Phoenix Group

Investor Day

14 June 2017

Introduction

Clive Bannister

Group Chief Executive

I. Welcome

In a slightly perspiring mood, I walked quickly from our offices to arrive at this fine building: the old Port of London Authority, built in the 1920s. Look at the room; look at the names above the escutcheons. Anyway, I saw a red carpet, and I thought, 'Finally somebody has recognised Phoenix.' Far more importantly, they had recognised me. I was just about to put my right foot on the staircase, and the man said, 'Please do not. Kindly come round the side.' That is how the real world works. The red carpet was laid out for the Chinese owner. Is that not a reflection? The largest port in the world pre-1950 here ran out of this building, and is now owned by friends from China.

Anyway, you are very welcome to our Investor Day. It is quite a straightforward day. We are going to talk about four big things. The first thing is we are going to talk about the quality and speed and progress we have made on integration. Andy is going to do that, and then my colleague Susan is going to talk about our customers. They are our raison d'être; that is what really matters to us. It is important because it is the right thing to do, but also it is important that in the eyes of vendors and the FCA we convince people that we are doing the right thing for our policyholders. My colleague Rakesh is going to talk about the Solvency and Financial Condition Report (SFCR) and explain the maths, which we think is uneventful, and we are being as clear and as thorough as we can be to the marketplace. Finally, my colleague Simon is going to talk about the evolution – as we see it – in the annuities space, what we do in that space today and looking forward a bit.

II. Position and Strategy

I start with this statement: there is a £300 billion requirement within the UK life industry for a separate closed life industry focused on the requirements of policyholders who hold legacy products that are no longer actively marketed, namely a Heritage life business. Phoenix's strategy is built on six key areas, which we call the six Ss:

- Having a scalable platform capable of managing any type of product;
- A sustainable balance sheet;
- A specialist operating model designed for closed funds;
- Delivering value for our customers as stewards of their savings;
- Employees with distinctive skillsets required to deliver management actions;
- Significant growth opportunities – which I will talk about later – through future acquisitions.

I do not want to take up any more time. I want to hand over to Andy, who will talk about our Group's ability in integration, and the progress we have made to date.

Industrialising the Integration Process

Andy Moss

Chief Executive, Phoenix Life

I. Target Operating Model

Thank you, Clive, and good morning everyone. Phoenix Group's operating model is now well-embedded and provides a solid basis for the integration of acquisitions. We believe an effective closed fund operating model needs three key pillars:

- Firstly, having a customer services and IT platform that is scalable and sustainable through the use of outsource partners;
- Secondly, having a retained skillset of financial management and transformation capability that allows continued simplification and value creation through management actions;
- Thirdly, having a strong investment management capability with the appropriate level of oversight in order to maximise investment returns for customers and shareholders.

Across these three pillars is a requirement for a stronger governance structure to ensure that contractual agreements with the outsource partners are supportive of the target operating model, and one that is aligned architecturally to futureproof investments and to simplify processes. Taken together, this provides a truly scalable platform both upwards and downwards for a runoff business, and one that fully supports acquisitions.

It is sometimes assumed that any acquisition needs to be fully integrated before the Group can consider further transactions. However, the key issue is actually at what point the business has been stabilised and is being run as part of the overall group. We therefore see the process being in three stages.

II. Integration Process

1. Connect

The first is connecting the acquired business with Phoenix. The key focus at this stage is on stabilisation and ensuring that the Group's governance structure and risk management framework is in place. It is essential to ensure that the customer services operations are stable by ring fencing the policy administration. This ensures that there is minimal impact from the customer's point of view in how they interact with the business on a day-to-day basis. This will include ensuring that any transitional service agreements are working smoothly.

The focus on common corporate functions such as Finance and Risk is on connecting into the overall governance structure and rolling out the risk management framework. Also in the first 100 days, clear communications are made with staff to set out the direction of travel around the operating model. People expect change, and setting out the direction early avoids extended uncertainty for all.

2. Integrate

The 'integrate' stage can take between six and 12 months. This means applying the Phoenix Way to all of our operations, and operating with a common approach and management. The governance and oversight process is essential to plan and execute a complex integration. There needs to be a balance between speed, ensuring adequate controls, and avoiding a negative impact on our business as usual operations. The speed of integration for each area will depend on the amount of change needed.

3. Merge

Finally, we will look to fully merge the business. Ultimately this means moving retained roles to our main office in Wythall and operating on Phoenix systems. This final stage can be delivered over an extended period of time, and it is not necessary to complete all stages before we seek further acquisitions. As I will explain shortly, the acquisitions we have made have already been stabilised, and we are well on our way to delivering the integration stage.

III. Challenges and Risks

Before I talk about some of the specific actions we have taken with the acquisitions, it is important to set out the different challenges we have faced with each of the businesses we have acquired. AXA is more complex from an operational perspective, as the UK business had been sold in three separate parts. The Embassy and SunLife businesses are based in different locations, and there are a large number of transitional services agreements as we transition the business across to Phoenix's platforms. Given that the Embassy business runs its policy administration in-house there are also significantly more staff than with Abbey Life. We have also had to close certain Embassy products to new business while SunLife has been reorganised as a standalone distribution unit based in Bristol.

Abbey Life, despite being a larger transaction than AXA was already run as a separate business with an existing outsource agreement in place. Therefore there is less complexity from the perspective of transitioning the business; however, it was important to move rapidly in putting in place Phoenix's governance and management team, given the ongoing FCA enforcement action.

IV. Integration Plans and Status

1. Outline

We are able to run both integration programs in parallel. Our outsource partners are leading on the customer services work in line with previous migrations whereas our team in Wythall are focused on the detailed financial and risk management consolidation. The AXA integration will be completed by the beginning of next year. The Abbey Life integration is on course for completion by June 2018 with the next material step being the application for the Internal Model.

2. AXA Wealth

a. Overview

Moving on to the AXA integration; progress is ahead of plan and the business has been stabilised with governance and risk management oversight in place. The TSAs are operating to support business as usual processes, and these will be terminated as we move towards the final target operating model. I will talk in more detail shortly about the work we are undertaking with regard to policy administration where we are leveraging our previous experience in migrating policies to Diligenta. We have also made progress on integrating the finance and actuarial reporting processes.

An important milestone was achieved in March when the AXA business was incorporated within the Group's Solvency II Internal Model, allowing us to deliver further capital synergies from the diversification of AXA's mortality risk with the existing longevity risk. Finally, we are taking steps to rebrand the business as Phoenix Wealth Assurance, and will, over time, move the retained functions to our main office in Wythall. This will involve creating around 20 additional roles in

Wythall to ensure the necessary activity is resourced. We will complete the migration work by the end of the year, with the following few months for stability and warranty periods.

b. Outsource Model and Cost Synergies

A key part of the Phoenix operating model is the use of our outsource partners to undertake policy administration. By moving the cost of administration to a per-policy charging basis, Phoenix can deliver a variable cost base over the lifetime of the book. In addition, the contracts allow us to move further policies to our outsourcers on the same terms, delivering cost synergies and also allowing us to utilise the outsourcer's transformation experience. The Embassy pensions book of AXA was administered in-house, and this exposes the group to regulatory change costs and to managing a fixed cost base in a runoff business.

A key part of our integration process is moving this across to a fully outsourced model, delivering a variable cost base, transferring the risk of future regulatory change costs and leveraging the IT investment made by our partners. This will involve expanding our existing relationship with Diligenta, who will take on the current staff together with the Basingstoke office. In addition, we have an agreement with FNZ, who will act as the specialist SIPP provider for the AXA business.

Phoenix will continue to be responsible for the quality of customer service, and therefore maintains close oversight of the outsourcers and the customer services provided. We have also set up a dedicated unit to service IFAs, recognising the nature of the Embassy book and the IFA services required. Our initial expectations of cost synergies were approximately £10 million, but we now expect to deliver between £13 million and £15 million per annum of savings.

c. Capital Synergies from AXA Wealth

There have also been significant capital synergies from the integration of AXA, and this slide sets out the three separate steps involved in delivering these benefits. On day one following the completion of the acquisition in November, the Group reassured the risks of AXA Wealth into Phoenix Life Limited; one of our existing life companies. The resultant change in the risk profile of Phoenix Life Limited permitted a recalculation of transitional benefits for that entity including the new liabilities from AXA. The net impact of the release of cash from AXA offset by the additional capital required within Phoenix Life Limited was net cash generation of £117 million.

The second step was achieving regulatory approval to incorporate AXA within the Group's Internal Model. This allowed access to the benefits of the diversification that the transaction offered between mortality and longevity risks by calculating the overall requirements to the business under the Internal Model. The subsequent release of an additional £165 million of cash achieved the Group's target of releasing £250 million within six months of the completion of the acquisition.

The final step of a formal Part VII merger of the life companies is now underway. This involves the legal transfer of their policies to Phoenix Life Limited replacing the reassurance agreement. We hope to complete this by the end of 2017 and expect a further benefit of around £20 million at that time. These three steps show the rapid progress that the Group can make in extracting capital efficiencies from acquisitions, and are built on a long track record of executing similar measures within the Group in the past.

3. AXA SunLife

As well as the Embassy pensions business, the AXA acquisition included the SunLife business. SunLife writes protection business for the over-50s market, and we are supportive of the business and its management team. At the full-year results I spoke about the benefits of writing protection business alongside our existing vesting annuities, as these have a complementary risk profile and provide additional value to the Group. We have therefore restructured the SunLife business as a distribution company with the mortality risk being underwritten by Phoenix Life. This allows the ring fenced management team based in Bristol to focus on their key skillsets of direct marketing and customer management.

The split of the distribution and manufacturing roles provides clear definition of responsibilities within an overall governance framework, with SunLife receiving commission from Phoenix Life, which is responsible for pricing and underwriting the mortality risk. SunLife now represents a positive adjunct for our business, providing options to our ageing policyholder base and providing a complementary risk profile. With its strong and focused management team, it does not distract from our core closed life focus.

4. Abbey Life

a. Overview

Moving on to the Abbey Life transaction, which completed on the last day of 2016; the operating model of Abbey Life was already closely aligned to Phoenix's target operating model, and this makes the operational integration less complex than AXA. The key focus so far has been to ensure that governance and management has been put in place quickly, ensuring that oversight of the business and its outsource arrangements are enhanced. The existing outsource relationship with Capita has been retained, and ways to improve the policy administration service have been identified.

Now that the AXA Internal Model application has been approved, we are now focusing on the Abbey Life application. This is expected to be submitted in the second half of the year. Once the Internal Model approval has been granted – most likely during 2018 – we will look to undertake a Part VII transfer of Abbey Life into Phoenix Life Limited.

Finally, Abbey Life had far fewer employees than AXA, with only around 45 people based in Bournemouth. The activities undertaken within the Bournemouth office will also be moved to Wythall as part of the 20 new roles that I referred to earlier. Therefore, although the Abbey Life business started with a very different model to AXA, the end state of the integration will look very similar.

b. Management Actions Planned to Generate Capital Synergies

Although Abbey Life does not offer the same level of immediate risk diversification as the AXA business there are a number of management actions planned over the coming years to generate capital synergies from the acquisition. As I have already mentioned, the application to move Abbey Life onto the Internal Model will be submitted in the second half of the year. As with AXA, this will allow transitional benefits to be accessed through reinsurance of the Abbey Life Business into Phoenix Life Limited.

We will also be looking to extract further efficiencies from the annuity portfolio this year by extending the matching adjustment benefits to all qualifying annuity liabilities. The use of matching adjustment results in the use of a higher discount rate for those annuity liabilities, increasing capital surpluses within the life company. Further, matching adjustment benefits can be accessed in 2018 following the reinsurance into Phoenix Life Limited.

Finally, we will look to apply the Group's hedging and asset allocation strategy to the Abbey Life business. Some equity hedging has already been undertaken for the Abbey Life unit linked business, which reduces the impact of equity market falls on solvency and therefore enhances the capital efficiency of the business. Phoenix will also allocate a greater proportion of assets back in annuities to higher yield liquid assets. This increases return whilst offering greater diversification of asset risk and is in line with the progress the Group has made on its own asset portfolio. It can be seen that these management actions will complete over the coming three years and support the expected cash generation targets we have set ourselves out to 2020.

c. Indemnity Protection

As you are aware, the acquired Abbey Life business participated in both the legacy review and the annuity sales review which were initiated by the FCA. Following the publication of the legacy review, Abbey Life received specific feedback on the actions the FCA expected Abbey Life to take to address the issues. In addition, Abbey Life was referred to the FCA Enforcement division to consider whether any of the issues identified in the thematic review warranted further intervention from the FCA. This investigation is ongoing. Abbey Life was unable to complete their review of annuities sales in the same timeframe as other providers. This work has now been completed, and we are working with the FCA to understand the outcomes of the review, and the scope of any further activity.

As part of the transaction, the Group obtained indemnity protection against fines and costs of any action related to the legacy or annuity reviews. Risk sharing was also put in place for potential redress costs. The FCA investigations are still ongoing but, to date, expectations of any residual cost to Phoenix remain in line with our original views.

V. Key Metrics

On this slide I summarise the key metrics that we should be judged upon with regard to the integration of these acquisitions. We have made a strong start by delivering £282 million of cash from AXA, and we now expect cost synergies in the range of £13 million to £15 million per annum, up from the previous expectations of £10 million per annum. We are also consolidating the financial and actuarial systems, and basing the core life company functions in our main office in Wythall. Finally, the indemnity agreed with Deutsche Bank provides protection against outcomes from the ongoing investigation into Abbey Life. We will update you again on progress at our half-year results in August.

VI. Conclusion

In conclusion, Phoenix has a clear target operating model for the AXA and Abbey Life acquisition, ensuring that integration is undertaken quickly. How these integration principles are applied will depend on the required operating models, but the end state will always be the same. The key advantage of the operating model is the rapid delivery of capital and cost synergies, ensuring that Phoenix can deliver value from serial acquisitions as the closed life market in the UK consolidates. The progress already achieved in the first half of this year is evidence of the success of this strategy. However, we firmly believe in continuously improving our processes and procedures, and there have undoubtedly been learning points for us over the last few months. We believe that enhancing our process based on these points will further improve the effectiveness of our integration approach.

I will now pass you across to Susan to talk about our customer model in a bit more detail.

Improving the Customer Journey

Susan McInnes

Customer Director, Phoenix Life

I. Introduction

Thank you, Andy, and good morning everybody. I am Susan McInnes, Customer Director at Phoenix Life. Following last year's acquisitions, Phoenix now has over 6 million policyholders split between with-profit, unit linked and non-profit products. There are several hundred historic brands within the group, the most recognisable being Pearl, Britannic, Sun Alliance and National Provident. All of these are now managed using a consistent methodology.

On this slide I have also set out the range of products that we currently manage for those policyholders. We also have a wide range of different customers, both from a net worth perspective and also in terms of financial requirements, and we believe that we have a key role in assisting our policyholders in understanding their products and their future potential financial options.

The Group has built experience with all types of legacy products, providing a critical advantage in understanding potential challenges from acquiring other closed funds both from a customer and from a conduct perspective. The AXA and Abbey Life books just bring us more of the same types of products and services, and this is something for which we have tried and tested processes to deliver better outcomes for customers. A key element of this year's and next year's strategy will be about doing the same for AXA and Abbey Life customers.

II. Conduct Regulation

1. Overview

Conduct regulation for life insurers has increased significantly in recent years with two major FCA reviews being undertaken. Two further areas have seen government intervention on charges, where in their view the existing position was not providing adequate flexibility or value for customers.

2. FCA Legacy Review

First, the FCA legacy review, which was originally announced in March 2014, involved detailed review of products, analysis of customer treatment, and the scrutiny of the efficiency and quality of customer communications. A number of UK life companies have been identified as having to undertake further investigation in their customer service models as a result.

3. Pensions Freedoms

Following that came pensions freedoms, which were introduced in 2015, and as I am sure you will all remember, the pension freedoms ended compulsory annuitisation and allowed over-55s to access their pension pots. One impact of that was to highlight the impact of exit charges for certain customers, and that ultimately led to further government action to cap exit charges at 1% of pension pots for those over 55 accessing freedoms.

4. FCA Annuity Sales Review

The FCA annuity sales review was completed in 2016 and focused on communications with customers at the date of retirement. One particular focus of the review was the extent to which customers were informed of their options with regard to buying an annuity including possible eligibility for an enhanced annuity and the ability to shop around for a better quote. Again, a number of UK life companies have had to undertake further business reviews which may lead to additional customer rectification costs.

5. Workplace Pensions

Finally, there has also been Government legislation on workplace pensions. Independent Governance Committees are in place to review the treatment of customers within workplace pension schemes, and there have been additional government intervention on management charges, capping annual charges to 1% per year.

III. Operational and Financial Impacts of Conduct Regulation

1. Overview

There is clear regulatory pressure on the UK life industry to ensure that our customers are engaged with their policies and are informed of their available options in relation to the products. From a Phoenix perspective, we feel that regulatory reviews are closely aligned to the Phoenix Way and our objective of seeking to continuously improve customer outcomes. This slide sets out in more detail how each of these reviews has specifically impacted Phoenix. There have been both operational and financial impacts on Phoenix that have arisen from the changes to the conduct regulation I talked about.

2. FCA Legacy Review

As part of their final guidance from the legacy review the Regulator as clearly set out their expectations regarding customer communications, how firms keep in touch with gone away customers and how reviews of legacy products are carried out.

In Phoenix we have a business as usual programme of activity covering all of these areas, and it is pleasing to see that the Regulator’s focus is absolutely in line with our strategy of optimising customer outcomes. That is a key part of the Phoenix Way methodology of managing closed funds. The cost of these activities is part of our BAU maintenance cost, and we are now widening our work to incorporate the recent acquisitions.

3. Pensions Freedoms

The main impact in terms of pensions freedoms has been a sharp increase in customers fully encashing their pension pots rather than buying an annuity. We currently observe that about 56% of pots in cash at retirement and those that do take an annuity often have attractive guaranteed returns that are above the current rates available on the market. Although this is a big percentage in terms of policies, the large majorities are pots with a value of under £30,000. I will talk more about encashment on the following slides.

In relation to the cap of 1% on early exit charges that came into place in March of this year, the overall financial impact is £26 million including the Abbey Life businesses. That had already been reflected in the free surplus position of our life companies in the 2016 results. Therefore, the financial impact of exit charges has been relatively low and the key driver for that has been the fact that over 80% of our unitised pension pots had no exit charge in place. Our view has always been that exit charges do not act as a barrier to customers accessing their money early, and while it is early days it is also worth stating that we have seen no evidence to date that the exit charge has led to a change in policyholder behaviour in relation to the products.

4. FCA Annuity Sales Review

The FCA annuity sales review is also now complete, and there were no changes needed to the way Phoenix looks after its customers. However, we are never complacent in this area, and in an effort to ensure customers fully understand the implications of buying an annuity we have initiated a new programme to allow customers to access alternative quotes from a panel of third party annuity providers. This is evidence of how Phoenix ensures that customers have access to alternative products before making a final decision on their retirement.

5. Workplace Pensions

Finally, workplace pensions constitute a small part of our business with just over 100,000 policyholders within the Group's life companies. The Group's Independent Governance Committee has recently published its second annual report, and given the unique set of circumstances surrounding this group of customers, the Group's life company boards have agreed that annual fees on workplace pension products will be reduced to 1% at the end of 2017. The financial impact on the Group of this management fee reduction is around £25 million, and again that includes Abbey Life.

Therefore, in summary, Phoenix has not been immune to the financial impacts of the recent regulatory and legislative changes. However, the work undertaken by Phoenix to develop a robust customer model over the past years has meant that the Group has avoided any material negative outcomes for our shareholders.

IV. Early Encashment of Non-GAR Pension Pots

Across Phoenix as a Group, the average pension pot at retirement is about £26,000. The pensions freedoms have led to an increase in early encashment of smaller non-guaranteed annuity rate pension pots, but we can see that the customers still value their guarantees and are annuitising where the value warrants this.

The chart on this slide provides more detail on the relationship between pension pot size and likelihood of encashing together with how having annuity rate guarantees does influence behaviour. Whether it is a guaranteed annuity rate or a non-guaranteed annuity rate, customers with pots below £30,000 are more inclined to encash upon retirement, with those policyholders that do encash having an average pot size of around £12,000. However, we do continue to see that annuities remain more popular for larger pots, especially where there are guaranteed annuity rates.

The average pot that does annuitise is about £50,000, and that is more than four times larger than those that are being taken as cash. By value, only 7% of non-GAR policies annuitise either with us or with another provider, and that compares to 41% for those pots that do have guarantees. At the same time, we are also observing the beginning of an increase in customer awareness of the need to shop around and investigate options available to them.

In terms of persistency, we have seen policyholders taking advantage of pensions freedoms to access their pots early, but again these are for smaller pots. Overall, however, consistency on the pensions book is broadly unchanged as we have seen other policyholders push back their retirement dates.

With regard to the use of Pension Wise, although statistics suggest that over 40% of customers use this service, we remain sceptical about the accuracy of that figure. From what we experience in our day-to-day contact with our customers, retirement remains a difficult subject for many customers, and they still show a clear desire to be guided through the process. This does move the burden onto the life company to explain retirement options. That increases the time taken talking with customers and heightens conduct risk.

V. Customer Strategy for Phoenix Life for 2017

1. Overview

Our broad strategy for Phoenix Life remains unchanged with our focus being on improving outcomes for customers, including bringing the new AXA and Abbey Life customers into the Phoenix Way and ensuring that they benefit from both past and present customer initiatives. Change in customer behaviour results in both risks and opportunities for Phoenix, and therefore I want to use the rest of this presentation to talk through our plans for the future.

2. The Three Cs

Improving customer engagement with their products remains key to us, hence our continued investment in types and content of communication. Over 2016 and 2017, we have set aside a limited investment of between £5 million and £10 million to use digitisation to deal with what we refer to as the three Cs.

- Customers: our customers are not only keen to interact with us digitally, but they are looking for us to make processes – particularly around retirement – simpler for them.
- Conduct risk: I talked earlier about the rectification work needed by some firms who may either have not done enough to signpost shopping around, or potentially could not evidence what they had done. Customer processes have become significantly more risky, particularly given the fine line between providing guidance rather than advice. When looking at it retrospectively, this can be very costly.
- Costs: while there is no doubt that this increasing concern around how companies ensure conduct risk is appropriately managed has the ability to add cost to both written and verbal processes in the future, on a small scale we have seen call times increase in a desire to spend more time with customers as part of retirement processes. We expect that to grow in the future as that lens is applied to other processes, and therefore an investment now in digitisation will allow us to protect ourselves and our partners from any potential impact.

These three issues pose a dilemma for insurers. On the one hand, customers need dedicated assistance with their pension products, but on the other hand life companies face heightened conduct risk and potentially increasing processing times.

As an example of that, we see around 4,500 of our customers take retirement benefits every month. Most of our customers call us in advance to request information on their policies, and following that first phone call all customers receive a wakeup pack setting out their options. These packs are often around 40 pages long, and given the range of options available customers will typically call us again for a longer, more detailed conversation. That call can often take up to 40 minutes. As I discussed in an earlier slide, 56% of these customers then end up fully encashing anyway as they have probably just got a small pot.

3. Digitisation

Digitising the customer journey would not only produce a much better customer experience, but also considerably reduce conduct risk which could arise if those call centre staff go off script and could be construed as providing advice to customers. We have illustrated here our digital vision, which seeks to improve and personalise the customer journey while focusing on improving data and insight, helping customers and guiding them at retirement and providing richer information to help them with their decision-making. Our research shows us that customers can feel intimidated talking to life companies on subjects that they do not fully understand, whereas they are happy to go online in their own homes and source the information that helps with their decision-making themselves.

We have already started testing the potential of our digital vision by offering online encashment for smaller pension pots. Currently we see about 1,300 customers with pension pots under £10,000 encash each month. These are non-GAR customers, and the majority access their smaller pots before their selected retirement date.

In order to service the customers we have made our website more interactive with information videos, retirement calculators and other tools. From a standing start with no advertising undertaken, we have seen an excellent response from our customers. Our current experience is that about 38% of customers with a pot worth less than £10,000 have transacted online, which constitutes about 11% of our total retirement transactions. In addition, you can see from the screenshot on this slide that the online encashment also offers a link to just retirement solutions for customers who might require more bespoke solutions such as drawdown products or enhanced annuities.

Considering this positive response, our natural next step is to create more digital journeys with the aim of eventually allowing customers to see all of their Phoenix products together on one page. This new dashboard will enable customers to transact online, to access detailed information to support their decision-making and to learn about products that might meet their requirements. Along with an investment in enhancing our web offering, we have also joined the ABI's Pensions Dashboard initiative, which we believe will help both existing and new customers in keeping track of their policies and to be better prepared for their retirement. As in everything we do in relation to the treatment of our customers, our thinking behind this is doing the right thing for the customer can never be the wrong thing to do.

VI. Conclusion

To summarise, although regulatory and legislative agendas remain challenging and fast-paced, the changes arising from these are very much aligned to our own objectives of delivering enhanced benefit for our customers. A key challenge for the industry is how to get customers to engage with their products, and we believe that initiatives such as improved communications and the Pensions Dashboard help us with that aim. Our investment in digital is relatively modest, as we test and learn what gives us and our customers benefit. The early feedback from our work has certainly been very encouraging. We look forward to further collaborating with our customers and the Regulator on advancing our digital vision to improve customer outcomes while controlling cost and conduct risk.

Thank you. I would now like to hand over to Rakesh, who will be talking about the recent SFCR disclosures.

Solvency II – 2016 SFCR

Rakesh Thakrar

Deputy Group Finance Director

I. Phoenix's Solvency II Capital Position

Thank you, Susan, and good morning, everyone. I want to start with a recap on Phoenix's capital position. At 31 December 2016, the Phoenix Life Holdings Limited Solvency II surplus is slightly higher than the estimated position we reported in March at £2 billion with a shareholder capital coverage ratio of 171% on a pro forma basis. As a closed fund, Phoenix writes a limited amount of new business, and this provides us with a greater level of understanding of the risks within the business as the policies run off over time.

Although Solvency II ratios are a focus of many in the industry, the large and strong with-profit funds within Phoenix make our headline coverage ratio less relevant as a comparator to our peers. We have therefore always focused on the absolute quantum of surplus within the Group, and more importantly the resilience of the level of surplus to changes in markets or demographics.

Indeed, the hedging strategy of Phoenix is focused on protecting the level of Solvency II surplus from market shocks, as this helps protect the level of cash generation from the regulated life companies as well as maintaining our capital position. Going forward, the Group will manage its capital position at the Phoenix Group Holdings (PGH) level with the onshoring process well underway. The recent tap of the Tier 3 bond in May has further strengthened the PGH capital position.

This 2016 pro forma Solvency II position assumes a dynamic recalculation of transitionals as at 31 December 2016 as well as the impact of the January Tier 3 bond issue and the approval of the AXA Wealth businesses into the Group's Internal Model that we received in March. Abbey Life's position is calculated on a standard formula basis at full year 2016, but we are aiming to make an application in the second half of this year to bring the Abbey Life business onto the Group's Internal Model.

The surplus within the Group's strong with-profit funds, together with the surplus in relation to the PGL Pension Scheme, are not included within the overall £2 billion surplus. Our shareholder capital calculation therefore excludes the related own funds and the SCR of the strong with-profit funds and PGL Pension Scheme. This provides a clearer view of shareholder position, and is similar to the approach taken by many of our peers.

II. SFCR Requirements and Basis of Position

We have published our Group SFCR this morning, calculated at the level of Phoenix Life Holdings Limited. However, the basis of preparation of the Phoenix Life Holdings Limited (PLHL) SFCR is different from the pro forma calculation. First, there is no allowance for the pro forma adjustments of the Tier 3 bond issue and the AXA Internal Model approval. In addition, there was no formal approval from the PRA of a recalculation of transitional benefits at 31 December 2016. Hence, this impact is not included in the SFCR Regulatory position. Subsequent approval for Phoenix Life Limited has now been received.

Although the SFCR is currently calculated at the PLHL level, once the waiver expires in June, the future focus will be on the position of the Group's TopCo, Phoenix Group Holdings, as we look to bring the Group onshore. I will return to this point later in the presentation.

III. Effects of Pro Forma Adjustments

This table shows the position both before and after the pro forma adjustments. Although the Solvency II surplus and the overall regulatory coverage ratio is broadly similar on both basis, the benefit of the Tier 3 bond and the AXA Internal Model approval is offset by the dynamic recalculation of transitionals at 31 December 2016.

IV. Reconciliation of Pro Forma Shareholder Capital and Regulatory Positions

This table shows the reconciliation of the pro forma shareholder capital and regulatory positions as at the end of 2016. There is also an additional surplus of around £0.4 billion within the strong with-profit funds and PGL Pension Scheme. This surplus provides additional resilience to the Group, but is not formally recognised within the Solvency II surplus of £2 billion. The shareholder capital basis excludes the SCR and the equivalent level of own funds of these strong with-profit funds and the PGL Pension Scheme. This provides a more comparable coverage ratio of 171% at the year end.

V. Impact of Transitional Measures for Technical Provisions

In line with many of our UK peers, Phoenix has a received approval to apply transitional measures to smooth the introduction of Solvency II, including the impact of the new explicit risk margin. Excluding these transitional benefits, the overall coverage ratio would decline to 93%. As we stated at the full-year results, transitional benefits are Tier 1 capital, which can be used to pay dividends and will amortise over a 16-year period.

The risk margin will also run off over the duration of the liabilities. As the risk margin will run off slightly slower than the transitionals, there is a small headwind of around £50 million per year. This impact is already incorporated within our public cashflow targets.

Due to the dynamic recalculation of transitionals and the runoff of both the risk margin and transitionals, the impact of changes in interest rates on this level of annual headwind should be minimal.

VI. Impact of Matching Adjustment

Similarly, Phoenix also has approval for the use of matching adjustment, which is permanent and non-amortising. The concept of matching adjustment is similar, but a more conservative application of the old Solvency I regime, which used a liquidity premium together with a provision for defaults. Excluding the matching adjustment would lead to an overall coverage ratio of 104%.

VII. Onshoring Process and Tier 3 Bond

The work to bring Phoenix Group Holdings onshore continues to progress. At 30 June 2017, the Solvency II position will be calculated at both the ultimate holding company level – currently Phoenix Group Holdings – and the level of Phoenix Life Holdings Limited. The main difference between the two calculations is the recognition of the Group's current senior debt at Phoenix Group Holdings level. As we stated at our full-year results, any diversification from senior to subordinated debt would increase the Solvency II surplus at the PGH level. This is evidenced by the recent tap of the Tier 3 Bond and the related tender for the senior bond that we completed last month.

We will report the Solvency II capital position at the level of PGH at half-year 2017, and are currently targeting to put in place a new UK plc TopCo during the course of next year. I will now pass you across to Simon to discuss our plans for growth in the annuity market.

Creating Value from Annuities

Simon True

Group Chief Actuary

I. Introduction

Thank you, Rakesh, and good morning, everybody. Clive has already highlighted the £300 billion of closed life fund M&A opportunities available to Phoenix. The purpose of this section is to focus on one specific segment of that target market; namely, annuity business. In particular, I am going to explain how historically we have been both a buyer and a seller of longevity risk and annuity books, to describe the management actions we have undertaken and to outline the potential sources of annuity books in the future.

II. Product Types and Critical Success Factors

As Andy and Susan have already discussed, we have developed an operational platform that has the ability to manage any type of policy. We already manage almost all of the UK life industry's products within the Group, and this is reflected in the comprehensive nature of our PRA-approved Internal Model. The skillsets required to manage with-profits, unit-linked, annuity or protection portfolios are very different. However, the Group has built the capabilities to generate synergies from all of these product types, and we benefit from the diversification of these risks across these books.

Annuities are a key focus of the Group's M&A strategy and make up a significant part of the assets within UK closed life funds. We already manage around £12 billion of annuity business and we expect this to grow over time.

III. Risk Reduction and Risk Acquisition

For those of you who have followed Phoenix for some time, you will be well-aware that we have been both a buyer and a seller of longevity risk in recent years. Historically, the Group's focus has been on releasing capital to pay down debt and reduce gearing. This has led to the significant levels of de-risking, as shown in the top-left corner of this slide. However, 2015 was an important year for the Group, as we gained an investment grade rating from Fitch and also PRA approval for our Solvency II Internal Model. The Fitch rating was external validation of the strength of our restructured balance sheet and the Internal Model gave us clarity over our future capital requirements.

These two factors gave us a strong foundation for our two acquisitions in 2016, which further expanded and diversified our balance sheet. Our annuity book grew by over £4 billion in 2016 from three sources. Firstly we wrote over £500 million of new annuities arising from the vesting policies within our own portfolio. Secondly, underpinning the Abbey Life transaction was a £2.5 billion annuity book which both strengthened and extended the Group's cashflows. Finally, one of our key management actions in 2016 was a £1 billion pension buy-in from one of our defined benefit pension schemes. This generated significant shareholder value and contributed to the achievement of our cash targets. I am now going to talk in more detail about these last two transactions.

IV. Abbey Life Acquisition

The Abbey Life Acquisition included the material annuity portfolio on which the majority of the longevity risk had already been reinsured externally, but during the pricing of this book we identified a number of additional management actions which could deliver synergies and additional shareholder value. As Andy has already described, we have put in place enhanced hedging of the market risks within this annuity portfolio to optimise the risk capital. We have also established new expense agreements between the Group's service companies and Abbey Life, which has reduced the cost to the life company of administering these policies, thereby releasing expense reserves and enhancing the capital position.

There are, however, a number of further management actions that the Group is planning to take in the coming years within this portfolio. These include extending the Group's strategic asset allocation and improving the amount of matching adjustment achieved on the portfolio. These actions will underpin the strong cashflows that we expect to generate from this annuity book.

V. Transaction with PGL Pension Scheme

In addition to the Abbey Life transaction, in 2016 we also announced a £1.2 billion buy-in of the in payment pension liabilities from one of the Group's defined benefit employee pension schemes. This management action was the first pensions buy-in completed by the group, and it transferred the longevity investment risks from the PGL Pension Scheme to Phoenix Life Limited. This transaction was the largest single pension buy-in deal executed in the market last year, and it advanced our knowledge of the operation of that bulk purchase annuity market. It was an important management action, as it delivered both Solvency II and IFRS benefits.

During the project we developed a number of new skills required for the pension buy-in market: a robust legal framework; an effective operational structure and; capital efficient longevity reinsurance, all tailored to our Internal Model calibration and our matching adjustment requirements. Importantly, we were able to tailor a solution that met the Trustee's specific needs with compelling pricing and a clear path to full buyout in 2018.

VI. Overall Market and Phoenix's Position

The closed life market remains our key focus for acquisitions and we have a proven track record in delivering value from closed funds consolidation with the associated management actions. However, the nascent bulk annuity market has the potential to be a complementary source of annuity books for Phoenix in the future.

This market has grown steadily in recent years and there is a projected demand for over £350 billion over the next 10 years as pension trustees look to transfer risks away from their sponsoring employees to the life insurance market. At the right price, this source of back books could be attractive to us, as it would meet our key M&A criteria; namely UK, closed, value accretive and supportive of both the dividend and our investment grade rating.

VII. Key Competencies of the Bulk Annuity Market

1. Asset Allocation

In order to successfully participate in this market, there are, however, key competencies required. The first is access to illiquid, high-yielding assets that can provide enhanced returns over the lifetime of the book, typically in excess of 40 years. This is an area in which the group has invested heavily in recent years, and we have developed a strategic asset allocation for our £12 billion annuity portfolio. This involves investments in corporate credit, equity release mortgages, local authority loans, commercial real estate debt and infrastructure loans.

2. Pricing Longevity Risk

The second key competency is a strong understanding of the underlying longevity risk being acquired. Using our Internal Model we have extensive experience in pricing our own vesting annuities, the recent PGL Pension Scheme buy-in, and of course the Abbey Life annuity portfolio.

3. Managing Risk

Thirdly, risk management is obviously integral to our business model and involves access to effective and competitive longevity reinsurance. We have strong and extensive relationships with the external reinsurance market as evidenced by the activity I shared earlier.

We also have a well-established asset liability management framework which proactively manages our market risks.

4. Operational Capacity

Finally, as Andy and Susan described, we have the operational platform to onboard additional assets with a robust outsourced model. We also have a strong understanding of trustee requirements given the Group's position as sponsor to three separate defined benefit pension schemes. Crucially, however, any participation in this market would only be complementary to our core closed life M&A focus and would only be executed if the pricing could be proved to be attractive.

VIII. Conclusion

In conclusion, Phoenix now has the balance sheet strength and scale to further grow its annuity book and thereby extend and strengthen the Group's future cashflows. This growth will be achieved in three potential ways.

Firstly, we will continue to write substantial volumes of annuities for vesting policyholders, and as Susan has mentioned, annuitisation of pension pots is still high, particularly where policyholders have existing guarantees.

Secondly, we will continue to look at closed life fund acquisitions, and many potential books will incorporate existing annuity portfolios, and in addition it is very likely that vendors may well sell annuity books separately in order to release capital tied up within those. Phoenix's Internal Model provides us with the ability to accurately price these portfolios, and offers clarity on the potential synergies and the future management actions that we can take.

Finally, the bulk annuity market is expected to grow rapidly over the next decade, and offers us a potential additional source of assets for Phoenix to manage. Any transaction in this market would be judged on our existing M&A criteria and would therefore need to protect both the existing dividend and the Group's investment grade rating.

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

Conclusion

Clive Bannister

Group Chief Executive

Thank you, Simon. I want to wrap up, and I want to start by saying that it has been a good first six months in 2017 for Phoenix. We are ahead of targets in terms of the integration of the two acquisitions completed last year, and therefore we are well-placed to lead further consolidation of the UK market. Of that we are confident. The impact of regulation on customer treatment has highlighted the importance of a specialist model to manage closed life funds, and we will continue to invest in this critical capability that we so clearly possess. Finally, we see a wealth of opportunities in the UK across various product groups. In addition, the recent knowledge gained in the bulk annuity market offers the ability to acquire additional assets in that sector on a very selective basis.

This should be a very familiar slide. Phoenix has a clear set of strategic priorities. The cash generation targets of £1 billion to £1.2 billion delivered this year and next over the next two years are supported by the efficient and well-managed integration of the AXA and Abbey Life businesses. Continued delivery of cash will allow an expected further 5% increase in the 2017 interim dividend as we advertised with our full-year results in March. We continue to look to diversify our debt structures away from senior debt and towards subordinated debt, supported by our investment grade credit rating. This has already been well-demonstrated by the issuance of £450 million of Tier 3 debt issued so far in 2017. This will, in turn, support the simplification of the Group's structure as we onshore Phoenix Group Holdings, creating a new plc TopCo.

As we look towards the future, we have a growing confidence that potential closed life vendors are appreciating the upside to the redeployment of trapped capital. Thus, Phoenix remains well-placed to examine further M&A opportunities that meet our stated criteria, and believe that the Group has both the platform and financing flexibility to deliver additional value from future transactions.

That, ladies and gentlemen is the end of the formal session. Thank you very much for all your engagement – that means not going to sleep. That is a low bar but we are grateful for that. Let us move on to Q&A.

Questions and Answers

Craig Bourke, Whitman Howard

I just want to focus on your bulk annuity ambitions. One of the problems that new start-ups had that came out a few years ago was getting onto the panels of the consultancies. I was wondering what you think about that and whether that is much of a barrier for you. Secondly, what is the limit to your appetite in this market? If you did crack that, it would be a highly attractive market, so I am just wondering, is it a portfolio balance question? What is your limit? What is limiting your appetite on that area?

Clive Bannister

Craig, thank you very much: a three-part question about panel and competence, about our degree of ambition in this area and where it may lead us. I will start with a spoiler alert, Craig: we are in this business already, so this is not new news. Simon has described £12 billion of exposure which increased last year by nearly £4 billion because of three different contributors; about 17% of our assets of £76 billion.

I think Simon advertised this is a complementary business, which is another way of getting what we do anyway, which is the closed life business. It is a complementary way of finding closed books of business. I think people would be surprised, Craig, if we were not doing that and looking hard, and this is for the first reason because we are already in the business. The second reason we have to look at is that vendors come to us – as we saw last year with Abbey Life – and said, 'Listen, this is a combination offering.' In Abbey Life it was £2.5 of the total £13 billion value. For us to say, 'We do not do that' when we clearly manifestly do would close our market opportunities, and we are in the business as the UK's largest closed life consolidator to welcome vendors and solve their problems for them.

I think Simon also showed this third reason why we are in this business is managing capital through the cycle. We have been a buyer and a seller. That is a smart thing to do depending on where we find ourselves, and that is capital acuity and dexterity, and we want to do more of that. Simon also advertised that it extends our cashflow profile, and in a business where we have advertised the stability and the quality of our cashflows – their longevity – this is a natural adjunct.

Finally, Simon advertised the fifth reason for looking at this is that this is a growth market and we are determined – we have a stable and sustainable dividend policy and that stability and sustainability is served by finding growth. Simon gave two caveats in his presentation. One is that it is complementary and the other was that it has to be done at the right price. Simon, going back to the panel part of the question, would you like to talk about our competencies and how we feel about panel engagement and involvement, and then I will talk about the appetite?

Simon True

Sure. Craig, you raise a good point. This is a slightly different market in that there are different sellers and we are dealing with a different set of people, but fundamentally it does not really change our M&A skillset which is around trying to price things competitively and trying to find innovative solutions. In this case it is a slightly different dynamic because you are dealing with trustees, potentially with finance directors as well, usually intermediated by employee benefit consultants.

If we want to participate in this market we are probably going to have to learn a bit of a new language and we are going to have to translate things, but ultimately it comes to being pragmatic, making sure that the risks are very well-understood by both sides about what is being transferred, and that we can make a compelling price. The compelling price will be dependent upon a whole range of factors, not least the existing mix of liabilities we have on our own book.

I think that is really a segue into your second question; what is the limit to our appetite and what will restrict us? What will restrict us will effectively be the shape of our book at any point in time. If we go down this route and decide to continue to bring in annuities to the business we are not stopping on the other M&A. We are bringing in other risks over time, and at any point in time our balance of risks will dictate how competitive we will be. It will be effectively self-regulating. If we get out of kilter with our risk profile, we will not be competitive, so therefore we will not take on risks. Crucially, we are always going to exercise that financial focus which means we are never going to overpay. We are always going to do what is right for other cashflows for this group.

Clive Bannister

Thank you very much for answering the second part of the question.

Andy Hughes, Macquarie Group

I have a couple of questions, if I could. The first one is to Susan on the dashboard. I know you said everything that is good for customers is good for Phoenix. I take it from that you are not expecting a whole bunch of people to look at the dashboard and say, ‘Oh, I have a Phoenix policy, I will move it somewhere else,’ because presumably, given all of the mergers and acquisitions, there must be quite a large number of the customer base who have lost touch with Phoenix, and this is a natural opportunity for advisors to switch customers around.

The second question; on the annuity portfolio strategy, are you going to 100% reinsure the longevity risk, and how is that going to keep the capital strain low? The third question is on how we are doing with the SunLife over 50s plan. We have had a lot of adverse mortality in the older ages recently. I am just wondering if that is translating into the over 50s plan as well. Obviously we hear the longevity guys talking about how life expectancies are coming down, and I wonder if that is impacting that. Thank you.

Clive Bannister

Thank you very much: three questions there. I think, Susan, you are being asked to think about our involvement in the pension dashboard, good news, bad news, how we will take advantage of that. Can you address the reinsurance question, and then the good developments on the SunLife side and the issue about mortality and the impacts in that environment in terms of reserving etc?

Susan McInnes

You are absolutely right. I suppose there are two schools of thought on the dashboard. There is one that says, ‘Customers are able to see all of their policies in one place and then immediately consolidate them.’ In my personal view I think that is a little simplistic given the advice and guidance issue I talked about, and many of the products that we have within Phoenix have significant options and bells and whistles, so I do not think that it is the case that consolidation closely follows being able to see them.

I think the other side of that is that if a customer can see them all in the one place, actually that is a good thing for them. As long as they know where they all are and the company that has that particular policy, Phoenix is treating them well. I know there are two schools of thought, but my own view is that this concept of mass consolidation is yet to be proven, and it has significant details in delivering.

Simon True

In response to your second question concerning the percentage of reinsurance that we will take on longevity, we are certainly going to look at a very high proportion, and that is driven by two factors. Firstly, it is very punitive under the Solvency II regime. For new business, and effectively if you are taking a book from bulk annuity it will be new, therefore it will attract a risk margin which will not be offset by transitional measures. That is quite punitive and so definitely leads you towards a high proportion of reinsurance.

The second is that within our own book currently our two biggest risks are around market and longevity risk. Incrementally we get some diversification benefit but not a full amount, so we continually look at our mix of risks within our portfolio to optimise that. I would guess that we are going to be using a very high proportion initially.

Andy Moss

In respect of SunLife it is probably worthwhile saying first of all that we believe it is a very useful adjunct to our business, and obviously, with our ageing policyholder base, being able to have enough room for the over 50s to provide for the mass market a very useful sum of money at death for either funeral plans or for their loved ones we think is a very good service to be offering. I think from the mortality point of view, as you say we have seen worsening mortality, and this is really where the benefit of having both longevity and mortality risk comes into play, because on the flipside we are seeing better longevity than we would have thought. Those two risks which we see are at play with those complementary risk profiles will offset each other over time.

Angel Kansagra, Barclays

No one is asking questions to Rakesh and Jim, so I will kick off with a Solvency II question. I am keen to understand what the combined impact of the transitional measures and matching adjustment on Phoenix Life would be. I am also keen to understand what the impact would be on PGH level for that. My second question is on annuities. You said you would want to invest in illiquid assets as you grow your business. Are you looking at your current books of unit-linked and pension customers to generate lifetime mortgages and then use it for your annuity book? What are the other specific direct investments you might be looking at?

The third one is – there would be £350 billion of demand for annuities in the next 10 years and you have mentioned that the market does not have enough capital to do that; what do you think is the likely direction for the market to meet that demand? That would be something which may lead to price increases if there is not enough supply.

Clive Bannister

A full-fat three questions from Barclays – thank you very much indeed. Be careful what you wish for. We have advertised the effects of transitionals and now it is transitionals plus matching adjustments. Rakesh will do that. Perhaps, Simon, you would take forward illiquid investments and how we will be dealing with that and investments one way or the other, and I will wrap up on what we think about the availability of capital to deal with the restructuring of the industry.

Rakesh Thakrar

Thank you for the question. I think it is one of those questions that has been discussed within the industry when everyone released their SFCR, so it was a question I was partly expecting. On one of the slides I showed, the impact of actually excluding the transitionals which was on slide 37, which gave a ratio of 93%. I think if you effectively then also removed the matching adjustment on that you would probably get to somewhere around 60% to 70% coverage ratio. As I previously mentioned, transitionals are Tier 1 capital and we can pay dividends from this, and matching adjustment was no different to what we had under the old Solvency I regime – just a more conservative application of illiquidity premium and a provision for default. As far as we are concerned, the measure we are monitoring is the 171% coverage ratio.

Simon True

I think your question was whether we should offer lifetime mortgages to our existing books. It is an interesting idea. It is not something we are close to yet, but just to amplify that we actually have arrangements in place with two existing lifetime mortgage providers and we have a flow of business which we use to back effectively the vestings which Susan talked about earlier on and to build up a stock that would allow us to price, we think, relatively competitively in the market should we acquire a book going forwards.

You also mentioned other assets that we are looking at. Within our Internal Model and our matching adjustment allowance we have a full range of assets that we are comfortable with. It involves all sorts of credit, both UK and overseas, to give us access to deeper markets. We also have permissions to write equity release mortgages, commercial real estate, infrastructure etc. We are looking at other sources as well and we are trying to bulk up our ability to write those on tap.

Clive Bannister

The third part of the question is profound and nuanced. If I knew the answer I would be in a good position, so let us just get the maths. We have said that the closed life space is about a £300 billion market in the UK. That does not include Europe. There is a fuzzy line – as I have said there is a broad spectrum of what is called annuities. We clearly do that spectrum, starting with the vesting annuity and moving up towards the buy-in and buy-out and bulk end. That is a broad spectrum.

If you take the biggest description of that market it is somewhere around 1 trillion, 1.5 trillion or even 2 trillion. These are two very big and two different things. They meet somewhere in the middle. Ours is one-fifth – i.e. 300 billion pure closed life against a market sector on a BPA of 1.5 trillion. It is our absolute belief that over time that capital will be shifted from current owners and go to new owners as the existing owners of that capital and the risks associated wish to have them transferred. There is no change in that script.

The three questions that are of interest are; what is the market share of the new capital providers? What is the speed at which those transactions take place? i.e., the capital is redeployed; and the third is the pricing of that capital to give our type of shareholders – you – rewards for moving the risks across. I think that is at the heart of the strategy behind the logic of Phoenix as a specialist provider, and I think we are witnessing a systemic change. Solvency II and a whole set of other things moving on in the market where owners of that capital against those historic risks. Heritage businesses in our business – which is closed life sector – but also in the bulk space are looking to redeploy. Those three factors – size of the market, share, pricing and timetable of the transfer – are at the core of what underlines our economic proposition as a business and also the rate of growth that Phoenix can achieve. I use the words carefully in my summation. I think we are confident about our position in that consolidation and the opportunities that exist.

Andrew Crean, Autonomous Research

Can I also ask on this entry into the BPA market, are you looking at the small end of the market or bigger transactions? Generally, can you speak a little bit about your annual appetite for BPAs? They are not self-funding from a Solvency II position, and that, I would assume, would put some strain on your dividend-paying potential.

Clive Bannister

Andrew, thank you for the question. I am going to say some things then ask Simon to say some things. We are not changing the direction of the ship of state. Phoenix is still absolutely focused on closed life. There is an adjustment on the tiller to make ourselves vendor-friendly to people who come to the market with assets that go right across the waterfront. My spoiler alert to Craig was that we are in this business already. What we have noticed is there is the opportunity at the right price to extend our cashflows by participating in the annuities space, and at the right price it generates yield for our shareholders.

The second point I would make structurally is we are a cash-generative business and, Andrew, as you have observed and that is why we have been a buyer and a seller of these businesses. That is to generate cash, and certain deal constructs in the annuities space consume capital rather than release capital. We are immensely sensitive that we are not going to corrupt or damage our business model by becoming a consumer of capital rather than a releaser of cash. We are very clear about that.

Simon True

Your first question was about what sort of scale we would look at. I think we would be looking at medium to large because that fits with our skillset on M&A and as we have said a number of times this is complementary to M&A. It looks like M&A, it feels like M&A, you end up with the same result, you end up with an annuity book that extends your cashflows and you have to price it properly. We are probably not going to play at the very, very small end because we do not have a machine that churns through pricing. We do not have the infrastructure that supports that. What we do have is a very well-oiled M&A machine which we could apply potentially to some of the larger schemes.

If you look at the league table last year, you can see that to do even £500 million of deals would put you in the middle of the table of providers. That is the sort of annual appetite that we might look at. These things are always blocky. Crucially, as you have raised, if it is not self-funding then we cannot corrupt our story and we are not going to change our cash generation target, but in the hundreds of millions of pounds would be the targets I guess.

Colm Fagan, Private Investor

I am interested in the slide that says that you are protecting your unit-linked VIF through hedging. It does seem to be a very financially-astute strategy but it does raise some concerns on if you are agnostic now on wanting good investment performance for your customers because it does not matter to you whether the values go up and down. I think a lot of other insurance companies would have looked at this and opted against it because of this conflict. I would be interested in your comments on that, and obviously there is the issue of when you hedged relative to where markets at the moment.

A related question, coming back to the bulk annuity market: you said that one of the things you are looking for is alternative illiquid assets. It seems to me that good quality VIF could be a potential source of such alternative high yielding illiquid assets.

Clive Bannister

A two-part question. I will say first of all that we are not indifferent to the outcome of our policyholders' investment. It matters enormously, and we demonstrate that in a variety of ways. We do not manufacture our own asset management. We outsource it to world-class players such as Standard Life, Henderson and people we have worked with for many years to which we add the accelerated distribution of estate, etc. Policyholder outcomes matter in the way in which we work with our outsourcers to make sure we optimise the outcome of their investment and their investment performers.

Simon, when do we think about hedging? Simon leads our financial management group which works with the life company in terms of asset management strategy. The second part of this question was about finding alternatives to back against annuities should we do more business in the annuities space.

Simon True

Starting with the hedging, we do not hedge out 100% of the risk. We take a lot of the risk off the table, and that is because a lot of that is unrewarded risk, and that is not our business model. As Clive says, we are not agnostic to fund performance. We care deeply about how policyholders perform within our Group, otherwise we are going to see mass lapses. It is not just that we do care. We do care, but it makes a financial impact as well because people are not going to stick around for poor performance. That is crucial.

As to how we hedge, we take an overall hedging framework. We look at all the risks within our portfolio and we look at what we think about as rewarded and unrewarded risks. The market risks are largely unrewarded to us and that is not why our investors are with us, so that is why we try and take that risk off the table. We are rewarded for other forms of market risk; the assets backing our annuity portfolios. We take on the illiquidity premium which we have talked about at length today. We think that is rewarded risk, so we do not take that off the table.

Your second point about the value of in-force business when looking for good quality illiquid assets is an interesting one. I think that effectively the reason it does not quite work is because of the punitive capital treatment you have to hold behind it, because you are not really holding the direct investment. That would probably mitigate against it. Implicitly we have got VIF within our business anyway, so we would not necessarily double up on that.

Oliver Steel, Deutsche Bank

I am going to ask another question about annuities. Annuities are actually higher risk than your average book. I know you are saying you are in there already, but you have not been in there in terms of new business acquisition except as part of an existing portfolio, so it does seem to be a change of strategy. I am trying to wrestle with exactly what you are trying to tell us about this. Can you specifically rule out the idea that you will be looking to buy large existing annuity books? By large I mean £1 billion to £2 billion or above.

Secondly, what is the fact that you are going for higher risk annuity books rather than the wider mixed profile that you have had so far on your acquisitions telling us about your ability to find other acquisitions? Thirdly, on the annuity front again, can you assure us that you will not change, or that through hedging you can maintain the currently low volatile solvency and future cash profile? Then, as a bit of light relief, the £25 million cost that you talked about as a result of the workplace pensions fee cap. I think that is new information. If so, is that a pre-tax per annum figure or?

Clive Bannister

Very straightforward and relatively easy question to answer – this is not a change in strategy. If there was going to be a change in strategy I would stand up and indicate it entirely. We are not trying to dress something up.

Therefore, going back to the second part of the question as to whether in any way we are lacking confidence in the pipeline or the opportunities that present them in our core space which is closed life and that at the Heritage business. That is why I started talking about the Heritage business in the first paragraph of today and that is where I have ended. I am completely convinced. I talked about a growing confidence in the opportunities that present themselves in our core space which is £300 billion. Put crudely; at a number between 5% and 10% of capital backing, that is £15 billion of capital that has to be used industrially to redeploy, to take businesses out of one home and put them somewhere else. We are absolutely convinced that that motorway and that opportunity where we are clearly an extremely well-qualified – I would like to say the best qualified, but I think it is an exceedingly well-qualified competitor or it is a contender, and we will get our fair share and compete in that business.

There is going to be no change – and you have heard that twice now from Simon – that we would never do an annuities deal at a price point that would jeopardise the stability of the cashflows that we can generate. What we are interested in is the attenuation, which I think is another core characteristic of the business that we have developed.

You asked if we can categorically say that we will not do big bulk purchase annuity deals. The answer is that I do not know forever. The same thing for perpetuity is always dangerous. Ask the current Government. I do not wish to be tarred by that particular brush, but it is not part of our flight plan to go from – and that is why I think the sizing that Simon gave was very clear. He said at £500 million that would be very substantial in today's market. It happens to be about half of what we did last year when we did the buy-in and that happens to have put us in the league table. That was part of a management action that we did last year that yields substantial solvency benefits and will give cashflow benefits in years going forward; so a very focused management action in a year when it was designed to reinforce our solvency strength when we were doing transactions.

As I said, this is not a U-turn. We are absolutely convinced by the quality of the business opportunities that are presented to us and our ability to compete in the current space. It is not because we have lost space in one area that we are looking at another, but there is this real issue of bandwidth capabilities from the vendors' point of view, and we have to be able to cover that bandwidth. The final question was about the £25 million and whether that is new news in terms of the hit that we are going to take on the pensions side.

Rakesh Thakrar

I can take that one. The £25 million is new news, so it was not there at 31 December 2016, but will form part of our half-year results when we announce in August. Just to be clear, the exit charges were all reflected in the 31 December 2016 position.

Clive Bannister

We will announce our results on 24 August.

Andy Sinclair, Bank of America Merrill Lynch

I have two questions; one short and sadly another one on the annuities. Sorry about that. Firstly, the cost of the FCA reviews. I just wanted to reiterate for myself just to make sure that this is included in the previous cash guidance that had been given. I think it was, but I just wanted to make sure for your expectation of what those reviews will cost, which you said was still in line with those.

Secondly, apologies for another question on the annuities business, but one way or another I have possibly been slightly confused by the answers coming back. My initial impression was that you are looking to just do standalone bulk annuity deals. Some of the feedback in the answers felt to me like actually you are doing this because you want to show that you can do across the board on back book acquisitions. It is truly looking for a bit of clarification. Is this something where you are really saying, 'We want to make it aware that we can do all sorts of transactions across the board so that we are not closing off, say, savings books or with-profits books' or are you genuinely going to be looking to do pension funds, derisking bulk transactions on just a pure standalone basis?

Clive Bannister

The first question is about the treatment of the FCA reviews and the maths included one way or the other. The FCA reviews were reaching completion in the maths.

Andy Moss

I think your question was whether that has any impact on our cashflow. We have not seen anything in those FCA reviews which would impact our stated cashflows. I think you can see in the overall scheme of things the impacts are relatively modest, and as Rakesh is already saying, part of that was already provided for year-end, on the workplace pensions there will be a provision at half-year, but there is nothing in that that we are seeing that impacts our overall stated cashflows.

Clive Bannister

On the second question about annuities, I am sorry if I have not been entirely clear. Let me try and be entirely clear. Our first statement is a complete commitment to the closed life space and our confidence in our role and the availability of transactions for us to carry on running the business entirely as is. The second point was that we are seeing transactions which combine annuities with other aspects – with-profits and everything else. We have known for a long time we have had this capability and we do annuities. In some of the comments which have been written in the press we have been excluded from the recognition that we have that capability which is embedded.

The third point – coming back to Oliver's question – is that there are opportunities that we think we can make good returns for our shareholders and attenuate cashflows because it is a complementary way of buying closed life businesses. This is not a different business; it is an extension of what we do today. That falls well short of getting into a BPA market of billions of dollars where you are in a different sort of swimming pool or a different altitude. Those are the three points that I hope I am being very clear about right now.

Simon True

Just to be absolutely clear: we write annuity business, we manage it and it is attractive to us. I am going to pick up a little bit on Oliver's question. It is not inherently more risky. We have very extensive reinsurance programmes in place and the longevity risk is not material in that context. It is well-managed. We manage our assets very, very tightly as well, and we are agnostic to the source of those assets. Whether they come through our vesting annuities, whether we buy them as part of a bigger business in Abbey, whether we buy them as an individual block from another seller or we get them from the bulk purchase annuity market, the liabilities and the assets are the same and we are going to manage them in that way. We are agnostic to the source.

Clive Bannister

Echoing what Simon said, I said we would not distort our business model which is one that generates cash and therefore meets all of our dividend commitments that we have identified so clearly. Those cash targets of £1 billion to £1.2 billion over the next two years set in the context of between 2016 and 2020 of £2.8 billion and thereafter without management actions of a further £4.4 billion this is our best way of advertising the strength of the closed life business. We have not lost any confidence in that model, nor are we about to distort it by aligning with business that might damage the key attributes which have been so well-supported by our shareholders in the last seven years.

Fulin Liang, Morgan Stanley

I have two questions. I hope the first one is easy. Andy mentioned that for the next three years you are going to have some MA benefits from the Abbey Life deals. Could you give some guidance about the phasing of that benefit?

The second question is not a directly annuity-related question, but it is related. Sorry to come back to this point. I appreciate this is your way of keeping the optionality open and keeping your eyes open for whatever opportunities emerge, but does that mean you have to rethink your distribution channels and how you want to build up your distribution capabilities? An obvious capability to backing your bulk annuity liabilities is doing more lifetime mortgages. That actually means you probably need some retail distribution capabilities to support a £500 million or even higher deal size. Would that actually make you think about rebuilding or a different way of building your distribution skills?

Clive Bannister

These are two good questions. Could you give a summary of the benefits that we can anticipate, Andy?

Andy Moss

I think the first key point to make is that in terms of our stated cashflow targets – and obviously we have a two-year target out today – obviously the benefits from Abbey Life business and the AXA integrations etc. are included in those targets, so in totality that is probably the key guidance we can provide. In terms of where we are in terms of delivery and the management actions from Abbey, by the end of next year we will have anticipated delivering the majority of those management actions. I think there will be longer-term things that we will do around our annuity portfolio as we acquire further assets and as we gain further matching adjustments which would come in 2019.

Clive Bannister

Just on finding alternative assets, because it goes well beyond ERM.

Simon True

We are absolutely going to have to source illiquid assets. We have relationships with a number of partners to source those illiquid assets, noticeably in a lot of our assets with Standard Life Investments, but we also have other partners who source things like the lifetime mortgages for us. In essence, we are going to have to think about that. We are not going to ramp those up today because we are still very much in the phase of thinking through this, making sure that we do this soberly, so we are not going to go and change our business model, as Clive said, we are not going to go and ramp up lifetime mortgage amounts anytime soon, but we are going to have to think about that for future aspirations, you are right.

Clive Bannister

It is the optionality that you referred to.

Marcus Barnard, Numis Securities

Just a question for Susan: I see the points you are making about customer engagement, but it does seem that the pension freedoms were brought in and a lot of the customers seem very confused about what to do. That is obviously costing you quite a lot of time and effort in trying to educate them. Can you see any change coming in the next few years in terms of the definition of guidance or whether you can outsource that process to someone else or be giving more advice and maybe charging for it?

Susan McInnes

Thank you, Marcus. It is a good question, and I hope I brought the point out that customers are absolutely confused and they are reaching out to providers to give them help. I think that the financial market view is moving a little bit towards allowing providers to give more in the way of guidance. It is moving that line from guidance and advice. I hope that our digital proposition allows us to give customers more information which helps customer decision-making.

I think many of our customers' pots are probably too small to warrant them going for advice, so we think the trick is to give them enough information, and I think the FCA is moving towards allowing firms to move that line a little bit as long as you can do that in a way that you control your conduct risk. My own view is you do not do that in a conversation. You do not do that verbally. You do that digitally so that you can prove the information you gave to a customer and you can help them with their decision-making. That is the way I see it moving.

Clive Bannister

Is there a final question? Otherwise we are going to wrap up because we have gone on a bit longer than we thought.

Soraya Hakuziyaremye, ING

Maybe a point we did not touch upon is the financial leverage. Rakesh, I was wondering what the measures have been taken in the last two to four years to bring the financial leverage lower.

Clive Bannister

The question is about our financial leverage, its trajectory, where we have been, where we are today and where we may go.

Rakesh Thakrar

We do not have a financial leverage calculation that we report externally, but we do monitor the leverage that is calculated by Fitch. We have previously stated in our results announcement that we do have a target range in mind of about 25% to 30%, which is where we think we broadly are at the moment. Our intention is to stay within that range.

Closing Remarks

Clive Bannister

Group Chief Executive

I am going to wrap up now. If there are any burning questions come and grab any of us. I see Jim – he is not hiding there – but Jim is available for all those tricky questions that you have not managed to pose.

I will start with a thank you. Thank you for supporting and being engaged with the Phoenix story. The next time we meet if you are not on holiday is on 24 August 2017. What we have tried to do is communicate that we have had a good first six months of 2017. We ended with Simon talking about a part of the business that we feel very comfortable with. We have said that this is absolutely not going to reduce or distort the business model that we have and our key priorities and our confidence in the closed-life sector.

Rakesh has reminded all of us that we have a solvency which is around £2 billion. Very comfortable, it is never the single number. It is the resilience that really matters, and that resilience has been tested in earnest last year and in prior years and we are very comfortable about that resilience. We care about our customers, and we care because that is sensible and it is the right thing to do. It helps us manage our costs better. We hold conversations with those clients, and therefore minimise conduct risk, and you know from other places how expensive it is when you do not pay attention to conduct risk.

The big advert of today: the unknown question six months ago was what progress would we have made and can we make with the safe integration of the businesses that we bought last year. Andy gave us a shining advert that we are ahead of where we thought we would be, and very confident with the progress being made on integration. It is a good first half, and I very much look forward to seeing many of you – if you are not on holiday – on 24 August. Thank you very much indeed.