Q2 2017 Earnings Call

Company Participants

- David Louis Richardson, Group Deputy Chief Executive Officer & Managing Director-UK Corporate Business
- Rodney Malcolm Cook, Group Chief Executive Office & Director
- Simon George Thomas, Group Chief Financial Officer & Director

Other Participants

- Barrie Cornes, Head-Research
- Fulin Liang, Analyst
- Gordon Aitken, Analyst
- Greig N. Paterson, Analyst
- Marcus Barnard, Analyst
- Oliver Steel, Analyst

MANAGEMENT DISCUSSION SECTION

Rodney Malcolm Cook {BIO 14008420 <GO>}

Right. Good morning, everyone. I am Rodney Cook, CEO of the Just Group. I'm joined, as usual, by our CFO, Simon Thomas; and my Deputy Chief Executive, David Richardson. Once again, thank you to Numis for the use of their conference facilities today, and welcome to all of you joining us. We do appreciate your continued interest.

So, here is today's agenda. As usual, I'll start by giving you a brief update on how we see the business. Simon will then go through the numbers in more detail, and David will talk about our capital position. And, of course, we will conclude with your questions. Important to note that once again comparative figures in many of these slides are presented on what we call a pro forma basis, as if the merger had taken place at the beginning of 2016 rather than in April.

Moving to slide 4. Before I launch into the detail of the first half year's trading, I'd like to highlight for you the investment story of our company in very simple terms, and I make no apology that I may be repeating what I've explained to you before. We do think that the story bears a repetition. We see our model as both unique, but actually quite simple.

So, firstly, we're at work in some of the UK's most attractive financial services growth markets. Indeed, the DB De-risking segment offers a huge opportunity, which only a handful of companies can compete for. And although, obviously the Guaranteed Income for Life, or GIfL market, has had its challenges over the last few years, conduct regulation is moving in our favor and our addressable market, as you'll see later, has grown as the shopping around continues to improve.

Secondly, we enjoy a competitive advantage in our markets, based on our hard-to-replicate intellectual property. And I'm not just talking about medical underwriting capabilities and our powerful distribution franchise, but our expertise at lifetime mortgage origination, and that's an important point. Now, this creates for us an attractive matching asset into which we invest our GIfL and DB premiums. And our competitive advantages are more valuable as the standard underwriting models previously in the market become more difficult to sustain.

And moving now across the slide, thirdly, we do understand the value of capital and we intend to continue to manage it carefully. We are creating a sustainable capital story, and while there is growth in the markets I refer to, we are taking advantage of that growth to expand our margins and to improve the shareholder economics, given that means a lower market share as it might happen. We're seeking to maximize profits rather than headline volumes, and that's my key message there.

Next, the cost efficiency achieved from our merger has contributed much to the margin improvement story we're telling today and the higher returns are clear for you to see. We've also adopted a vibrant new brand during the first half of the year, and we have well and truly moved on from the predecessor groups. We'll be going into more detail in some of these areas shortly, but you'll see these results demonstrate our success as follows: increasing volumes; expanding margins; and thirdly, creating - and importantly, a store of value from which we will draw upon in the future. So, I want to say right up front that we think this adds up to a sustainable model in growing markets.

Now, moving on to slide 5, you'll see the main operating highlights. Today is the further improvement in the new business margin, and that has driven a 39% increase in the adjusted operating profit to £67 million. We've already reported to you in July that we have reached our original £40 million cost synergy target following the merger and that is more than a year ahead of plan, and now we will seek to exceed the £45 million revised target that I shared with you at that time.

In July, we indicated that we expected the margin for the year 2017 to exceed 7%. So, of course, I'm pleased to announce this morning that for the first half of 2017, we've achieved, indeed, 8.9%. Obviously, this is a substantial increase from the result of the first half of 2016, which was at 5%, and it does remain ahead of the pre-Pension Freedoms margins that our groups achieved back then. The margin expansion was necessary given the changing capital requirements after the introduction of Solvency II and we are making also good progress on our cost base, which of course, will increase returns on capital invested in new business.

You'll also see that it has been a solid six months for our balance sheet, our Solvency II ratio stands at the end of June at 150%, more or less the same as at the end of December 2016, which was 151%. Given the new business strain, the integration costs that you'll see and importantly the amortization required on the transitionals under Solvency II, this is very pleasing.

We also had significantly increased our financial flexibility since the end of June by agreeing a £200 million revolving credit facility with the panel of three banks, on more attractive terms than our previous arrangements.

In addition, our recent announcement on the inaugural credit grade ratings from Fitch for various of our group entities should reduce the future cost of new capital should we reenter debt markets. You'll see our embedded value has ticked up to £2.21, and the tangible net asset value now stands at £1.55 per share at the end of June. So, overall, a very strong first half for this year.

Now, I'd like to move on to talk about our attractive growth markets, which I referred to. Our strategy to repeat is about growing profit not about growing headline sales for a sales sake. We're expanding in the expanding markets will enable our profit growth. As importantly, our risk selection strategy is easier to apply when you have more business to choose from. That's the important points.

So, on slide 6, you'll see that the DB momentum has been very strong, industry volumes being 88% ahead of last year and our result was up 80%. This will also bode well for the second half of this year and you will see in the chart Hymans Robertson's research suggests that DB de-risking market will continue to grow substantially over the next decade. They're predicting indeed a total of £700 billion of business in the 15-year period to 2031. The math indicates that that's around £45 billion per annum of new business, which of course, should that eventuate is well ahead of historic levels which have tended to between £10 billion and £15 billion per annum.

We note from recent market comments that there may be back-book acquisition (08:58) opportunities. But let me say that £10 billion case sizes are not on our radar. Our focus is clearly on the £250 million or lower transaction size sub-segment, especially buy-ins. I'll stop there on DB, because I know many of you came to our seminar in February.

But turning now to the GIfL market, Guaranteed Income for Life, the outlook there is also positive. On the top right-hand chart, if I can refer you to there, you'll see that the open-market GIfL volumes were up by just over 12% in the first half compared with the comparable period in 2016, and that is more than double the growth for the total GIfL market, which was around 5%. Importantly, we observed that the open market now accounts for around 50% of the total. And that's well up from the 41% immediately post-Freedoms.

It's good to see the inputs we have described to you in previous presentations are now translating into more open market business. The seminar we held in June, the team then detailed a series of growth drivers, it's worth to look at that if you missed the seminar and we have reproduced for you in the pack some of the slides that may appear in the appendix later.

Adding it up, we think that over the five-year period post 2016, in other words, by 2020, the open market could indeed grow to around £2.9 billion from the 2016 level of £1.9 billion. But, of course, if all of the drivers of that market were to come together, the upside could be much more than that.

Turning now to the lifetime mortgage market in the bottom left-hand side of this chart, you'll see that over the last year the market grew importantly by 34%. But incredibly as we've shown there, the half-on-half a 54% growth in the lifetime mortgage market.

We believe that this market will continue to grow from here, driven by demographics, increasing housing wealth which happens to coincide with inadequate defined contribution pension scheme saving, and importantly, the need for people to settle mortgages and credit card debts (11:50) retirement.

Obviously, that market over past years has generally been growing more quickly than the defined benefit and GIfL segments which we use to fund those mortgage advances. What this means for us is that if we've been able to more than achieve the volume we require, and importantly, at attractive spreads, and both of those have contributed to the margin growth that we've announced. We respect the fact that new capacity is entering the lifetime mortgage market, but demand has been growing more quickly, and so pricing from our perspective has remained sound.

We're hoping to explain more on mortgages at another seminar, perhaps, in the fourth quarter of this year. But, for now, the takeaway is that for us this remains an attractive market in its own right, not just as a valuable investment for some of our defined benefits and GIfL premiums.

So before I pass over to Simon who will take you through the details of the financials, just some of the key numbers to look at. You know we've been pursuing new business margin expansion rather than headline sales growth as I said. But this is where our relatively young business comes into its own.

So the left-hand chart, you can clearly see that reserves grew a further 7%, driven for us importantly by net inflows. And those inflows far exceeded outflows in the 12 months to June of 2017 And the falls in bond yields over that period have also contributed positively.

Our net inflow dynamics ensure that we are still growing our reserves which is shown here, and that, of course, will drive future profit growth. As these inflows each year accumulate, they are building for us a store value which will be released over the future as the invested capital that we are applying against those reserves and the potential margins, which are significant and included in that reserve, begins to unwind. That stock of capital and discounted future profits on existing business passes over to the right-hand side of the chart and you'll see that our embedded value has increased to £2.21 per share.

And moving on to slide 8, you can observe on the left-hand chart, new business margins made further substantial progress in the first half of the year. The margin expansion, together with a 16% increase in first half retirement income sales shown there, has meant that new business profit more than doubled, helping the adjusted operating profit increase by the 39% shown. Like us, you may conclude that our strategy of disciplined growth, which is the headline for today's presentation, is actually working.

So with that, I'll hand over to Simon to explain the details behind the numbers and David will conclude with our balance sheet and dividend plan. Simon?

Simon George Thomas {BIO 15219564 <GO>}

Thanks, Rodney. Good morning, everybody. If I can take you straight to slide number 10, this slide shows the summary IFRS results, and Rodney has already highlighted some of the key takeaways, but let me focus on one of them.

Our adjusted operating profit grew by 39% and our underlying operating profit by 49%, both driven by the 106% increase in new business profit. This is a real vindication of our disciplined pricing approach with the benefits of cost synergies also starting to come through. Clearly, the new business profit growth and the margin is the eye-catcher, and I'll go into that in more detail in a moment.

But further down the P&L account, the in-force profit was unchanged from last year. Here, the positive impact of higher opening actuarial reserves was offset by further corporate bond spread tightening and a slightly reduced earning on surplus due to a change in the mix of surplus assets.

We have some small operating variances, which were mainly results of higher mortality experience on our lifetime mortgage book.

The Other Group companies' result includes our continued investments in HUB, our professional services and distribution business, which provides solutions to corporate and which helps to grow our addressable open market in GIfL and extend our distribution into the lifetime mortgage market.

The increase in the reinsurance and finance costs shouldn't come as much of a surprise and is a direct result of the issue of our £250 million Tier 2 debt in October 2016.

Now, these are pro forma figures, and I'll circle back on the below the operating profit lines when we look at the statutory figures later.

So moving on to slide 11, I want to look at the sales in a little more detail. The total retirement income sales figure was up 16%, driven by a strong DB performance. DB sales have recovered strongly, up 80%. I should flag that this was helped by a weak comparator in the first half of 2016 when the market was quiet after the rush to transact in Q4 2015, ahead of the introduction of Solvency II.

Following this regulatory change, it's good to see that the structural growth trend is resuming. GIfL sales were broadly flat year-on-year, reflecting our disciplined pricing approach. The open market is growing again, and this feels like a market which is back on its feet after the Pension Freedoms. We saw a 24% increase in our own GIfL sales in Q2 compared with the first quarter, helped by some larger cases, particularly individual customers transferring from DB pension schemes.

The other area to highlight is our mortgage sales, which were slightly ahead of our ALM appetite for the half year. We highlighted at our full year results that we no longer target a 25% mix, but we'll dynamically allocate lifetime mortgages in line with the profile of the liabilities written in any particular period. In this first half of the year, the optimal mix was just shy of 30%, and lifetime mortgage volumes are being managed with near-term DB and GIfL origination in mind.

On the next slide, we want to look more closely at the DB sales. We've already touched on the long-term growth drivers in this area and, as I said earlier, DB sales increased by 80% over the comparative period.

On the chart, we wanted to highlight that after the reporting period, since the end of June 2017, we've written just over £260 million in premiums, which sets us up nicely for the seasonably busy Q4 period. In the near term, I can say that our pipeline is robust with multiple potential transactions of various sizes less than £250 million.

Now, turning to the new business margins on slide 13. The benefits of our disciplined growth strategy are clearly demonstrated by our new business margin expansion from 5% in H1 2016 to 8.9% in H1 2017. As you can see on the chart, the first half 2017 margin was a further improvement on the 7.7% margin achieved in the second half of 2016. Combined with retirement income sales growth of 16%, this led to a more than doubling of new business profitability.

This growth in new business margin was driven by three key drivers. Firstly, following the implementation of Solvency II, pricing has generally been maintained in the market. Alongside that, we've continued to adopt a disciplined approach together with the implementation of some improvements in the targeting of margins. Secondly, margins were helped by continued attractive mortgage yields. Rodney has already described the market dynamics here. Growth in supply has been exceeded by growth in demand, and mortgage spreads have remained healthy. This has supported the overall attractive new business margin.

In addition, as I explained earlier, we've selectively increased the mortgage proportion backing our new liabilities to create more efficient ALM. This efficiency is increasingly important for DB schemes with longer duration liabilities. And on a case-by-case basis, we can selectively increase the amount of lifetime mortgages to better match the policyholder liabilities as they fall due. DB liabilities can have a much longer tail, typically due to the predominance of benefit indexation in contrast to the GIfLs.

And the final driver of the margin is the synergy benefits which are now being felt. The first half of 2017 saw the impact of a meaningful amount of synergy benefits, and this is in contrast to the first half of 2016 which had no material synergy benefits to speak of as the merger had just completed in April 2016.

Looking ahead for the full year, we feel that a new business margin in the mid-8%'s is increasingly likely. We remain comfortable with full-year expectation, albeit with moderated volume growth and higher margins than previously expected.

Now turning to in-force, our first half in-force profit has been maintained at the same level as the first half of 2016. While opening reserves for the period grew, the flat in-force profit is reflective of a couple of other factors.

Firstly, corporate bond spreads continue to tighten. In this half, they fell a further 30 basis points as investors searched for yield. This followed the falls in the second half of 2016 which led to a more pronounced effect on the in-force margin in the first half of 2017.

Remember, we apply actual rather than opening yields, and that although the fall in bond spread dampens our in-force earning, it releases the full effect of the fall of the default allowances into our investment and economic variances. So, it's not lost.

The second issue was created by the fact that we had warehoused more mortgages in surplus in the first half of 2016. This gave the return on surface assets a boost. The level of warehoused mortgages has fallen in the first half of 2017, and that slightly reduced the return.

Looking ahead, for the remainder of the year, subject to spread developments, I'd expect the second half in-force profit to be broadly similar to the first half.

Now, I just wanted to look at our statutory result and specifically the non-operating items. This slide shows the statutory result and compares the six months of Just against the six months of Just Retirement and the three months of Partnership. You'll recall that the merger completed for accounting purposes in April 2016.

I wanted to highlight the below the operating profit items. These include non-recurring expenditure of £3 million. This includes investments in digital and online capability, although these amounts are relatively modest. The investment and economic profit line makes a positive contribution of £31 million.

Here, as I mentioned in the in-force discussion, this line mainly benefited from the tightening of credit spreads, partially offset by the impact of rising interest rates on our surplus assets. This is comparatively much smaller than the positive economic variance last year of £145 million, which was mainly driven by last year's huge fall in risk-free rates.

Merger integration costs of £16 million were relatively static, more on the cost synergies in a moment. And finally, we have the amortization of intangible assets, which has doubled due to the inclusion of two quarters post-merger rather than one in the prior half year.

Now moving on to our cost synergies. We've been making rapid progress on the integration program, which has already achieved £41 million run rate of cost synergies and expect to achieve around £45 million by the end of 2017, a year ahead of target. You can see in the chart that savings have been made across the business, although staff savings make up the majority of the £41 million.

In relation to our properties, we've sublet two floors out of our four of our Bishopsgate offices, and we did not renew our lease in Redhill significantly reducing our premises costs.

Finally from me, I wanted to highlight that we've made real progress in terms of improving our financial flexibility. On slide 17, our new five year revolving credit facility gives us flexible access to up to £200 million from a group of three banks at attractive rates of interest. These rates are broadly 100 basis points less than under the previous senior term facility, recognizing the balance sheet progress we have made.

As you can also see on this chart, increasing investor confidence in our credit story was already being expressed by the falling secondary market yields on both of our Tier 2 bond issues. You could also see that this confidence appears to have risen further following the recent announcements of our inaugural investment grade credit ratings from Fitch, where they rated Just Retirement Limited with an A+ Financial Strength Rating.

So we now have better access to liquidity via the RCF and a new credit rating should significantly improve our access to debt capital markets should the time come.

With that, I'll hand over to David.

David Louis Richardson {BIO 18045016 <GO>}

Great. Thanks Simon for taking us through a strong set of figures. And I want to focus on our resilient capital position, and also touch on dividends before Rodney wraps up.

So, first of all in slide 19, this shows that our Solvency II capital coverage ratio continued to be resilient over the first half of this year and was 150% at the end of June, almost unchanged from December. This was despite the final dividend payments, new business strain, integration costs, and amortization of six-month transitionals over the period. We'll go to the moving part shortly.

This figure is well ahead of the 134% that we reported this time last year due to the £250 million hybrid debt that we issued in October last year. Our economic capital ratio was similarly resilient at 214%. It is significantly higher than our Solvency II capital ratio and it reflects our true economic view and does not contain the more onerous elements of Solvency II such as the risk margin.

I also want to highlight that our gearing level remains conservative compared to our sector peers. At 17%, we still have significant hybrid debt capacity, whether you consider the regulatory capital limits of 50% of SCR, or market norms as shown here in the bottom left-hand corner. The improving credit market perception of us that Simon touched on means that this is an increasingly viable option if we see scope to accelerate profitable growth.

Now, slide 20 shows the development in our Solvency II surplus over the first half of 2017. I'll step through each components and share our view on how it may develop in the future. Note that all the figures here that I'm about to quote are net of tax.

Now, in-force surplus over the period was £58 million. This represents the gradual release of all the prudent margins Solvency II requires you to hold, including risk margins and SCR, and allows a six months amortization of transitionals. Look, for the avoidance of doubt, this means the release of prudent Solvency II margins was significantly in excess of the amortization of transitionals over the first six months of the year.

Now, moving on to new business strain over the period, loaded for post-synergy expense levels, it was £29 million. Now, on £723 million of new business premiums, that represents a strain of around 4% of premium in line with our previous mid-single-digit percentage of premium guidance. This figure benefited from the same new business drivers that Simon highlighted in the IFRS results. As previously explained, the amount of new business strain is subject to a number of variables, including customer rates on GIfL and DB, spreads on LTMs, the level of risk-free rates and other economic variables.

However, we continue to expect our new business strains typically be a mid-single-digit percentage of premium fully loaded for post-synergy expense levels. The dividend and interest cost in the first half captures the final dividend and reflects the coupon on our new hybrid debts. For 2017 full year, interest costs are expected to be £32 million pre-tax, which you can then net down for tax in your projections.

As Simon explained, we've made great progress in achieving merger expense savings. However, we've not fully achieved them yet, and over the period there was a £15 million cost overrun. This includes an element of expense overrun due to seasonality in our DB new business premiums. In addition, there was £13 million of integration costs. We expect both of these items to be eliminated over the course of 2018.

Finally, the first half of the year also benefited from favorable financial market effects with risk-free rates rising, which is a benefit in the Solvency II balance sheet and credit spread tightening. This contributed to other. Please note that the cumulative changes in economic condition since we last recalculated transitionals, which was the 30th of June 2016, did not trigger a need to recalculate the transitionals this time around. However, if we had recalculated the transitionals at the 30th of June 2017, it would have reduced the surplus by around £63 million, reducing the Solvency II coverage to approximately 145%.

Now, putting all of this together, our expectation remains that the business will be capital neutral in pound terms by the end of next year. We still expect the Solvency II capital coverage ratio to reach its low point in 2019, and to start improving around 2020. Now, of course, there are a lot of variables which will affect the capital ratio development over time, but that's our baseline expectation.

Let me briefly touch on interim dividends whilst we discuss the capital position. We're pleased that the board has declared an interim dividend of £0.0117 per share. This is consistent with our resilient capital position. The payout ratio is not something we intend to change significantly in the short-term. However, the dividend has always been intended to be progressive subject to continued earnings growth and a satisfactory capital position.

Now, moving on to slide 22. This shows the sensitivity of our capital position as a key risk that the balance sheet is exposed to. First of all, it shows that we can absorb falls in interest rates. A 50-basis-point fall from the 30 June 2017 levels leaves the Solvency II coverage ratio at 138%. For falls of greater than 50 basis points, we have positioned the balance sheet so that the Solvency II coverage ratio is broadly neutral to changes in risk-free rates after recalculation of the transitionals.

To be clear, a 50-basis-point fall does not automatically trigger a recalculation of the transitionals, but it does allow you to understand the dynamics and how we're managing the balance sheet. Please note that the transitionals will be recalculated at the end of 2017 regardless of what happens over the balance of the year.

In terms of impact on capital ratio, credit spread expansion in isolation is broadly neutral for us in the world of Solvency II. So, our principal balance sheet risks otherwise remain property and longevity. Our exposure to property risk primarily relates to the no-negative equity guarantee commitments on lifetime mortgages.

The Property stress shown here represents a 10% permanent fall below the assumed long-term trend for property prices and assumes no subsequent recovery of that fall; in other words, a permanent step-down below the long-term trend. This stress would reduce the Solvency II coverage ratio to 138%.

Now, as for longevity, trends are actually favorable currently judging by the general population statistics and are now thus carried out by the CMI Bureau. That 5% uniform increase in longevity shown here would represent a material shock to the business, given the credibility of our accumulated mortality IP, and again, this is a risk we could absorb. In addition, we recently increased our longevity reinsurance cover to 75% for standard underwritten DB business and for GIfL business. So, over time, our longevity sensitivity will fall as a proportion of our balance sheet, as more years are added under the new reinsurance terms.

So, overall, the picture is one of a resilient balance sheet, with scope to absorb various stress scenarios and still support the growth of the business.

Our confidence and capital position is partly premised are not just the amount of surplus that I've talked through, but also our diversified investment strategy which is shown on slide 23. Our overwriting investment strategy is meet policyholder liabilities as they fall due through duration and cash flow matching with prudent investments.

The public bond portfolio is managed by three managers, Insight, Robeco and BlackRock, with clear mandates and oversight provided by our in-house investment team and investment committee of the board. Interest rates, inflation and currency risks are hedged using derivatives and supported by collateral agreements.

Migration is reduced as the bonds are predominantly used to match shorter dated liabilities, and we also have appropriate controls on, first of all, rating, where we limit ourselves to no more than a 5% deviation on BBBs relative to the iBoxx corporate sterling index. On single name exposure, where we won't hold more than 1.5% of total assets in one issuer, and to provide some context on that, we have a total of 340 issuers that we invest in with an average holding of just over £30 million.

On sector, first of all, in financials, we formally review exposures if our managers exceed the iBoxx financial sector by 5%, and for other sectors, we target a limit of 20% of the life company's credit assets. And on foreign currency, we hedge all currency risk, exposures are closely monitored, and we swapped those cash flows to maturity back to sterling.

Again, the chart shows a well-diversified portfolio of good credit quality and an average rating of A. Continuing the trend since the 2008-2010 financial crisis, we experienced no defaults, and the portfolio is performing as expected. At our previous seminars, we talked about lifetime mortgage portfolio. It has an unchanged 28% loan-to-value ratio and is well diversified geographically across the UK.

Moving on to slide 24, reinsurance remains a key tool for us. We continue to reinsure more than half of longevity risk in our key DB and GIfL business lines, which significantly reduces our Solvency II capital requirements.

Now, for recent years' business, our reinsurance treaties are straightforward longevity swaps. If experience difference from expectations, we pass on a proportion of the difference to our reinsurers. What this does is it reduces our longevity risk which in turn significantly reduces our Solvency II capital requirements on new business. This increases the internal rate of return on the capital invested in new business.

Now, of course, reinsurers do not provide longevity risk transfer for free, and we do give up some future profits. However, by utilizing longevity reinsurance, we're able to generate more profit per pound of capital invested than we could otherwise do without reinsurance. Now, more generally on the topic for longevity, there has been much industry comments on a slowdown of longevity improvements at national population level. Our view is this is a real change in general population trends, rather than a temporary blip.

However, it is too soon for us to make any reserve releases. It is not a simple read across in a general population to our portfolio of business. Insured lives are not always typical of the population. And it is particularly the case for Just due to our use of medical underwriting, which places more emphasis on the individual customer circumstances and less emphasis on proxies drawn from the general population.

That said, we have seen some early evidence of higher mortality experience on our book, for example on our Care portfolio, where the average age is high. We will review the evidence closely as part of our usual year-end review of longevity assumptions, and we'll update you with our preliminary full-year results.

So, with that, I'll hand back to Rodney for concluding remarks.

Rodney Malcolm Cook {BIO 14008420 <GO>}

Thank you, David. So, I'd like to finish by going over on our investment thesis once more. So, firstly, we're increasing our profits in markets that are growing and economically attractive to us. We are maximizing those profits through the use of risk selection techniques rather than going for headline sales growth for its own sake.

Secondly, we have a sustainable competitive advantage within those attractive markets driven by medical underwriting our extensive distribution franchise, and as I mentioned before, importantly our mortgage origination capabilities. These advantages power our risk selection and are indeed translating into higher profits.

Moving across, thirdly, the improving returns mean that we remain confident in achieving a self-sustaining capital position over the medium-term. But in the meantime, we have improved our access to both liquidity in hybrid debt markets as Simon explained.

And finally, we are driving growth in those profits by delivering the benefits of our merger at least a year ahead of schedule. So, bringing this all together, I hope you'll agree with me that this adds up to a sustainable model in growing markets.

As you've seen today, this strategy has already delivered a significant improvement in our returns, but we think there's actually more to come. As the store value I referred to, the store value that we're actually creating by those net inflows matures, and we're looking forward to the second half of this year with confidence.

So, with that, I'll pass over to questions. So, who will be the first question? Gordon. Just wait one moment for the microphone.

Q&A

Q - Gordon Aitken {BIO 3846728 <GO>}

Thanks. This is Gordon Aitken from RBC. Three questions, please. First, on the GIfL market. And you said the open market, they grew 12%, and now accounts for 50% of all GIfL sales. But presumably, regulated entity is not at all happy with this 50% figure. I mean, it's currently forcing two companies to address customers. Just wondering, anyone in the pension book must be presumably super nervous of selling to their own customers. So what was the regulator's current thoughts, and where is this 50% going to go?

And second on funding, last year, you gave guidance that on a cash flow basis, you had the breakeven in next year, and in 2021 you'd be moving into positive territory. I mean, margins have improved and debt costs have come down. Is there any change to that guidance?

And finally on this potential longevity release that I just talked about. You haven't pushed anything through in these results as in contracts or legals and Phoenix. Lots of DB schemes which are moving to more up-to-date tables. I mean, to what extent is it that you genuinely don't know because you just haven't – you only do these things once a year in the second half, you look at assumptions, or is it because you actually think and you actually know that your book is different because you only place in the open market because you've done a lot of medical underwriting and because it is a thing that the wealthy actually haven't seen too much of a change in their life expectancy improvement? Thanks.

A - Rodney Malcolm Cook {BIO 14008420 <GO>}

Okay. So the first question was with respect to GIfL market. Clearly, the regulator's announcements a year or so ago indicated that when they examine customers who had not accessed the open market, they'd be more than 80-odd percent of the cases that they were worth of. So, they drew the obvious conclusion. But if you're like everybody, you should at least check in the open market. So, at this point, I don't believe they would see the 50% had achieved their objective. They are also doing a full review of the retirement income space, and why customers and where the customers are sleepwalking into drawdown rather than taking appropriate guarantees.

So, the only point I can add to your observations is that their focus and it continues to give us confidence that we can work with other providers to grow the open market. There have been some large insurers who're now utilizing our HUB Financial Solutions to broke their business. And just to be absolutely clear, we are broking that business through a panel of providers, of which Just is just one of them, but we still have to compete for that open market business. But my important point there is our risk selection strategy is further enabled that more business that comes past our door to choose from. So, yes, Gordon, we see that as positive going forward.

The next question was with respect to 2020 capital position, so I'll get David just to clarify that. But I think he was very clear, the difference between capital self-sufficiency in pound terms are clear that the ratio, however, as our reserves and our business continued – the book continue to grow that, by definition, the ratio must continue to come down. And then, eventually, the releases will be sufficiently great to overcome the growth in the reserves and cause the ratio to go up.

So, David, just clarify the years.

A - David Louis Richardson {BIO 18045016 <GO>}

Yes. So, I guess, key headline is there's no change in the fundamental guidance there, Gordon. So, we're still saying that in pound terms, we expect to be capital neutral by the end of next year, 2018. The ratio we expect to continue to fall and hit its low point in 2019, and then it will start to pick up around 2020, the ratio that is. So, we should be in positive capital generation in pound terms in 2019, but as Rodney has explained, that doesn't translate into a ratio increase immediately because the balance sheet continues to grow.

Do you want me to go on to longevity as well?

A - Rodney Malcolm Cook {BIO 14008420 <GO>}

Yes. I think just to make the broad conclusion that (47:40) – we mentioned we were a young company, we're growing obviously from the Just Retirement's book, all of our risks have been written since 2004, and you might be comparing us with some other insurers in the market who've got books that are 20 and 30 years old, but David?

A - David Louis Richardson {BIO 18045016 <GO>}

Yes. I think just probably three points that I'd draw out there, Gordon, on your question. And it wouldn't be usual for us to look at changing our longevity basis at the half year. So, there's definitely an element of that, which is we weren't actively looking to kind of make any changes there.

But to Rodney's point, the second point I'd make is, I'm not saying the future isn't present in our book, that's a double negative, but it is a more complex picture for us. We use medical underwriting and we don't just write a cross-section of the whole population, and the interaction between the medical underwriting factors and the over underlying population trend is not a straight forward one and needs to be carefully analyzed.

And as Rodney pointed out, we have a less mature book than (48:57), for example, and establish insurers in writing business for 30 years, where they've got older average ages and you're trending more towards the population anyway.

And the final fact I'd mention is, we are in the process of merging the IP between the two companies and that will also feature into our longevity review at the year-end. So like most companies we focus most of our efforts in the basis that the calendar year-end and we'll give you more of an update with (49:27).

A - Rodney Malcolm Cook {BIO 14008420 <GO>}

Right. Next question.

Q - Marcus Barnard {BIO 2103471 <GO>}

Marcus Barnard from Numis. Can you give us a little more color on the adverse mortality experience in the mortgage book? Does this rate relate to particular cohorts or particular areas or particular age groups? And secondly, the revolving credit facility. Can you tell us what you intend to use that for, how much you might draw down? I appreciate that you're financing for general corporate purposes, but can you give us some more color on that, please?

A - Rodney Malcolm Cook {BIO 14008420 <GO>}

So, I'll make a comment. Thanks, Marcus, on the adverse mortality. David will round it out. Just to be clear, we did not and certainly not in 2017 that we see that as a disadvantage. Let me explain why. So, these are people, of course, that are dying and paying back the money earlier. So, they're paying, in fact, with no neg risks. Secondly, it's increasing our liquidity. And thirdly, as it's happening, we're reinvesting into a market with greater spreads than we were achieving on that business previously. So, that was written at the spread five years ago per se, and that spread is actually lower than we are now reinvesting. I can't guarantee that will be the same next year and the year after. So, clearly, we will tackle those years when we come to them. So David just talk about the adverse, and then Simon, if you cover the revolving credit, please.

A - David Louis Richardson {BIO 18045016 <GO>}

Yeah. On the adverse mortality on the lifetime mortgage portfolio, there's no particular driver there, Marcus. It's not concentrated in any particular age group. We're just seeing some elevated mortality, particularly in the third quarter actually this year. And it's something which we'll take a look at in the context of our overall longevity base review at the year-end. But I wouldn't point any particular driver behind it.

A - Rodney Malcolm Cook {BIO 14008420 <GO>}

Simon?

A - Simon George Thomas {BIO 15219564 <GO>}

Marcus, yes you're right about the half year. I mean, essentially, this was taken out for general corporate purposes which is – I think it's the casual description for general use in the business. I would flag to you that it's at the top of the house, so it's in the group company, so it can be used at any parts of the overall group itself and any parts of the overall group.

But first certainly, I can say to you, I haven't got a long list of the things that are going to be used in the next six months (52:15). It is there. It's a five-year facility. I think this is something that generally in the insurance market, life insurers tend to have as something, just given sort of extra fire power for liquidity.

A - Rodney Malcolm Cook {BIO 14008420 <GO>}

Particularly liquidity. As you know, the regulator has asked questions about the liquid nature of lifetime mortgages. So having additional facilities gives us greater confidence of values in that asset.

Any other question – oh, sorry, Barrie you did put up your hand. Forgive me. (52:52).

Q - Barrie Cornes {BIO 2389115 <GO>}

Good morning, everybody. It's Barrie Cornes, Panmure Gordon. And I've got three questions, if I may. First of all, Simon, I think, on slide 13, you just went through the reasons for the increase in new business margin to 8.9%. I just wondered if you could give us some sort of weighting in terms of where the biggest increase of that movement occurred please?

Secondly, Rodney, I think you mentioned earlier when you started about looking to whether or not you could increase the cost savings from the £45 million. I appreciate it's only just gone up to £45 million, but is there a sort of new target or some sort of flavor you could give there? And - sorry - and thirdly, lifetime mortgages, obviously, there's a fair bit of increased competition in the market as, again, you mentioned. Just wonder what the position is in the individual annuity GIfL market? Is there much competition or is it being sort of waning? Thank you.

A - Rodney Malcolm Cook {BIO 14008420 <GO>}

Right. So, if I take it in reverse order, as I said, we acknowledge that the lifetime mortgage market has more participants. And that exciting involvement has actually helped stimulate the growth in the market. What's wrong with the 54% increase year-on-year? And as I've observed, we've been more than able to achieve the volumes that we require. We're actually ahead of target, and by being more selective and not seeking to grow market share, Barrie, or even retain our market share, because we are now with our total lending around the 15%, 16%, and we have been as high as 30% market shareholders in niche markets. That's leading to us maintaining the better spreads that we observed.

In terms of GIfL, as I said, we have no pension customers. We can only deal with the customer once they - if we use the word escape on to the open market. And of course, we are delighted to see a 12% increase in that market.

It is still a competitive market, and as I indicated, even the panel that we operate for Prudential has L&G, Aviva and Retirement advantage on it. So, we are competing for every piece of business, but of course, we would put to you especially post the merger of Partnership and JR that we do see ourselves in a preeminent position in terms of medical underwriting. We don't need to debate any longer as to which of the two companies have the best. So still competitive, but that risk selection is driving an improvement in the margin.

An easy answer to your question, no, I'm not announcing a new target. I've said - and the board - the Chairman is here. He's expecting me to beat £45 million. He has a number in mind, but I doubt that he's going to tell you either.

Simon?

A - Simon George Thomas {BIO 15219564 <GO>}

Yeah. Barrie, just to give you a bit more flavor...

A - Rodney Malcolm Cook {BIO 14008420 <GO>}

On the margin.

A - Simon George Thomas {BIO 15219564 <GO>}

...on the margin side, yes, I think – certainly looking at page 13, you can see that the second half of 2016 had a very strong margin, but I think you might recall that in the March announcement we were suggesting that there was some unusual conditions in the mortgage margin certainly coming through because of the huge fall in risk-free rates that has taken place in the second half of 2016. And I think from a guidance perspective, we were suggesting that that mortgage margin was going to normalize primarily because there was greater competition coming in from the mortgage space.

And to offset that, I flagged that we were going to have the synergistic benefits coming the other way, and therefore I thought it would broadly flatten out essentially. I think that certainly in this first half, what we've seen is from the mortgage perspective, the competition frankly has been less than we first anticipated. It's been there. But I think the fundamental thing is that the growth in this market has been huge. So, this market grew in 2016 by 34%. And in the first half of 2017 grew by 54%. So, it's a market that has got huge demand there at the moment. And frankly, I think the supply coming in has easily been met in that respect. And so what we've seen is that yield has come down definitely, but nowhere near as much as I first would have envisaged.

The second thing I flagged, Barrie is that we talked about for the disciplined pricing after Solvency II. That discipline pricing in the market has been generally maintained. So, people are pricing appropriately through Solvency II capital. And it also flagged from the pricing perspective that we've developed further metric to target better (58:01). And those have started to come along on line in the first half of 2017.

And the final point of course is that, obviously for the second half of 2016, the run rate of synergy was actually – and it's starting to build up from the June position to the December position. And December, if you remember, we've got the £30 million run rate. We're now with a run rate of £41 million. So, you get the accretive element coming through from that as well coming through into the margin. Those are combination of those three items that I suggest to you that's driving that margin growth.

A - Rodney Malcolm Cook {BIO 14008420 <GO>}

And perhaps, I'll just make a couple of comments on the margin guidance. Because I know we've been asked some very good questions as to why did you announce the prospective margin for 2017 in excess of 7% in July, and now you're telling us it's 8.9%. So, please remember, 8.9% applies to the first half of the year. In July, we had no visibility of what defined benefit business we would write for the second half of this year.

We were pleased to announce today that we've written a further £260 million-plus of business already at very strong margins. And it's that change that gives us the confidence on top of the 8.9% achieved in the first half to talk about a margin in excess of 8% for the whole of this year. If someone in the audience will bring along a couple of pension funds, who'll guarantee to place some defined benefit business between now and the end of the year until we meet our business plan, I'll gladly give you a higher margin than what we just guided.

But please understand in a defined benefit bidding situation, and there are number of competitors, you either win or you get nothing. And so, you would expect me to have regard for the dynamics in the markets and not be overconfident and underperform. So, we're confident about the guidance we've given you in excess of 8%. But that is the reason for the sequence of announcements. And as the year progresses, obviously, we will become further confident, but I'm not - are we planning any - we will share with you our sales for the three quarters. But we wouldn't normally be announcing profits.

Of course, 2018 will be another year again and everyone starts off at zero in terms of DB business. But I hope that gives you a picture of how we're grappling with that point. So, Oliver.

Q - Oliver Steel {BIO 6068696 <GO>}

Good morning. Oliver Steel, Deutsche Bank. So, the first question is a little bit sort of muddled as to the sort of positive versus negative on longevity because you clearly have negative experience variance in the first half, and I assume that's the net of a negative on LTM versus a positive on annuities. And yet the sort of sense you're giving at the full year is not necessarily the assumption changes will be negative. And then, at the same time, I'm thinking that you've got 75% of your annuity book reinsured for longevity, but I assume you're taking on 100% of the longevity risk on LTMs. So, can you give some sort of indication as to whether - as to how we should think about that?

And secondly, on the increasing of the percentage mortgages, you're using in your new business calculation to follow up on Barrie's question, can you say how much benefit that brought to your new business profit?

Secondly, on that mortgage issue, are you also expecting to increase the percentage of mortgages as a percentage of the total book or is this just a new business issue?

And then, finally, if I haven't asked three questions already.

A - Rodney Malcolm Cook {BIO 14008420 <GO>}

I've already got four.

Q - Oliver Steel {BIO 6068696 <GO>}

LCP has said the pricing has become more competitive in DB schemes since the latest CMI tables have been published. So, I just wanted to hear what you were saying on that.

A - Rodney Malcolm Cook {BIO 14008420 <GO>}

Right. Well, I'll (01:02:38) but just to correct any misunderstanding. It is only on business post the Solvency II introduction that we have the longevity swaps. So, over time, a large proportion of our back book, we will be retaining the longevity experience forward. Just to clarify that one, Oliver.

The one exciting point before I hand over to David is that, as we've become more sophisticated in our pricing – matching capabilities, and indeed, even in the individual space now, we have the technology for every single quote to know the IFRS impact and how to pitch that and also the capital utilization, which is important.

So, post-Solvency II, we have taken risk management to a much more sophisticated level. And for the defined benefit schemes, we're actually looking at the right mix, Oliver, of bonds and lifetime mortgages, and indeed, the type of lifetime mortgages because we write drawdown mortgages, we write lump sum mortgages, we write them at various ages. The investment team actually align the right portfolio of bonds and mortgages and that enables the team to be confident in the pricing that they're offering to the employee benefit consultant in that competitive pitch which we don't deny that the market is competitive.

So, David, there's actually four or five points. But if you do the longevity, the proportion of lifetime mortgages and the proportion of total book question, please.

A - David Louis Richardson {BIO 18045016 <GO>}

Okay. So, I'll start off with – let me talk to your first question about the positives and the negatives on longevity. So, first of all, yes, there are opposing forces at work here. You will generally in period see a positive effect on annuity portfolio if people are dying more quickly than expected, and you'll see a negative effect in period on lifetime mortgages. But as Rodney says, then what we try and do is recycle that LTM liquidity into new loans at higher spreads.

And overall, our exposure to longevity though is skewed towards the annuities. And you can see that from the longevity sensitivities that we share. So, we show a 5% change in longevity across all our product lines. So hopefully, that gives you a little bit of clarity where the waiting lies, and the last thing (01:05:27) I wouldn't read too much into six months experience. We look at these assumptions over longer time period than that.

On the risk-based approach on lifetime mortgage allocation to liabilities, that's something we talked about at the full year. It is really just a development in our risk management, a development in our asset liability management and I should say the byproduct of bringing the two companies together, still fixed 25% with more on the JR side, Partnership side. We didn't have that same limit.

So what you're seeing is the natural evolution there, I'd point you to slide 34, which is a rerun of a slide we've shown on asset liability management in the past. And what that shows in kind of graphic terms is how DB business can support a car (01:06:19) allocation of LTM, which again I think is quite intuitive, but it kind of brings this life (01:06:24) graphically there.

And as Rodney said, this increased allocation we're looking at is only if the liabilities support us and only if the economics are attractive on lifetime mortgages.

And on the pricing in the DB market and to what extent, that's getting more or less competitive as expectations of longevity develop. I think the comments from LCP probably and you just asked them (01:06:56) but probably reflect what they're seeing reinsurers do in this space, because it's the reinsurers' longevity assumption which support the pricing on the majority of the risks there and for the players in that market because most players in the DB market then cede most of the longevity risk onto reinsurers.

So what the reinsurers are feeding through in their longevity pricing is what then drives what they offer to the trustees, and, of course, what you're looking out there in the vast majority of cases for other providers is standard, non-underwritten basis rather than medical underwritten basis.

A - Rodney Malcolm Cook {BIO 14008420 <GO>}

Just to round out that point. So, obviously, one very large defined benefit de-risking company announced their results this week, but it would be a challenge to find for £2 billion scheme immediately lifetime mortgages at 25% or 30% of £2 billion. But because we're concentrated on schemes and more particularly transactions forgive me – transactions under £250 million, and we're building a store of them, we believe we can apply them on a case-by-case basis confidently. So, that also sits in our competitive pricing.

I'm not going to ask Simon to split up the individual components, but I think the important one, and you will be very able to calculate this. So, we announced at the 31st of December £30 million of savings, we're now at £41 million. If you average that out, at £35 million over the six-month period, 70% of our costs are applied to new business. So 70% of £35 million, divide that by 2 because it's only half a year, that will give you the increase in the contribution of the synergy savings to that line, that new business line. So, 70% of our costs, we've saved £35 million. That's a run rate per annum, just to be absolutely clear, it's only half a year. But when you apply that, you can see that that is a big contributor.

Once you take that one-off, you could take it from Simon that our expectation was that the spreads would decline over the very high levels of last year. That has not happened. So, it was more that that has continued at good levels that has helped to achieve that result. But, it's not to underestimate the importance of achieving the synergies. And thank you, Barrie, for prompting the Chairman to increase the target. Right. This question here.

Q - Fulin Liang {BIO 21126177 <GO>}

Hello. This is Fulin from Morgan Stanley. Can I ask three questions, please? Just to follow up the lifetime mortgage questions. One is the – for the longevity risk of your lifetime mortgage, presumably, that's more like population-based assumption and versus your kind of portfolio-based assumption on your annuity book. Theoretically, if I understand correctly, can you actually just say, okay, if we have enough evidence for CMI to support the population-based longevity assumption? I can change the assumption for lifetime mortgage, but retain the assumption for annuity, is that right?

And then my second question on lifetime mortgage because you're right, flexible drawdown on lifetime mortgage, and I just wonder how much of your lifetime mortgage is for that kind of drawdown type and how much is – can be in terms of the balance is you kind of the face value committed but hasn't been drawn?

And my third question is – so in terms of the GIfL and DB kind of de-risking proportion. So, obviously, your GIfL is flat, while we see some competitors actually seeing increase in this area. And at the same time, your kind of DB risking – de-risking mark kind of growth pretty much in line with the market. And I was just wondering. So, obviously, your book is more geared towards DB de-risking, and is that intentional choice, is that because you think is a better kind of return on capital now you find is better for the DB de-risking instead of GIfL? Thank you.

A - Rodney Malcolm Cook {BIO 14008420 <GO>}

Okay. So, just to clarify, as I said, we are content that our market shares will go down if it enables our more sophisticated risk selection to deliver that disciplined growth. The GIfL market, there has been a number of major contracts. So, some of the people who have been announcing growth have got exclusive arrangements. So, we have arrangements where we are competing for all business. And I think Gordon did raise the question that he thought all large insurers would be careful about selling to their own customers if they're not offering the best rates in the market. And we will see how that emerges. We are yet to see the new FCA requirement which is that all pension providers have to show competitive quotes. And we will see whether that has a further impact on opening up the open market.

I'll answer the question on flexible drawdown. We offer both lump sum products and drawdown products. The critical point here is, what does the customer need and what is their advisor recommending? Because if you have to repay a large credit card debt or if you have to repay a mortgage, you can't ask the half of it because we will require (01:13:39-01:13:43) so you can't have a bank with the first mortgage and lifetime mortgage provider having the first mortgage.

So, there has been an increase in the number of customers choosing lump sum. And also, you'll see in the appendix this time that I believe we've included examples on both a 20% loan-to-value and also 30% loan-to-value because some people have asked as well what does the dynamic look like if people borrow more money rather than just 20%.

If I can just – when those of you look at that slide, if I can remind you that the average longevity for a 70-year-old male is to age 85 and for female is to age 88, and you'll see than the zero HPI growth over that entire time. The product looks still very attractive. But clearly, if you start off with 30% loan to value on day one, it will get to 100% of the value of the property more quickly.

Q - Fulin Liang {BIO 21126177 <GO>}

David, can you do that complicated one about, can actuaries be half of one and six of one-and-a-half or dozen of the other?

A - David Louis Richardson {BIO 18045016 <GO>}

Yeah. So, on our lifetime mortgage portfolio business, yes, the use of medical underwriting is less there than it is in our GIfL business. We still do underwrite a minority of the business there, but it is a smaller proportion. So, it will look more like the general population than our GIfL will.

However, I did make a comment in my remarks that the insured population is not the same as the general population and that quite some debate is going on in the actuarial profession at the moment is how much do you read into CMI bureau studies which are based on population, experience and how much that translates into insurance company because typically insurance (01:16:03) higher socioeconomic group and the longevity improvement have continued at a slightly higher rate at higher socioeconomic groups. So, it is a complex picture.

Now, mechanically, to your question, can we set different assumptions for different portfolio of the business? Absolutely. But I wouldn't want you to go away thinking LTM is just like general population and GIfL is very, very different. It's much more nuance than that.

A - Rodney Malcolm Cook {BIO 14008420 <GO>}

Clearly, people who have the lifetime mortgage own a property. So, by definition, that's a selected group in the UK. They're not renting a property which will be part of the general population. Just to clarify again, the reason for me showing you in the appendix the economic dynamics of a 20% loan to value for a 70-year-old and also a 30%. In previous years, the mean of our loans was just under 20%. For this first half of the year, it's been 25% for 70-year-old's loan to value. And that is, as I said, because more people are taking maximum lump sum.

And therefore, I have given you example of 20% and an example of 30% and the current mean of our lending this year was at 25%. But I wanted to do that because, clearly, we've previously only shown 20%, which looks extra attractive. Greig?

Q - Greig N. Paterson {BIO 6587493 <GO>}

Good morning, gentlemen. Greig Paterson, KBW. Solvency II, just update us on where you are with the peer internal model. And importantly, someone was talking about it to me the other day, whether it actually is going to give a benefit or not to your Solvency II ratio. And in that context, the merging of the IP, will that release some surplus whereby maybe the regulators made you hold some extra surplus because of the non-merged position currently?

And then, just to clarify for mortgages, individual annuities and bulk annuities. On the mortgages side, obviously, you allocate lifetime mortgages from your stock. Stock was generated over a 12-month period. What was the spread you are achieving on a stock allocated in the first half of this year versus what the current run rate is for accumulating lifetime mortgages? So, that's the one thing. So, we've had a whole bunch of noise and you're making whole bunch of statements back and forth. I just want to know, has it gone up or down?

And the same question with regard to individual annuities and bulk annuities, the gross margin written in the first half versus the gross margin currently being written, i.e., third quarter. So, it's basically the spreads allocated on the lifetime mortgages to the first half versus what you're writing gross current (01:19:19)?

A - Rodney Malcolm Cook {BIO 14008420 <GO>}

Well, I'm not sure, Simon will do all of your homework for you, but I would like, David, please, to do the internal model and the prognosis development.

A - David Louis Richardson {BIO 18045016 <GO>}

Yeah. I see. Yeah.

A - Rodney Malcolm Cook {BIO 14008420 <GO>}

And then, Simon, the spread movement over the last six months.

A - David Louis Richardson {BIO 18045016 <GO>}

Yeah. So two very complex programs, both merging internal models and merging the intellectual property of the two legacy organizations. We're making – I'm pleased the progress we're making on both fronts, but they are, I would say, labor intensive and complex processes. And, clearly, in the case of the internal model, it's also the question of both getting the regulator comfortable and going through approval process with them. So, that also adds additional time to that process.

And will there be a benefit from the internal model? I'll just refer you back to our previous guidance on that, which is we're not necessarily going into that expecting a significant benefit. And ultimately, you need to get an internal model that the regulator is comfortable with. And so, I think that's where we are on that.

The one thing which will help, all other things being equal, is diversification benefits because whilst the two businesses are very similar, and when I say (01:20:50) businesses, I mean the old life companies, when you bring two life companies together in a group internal model, you get diversification benefits which you can't access when they're two standalone entities. So, that needs to be looked at in the overall mix. So, I'd urge caution there.

And, again, on the IP, there's no reason to accept that to generate surplus in itself on the back-book, and that would imply that either or both organizations were being prudent in their best estimate assumptions in the past, which in a competitive markets, I doubt either company speaking to be (1:21:27). So, I wouldn't expect any benefit on the back-book there. However, the real benefit it gives you is in risk selection on new business.

The greater quantum of data, the insights we will get from bringing together two sets of IP will allow us to select and price more accurately, we have greater granularity on our pricing sales, and that will translate into the better and more robust margins.

A - Rodney Malcolm Cook {BIO 14008420 <GO>}

And one of the important things in preparing ourselves, given Gordon's challenge that more business will be coming on to the open market, that of course will include people who are healthy, and we've done significant amount of work, which the board has signed off on, which will enable us to price accurately for healthy lives with limited medical and lifestyle conditions, as well as impaired lives. So, we are ready for that further amount of business that will come on to the market.

Of course, previously, those customers went to standard writers, because they were being cross subsidized between people who were slightly less healthy and those who are healthy. So, we're pleased about that.

So Simon, just quickly on the spreads and movement?

A - Simon George Thomas {BIO 15219564 <GO>}

Yeah, Greig, in terms of sort of the matching of the mortgages to the liabilities, we try and sort of bring them in as and when we can see the liabilities are coming through the book. So you'll see in this first half year, for example, I think if you look at the actual percentage, it's more like 34%. So, we've got a little bit more than you would narrowly would have expected for the business that's permanent (1:23:07) in this period. And we try and do that as best we can, subject to the vagaries obviously of DB coming through.

In terms of the spreads, what I could probably give you is an idea that clearly back in 2016, we saw some extremely high spreads for the first – for those six months, probably the three months after the June announcements of Brexit. They went up into the £400 million, £425 million, £430 million. They, I would suggest even now, come off down to below £403 million, recently (1:23:36), something like that. So that's the sort of move we've seen. I would've expected to go a bit lower than that because of competition, Greig, but that's been more resilient than we first brought (1:23:44).

Q - Greig N. Paterson {BIO 6587493 <GO>}

(1:23:46).

A - Simon George Thomas {BIO 15219564 <GO>}

Yeah. Yeah. No, sorry. Sorry. As I said, it's come back from, as I say, about £425 million, £430 million, down to about £380 million, I'd suggest, the announcements we have in that sort of order. (1:23:58).

A - Rodney Malcolm Cook {BIO 14008420 <GO>}

And, Greig, the mix changes fell slightly, because people who take lump sums...

A - Simon George Thomas {BIO 15219564 <GO>}

Yeah.

A - Rodney Malcolm Cook {BIO 14008420 <GO>}

...the interest rate charged is slightly higher than for those who take low loan-to-values and drawdown.

A - Simon George Thomas {BIO 15219564 <GO>}

That's the gross spread correct, correct (1:24:13).

A - Rodney Malcolm Cook {BIO 14008420 <GO>}

So, that's the gross customer interest rate. I'd like to just check, is there someone on the line, because to be courteous to the people online.

A - Simon George Thomas {BIO 15219564 <GO>}

All right. Greig, that (1:24:25).

Q - Greig N. Paterson {BIO 6587493 <GO>}

So that's the spreads of the assets on the liability side. I was wondering what - so the gross spreads you achieved on (1:24:32) in the first half versus as current run rate - the gross margin you received on - well, I mean, on individuals, I'm trying to understand how the pricing has changed year-to-date?

A - Simon George Thomas {BIO 15219564 <GO>}

Yeah. You're asking about the actually margins, the competition of the margins and so...

A - Rodney Malcolm Cook {BIO 14008420 <GO>}

Q3 versus first half.

A - Simon George Thomas {BIO 15219564 <GO>}

I think (01:24:55)...

A - Rodney Malcolm Cook {BIO 14008420 <GO>}

We could tell you that £260-odd million we've just announced is at least as attractive...

A - Simon George Thomas {BIO 15219564 <GO>}

Yeah.

A - Rodney Malcolm Cook {BIO 14008420 <GO>}

...as the margins we earned on the first half.

A - Simon George Thomas {BIO 15219564 <GO>}

Greig, we don't tend to give you a split of margins between the GIfL and the DB business. We've never done that in the past.

Directionally though again, I'll try and help. I mean, clearly, if you and I (1:25:11) sat here 24 months ago, I think we talked about that GIfL frankly was far, far more competitive and the margins on GIfL were far, far lower than the DB's gains.

That GIfL with the re-pricing that took place on the 1st of January 2016, that pricing is far, far closer now. And what you'll find is that the GIfL pricing doesn't tend to move dramatically, it does move with investments - with the investment market.

On the DB schemes, frankly, it depends what DB scheme comes through the door, and depends on the nature of the duration, and how you can actually back with the assets themselves. So, there'll be times when expected to allocate more capital to the DB side. There will be times when expected to be more on the GIfL side. That does vary over time and a far closer now than they were previously.

A - Rodney Malcolm Cook {BIO 14008420 <GO>}

And I think Greig, we've talked about it before, the actuarial allowances for costs are substantially higher in the GIfL business, given the overall business model. So, we're very pleased that we have a very - a regular flow of that business, because the cost allowances built into that product pricing is covering the cost of the business and that's why we're pleased that that is contributing to the margin as well. There is someone on the line with...

There are two questions, Rodney. The first one from Paul Walsh I got that (01:26:31). Thank you. Can you explain the shift in the reinsurance strategy from quota share swaps? And the second question from Vishal Bhatia (01:26:41). Another quick one on mortality tables. If you were to use the same tables as the likes of Aviva and L&G, what would be the impact of sensitivity on EEV?

David, I think that the second one is an impossible one, but the reinsurance?

A - David Louis Richardson {BIO 18045016 <GO>}

Yes. So, on the reinsurance, we've actually been using effectively longevity swaps since - before Solvency II went live, so back of 2015. And the prior quota share arrangements that were on the (01:27:17) entity were ones which worked in the Solvency I world for capital release. So, the longevity swaps are a lot more efficient in a Solvency II world. That's the real driver behind that. And as Rodney hinted, it's not really possible to say what applying the mortality table that you use for kind of a standard underwritten company with a large legacy portfolio business would be for a company like ours, which is based on medical IP (01:27:45) and customized mortality rates for each customer.

A - Simon George Thomas {BIO 15219564 <GO>}

Rodney, there's a question at the back.

A - Rodney Malcolm Cook {BIO 14008420 <GO>}

Next question? There were two – I think there are two questions.

There are two questions, I think.

Oh, fabulous. There is someone at the back.

(01:27:59) I just got two questions. On the Solvency II sensitivity, as you mentioned, 10% versus the assumed long-term trend of property prices, can you tell us what that figure is? And just on the ratings, why did you decide to not get the initial bonds rated, and is that something you might look to fix potentially in 2020 at the first call date?

A - David Louis Richardson {BIO 18045016 <GO>}

So, on the first one, the long-term trend growth assumption, we assume, it's 4.3%.

A - Simon George Thomas {BIO 15219564 <GO>}

Okay. And the second one on the ratings, this is the individual bonds themselves, I think we just looked at this from a cost benefit perspective. And at that particular in time, we were getting a rating for the whole business essentially on the life companies. And we decided that it wasn't appropriate do it at that time. We may well consider looking at that in the future though, yeah.

A - Rodney Malcolm Cook {BIO 14008420 <GO>}

If I could just add one point on the sensitivities, those sensitivities of course are Solvency II sensitivities. The same one on what we would regard as the real world, the economic world, is around £80 million, not £156 million. And, of course, the real world is what's going to transpire in the future, not one invented by EIOPA or regulators under Solvency II with all of the additional capital requirements attached. I think it's important to put that risk into perspective.

And were you're comfortable with David's description that if the long-term trend was 4.3%, this was a 10% deduction from the entire pricing curve, both today and in the future. Our observation in the past, in the UK, is you might have a step down in prices, but we have a term called mean reversion, which means that over a period, you might have some years where the growth in the UK would exceed that long-term trend and catch back up. Do you follow what I mean? If that happens for lifetime mortgages, the capital hit would be zero, because the risk here is the NNEG, no-negative equity guarantee, and that only occurs in 20 years' time. But what we are demonstrating to be absolutely clear is a permanent reduction in UK house prices that is never recovered. And therefore, we want to be clear on the capital impact.

Ladies and gentlemen, our time has expired. And thank you very much for those questions, and thank you to those online. We look forward to seeing you again soon. Thank you.