Phoenix Group Holdings

2016 Full Year Results

Monday 20th March 2017

Henry Staunton, Chairman

Good morning ladies and gentlemen, and welcome to the Group's 2016 results presentation. I'm joined on the podium by Clive Bannister, our Group CEO, Jim McConville, our CFO and Andy Moss who's the CEO of the Life company.

2016 has been an extremely busy and successful year for the Group. The acquisitions of AXA Wealth and Abbey over the past year have significantly increased the scale of the Group. Assets, policyholders and future cash generation have all increased by around 40% since the start of 2016. We've also strengthened the Solvency II surplus of the Group, despite the fall in interest rates. This provides Phoenix with greater resilience to future market volatility and supports the 5% increase in the dividend per share which we announced today.

With over six million policyholders Phoenix has the platform and expertise to manage the additional closed funds and enhance returns for both policyholders and shareholders. This greater scale and strength provides the Group with an opportunity to make further acquisitions as the UK life market continues to consolidate in response to regulatory and competitive pressures.

Finally, I'd like to take this opportunity to thank our employees for the hard work and dedication, it's been a very busy year and without them none of the achievements of 2016 would have been possible. And now I'd like to pass you over to Clive and the team to take you through the results in more detail.

Clive Bannister, Group Chief Executive

Thank you, Henry, and good morning everyone. As Henry has just mentioned, the major events for the Group in 2016 were the acquisitions of AXA Wealth and Abbey Life. We have already delivered significant cash flows from AXA acquisition. Of the £486m of cash generated in 2016 £117m was from AXA. In addition, following the PRA's approval to bring the AXA business onto the Group's internal model we have delivered a further £165m of cash in 2017. Total cash generation to date from the AXA business is therefore £282m, exceeding the target of £250m of cash from the acquisition within just six months of its completion.

We are well advanced with the integration of the acquisitions and are on target to deliver additional cost savings to those which we announced last year. The acquisitions, together with the recent Tier 3 bond issue, have increased the Group's capital position, this allows us to progress our on-shoring plans as well as providing the Group with additional resilience against future market volatility.

Both acquisitions were completed before the end of 2016, with Abbey Life change of control approval taking just 93 days. The AXA integration will be completed by the end of this calendar 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. Because the integration is going well the Group remains active in looking for further consolidation opportunities in the market.

I summarise on this slide the key metrics that we should be judged upon with regards to the integration of the acquisitions. As I have said, we have made a strong start in delivering £282m of cash from AXA and we now expect cost synergies in the range of £13m to £15m per annum, up from the previous expectation of £10m. A key part of the integration process is to move the acquired businesses to our target operating model consolidating the finance and actuarial systems and basing the core life company functions at our main office in Wythall.

Finally, the indemnity agreed with Deutsche Bank provides protection against outcomes from the ongoing investigation into Abbey Life. This is at an early stage but preliminary assessments of the risk sharing are within the tolerances expected.

We have today updated our long-term generation target between 2016 and 2020 to a new level of £2.8bn. Given the integration work that needs to be carried out there will be a significant level of management actions within the cash generation over the next two years. We have therefore set a two year target of between £1bn and £1.2bn of cash generation in 2017 and 2018. Beyond 2020 we anticipate a further £4.4bn of cash generation, demonstrating once again that the Group's long-term cash flow profile remains a key strength.

One of our key criteria for any acquisition is that the level of dividend per share should be at least sustained. The cash generation from the acquisitions has allowed us to announce a 5% equivalent increase in the final 2016 dividend per share. In addition, we intend to raise the 2017 interim dividend by a further 5% as announced at the time of the Abbey Life acquisition. Therefore the total dividend uplift from 2015 will amount to over 10%. This is in line with the public statements we made at the time of the two acquisitions last year. Following these step ups in dividend the dividend policy remains stable and sustainable.

I will now pass you over to Jim who will take you through the numbers in greater detail. Jim.

Jim McConville, Group Finance Director

Thank you, Clive, and good morning everyone. Phoenix had a strong set of financial results in 2016, despite the market volatility during the year. I'll 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 £486m during the year with an additional £165m achieved from AXA in the first quarter of this year. Holding company cash as at the end of 2016 of £570m. A Solvency II surplus of £1.9bn and a shareholder capital coverage ratio of 170%, both of these allow for the pro forma impact of the recent Tier 3 bond and the approval to move the

AXA business onto the Group's internal model. Operating profit of £351m and a final dividend for 2016 of 23.9 pence per share.

As we described last year, the 2015 cash generation was impacted by the transition to Solvency II with the Life companies retaining capital during the year rather than releasing it up to the holding companies. 2016 cash generation has seen a return to a more normalised level of cash generation, although the impact of lower interest rates has meant that management actions have been particularly important in driving cash flows this year.

Non-recurring costs have also been significant this year, driven by the significant project and transaction costs for the acquisitions, together with the costs of putting in place hedging to protect the capital position of the acquired businesses up to completion. Non-recurring costs also include a payment of £68m to PA(GI) Ltd, a subsidiary of the Group that formerly transacted general insurance business. The payment relates to a provision of £33m and an additional £35m of risk capital, associated with redress costs of creditor insurance written before 2006. Andy will provide further detail on the background to this shortly.

Debt interest payments decreased during the period, the 2015 interest cost was impacted by the Tier 1 bond exchange undertaken in that year and there has also been a positive impact from the debt repayments made in 2015 and the reduced margin on the Group's senior bank debt.

We have reduced debt during the year through the repayment of £239m over the year, including the entirety of the AXA acquisition facility. Finally, after taking into account the cost and financing of acquisitions we ended 2016 with £570m of cash at the holding company level.

We have set out here an updated version of what is now a familiar slide to you all, showing the illustrative sources and uses of cash over the period to the end of 2020, based on a new £2.8bn cash target. We begin with our cash at the holding company level of £0.6bn. The green bar to the right of this of £2.3bn represents the remaining cash generation expected to emerge over the period. The free surplus within the life companies was £0.7bn as at the end of 2016, giving us confidence in meeting this long term cash flow target. Details of how the free surplus has built up over the year is included as an appendix.

And continuing to the right we show the various uses of cash over the period to 2020. As can be seen, we have assumed that the remaining £550m of the bank facility is fully repaid. Given our recent Tier 3 bond issue we have the ability to refinance additional bank debt into longer term subordinated debt and I will return to this point later in the presentation.

There is also a £0.8bn to fund an illustrative stable level of dividends, after taking into account the further expected increase at the time of the 2017 interim dividend. After these uses of cash we are left with an illustrative £1bn of cash at the holding companies. This build up of cash balances over the coming years offers the Group the potential to deploy more of its own resources for future acquisitions.

Looking forward, and starting with the £1bn from the previous slide we have shown on this slide the future £4.4bn of cash emergence over the longer term. As you'd expect, cash generation will decline over time as the current book runs off, however it is important to remember that the amounts shown here after 2020 do not include any benefit from management actions. As we have always stated the key strength of the Group is to continuously find ways to add value to stakeholders and this will continue well into the future.

Moving on to the PLHL Solvency II position. The position assumes a recalculation of transitionals as at 31st December 2016. We have also included the pro forma impact of the recent Tier 3 bond and the approval of the AXA Wealth business onto the Group's internal model within our year end numbers. Abbey Life's position is calculated on a standard formula basis as of the end of 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.

As we discussed last year, there are an additional £0.4bn of unrecognised surpluses within the Group's strong With Profit funds and the PGL pension scheme. These surpluses are not included in the overall Solvency II surplus, but do provide the Group with additional resilience in a stress scenario.

Our shareholder capital calculation therefore excludes the Own Funds and SCR of the Group's strong With Profit funds and the PGL pension scheme. This provides a clearer view of the shareholder position and is similar to the approach taken by many of our peers. The shareholder capital coverage ratio is 170% as at the end of 2016, a 16% increase on last year.

This slide provides more detail of how the surplus has changed over the course of 2016. The increase in the PLHL surplus has been driven by positive benefits of the run off of the book, management actions and the impact of the acquisitions completed in 2016. These effects have been partly offset by the negative impact of assumption changes and the recognition of a provision and associated risk capital in respect of creditor insurance redress costs.

In particular, we have strengthened some of the persistency assumptions on guaranteed products within certain life funds due to the low interest rate environment. We constantly review the appropriateness of our actuarial assumptions and the persistency impact was partly offset by positive changes on our longevity assumptions. The fall in long-term interest rates has also had a negative economic impact on the capital position, although we have seen a small recovery in rates during the second half of the year. Finally, the pro forma adjustments add an additional £0.2bn to the surplus.

Management actions broadly fall into two categories under Solvency II, those that have increased Solvency II own funds and hence increased 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 have otherwise been expected to emerge over time. Management actions added a total of £463m to our Solvency II surplus in 2016 with a number of key actions taken over the course of the year as the Group has adapted to the new capital regime and reacted to changes in markets. Those management actions that have increased own funds included the benefit from a Part VII transfer of an annuity portfolio to ReAssure Life Ltd, formally known as Guardian Assurance, and reduced expense charges to the life companies. The remaining £213m is from cash acceleration actions such as a longevity swap with an external reinsurer, and hedging actions.

The Group's Solvency II position remains resilient, partly due to the additional surpluses within the strong With Profit funds and the PGL pension scheme. The Group's material risk driver is to longevity on our annuity portfolio. However, this is a single stress and does not assume any offset in diversification from our mortality book. It is important to note 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.

Transitionals are seen as a key part of Solvency II, smoothing its introduction from the previous Solvency I regime over a 16 year period. Within the product groups at the life company level that were written before 2016, transitional measures offset the changes to the calculation of transitional technical provisions under Solvency II. The introduction of the explicit risk margin is the most important of these changes. The recent interest rate volatility has shown how sensitive the explicit risk margin is to movements in the yield curve and the transitionals can be recalculated in response to these moves, subject to regulatory approval.

The chart on this slide shows how the risk margin and the recalculated transitional benefit has moved over the course of 2016. It is therefore important to think about these two metrics in parallel, a material shift in the risk margin will lead to a broadly similar move in the level of transitionals and therefore the capital positon of the Group as a whole is less volatile. These transitional benefits will run off over 16 years and will reflect the run off of the business over that period. However, the risk margin and other technical provisions will also run off with the business and therefore offset the impact of the loss of transitional benefits over the period. There will be a residual headwind as the risk margin will run off slightly slower than transitionals and this effect has been factored into our cash flow targets and longer term forecasts.

The Group's operating profit was £351m for the year, which includes £157m from management actions. The impact of management actions on IFRS profits can be lumpy, and were higher than in the previous year. The key actions in 2016 relate to the optimisation to matching adjustment portfolios, and lower expense charges to the life companies. Below the line negative economic impacts were driven by lower yields and also the equity put options. This equity market hedging protects the solvency capital position from equity exposure in the unit linked funds and future shareholder transfers from the With Profit funds. In a rising market the loss on the put option is recognised immediately under IFRS. Whereas the higher future profits and the increased value of in force are not recognised under IFRS until later periods. But there were also some non-recurring items, including the project costs incurred during the year, a provision for the costs of integrating the AXA business, and the provision made for the PA(GI) redress costs. This has led to the overall IFRS loss after tax that you see at the bottom of the table.

Fitch Ratings assigned investment grade ratings to both our senior and subordinated debt in 2015. We were put on positive outlook for our credit rating at the time of the AXA acquisition, and this was reaffirmed on the announcement of the Abbey Life transaction. This has been important in allowing the Group to access funding from the lending banks and the broader capital markets. We have also recently expanded our senior revolving credit facility to £900m, of which £550m is currently drawn down. This facility has no mandatory or target amortisation payments and offers the Group greater flexibility to make acquisitions.

The Group has also taken advantage of the wider investor universe in the debt capital markets, with a successful issue of Tier 3 bonds completed a couple of months ago. In terms of the future, we continue to examine options with regards to replacing our bank debt with longer-term subordinated debt. As we discussed at the time of the 2016 interim results, the Group continues to plan a further simplification of the Group structure, ultimately replacing the current Cayman Islands' registered Topco with a UK Plc. This will provide greater clarity for the Group's stakeholders, including investors and regulators, and is a natural step for the Group in terms of corporate simplification. The recent changes to our debt structure are supportive of these plans.

The work to bring Phoenix Group Holdings onshore has progressed over the past 12 months. As we discussed in August, creating a UK Plc Topco will mean that the Solvency II position will be calculated at the ultimate holding company level, currently PGH rather than at PLHL. The main impact of this is the recognition of the Group's current senior debt at the Phoenix Group Holdings level. As can be seen from the graph on the left, the surplus at the PGH level at 31st December 2016 is strong with an overall surplus of £1.1bn. This is the same quantum of surplus as the PLHL position at the time of the half year results, and the resilience is consistent with the PLHL surplus. The PGH surplus also recognises the upcoming final 2016 dividend that will be paid in May.

We will report the Solvency II capital position at the level of both PLHL and PGH from the half year 2017 results, and are currently targeting to put in place a new UK Plc Topco during the course of next year. This will allow us to simplify both the Group structure and our governance processes, as well as provide further clarity for our investors and stakeholders. Finally, as I mentioned on the previous slide, any further diversification from senior to subordinated debt would increase the Solvency II surplus at the PGH level.

That brings me to the end of the financial section, and I will now pass you across to Andy.

Andy Moss, Chief Executive, Phoenix Life

Thank you, Jim, and good morning everyone. 2016 has been a busy year with a number of management actions achieved alongside commencing integration of the two acquisitions. These actions include the completion of the Part VII transfer of an annuity portfolio, further optimisation of the matching adjustment portfolios, in particular by further investment in equity release mortgages, and the implementation of a longevity swap.

From a customer perspective we have reviewed the detail from the FCA reviews into outcomes for legacy and annuity customers. We continue to make improvements to our customer service in line with our strategy, in particular around the transparency of information, including that delivered through our website. In addition, we seek to ensure customers get the best possible outcomes, for example, by providing product options and assisting them in understanding the full features of their products.

Moving on to the integration of the acquired businesses. Over the last few years we have invested in the Phoenix operating model to create 'the Phoenix way', which adds value for both policyholders and shareholders. This has enabled us to integrate previous acquisitions, improve customer service, and manage our costs on a variable cost basis, making the model scalable both upwards to accommodate further acquisitions, and downwards as business runs off.

The key features of this model are to: outsource core customer and related IT operations, retain in-house financial management activity where we can add value via management actions, and to operationally use a one core actuarial valuation system, one core general ledger, and one core PRA reporting tool. And finally, to locate all of our core life operations at our centre in Wythall. The strength of this model is now being deployed to the acquisitions, and this clarity of direction will enable cost synergies to be achieved, and key metrics to monitor progress on its deployment to be set. The slide shows the key metrics we will manage over the next 18 months, and the impact the deployment will have on the inherited costs of the organisation.

Moving on to progress of the integration of the acquired businesses, starting with AXA. As Clive mentioned, we now expect cost synergies relating to the back book to be in the range of £13m-15m per annum, an increase on the previously announced target of £10m per annum. We have closed to new customers the majority of products within Embassy, eliminating an additional £10m of costs relating to this new business, whilst the SunLife business has been retained as a separating operating model targeting the over 50's market.

The AXA business is being reassured into Phoenix Life Limited, creating capital synergies, and Phoenix's governance, oversight and risk model is now in place over the entirety of the AXA business.

The approval of the internal model application was received recently, and this has facilitated the further cash generation of £165m that we have seen so far this year, in addition to the £117m delivered in 2016. We are now focusing on the integration of the business into Phoenix's operating model, including a Part VII transfer into Phoenix Life Limited, the outsource of customer services operations and the movement of finance and actuarial systems onto the Phoenix platforms. Ensuring customer service remains at a high level during the integration is of critical importance, and this covers both a smooth transfer of policy administration as well as strong support for IFAs.

The Abbey Life integration is at an earlier stage, but the operating model of Abbey Life is already similar to Phoenix's. Phoenix governance and management is in place, and work has started on the application to move the business onto the Group's internal model. We are expecting that this application will be made in the second half of the year.

As you are aware, the acquired Abbey Life business remains under enforcement investigation. 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. We are at an early stage in the investigation, but to date expectations of any residual costs remain in line with the acquisition announcement in September.

The last year has seen the publishing of two key reviews by the FCA. The guidance from the reviews is aligned to the Phoenix Life focus, in particular around clarity and transparency of communication and identifying ways of maximising outcomes and options for customers. In addition, this year has seen clarity on the capping of exit charges on over 55s' pensions products. This will be implemented on 31st March 2017, and has a small financial impact on the Group's business which has already been recognised. As Jim referenced earlier, there is a provision against a legacy issue relating to creditor insurance policies that were written before 2006. We have established a claims handling capability through industry specialists who are experts in this field to manage this issue, and will continue to carefully monitor this situation.

Improving customer integration with our products remains key to us, hence our continued investment in types and content of communication. 2016 has seen us invest in our digital capability to both provide enhanced information and to enable transactional capability via digital means. We have also widened product options for our customers via our partnership with Just Retirement Solutions. We have also continued to deliver on our customer service targets, including maximising the distributable estate within the With Profit funds.

Phoenix Group's focus remains on the efficient management and integration of closed life funds. However, there are two key sources of new business. First, the writing of annuities for existing policyholders where we have seen a small increase in premiums since 2015. Second, the SunLife business is focused on protection products for the over 50s' market, with a recognised brand and a proven track record of direct marketing. These two products are complementary with offsetting exposures to longevity rates. Although a small part of the overall Group's profits, the new business can be written without significant capital strain. The Group will therefore continue to support this new business generation capability within a well controlled customer environment.

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

Clive Bannister

Thank you, Andy. The Group has a good track record of meeting its public targets and I am confident that Phoenix will continue to do so in the future. Successfully integrating the AXA and Abbey Life businesses is clearly critical to meet our updated cash generation targets. We will continue to leverage our specialist operating model to identify further management actions in years to come. The cash generation underpins the Group's credit rating and supports our stable and sustainable dividend policy. As we continue to meet our cash flow targets, we will have a growing ability to use more of our own resources for future acquisitions.

The UK closed life market has a wide number of life companies holding a range of legacy products. We have always had the ability to manage any type of policy. We will therefore seek to acquire with profits, unit linked, protection, or annuity portfolios. The key attraction of any specific closed fund is not the policy type or size of business, but the ability of the Group to add value through realising capital and expense synergies. We have updated our assessment of the overall market, and believe there remain over £300bn of assets in closed funds. Therefore there remains a significant opportunity for the Group to make further acquisitions.

In 2016 we have seen both AXA and Deutsche Bank both dispose of their UK life companies for differing reasons; and we see the regulatory, cost and capital pressures continuing to motivate potential closed life vendors into the future. With longstanding outsource partners and a PRA approved internal model, Phoenix has a specialised platform designed to deal with the pressures to which closed funds are currently exposed. Just as important are our obligations and our ability to add value to policyholders. This remains in our opinion a critical success factor as the UK's leading industry consolidator. With the integration of the AXA and Abbey Life businesses already providing results, we will therefore continue to examine opportunities that meet our M&A criteria during the course of 2017.

Phoenix has a clear set of priorities. The cash generation targets will be reliant on an efficient and well managed integration of the acquired businesses. Continued delivery of cash will support the expected further 5% increase in the 2017 interim dividend, in addition to the 5% announced today. We continue to look to diversify our debt structure away from senior debt and towards subordinated debt, supported by our investment grade credit rating. This will in turn support the simplification of the Group's structure as we seek to replace Phoenix Group Holdings with a new Plc Topco and come onshore. Finally, we remain well placed to examine further M&A opportunities that meet our stated criteria, and believe that the Group has the platform and financing flexibility to deliver additional value from future market consolidation.

Thank you very much.

Henry Staunton

That ladies and gentlemen brings us to the end of the formal presentation. Thank you for your engagement. Now I would like to move on to the Q&A session.

<u>Q&A Session</u>

<u>Question 1</u>

Abilash P T, HSBC

I've got two questions please. On slide 27 you're showing the costs which are running off around 20% over 17-19, versus the policies which are running off a bit slower. I was just wondering if you could clarify a bit more those numbers there, and what's assumed under 2017 baseline level which is indexed to 100?

The second question is on the cash generation target for ’17-’18. I'm just wondering how should we think about this on a year-on-year basis? In particular I think at the end of 2017 you get to recalculate your transitionals, I'm just wondering whether that would impact that number at that point? Also, if you're ahead of your run rate at the end of the first year, would you be willing to reassess that target? Thanks.

Henry Staunton

I'll perhaps ask you, Clive, to deal with that. I think we're in the first year of a five year cash target so you wouldn't expect us to change that at this stage, and I think we wouldn't necessarily give any commitment when you're in the second year of a five year cash target, but we'll think about that as the time arrives.

Clive Bannister

Chairman, thank you. I'll answer the second question and then I’ll give the cost run off slide which we put up to Jim, page 27. It's fairly logical in our mind. We've given a five year target of £2.8bn, and then we have chopped that for ’17 and ’18, and the first forecast is for £1-1.2bn in 2017 and 2018. Jim used the wonderful Scottish phrase often associated with porridge which was lumpiness in terms of our management actions. That's just the practical nature of our business. Of our ongoing cash flow somewhere between 35-40% of our cash flow will come from management actions. That is not unexpected, because when you've acquired businesses you then have to put them on internal model, matching adjustments etc, and this requires regulatory approval. So there's an inherent lumpiness. Then behind that there's an 18 month and the formal transitional period within the PRA, and the next one is on 1st January 2018.

So, the component of noose around our proverbial neck is, if we do well, and as obviously we will update the market on our cash delivery throughout this current year, then we realise that we have another obligation which we may then have to amend in 2018. But as the Chairman says, at this moment in time we're very comfortable with the £1-1.2bn analysis and projection going forward for 2017 and 2018.

Jim, you got asked the question on this about the cost run-off.

Jim McConville

Yes, I'm going to pass this straight to Andy since it’s his slide and he's extremely proud of the historic track record of reducing costs faster than the policy run-off.

Andy Moss

Okay so the base into 100 is our cost base as at 1st January this year, so obviously our inherited cost from the acquisitions plus our current Phoenix cost base and what you see there, as you quite rightly say is a run-off of around about 18% in terms of costs compared to about a 5% policy run-off.

This is something that we've shown in the past basing back to 2010 when we did a number of other integrations and as you will have seen in the past basically our costs are running off slightly faster than our policies and obviously with the two acquisitions we see that continuing, so effectively we're maintaining or reducing our average cost per policy of our administration. And obviously it's the Phoenix Way and the operating model I referred to that enables us to do that with having a reasonably variable cost model.

Henry Staunton

I think the cost reductions that we've achieved were in excess of what we anticipated at the time of the deal and it reflects the excellent deal that we have with our outsourcers primarily which of course is a great competitive advantage for us as a company.

Question 2

Oliver Steel, Deutsche Bank

So three questions. The first is just can you clarify the pro forma nature of the solvency calculations? So I think you've taken up front the expected transfer from AXA in the first quarter of this year so what I really just want clarification on is the extra £100+ million that you're expecting from AXA in the first quarter or first half of 2017? Are we still expecting that in the cash number but obviously it's already in the solvency number? And also just clarifying that you only seem to be counting £100m benefit from the debt issue but that was a £300m debt issue so I'm a bit muddled about that.

Secondly, sticking with solvency, at the Group level what is the minimum target solvency that you'd be looking for because that should grow pretty strongly over the next couple of years particularly if you issue more sub debt which in turn I would imagine gives you quite a lot of potential to use that as well for bolt on acquisitions?

And then thirdly, I'm a bit disconcerted by the amount of actuarial reserve strengthening and the credit insurance provision that you've taken so I wonder if you could just talk a little bit more about that and why suddenly they seem to have developed having not seen any adverse experience for some years?

Jim McConville

So firstly the pro forma nature of the solvency in terms of the capital there are two adjustments which we've reflected in the pro formas. The first is the impact of the Tier 3 debt issue which at PLHL level had a benefit of £150m, but at the Phoenix Group Holdings level had a benefit of £300m and the difference related to the internal loan structure within the Group and how that unfolded.

The second was related to the impact of the AXA internal model; the benefit in capital terms is around £115m/£120m which came through in Quarter 1 this year and is reflected in the pro forma. And in cash terms the benefit of putting it onto the internal model was the ability to release £165m of cash which was also taken in the first quarter of this year whereas in addition to the £486m that we reported for 2017.

In terms of Group solvency, as you rightly say Oliver, we expect that surplus to improve as we go forward and indeed if we were to do a further subordinated debt issue that would increase the surplus at the PGH level. We have not given any details of our PLHL minimum requirements that we hold within the company and we don't intend to do so funnily enough at

PGH level. The key thing for us, as we've always said, is the absolute level of the surplus and the resilience to various stresses which you can see from the sensitivities slide remains a robust position.

And frankly on PA(GI) that relates to an old GI business which was sold by the Group in 2006, so a long time ago, that business underwrote creditor insurance. And the reason it's just come up recently is the liability that Phoenix has for any claims was only established in 2015 following a Court process. We have based our year-end provision of £33m based on the experience that we've seen in 2016 which is the bulk of the experience that we have seen and obviously looking forward in terms of run rates to the end of the claims period in August 2019. So it's based on the best information that we have and takes into account the FCA's time bar. We'll obviously keep the position under review as we go forward and update you accordingly.

<u>Question 3</u>

Andrew Crean, Autonomous

Just a couple of questions, one technical question: you recalculated your transitionals I think in the second half if that's right, dynamically, could you give us the impact of that?

And then secondly more broadly, could you talk a bit more in depth on the acquisition environment, the £300bn available? What do you think is the most likely or the most sensitive areas? Do you think it's Mutuals, do you think it's overseas holders and are you likely to be more doing deals where you're buying out from one company a part of their business or buying the whole of a business from a company?

Jim McConville

So I'll pick up the transitionals question. As at the end of the year, Andrew, we have assumed in our calculations that we will recalculate the transitionals and that has had an effect of reducing the number otherwise by £0.3bn, so it results in a lower declared solvency position. Of that we have had approval from the PRA for £200m of that and that was related to the AXA internal model process which has been approved.

Henry Staunton

And Clive perhaps you could look into the crystal views and give us your views to where this £300bn is?

Clive Bannister

I was going to say, Andrew, thank you for asking the question about the crystal ball and I'm just trying to find the slide which is right here. I think it's a really exciting time to be in our industry. I'd make four observations about the macro part of where we see ourselves. The first is that we are clearly at a point of cyclical change and that can be driven by low interest rates, Brexit, changes in price of capital via Solvency II or, and as we've seen in the last six months of this year, half of our industry, the asset management industry, finding itself challenged to offset decline in fees, 60% of funds going into passive and how they respond as an industry.

So the first observation is for a set of cyclical things driving change in our industry. That challenges the old vertical triptych of our industry, collected the premiums, you provided underwritten protection and you did asset management. That old vertical of three layers I think is being stripped apart. It means that the industry finds itself at a crossroads and that crossroads says are you in the protection business or are you in a savings-light, savings and investment business? And if you're in the protection business which dollar do you put behind open businesses versus which dollar do you put behind a heritage business?

And we see the motivation for our vendors that we talk to, potential vendors, are how to deploy trapped capital? So we found in both AXA and in Abbey Life we could do things because we were already IMAP'ed, one of only nine life companies to be IMAP'ed when we inboarded their standard formula firms and then took them through the internal model process. That is something we could do that others would find more difficult.

The other motivation about stranded and trapped costs on one of the slides that Andy showed we're going down from nine actuarial systems down to a number which is closer to three. We're moving from four physical locations for the closed life business down to just one and that allows us to realise cost synergies with our outsourced model which are not possible for many others.

Managing the regulatory environment gets no easier. You saw that there was a slide that says with regards to the annuities review, with regards to our own business, no significant requirements are changed so we are on course, having come through the two largest industry reviews that we've had, at least in a decade, treatment of longstanding clients, legacy industry review and the annuities review and Phoenix has come through relatively unscathed.

So then you posed the question, Andrew, well wither? And you'll see on this slide that we show on the top right hand side Market Opportunities by Owner of Funds, bank-owned businesses, so we bought from a bank last year; foreign-owned businesses, we bought from AXA. And then UK life companies and then by product type.

We are next to indifferent to product type because we do all: annuities, with profits, unit linked and protection. We are relatively indifferent to scale, obviously we would prefer larger deals but the most important thing is where we can realise cost or capital synergies and in that respect I think there will be both books of business coming out of larger firms and businesses in their entirety.

It was interesting, if I step back and look at AXA, AXA decided that it wanted to retreat and that was a sales platform, Elevate, an Isle of Man business and Sun Life Direct and what we call Embassy, the closed life business, they wanted to retreat and then reposition and focus on their GI business. And in that respect I think it's a model of some of the things that are taking place in the minds of potential vendors and you can overlay that with the stresses created by low interest rates. So this time a year ago ten year gilts were at 200 basis points. The nadir, the low point was 67 basis points in late July, we're back at 120 but that is a persistent sort of background radiation in a spread business. And then finally it's that ability to deal with costs.

So I'm afraid I can't look at the crystal ball. We engage in conversations with a wide range of potential vendors, as you might imagine, because we never know what might happen. Indeed when we announced the Abbey Life deal on 28th September we said, you never know when red London buses come. Sometimes they come clumped together and sometimes there is quite an interval between them. What is important, and Jim has said this on many occasions, is that the cash flow we anticipate for this year/next year of £1bn to £1.2bn plus the £2.8bn is not dependent upon doing another deal.

Question 4

Marcus Barnard, Numis Securities

Just on the AXA Sun Life business, or the Sun Life business you've got now, can I ask where you anticipate new business levels will go, whether you'll increase them or maintain them at this level and is that a business you're looking to grow?

And linked to that you've mentioned on slide 33 that you've established a marketing and distribution business. Is that linked to bringing down the new business costs and the cost of acquisition?

Andy Moss

So on the new business side there are two aspects to the Sun Life business, guaranteed Over 50s Plan, whole of life protection, which is the biggest seller for Sun Life and which we have a 40% plus market share. We anticipate that we'll maintain that market share and that's a significant market share and Sun Life is the clear leader in that market.

What we're also looking to do is to grow the offering to the over 50s market and that is likely to be via partner products. So we're currently exploring partner products so we won't necessarily take on the risk within Phoenix itself, but as a sales and distribution business it gives the option to use our direct marketing expertise with third party products to give an offering to the wider over 50s market.

And for our customer base that works very well because we have an aging customer base who are approaching that sort of age and we believe that on the wider UK market the over 50s market is not widely served.

Clive Bannister

To be very clear, thank you Andy, we run a closed life business and that is our focus. Sun Life Direct is a business we're immensely proud of, highly branded, very competent management, significant market share, natural offset to our longevity, it gives us mortality indeed in the resilience slide that Jim showed it's the first time we've been able to show the effects of that offset.

But our main meal as a business is not to by mistake wake up one day and be open. Our absolute focus is remaining a closed life business, but this Sun Life capability gives us the ability to engage in better conversations with our policyholders as they age and go through the journey of retirement.

Andy Moss

And just to amplify that that's exactly why we've set it up as a separate sales and distribution business with an experienced management team.

Question 5

Andy Sinclair, BofA Merrill Lynch

I'm going to ask a completely unfair question but I'm going to go for it anyway. There's clearly one large book in the UK life sector that's up for grabs at the moment which is the Pru

UK Annuity book, you've said you were ambivalent about scale but would you be interested in doing a transaction that is as large as that or would you only be looking for something smaller? Could you be looking for a genuine transformational deal that is as large or larger than yourself?

Clive Bannister

That's a politically risky question isn't it? It's not something I heard Mike Wells say or Nick McAndrews and the word 'transformational' when being attached to the word 'M&A' is always dangerous. So we never make any comment on any specific firm in the United Kingdom.

But then let's come to the heart of your question, what can we afford and where are our ambitions? So I refer to Jim's treasure chest and that is not a remake of the Pirates of the Caribbean but Jim's acquisition treasure chest has an advert part and a role part. The advertisement part takes three layers of the treasure chest and totals £1.6bn. The first component is our HoldCo cash at £570m, to which you would then add the life company free surplus which is significantly up at £700m. And then you would end that with the undrawn portion of the revolving credit facility which is at £350m. That is how you get to the advertisement of £1.6bn which is, like many advertisements, an unreal number.

So let me give you the dose of reality and the dose of reality goes that we have HoldCo cash for the purposes of meeting all of the costs that we identify, we have to have it for solvency and liquidity purposes and of course being a conservative, prudent company that's why you have HoldCo cash. The vast majority of that lifeco surplus is associated with the capital surplus inside Abbey Life and we have to go through a whole series of hoops including getting it on our internal model, matching adjustments, and other things for it to be releasable. We will do that in time but that's not hot cash in our pockets.

And then finally I'm sure Jim would absolutely love to spend that £350m on behalf of the banking community in the RCF which he has so well engineered for this firm.

So what that does mean, let me put it in the real world maths, is if we were to do a similar sized deal, £400 odd million like AXA, that it would have to look the same in terms of the attributes of being able to release cash very quickly. There is the prospect of us not having to have recourse to the equity markets. So for the first time in this company's history we have both the financial wherewithal and strength to contemplate fairly sizeable transactions without an automatic call upon our shareholders. It does of course depend on the size, the shape and the nature of that transaction.

We were very clear about how rare AXA was as a deal and we're extremely proud to have been able to deliver the £282m rather than the £250m. But you can't bank on these things but I want to put something in your mind as an indication of what we're now capable of doing.

Then the question is the nature of our ambition. Well two years ago we were involved in a transaction, this was the Guardian transaction that went to Swiss Re. That was at a final price point at £1.6bn, we are clearly financially far more secure and far more capable of financing transactions of that scale and above.

And the really important thing in any deal, as I said, is less its type or size but our ability to realise synergies and we look forward to playing an extremely full role in an industry that without doubt is going to consolidate.

Henry Staunton

So in summary Clive would look at most things I think is what that means. Going back to Andrew's questions when we saw that bar chart I think last year I may have indicated that the UK life companies would be most likely to come up first because of their focus on asset management companies, their focus on specialist products, their focus on their overseas subsidiaries and indeed the impact of Solvency II generally. As it happens it's gone for the blue chart where the overseas companies have sold first which actually I think has been quite fortuitous for us because they've been two smaller deals which has allowed us to get to a size where inevitably some of these UK companies are going to be larger deals for us and the way it's come out in terms of the order of events has been quite helpful.

<u>Question 6</u>

Mr Colm Fagan, Private Investor

Two questions in regards to management actions. The first question: the cash receipts for £486m for 2016 include £265m from management actions; the CEO indicates in his report that the cash generation target of £2.3bn for 2017 to 2020 includes future management actions, could you indicate the proportion of the cash generation target for 2017 to 2020 represented by future management actions?

And the second question: the cash for £4.4bn expected to be generated from 2021 onwards does not include any future management actions, how much extra do you think management actions could contribute to that total?

Jim McConville

Thank you I'll deal with these. So last year we generated cash of £486m of which £265m was a result of management actions, that compared with historic periods was slightly higher in percentage terms and was a direct reflection of the AXA acquisition and what we were able to do there. Looking forward to the 2020 long-term target period we do see management actions between 35% and 40% overall. Again that's just a tad higher than we've probably averaged over the last few years and reflects the fact that we've had lower interest rates impacting the cash generation which have been factored into our future forecast.

As we stand today, and I've described it many times before about the dynamic nature of our management actions process, we have a hopper which is full of potential opportunities and keeping us very busy in terms of delivery of those management actions.

You're right to reflect that the £4.4bn cash that comes out after 2020 does not include management actions. We have not put a figure in percentage terms of what we think that could come through, although clearly as the Group matures the potential for management actions will reduce, but hopefully long before then further acquisitions will give us more opportunities.

Closing remarks: Henry Staunton

That concludes the proceedings. Thank you very much for coming and we look forward to seeing you soon.