PHOENIX GROUP

2017 Full Year Results

Thursday, 15th March 2018

Henry Staunton, Chairman

Good morning ladies and gentlemen and welcome to the Group's 2017 results presentation. I'm joined on the podium by Clive Bannister, our Group CEO, Jim McConville, our CFO and Andy Moss CEO of Phoenix Life.

2017 was another successful year for the Group in which we delivered strong financial performance and substantially completed the integration of the businesses acquired during 2016. This demonstrates the strength of Phoenix's specialist operating model.

2018 will be a transformational year for Phoenix. On 23rd February we announced our plans to acquire Standard Life Assurance and enter into a strategic partnership with Standard Life Aberdeen. This transaction is fully aligned to Phoenix's strategy and will make us the largest closed life consolidator in Europe. These acquisitions have enabled us to increase our dividend from an annualised amount of £120m 2015 to an expected £338m in 2019.

I'll now pass you over to Clive who will provide you with the detailed business update.

Clive Bannister, Group Chief Executive

Good morning everybody and thank you, Henry.

2017 has been a successful year for the Group with strong financial performance across each of our key metrics. We have already updated you on our 2017 cash generation of £653m, which included significant contributions from the acquired businesses of both AXA and Abbey Life. We've improved our capital resilience to the restructuring of our debt, increasing our Group Solvency II surplus.

In July 2017 Fitch upgraded the Group's life companies' rating to A+ and this rating has been reaffirmed by Fitch following announcement of the Standard Life transaction.

As Henry mentioned we have substantially completed the integration of AXA and Abbey Life and the expected synergies from these acquisitions are ahead of our original targets.

The Final 2017 dividend has been increased to 25.1p per share. This amounts to an annual level of 50.2p per share, a stable and sustainable level. We have announced our commitment to increase this dividend further following the successful completion of the Standard Life transaction.

During 2017 Phoenix focused on the integration of the businesses we acquired during 2016. As I speak today these integrations are substantially complete and have delivered synergies ahead of target.

Andy will talk in more detail about the work we have undertaken to integrate both businesses but I wanted to recognise the achievements made against our key metrics. We have already delivered £518m of cash generation from the AXA and Abbey Life businesses and cost synergies of £27m against our original expected synergy target of only £17m. The move to our target operating model will be completed at the end of the first quarter of 2018, ahead of plan.

On Friday 23rd February we updated the market on our expectations for future cash generation signalling that we expect to be at the upper end of our two year target of between £1bn and £1.2bn. We also announced a new five year cash generation target of £2.5bn. Beyond 2023 we anticipate a further £3.8bn of cash generation from a run-off of the Phoenix alone book.

The acquisition of Standard Life Assurance is expected to bring further cash generation of £5.5bn which will provide increased sustainability to the long-term cash profile of the Group. Jim will talk more about this cash profile in a few minutes time.

In June 2017 we described our plans to move into the BPA market and on 23rd February I was delighted to announce that we were currently in exclusive discussions on our first BPA transaction. We expect this transaction to be completed shortly.

We only look at BPA transactions through an accretive lens and any transaction will be proportionate, selected carefully and funded through our own existing resources.

I will now pass you on to Jim who will take you through in greater detail our numbers. Jim.

Jim McConville, Group Finance Director

Thank you, Clive, and good morning everyone. 2017 has been a successful year for Phoenix and this is highlighted with a strong set of financial results. I'll take you through each of the key metrics in more detail shortly but let me set out in summary the key results.

Strong cash generation of £653m during the year, including £401m from the acquired AXA and Abbey Life businesses.

Holding company cash as that the end of 2017 of £535m.

PGH Group Solvency II surplus of £1.8bn and a Shareholder Capital Coverage Ratio of 164%.

IFRS operating profits of £368m.

Life company assets under management of £74bn and

a final dividend for 2017 of 25.1p per share, which is reflected in the reported solvency positions.

The cash generation from Phoenix Life for 2017 was £653m. This includes £165m from the ex-AXA businesses, £236m from Abbey Life and £252m from the other operating companies.

The AXA cash release largely resulted from the inclusion of the ex-AXA wealth business onto our internal model in the first quarter of 2017. During the fourth quarter of 2017 we completed the Part VII transfer of this business to Phoenix Life Limited, as a result we will no longer separately report cash generation from this business.

In December 2017 we reinsured the majority of the Abbey Life business into Phoenix Life Limited. This supported a cash release of £162m which took total cash generation from the Abbey Life business during 2017 to £236m.

With regards to the uses of cash the increase in pension scheme contributions during the year is driven primarily by a one-off contribution of £25m made to the Abbey Life staff pension scheme. In addition, the move from annual to monthly contributions to the Pearl pension scheme has resulted in an additional £10m of contributions during the calendar year, representing an acceleration of our agreed payments. Non-recurring outflows consist of project costs associated with acquisition, integration expenses and costs associated with hedging.

Debt interest is slightly higher than the previous year reflecting the higher coupon payable on hybrid debt issued during the year which has more than offset the impact of lower debt principle balances following repayments.

The Tier 3 and Tier 2 bond issues completed during 2017 raised net proceeds of £830m. The proceeds from these debt issues, as well as funds from our existing resources, were used to repurchase £178m of our senior bonds and to repay in full the revolving credit facility so that at year-end it was completely undrawn.

Finally, we ended 2017 with £535m of cash at the holding company level.

We communicated the progress made on our debt strategy when announcing our half-year results, we now have a more appropriate funding structure for the Group and the maturity profile better matches the underlying cash generation of the business.

Fitch upgraded its ratings for the Group in July with Phoenix's main life companies having a rating of A+. Fitch has also considered the impact of the proposed Standard Life transaction and reaffirmed all ratings with a stable outlook.

The work completed to bring the Group onshore has progressed well. The head office became UK tax resident on 31st January 2018 and the governance structure has been simplified. Solvency II reporting will now be completed only at the level of the PGH Group.

The final stage of the on-shoring process will be the establishment of a new UK holding company. It remains our intention to complete this final stage as soon as possible after the completion of the acquisition of Standard Life Assurance.

So moving on to the PGH Solvency II position. As at the start of 2017 the surplus at PGH was £1.1bn which included the pro forma impacts of the £300m Tier 3 issue in January and the incorporation of the AXA business into the Group's internal model.

The surplus at the end of the year has increased to £1.8bn with a Shareholder Capital Coverage Ratio of 164%. The year-end position anticipates the final 2017 dividend of £99m payable in May.

As we have discussed previously there are an additional £0.6bn of unrecognised surpluses relating to the Group's strong with-profit funds and the PGL pension schemes. These surpluses are not included in the overall Solvency II surplus but do provide the Group with an additional resilience in a stress scenario.

On 1st March we received approval from the PRA to bring Abbey Life Assurance Company Limited onto the Group's internal model. This returns the Group to a full internal model with no business remaining on the standard formula basis. The additional benefit of around £40m associated with this approval will be reported in the 2018 results.

This slide provides more details on how the Solvency II surplus has changed over the course of 2017. The increase in the surplus has been driven by positive impacts from management actions and the subordinated bond issues. Andy will take you through the management actions shortly.

These effects have been partly offset by negative impacts of economic and other variances: the costs of the senior bond tender; the workplace pensions management fee cap and the dividend payments over the year.

The Group's Solvency II position remains resilient, this partly is a result of the additional surpluses within the strong with-profit funds and PGL pension scheme, together with the hedging actions that we carry out designed to protect the Group's solvency position and therefore our future cash generation. The Group's most significant sensitivities are to increased longevity on our annuity portfolio and the widening of credit spreads. It is important to note that on our expected cash flows there are broadly similar impacts. Any detrimental impact on our life companies' Solvency II position directly reduces the free surplus that is available to distribute up to the holding companies as cash, therefore there is a direct and immediate impact on the cash generation from these stress scenarios.

As at the year end the Group had limited sensitivity to equity markets and following the announcement of the acquisition of Standard Life Assurance, hedging actions have been taken to mitigate the Group's exposure of the acquired Standard Life value of in-force to equity risk.

This slide shows the Group's operating profit which was £368m for the year, slightly up on 2016. The Phoenix Life operating profit of £388m has been enhanced by assumption changes. As reported at the half year, we have incorporated CMI_16 into our reserving assumptions, and the resulting release, together with positive impacts from reduced life company expenses have more than offset the negative impacts of persistency experience for products with guarantees.

Group costs were higher in 2017, primarily as a result of increased pension scheme charges. As stated earlier, our hedging strategy is designed to protect our solvency position but introduces an element of volatility in our IFRS results. Losses on the equity put options and swaptions held to protect the solvency exposure of the Group to equity and interest rate risk have led to a negative investment return overall.

Non-operated items include a £25m impact from the tender for the senior bond and a £27m impact of the management fee cap relating to workplace pensions.

Moving on to cash generation. I appreciate that many of you will be familiar with this slide which I presented to you on 23rd February. Total cashflows of £5.5bn are expected to be generated from Standard Life Assurance's in-force book which will increase the combined Group cash generation to £11.8bn.

As you will note, the cash generation profile of the Standard Life Assurance business is more long dated than that of the legacy book. This is primarily driven by the fact that the Standard Life Assurance book has continued to be open to business, whereas the legacy books of Phoenix closed many years ago. As a result, the duration of the acquired cashflows is longer than that of Phoenix.

In addition, the cost associated with moving the Irish and German business of Standard Life Assurance from branches to subsidiaries through a Part VII transfer in readiness for Brexit is delaying an element of cash generation from earlier to later periods.

This slide shows the sources and uses of cash for the combined Group over the period to the end of 2022. As Clive mentioned, we have updated our long-term cash generation target between 2018 and 2022 to £2.5bn. We have also announced that we expect Standard Life Assurance to generate cashflows of £1bn over this period. This cash generation is shown in the green bars on the chart and is additive to the opening holding company cash position at the end of 2017 of £0.5bn.

Moving along to the right, we show the various uses of that cash.

Pension scheme contributions, include our funding commitments to the Pearl and Abbey Life pension scheme periods over the period. The PGL scheme is now fully funded.

The analysis assumes that the dividend has increased from the time of the 2018 final dividend to an annualised amount of £338m.

After these uses the cash we are left with an illustrative £1.3bn of cash at the holding companies as at 2022. And over the coming years this accumulation of cash balance positions the Group to potentially deploy more of its own resources for future acquisitions or to support BPA transactions.

This slide follows on from the previous one showing the position for the combined Group from 2023. There is a significant expected cash flow over the longer term with the acquisition adding £4.5bn to Phoenix's existing expectations of £3.8bn. These longer term cashflows do not assume any management actions, nor do they assume any value from the new business generated through the strategic partnership with Standard Life Aberdeen.

Holding company cash of £7bn will be used to meet interest and head office costs, and to service the dividend. The acquisition therefore provides significant additional durability to the dividend and supports our stated stable and sustainable dividend policy.

I will now pass you on to Andy who will talk more about the achievements of Phoenix Life in 2017.

Andy Moss, Chief Executive, Phoenix Life

Thank you, Jim, and good morning everyone.

2017 was a very busy year for Phoenix Life, in which we have substantially completed the integration of both AXA and Abbey Life, delivering cost synergies and cashflows ahead of target. We have also delivered a number of management actions which have added £553m to Solvency II surplus and supported our ability to meet our cash generation targets in 2017 and in future years.

From a customer perspective, we continue to invest in digitalisation to improve customer communication and engagement and reduce conduct risk and cost. In addition, all of our service levels across both internal and external matrix remain within target.

Our integration plans for AXA and Abbey are focused on moving the acquired businesses onto Phoenix's target operating model and harmonising the approach to capital and risk management. These integration activities underpin the delivery of both the cash generation and cost synergy targets. For AXA, our integration activity is now substantially complete, generating cost synergies of £17m per annum, well ahead of our original target of £10m per annum and enabling us to deliver £282m of cash from the acquisition to date.

Integral to this integration has been the establishment of SunLife as an independent distributor based in Bristol. I will talk more about this business model shortly.

The migration of all core functions to Wythall was completed during the year and the outsourcing of policy administration for the AXA business became fully operational with Diligenta and FNZ on 1st January 2018.

On the capital side we have accessed significant diversification benefits with the mortality exposure of the SunLife business offsetting the Group's existing longevity exposure from its annuity liabilities.

In March the acquired business was incorporated into the Group Solvency II Internal Model and the policies were legally transferred to Phoenix Life Ltd via a Part VII transfer during the fourth quarter of 2017.

In 2017 we have completed our work to establish SunLife as a distribution business, which continues to be based in Bristol and has 121 employees. The SunLife operation is responsible for the advertising and direct sales of over 50s products, for which it has a 45% market share. These are manufactured and administered by Phoenix Life.

Whilst smaller in scale, this operating model is similar to the one that we intend to use under the strategic partnership with Standard Life Aberdeen. Under this arrangement, Phoenix Life will provide white label manufacturing and policy administration for workplace pensions, self-invested personal pensions and drawdown products branded by Standard Life.

Moving on to the Abbey Life transaction. This integration is also substantially complete and will deliver cost synergies of £10m per annum, ahead of the original £7m per annum target. £236m of cash was generated from the business in the year towards the £0.5bn target to the end of 2020.

The operating model of Abbey Life was already closely aligned to Phoenix's target operating model, with an existing outsource agreement in place with Capita. Our initial focus was to put in place governance and management quickly, ensuring that oversight of the business and its outsourcing arrangements were enhanced.

The migration of all functions to Wythall will complete by the end of April. The Abbey Life business was reassured into Phoenix Life Ltd in December 2017. This reinsurance allowed the Group to access transitional benefits on the Abbey Life business. It also provided efficiencies from the annuity portfolio by extending the matching adjustment approvals of Phoenix Life to all of Abbey Life's qualifying annuity liabilities.

In the fourth quarter of 2017 we submitted our application to move Abbey Life onto the Group's Internal Model. This application was approved on 1st March.

Management actions broadly fall into two categories under Solvency II. Those that increase Solvency II Own Funds and hence increase the total quantum of cash flows emerging from the business, and those that reduce the SCR and hence allow an acceleration of cash that would otherwise have been expected to emerge over time.

Management actions added a total of £553m to our Solvency II surplus in 2017. Those management actions that have increased Own Funds by £321m include the benefit of investing in illiquid assets, lower expenses for the life companies, which has been possible due to the economies of scale from the enlarged business and also from the Part VII transfer of AXA policies to Phoenix Life Ltd.

Long-term illiquid assets return a higher yield for shareholders and better match the duration of long dated annuity liabilities. During the year we've increased our shareholder asset allocation to illiquid assets from round about 6% to circa 15%, and this has primarily been driven through an increased holding of equity release mortgages obtained through both back-book acquisitions and ongoing sourcing.

Finally, the £232m of management actions that accelerated cashflows included the AXA internal model approval, hedging actions and credit optimisation.

We continue to be committed to delivering a high level of service and engagement to our customers. We are currently investing in online capabilities to connect digitally with as many customers as possible. Not only will this improve customer communication, but it will ease processing for customers and reduce costs. Our digital offering has been developed in cooperation with our outsource partners and will enable customers to better understand their Phoenix policies and make more informed decisions.

Central to this digital vision in 2017 has been the offer of online encashment for smaller pension pots to over 55s. This offering has been well received, with 23% of eligible customers completing the transaction online.

Another area of focus for us in 2017 has been the development of a dedicated advisor unit to support the IFA business within AXA Wealth. Regular feedback has been sought from advisors throughout the process of migration to Phoenix. This feedback from advisors has been positive and has translated into persistency experience which is better than expected. Maintaining these strong service levels for IFAs and for employers for workplace pensions business will be a key area of focus for the acquired Standard Life Assurance business.

We continue to innovate so that we can deliver wider options to our customers. During 2017 we launched an initiative to buy-out customers with smaller annuities in payment. This offers customers real optionality in their retirement journey. By the end of April we expect to have contacted 16,000 customers and are anticipating an eventual take up rate of around 70%. The table on the right hand side of the slide sets out our key customer metrics, which are a combination of internal and industry metrics. I am happy to report that we met all of these targets in 2017 and our FOS overturn rate is our best ever.

Phoenix has continued to be active in progressing the work required in response to the Abbey Life annuities review and legacy enforcement action. The indemnity with Deutsche Bank provides protection against outcomes from these ongoing reviews and our current assessment of the associated settlement and restitution costs are within original expectations.

We continue to process PA(GI) creditor insurance claims, with the deadline for claims set by the FCA for August 2019. The provision for claims has been increased to £40m but has been offset by the recognition of a corresponding reimbursement asset of £32m. This asset represents recoveries due from third parties under contractual arrangements and limits the Group’s downside exposure to this risk.

Finally, the regulatory landscape remains fast paced, with a number of FCA publications and consultations under consideration. We continue to actively review customer outcomes and as a result we believe Phoenix is well placed to respond to regulatory change. I will now pass you back to Clive.

Clive Bannister

Thank you, Andy. On the 23rd of February we announced our plans to acquire Standard Life Abederdeesn’s UK and European life businesses and enter into a new strategic partnership with Standard Life Aberdeen. Thus this deal is both a transaction and a marriage. The strategic rationale for the proposed transaction is simple. It allows both of us to focus on what we do best, Phoenix will become the pre-eminent closed life consolidator in Europe, and Standard Life Aberdeen will focus on its world class investment management business.

The Standard Life Aberdeen transaction is fully aligned to the Phoenix strategy and it is financially compelling. It is value accretive, giving us £5.5bn of cash generation, which will not only enable us to increase our dividend, but will also significantly enhance the sustainability of these dividends. It delivers scale with a capital 'S' in an industry that rewards scale, and we believe this scale will enable us to deliver cost and capital synergies of around £720m.

We have future opportunities, first in the form of asset growth generated from the strategic partnership; and second as the transaction provides us with a base in Europe which we can leverage in taking forward a European growth strategy. Finally, it is a strategic partnership between two companies whose objectives are aligned, and it is embedded through a 19.99% strategic stake by them in us.

Phoenix has long seen the potential in Europe. The acquisition provides an existing European base in both Germany and Ireland. The European closed life market is still very nascent, but it offers an additional avenue to create value for Phoenix stakeholders in the future. We believe that there remains a market opportunity of around £380bn in the UK, that is up £80bn from our original estimate of £300bn, and Germany and Ireland add an additional £160bn of assets to an overall total market potential of £540bn.

Looking to the future, Phoenix remains focused on its strategy of delivering value from closed books. The bifurcation of our industry that we are seeing today, particularly yesterday, supports this strategy. We will continue to seek selective transactions in the bulk annuity market. We will continue to write annuities for our own policyholders, as well as over 50s' protection through products delivered by SunLife. These are complementary capital life products providing a natural longevity hedge for the Group.

In addition to the new business written by the existing German and Irish businesses, our new strategic partnership offers the opportunity to generate future assets and cashflows on a white label basis. Whilst we have placed no value on this business in the cashflows that Jim has just presented, asset growth through this arrangement will act as a natural dampener to the runoff of our closed life book.

In summary, some transactions make you bigger, some transactions make you better, this is one of those very unusual transactions that makes us both bigger and better.

I close today by setting out our strategic priorities for 2018. Cash generation continues to be our key metric as it underpins our stable and sustainable dividend. We are clearly on track to be at the top end of our £1.0-1.2bn target for 2017 and 2018. We will obviously be working closely with our colleagues at Standard Life Assurance to progress the change in control application process, and expect to complete the transaction in the third quarter of 2018.

Customers will always remain a key priority for the Group, and in 2018 we will further develop our Digital proposition, as Andy talked about, which will improve our customer communication.

The work to simplify our Group structure, as Jim described, is largely complete, and the final stage of our onshoring work will be undertaken as soon as practicable following the completion of the Standard Life transaction.

Whilst our primary focus in 2018 will naturally be upon the completion of a Standard Life Assurance transaction, we are of course focused on other opportunities in the M&A environment.

So, that is the end of the formal presentation, so ladies and gentlemen we move on to the Q&A.

<u>Q&A session</u>

<u>Question 1</u>

Gordon Aitken, RBC

Three questions please. First, Prudential yesterday upped its retail annuity redress provision, 175, doubled it to 400. You talked about the Abbey Life provision. Standard Life also had a 175 provision, and if the provision has to be increased then who picks up the tab for that?

Second, there's obviously been a slow down in life expectancy in the UK, so there will be gains coming. I'm just wondering, on part of the Standard Life acquisition, who gets the gains? And really what table was used when you priced the Standard Life book, because if it was CMI 15, and we obviously know what CMI 16 and 17 looks like, and we've got a pretty good insight into what CMI 18 will look like, does that mean the price you paid was effectively a good chunk, or will be a good chunk lower than that stated?

And finally on workplace pensions and the SIPP business, I was surprised when these were included in that Standard Life transaction. If you did want to sell those, could you?

Henry Staunton

Thanks, Gordon. While you're thinking about it, just to say in terms of the Standard Life provisions, you're quite right, they were 175. They were increased by 100, and it's in the numbers, and the use of about 25, which means it's a net 75 increase. And we do have indemnities in that area as we did with Abbey Life as you know.

Clive Bannister

Of course we're well aware there were two players in terms of the annuities: one was Standard Life; and one was the Pru. This is territory that we understand well, and you can imagine that it was a focus of the due diligence that we completed, and therefore we have made appropriate considerations both in terms of the price paid and the indemnities sought.

Jim McConville

On the use of the CMI tables, so just to confirm Phoenix use the CMI 16 table, so we are up-to-date with the tables that have been published. Standard Life use their own data primarily to establish their annuity provisions. But the latest position reflects their latest experience, and so you can consider that is also up-to-date.

Andy Moss

And then on workplace and SIPP, I think we see this as a key part of the strategic partnership. We will have an arrangement in place with Aberdeen Standard for the exclusive manufacture of those products, so we see it as continuing and being a key part of our offering going forward.

<u>Question 2</u>

Ashik Musaddi, JP Morgan

Just two or three questions. First of all, how should we think about movement of liquid assets into illiquid asset, how does that create capital strain? Can you give us some clarity, if you shift £1bn to illiquid assets what does it do?

Secondly, you still have north of 55% of your stakeholder assets in gilts, cash, super national bonds. I doubt that a lot of UK companies have that much in low risk assets, so what is the potential you see in your book to keep on shifting these assets into illiquid or say a bit more high yielding assets? So that would be the second one.

And third one, SunLife is still generating some new business. Can you give us some colour about what volumes in terms of premiums, profits, anything, that is coming on top of your guided numbers already?

Andy Moss

We sold just over 100,000 Whole of Life plans within SunLife last year. We also distribute third party products to the over 50's market as well. On the Whole of Life product we have an annual premium equivalent of about £25m, and that's currently producing round about £5m of bottom line profit for us at the moment.

In terms of the illiquid assets, I think I just said in the presentation we've moved up from round about 6% to 15%. We do have a longer-term target on our annuity assets to get between 30% and 40%, and obviously that for us gives us overall a high yield, but also from diversifying our overall portfolio it's actually quite capital efficient for us as well.

Clive Bannister

And you had a third part of the question, Ashik, was there any appetite to change our bond and credit and go into higher yielding and taking on commensurated either rewarded or unrewarded risk. I think we've thought about that hard in the strategic allocation process. The doubling takes us through to about £5bn, and we're doing it in a measured way so it's ERM, it's local authority loans, it's commercial real estate, and touching at the edge of infrastructure. That's where our appetite stops. That is principally involving our own shareholder funds. And with the life companies and your funds the risk profile we've taken is appropriate for the nature of the assets and the policyholders that we wish to serve over time. So there's not going to be a change in our risk appetite for the assets you've made reference to.

Question 3

Andrew Crean, Autonomous

Could I ask three questions as well. Firstly, you said that by 2022 the holding company cash would be about £1.3bn. How much holding company cash do you need to hold as a Group, what's the policy around that on liquidity?

Secondly, I suppose it's something of the winner's curse. Winning Standard Life means that you're so large that...

Clive Bannister

Large in what criteria, Andrew?

Andrew Crean

Well in terms of assets and profitability, that the number of further consolidation deals to be done in the UK must have shrunk just purely because they wouldn't make a difference. Could you give us some idea as to how many targets now are relevantly on your radar screen?

Then thirdly, cost synergies. Not in this presentation but the one in late February, I think you capitalised the cost synergies' benefits, they were about £50m pre-tax, £40m net of tax, and you capitalise them over 10 years at £415m or something. I was just wondering how that worked, as to whether you could go into more detail as to where the cost synergies are coming, what you're not assuming? Because this is quite a substantial target which you could yield quite a lot of cost synergies out of.

Jim McConville

Cost synergies first. So what we mentioned on the 23rd was cost synergies of £415m, which was a capitalised number over 10 years. That represented the equivalent of £50m pre-tax, and that was out of a combined cost base of in excess of £600m. Once you strip out the European businesses, because they are standalone with no equivalent Phoenix business, the shareable cost base is round about over £500m. So the savings represented some 8% of the relevant combined cost base.

Where these come from is really doing what you would expect us to do. First of all, putting the management of the life companies together. Secondly, looking at the support functions for the two life company operations and harmonising these where appropriate.

Finally, in terms of opportunity, we need to look at whether we make more use of our outsource model or make more use indeed of Standard Life's insource model. But in the numbers that we have presented we have not built in any significant savings for that opportunity.

Clive Bannister

And Jim, would you answer the first question which was about the nature of your war chest: just how much money do you need lying around? That is what Andrew is asking. And I think that goes back to the slide where you talk about your sources and uses, and it goes from about £535m hold co cash today, building up to £1.3bn, and then thereafter to 2023 a much larger number.

Jim McConville

Yes. So, if you remember past presentations, Andrew, we've spoken about having a war chest of around £500m available to support further acquisitions. We will obviously be utilising some of that war chest to support the Standard Life acquisition, as we've previously described. But thereafter as the business progresses it will start to build up again, and indeed you will see at the end of the five years we see the amount building up to £1.3bn.

So, Phoenix as a standalone business we have £90m undrawn RCF, and we have the £500m of cash; we have more than sufficient liquidity for our needs. The minimum liquidity requirement we need is a fraction of that total amount, so there is no shortage of liquidity. And a substantial proportion of that £1.3bn at the end of the five years could be available to support BPA or further M&A deals.

Clive Bannister

And then you asked an impossible question Andrew about what is the market remaining. So I don't have a crystal ball, but I am robust in my belief that there is a cyclical change. The events of yesterday just confirm it. So the tectonic plates of our industry are changing, and we think that the overall size of that in the closed life – let's just talk closed life in the UK before we talk about BPA and before we talk about Europe – is £380bn. And we've taken that up, and outside of this meeting we can go through the component parts of it.

What is intriguing for me is that three years ago we put up a pie chart and we said that half of the owners of these legacy historic closed books were UK insurance companies, about 30% were foreign insurance companies in the UK, and then about 10% to 20% were banks. So if you look at the three deals we've done since 2016 they've come out of each of those pots.

We started with a foreign insurer saying they wanted to direct their assets towards the GI market. That is AXA. They haven't left the UK they just repositioned it, a deal we paid £375m for, and we've got £283m already out from that transaction. The next one was a bank. Deutsche Bank decided that they didn't want to have capital committed to a legacy business. And then here we have a UK insurance company redeploying it.

So I don't have a crystal ball for when and how much, but I am absolutely certain that there are boardrooms that are thinking hard about which way their capital is facing. The seminal event that took place, and there are two big drivers to the change of our industry: one, the starting gun was set off by George Osborne: he gave clients choice. So the capital that was mandatorily fixed behind paying for annuities can now be put against a DC rather than some DB environment. That's not stopping any time soon, and especially with auto-enrolment and the freedoms that come with that. It is a DC, it is a fee based, fee rich environment, which is why our strategic partnership is so seminal because we still get the opportunity of benefiting from Standard Life Aberdeen's success in that area.

The second one was the repricing of capital in 2016 which was made reference to in yesterday's presentation by Solvency II. And that's not going away any time soon. So I think this is inexorable.

And then part of your question was: well, are you going to run out of road of any bigger ones versus little ones? I had a wise Irish grandmother and she said, never ignore the pennies at your feet looking at the sixpences in the stars. And so I am completely convinced that there will be – plethora is the wrong word – but there will be sufficient small and medium size deals, and there may be whales out there yet to come that I can't identify, but that gives us a very sustainable future as a growing business in the UK.

I'm going to finish the question there very quickly. We then look to a place called BPA. Many people give you statistics: £550bn of assets to be transferred in the next 15 years. It's enormous. There is the very big bulk end, and then there are the vesting annuities. It's a spectrum. We do on average, we did £529m vesting annuities last year, £540m the year before that, £500m or £486m the year before that. We think with our business with Standard Life will be another £200m. So we're in the annuity business, that is a great business and builds out our ability to pay, extend our dividend paying capability.

Then we can acquire annuities by buying deals as we did with Abbey Life, one third of that, £2.5bn of that was an annuity. And then in the BPA space, as we've advertised, we're looking at that. We looked at seven transactions last year; we did one. Immensely selective, proportionate – which means small in my category – using Jim's war chest, so we're never going to come to shareholders for it. And it has to meet the criteria of being accretive, sustaining the dividend and our investment grade rating. So there's some portion of that £550bn which is available. And then there is a new environment called Ireland and Germany in terms of closed life, we've priced that or we see the market at about £160bn. Who knows?

So we don't think we're running out of road any time soon and actually we see the tide coming towards in the fact that boards are now contemplating which way their capital is facing. And it is not, in my opinion, correctly aligned in many of the businesses against the strategic objectives of getting into the wealth management business and capital like business.

Apologies, long answer.

<u>Question 4</u>

Oliver Steel, Deutsche Bank

Two questions. The first is, I suppose sort of building on Andrew's question, there are a number of sort of smaller deals potentially over the next 12 months, let's say. Ignoring the cash, do you actually have the management capacity to take on those deals in the next, say, 12 months?

Actually I'm going to make it three questions.

Clive Bannister

Why break the habits of the morning? Everybody has asked for three.

Oliver Steel

The second question linked to that is: if there are a plentiful number of small deals available in the future, do you have the management capacity to do, say, more than one a year of those smaller deals? Because I suppose getting round Andrew's question about relevance you just have to do them more frequently.

And then the third question is about the German and Irish cost. Is that in the £135m or is that deducted off the cashflows that you're expecting from Standard Life over the next four or five years?

Henry Staunton

Shall I just touch on the management one to start with?

Firstly we did do two deals in 2016 in AXA and Abbey, and the management team succeeded in doing that.

At Standard Life in Scotland we've got huge expertise and talent there that is now part of our Group and part of our management team. And when we talk about things like BPA, have we got the management to do it, we already have £11bn of annuity, bulk purchased annuity liability, so we're in that business already. So it's not as if it's a new business and new management that's required.

Do you think we've got the management team invested in it? I certainly think we have.

Clive Bannister

That's very generous of my Chairman to say that. I echo his comments, having done two deals.

But I think there's a more subtle point to Oliver's question as to whether we increase the frequency on the smaller deals, so you fly at two different altitudes.

Oliver Steel

Yes, that's fair.

Clive Bannister

The gating item, Oliver, in doing deals are management bandwidth, do we have the money, and how does our regulator feel about it.

I am robustly confident, particularly at the prospect of getting more talent in Scotland, that we have the management talent to do these deals.

Then when it comes to financing, Jim has a lot of money and the markets have been very supportive. He has an unspent RCF of £900m.

And then I think you get into more interesting territory with our regulator. They are navigating Solvency II. There is a plethora of Part VIIs literally. And we have a lot of model changes and matching adjustments. And I think it is not unfair of our regulator to say, listen, you focus on the things that really have to be done before you start dashing off elsewhere.

And therefore, I'm going to use the word bifurcated approach where there are smaller deals, where it is more administration and fee oriented rather than capital related. There was a transaction last year which had a capital component, but it was a lot about administration and taking on a book and how to manage it.

So I'm interested in, it's not so much the scale issue and the frequency, which I think is a good way of looking at it, but it's whether it involves me having to create burdens for our regulator and of course burdens for ourselves.

But as the Chairman said, we've already done two deals in 2016, and they take a long time to gestate as businesses, and we're always attentive to prospects in the market.

Jim McConville

Your final question, Oliver, was about the treatment of the integration costs and the German and Irish Brexit related costs.

So on slide 19 the integration costs which we expect amount to £135m after tax are included within the operating and pension cost line of £0.5bn shown on that chart.

The cost of capitalising the subsidiaries following Brexit for the German and Irish businesses are deducted from the cash generation line in the green box, so within the £1bn that is after the capitalisation of those businesses. What it does is it depresses the cash we expect to get out over the first five years. And that is a number of several hundred million pounds.

<u>Question 5</u>

Angel Kansagra, HSBC

My first question is on the illiquid assets. You said you have a target of increasing it from 15% to 30% to 40%, and you have a range of assets you would be investing in. But do you have a preference for specifically equity release mortgages, because that's what you did in H2 2017?

When you acquired the equity mortgage release back books can you maybe share the risk profile of the back books in terms of what's the loan to value you get from the business?

And the third one is actually on longevity reinsurance simplification. That was one of the points you mentioned as management action. Can you give some more details on that?

And a quick one actually, the answer would be yes or no, but the £160bn Standard Life assets were they part of your £300bn market size estimate previously or was it something out of that?

Andy Moss

Yes, we do have a preference for equity release mortgages. We have an ongoing flow of equity release mortgages through various funding arrangements which we have in place. And actually the margins which we can earn above swaps are quite attractive on equity release mortgages at the moment.

In terms of back books, I think we've acquired two or three over time, at the point in time of acquisition of back books we do extensive due diligence. So the features of all them vary significantly across the piece, but particularly we are looking, as you say, at loan to values, no negative equity guarantees, ship certificate, so this where the Equity Release Council is basically issuing certificates around it, particularly to make sure that they've been legally drawn up properly, that families have been involved in all of those.

So we do quite a lot of due diligence around the risk of that, and then obviously continue to monitor that as we take on the administration of those back books as well.

Jim McConville

On Standard Life and the amounts of books available for sale, on the announcement on the 23rd February we updated our estimates for the market size in the UK at £380bn, and that excludes the Standard Life books.

<u>Question 6</u>

Andrew Sinclair, Bank of America Merrill Lynch

Three from me as well. Firstly, given the step-up in the cash generation from the Standard Life deal and where your hold co cash goes over the next few years, were you not tempted to increase the dividend a little bit further in the step-up?

Secondly, actually on the results today believe it or not, another significant IFRS loss on the supported with-profits book. Just any colour that you can give us there?

Thirdly, just thinking about bulks, how should we think about the cash generation step-up from bulks? I know you've typically said that the dividend only really steps up when you do an acquisition. If you're doing a decent number of bulks how should we think about that?

Jim McConville

As we explained on the 23rd, Andy, our dividend policy remains stable and sustainable and we review it at every period on a transaction. We've taken the decision to increase the dividend by 3% this time, compared to the 5% that we declared at the time of the AXA deal, and again at the time of the Abbey deal.

I think I used the phrase that getting to the appropriate amount is art not science. We were very mindful of the phasing of the cashflows, and in particular the Brexit related cost that I've just spoken about in the previous question, so there was a longer-term back-ended nature to the cashflows from the Standard Life book compared to, say, the AXA book. And we came to the view that looking at the dividend, the yield where it currently sits, that 3% was the right answer.

Andy Moss

On the IFRS loss what we're generally seeing across all of our books of business is that people are retiring later, and we have a couple of particular products in our supported with-profit funds which have guarantees in terms of roll-up. And what we're seeing is those people are staying in those products longer, and hence I think Jim referenced the negative impact from overall persistency experienced, and that effectively is that particular one.

We are seeing on the positive side in our unit-linked book the same trend, and that obviously gives us a benefit, which partly offsets the total persistency experience.

Jim McConville

And I think your final question was on the impact of bulk transactions. We have said that bulk transactions will be selective and proportionate. We've talked in the past about doing deals roughly equivalent to £500m of liabilities per annum. So the annual impact of the cashflows of that business will clearly build up over time as we do deals going into the future, but initially will not be significant.

Henry Staunton

We should have said selective and accretive.

Jim McConville

And accretive.

Henry Staunton

It won't be material; it's interesting because we're already in that business, but it won't be a material impact.

Jim McConville

It will build up.

Henry Staunton

Our focus is going to be on closed funds, that's the key message. Dividend is an art, not a science, is all I would say.

Clive Bannister

Shall we say thank you very much?

Henry Staunton

That's it. Thank you.

Clive Bannister

Thank you very much indeed. It was a strong year financially for Phoenix Group, and that gave us the confidence to increase our dividend based off strong cash flow and strong solvency. Thank you very much indeed.