a similar strategic asset allocation policy to that which we adopt for Phoenix, and we believe that will give us an uptick in yield.

We will put the business onto our internal model and we will apply for matching adjustment treatment for those assets that are within the annuity book, and we will look at reinsurance and transitional relief, and in addition we have obviously the benefit of the cost savings coming through.

So, what I would say about the nature of these management actions is that they are all things that we are very familiar with and have trodden that path before in terms of both the AXA acquisition and our own business. So, there is nothing new about the management actions in their design that we haven't come across before.

Craig Bourke

Just a follow up. It's just more a question on the mix, so the message is the mix of management actions as to normal run-off is pretty well the same as existing?

Jim McConville

Correct.

__**Question 2**__

Jon Hocking, Morgan Stanley

Good morning, Jon Hocking from Morgan Stanley. I've got three questions please. Firstly, could you give a little bit more detail please in terms of the phasing of the capital synergies, in particular in terms of what you envisage doing with Part VII transfers and how that sort of fits into the AXA block?

Second question, you mentioned improvement in the sort of Fitch leverage metrics as a result of the transaction; I wonder if you could talk a little bit about this ongoing normalisation of the Group's debt structure and where we might expect to see sort of a further hybrid issue and how you think about that with the Topco etc.

And just a final question: given the Ignis transaction, I think at the time you mentioned the strategic partnership with Standard Life in terms of asset management, are any of the non-linked assets going across to Standard Life as a consequence of this? Thank you.

Clive Bannister

Jon, thank you for your question in three parts. The first one about the phasing of capital and whether we've got Part VIIs in mind. The second one was to talk more about Fitch leverage and the normalisation of our structure and Topco. And the third one was about our relationship with Standard Life and the assets contained therein. Let me do the last one first and then I'll hand them over to Jim.

So we talked about £10bn of assets under management in the Abbey Life deal, two thirds of those are with Aberdeen, one third are with Deutsche Asset Management, and there they shall remain until there is a normal mandate maturity process. At that juncture there may be the opportunity for other people to be considered as managers, but there is no intent at this moment in time to shift the assets.

Jim McConville

Okay, so turning to the Fitch leverage and how we think of that going forward into the future. As we have discussed before we have set as a target range for our leverage a range of 25% to 30%; we believe that is consistent with the maintenance of our investment grade and where we were at year end 2015 was on a Fitch basis a leverage of around 31%. So, we do see following the repayment of the short-term funding taken on for the AXA deal that that will reduce by 2% and as we said, for this Abbey deal we would expect a further reduction of up to 1% in the leverage number immediately on completion of this transaction. And therefore you see us moving I think quite comfortably into the middle of the target range which will reinforce the positive outlook that we have from Fitch and hopefully put us within scope of an upgrade in due course.

We have for some time, Jon, said that our ambition is to move away from senior bank debt and further diversify the debt; that remains our ambition. Every time I'm up here I get asked as to when we will be putting out a bond issue and as I've always said we won't give any indication of that timing other than to say we're actively monitoring those markets as we speak.

In terms of the phasing of the capital synergies, what I outlined in response to Craig's question was quite a basket of activities, all of which are quite sizeable pieces of work, all of which require regulatory approval, and indeed as we've said in the presentation, the application for the internal model will only go in in the second half of next year. So you can see us working through 2017 and into 2018 to deliver those acquisitions, and in thinking of the cash flows we have recognised that timing, so they're more likely to be slightly back ended beyond 2017 into the later years in that five-year period.

Clive Bannister

Jon, you asked specifically about Part VIIs. This year we're doing, as part of a management action before year end a Part VII transfer of the Guardian business; that's well advanced and that is contributing to our cash flow target of this year of £350m to £450m. Next year we're doing a Part VII with AXA and so I think if we get round to doing a Part VII on the Abbey Life transaction, so that is not currently embedded in any of our plans, it would be 2018 and beyond.

Any other questions?

Question 3

Oliver Steel, Deutsche Bank

Oliver Steel at Deutsche Bank. So, first of all just a question on the solvency uplift that you're projecting. It sort of seems to include quite a lot of things which is fair enough, so my understanding at the moment is that it includes a shift to the internal model, it includes all the cost savings and other efficiencies that you're talking about, matching adjustments, other management actions. But actually you sort of seem to imply then that it doesn't include a Part VII, so I'm just wondering what else is not included in that solvency number.

And actually, while we're on the solvency number, I see that it's based on end 2015, and can you give us an indication of how much that might have fallen by since the end of 2015, if it has?

The second question is, you seem to be sort of intent on keeping the annuity book. Is that right or might you look to pass it on to somewhere else at some stage?

And then the third question is on the new Topco. So, I'm just trying to sort of understand, you've got quite a lot of Topcos and sub Topcos and other cos.

Clive Bannister

We're going to have fewer of them.

Oliver Steel

So, I'm just wondering what makes the new Topco different from the existing Topco?

Clive Bannister

Fine, so there are three questions. Jim, why don't you take the first one which looks at the solvency and I think that was on our exhibit 14 or something.

Jim McConville

Right, so just so we're clear what this page shows, so on the right hand side we show a proforma number which takes our shareholder capital ratio up from 144% to 151%, so that recognises Phoenix on a standalone basis as at the half year 2016, the £1.1bn surplus that we disclosed at that point, and it proformas in the year end '15 number for the Abbey Life business on a standard formula basis. So, that takes us to the 151%.

I would expect that following completion of the various capital initiatives that we spoke of that if we were to proforma these in, which I can't at this stage, but it would lead to a further improvement in that ratio percentage by a few single figure percentages, and of course on completion of the AXA deal there will also be another small increase in that ratio.

Now, since the year end obviously the Abbey business is on year end 2015, if we roll that forward to the half year we would see an improvement in their ratio because of specific action they had taken during that period.

Clive Bannister

The second question was about annuities. No it's not for sale. We're very comfortable with annuities, two reasons, first of all we run that business today in our own family, it is a business that allows us to deliver management actions which are 100% for the benefit of the shareholder rather than on a unit linked basis. It is also open so we get vesting annuities, this calendar year we expect out of the Phoenix Group today £400m plus of vesting annuities and this will add about £100m, and so this is a business we're very comfortable with. It has to be appropriately risked but we've always said appropriately priced, appropriately managed, with the risk being thought through, annuities have a role to play for our customers and for us and our shareholders.

Then your final question was about Topco and their multiplicity. I'll just do the overall design and intent and then Jim might tackle the details that you asked. We have a structure: Cayman Islands, Jersey and into the UK which is a function of history, fit for purpose pre Solvency II days, not what we want to have today, so what we want to do is continue the simplification and have a UK Topco. That has great advantages for us in terms of being able to issue both debt and equity with greater simplicity. There are certain investors in this world that will not trade with firms that have a final home in the Cayman Islands; we want to take that away. It makes us a simpler counterparty in the eyes of other vendors because of who they're dealing with. We have always run the company subject to UK codes etc, but this would make it absolutely explicit and therefore it is future proof as a Solvency II vehicle.

So Jim, that's what I was going to say about the structure. I don't know if you want to talk about the timing without committing to doing subordinated debt, which I know some bankers may wish you to commit to.

Jim McConville

Yes indeed. I mean, the impact of putting in this new Topco into the UK is that the senior bank debt within our structure we get included within the capital calculations at the EEA sub-holding insurance company level. So, what that effectively means for us is that one of the ways of dealing with transition is to issue hybrid debt which is of a capital qualifying nature and provides us with greater resilience and better cash flow matching of our book, which is obviously part of our plans going forward into the future, and the acquisition such as Abbey Life because of the financing structure that we put in also aids that process.

So it's an important step along the way of that. We will look to do a transaction, I'm not going to give you a time over 2017, I think that would be foolish to do because it depends on markets, but you could expect something in the nearer term than something way out in a few years' time.

Clive Bannister

Jim, where is Fitch at the moment?

Jim McConville

We spoke with Fitch in the last few days and they have reaffirmed our rating, which is on positive outlook, having reviewed this transaction.

<u>Question 4</u>

Barrie Cornes, Panmure Gordon

Three questions. I just wondered if the integration of the business will have any impact on sensitivity to asset changes on your book.

Secondly, I just wondered, with the exception of the annuity book, are there any guarantees in the business you're purchasing for policyholders?

And thirdly, I appreciate I can ask them the question, but what's your view on the reason the business was being sold?

Clive Bannister

Can you just repeat the first question? I got the guarantees in policies; I got the reasons the business was being sold. I just misheard the first question.

Barrie Cornes

I just wondered if when you integrate the business into your business whether or not the sensitivities to changes in asset values will be changed as a result of the integration or if it would be similar to your existing business.

Clive Bannister

Let me do it in reverse order, if I may, and Jim you take the first one when I get to it.

The reasons for the business being sold, you'd have to ask the vendor, not us. But it gives me the opportunity to say that Deutsche Bank has been a very good counterparty in this process with whom we've had effective dialogue and conversations to get to the point where we are today. But that is a question you should ask Deutsche Bank.

The only guarantees that I know of will be embedded in the annuity book, which is £2.5bn; I think it's nearly 270,000 clients. But I know the unit linked don't have it. There are two small with-profits. So, the answer I believe is no, but if I've got that wrong Sam will come back to you later today.

Jim, on the asset side?

Jim McConville

On the sensitivities, obviously in due course we will publish revised sensitivities for the business in due course.

I think at a headline level there's nothing in the nature of the risks of the Abbey Life business that we're not familiar with. If we look at their risk capital the largest risks that they have is first of all is credit; that is a substantial proportion of their risk profile, as you would expect. Following that their persistency risk and equity risk is probably the two larger risks.

So, we have already taken action to put in some hedging to protect against the equity risk. As you know, for the Phoenix book we substantially hedge away the shareholder exposure to equity risk. And we will do a similar thing with the Abbey Life business, and have already taken some action on that.

The other hedging activity that we will look to do is, working with our pension trustees, is look at the interest rate risk within the pension scheme and put in hedging programmes more akin to what we have done with our own pension schemes.

Clive Bannister

Are there any other questions? If not we move to the telephone and internet.

<u>Question 5</u>

Andrew Crean, Autonomous

Actually I've got two questions. The first one is: I think you're publishing at 0.77 times EV, the EV is at December 2015. Would there be much change in the EV if you were to do it at an up to date level?

And then the second question is: I was kind of surprised by the size of the EV relative to the £10bn of assets; certainly for a unit linked book that looks rich. And I was just wondering in broad construction what proportion of the EV pertains to the unit linked versus the annuities versus whether there's much value in the de-risking transactions and the with-profit funds.

Jim McConville

The first one yes, you're quite right Andrew, that the number at the end of 2015 was 77%. If we roll that forward into the first half of the year I don't think we'd see a substantial difference in that percentage. I'm afraid I don't have to hand the split between the unit linked and the annuity book, but that is something we could get to you later I'm sure.

<u>Question 6</u>

Trevor Moss, Berenberg Bank

Just a very quick question please. On the £175m indemnity that you received from Deutsche can you explain even in broad outline how you got to £175m? And secondly, why it was felt necessary for that to be capped?

Clive Bannister

Trevor, thank you very much, and thank you for the note that you issued earlier today. It is on page 17.

Abbey Life is one of 11 firms that took part of the thematic industry legacy review. We also played a part in that, and Abbey Life was put in enforcement; that is a process that is still continuing. Clearly we have to protect our shareholders. We've done that in two ways: first of all embedded in the price that we made, £935m, we've taken in the risk of the enforcement, of consequence of the enforcement; and also we've got an indemnity of £175m.

Trevor your question has two components: there is art and there's science in reaching a view of what is an indemnity.

Architecturally we as a firm had to think about three things. First of all we had to think about the time of the indemnity; so how much time there is for us to take on risk and share that risk with the vendor. The second is to think about the scope of the indemnity. And then its quantification.

If we take time first of all: we've given ourselves six years on the industry legacy review, and eight years on the annuities, because there are two things which are working through our industry at the moment.

And then in terms of scope we thought very carefully about three big issues: one of which is fines which may evolve; professional fees that may occur between where we are today and until these issues are sorted; and then finally the possibility of customer rectification.

Dealing with then the quantification thereof, the fines are 100% for the vendor. It would not be right or proper or expected for us to meet the fines. And then there is a sharing mechanism on professional fees and also client rectification, because quite fairly the vendor would expect us to have some skin in the game, so as we work to the solution of these issues we are very conscious about the money we spend and we're not capricious in any way with somebody else's funds.

And then you come to the question about that cap. Any vendor will expect a cap. You get a cap on time, six and eight years; you get a cap on scope; and you get a cap on financial. And indemnity is there because it's not expected to be paid, but if it needs to be paid it is for the account of the vendor.

And we arrived at that in four ways, and we've thought about it extremely hard. The first is that we were part of the legacy industry review and we came out of that in good shape, not perfect but in good shape, and therefore we have a very clear idea of where the bar is set, so what the expectations are. The legacy, the industry legacy review was about the treatment by our industry of longstanding clients. At the heart of it was the culture, communication and the way in which you dealt with the issues where there was optionality for clients.

So, we know what the expectations are. And where there is a delta between the "Phoenix Way" and what we will inherit from Abbey Life we've worked out what that delta is and, as I said, factored it into the price and thought about it in the context. So, we know where the bar is; it’s not an unknown in our opinion.

The second is that we had several months of doing extensive due diligence where we took additional professional advice. So, this is not something where we stuck our thumb in the air, but come to a qualified and quantified view.

We sit here today having shared those thoughts with the key regulator when it comes to conduct, which is the FCA, and we have taken them through our understanding of issues, our thinking of what is required, the time and cost in the rectification, and therefore that is reflected in our finalised maths.

And the final thing, as we should acknowledge that the vendor, Deutsche Bank, and Abbey Life have not been sitting on their hands; they have been working through plans for rectification and remedial action. So, it’s not like we’re picking up something that hasn’t made progress; we are going to inherit a situation where progress is being made.

So, for all of those reasons we came to a number which in our opinion errs on the side of conservativeness and being prudent. And I would say that in discussions with the vendor they would clearly have pushed us down, and we have ended up in something where think we have fairly and appropriately protected our shareholders.

Jim, would you add anything more to that?

Jim McConville

The only other thing I would add is it was clearly a major part of our due diligence process, and we took appropriate external professional advice to assist us in forming the view that we came to.

Trevor Moss

That’s very, very clear gentlemen. Thank you very much for that.

<u>Question 7</u>

Ashik Musaddi, JP Morgan Cazenove

It looks like you haven’t presumed any sort of synergy benefits in cash flows after 2021. But can you give some clarity around what sort of synergies can be expected? I’m not looking for a number, but any sort of clarity about operational synergies, capital, asset allocations; any thoughts on that would be good. Thank you.

Clive Bannister

Ashik, you say you’re not looking for any number and then you ask my colleague, Mr McConville to give you a number. So, there you are, impossible question Jim: Ashik has asked we have not put any management actions in the cash flows post 2021 and he wants to know what you would put in post 2021. So, you ask that question.

Jim McConville

I'm sure in the best guide analogy the answer is 42. No, Ashik, we haven't put a number in as is our normal practice, beyond the projection period that we put in the public domain.

The source of the synergies will be very similar to that which we have discussed in previous presentations and investor days. So, we have opportunities in terms of risk management, in terms of operational synergies, in terms of capital efficiency and the like.

As I said in answer to Craig's question earlier I don't think there is anything in here that is out of the norm or that we haven't seen before. If we just apply what Phoenix has done very successfully in the past we will continue to deliver synergies from this book. And if you look over the history that we've had over the past few years we have more than delivered significant percentages of uplift in cash generation from the work we have done.

Ashik Musaddi

Just one more follow-on on that one: should we be thinking more about value enhancement or should we be thinking a bit more on the early extraction of cash? Do you really see a lot of scope for value enhancement as well in that cash flow book or is it just too early?

Jim McConville

It is relatively early but I think you will see both. I think the nature of the assets and the annuities, with-profits and unit linked gives us a wide scope of opportunity to deliver both enhancement and acceleration.

Ashik Musaddi

Thank you. That's very clear.

<u>Question 8</u>

Callum Tanner, InsuranceERM

I wanted to ask if you can foresee where the solvency ratio will be after the management actions, after the internal model, where you think that will be; whether there's a certain appetite for somewhere closer to, I don't know, somewhere like 180%?

And the second question is just if you could give a bit more detail on why the solvency surplus has increased to 151%.; the annuity business is quite capital intensive with things like the risk margin. So, if you could just unpack maybe a little more detail on the improvement to the ratio? Thanks.

Clive Bannister

Jim, I think those are two questions for you: do we have a target solvency level in mind and what might that be over time? And then secondly why is there an increase from 144% to 151%, given that this has a third of its business in the capital intensive annuities?

Jim McConville

Just to go back over some of the ground we covered slightly earlier, Callum. Dealing with your second question first: the 151% represents our half-year 2016 solvency surplus of £1.1bn and 140%, taken together with the Abbey Life proforma number as at the year end

2015, which is built from their standard formula basis. And the combination of the two gives us an improvement in surplus of £400m and the ratio of it goes to 151%.

Now, as I said earlier in the presentation the AXA transaction will deliver a further small percentage improvement to the ratio, as we've announced in previous discussions, and the combination of all the different capital measures that I spoke of earlier will improve that 151% by a few percentage points; so single figure percentage points but a meaningful number.

I don't think it's appropriate at this stage, given the work and the nature of the proforma process, that we try and size that number at this stage.

We have never operated to a specific shareholder percentage target for our solvency ratio. We have always been concerned with the absolute value of the surplus and our resilience to that surplus in terms of market stresses and the like. And so we will not be setting a different percentage number as a target.

Clive Bannister

Ladies and gentlemen if there are no questions from the floor? Well, this brings to the end the formal session. I just want to end where I began: thank you very much, an important and good day for Phoenix.