Business review

Delivering sustainable cash generation

In 2023 we have once again delivered a year of strong performance, as we execute on our strategy and fulfil our purpose.

We have delivered another year of resilient cash generation, with £2.0 billion of total cash generated in 2023, exceeding our upgraded target of c.£1.8 billion. With £5.2 billion delivered across 2021 to 2023, we have also therefore over-delivered our three-year cash generation target of £4.4 billion, by c.£0.8 billion.

We saw a strong performance in our growth businesses, which increased our incremental new business long-term cash generation ('NB LTCG') by 23% year-on-year to £1,514 million, and therefore have achieved our 2025 target two years early. This was supported by new business net fund flows that grew 72% to £6.7 billion (2022: £3.9 billion).

Our Shareholder Capital Coverage Ratio ('SCCR') of 176% remains towards the upper-end of our operating range of 140–180%, but reduced given our investment into growth, as well as our integration and transformation expenses. Similarly, our Solvency II ('SII') surplus reduced to £3.9 billion, but remains resilient.

A strong performance in 2023

Key financial performance metrics:		2023	2022	YOY change
Cash	Total cash generation	£2,024m	£1,504m	+35%
New business	Incremental new business long-term cash generation	£1,514m	£1,233m	+23%
	Net fund flows	£6.7bn	£3.9bn	+72%
Dividends	Total dividend per share	52.65p	50.8p	+3.6%
	Final dividend per share	26.65p	26.0p	+2.5%
IFRS	Adjusted operating profit before tax[1,2]	£617m	£544m	+13%
	Loss after tax[1,2]	£(88)m	£(2,657)m	N/A
Solvency II capital	PGH Solvency II surplus	£3.9bn	£4.4bn	-11%
	PGH Shareholder Capital Coverage Ratio	176%	189%	-13%pts
Assets	Assets under administration	£283bn	£259bn	+9%
Leverage	Solvency II leverage ratio	36%	34%	+2%pts

1 2022 restated comparative to reflect adoption of IFRS 17
2 Incorporates changes to the Group's methodology for determining adjusted operating profit since Half Year 2023 (see Note B.1 to the consolidated financial statements for further details).

Our strong overall performance this year has therefore enabled the Board to recommend a dividend increase of 2.5% for the year.

In terms of our IFRS earnings, the Group's adjusted operating profit grew 13% to £617 million, supported by 27% growth in our Pensions and Savings business and an 8% increase in our Retirement Solutions business. While we reported an IFRS loss after tax of £88 million, this was a £2,569 million improvement on 2022. The loss in 2023 was primarily driven by £(781) million of non-operating items, as outlined on page 36.

The segmental information given reflects the Group's new operating segments, further information is provided in note B.1 on page 180.

Clear strategic progress

We have made significant strategic progress in delivering sustainable organic growth. In Pensions and Savings, our Workplace business continues to see an attractive retention rate with existing clients but is also now winning new larger schemes. Our Retail business remains in net outflow, but we have a clear strategy to address this over the coming years, by investing to deliver compelling customer propositions.

The progress we have made in executing our strategic priorities has enabled us to deliver a strong set of results in 2023, and supported the Board's decision to recommend a 2.5% increase in the Final 2023 dividend.

Rakesh Thakrar,
Group Chief Financial Officer

In Retirement Solutions, we continue to adopt a disciplined approach to Bulk Purchase Annuities ('BPA') and have been successful in reducing our capital strain. In September, we also launched a new individual annuity product, our first that is available in the open market.

From an M&A perspective, we successfully completed the acquisition of Sun Life of Canada UK ('SLOC') in April with the integration progressing well.

In summary, 2023 has been another year of clear strategic progress, that has supported the delivery of a strong set of results.

We continue to deliver sustainable and resilient cash generation, which underpins our new progressive and sustainable ordinary dividend policy. Our Solvency capital position also remains highly resilient, and can support the investment to grow, optimise and enhance our business going forward.

An evolved financial framework for the next phase of our journey

We are introducing our evolved financial framework that focuses on the three financial outcomes we deliver for our shareholders: cash, capital and earnings.

Phoenix has always managed its business for cash and capital, but our evolved key metrics provide clearer line of sight to the underlying business performance and more comparability with peers. We are also elevating the importance of IFRS earnings in our framework, following the transition to IFRS 17.

The key metrics we use can be seen here

Our key performance indicators
With our financial framework designed to deliver cash, capital and earnings, we recognise the need to use a broad range of metrics to measure and report the performance of the Group, some of which are not defined or specified in accordance with Generally Accepted Accounting Principles ('GAAP') or the statutory reporting framework. The IFRS results are discussed on pages 36 to 37 and the IFRS financial statements are set out from page 164 onwards.

Alternative performance measures
In prioritising the generation of sustainable cash flows from our operating companies, performance metrics are monitored where they support this strategic purpose, which includes ensuring that the Solvency II capital strength of the Group is maintained. We use a range of Alternative Performance Measures ('APMs') to evaluate our business, including the below. Please see the APM section on page 312 for further details.

Total cash generation
Cash generation represents the total cash remitted from the operating entities to the Group, supported by the Operating Cash Generation (see below) and the release of free surplus above capital requirements in the Life companies, which is generated through margins earned on life and pension products and the release of capital requirements, and Group tax relief. This cash generation is used by the Group to fund expenses, interest costs and shareholder dividends, with any surplus then available to reinvest into organic and inorganic growth opportunities.

Operating Cash Generation
Operating Cash Generation ('OCG') is a new reporting metric. It represents the sustainable level of cash generation in our life companies each and every year, that is remitted from our underlying business operations. It comprises the emergence of cash as in-force business runs off over time and capital unwinds, plus day one surplus from writing new business (net of day one strain for fee-based business), group tax relief and recurring management actions. In addition, it includes a small cash contribution from the release of the Capital Management Policy that we hold in our Life Companies. The measure provides the sources of recurring organic cash generated which can be used to support sustainable cash remittances from the Life Companies, which in turn supports the Group's dividend, group costs and debt interest as well as funding investment to generate sustainable growth.

Incremental new business long-term cash generation
Incremental new business long-term cash generation is a key metric for measuring growth. It represents the operating companies' cash generation that is expected to arise in future years as a result of new business transacted in the period.

New business net fund flows
Represents the aggregate net position of assets under administration inflows less outflows for new business.

Adjusted operating profit
The Group uses adjusted operating profit as a measure of IFRS performance based on long-term assumptions. Adjusted operating profit is less affected by the short-term market volatility driven by Solvency II hedging (as illustrated on page 36) and non-recurring items than IFRS profit. A more detailed definition of adjusted operating profit is set out on page 312.

Solvency II
Solvency II is a key metric by which the Group makes business decisions and measures capital resilience. It is a regulatory measure that prescribes the measurement of value on a Solvency II basis and the calculation of the solvency capital requirement ('SCR'). The excess value above the SCR is reported as both a financial amount, 'Solvency II surplus', and as a ratio 'Solvency II Shareholder Capital Coverage Ratio ('SCCR')'.

Solvency II leverage
The Group seeks to manage the level of debt on its balance sheet by monitoring its financial leverage ratio. Solvency II leverage is calculated as the Solvency II value of debt divided by the value of Solvency II Regulatory Own Funds. Values for debt are adjusted to allow for the impact of currency hedges in place over foreign currency denominated debt.

Business review continued

Cash

£2,024m

Total cash generation REM APM

£1,514m

Incremental new business long-term cash generation REM APM

Group cash flow analysis

£m	2023	2022
Cash and cash equivalents at 1 January	**503**	**963**
Total cash generation[1]	**2,024**	**1,504**
Uses of cash:		
Operating expenses	(97)	(78)
Pension scheme contributions	(16)	(16)
Debt interest	(229)	(244)
Non-operating cash outflows	(111)	(395)
Debt repayments	(350)	(450)
Debt issuance	346	–
Shareholder dividend	(520)	(496)
Total uses of cash	**(977)**	**(1,679)**
Support of BPA activity	(288)	(285)
Cost of Sun Life of Canada UK acquisition	(250)	–
Closing cash and cash equivalents at 31 December	**1,012**	**503**

1 Total cash receipts include £219 million received by the holding companies in respect of tax losses surrendered (2022: £55 million).

Total cash generation

Cash generation represents cash remitted by the Group's operating companies to the holding companies. Please see the APM section on page 312 for further details of this measure.

Cash generation is principally used to fund the Group's operating costs, debt interest and repayments, investment into growth and shareholder dividends. Excess cash is available for investment into the business and/or additional shareholder returns.

The cash flow analysis that follows reflects the cash paid by the operating companies to the Group's holding companies, as well as the uses of those cash receipts.

Cash receipts

Total cash generated by the operating companies during 2023 was £2,024 million (2022: £1,504 million). This exceeded the Group's upgraded target of c.£1.8 billion for the year, due to additional management actions being delivered.

Uses of cash

Operating expenses of £97 million (2022: £78 million) represent corporate office costs, net of income earned on holding company cash and investment balances. The increase compared to 2022 reflects the investment we have made in our Group capabilities to support our growth strategy,

Debt interest of £229 million (2022: £244 million) reflects interest paid in the period on the Group's debt instruments. The decrease year-on-year is due to the repayment of debt in July 2022.

Non-operating cash outflows were £111 million (2022: £395 million). This primarily comprises centrally funded projects and investments totalling £307 million. Of this, £129 million relates to Group project expenses for the transition activity in relation to legacy platform migrations, £18 million for other ongoing integration programmes including ReAssure and SLOC, £56 million of investment related to our growth propositions, and £12 million for our Finance Transformation. These costs were partially offset by a £196 million inflow in respect of net collateral cash and hedge close-outs.

Debt repayments and issuance in 2023 reflect the debt re-terming exercise we undertook in the fourth quarter.

The shareholder dividend of £520 million represents the payment of £260 million in May for the 2022 Final dividend and the payment of the 2023 Interim dividend of £260 million in September.

Funding of £288 million (2022: £285 million) has been provided to the Life companies to support another strong year in BPA with £6.2 billion of premiums written (2022: £4.8 billion). The Group's success in further optimising its capital efficiency is reflected in the reduction of the Group's capital strain on BPA to 2.7% (2022: 3.2%) on a pre-Capital Management Policy ('CMP') basis, including the benefit of the Solvency II reform risk margin reduction. This enabled the Group to write increased NB LTCG but with a similar level of capital invested.

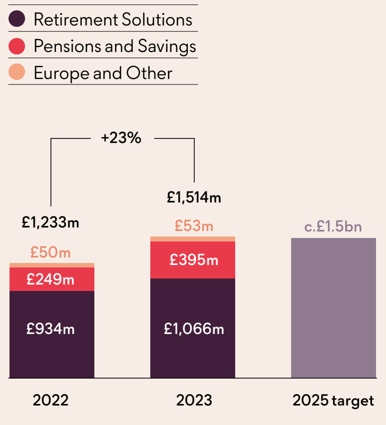
Incremental new business long-term cash generation

NB LTCG reflects the impact on the Group's future cash generation arising as a result of new business transacted in the year. It is stated on an undiscounted basis.

In 2023 we delivered another record year of organic new business growth including NB LTCG of £1,514 million (2022: £1,233 million), enabling us to achieve our 2025 target two years early.

Strong growth in our capital-light fee-based business, Pensions and Savings, led to a contribution of £395 million (2022: £249 million). Our disciplined approach in a buoyant BPA market drove an increase in NB LTCG in our Retirement Solutions business to £1,066 million (2022: £934 million). Europe and Other contributed £53 million (2022: £50 million).

Strong incremental new business long-term cash generation



Introducing Operating Cash Generation

As part of our evolved financial framework we are introducing Operating Cash Generation ('OCG') as a new alternative performance metric to demonstrate the long-term sustainability of our cash generation.

OCG is the combination of the operating surplus emerging and recurring management actions. It represents the sustainable surplus generation remitted from our Life Companies to the Group Holding Company. OCG can be easily reconciled to operating surplus generation ('OSG'), with the bridge being the small release of the Capital Management Policy ('CMP') held in our Life companies.

OCG totalled £1.1 billion in 2023, comprising £0.8 billion of surplus emergence and £0.3 billion of recurring management actions.

Outlook

We will grow OCG sustainably over the long term through investing our surplus cash across our three strategic priorities of Grow, Optimise and Enhance.

We will Grow by investing c.£100 million into our growth propositions and by continuing to grow our annuities business with c.£200 million of capital invested annually. This will support strong growth across our Pensions and Savings and Retirement Solutions businesses.

As we Optimise, we will deliver recurring management actions of c.£400 million per annum by 2026, supported by c.£100 million investment in our asset and liability optimisation capabilities and as our business grows.

As we Enhance our business, we will continue to migrate customers and drive through cost efficiencies that will deliver c.£250 million of annual cost savings by the end of 2026.

Together these will increase OCG by c.25% from £1.1 billion in 2023 to £1.4 billion in 2026. After which we expect it to grow at a sustainable mid-single digit growth rate over the long term.

Future sources and uses of total cash generation

While OCG is our new primary metric, total cash generation remains very important, as we invest across our strategic priorities.

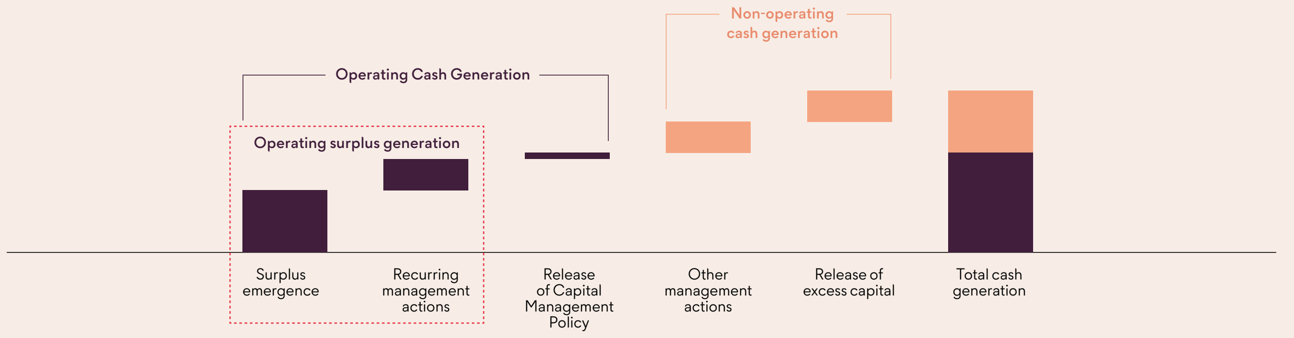
We have set a new total cash generation target of £4.4 billion across 2024–2026, that will enable us to cover our recurring uses, pay our growing dividend and invest in our business.

We expect to generate c.£3.7 billion of OCG over this period, which will more than cover our recurring uses and our planned investment of capital into annuities each year.

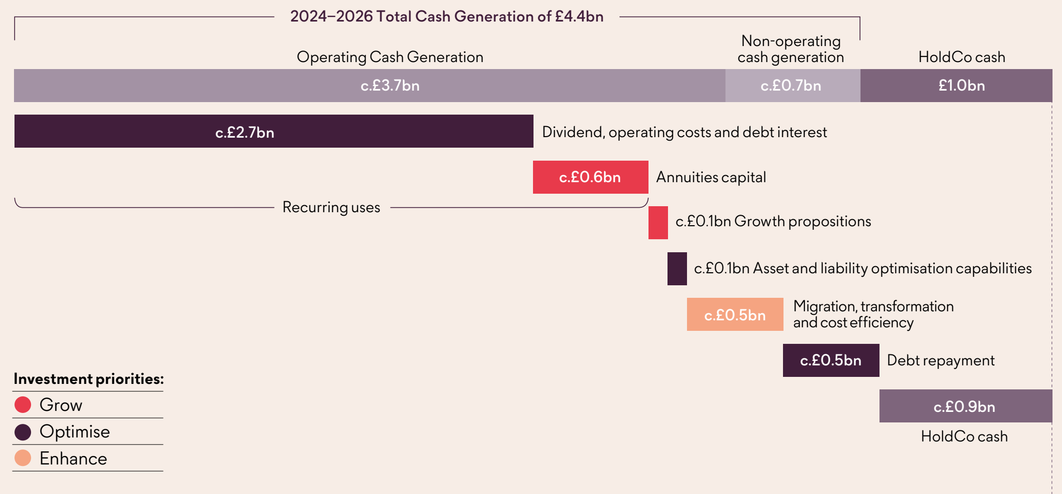
In addition we expect to generate a further c.£0.7 billion of non-operating cash generation across 2024–2026 comprising other management actions and the release of historic excess capital that has built up in our Life Companies. That provides us with a significant amount of surplus cash that we can invest across our strategic priorities.

Our HoldCo cash position is a healthy £1 billion today, which we expect to remain broadly consistent over 2024 to 2026.

We are introducing Operating Cash Generation as a new metric to demonstrate the long-term sustainability of our business model



Operating Cash Generation is expected to more than cover our recurring uses and generates surplus to invest into our business



Business review continued

Capital

£3.9bn
Group Solvency II surplus (estimated)

176%
Group Solvency II shareholder capital Coverage Ratio (estimated) APM

Capital management
A Solvency II capital assessment involves a valuation in line with Solvency II principles of the Group's Own Funds and a risk-based assessment of the Group's Solvency Capital Requirement ('SCR').

The Group's Own Funds differ materially from the Group's IFRS equity for a number of reasons, including the recognition of future shareholder transfers from the With-Profits funds and future management charges on investment contracts, the treatment of certain subordinated debt instruments as capital items, and a number of valuation differences, most notably in respect of insurance contract liabilities, taxation and intangible assets.

Group Solvency II capital position
Our Solvency II capital position remains strong and resilient, with a surplus of £3.9 billion (2022: £4.4 billion), after the accrual for the deduction of our 2023 Final dividend of £267 million. Our SCCR reduced marginally to 176% (2022: 189%) but remains towards the upper-end of our 140–180% operating range, providing the capacity to continue investing to grow, optimise and enhance our business.

Change in Group Solvency II surplus and SCCR
Operating surplus generation increased the SII surplus by £1.1 billion, contributing to an increase in the SCCR of 27%pts. This was comprised of our ongoing surplus emergence which increased the SII surplus by £0.8 billion during the year and recurring management actions of £0.3 billion.

Other management actions increased the SII surplus further by £0.4 billion and added 16%pts to the SCCR.

Operating costs, debt interest and dividend totalled £0.9 billion, reducing the SCCR by 19%pts.

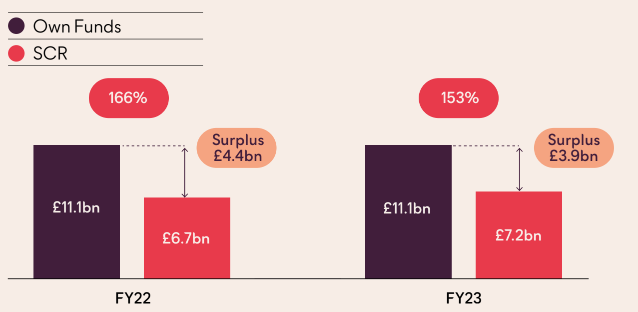
We have also chosen to invest £0.4 billion of surplus capital into growth. This includes £0.3 billion of capital investment to fund £6.2 billion of BPA premiums written in the year, reducing the SCCR by 10%pts, and £0.1bn of investment into our organic growth propositions, reducing the SCCR by a further 3%pts.

Our comprehensive hedging strategy is designed to protect our capital position. In 2023 this led to a small adverse impact from economic variances of £(0.3) billion on our Solvency II surplus. This included a £(0.1) billion adverse impact from unhedged gilt-swap spread movements, as well as adverse currency movements and some other smaller adverse impacts.

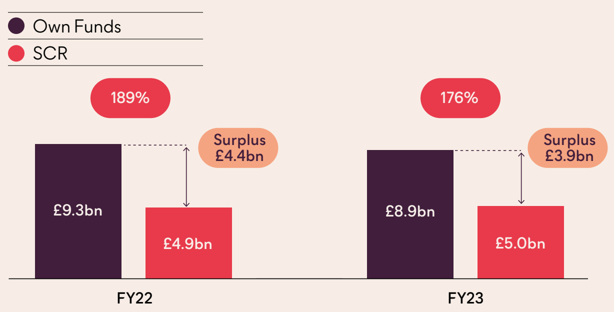
We are on track for the effective date for Consumer Duty on back-book products in July. Our ongoing focus on ensuring good outcomes for Heritage customers means we have identified only a small number of products that we believe need addressing in advance of the compliance date. We have set aside a prudent c.£70 million of Solvency II capital to reflect the impact of the possibility of introducing further charging caps on certain products, reducing the SCCR by 2%pts.

Other movements include the benefit of the Solvency II risk margin reform and favourable longevity assumption changes. These were offset by the strengthening of expense provisions associated with our transformation projects, in addition to a net adverse impact arising on the completion of the SLOC acquisition. Overall, these movements decreased Solvency II surplus by £0.3 billion and the SCCR by 13%.

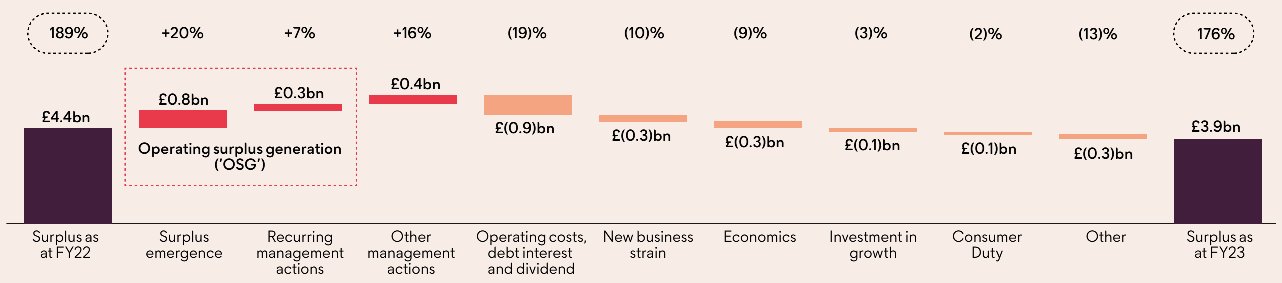
£3.9 billion Group Regulatory Solvency II surplus



£3.9 billion Group Shareholder Solvency II surplus



2023 change in Group Solvency II surplus



Sensitivity and scenario analysis
As part of the Group's internal risk management processes, the Own Funds and regulatory SCR are regularly tested against a number of financial scenarios. The table provides illustrative impacts of changing one assumption while keeping others unchanged and reflects the business mix at the balance sheet date. Extreme market movements outside of these sensitivities may not be linear. While there is no value captured in the Group stress scenarios for recovery management actions, the Group does proactively manage its risk exposure. Therefore in the event of a stress, we would expect to recover some of the loss reflected in the stress impacts shown.

Unrewarded market risk sensitivities
We have a low appetite to equity, interest rate, inflation and currency risks, which we see as unrewarded, i.e. the return on capital for retaining the risk is lower than for hedging it. In order to stabilise our Solvency II surplus, we regularly monitor risk exposures and use a range of hedging instruments to remain within a Board-approved target range. Equity risk primarily arises from our exposure to a variation in future management fees on policyholder assets exposed to equities, while our currency exposure primarily arises from our foreign currency denominated debt. Our interest rate exposure principally relates to our shareholder credit portfolio, while our inflation exposures arises from both cost inflation expectations and inflation-linked policies.

Rewarded market risk sensitivities
We do however retain the credit risk in our c.£38 billion shareholder credit portfolio, and property risk in equity release mortgages, where we see these risks as rewarded. The shareholder credit assets are primarily used to back the Group's annuity portfolio. Exposure to these risks is needed to back growth in the Group's annuity portfolio. Stress testing is used to inform the level of risk to accept and to monitor exposures against risk appetite. We actively manage our portfolio to ensure it remains high quality and diversified, and to maintain our sensitivities within risk appetite. Our portfolio is c.99% investment grade and we have suffered no defaults, testament to the proactive approach taken by our in-house asset management team.

We also remain conservative in our property exposure. We have c.£4.5 billion of our credit portfolio exposed to equity release mortgages, which are all UK-based with an average rating of AA and average loan-to-value ('LTV') of 33%, and c.£1.1 billion in commercial real estate which is high quality and all UK-based with an average LTV of 47%. The full sensitivity we focus on for credit is a full letter downgrade of 20% of our credit portfolio, which is £(0.3) billion and is therefore small relative to the Group's £3.9 billion Solvency II surplus.

Estimated impact on PGH Solvency II[1]	Surplus £bn	SCCR %
Solvency II base	3.9	176
Equities: 20% fall in markets	0.1	5
Long-term rates: 100bps rise in interest rates[2]	0.1	6
Long-term rates: 100bps fall in interest rates[2]	(0.1)	(5)
Long-term inflation: 50bps rise in inflation[3]	(0.1)	(1)
Property: 12% fall in values[4]	(0.2)	(5)
Credit spreads: 135bps widening with no allowance for downgrades[5]	(0.2)	(4)
Credit downgrade: immediate full letter downgrade on 20% of portfolio[6]	(0.3)	(9)
Lapse: 10% increase/decrease in rates[7]	(0.1)	(1)
Longevity: 6 months increase[8]	(0.4)	(8)

1 Illustrative impacts assume changing one assumption on 1 January 2024, while keeping others unchanged, and that there is no market recovery. They should not be used to predict the impact of future events as this will not fully capture the impact of economic or business changes. Given recent volatile markets, we caution against extrapolating results as exposures are not all linear.
2 Assumes the impact of a dynamic recalculation of transitionals and an element of dynamic hedging which is performed on a continuous basis to minimise exposure to the interaction of rates with other correlated risks including longevity.
3 Rise in inflation: 15yr inflation +50bps.
4 Property stress represents an overall average fall in property values of 12%.
5 Credit stress varies by rating and term and is equivalent to an average 135bps spread widening. It assumes the impact of a dynamic recalculation of transitionals and makes no allowance for the cost of defaults/downgrades.
6 Impact of an immediate full letter downgrade across 20% of the shareholder exposure to the bond portfolio (e.g. from AAA to AA, AA to A, etc.). This sensitivity assumes management actions are taken to rebalance the annuity portfolio back to the original average credit rating and makes no allowance for the spread widening which would be associated with a downgrade.
7 Assumes most onerous impact of a 10% increase/decrease in lapse rates across different product groups.
8 Only applied to the annuity portfolio.

Managing demographic risks
We have three key demographic risks – lapse risk from early surrenders, longevity risk on our annuity portfolio and mortality risk on our protection book. We manage lapse risk through our strong customer proposition. Our longevity risk principally arises from our annuity book, but this is managed through reinsurance. We retain around half of this risk across our current in-force book, and reinsure most of this risk on new business. Mortality risk arises from our protection business and we seek to manage this as part of a well-diversified portfolio.

Life Company Free Surplus
Life Company Free Surplus represents the Solvency II surplus for the Life Companies that is in excess of their Board-approved CMPs. It is this Free Surplus from which the Life Companies remit cash to Group. We retain a significant Life Company Free Surplus of £2.2 billion which provides resilience to the Group's long-term cash generation.

Solvency II capital outlook
We maintain a 140–180% SCCR operating range, which reflects our low sensitivity to economic volatility due to our comprehensive hedging.

We have been at the top-end of our range for the past three years, but will invest some of this surplus as we transform our business, with the investment more front-end weighted across 2024–2026. In addition, our intention to repay at least c.£500 million of debt by the end of 2026 will also reduce our SCCR over the coming years.

Leverage
We manage our leverage position by considering a range of factors including our cash interest cover, the interplay of our balance sheet hedging, and our capital tiering headroom. It also includes a number of output metrics that we monitor, such as the Fitch leverage ratio and Solvency II leverage ratio.

Our approach to leverage has always been to increase leverage to support M&A and then pay down that debt with surplus cash as it emerges. Since 2020 the Group has repaid c.£800 million of debt through this approach.

As at 31 December 2023, our Solvency II leverage ratio was 36% (2022: 34%). This increased in 2023, largely due to our investment in growth, integration and transformation. The Group's Fitch leverage ratio was 23% compared to full year 2022 on a restated basis of 23%, and is favourably below Fitch's stated range of 25–30% for an investment grade credit rating.

We plan to continue our approach of repaying M&A-related debt with surplus cash, and subject to regulatory approval, we intend to repay at least £500 million of debt by the end of 2026, including the £250 million Tier 2 bond that is callable in June 2024. This will support us in achieving a c.30%[1] Solvency II leverage ratio by the end of 2026. This is a steady-state level of leverage that we will believe is the appropriate for our business, absent M&A.

1 Assuming economic conditions in line with 31 December 2023.

Business review continued

Earnings

£617m

Adjusted operating profit before tax APM

£4.6bn

Adjusted shareholders' equity APM

IFRS profit and loss statement	2023	2022[1,2]
Pensions and Savings	£190m	£150m
Retirement Solutions	£378m	£349m
With-Profits	£10m	£54m
Europe and Other	£132m	£60m
Corporate Centre	£(93)m	£(69)m
Adjusted operating profit before tax	**£617m**	**£544m**
Investment return variances and economic assumption changes	£147m	£(3,309)m
Amortisation and impairment of intangibles	£(322)m	£(353)m
Other non-operating items	£(439)m	£(262)m
Finance costs	£(195)m	£(199)m
Profit before tax attributable to non-controlling interest	£28m	£67m
Loss before tax attributable to owners	**£(164)m**	**£(3,512)m**
Tax credit attributable to owners	£76m	£855m
Loss after tax attributable to owners	**£(88)m**	**£(2,657)m**

1 2022 restated comparative to reflect adoption of IFRS 17.
2 Incorporates changes to the Group's methodology for determining adjusted operating profit since Half Year 2023 (see note B1 to the consolidated financial statements for further details).

IFRS results

IFRS (loss)/profit is a GAAP measure of financial performance and is reported in our statutory financial statements on page 164 onwards. Adjusted operating profit before tax is a non-GAAP financial performance measure based on expected long-term investment returns. It is stated before amortisation and impairment of intangibles, other non-operating items, finance costs and tax. Please see the APM section on page 312 for further details of this measure. On 1 January 2023, the Group adopted the new accounting standard, IFRS 17: 'Insurance Contracts', with comparatives restated from 1 January 2022. IFRS 17 requires a company to recognise profits as it delivers insurance services (rather than when it receives premiums) and to provide information about insurance contract profits the company expects to recognise in the future. The impact of the transition to IFRS 17 is set out in note A2.1.

IFRS loss after tax attributable to owners

The Group generated an IFRS loss after tax attributable to owners of £88 million (2022: loss of £2,657 million). The improvement versus 2022, primarily reflects a £3,456 million improvement in economic variances due to a much lower level of market volatility in the period, particularly interest rates. This has been partially offset by an increase in non-operating items as a result of our investment into growth in the period and ongoing migrations and transformation.

Basis of adjusted operating profit

Adjusted operating profit is based on expected investment returns on financial investments backing business where asset returns accrue to the shareholder and surplus assets over the reporting period, with allowance for the corresponding expected movements in liabilities (being the interest cost of unwinding the discount on the liabilities). Adjusted operating profit includes the unwind of the Contractual Service Margin ('CSM') and risk adjustment attributable to the shareholder. The principal assumptions underlying the calculation of the long-term investment return are set out in note B 2.1 to the IFRS consolidated financial statements.

Adjusted operating profit includes the effect of variances in experience relating to the current period for non-economic items, such as mortality and expenses. It also incorporates the impacts of asset trading optimisation and portfolio rebalancing where not reflected in the discount rate used in calculating expected return. Any difference between expected and actual investment return, along with other economic variances described further in note B1.1 are shown outside of adjusted operating profit. Adjusted operating profit is net of policyholder finance charges and policyholder tax.

Adjusted operating profit

The Group increased adjusted operating profit by 13% to £617 million (2022: £544 million). This primarily reflects strong growth in our Pensions and Savings business, which delivered adjusted operating profit of £190 million, an increase of 27% year-on-year (2022: £150 million). This was largely driven by higher AUA resulting in increased charges, and an improved margin through operating leverage.

Our Retirement Solutions business delivered an adjusted operating profit of £378 million (2022: £349 million). The 8% increase year-on-year primarily reflects a higher expected investment margin as a result of higher risk-free rates. The positive impact of BPA new business on CSM amortisation has offset the run-off of the remaining annuity book despite the phasing of a significant proportion of new business in late 2023.

With-Profits adjusted operating profit declined to £10 million (2022: £54 million) principally as a result of the run-off of this business and the adverse impacts of modelling refinements in the period.

Europe and Other adjusted operating profit increased to £132 million (2022: £60 million). This segment includes the expected investment margin from surplus assets within shareholder funds, which has increased due to the significant increases in interest rates over 2022. This has been partially offset by a reduction in CSM amortisation following the strengthening of the mortality assumptions on our Protection business.

The Group's Corporate Centre includes net operating costs in the period of £93 million (2022: £69 million), which increased due to investment in central functions to support our growth ambitions in the first phase of our journey, partially offset by increased interest income on Holding Company cash.

Investment return variances and economic assumption changes

The net positive economic variances of £147 million (2022: £3,309 million loss) results from a more stable market environment compared with the significant volatility experienced during 2022. The impact of positive changes to discount rates, primarily on annuities and including the impact of methodology refinements, more than offsets the losses arising from the impact of positive equity market movements on the hedges the Group holds to protect the Solvency II position. As the full value of future profits impacted by equity markets is not held on the IFRS balance sheet, this results in an 'over-hedged' position on an IFRS basis.

Amortisation and impairment of intangibles

The previously acquired in-force business, relating to IFRS 9 accounted capital-light fee-based products, is being amortised in line with the expected run-off profile of the investment contract profits to which it relates. The amortisation and impairment of acquired in-force business during the period of £316 million (2022: £347 million) has decreased year-on-year reflecting the impact of the business run-off. Amortisation and impairment of other intangible assets totalled £6 million in the period (2022: £6 million).

Other non-operating items

Other non-operating items in the period totalled a £439 million loss (2022: £262 million loss), inclusive of a £66 million gain recognised on the Sun Life of Canada UK acquisition. This includes £169 million expenditure to support our growth strategy and £36 million impact from setting up a new European subsidiary that was required post-Brexit to continue serving some of our overseas Heritage customers.

Other items include £217 million of costs relating to finance transformation activities, £111 million in respect of ongoing integration, transition and transformation projects, £12 million of other corporate project costs, and net other one-off items totalling £74 million, including costs associated with the Part VII transfer of three of the Group's Life insurance entities.

Lastly, finance costs of £195 million reflect interest borne on the Group debt instruments and were broadly stable year-on-year (2022: £199 million).

Tax charge attributable to owners

The Group's approach to the management of its tax affairs is set out in its Tax Strategy document which is available in the corporate responsibility section of the Group's website. The Group tax credit for the period attributable to owners is £76 million (2022: £855 million tax credit) based on a loss (after policyholder tax) of £(164) million (2022: loss of £(3,512) million). A reconciliation of the tax charge is set out in note C8 to the Group financial statements.

Contractual Service Margin ('CSM')

The CSM represents a stock of future profits that will unwind into the P&L in future years.

The Group had a CSM (gross of tax) of £2.9 billion as at 31 December 2023, which grew by 10% in 2023 (2022: £2.6 billion) primarily due to new BPA business written, the acquisition of the SLOC in 2023, interest accretion and assumption changes, which was partly offset by the CSM release into the income statement.

The CSM release in the period represents c.8% of the closing CSM (gross of tax) pre release of £3.1 billion. We expect the release of the CSM (gross of tax) to be c.5–7% over time, primarily driven by annuities.

Assets under administration

AUA provides an indication of the potential earnings capability of the Group arising from its insurance and investment business, whilst AUA flows provide a measure of the Group's success in achieving growth from new business.

Group AUA as at 31 December 2023 was £282.5 billion (2022: £259.0 billion), an increase of 9% year-on-year. This increase was primarily driven by an £18.7 billion benefit from positive market and other movements and £8.0 billion relating to the SLOC acquisition. Net inflows in Workplace, Retirement Solutions, Europe and Other were £4.7 billion, £3.3 billion and £0.3 billion respectively, but these were offset by £1.6 billion of outflows in Retail and £9.9 billion of legacy outflows.

Outlook

The investments we are making across our strategic priorities will support strong growth in our IFRS adjusted operating profit before tax over the next few years.

We are targeting £900 million of IFRS adjusted operating profit in 2026, up from £617 million in 2023, reflecting a c.50% increase. This includes the majority of the £250 million cost savings as well as the impact of our organic growth and management actions.

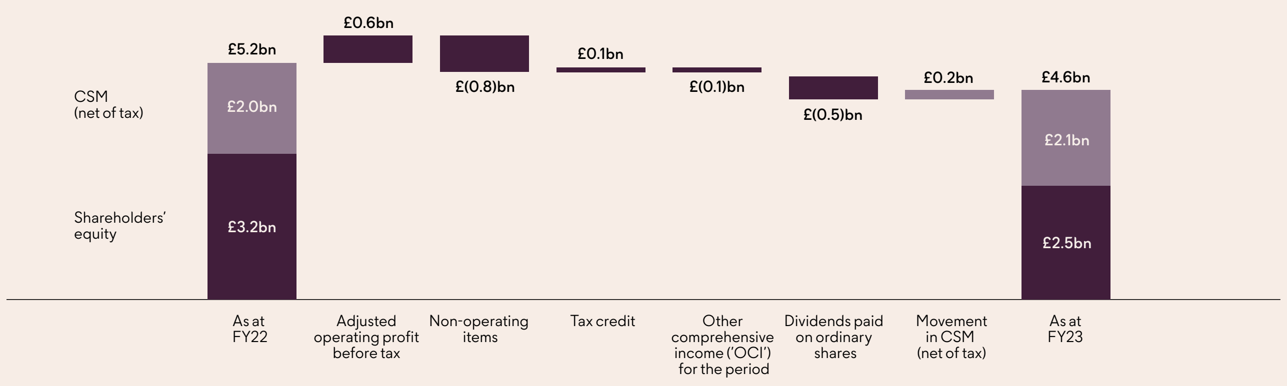
We have an elevated level of non-operating costs at present, but we expect these to normalise after we are through our three-year investment programme. We have also suffered significant headwinds to shareholders equity from adverse economics over the past two years, primarily related to the significant rise in long-term interest rates and rise in equities. While future economic impacts are hard to forecast, we would expect to see some unwind of this adverse impact if interest rates return to normalised levels. We would also earn higher revenue from higher asset values in our Pensions and Savings business.

The other below the line items are more predictable and while we expect our shareholders' equity to decline over the coming years, we expect it to remain positive over the long term.

Our adjusted shareholders' equity, inclusive of the CSM, will remain broadly stable near-term and then begin to grow. Supported by strong CSM growth from our annuities business and other management actions.

As a reminder, our Group consolidated shareholders' equity is not a constraint to the payment of our dividends. This is because our dividends are paid from the Phoenix Group Holding Company, which is not impacted by IFRS 17 and has c.£4.6 billion of distributable reserves.

Movement of IFRS adjusted shareholders' equity over 2023



Note: Numbers in the graph above do not sum due to rounding.

Business review continued

Capital allocation

52.65p
Total 2023 dividend per share

+2.5%
Final 2023 dividend increase

2023 dividend increase
Phoenix has demonstrated a strong dividend track record over the past 13 years, with a c.4% compound annual growth rate ('CAGR') since 2011. Our strong strategic and financial performance in 2023 has supported a 2.5% recommended increase in the Final 2023 dividend to 26.65p per share, taking the Total dividend to 52.65p per share.

New capital allocation framework for the next phase of our journey
As we embark on the next stage of our journey, we are outlining a new capital allocation framework.

There are two key underpins to our framework. The first is that we will operate a progressive and sustainable ordinary dividend policy. The second is that we will maintain our strong and resilient balance sheet, by operating within a 140–180% Shareholder Capital Coverage Ratio range.

We will seek to balance the investment of our 2024–2026 surplus capital across our strategic priorities of grow, optimise and enhance.

In our Grow strategic priority, we will invest c.£100 million into developing our growth propositions and c.£200 million of capital per annum to grow our annuities.

In our Optimise strategic priority, we will continue our approach of repaying M&A-related debt using surplus cash, with an intention to repay at least £500 million of debt by the end of 2026. This will support a Solvency II leverage ratio of c.30%[1] by the end of 2026.

We will also invest c.£100 million into our asset and liability optimisation capabilities to support recurring managements over the long term.

In our Enhance strategic priority, we will invest c.£500 million on migration, transformation and cost efficiency programmes bringing our businesses onto a single Group-wide operating model that will further enhance our cost efficiency.

Additional surplus capital, over and above these committed investments, will be allocated to the highest return opportunities. This could include additional investment into growth, further deleveraging, M&A, and/or additional capital return to shareholders.

New progressive dividend policy
The Board has evolved Phoenix's dividend policy to reflect the confidence it has in the Group's strategy. The Group will now operate a progressive and sustainable ordinary dividend policy.

The Board will continue to announce any potential annual dividend increase alongside the Group's Full Year results and expects the Interim dividend to be in-line with the previous year's Final dividend. The Board will continue to prioritise the sustainability of our dividend over the very long term. Future dividends and annual increases will continue to be subject to the discretion of the Board, following assessment of longer-term affordability.

Capital allocation framework:

- Operate a progressive and sustainable ordinary dividend policy
- Strong and resilient balance sheet: 140–180% Shareholder Capital Coverage Ratio operating range

2024–2026 investment priorities:

Invest to grow	Invest to optimise	Invest to enhance
• c.£100m into growth propositions • c.£200m of capital per annum into annuities	• Debt repayment of at least £500m by the end of 2026 • c.£100m to enhance our asset and liability optimisation capabilities	• c.£500m of migration, transformation and cost efficiency investment

Surplus capital allocation approach:

Allocate surplus capital to the highest return opportunities
- Investment into growth
- Further deleveraging
- M&A
- Return capital to shareholders

1 Assuming economic conditions in line with 31 December 2023.

Outlook

Growing Operating Cash Generation that more than covers our recurring uses and supports our new progressive and sustainable ordinary dividend policy.

Looking ahead
Our purpose is to help people secure a life of possibilities. The continued execution against our three strategic priorities of Grow, Optimise and Enhance, will support us in delivering strong financial outcomes for our shareholders.

Clear financial outcomes for shareholders
We have a new set of ambitious 2026 targets, across our evolved financial framework of cash, capital and earnings.

Starting with cash, Phoenix has set three new cash generation targets. The first is that we expect Operating Cash Generation to grow to £1.4 billion in 2026, a c.25% increase from 2023. This growth underpins our Total cash generation target, with a one-year target for 2024 of £1.4–1.5 billion, and a three-year target of £4.4 billion across 2024–2026.

Our cash targets demonstrate our confidence in our ability to deliver sustainable, growing cash generation over time.

In terms of capital, we will continue to maintain a strong Solvency II balance sheet through our comprehensive hedging approach. This will see us continue to operate within our Solvency II SCCR operating range of 140–180% and continue to manage our key individual risk sensitivities on a Solvency II surplus basis.

Our intention to repay at least £500 million of debt by the end of 2026. This will support us on our path towards a c.30% Solvency II leverage ratio by the end of 2026, which is an appropriate steady-state level for our business absent M&A.

Turning to earnings, we are targeting IFRS adjusted operating profit to grow c.50% to £900 million in 2026, as we grow, optimise and enhance our business. This will include the majority of the c.£250 million of annual cost savings we aim to deliver by the end of 2026.

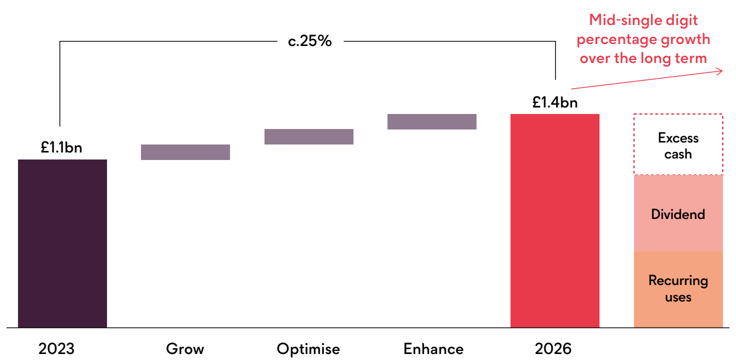
We expect the improving macroeconomic outlook, with interest rates and inflation normalising, to support our future growth ambitions and targets.

Delivering against the targets across our evolved financial framework of cash, capital and earnings, in turn supports our new progressive and sustainable ordinary dividend policy.

2024 will be another exciting year for Phoenix Group on our journey and as we continue to deliver on our purpose and our strategy.

Rakesh Thakrar
Group Chief Financial Officer

Growing Operating Cash Generation supports our new progressive dividend policy



Phoenix Group's new dividend policy
The Group operates a progressive and sustainable ordinary dividend policy

We have a clear set of supporting targets:

Cash
- £1.4 billion Operating Cash Generation in 2026
- £4.4 billion of Total cash generation across 2024–2026
- £1.4-to-£1.5 billion of Total cash generation in 2024

Capital
- 140–180% Shareholder Capital Coverage Ratio operating range
- Solvency II leverage ratio of c.30% by the end of 2026

Earnings
- Targeting £900 million of IFRS adjusted operating profit in 2026
- c.£250m of annual cost savings by 2026