Phoenix

Half year 2022 results transcript

H1 2022 review

Andy Briggs, Group Chief Executive Officer

Good morning everybody and welcome to Phoenix Group's 2022 Half Year Results Presentation. It's great to be presenting here at our new London head office building for the first time. So thank you for coming and welcome to those of you joining us on the live webcast.

Phoenix has had a fantastic first half, despite the tough economic backdrop. We have once again delivered a record set of results across our financial framework of cash, resilience and growth.

This was underpinned by the strong progress we've made across our wider strategic priorities, which ensure we are delivering for our customers, colleagues and investors and on our core social purpose and wider role in society.

We continue to grow organically, delivering strongly for customers, with £1.8 billion of net inflows across our Open business and a very pleasing 42 new Workplace Pension scheme wins in just six months.

And I'm delighted that we have announced our first ever cash funded acquisition of Sun Life of Canada UK and can demonstrate the value creation available from smaller cash funded M&A.

This means our dividend is now growing, both organically and inorganically. We have delivered therefore on all of the key objectives I had set for the business at the start of the year, and I am proud of how well the team are delivering.

So starting with the financials, Rakesh will cover this shortly in more detail, but in terms of the headlines we have delivered £950 million of cash generation in the first six months and are now on track to be at the top end of our target range for the year.

Our balance sheet remains both strong and highly resilient with our Solvency II surplus at £4.7 billion. While our Shareholder Capital Coverage Ratio of 186% is above our target range, providing the capacity for us to invest into growth such as the acquisition of Sun Life of Canada UK.

Finally, we have reported £430 million of new business long-term cash generation, this is more than double the first half of last year on a like for like basis.

As you can see from this slide, we continue to make excellent progress across our five strategic priorities, as we deliver on our purpose and strategy.

The strength of this delivery is down to the strong talent we have in our business. Engagement is high as we prioritise our culture and support our colleagues through the cost of living crisis through a range of measures. This includes the payment of a one off £1000 net lump sum to all employees other than our top 100 leaders.

I'm not going to go through everything on the slide, but I did want to highlight a few key achievements. Optimising our in-force business is the bedrock of Phoenix. I am therefore pleased that we have delivered a further £421 million of management actions in the period, while we remain as super resilient as always, with both our long-term cash and Solvency surplus protected despite the volatile markets.

We have also continued to enhance our operating model, with the standout success being the migration of all 400,000 Standard Life annuities to the TCS platform, which is our first major migration off the legacy Standard Life mainframe. A great outcome for customers and a key strategic milestone.

And we have also delivered a further £15 million per annum of cost synergies from ReAssure which means that we have now exceeded our revised synergy target with nearly £1.1 billion of synergies in just two years.

Our third strategy priority is to grow our business to support both new and existing customers. Here we have continued to deliver organic growth in the first half, including another strong performance from BPA.

But most pleasing for me is the clear momentum we have in our capital-light fee-based businesses, with a £1.9 billion year-on-year increase in net fund flows.

Our fourth strategic priority is to innovate, to provide our customers with better financial futures. On the slide you can see just some of the initiatives that we have delivered in the first half that go right to the heart of our purpose. We are here to help our customers on their journey to and through retirement, which is even more important given the current economic backdrop.

Finally, we have continued to invest in a sustainable future as we respond to both clear customer demand and demonstrate leadership as a purpose led business.

So in summary, a great start to the year.

However, probably the biggest achievement in the first half has been the announcement of our first ever cash funded acquisition, which I am confident will allow us to demonstrate the significant value for shareholders available from smaller sized cash funded M&A.

We very much look forward to welcoming the Sun Life of Canada Life UK customers and colleagues to the Group. It will be a simplified integration as the vast majority of the business is already with TCS Diligenta who are of course our strategic partner here.

As responsible stewards of shareholder capital we have remained disciplined in our transaction pricing, with the £248 million consideration representing an attractive price to Own Funds of 83%, the lowest multiple for any deal we have ever done.

We expect to generate £470 million of incremental long-term cash generation from this acquisition, with around 30% of that to emerge in the first three years. And we are targeting £125 million of net synergies.

As a result of the value creation expected from this transaction, I'm delighted that the Board has been able to propose a 2.5% inorganic dividend increase that, subject to completion, will be effective from the 2022 final dividend.

This is proof of concept that smaller, cash funded M&A can add significant shareholder value and we expect further opportunities to emerge over time.

So what does our success in the first half mean for our dividend trajectory? As you can see, we have a consistent track record of dividend growth over the past 10 years, having delivered a compound annual growth rate of 4%, primarily driven by M&A.

Last year as you know we delivered our first ever organic dividend increase from the growth of our Open business. This year, our interim dividend is, as ever, equal to last year's final dividend, which is a 3% increase year-on-year, reflecting last year's organic growth.

Looking forward to the second half, we have the opportunity to prove our unique business model by delivering both organic and inorganic dividend growth, with the 2.5% increase already announced for our recent acquisition and the potential for an organic dividend increase as well.

Phoenix is therefore well positioned to deliver on our policy of paying a dividend that is sustainable and grows over time. And with that I will now hand over to Rakesh who will cover the financials in more detail. Rakesh.

H1 2022 financial results

Rakesh Thakrar, Group Chief Financial Officer

Thank you, Andy, and good morning everybody. There are three key things I want you to take away from our financial results today.

Firstly, we continued to deliver dependable cash generation, which underpins our reliable dividend.

Secondly, we remain resilient as ever and are well hedged against the challenging economic backdrop.

And thirdly, we are on track to deliver both organic growth and inorganic growth, which will support our dividend that is sustainable and grows over time.

So turning to the slides. As Andy said, Phoenix has delivered a strong financial performance in the first half of 2022. We delivered cash generation of £950 million in the period, maintained our strong Solvency balance sheet and more than doubled our new business long-term cash generation to £430 million.

Our leverage ratio has also reduced to 27% following a £450 million debt repayment in July.

Starting first with cash. Phoenix is unique in its ability to deliver dependable cash generation over the very long term. This enables us to set very clear one year and three year targets and provide guidance for lifetime cash generation. I want to talk to you about each one of those in turn.

Starting with the one year target. We have delivered £950 million of cash generation in the first half and now expect to deliver at the top end of our target range of £1.3 billion to £1.4 billion for the full year. We have also set a three year cash generation target of £4 billion, which I will take you through over the next two slides.

We are often asked by investors who are not insurance specialists how they can compare the performance of Phoenix against companies in the wider market. We primarily run our business to generate cash, and this is easily comparable. Looking at the £4 billion of cash we expect to generate over the next three years and after deducting our operating costs and debt interest, we are left with around £2.9 billion of Free Cash Flow. This translates into an impressive three-year average Free Cash Flow yield of 15%, nearly double the FTSE 100 average. This demonstrates just how cash generative our business is relative to companies in the wider market.

This slide sets out the expected sources and uses of cash generation over the next three years as 31 December 2021 and shows that we expect to generate £1.7 billion of surplus cash. We also have the capacity to raise up to a further £1 billion in debt, while remaining within our leverage target ratio. This means we have a total of £2.7 billion available for growth.

This provides us with the capacity to cash fund the Sun Life of Canada UK acquisition, invest our target allocation of around £300 million into BPA in 2022, and to continue investing into future growth opportunities over time.

Finally on cash, we have provided guidance for lifetime cash generation of £17 billion. After servicing and redeeming all outstanding debt, and deducting committed integration costs, we expect £11.8 billion of long-term free cash available to shareholders. And this long-term free cash number is prudent because it is from our in-force business only, so does not include any new business or M&A, nor management actions past 2024. This means we can cover our £500 million annual dividend cost over the very long term.

Protecting the resilience of this long-term free cash is therefore key in ensuring the long term sustainability of our dividend. We view the key market risk associated with equities, interest rates and inflation as unrewarded risks as they could cause volatility to the value of this cash. Therefore we hedge these risks to mitigate the volatility and deliver dependable cash generation, which means there is no material impact on our long-term free cash from key market risks as you can see from the right hand side of this slide. We are therefore well positioned to continue delivering for our shareholders in this challenging economic environment.

Our Solvency II capital position remains strong, with a resilient surplus of £4.7 billion, which as ever, reflects the accrual of our interim dividend.

Our strong position enabled us to repay the £450 million Tier 3 bond that matured in July which was deducted from our June Solvency position.

Our economic variance was once again small, at just £0.2 billion, despite the market volatility. This reflects our approach of hedging the majority of our market risks, which are designed to stabilise our Solvency II surplus and our long-term free cash.

This in turn underpins the resilience of our dividend over the long term. However, our approach does result in temporary Own Funds volatility. This is a trade-off we accept to deliver the sustainable and resilient dividend that Phoenix is known for and which our shareholders value.

And looking to the full year, I currently expect our surplus of £4.7 billion to remain broadly stable. Meanwhile our Shareholder Capital Coverage Ratio has increased to 186% and the recently announced acquisition of Sun Life of Canada UK is expected to reduce this to 179% on a pro forma basis.

With our Solvency shareholder ratio at the top end of our target range of 140 to 180% we have the capacity to invest into future growth opportunities.

As I have explained, delivering resilience in our balance sheet is fundamental to Phoenix. We therefore have a low appetite for retaining equity, interest rate, inflation and currency risks, which we see as unrewarded and hedge. This translates into the low sensitivities presented here.

We also manage our longevity risk through reinsurance, retaining around half of the risk across our current in-force book and reinsuring most of the risk on new business.

We continue to see credit risk as rewarded and actively manage our portfolios to ensure they remain high quality and diversified. The key sensitivity we focus on here is a full letter downgrade of 20% of our credit portfolio, which is currently £0.3 billion, after expected management actions and small in the context of our £4.7 billion Solvency II surplus.

Given inflation is so topical at the moment I thought it was worth reiterating that we have no material exposure to inflation. Inflation emerges in two principal areas within our business, both of which we have hedged. Firstly, we have the inflation linked annuities which are hedged with index linked gilts. And secondly, we have the exposure on our policy administration and operating costs which we also hedge. All of which means that the current inflationary environment will have no material financial impact on Phoenix.

As I have shown many times before as a consequence of our comprehensive hedging approach, we continue to be far more resilient to the major market risks than our UK peers. This low sensitivity is especially important during times of market volatility as we have at present. And therefore it remains a key differentiator for us.

We manage around £270 billion of assets on behalf of our customers and shareholders, our assets reduced in the period by around £38 billion, due to the significant market movements experienced by all. However, these market movements have a limited impact on the fees we earn, as we hedge annual management charges against movements in equities and interest rates.

We maintain a prudent, diversified £34 billion shareholder credit portfolio, comprising both liquid and illiquid credit. With a BBB exposure of 19% and our BBB minus exposure at just 3%.

We also remain conservative in sector positioning of our credit portfolio and have sought to limit our exposure to highly cyclical sectors by further rotating out of these during the first half. As a result, we have only £1.1 billion, or 3%, of our £34 billion credit portfolio exposed to cyclical sectors. However, these are with high quality counterparties as evidenced by an average credit rating of A-. And we continue to have circa £1 billion credit default reserve. We therefore remain very comfortable with the quality of our credit portfolio.

Our ability to deliver value accretive management actions is a key differentiator for Phoenix, and optimising our in-force business is one of our five key strategic priorities. We continue to demonstrate our capability here with over £400 million of management actions delivered in the first six months of the year. These were primarily from recurring business as usual actions which are not reliant on integrations and will continue into the long term.

This included our ongoing illiquid asset origination where we delivered a 60 basis points illiquidity premium. We also invested over 50% of our illiquid assets, excluding ERM, into sustainable assets during the period. And we have proactively deployed into US liquid credit to take advantage of the relative spread widening and delivered a host of other balance sheet optimisation actions too.

Moving now to growth and it is great to see that our investment here is paying off. I am delighted that we have more than doubled new business long-term cash generation to £430 million on a like for like basis.

Retirement Solutions contributed £282 million in the first half, delivering more than triple the volume in the first of 2021 from external transactions.

Elsewhere it was pleasing to see our fee-based businesses report a 17% year-on-year increase to £148 million - noting that the new business long-term cash generate here is seasonally more weighted to the first half.

Last year we delivered organic growth that more than offset the Heritage run-off for the first time. And given our performance in the first half of 2022 we are on track to achieve it again this year.

2021 was the year that Phoenix, through our newly acquired Standard Life brand, firmly established itself as a key player in the BPA market. We have built on this foundation with a strong start to 2022, having completed £1.6 billion of premiums across 6 external transactions. Our capital strain has also reduced again from 6.5% last year to 6.2% in the first half, which on a pre Capital Management Policy basis equates to 3.8%.

And we have improved both the cash multiple and payback leading to improve IRRs in the period.

Looking forward we have a very strong pipeline for the second half, we have already completed two further transactions, totalling £1.1 billion and are exclusive another £500 million transaction expected to complete in Quarter 3. We will also complete the buy-in of the

remaining £600 million of the Pearl Pension Scheme liabilities in the second half, too. As a result we are confident of fully deploying our target level of capital into BPA this year of around £300 million. With the second half deal economics expected to be broadly similar to the first half.

I was particularly pleased to see the strong turnaround in net flows from our capital-light fee-based business in the first half. We delivered a net inflow of £1.4 billion in the period, compared to £0.5 billion outflow in the same period last year, an improvement of £1.9 billion.

This was driven by our Workplace business where the investment we have made into our proposition and into our Standard Life brand is enabling us to both retain our existing schemes, and win new schemes in the market. As you can see the momentum in scheme wins continues to accelerate with 42 new scheme wins in the first half of 2022, which is more than the whole of 2021 already.

The scheme wins this year do remain in the smaller scheme category, but we are now being invited to bid for the larger schemes and we are confident we will be successful here too.

Turning to our IFRS results, we delivered operating profit of £507 million in the first half of 2022, marginally down on the prior year. This included increased BPA new business profits in our Open division, offset by a reduction in Heritage, primarily due to a lower expected return as the business runs off. We also experienced adverse investment variances under IFRS from rising yields, due to our hedging approach of protecting the Solvency balance sheet and our long-term free cash.

Other non-operating items includes a provision for future project costs in relation to the re-phasing of our Standard Life IT migration that we told you about at the full year. It also includes costs in relation to IFRS 17 and the planned investment into projects to support our Open growth strategy.

So to conclude, we delivered strong financial results in the first half of 2022 across our financial framework of cash, resilience and growth, and we are on track to deliver across all of our targets for 2022. This includes delivering at the top end of the 2022 cash generation target range of £1.3 billion to £1.4 billion and retaining our resilient balance sheet by operating with our target ratio ranges for Solvency and leverage.

In terms of growth we are confident of delivering more than £800 million of long-term cash generation from new business this year. And we are aiming to complete the acquisition of Sun Life of Canada UK in Quarter 1 2023. This will support us in delivering on our dividend policy, which is to pay a dividend that is sustainable and grows over time.

With that I will now hand you back to Andy for the outlook.

Outlook

Andy Briggs, Group Chief Executive Officer

Thank you, Rakesh. As I've said before I passionately believe that the best businesses have a core social purpose, which is why ours is helping people secure a life of possibilities. Helping a broad range of people in the UK to journey to and through retirement and enjoy a better later life.

As a purpose led organisation, we look to have the best people who are focused on our purpose to then deliver better outcomes for our customers and wider society and in turn produce stronger returns for all of our investors, the virtuous circle you see on this slide.

And sustainability is embedded throughout this, from engaging customers with their financial futures, to being a model employer, to investing our £270 billion of assets to support net zero and levelling up.

This purpose led approach underpins everything we do at Phoenix, and I am confident that it will enable us to execute on the clear growth opportunities ahead of us.

Standing in the shoes of our customers there are a number of sources of retirement income available to them. And these underpin the four major trends in the UK long-term savings and retirement market, which offer us multiple growth opportunities.

The first is the huge stock of legacy pensions and savings products, where we can improve customer outcomes by moving them from outdated legacy systems to more modern platforms. There are £480 billion of Heritage assets, much of which we believe will come to market over time.

The next key customer income source is from the £2 trillion of defined benefit liabilities in the UK. This underpins what is a thriving BPA market of around £40 billion per annum where we are performing strongly.

And finally we have the capital-light, fee-based defined contribution pensions offered through the Workplace and direct to individuals. In the Workplace market, which we believe will see around £40 billion of flows per annum, we have been building strong momentum. While in the individual pensions and savings market, which is another £40 billion of flows, we've been working on developing innovative retirement income solutions.

The right hand side of this slide sets out the impact on these market growth trends of the current economic environment. We believe it accelerates both the M&A market due to cost inflation pressures for vendors and the BPA market, where rising rates make BPA transactions more affordable for corporates.

Clearly many people are facing significant challenges from the cost of living crisis, and this is impacting spending habits and bank deposits. So far, we've seen limited change in pension contributions and do not currently envisage a material impact on our fee-based businesses. But importantly, as we did in our response to COVID, we will continue to support our customers in every way we can.

We have a clear and differentiated strategy which creates shareholder value through leveraging all four of the major market trends I've just covered. It is simpler and more focused than our peers. Heritage is the bedrock of our business, which delivers high levels of predictable cash that covers our dividend into the very long term. And it also generates surplus cash that we cash that we can reinvest into both our Open business to support organic growth and into M&A to deliver inorganic growth, both of which can underpin future dividend increases.

But what really differentiates Phoenix is how the whole is greater than the sum of the parts. With our Heritage business creating clear competitive advantages in both Open and M&A. For our Open business, diversification with the large Heritage books means we will be more capital efficient than peers, particularly in retirement solutions, including BPAs, where we are already at a 3.8% capital strain on a more comparable pre Capital Management Policy basis.

While our strategic partnership with TCS provides us with a market leading cost per policy administration platform that will give us a meaningful cost advantage for our fee-based businesses over time.

Now to be clear, we are not fully leveraging these advantages for our Open business today, but if you think about the progress we are making and the structural competitive advantage we will have in time, I think this is really exciting.

And exactly the same logic applies when we do M&A, which enables us to generate significant cost and capital synergies to underpin our ongoing track record of shareholder value creation in M&A, as evidenced by the Sun Life of Canada UK transaction where our synergy target is a 50% uplift on the price paid. So a simple, clear strategy.

2021 was a pivotal year for Phoenix as we delivered organic growth from our Open business which more than offset the Heritage run-off for the first time, which we accelerated through the acquisition of the Standard Life brand and the investment into our Standard Life business. We are now confident of delivering this on an ongoing basis and therefore expect to continue growing our in-force cash generation over time.

I covered the four market trends earlier, three of these are organic and we will leverage all three of these. We initially turned our focus onto BPA and have already become an established player in this market. We are now turning our attention to the fee-based businesses, with our momentum in Workplace building and a big opportunity in individual pensions and savings to go at.

Over time we expect to balance our growth between BPA and the capital-light fee-based businesses and we've scheduled a capital markets day on the 6th of December where we plan to do a deep dive into our Open business.

M&A remains a core part of the ongoing growth strategy, both large and small, with the remaining £470 billion of UK Heritage assets potentially available over time.

I continue to have cups of tea with my fellow insurance CEOs and the message from the majority of them remains very much one of 'when', not 'if'. We stand ready to consider our next deal, enabled by our scalable platforms and our £1 billion of remaining fire power.

With Sun Life of Canada UK being our first ever cash funded acquisition it was important that we clearly demonstrate the benefit for shareholders from smaller sized, cash funded M&A. And we did this by announcing our proposed inorganic dividend increase with the transaction announcement.

However, going forwards, given the Board's confidence that we can now deliver both organic and inorganic growth on an ongoing basis, we intend to simplify our dividend communications. We will do this by announcing any potential annual dividend increase at our full year results, and which will combine both organic and inorganic growth.

In summary, Phoenix is unique in the insurance sector, with the cash from our in-force business funding our attractive dividend over the very long term. While our business is highly resilient owing to our strong capital position and our hedging, which protects both the capital position and our long-term cash generation - particularly important in these uncertain times.

And we are growing both organically and inorganically. This supports us in continuing to deliver cash, resilience, and growth. Phoenix is a growing business with a defensive balance sheet that offers a uniquely reliable dividend that is sustainable and grows over time. We believe this is hugely valuable and particularly so in an uncertain economic environment.

And with that we'll move to questions. So we're going to start with questions from the audience in the room, if you can raise your hand if you have a question, lots and lots by the looks of that, and we'll direct one of the roaming microphones to you. If you can please start by introducing yourselves and the institution you represent.

For anyone dialled into the conference call, please let the operator know that you have a question. And for anyone watching on the webcast, please use the Q&A facility and we'll come to your questions after we've answered those in the room and on the call.

Q&A

Andrew Sinclair, Bank of America

Thanks, morning everyone. Andy Sinclair from Bank of America. Three please. Firstly it was just on the Workplace pensions business of the 42 schemes you've won and frankly on the 41 you won last year, if you can give us an idea of how many of those have

transitioned in H1 this year, just so we can get an idea of what that means for what's going to be transitioning over the next kind of 6, 12, 18 months?

Secondly, just on bolt-ons, congrats on the first organically funded bolt-on, great to see, and the dividend increase. But at full year results – I'm obviously already looking for more - at the full year results you said that you saw a good chance of M&A deal this year. You were clearly right. What is your outlook for the coming 12 months, do you still feel similar levels of confidence?

And thirdly was just on the non-operating cash flows line, just a fairly punchy cost again in H1 this year, just if you can remind us what's coming through that line and perhaps give some guidance on it? Thanks.

Andy Briggs, Group Chief Executive Officer

Okay, thanks Andy, so I'll let Rakesh take the third of those. So in terms of the Workplace schemes, the schemes we're winning at this stage are smaller schemes. So don't expect them to have a kind of transformational impact to the numbers overnight. But what's pleasing is we're now getting invited to tender for much larger schemes which clearly would have a more transformational impact.

Typically the lead time from winning a scheme – you tend to get the regular premiums come in you know within say 6 to 9 months, but quite often you wait over a year to see the lump sum assets come across. So just sort of summarising our numbers in the first half, what we saw was a big shift in the net fund flows, from a small outflow, to a £1.7 billion positive inflow from the Workplace pensions business. And that was basically a 28% increase in the gross inflows. And that 28% increase in the gross inflows led to a 60% increase in the new business long-term cash generation from Workplace. So you can see the kind of benefits as you grow, the kind of leveraged effect on the business.

But we also saw a 44% reduction in outflows. So what is basically going on here is we have invested heavily in the proposition, we're now attractive in the market so we're stemming the outflows we had historically in terms of losing the existing schemes, and we're now starting to win the new schemes. So good positive momentum there.

You know, this is a flywheel business so you work hard to get the flywheel going, it takes a while to get going, but when it does it self-sustains and it's obviously capital-light and we are very determined and confident that we can balance the growth between the fee-based capital-light and the BPA going forward.

In terms of the M&A question, as I say, think about the market as £470 billion of assets, just under half of that is a small number of larger deals and it's hard to know the 'when' or 'if', but if ever anything in that space was available, we'd obviously be very enthusiastic.

But then you have, over half the market is a much larger number of smaller deals. And basically what the CEOs say to me when I talk to them is that they like the cash flow coming off that closed book business, but then they recognise that typically a Heritage book runs off at about 6% a year, so every year they have to cut their costs by 6% in order to stand still. And if they don't cut the costs by 6%, effectively there's an increased expense reserve and they don't get the cash flow out. And that is why people say it's a question of 'when', 'not' if, because they are struggling with legacy platforms, and fixed costs of regulatory change.

So it's hard for us to predict the exact timing of when deals will come about, but we are confident there will be deals going forward, for those very market dynamics I've just set out. And as I say, because Sun Life of Canada UK is a fairly straightforward integration for us, we remain keen and enthusiastic and ready to do the next deal as soon as anything is available in the market. We have £1 billion of remaining cash firepower.

Rakesh, do you want to pick up on the non-operating items?

Rakesh Thakrar, Group Chief Financial Officer

Yes, so I think the question was in relation to cash uses within non-operating. So these are really in two areas that I'd like you to think about it. One is generally the fact that we hedge a lot of the currency risk at the Group level in relation to the debt and that will have collateral movements and close out of positions. So that will be one aspect of it.

And the second aspect, which I already touched on, but probably more in the context of the IFRS results, is the fact that we have integration that we're still going through, you know, so Standard Life IT migration, the ReAssure integration, you know, that will have cash associated with it and that will come through that line as well.

Andrew Crean, Autonomous

Good morning, it's Andrew Crean at Autonomous, again three questions if I can. On Europe you failed to sell the package of European businesses last year, would you consider – and I assume that that Irish business would be a lot easier to sell than your German, would you consider – is that something which is on the table?

Secondly, you're still dual running platforms, the ALPHA platform and the TCS platform, would you consider shutting one of them? And what would be the cost benefits of doing that, I'm assuming the ALPHA platform?

And then thirdly Andy, you talk about how many cups – well you talk about your cups of tea, outside of the large deals, which I think we know, how many cups of tea are actually there? I mean how many companies are actually likely to consider, because there is a bottom end to this where it's just not worth the bother of you actually going out and doing something.

Andy Briggs, Group Chief Executive Officer

Okay, so let me take each of those in turn. We did a strategic review of Europe last year having had a number of unsolicited expressions of interest. What we basically concluded was that the highest value way forward on Europe was to sell the Ark Life business which we did for 91% of Own Funds. But then there was real value to be had by both putting in place a partial internal model for Standard Life International, which we got approval for much quicker than actually others have done from the CBI in Ireland. But then also as part of the Standard Life transition to migrate to a much more modern technology.

So that is what we're focused on in Europe, that's the right thing to do to optimise the value of the European business which is performing strongly, and it is making a good contribution in terms of flows going forwards. But it also would create the right base for us to consider inorganic expansion into Europe in due course.

In terms of the dual ALPHA – two platforms and so on, so you're absolutely right. When we did the ReAssure acquisition, we have now exceeded our revised target of synergies, we're up at nearly £1.1 billion, but there is nothing in there for Phase 3 integration, that's just the Head Office Phase 1 integration and Phase 2 for Finance and Actuarial. The reason we haven't looked at that is that our priority has been migrating off the old Standard Life mainframe, across to the TCS Banks platform. And delighted in the first half that we moved our first 400,000 customers across in terms of, all the Standard Life annuity customers went across really smoothly without any hitches, the team did a fantastic job of that. So that is our priority there.

But in time we could well consider whether there's a more efficient way of looking at the operations in terms of ALPHA and the ReAssure side. And I would say that – you know historically when we have done Phase 3 integrations there has been material benefits attaching to those. So I'm not going to give any specific numbers, but there have historically been material benefits attaching to those.

Finally, in terms of the cups of tea, I think one of the things I was quite keen to demonstrate with the Sun Life of Canada UK acquisition, it's only £10 billion of that £480 billion, so it's what 2% of it, yeah. And yet that led to a 2.5% inorganic dividend increase. I'm really trying to demonstrate that actually doing smaller deals can be really quite accretive and valuable from a shareholder perspective.

So the way to kind of think about this is as we had on the slide, there's £245 billion of assets in these smaller deals that we could kind of cash fund. So they'd be up £1 billion of purchase price. So you know – I'm not going to put specific numbers around it, but there are a significant number – you know if you think the £10 billion Sun Life of Canada acquisition, you know there are books from that size up to say £30 billion or £40 billion odd that would fit into that £1 billion purchase price. If there's £255 billion of assets there you can kind of get a sense of working through the number of numbers.

Different organisations are at different places on their journeys, but there are a significant number of potential opportunities out there.

Ming Zhu, Credit Suisse
Good morning. My first question is on your BPA, you have mentioned – you have reiterated your £300 million capital commitment, is there scope for this to go up and when would you reach the self-sustainability level?

And my second question is on the Group cost base. Would you be able to disclose on a clean set what is a steady state on the cost base going forwards, if we exclude those one-off projects and assuming that Andy's cups of tea are not material?

And my third question is actually on M&A, what sort of M&A pricing landscape are you seeing because the deal you have just done, the Sun Life one, it's a 17% discount, where your shares were trading slightly – a bit more discount than the deal, so why didn't you just do a share buyback?

Andy Briggs, Group Chief Executive Officer
Okay, so if I take the first and third of those. So it is our intention to spend £300 million of capital on BPA. We think that is a sensible allocation. Think about BPA as an attractive profitable market. But I sort of tend to think about Phoenix as a three legged stool, we've got Heritage, Open – the Standard Life Open business - and M&A and within that kind of Open leg we want to be balanced between BPA and the fee-based capital-light business.

Now that is not to rule out that we might not spend a bit more. And what happened last year in practice is that we secured two large cases, two cases over £1.5 billion in December and ultimately, you're bidding for these cases, we were – the team did a fantastic job, so we won both of them and it meant that we spent a bit more capital. But all other things being equal we'd expect to spend around the £300 million level. And that kind of keeps things balanced.

In terms of the M&A pricing landscape. So – and I might get Rakesh to add a comment to this in a moment, but the 83% of Own Funds is the lowest priced of any of the deals we've ever done. I think Own Funds is a reasonable metric to look at closed book businesses, I think it's a pretty poor metric to look at Open businesses, there is a lot of conservatism built into risk margins and fundamental spread and so on and so forth.

So the way we go about valuing deals that we do, is we actually look at the cash flows and then we look at the synergies we can generate, in the case of Sun Life of Canada the net synergy number we're targeting is 50% of the price paid. So basically – our cost and capital efficiency, our structural competitive advantage, means we can run it 50% more efficiently than the previous owners. And that then delivers an attractive return on capital on those cash flows. So we're not valuing it by looking at Own Funds, we don't think it's a particularly good measure. We are focused on cash, predictable cash over time. And that is how we think about the value created.

I don't know if you want to add anything to that and then talk about the cost base.

Rakesh Thakrar, Group Chief Financial Officer
Yeah, thanks Andy. So I think at the Capital Markets Day probably two years ago we talked about how we look at acquisitions. And as Andy pointed out we actually look at those cash flows and then effectively determine an IRR and then consider that in the context of

other opportunities. And certainly for these transactions, you know, that is in my view the right way to look at it. And that would include if there was a buyback opportunity, we'd look at it in that context.

But in terms of buyback anyway, we have a capital framework that is out there, and we operate within the framework. And currently we are at the top end in terms of our shareholder coverage ratio, but we know post the acquisition of Sun Life of Canada UK we will be just on the cusp, at the border. But when looking at those cash flows – certainly in our view, its value – it was better to do this transaction than consider any alternatives, such as share buyback.

We'd also consider how quickly the cash comes back and the potential for reinvestment of that cash for other growth opportunities. So we think there is some sort of compounding effect happening there, especially if we also over-deliver on synergies as well.

And then your question on the cost base within the Group, certainly if I put those into two categories, one is just the normal operating expenses that we would expect and that would be somewhere around £75 million, £80 million a year on an ongoing basis. And then you'd have, what we'd call the one-off costs. And as I mentioned earlier in my response, you know, effectively made up of two areas.

One is movements in our hedging that will come through and that is difficult to predict what that will be, it depends on the currency movements how that will change. But in terms of projects, you know it's probably fair to say, probably we are seeing a higher level of these projects because of the integration that we're doing. You know we've got the Standard Life; we've got the ReAssure, we've got the IT migration that we spoke about. We've also got some payments that we're making in relation to IFRS 17. So these are one-off multiyear programmes that is just meaning that at the moment they are quite high, but you know all other things being equal, you know, you would expect those to normalise.

Andy Briggs, Group Chief Executive Officer
Sorry Ming, I didn't answer about the competitive landscape. So up until a couple of years ago there were two players that were bidding for these types of businesses, Phoenix and ReAssure, we're now together as one. And so we're undoubtedly seen as a very credible counterparty by anyone looking to sell a business. We know that we will be the best home for their customers and for their people. We have got a strong track record of successfully executing on these deals through regulatory approvals and so on and so forth.

And so we're never complacent. There is a lot of private equity money looking to get into this space. But I would say generally the private equity money is more focused on Continental Europe and the US than it is on the UK because it is a challenging regulatory environment for private equity to come into the life insurance space. And you have only got to look at what happened with the LV= deal with Bain to see some of the potential challenges within that. So we think we are well placed in a competitive landscape, and I think you know because of the scale of our Heritage business we will generate higher levels of cost and capital synergies.

Ming Zhu, Credit Suisse
Sorry I think there's one question missed, it was on the BPA, what sort of level of AUM, or in which year do you think you will achieve the self-sustainability? Thank you.

Andy Briggs, Group Chief Executive Officer
I think I'm going to say we don't – BPA is actually quite – you know we've got £38 billion of annuities and BPA would be less than £10 billion of that. So we are – because we're far more diversified than others across our fee-based capital-light businesses, annuities, and then the Heritage business, we tend to look at the financials of the business in the round. We're generating lots of excess cash from Heritage and it's attractive to redeploy that at attractive returns on both M&A and on BPA.

Larissa van Deventer, Barclays

Morning. Congratulations on very strong cash generation and I have three questions on that if you don't mind. The first one, it was a major beat relative to expectation consensus and ours, can you help us understand a little bit better about the moving parts and why you're so confident that the level is sustainable?

Second, in light of the strong generation in the first half, is the second half target too modest?

And third, you mentioned the contribution from illiquids, and that it added to the cash generation, can you help us understand what has changed in the illiquids and how we should think about that going forward please?

Andy Briggs, Group Chief Executive Officer

Those three are all for you. I can sit back and have a cup of tea now.

Rakesh Thakrar, Group Chief Financial Officer

So let us start with the first one, so this was on the £950 million cash generation in the first half. I mean what you see there, we delivered our normal organic surplus which was about £0.4 billion. We also had a strong – if you recall management actions during 2021 – and again, we had £1.5 billion last year, and we had over £400 million in the first half of this year.

That, together with the fact that I was also cognisant of the fact that we had the Tier 3 repayment of £450 million during July, which is why that has been slightly – probably - higher than you were probably expecting. But it is taking all of those items in the round and coming to that.

So the second part – is cash generation in the second half too modest. Clearly, I did reiterate albeit it's not a change in the target, that we will be at the top end of the target range. And we do think that that's fairly – pretty good for the full year. Do we think that is sustainable? You've seen from what we've done previously, and I'll leave it at that.

And finally on the illiquids, right, so illiquids we were currently at 32% in terms of our illiquid allocation, our aim is to get to about 40% across annuities in the medium term and then we'll consider further thereafter.

But what we get from illiquids, we still focus on value over volume, but we haven't gone probably as much as people would have thought this year in illiquids because we have seen opportunities in liquid credit. So we diverted a lot of funds to the US because we saw the relative spread widening and we took that opportunity, which I think is absolutely the right thing to do.

But despite that, in the illiquid space we still got 60 basis points premium on that, and as you know the illiquid assets are a really good match for our BPA annuity liabilities and therefore, we're in a good space in that regard.

Andy Briggs, Group Chief Executive Officer

And I would just quickly add Larissa, one of the things – well many things have impressed me at Phoenix, but one of the things that impresses me most is this core capability in the organisation to optimise the in-force business. So the fact that we had £421 million of management actions in the first half, just from BAU so that is not integration related, that's just BAU, really does demonstrate the ability of creating value from our in-force business over the long term. And that is one of the key drivers behind cash generation is the ability to drive those management actions. It's impressive stuff.

Farooq Hanif, J.P. Morgan

Hi. Thanks very much, it's Farooq Hanif from J.P. Morgan. Just on the Workplace Pensions, I mean that was really impressive growth, and the new business contribution from that is not completely comparable on a full year basis but it's getting chunky. Can you talk

about the outlook here? You talked about larger schemes, you know, what have you done that's different, and do you think you can maintain that level of new business profit generation?

Secondly, can we go back to the whole question of air traffic control of deals? So, obviously, Sun Life of Canada's on Diligenta already, but if it wasn't, what would be the constraint in, sort of, number of deals you can do and therefore, you know, how many teas do you need to, sort of, forego because there's no point?

And then last question is on the Commercial Real Estate portfolio. Can you remind us about your exposure there? There's obviously been heightened concerns about refinancing risk, and how do you feel about the safety of that portfolio? Is it a big deal for you? Thank you.

Andy Briggs, Group Chief Executive Officer

Okay. So, I'll take the first two and I'll ask Rakesh to cover the third. So, we are pleased with progress in Workplace, and Andy Curran sat in the front here will kill me for saying this, but we haven't scratched the surface of what we can do in this market yet, and there's three reasons why there's a lot more to come here.

The first is, as we migrate this across onto the Bancs platform, we've negotiated by far a market-leading cost rate there. You know, in the past, we got a fantastic rate for the Heritage business but, because it's declining each year cost per policy, you know, TCS thinking – okay, look I've got to manage that reduction every year - we said to them – well, look, this is growing so we need a much, much lower rate if we're going to give this to you – which they've agreed to. So, we've got that margin benefit still to come through, is the first.

The second is that the new schemes we've been winning have all been smaller schemes. Advisors are going to try you out with their smaller clients before they get you going on the bigger clients. We've got a couple of enquiries on the go at the moment, for example, where we're well-advanced with the enquiries, you know. We haven't won them yet but we're well-advanced and progressing well over £1 billion of assets, yeah. So, we're starting to play in that space, which will accelerate as well.

And then the third is, I, sort of, think about, you know, the three main drivers of the Open business, going back to the market trends, BPA, Workplace and then the Individual Pensions & Savings. So, we, sort of, started out on BPA in 2018, you know. We're now established. We were number two in market share last year. Workplace, we've got real momentum going. The third area we're starting to turn our attention to is the Individual Pensions & Savings market where, basically, customers need to consolidate their different pension pots together and plan a journey through into retirement income, and yet only 10% of the UK population get advice on that journey to and through retirement, 90% currently flounder around largely in the dark. So, we're building our capability.

We're building the Advisor market as well. We're building capability to play in the 10% of customers that are advised, but the 90%, we've got more of those customers than anyone else – 13 million customers – and a lot of them are in the Workplace, yeah. So, the ability to talk to Workplace members, get them to consolidate other pots in and stay with us to journey into retirement income would be another driver, and this will take time, but, in time, we want the fee-based capital-light businesses to give us a similar kind of value creation each year as we get from BPA.

Air traffic control of deals, I think the key point I'd make here is that we can buy businesses and run them separately on the side for a period of time, yeah. So, it's unlikely that there'll be a constraint for us around doing the deals.

Just to Andrew's question on ReAssure, you know, we're full at the moment in terms of migrating to Bancs, so we've not planned that part of the ReAssure business at this stage. It hasn't stopped us delivering £1.1 billion of synergies from ReAssure in two years, so, you know, we can still do the deals.

I think, you know, even, kind of, constraints around the Financial and Actuarial side, the Phase 2, we need to be mindful of those but, you know, to date, we've never not backed an M&A opportunity for bandwidth within the business. We gear up and create the bandwidth and we'd look to take advantage of the opportunities as they present themselves. On Real Estate…?

Rakesh Thakrar, Group Chief Financial Officer

Yeah, on the Commercial Real Estate, probably just worth putting into context first, you know, we have a total of just over £11 billion of illiquid assets and Commercial Real Estate is probably just over £1 billion to £1.5 billion, in that region. So, it's not material in our overall context.

Clearly, you know, with our, you know, Asset Management team, you know, they are in regular interaction with the people on the Commercial Real Estate, you know, investments. You know, clearly, a lot of these have, you know, relatively lower loan to values – they're about 60% to 65% - and they're also secured on the underlying property.

So, certainly what we see is that, you know, we're actually happy with the credit portfolio, and our exposure to Commercial Real Estate, and then we keep a close eye on all our investments, not just Commercial Real Estate.

Steven Haywood, HSBC

Good morning, Steven Haywood from HSBC. Three questions, please. In one of your slides, I can't remember which one, sorry, apologies, inflation going higher has no impact on your long-term free cash flow. Can you explain the dynamics on this, please?

Secondly, in your sensitivities, the credit downgrade sensitivity, it now includes management actions whereas, previously, it excluded management actions. I mean, the difference between the two sensitivities is very low, but if you can explain why the change that would be great.

And, finally, on the BPA and the Workplace, what rate of IRRs are you achieving here and what capital strain margin can you come down to on the BPA? Thank you very much.

Andy Briggs, Group Chief Executive Officer

Okay. So, I'll take the third of those and ask Rakesh to take the first two but, because I'm a good CEO, I'll do the third one first and you can think about the first two, you see I'm good like that.

So, we don't disclose specific IRRs, but that's exactly how we think about it. We think about all the excess capital we have. We're very determined stewards of that capital to allocate against the highest value opportunities and so, you know, the IRRs are comfortably double-digit on what we do, but we don't disclose them explicitly.

In terms of the capital strain, we did think it would be helpful because, you know, we think about capital strain with the Capital Management Policy because we, like every other insurer, have a Capital Management Policy, and that's the capital you deploy and that's the kind of, clean way to think about what you're actually tying up in terms of capital. But most of our peers quote a pre Capital Management Policy number. So, our 6.2% in the first half would be 3.8% on a pre Capital Management Policy basis, which is more comparable with others and in a similar ballpark to others.

Now, what we've said is our ambition is to get the strain, including capital management policy, down to 5%, so that will be more like 3% on a pre Capital Management Policy basis on a kind of like for like with others. And the reason why that is lower than many others achieve is, basically, that the point I made about the diversification with Heritage. So, others don't have a big Heritage business of different risks, and therefore we will be more capital efficient because we get the opportunity to diversify against that.

The levers to get there are basically a broader range of reinsurance partners - our Solvency II internal model's not fully optimised yet in the way some of our peers are - and also broadening the breadth of illiquid assets that we can invest into. So, all of those are actually a well-trodden path. We know what we need to do. We've got plans in place to do it. We'll do it and we'll get the strain lower still and will then be a structural competitive advantage over others.

Rakesh Thakrar, Group Chief Financial Officer
Thanks, Andy. Let me start with the second question which was around the credit downgrade and the management actions. So, I mean, certainly from our perspective, it was important that, you know, we showed a realistic position of what would actually happen in practice if that stress actually merged, and also to allow you to actually compare against our peers in this regard.

So, what we've done for that particular sensitivity is assume that we would take what we call reasonable management actions to adjust for it now. The impact of it with those management actions is a strain to surplus of £0.3 billion. Without any management actions, the strain would only be £0.5 billion. So, it's not talking big numbers here. So, even without the strain, we're only at £0.5 billion. With the stress, it's at £0.3 billion. And, again, the kind of actions we would do is what certainly I consider is reasonable.

So, we wouldn't do anything, clearly, on the illiquid space because that will be what it will be, and then there's not much we can do there, but on the liquid, we just aim to get back to the overall portfolio average, and there'll be a cost of change in doing that, and that's what's reflected, and those are the reasons why.

On the first one, on inflation, so what we do, so inflation, as I mentioned in my presentation, comes from two areas; one is from annuities where, effectively, you know, you get those annuities going up with inflation. So we use index-linked gilts to match them. So, we're actually, you know, really well-matched on that basis.

So, then the other area comes through our policy administration and through our costs. So, what we do is, effectively, we look to hedge, you know, long-term inflation by stressing our capital balance sheet and looking how that would move with inflation and then putting a hedge in place that effectively covered us across all our products, etc., and our MSA charges against those costs. And that's why the inflation sensitivity is virtually nil, because we do that on a regular dynamic basis.

Ashik Musaddi, Morgan Stanley
Yeah, hi. Thank you, this is Ashik Musaddi from Morgan Stanley, good morning. Just a couple of questions I have, is first of all, this thing about integration keeps on coming, especially on Standard Life, I mean, if I remember correctly, this deal was done about five, six years back, so when do you think that the Standard Life and ReAssure deal will be completely integrated and there will not be any extra cost? Or would you say that the cost you're incurring at the moment is in line with when you announced the deal? So, that would be the first question.

The second one would be about management actions. I mean, it was a phenomenal first half, £421 million of management action, which is kind of equal to the organic capital generation of £400 million. Now, if I remember correctly, historically, your guidance has been that whatever capital you generate, I mean, one-third would be roughly management action. So, is there any upgrade on that or would you say that longer term, it should still be one third, it's just that first half was strong?

And thirdly, just on management actions again, I mean, there is a big item called balance sheet efficiencies, removing inefficiencies, I mean it's a big one, £280 million or something, any colour on that would be good. Thank you.

Andy Briggs, Group Chief Executive Officer
Okay. I'm happy to take the first of those and, Rakesh, you take the second. So, the way we think about the integrations is we set clear targets. So, if you take Standard Life, we set a target originally of £0.7 billion. We then upped that £1.2 billion. At the full year, we

delivered £1.6 billion. So, we spent £2.9 billion to buy the business. We did £1.6 billion of synergies. So, what we basically said is – look, yeah, you're right. It's a few years down the track. We're going to stop reporting Standard Life synergies because, you know, we've already busted the target by some margin.

The other point I would add is that, you know, what we're doing is, kind of, more than the base migrations. So, what Andy and the team are doing, yes, they are migrating all 4 million Standard Life customers across onto Bancs, but they're doing it in a way that we then have this really attractive advantaged platform for the Open business growth going forward, and that's basically, kind of, reflected through the numbers.

If I take ReAssure, the original target was £0.8 billion, we upped that to £1.05 billion, and we're now just under £1.1 billion after two years, but we'll keep reporting on the ReAssure side as well going forward.

Rakesh Thakrar, Group Chief Financial Officer
Yeah. So, on management actions, clearly, very pleased with delivering £421 million of management actions in the first half. You know, when I look ahead to the, you know, second half, it's not going to be as high as that, and that's why, when I said in my presentation that I broadly expect, you know, the Solvency surplus to be flat during the year with, you know, inorganic surplus plus management actions offsetting our financing costs and offsetting the investment into BPA. That's why I think it'll be broadly flat.

Now, over the longer term, I still think that about a third is about right, you know, going forward, but clearly, as you get closer, you know, you have a better idea on what exactly those items will be, but over time, you know, if you look at our track record, you know, I think a third continues to be, and many of you know as well, continues to be a good proxy here.

And in terms of the other areas, I mean, what's been pleasing is, as Andy said before, a lot of these actions are recurring actions that we know will be there each year. So, for example, on the other line included items, like ERM securitisations, for example, we go and get ERM to back our business, but we can then do further actions to make sure they're more efficient within the structures to generate the additional benefits on that.

There is the fact that we've got this new internal model that we're making, you know, tweaks to that as the business grows, you know, in terms of the way we model certain businesses, the capital associated with that, and this continuous, you know, harmonisation, so the fact we're doing a lot of this integration and doing this Phase 2 for Standard Life we've just finished, then do the same on ReAssure. That gives a number of opportunities. So, again, those are the kind of items in that other line.

Alan Devlin, Goldman Sachs
Alan Devlin from Goldman Sachs. Yeah, a couple of questions from me. First of all, just a couple of follow-ups on the Workplace Pension opportunity. You know, what makes you confident you've got the competitive advantage now in that market through investments and where do you think that competitive advantage is? Is it on the cost side, on the new platform, or on the capability side?

And you said you're only, kind of, scratching the surface of the opportunity. Given there's only three big players in that market, do you think you'll get your fair share of the £40 billion of flows at some point in the future when you are fully competitive?

And then second question on the liquid opportunity, is that temporary given the market dislocations in H1 or do you think there is more of an opportunity on the liquid credit side over and above the illiquids given? I think your portfolio's still heavily UK-focused, so is there more you can do to diversify that? Thanks.

Andy Briggs, Group Chief Executive Officer

Okay. So, I'll let Rakesh take the second in a moment. On the first, in terms of Workplace, I'd draw out four key advantages; the first is the Standard Life brand, it's one of the strongest, highest awareness, most trusted brands, and obviously we bought that last year.

The second is our proposition where we're building a very strong proposition. I mean, you wouldn't be invited to tender and winning all these schemes if that wasn't the case.

The third, and probably most important, is actually the people. So, we've built a fantastic team of people here from across the market, from different places, and I think people love the fact we're a purpose-led organisation with sustainability at the core. We're able to attract fantastic talent to the Group and, you know, for me, that's the most compelling competitive advantage over the longer term. People want to join us and to work here.

But then the cost advantage is very material, so, you know, the rate card we've got with TCS Diligenta here, is, I mean, I've run the Workplace Pensions businesses at Prudential, Scottish Widows, Friends Life, Aviva. I know this market well over decades, and, you know, we'll have a material cost advantage, and, in a relatively thin margin business, that's a huge structural advantage.

So, the other point I'd make here is we're not fully leveraging these things yet. I mean, Standard Life, as a core business, has got to some real strengths, but it was underinvested in for a number of years, and we're making good that investment now. We're making great progress, we're pleased with progress, but we're far from done in what might be feasible.

Rakesh Thakrar, Group Chief Financial Officer

Yeah, and just to then add on that second question, I mean, clearly, what's important to us, that we have the right assets backing our annuities, but overall, our asset portfolio has got the right diversification across currency and also against geographies as well. So, we want to have a high-quality credit portfolio.

Now, clearly, our sterling exposure is highly weighted, and so there is a natural tendency that we want to go more and diversify that portfolio into the US and, therefore, it's the right action to take, and getting that relative spread widening is a fantastic effort from the guys to actually achieve that with the same credit quality. So, that, you know, gives us a clear management action going forward. But what it also does is it then also effectively allows us to move to illiquid credit at the right time. As I said earlier, over time, we want to get to 40% - we're currently at 32% - and this allows us to get there as well. So there's further upside to this as well. So, I think, you know, the guys are doing a fantastic job.

Dominic O'Mahony, Exane BNP Paribas

Thanks. Three questions as well, if that's all right. Firstly, on management actions, you know, £0.5 billion of Own Funds creation there, is this already in the cash guidance as you set it at full year or is there a risk to the upside on the cash guidance, specifically from the management actions point?

The second, on the fee-based business, incremental LTCG very strong. Could you remind us, is there a seasonality, H1, H2, and if there is, how pronounced is that seasonality in just thinking about expectations for the full year?

And then a third, I guess, broader point, how has the change in inflation and rates impacted your counterparts, both on the BPA side and on the sort of, back book transactions? Has it changed the conversations? Has is made it, you know, in your view, more likely that people will bring deals to the table or, indeed, less likely? Thank you.

Andy Briggs, Group Chief Executive Officer

Okay. So, I'll take two and three and ask Rakesh to cover one, and I'm going pick up pace a bit because we're due to finish at 11.00am, in theory. So, on the fee-based side, yeah, there is some seasonality. Basically, in Workplace, you tend to get more salary increases in January and April than you do in the second half of the year. But, if you look at previous years, you'll get a sense of the typical split between the two halves, so that's as good a guide as any there.

In terms of the change in inflation and rates, and I say, the two big impacts, one is, if you're running a closed book portfolio and you don't hedge out inflation, then you're going to struggle to get your cash flow out because you're going to have to increase your expense reserves, and that, we think, would well lead to more CEOs saying – Right, I've enjoyed the cash flow out of this, but maybe now's the time to offload this – so, we think it'll be positive in terms of the deals there. Anna and the team are doing a fantastic job, doing a deal within four months of joining, not bad effort for Anna who's joined us in March there.

And then on the interest rate side, basically it makes BPAs cheaper because we're pricing relative to the return we can get on fixed income and cash flow matching, and so, for those schemes that aren't fully cash flow-matched already, typically their assets are going down less than the amount at which the price of a BPA's going down. So BPAs have become more affordable for more of the market and hence all players are calling the market's going to be pretty buoyant this year, yeah.

Rakesh Thakrar, Group Chief Financial Officer

Yeah. On management actions, you know, there is, again, you know, just reiterate, really pleased with what we delivered and, you know, £0.5 billion of it was Own Funds. You know, some of that would have already been in our numbers, and I'd probably look at the full year, see how we've done, whether there's any impact on that in terms of our overall performance of the year. But certainly, you know, some of that's already been reflected on what we've done.

Nasib Ahmed, UBS

Thanks, Nasib Ahmed from UBS. So, first question, coming back to, sort of, the M&A landscape and the £470 billion that you've got just focusing on the larger deals, if I look at the two biggest UK with-profit funds, you've got about £300 billion. I appreciate some of them would be open to new business, so first question is would you have cups of tea with those guys as well?

And, within the £225 billion of large deals, is there like a really big one that's £150 billion and lots of small ones that make up the rest? And, on M&A again, would you consider, given your focus on fee-based businesses, an advisor or a platform business to acquire as well? Again, would you have cups of tea with them?

And then, finally, on Sun Life, is that going to be funded through the LifeCo surplus or HoldCo? Thanks.

Andy Briggs, Group Chief Executive Officer

Okay. So, I love tea [laughter], and I'm interacting with the CEOs of all these businesses. I mean, we're a leader in sustainability so I'm going out talking to people about sustainability and how the insurance sector – we reckon the insurance sector could contribute about a third of what the UK needs to invest to get to net zero, for example. You know, we're doing a lot on Solvency II and, again, I take a kind of leading role around that. So, I'm meeting people all the time anyway, and I would look at all of those.

You know, we'd be relaxed if a with-profit fund was open or closed. That would be fine for us either way. And I think, in terms of the bigger deals, and I'm not going to comment on specifics, but I would say that the questions there are more strategic, yeah.

Generally, in the insurance sector, people are moving to focus on core businesses, yeah, and generally people are moving to more focused strategies. Lots and lots of examples of that, but you would know better than I. And so organisations that still have capital-

heavy life businesses with capital-light asset management, for example, most others are moving away from that and so, you know, it'll be a strategic call in terms of those.

In terms of advisor and platform businesses, so I wouldn't rule out doing, you know, potentially smaller acquisitions of capability build for the Open business. You know, equally, if you look at the valuations of platform businesses, I think that's unlikely. I think that the valuations there are particularly toppy and, you know, we've already got strong capability through our Standard Life platforms in that space at the moment.

Rakesh Thakrar, Group Chief Financial Officer
Shall I take that final one?

Andy Briggs, Group Chief Executive Officer
Yeah.

Rakesh Thakrar, Group Chief Financial Officer
So, this will be funded by Hold Co cash because, as you know, well, the way our operating model works, cash comes from the underlying businesses, but it'll funded from the Hold Co cash.

Mandeep Jagpal, RBC Capital Markets
Good morning, Mandeep Jagpal, RBC Capital Markets. Thank you for the presentation and taking my questions. Two from me, please. And the first is on H2 BPA. In the presentation, I think you mentioned that the economics for BPA would be similar in H2 to H1. Could you help us understand the specific economics you're referring to here, for example, as we head into H2, are market conditions now more positive than they were in H1 for margins, or are you referring to the profile of the deals you're expecting to do, so a deferred pensioner splits and therefore the strain?

And then the second question on longevity. Rakesh mentioned that half of the in-force longevity is reinsured, so it's one of the few areas where you appear to be keen to take some balance sheet risk. How would you consider your approach to retaining longevity risk on the in-force or new business if the risk margin comes down under any Solvency II reforms?

Andy Briggs, Group Chief Executive Officer
Do you want to do both of those?

Rakesh Thakrar, Group Chief Financial Officer
Yeah. So, first, on the deal economics, I think generally what I was saying more at the high level that we expect the cash multiple, the payback and the strain to be broadly similar to the first half generally. Clearly, each BPA will have its different characteristics in terms of the underlying but, overall in terms of the deal economics, I would be expecting the same for the full year.

And in relation to longevity, so you're absolutely right, we reinsure across. We take the whole of longevity risk, and on one of the slides we've got, you can see our exposure to longevity, it's about circa 20% of our SCR. You know, we do hedge 50% across all of it. All the new schemes, pretty much all of it, is hedged out under the current regime.

Now, if the risk margin falls, and clearly the market, it's expecting, in terms of the public comment, it's about 70%, I don't think it would change anything. We would still continue to reinsure all of that longevity risk out because, in our view, it's not quite big enough to make that difference, but we're working with both the PRA and Treasury to make sure that we get the right outcome.

For us, it's not a capital release. What's more important is to have the ability to invest into the different illiquid assets whilst, you know, protecting policyholders but also then ensuring that we can get to net zero. We need to find that balance, and it's not about capital, it's making sure policyholders are protected and we have the opportunity to do our bit, and we can do a big bit in this in helping Building Britain Back Better and getting to net zero.

Andrew Baker, Citi

Hi, Andrew Baker from Citi. Thank you for taking my questions. Three from me, actually. So, the first one is on the dividend. And so, Slide 7 shows an organic dividend increase, at least as I eyeball it, about 2.5% for this year. What would have to happen for that not to, I guess, get implemented?

And then, secondly, on your debt capacity, so £1 billion, presumably that's on a Fitch basis, if you were to move up, I guess, utilising that, your Solvency II leverage would be high relatively to peers, so is Solvency II leverage something that you think could be a constraint at some point going forward?

And then thirdly, just on the Sun Life integration of £125 million, you mentioned that simplified integration, because it's already on the Diligenta platform, so where are those, sort of, costs and capital synergies coming from? Thank you.

Andy Briggs, Group Chief Executive Officer

Okay. So, I'll take the first and third of those. So, on Slide 7, it's not to scale, yeah [laughs]. It says not to scale, but good try. But look, I mean, the organic dividend increase is a judgement that the Board makes, you know. You can do the sums yourselves. You know, we've already written £1.1 billion so far in the second half, we're £1.1 billion we're exclusive on. We're confident of deploying the £300 million of capital. You can do the sums, you know. We're clearly very confident that we'll exceed the £800 million and we'll be growing organically once again this year.

The Board will form a judgement on a range of factors at year end around what level of organic dividend increase might be appropriate based on the performance of the business. The one, sort of, watch out I would say is, last year, we invested £360 million into BPA. The plan this year is to invest £300 million, and obviously that will have an impact on the level of new business long-term cash generation. But suffice to say we are confident we'll grow organically and then the Board will form a judgement from there.

On the Sun Life of Canada deal, basically, the synergies are roughly half and half between capital and cost synergies, and the cost synergies would be Phase 1 and 2, so combining kind of the Head Office side if you like and combining the Financial and Actuarial side would be the drivers of those.

Not a concern in terms of job losses. Phoenix Group employs 8,000 people, just natural turnover each year is several hundred people. There's 70 people in Sun Life of Canada, and, you know, one of the attractions of the deal is 70 very good people that will add to the strength we've got in the business.

Rakesh Thakrar, Group Chief Financial Officer

Yeah, so on the debt capacity, I think it was one of the slides where we showed that we have £1 billion of debt capacity, and those numbers are as at 31st December 2021. And then, clearly, you know, from our perspective, it is looking at that Fitch leverage ratio to say, you know, can we be within that 25% to 30% range? That's our target ratio. But we also, you know, are aware of the other ratios as well, and, as you can see in our presentation in the appendix, you'll have the IRFS ratio as well as the Solvency II leverage ratio as well. So, we will look at that.

But what I will say is that, if you look at our business, it's cash generative and we then apply our resilience around it and we hedge it. We know that cash is predictable and long term, so we're happy to operate in that range. And that's why 25% to 30%, from a Fitch basis, is appropriate for us because of the long-term cash generation of our business.

Andy Briggs, Group Chief Executive Officer
Oliver, the last word, of the questions in the room, I should say.

Oliver Steel, Deutsche Bank
Oliver Steel, Deutsche Bank. So, first back to Andy Sinclair's question about the £165 million of non-operating cash, you said part of that was FX hedging. Why is the FX hedging in the holding company rather than the Life Company? And then, secondly, on the basis that you have actually put a dollop of assets into US liquids, does that number grow or should we at least assume a maintenance of that sort of number going forwards?

And then, secondly, you've stopped giving us the proxy to shareholder value. No surprise really given that your Own Funds have come down, but you've moved from a discount to that figure to a premium I suspect, if you were to give the figure. And look, I'm sort of teasing you slightly because you always used to push this number and now you're not pushing it anymore, but I'm just sort of wondering here, you hedge out the upside from rising rates but, equally, the NPV of your future cash flows has come down because of rising rates, so I'm just wondering how you feel about that, how we should feel about it.

Andy Briggs, Group Chief Executive Officer
Okay. So, just taking the second one. I think, you know, Own Funds and the shareholder value is not an unreasonable way to look at closed book Heritage business. I think it's a really poor way to look at growing Open businesses because you have a big risk margin, you have a fundamental spread and various other kind of conservatisms so it's not giving a realistic view.

So, what we are all about, which in fact we have been consistently all about, is cash generation, and we're looking to protect both the Solvency surplus, which is what drives cash generation and the dividend now, and we're protecting the £11.8 billion of cash over the lifetime of the business. So, you know, shareholders can be really confident that they're going to get the dividend from us short term and, you know, decades ahead into the long term. And that's always been our focus. That remains our focus in terms of that cash generation. Do you want to pick up on the operating cash?

Rakesh Thakrar, Group Chief Financial Officer
Yes. So, there's probably a straightforward answer to that, Oliver. So, the debt sits outside of the Life Company, and that's why it's done at the Group level rather than at the LifeCo level. So, the debt is outside of the Life Company, so there's no debt that sits in the Life Company itself.

And then, second, on the asset side, so clearly the assets sit in the Life Company. So, all the hedging for that will be done in the Life Companies to ensure that they're matched. So, where we went and got US dollar credit to invest and put in our matching adjustment fund, that fund will ensure that it has the right hedging in place to make sure we're cash flow matched on that basis. That happens in the LifeCo companies. The debt that sits outside, the Group debt, that is done at the Group level.

Oliver Steel, Deutsche Bank
What is the exception on FX hedging cost in the HoldCo? Is that going to continue?

Rakesh Thakrar, Group Chief Financial Officer
So, that will move as currency movements happens, and because we have a number of, you know, US dollar and euro-denominated debt which we're hedging.

Andy Briggs, Group Chief Executive Officer
Okay. Operator, do we have any questions from the conference call?

Telephone Operator
We have no questions on the line. If you'd like to ask a question, please press *1.

Andy Briggs, Group Chief Executive Officer
Okay. While anyone on the conference call is pressing *1, have we had any questions come through on the webcast?

Moderator
The only question outstanding that hasn't been covered is just on Solvency II reform, and could you give your thoughts on the package of measures and whether it's going to deliver the aims that the Government's set, and what impact would it have on Phoenix?

Andy Briggs, Group Chief Executive Officer
Yeah. So, our focus on Solvency II reform is on broadening the matching adjustment eligibilities. So, as I said before, the UK needs to invest about £2.7 trillion over the next 15 years in order to get to net zero, and we believe the insurance sector could do about a third of that, about £0.9 trillion, but you can only do that with regulatory reform because currently the matching adjustment eligibility is really tightly defined, and it doesn't need to be anything like that tightly defined.

Inevitably, when you're creating regulation to suit 28 member states, which is what the EU does, you know, you're not going to be ideal for any individual country, and we think there's the opportunity to change that.

Quite a lot of the debate has been around capital release. From a Phoenix perspective, we've not been lobbying for a capital release. We think it's important that the regime protects policyholders. So our focus is on matching adjustment eligibility.

I mean, for me, to be honest, the acid test here is trying to move away from hard and fast rules and have a more ongoing judgemental approach to this because, you know, at some point, someone will crack a model for hydrogen power, for example, in terms of the journey to net zero, but it hasn't been cracked yet and, until it has, we don't know exactly what it's going to look like. So, trying to codify rules today in detail isn't going to work.

It needs a more judgemental approach where we can work with regulators when there are scale, sustainable investment opportunities, and look to frame those in the appropriate way, recognising that, from our perspective, to want predictable cash flows in our annuity portfolio and matching adjustment portfolio because, you know, we want to be confident that we're going to have the money to pay our pensioners over time.

Anything else from the conference call? Okay, well, look, we're slightly over, 11.05am, but, after a long results season, I don't know about everyone else, I'm off on holiday tonight [laughter] and I'm sure many of you are, but thank you very much indeed for coming along.

We'll be hanging around for a few minutes afterwards if anyone wants to catch up, and then I think my journalist calls start at 11.15am, but thanks very much for coming along. We'll catch up soon. Thank you.

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