Phoenix Group Holdings

2016 Half Year Results

Thursday, 25th August 2016

Clive Bannister, Group Chief Executive

Good morning ladies and gentlemen. I apologise that none of you are on holiday, and grateful that you are here for this important day: GCSE results for those of us who have 16 year olds, and that's what really matters today. My Chairman would not like me to say that so I won't repeat it. But anyway, delighted that you're here.

As usual I'm joined by Jim McConville, our Group CFO, and Andy Moss, the Chief Executive of Phoenix Life.

It's been a busy and important six months for Phoenix, with the announcement of the planned acquisition of AXA Wealth pension and protection businesses for £375m. This transaction, which involved a successful equity raise of £190m, is the next step in the Group's strategy of consolidating closed funds as the UK market continues to evolve.

Despite the market volatility following the Brexit Referendum and an unprecedented decline in long-term interest rates we generated £147m of cash by the end of June, and remain on track for our 2016 cash generation target of £350m to £450m.

This confidence in our cash generation target is driven by first, our closed life business model and its long-term cash flows, and by the continued success of the Group in identifying and executing management actions. And this work will continue into the future.

Phoenix maintains a resilient Solvency II balance sheet despite the sharp declines in interest rates, and we maintain our stable and sustainable dividend policy.

The pending AXA acquisition marks a positive step in Phoenix's evolution. We are on track to complete the acquisition in the fourth quarter subject to regulatory approval. We have talked in the past about the potential value that can be generated from closed life fund consolidation, and this transaction is evidence of just that.

The acquisition offers significant capital and cost synergies, leveraging both our internal model and Phoenix's specialist operating platform, and we continue to expect £250m of cash to be generated within six months of its completion.

The acquisition meets all of our M&A criteria, and enables us to propose a 5% increase in the final 2016 dividend per share to 28 pence.

The transaction supports our investment grade rating, with Fitch recently affirming the Group's credit rating with a positive outlook. In addition it positions Phoenix to execute further value-added transactions in the future as the UK market continues to consolidate.

Given the UK focus of Phoenix's operations there is no direct impact on our operations from Brexit. However the EU Referendum has had a significant impact on financial markets, with a marked decline in long-term interest rates. To put the fall in interest rates into some context, we have seen 130 basis points decline in the 15-year swap rate on a year-to-date basis.

We were clear at the time of our Full Year results that the Group's solvency and cash generation would be negatively impacted by lower interest rates. This has indeed been the case. However we have also been successful in executing management actions during the first half of the year to partially mitigate this impact.

Furthermore Phoenix maintains a high-quality corporate bond portfolio, 99% of which are investment grade rated or above, and shareholders have minimal exposure to equities and property investments.

We have also put in place further interest rate hedges protecting the cash generation from the Group's life companies and the pending AXA acquisition. Jim will talk more about this in more detail, but it demonstrates the dynamic way in which the Group reacts to changes in the markets to protect capital and cash flows.

In March we announced a cash generation target of £350m to £450m for 2016 and a five-year cash generation target of £2bn between 2016 and 2020. Whilst headwinds for the life sector have clearly increased since then we reiterate both of these targets. Phoenix's long record of undertaking management actions has continued this year. Given the impact of interest rates on our solvency position, the achievement of further management actions from the second half of the year will help deliver the cash generation for the Full Year.

As Andy will discuss shortly, these include further Matching Adjustment portfolios, and the Part VII transfer of the annuities portfolio currently reinsured with Guardian. Over the longer term we will redouble our efforts to leverage our specialist operating model to identify further management actions in years to come.

I will now pass you to Jim who will take you through our financial results in greater detail.

Jim McConville, Group Finance Director

Thank you, Clive, and good morning everyone. I will take you through each of the key metrics in more detail shortly, but let me set out in summary the key results:

Cash generation of £147m on track for our stated target range for 2016. Our Solvency II surplus of £1.1bn and our shareholder capital coverage ratio of 144%. Both of these already allow for the impact of paying the 2016 interim dividend in October. IFRS operating profit of £107m and finally an interim dividend of 27.6p per share.

The cash generation in the first half was £147m. With regards to the uses of cash a key non-recurring impact is the cost of the purchase of swaptions which have helped hedge the exposure of the Group to interest rates.

Debt interest payments decreased as a result of refinancing of the bank facility, with the 2015 result reflecting the payment of the Tier 1 bond coupon during the first six months of last year. The remaining £6m of Tier 1 bonds have now been fully repaid. Under the new bank facility there are no mandatory amortisation payments.

The closing cash at the holding company level includes the net proceeds of the equity raising, which will be utilised for the AXA acquisition in the second half.

This slide sets out our Solvency II position at the Half Year, illustrating the results of our full internal model calculated at PLHL level. We have eligible own funds of £6.1bn and a Group SCR of £5bn giving a surplus of £1.1bn. The surplus of £1.1bn already allows for the payment of the interim dividend of £66m in the second half, as this will be funded out of cash at the level of Phoenix Group Holdings. The net proceeds of the £190m equity placing are also held outside the PLHL Group.

As at the Half Year the shareholder capital coverage ratio is 144%. As we discussed at the time of our Full Year results in March and the Investor Day in May there are additional unrecognised surpluses within the Group's strong With Profit Funds and the PGL Group pension scheme. This provides the Group with additional resilience in a stress scenario.

Our shareholder capital calculation excludes the Group's strong With Profit Funds and the PGL pension scheme; and this provides a clearer view of the shareholder position and is similar to the approach taken by many of our peers. Given our focus on closed funds we do not need to hold additional capital to fund new business growth, and so we continue to focus on the overall surplus number and its resilience.

This slide sets out how the surplus has changed over the first half of the year. The positive benefits of the run-off of the book and the management actions taken have been offset by the negative economic impacts from lower long-term rates and assumption changes.

Furthermore the PLHL Group also distributed further cash during the first half up to the level of Phoenix Group Holdings to pre-fund the interim dividend. This reduced the Solvency II surplus at PLHL level at 30th June but does mean that the payment of the interim dividend will not impact the Solvency II surplus in the second half.

The Group's Solvency II position remains resilient, partly due to additional surpluses within the With Profit Funds and the Group's pension schemes. And this is further enforced by the risk management actions we have taken during the first half. We are well protected against equity falls given the large majority of the exposure is borne by policyholders within unit linked funds or strong With Profit Funds.

We hedge out more than 80% of the residual shareholder exposure to equities resulting from the management fees we earn from unit linked assets, as an example. This is similar for property where the limited Group exposure to the asset class is mostly held within the strong With Profit Funds.

Although we have sought to optimise our position with regards to interest rates the Group still has exposure to interest rate falls. Along with our peers we have assumed that a significant fall in interest rates, which would therefore lead to an increase in the risk margin, would trigger a recalculation of transitional provisions. This has indeed been the case, as the Group recalculated its transitional measures at 30th June with the approval of the PRA.

Credit risk is also significant for the Group, arising from direct shareholder exposure to corporate bonds. The impact on widening credit spreads is dampened to a certain extent by the credit assets held in our Matching Adjustment portfolios held on a buy-and-maintain basis.

However, the key exposure from a capital perspective is to increase downgrades or defaults, and therefore our market stress includes an assumption of an increase in those specific risks.

The Group's largest individual exposure is to improvements in longevity in our Annuity portfolio.

It is also important to note that there are broadly similar impacts on our expected future cash flows. Any detrimental impact on our Life Company Solvency II position directly impacts 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.

The achievement of management actions over the first six months and the visibility we have on the remainder of the year have therefore been important in being able to reiterate our cash generation target for the year.

Finishing with IFRS:

The Group's operating profit was £107m for the first half. This result includes a lower contribution from management actions, together with a provision to reflect the expectations of persistency on products with guarantees.

The first half operating result also includes the impact from moving our IFRS reserving methodology closer to that used under Solvency II. For example, the use of a swaps-based discount rate rather than gilts-based. An advantage of this methodology change is that the sensitivity of the IFRS result will now be more in line with that of our Solvency II capital position and this change does not affect the regulatory position of the individual funds.

Investment return variances were negative overall with the key negative impacts being from the equity put option that the Group holds to protect its Solvency II capital position, as well as wider credit spreads over the first half. This has been partly offset by the increase in the value of the swaptions we took at the Group level as interest rates fell at the end of June.

I will now pass you to Andy who will discuss developments within Phoenix Life in greater detail.

Andy Moss, Chief Executive

Thank you, Jim, and good morning everyone.

The UK Life sector continues to be significantly impacted by regulatory change and we do see this continuing into the future.

The FCA review of the treatment of longstanding customers was published in March and we've seen a number of firms being investigated as part of this. As a closed life consolidator, it is essential for Phoenix to maintain its strong customer focus and we welcome the Regulator's Best Practice Guide, much of which is aligned to our current activity.

With regards to the proposed 1% cap on exit charges for those pension customers aged over 55, our experience has been that these charges are not a significant influence in our customers' behaviour and we continue to expect that any financial impact on the Group will not be material.

Despite the impact of the new Pension Freedoms, the levels of annuities we are writing has now started to normalise with overall volumes up on the same period of last year. In addition, margins have seen a recovery in 2016 compared to the second half of last year.

Solvency II continues to develop and the results today include the impact of the recalculation of transitionals. Although we are not anticipating any immediate impact from the EU Referendum, the regulations may continue to evolve over time and we therefore remain focused on taking further management actions to optimise the Group's position.

There has been significant activity undertaken on the pending AXA acquisition, but despite this, we have continued to deliver shareholder and policyholder value through The Phoenix Way. We have expanded our alternative asset capabilities and in particular with regards to equity release mortgages and commercial real estate debt.

We've also taken further steps to transfer some non-profit business out of the Group's With Profit Funds, which provides a more predictable run-off for the funds and therefore distribution of the estate to policyholders.

On the customer side, we are continuing to develop both our digital and product proposition following the introduction of Pension Freedoms. This includes some changes to our current web services with the provision of new information tools to help customers make better decisions. The tools help customers navigate through what can be a complex journey and help them source the right solution for their retirement needs.

Phoenix's Independent Governance Committee, the IGC, has also issued its first report which complements the company's existing approach to the treatment of our customers in workplace pension schemes. We look forward to working with our IGC to ensure that the strong customer focus continues.

Management actions broadly fall into two types 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 been expected to emerge over time.

Management actions have added a total £86m to our Solvency II surplus, including the benefits from modelling enhancements and asset and liability actions.

The key actions to complete during the remainder of the year include further Matching Adjustment portfolios and the Part VII transfer of an annuity portfolio currently reinsured to Guardian.

The overall aim of management actions is to maximise the level of surplus under Solvency II for the long-term as this will drive the cash that can be remitted out of the Life companies in support of the Group's cash generation targets into the future.

The delivery of strong service to our customers continues to receive significant focus. Improving customer engagement with their products remains key to us; hence our continued investment in types and content of communication. 2016 has seen us invest in our digital capability and we have also widened product options for our customers via our partnership with Just Retirement.

We have also continued our actions to prevent pensions fraud and have prevented over £28m of potentially fraudulent transfers to date.

The right-hand side of the slide sets out some of the key customer metrics and indicators that we track against. I'm very pleased to say that we are ahead of all of our stated targets. These take into account benchmarks that we see externally and we will continue to seek ways to improve.

We expect the AXA acquisition to complete in the final quarter but we are already well advanced in having an integration plan in place to deliver the capital and cost benefits. The acquisition allows us to generate value from our approved Internal Model as well as our operating platform. In addition, we'll apply our customer model to the acquired policyholders seeking ways to improve performance and value.

We are planning to deliver the expected capital synergies within six months of completion and believe that the integration of the acquired businesses will be completed during next year.

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

Clive Bannister

Andy, thank you very much.

As Andy has just mentioned, the AXA acquisition has been the key event for the first half for the Group. I believe there remain significant M&A opportunities available to Phoenix in the UK. The impact of the EU Referendum has increased the pressure on the UK Life sector and we see further consolidation occurring in the coming years due to low interest rates, cost of administration and ongoing regulatory scrutiny.

Phoenix has a busy schedule in the coming months. Management actions remain a vital part of the Group and Andy and his team will be focused on delivering further Matching Adjustment portfolios and the Part VII transfer of the annuity portfolio to Guardian to support our 2016 cash generation target.

Following the expected change of control approval through the AXA acquisition in the fourth quarter, I am confident we can leverage our Business Model to safely integrate the acquired businesses onto our operating platform.

We continue to look for ways to diversify our debt structure away from short-term senior debt and towards longer-term subordinated debt. We will seek, over the medium term, to replace Phoenix Group Holdings, which is incorporated in the Cayman Islands and tax resident in Jersey, with a new UK Topco. This will provide greater clarity and transparency for all of our stakeholders as well as streamlining the Group's current governance structure.

We remain well placed to look at further M&A opportunities that meet our stated criteria and believe that the Group has the platform to deliver additional value from future market consolidation.

Finally, before closing, I would like to note the appointment of three new non-executive directors: Wendy Mayall, John Pollock and Nicholas Shott. They will join the Board from 1st September. Their experience will augment our already highly qualified Board.

So, to end, the first half of 2016 has been about Phoenix's delivery of cash, resilient solvency and the advancement of the AXA transaction.

That, ladies and gentlemen, brings to the end the formal presentation. Let's move on to Q&A. Will you wait for a microphone to be brought to you and give us your name and then the institution you work for, and then we'll try and answer the question. In time honoured manner, the easy ones for me and the difficult ones for Jim and impossible ones for Andy. That makes me feel psychologically good and we'll take it from there.

A&A session

Question 1

Ben Cohen, Canaccord

Thank you, good morning. I have two questions please.

Firstly, on the cash target for '16-'20, has there been a pull-forward of cash from the later years in keeping that target unchanged? If you could comment maybe as to the profile beyond 2020 and whether that has changed.

And the second thing, on the IFRS operating profit for the second half of the year, given how swap rates have moved since the interim, would you expect a further negative impact on, I guess, the assumption you're making on people taking out annuities at this sort of relatively uneconomic level. I presume that's what's impacted the profit in the first half and is there more of that in the second? Thank you.

Clive Bannister

We had three parts to that question and I'm going to hand them to Jim. The first one was whether we had pulled things forward to make our £2bn 2016-2020. The second part was what were we saying about the real assumption changes 2021 and beyond, and there is a change there. Then finally about the IFRS profits and how people are reacting in a low interest rate environment when we have guaranteed products.

Jim McConville

First of all, the cash target for the current year, so that is £350m-£450m. As we said when we met here in March that remains unchanged. The delivery in the first half of the year of £147m is in line with what we had expected, because we'd always indicated that it was balanced towards the second half of the year, and that is a reflection of the timing of the expected management actions that are well in train and we expect to complete during the second half of the year. That was always the case when we set the target in March, so there hasn't been any real pull forward of cash into 2016.

We do see an impact in the cash generation beyond 2020, so for the sharp eyed you will have seen that previously we had said there was a further £3.2bn to come out of the book at the year-end beyond 2020. That is reduced to £3.1bn.

In terms of the IFRS operating profits, what we have recognised in the operating profit this year, and explains in a large way the reduction in the operating profit from the previous year, is that we have recognised changing customer behaviour in relation to products with guarantees. Basically they're holding onto them longer and it's costing us more. So we've set aside additional funds to recognise that change in behaviour. Clearly, we've said that is based on the current low interest rate environment and outlook, and it's something we will have to continue to monitor during the second half.

<u>Question 2</u>

Kailesh Mistry, HSBC

A couple of questions. Firstly Clive, reading the outlook you sound a little bit more confident about the M&A outlook. Why is that?

Secondly, on your comments about further benefits from corporate and debt restructuring, what do you think are the financial costs and benefits of these actions? Because I think you mention simplification.

Clive Bannister

The simplification of Topco?

Kailesh Mistry

Yes. And secondly, just following on from Ben's question, is there more to go in terms of aligning your IFRS and Solvency II reserving in the second half, or has most of it been done?

Clive Bannister

So, three questions. Jim, you'll take the last one. Can I take the first two. M&A, the degree of confidence, how we feel about that. And the second question about the Topco and what it means for our debt and capital raising.

I think there are four points to be made about M&A. The first one is the nature of cyclical change. The second one is the jeopardy or threat to the traditional insurance model. The third is that the industry is therefore at a crossroads. And the fourth point is the inevitability of further consolidation. So let me take those in sequence.

When we were here two years ago we talked about cyclical change and I pointed to one thing, and that was the regulatory changes, giving people freedoms. Absolutely necessary. That gives optionality. That was the key driver two years ago. We've had two more adding to a cyclical change. The first is the compression of interest rates across the whole industry, and therefore when the tide goes out those who aren't wearing swimming trunks are more visible. And third, a cyclical contribution to change post-Brexit is the depreciation of Sterling. So if you are a foreign owner of an insurance business in the UK, the first one gave you regulatory uncertainty, the second one gave you a decline in earnings' flow, and the third one depreciation of Sterling means that you're getting your dividends in a depreciated currency. Swiss Franc's down 20%, the Euro's down – choose a number – 15-20%. So those have to drive a sharper environment where it concentrates people's minds.

Then my second point, the traditional savings and investment business, the vertical integration. We did a piece of work a year ago called The Meaning of Life with Cass University. We don't believe that vertical structure of savings, investments and protection is going to survive. That is forcing the industry to my third point, which is a crossroads, and the industry is deciding are we going to be a savings and investment business, capital light, or are we going to remain in a protection business? And if we're in a protection business, if you've got a Dollar of capital do you put it under a business which is growing, or do you put it behind your heritage and legacy book? And we have absolutely no doubt that the events of lower interest rates and decline in Sterling is focusing people's minds on what they are going to do with their legacy and heritage books. Clearly, we're part of that thought process and we are engaged and will continue to engage in conversations, because we are a possible solution to that issue on other people's tables.

Then the fourth one is, there will continue to be inevitable industry consolidation because of the cost of capital, because of the scope of opportunities, and all the things we've mentioned before. Very administratively expensive to run heritage books with a set of specialist skills. Regulatory uncertainty/scrutiny. Trapped capital, and lower returns. That has to drive people to think more about how they're running their back books.

So, that's a rather longwinded answer to we expect further consolidation and we expect to play an active role because we are the UK's largest closed life consolidator, and Jim's got us an investment grade rating and we have the currency of paper to think about transactions.

Then your second question was about Topco. Listen, we have an organisational structure which is in effect an accident of history, it goes back to 2009. It was fit for Solvency I, it's not so fit for Solvency II, the Solvency II world in which we find ourselves. There hasn't been a meeting that we've had in the last five years where I haven't said that it behoves all of us to continue with that simplification. This is the necessary next step, or we would welcome it as a next step. That would in time mean doing away with Caymans and the Jersey company through which we operate.

You asked a question about what does it mean for equity and debt. There are certain investors who will not invest with us because we have a Cayman ultimate holding company, particularly in America but also elsewhere. So we just want to make it simpler. And then for debt reasons, Jim I think has already got our debt costs down from 4.75% of two years ago, and the debt facility on the AXA bridging facility is at 85 basis points, so I don't know if Jim's going to be ambitious and say that he can get it lower. But clearly with the investment grade, our ability to issue subordinated debt from the simplified structure so we're enabled, we have bank debt to be able to drive forward M&A, and you want to have subordinated debt to support the long-term nature of our liabilities. And therefore having a simplified structure will facilitate at least the issuance, although you can argue about the price of it.

And finally, from an M&A as a counterparty, we are clearly a normalised UK company without going through Jersey and then ultimately ending up in the Caymans. So this will take us, as I said, the medium-term to 18 months, and it's a simplification which we welcome.

Jim, you had the question about whether we have squeezed the alignment on IFRS.

Jim McConville

This is changes we have made to our reserving methodology within IFRS. Our old basis was designed for a Solvency I world, and largely what that meant was it was based on gilts as opposed to swaps which are prevalent in the Solvency II world. So we've taken the opportunity to change the reserving methodology. The changes, given the size of our sort of £50bn plus balance sheet, are neither here nor there at the end of the day in terms of the expectation of operating profits going forward into future years. But we don't expect, in answer to your question, Kailesh, that there'll be any further changes in the second half of the year.

Question 3

Andy Sinclair, Bank of America Merrill Lynch

Three quick questions if that's okay.

Clive Bannister

Did you say three questions? Two?

Andy Sinclair

Okay, two it is. Firstly, on subordinated debt and move towards subordinated debt. I just wonder what your triggers would be for this. As you've said, yields are getting ever lower on almost a daily basis, you don't seem to have any penalties for repaying your existing debt. What's stopping you, ultimately?

Secondly, and finally now, Brexit. I can understand how theoretically it should increase the desire for people outside the UK to be getting rid of their back book portfolios. Are you actually seeing that sort of attitude change? I'm sure you're speaking to quite a number of counterparties at the moment. Are you actually seeing a material shift in their desire to get rid of these books?

Clive Bannister

Jim, why don't you take what would be the triggers for subordinated debt. Not a need to but a nice to. What do you think of that?

Jim McConville

Well oddly enough, Andy, I'm not going to give you the timing at which we expect to go into the market to raise subordinated debt. We have said for some significant time that we have been on a journey, and that has taken us from a funding strategy which was predominantly senior bank debt, to one which has moved to a more balanced funding approach. We had said, and said in March, that we will continue with that journey, so further diversification of the debt: a) to better match our cash flows; and b) to move away from senior bank debt, has always been the aim. We monitor the market on a regular basis, and as and when we feel the conditions are appropriate and the pricing is appropriate we would take action to do that. But I'm not going to give you a timescale for that, as you might expect.

Clive Bannister

Andy, your second question was have we seen a difference in either the frequency or volume of conversations in the M&A and thinking about transactions. And the second part, are they being directed towards foreign owners.

We look at this market and see £300bn plus of closed life and heritage books across the UK. There are three big owners of those books.

The first are UK life companies themselves, the second are UK financial institutions including banks, and then of course foreign insurers. It is clearly front and central in our mind, AXA looked at the redisposition or redeployment of its capital, building a GI business, but retreating from a life pensions and savings sector.

The AXA deal meets all of our criteria, so solvency will go up by £100m, leverage will come down, £250m of cash will be delivered, but more importantly it allows us to raise our dividend, the final dividend, we're still waiting pending approval of course, regulatory approval, which we expect in the fourth quarter, but that would allow us to raise it by 5% to 28 pence per share.

So specifically to answer your question, I think the same level of conversations are taking place, they come from all parts in the compass, but what is absolutely noted is that in the annual planning rounds of last September and October in many firms they had not anticipated either the very significant decrease in interest rates, nor had they anticipated the decline in Sterling. So I'm absolutely confident and certain that this year's planning round will force incumbent managements to explain how they will get positive yields on the capital employed, and as a part of that, we expect consolidation in the industry and conversations to continue with Phoenix.

Question 4

Eamonn Flanagan, Shore Capital

Thanks Clive. It's Eamonn Flanagan at Shore Capital. A couple of questions if I may. With regard to the Part VII transfer you've referred to a couple of times, Clive, could you just explain exactly what's been planned and the implications of that in terms of the benefits?

Secondly, I was intrigued to see you've got no free surplus left within Phoenix Life, what if any are the implications of that?

And if I can, just a third question, it was suggested that we were going to have another metric to replace the embedded value, I was just wondering if Jim's made any progress on that?

Clive Bannister

Well Jim, there we are, it's exam day for you too. We'll mark him on GCSE results on the new metric. Andy, would you take forward, so Part VIIs, we've done many of them in our lifetime, the timeframe, the quantum and how we think about it. Management actions, always lumpy, we said that our management actions were going to be back ended towards this year, but Andy?

Andy Moss

Yes, so effectively a Part VII is we are transferring some of the annuities in our with profit portfolios to Guardian, so we reassured that book of business to Guardian about two years or so ago, and effectively are completing that via a Part VII. Effectively it gives us some benefits in terms of reserve releases and some small capital releases. And the direction here is in mid-September, so this is one of the management actions we always had planned for the second half of the year, and that should come through before the year end, but the first court hearing is in September.

Clive Bannister

Thank you, Andy. Jim, we were asked about no free surplus in life capital.

Jim McConville

Yes. So the movements in the life company free surplus really mirror the overall movements in the Solvency II free surplus, so the free surplus we were talking about when we talk about the Life company is the surplus over and above the capital management policies that the Life company holds. So they started the year with £0.1 billion of surplus, that improved as a result of surplus emerging and management actions, but reduced as a result of the economic impacts, largely the movement in yields and the strengthening for persistency movements that I spoke of earlier which reduced that surplus down to zero at the half year.

In the second half of the year we do expect the surplus to increase largely as a result of further surplus emerging and the completion of the management actions which Andy has partly referred to. So it goes back up again as a result of that and will source the cash flow that will emerge in the second half.

Clive Bannister

And then the new metric?

Jim McConville

The new metric, so we spoke long in the Investor Day about this, and really what we explained at that point was we intend to show the detailed movements in the Solvency II surplus position with the waterfall and I think we've made an attempt at that this half year. In many ways we see own funds as a sort of a proxy measure for embedded value and we'll monitor the disclosures that everyone else has made at the half year and continue to see in the second half of the year how we can continue to improve our transparency and disclosure that will give you a better idea of all the moving parts. So there is no magic answer as you might expect.

<u>Question 5</u>

Fulin Liang, Morgan Stanley

Just one quick question please. Given the interest rate drop significantly in the first half could you give an update or colour on your pension scheme funding status please?

Clive Bannister

Jim?

Jim McConville

Okay. So both our funds are in a surplus position on an IAS 19 basis, and that surplus position has improved in the first half of the year; so the movement in the assets has more than exceeded the movements in the liabilities as a result of the impact of low interest rates. We are in the process of completing the triannual valuations for both our main schemes, one has been completed and has resulted in no change to our contribution level; and the second is shortly to be completed and our expectation is that there will again be no change in the contribution levels that we've seen.

<u>Question 6</u>

Trevor Moss, Berenberg Bank

Hi, it's Trevor Moss from Berenberg. I think one observation I would make is that whether it be life insurance companies or whether it be pension funds there's a lot more slicing and dicing of their portfolios going on than ever before, and I think historically when we've thought about back book consolidators like yourself, Resolution in the past, we've thought of single big transactions integrated followed by single big transactions. It appears to me that we're in a process now of companies thinking of slicing and dicing up their portfolios a lot more than ever before, rather than trying to get rid of them in one big go. Would you agree that that is conceptually true and that is what you're seeing on the ground with people talking to you about lots of different types of transactions which involve slicing little bits of their book?

If you were to move into a situation now where you're seeing multiple transactions potentially occurring does that present you with any sort of more complicating factors in terms of managing funding, managing debt, managing sub-debt issues, equity raising and so forth? So is this a trend that you see and does it present you with any greater opportunities or greater problems?

Clive Bannister

Well Trevor it's a very astute observation, it's exactly right. So somebody says well we feel comfortable with our unit linked but we're not comfortable with With Profits; or we are comfortable with those and pensions but there's something to do with annuities because of the shape, because of the capital intensity and because of the management capability. We have always said that size is the wrong criteria, it is the least important of the factors that we look at when we're considering a transaction, we are comfortable across the full product range because we have them, we administer them already, and we're comfortable at large transactions, as you know summer two years ago with the Guardian transaction and we're delighted with the transactions, £375m which we described as important with AXA.

Why? The criteria are UK closed life, something that is accretive to our shareholders, so on an own funds basis, something that absolutely protects, if not enhances our investment grade rating, and very much so is positive and supportive of our dividend strategy. So for bits of books, parts of businesses, whole businesses, all of the above, and we are seeing people think very hard which goes back to my earlier comment that managers are being asked to justify the returns they're getting from deployed capital, and the returns against different books of business are clearly different by definition.

So then your second part of your question is well what happens if you have the luxury of opportunities, does that then put other strains on you? The AXA transaction was a Class 2 transaction, i.e. the total consideration was less than a quarter of our market capitalisation, so we don't think it puts us offside from considering further transactions. We have, and it's just there are three constraints, one of which is management bandwidth, do we have enough human beings to pull on more oars? The second constraint is can Jim find the money down the back of the sofa? And the third one is our regulator. In anything that is of any significance there is a change of control process.

So let me take those in sequence.

We have no bandwidth considerations at the moment, nor in the foreseeable future, either at Phoenix Life or in Group; that's what we're designed as, the UK's largest consolidator. More of the same please, and it's a luxurious problem I look forward to dealing with.

The second one is financing, I think on the debt side the investment grade, the wide support of our syndicate of banks and the equity markets, well we're one of a few companies to have done a share placing at a premium that we did at the end of May, so we think we have a wide measure of support because put crudely, buy or die, buy in a disciplined way, the way we get growth is not by writing new business it's by acquiring companies and we have equity support to do just that through our long-only owners.

And then we get to our regulator, our regulators are immensely busy, you can look at the agenda at the FCA and you can look at the agenda with the PRA, but they are enormously supportive. The change of control process is a 60 day from receipt, 60 working days, and that is why we can speak with a degree of confidence about getting regulatory approval in the fourth quarter for AXA.

So it's not easier if you have lots of things going on, as I said, it's a luxurious problem that we look forward to dealing with.

Concluding Comments: Clive Bannister

Well that brings to the end this formal session. I think like with the rest of the industry we're confronted by low interest rates. We are very proud that the resilience we advertised at the end of the full year last year is exactly what has transpired. This first half has been about three things, the delivery of cash, showing a resilience in solvency and the advancement of the AXA transaction, steady as it goes. Thank you very much indeed. And if any of your 16 year old sons are getting their GCSE results then you'll know where the focus is for later on this afternoon.

Thank you very much for your support.