Y 2020 Earnings Call

Company Participants

- Andrew Downey, Head of Investor Relations
- Andy Briggs, Group Chief Executive Officer
- Andy Curran, Chief Executive Officer Savings and Retirement UK & Europe and Group Director Scotland, Phoenix Group
- Andy Moss, Phoenix Life Chief Executive Officer and Group Director, Heritage Business
- Claire Hawkins, Corporate Affairs and Investor Relations Director
- Michael Eakins, Chief Investment Officer
- Rakesh Thakrar, Group Chief Financial Officer

Other Participants

- Analyst
- Andrew Baker
- Andrew Sinclair
- Ashik Musaddi
- Gordon Aitken
- Larissa van Deventer
- Ming Zhu
- Oliver Steel
- Steven Haywood

Presentation

Andy Briggs {BIO 4311809 <GO>}

hello, everybody, and welcome to Phoenix Group's Full Year Results Presentation. I hope you're all keeping well during these challenging times.

In line with the current Government guidance, we have opted for Rakesh and I both to present from home. I will start the presentation, with a look back at 2020, Rakesh will walk through the financials in detail, and I will return to discuss the outlook going forward. The presentation will last approximately 45 minutes. And will be followed by a live Q&A session with Andy Moss, Andy Curran and Mike Eakins joining us.

So turning to the opening slide. 2020 was a landmark year for Phoenix, with a significant number of achievements delivered in a uniquely challenging environment. We completed the acquisition of ReAssure, to establish Phoenix as the UK's largest long-term savings and retirement business.

We delivered record cash generation, and record new business long-term cash. And our financial strength allowed us to pay our planned dividends and enabled the Board to recommend an increased final dividend for 2020. We have a clear purpose, helping people secure a life of possibilities with a pivotal role to play in society. And we are focused on delivering better outcomes for all of our stakeholders with key achievements this year, including the announcement of our net-zero carbon commitment and the actions we have taken to increase colleague engagement.

As you would expect from Phoenix, we have, once again, delivered on our key attributes of cash, resilience and growth during 2020. Rakesh will cover these in more detail shortly. But in terms of the headlines, we delivered cash generation of GBP1.7 billion for the year, exceeding the upper end of our GBP1.5 to GBP1.6 billion target. With a GBP5.3 billion Solvency II surplus, and a shareholder capital coverage ratio of 164%, our financial position is strong. And our resilience has been evidenced through a small economic variance, despite the market volatility.

This year's strong financial performance has been supported by the significant progress we have made on delivering the ReAssure synergies, with nearly GBP700 million delivered to date, which has enabled us to increase our synergy target by over 30% to more than GBP1 billion. Finally, we have delivered GBP766 million of incremental long-term cash from new business in our Open division, a 59% increase year-on-year and significant progress towards proving the wedge.

Dependable cash generation and a resilient capital position, are the key to our rock solid dividend, which we have the resources to fund for over 20 years. We operate a stable and sustainable dividend policy. And historically, M&A has been the trigger for increases, as evidenced by the 50% increase in our dividend over the past 10 years.

2020 was no exception, with the Board recommending a 3% increase in the final dividend to 24.1 pence per share, as planned, owing to the significant value generated through the ReAssure transaction.

Obviously, going forward, both M&A and organic growth by proving the wedge can lead to future dividend increases. As the graph on the right shows, we significantly outperformed the FTSE100 in terms of dividend growth through 2020. And we expect to be the 27th largest dividend payer, in absolute quantum in the FTSE 100.

As a purpose-led organization, we believe we have a pivotal role to play in society as the UK navigates the shifting pension's landscape. That's why our purpose is, helping people secure a life of possibilities. This means providing the right guidance and products at the right time, to support the right choices. I passionately believe that businesses with the best people focused on their purpose, and their role in society deliver better customer outcomes, and in turn, stronger returns for shareholders.

The virtuous circle you see on this slide. Rakesh will talk through the detail of the financial performance shortly. So I want to spend the rest of my opening slides focused on how we have been delivering better outcomes for our customers, colleagues, communities and wider society, which will, in turn, drive longer-term shareholder value.

Our key priorities throughout the pandemic have been to protect our customers and colleagues, and to support the communities in which we operate. And what we have learned during this time will drive a lasting change in our business. For our customers, the uptake of digital has been accelerated by necessity. And this will endure, so we need to accelerate our digitization strategy to support this growing demand.

The pandemic has also widened social in-equalities. And so we are increasing our focus on financial education and inclusion, and enhancing our support for vulnerable customers. Our colleagues are telling us they want a more flexible working model, and so we have a group-wide Future Ways of Working projects. Here our colleagues are helping us to develop a model, that best supports their needs and well-being.

But with more flexible working, comes the opportunity to reduce our intra-office travel across the UK. And so we are establishing a green travel policy, that supports our net-zero carbon commitment.

And, we will provide tailored community investment, driven by the key challenges in their location, rather than applying a one-size-fits all approach.

Critical to our success is our focus on our customers. That is why I am delighted that, despite the significant challenges posed by the pandemic, we have continued to meet or exceed all of our customer satisfaction targets, during 2020. Key to this was our decision to keep our call centers open, while others closed theirs, coupled with the immense dedication of our customer support teams. I can see commentary, which suggests Heritage providers of the worst customer service, but that is definitely not the case at Phoenix, with all our key customer satisfaction KPIs 90% or greater.

And as you can see, we've also continued to invest in our customer proposition, with some significant initiatives delivered last year, which will support our future growth. These include the launch of an ESG default funds for workplace clients and an enhanced client analytics tool that will enable us to better personalize the customer experience. The launch of our in-scheme drawdown from Master Trust was another key proposition development, as it has filled a clear gap in our product offering, and now better enables us to retain customers.

Finally, the expansion of our digital functionality has supported a strong increase in digital engagement by our customers. We now have over 50% of logins made by our enhanced mobile app, and online secure messaging volumes have more than doubled in 2020.

A key part of our customer proposition is our Standard Life branded Workplace and Customer Savings & Investments offerings. These were previously operated through a fairly complex set of agreements with Standard Life Aberdeen, as you can see on the left of this diagram. As many of you will know, we recently announced that we've entered into a new agreement, to significantly simplify the arrangements of our Strategic Partnership.

The original transaction, back in 2018, saw us acquire the products and economics of the life and pensions business. However, if we wanted to make a proposition, marketing or distribution change, then we had first to engage an agreement with SLA, who would in turn implement them on our behalf. This meant we were slower to respond to the market than we would have liked.

We now own all of the Life and Pensions business of Standard Life, including the brand, marketing and distribution, meaning we are now in control of our own destiny. This will enable us to provide a more streamlined, multi-channel customer experience, and will allow us to accelerate the delivery of a broader set of propositions to customers.

We, therefore, see this as a key enabler for accelerating our Open business growth strategy, and delivering incremental new business long-term cash generation over time. Both the Transitional Services Agreement and Client Service and Proposition Agreement will also be dissolved, and we have extended our Strategic Asset Management Partnership with SLA until 2031.

It was also pleasing to see Standard Life Aberdeen reaffirm their commitment to their 14% strategic shareholding in Phoenix. I also noted that the arrangements previously in place have been operationally complex for many of our colleagues, day-to-day, so I am pleased this new agreement simplifies things to them as well. I now want to talk a bit more about how we are investing in our people and culture more broadly.

We want to make Phoenix the best place our colleagues have ever worked, and so we are investing in our people proposition. I was delighted that, despite what was clearly a challenging year for our colleagues, our recent employee engagement survey reported an increase of 10 percentage points in overall engagement, to 75%.

We have embedded a comprehensive Diversity & Inclusion strategy into our organization, and is seeing this focus come through in the more balanced profile in our recruitment and promotions. And we have also launched our Who We Are app, which is designed to enhance our diversity data, enable us to better track and inform our progress.

We have also been proactive with the wellbeing and mental health support we have provided to our colleagues. This has included financial support for home-schooling equipment, additional emergency leave for parents and careers, and the increased promotion of our employee mental health network, Mind Matters.

Finally, we continue to develop our excellent talent in the business, and are augmenting this with high caliber new appointments, as you will have seen from some of our recent press releases. We're building a team of the very best talent in the market.

We see sustainability as being at the core of our purpose, of helping people secure a life of possibilities, and a key enabler of our strategy. We outlined our comprehensive new Sustainability strategy, at our Capital Markets Day in December, which focuses on delivering for our 14 million customers and investing our GBP338 million of assets under administration, in a sustainable manner.

As we all know, the impact of climate change is one of the biggest global issues we face, and Phoenix is committed to supporting the goals of the Paris Agreement. That is why we've made a commitment to becoming net-zero carbon, with an ambitious target of 2025 for our operations, and 2050 for our investment portfolio.

We have already signed-up to a commitment to setting Science-Based Targets. We are on track to have 100% renewable energy contract across all of our offices by the end of 2021. And we have set ourselves the target of reducing our greenhouse gas emissions from operations, by 20% this year. And, for our equity and liquid credit assets, where we exercise control and influence we will also be base lining and setting reduction plans. You can find out more about the actions we are taking to be a sustainability business in our comprehensive 2020 sustainability report. And with that I'll hand you over to Rakesh

Rakesh Thakrar {BIO 20549114 <GO>}

Thank you, Andy, and good morning. As Andy said, Phoenix delivered a strong financial performance in 2020, with record cash generation of GBP1.7 billion, a new business of GBP766 million up 59% year-on-year as we executed on our strategy of managing our in-force business for cash and resilience, and delivered growth.

Operating profit of GBP1.2 billion reflects the inclusion of ReAssure, and the acquisition also allowed us to increase our final dividend by 3% to deliver a total 2020 dividend of 47.5 pence per share, a 6.5% yield on the current share price.

This financial performance was delivered despite the volatility driven by the pandemic. Our solvency position has strengthened during the year to GBP5.3 billion and continues to be resilient with a solvency ratio of 164%, that remained comfortably within our target range throughout the year. Our leverage ratio of 28% also remains within our target range and has reduced since the ReAssure transaction as we have made good progress on delivering synergies.

Turning first to cash. At our Capital Markets Day in December, we announced that we had exceeded the upper end of our 2020 target range, with GBP1.7 billion of cash generation in the year. This included GBP0.8 billion of organic cash generation as surplus emerged from our in-force business and GBP0.9 billion of management actions that have been remitted to Group as cash during the year.

And while 2020 had a slightly unusual intra-year phasing, going forward we do expect to see Group cash releases happen twice a year, in line with our normal practice.

Today we have set a new one year cash generation target range of GBP1.5 billion to GBP1.6 billion for 2021, and we remain on track to deliver our five year target from 2019 to 2023, which has been upgraded today to GBP6.8 billion to reflect the ReAssure acquisition, together with new business and over-delivery of management actions during 2020.

Having delivered a total of GBP2.4 billion of cash generation over 2019 and 2020, we therefore expect to deliver a further GBP4.4 billion over the next three years. Phoenix's cash generation guidance is based on in-force business only, and excludes the impact of any new business to be written in the future. At the end of each year, we will therefore have to roll forward our cash generation guidance to take account of new business written in the year and other known differences.

We estimate that the business in-force as at December 31, 2020 will generate GBP17.7 billion of cash over its lifetime. This excludes the Wrap SIPP, Onshore Bond and TIP businesses, which have been sold back to Standard Life Aberdeen. And it has also been adjusted to reflect a prudent estimate of the impact of the changes to corporation tax from April 2023, that were announced last week, but which do not impact our short-term targets given the enactment date.

This estimate of future cash generation excludes the benefit of management actions from 2024 onwards. Focusing first on the next three years, this slide sets out the Holdco uses of cash generation and illustrates how secure our current dividend is over that period. It also highlights the significant amount of surplus cash that will be generated over this period which will be available for growth, subject to operating within our Fitch leverage target range of 25% to 30%.

To improve the clarity of our reporting, we introduced a new metric called Group long-term free cash at our Capital Markets Day in December. The starting point is our GBP17.7 billion of long-term cash generation, which includes 10 years of capitalized future acquisition costs.

As a Group-wide metric it has the advantage of then netting out the impact of roaming cash from the operating company to the holding company, which you can see has occurred during 2020. It also adjusts for shareholder debt, and therefore provides a quantification of the total cash available to meet Group costs, growth and shareholder returns.

So let me talk in detail on the next slide about how Group long-term free cash has moved during the year.

As a Group, we generate additional long term cash by writing new business and through the over-delivery of value accretive management actions. In 2020 we delivered GBP766 million of new business long-term cash generation and are optimistic about growing this amount next year.

We have also over delivered on our management actions during the year by around GBP300 million, but have chosen to reinvest around GBP200 million back into our Open business growth strategy. We have made a one-off allowance around GBP20 million of cost per annum that has been capitalized for the next 10 years, which is a modest investment relative to the growth in the Open business long-term cash generation we expect to deliver over time.

This primary reflects the necessary investment in people, propositions and capabilities in our Open business, Asset Management business, as well as brand and sustainability in order to deliver the growth ambitions we outlined at our Capital Markets Day. The Group's recurring uses of cash include operating costs, interest and dividend plus the funding of new BPA business.

As you can see, incremental cash from new business fully funded our operating costs, interest and dividend. And by improving the capital efficiency of our BPA business and continuing to over-deliver on management actions in the future, we will increase the net long-term free cash contribution over time.

In 2020, our recurring sources of cash have, therefore, largely funded recurring Group uses of cash. However, we have also adjusted the 2020 Group long-term free cash to pro forma for two non-recurring items. We have recognized a GBP0.2 billion impact from the disposal of the Wrap SIPP, Onshore Bond and TIP business to SLA as well as a prudent GBP0.3 billion estimated impact from the future changes to corporation tax announced last week.

Group long-term free cash is GBP13.4 billion. After the servicing of debt until maturity, this leaves GBP11.8 billion of cash available to shareholders. This level of Group cash supports our stable and sustainable dividend for over 20 years. And whilst historically the trigger for uplift has been M&A, the Board now has a clear framework for considering where the organic growth has the potential to support dividend growth.

The framework has two conditions, both of which must be met. Firstly, we must prove the wedge and see the cash generated from new business more than offset the runoff of our in-force business. This will be the case when incremental cash generation from new business exceeds GBP800 million per annum.

The second is that our recurring sources of cash must exceed our recurring uses to deliver sustainable growth in our Group long-term free cash. Before we move on to talk about Resilience, I will walk you through our IFRS results. We delivered operating profit of GBP1.2 billion in 2020, 48% higher than the prior year. This increase is driven by the inclusion of the post-acquisition results of ReAssure and the benefit of new business.

Our Heritage business operating profit is down year-on-year as 2019 experienced one-off benefits from modeling improvements. While ReAssure, which still includes the annuity portfolio, contains a circa GBP190 million gain from updated longevity assumptions in 2020.

Open business operating profit has increased 10% year-on-year due to new business profits on BPA transactions and positive longevity assumption changes. We have updated our Group assumptions to reflect the move to CMI '19 tables and we have made no allowance for the pandemic on our future assumptions.

Finally, just to note that non-operating items include a GBP372 million accounting gain on the Reassure acquisition. Maintaining Phoenix's capital resilience has been my key priority during the economic turbulence of the year. As at December 31, 2020, the Group had an estimated Solvency II surplus of GBP5.3 billion and a shareholder capital coverage ratio of 164%. This ratio is comfortably in the middle of our target range of 140% to 180%, and is significantly higher than the December 31, 2019 pro-forma ratio of 152%, reflecting strong delivery of management actions and synergies during the year.

The year-end position is also stated after recognition of the 2020 final dividend of GBP241 million. Shareholder Owned Funds less debt continues to be a good starting point for determining shareholder value but does not include a number of areas where value exists. These include contract boundaries with the value of in-force on unit-linked business is restricted under Solvency II, and the shareholders' share of our with-profit estate.

Adjusting for these items provides a proxy for shareholder value at December 31, 2020 of GBP9.2 billion, which equates to GBP9.21 per ordinary share. This value proxy is effectively ex-dividend. It also places no value on future new business from vesting annuities, BPA and open channels or management actions. And I would note that this is significantly above our current share price of just over GBP7.30 per share.

Phoenix has a unique approach to managing risk. We have a particularly low appetite to equity, currency and interest rate risks, which we see as unrewarded. We therefore have a comprehensive and dynamic hedging program in place, which hedges 80% to 90% of shareholders' exposure to equity risk, and uses swaps and swaptions to protect the Group's Solvency II surplus to changes in interest rates.

This translates into low sensitivities as presented here. We see credit risk as rewarded and actively manage our portfolio to ensure that it remains high quality and diversified, and operates within our risk appetite. It is worth noting that the credit sensitivities we disclosed are very prudent as they assume no management actions are taken to rebalance our portfolio.

Finally, we manage our longevity risk through reinsurance. Our focus on risk management and delivery of management actions has driven the significant increase in our capital surplus and solvency ratio during the year. Despite the market volatility experienced in the year, we have seen only a GBP0.2 billion strain from economics. This evidences both our hedging program and active credit portfolio management in action.

We have also completed the annual review of longevity assumptions. As mentioned earlier, we have updated our assumptions to the CMI 2019 longevity tables but we have made no allowance to changes in assumption from the pandemic. As a result, we have seen a GBP0.2 billion release of longevity reserves.

Phoenix has a diversified high credit quality shareholder debt portfolio. Our GBP35 billion portfolio is proactively managed on a daily basis to respond to the changing macroeconomic environment, by a dedicated in-house team of market leading credit experts. The portfolio is defensively positioned, with limited exposure to companies most impacted by COVID-19 in sectors such as airlines, hotel, leisure and traditional retail.

98% of our portfolio is investment grade with only 2% of the portfolio sitting at BBB minus. The quality of our portfolio is demonstrated by a cash flow payment experience with greater than 99% of cash flows paid on illiquid bonds and 100% pay on liquid bonds, our active management approach has also enabled us to minimize our downgrade experience during the year with only 0.8% of bonds experiencing a downgrade to sub investment grade.

Long dated or illiquid assets provide excellent cash flow matching for our GBP41 billion annuity book. An illiquid asset origination is a key management action. Our GBP10 billion illiquid asset portfolio comprises 25% of annuity backing assets and is high quality and well diversified. It includes equity release mortgages, private placement's and infrastructure, with smaller holdings of commercial real estate and local authority loans.

We continue to target increasing our allocation of illiquid's to 40% and intend to originate circa GBP3 billion of illiquid assets in 2021. We are investing in our origination capabilities and are continuing to increase our focus on sourcing ESG assets and supporting the Government in building Britain back better, with plans to invest GBP20 billion over the next five years. We recognize that sourcing the right illiquid assets is a key enabler of reducing the capital strain on our BPA business and we will continue to focus on value over volume in our origination.

Management actions drive value and are a key strength of our business. During the year, delivery of management actions contributed GBP1.3 billion to surplus capital. Whilst the delivery of integration synergies from the Standard Life and ReAssure acquisitions is an important part of this year's actions, more than half of our management actions were delivered from our business as usual activities, which highlights the sustainability of our management actions.

As well as the sourcing of illiquid assets, benefits were also delivered through the active management of our credit portfolio and wider balance sheet initiatives, including operational efficiencies. Our plan had assumed we would deliver a strong year of management actions in 2020 and the over-delivery of value accretive own funds actions translated directly into a GBP300 million increase in our medium-term cash generation target, as shown earlier.

We are the market leader in the integration of Heritage businesses and the acquisition of ReAssure has significantly strengthened our capabilities in this regard. Having completed the ReAssure acquisition in July, we continue to progress with our plans to integrate the business into Phoenix. The strong progress made to date has enabled us to increase our synergy targets by GBP250 million for this acquisition from GBP800 million to just over GBP1 billion, an increase of over 30%. This reflects the strong progress we have made on capital synergies with GBP479 million already delivered against our original GBP450 million target as well as the identification of an additional GBP10 million per annum of after tax cost synergies, which we then capitalized for 10 years.

We continue to make no estimate of cost savings from moving to a single customer administration and IT platform. Instead, we see significant benefits from retaining a hybrid model utilizing both the ReAssure ALPHA and the Diligenta/BANCS platforms, which will enable us to integrate multiple M&A concurrently.

We continue to make good progress across both integration programs. We have already delivered our capital synergy target for the Standard Life transition program. The next key milestone for us will be obtaining regulatory approval for our harmonized Internal Model. We expect to submit our application this month, and hope to receive approval by the end of Q3 in line with the typical regulatory approval timeline

Not only will this allow us to proceed with our planned Part VII of the legacy Phoenix Life and Standard Life legal entities, but it will also allow us to proceed with bringing ReAssure into the new internal model. This Part VII will cover in the region of 10 million policies and be one of the largest ever undertaken in the industry. We expect this to complete in 2022.

The migration of the Standard Life business onto the Diligenta/BANCS Platform continues to progress the plan, targeting completion in 2023. This will deliver the remaining cost synergies and incur the majority of expected transition costs with a significant investment having already been made to deliver with these future cost synergies.

As I already mentioned, we have made strong progress in the first six months on the ReAssure transition, which is what has enabled us to upgrade our targets so quickly. 2020 was a record year for new business at Phoenix, delivering GBP766 million of incremental long-term cash generation; a 59% increase year-on-year.

As I mentioned earlier, we expect GBP800 million of incremental cash generation per annum from the new business, will be sufficient to offset the runoff of our in-force business. We believe this is achievable should market conditions continue to allow the investment of capital at acceptable risk-adjusted returns. And we therefore expect to prove the wedge in due course. 2020 performance was underpinned by strong delivery in our retirement solutions business unit. We also saw a resilient performance across the other four consumer-facing business units within the Open division, despite the impact of COVID.

Growth in our Retirement Solutions business is driven by BPA. In the year, we took an estimated 6% share of the external BPA market delivering GBP350 million of incremental long term cash generation. We have continued to see improvements in our external deal economics with average payback reducing to five years in 2020, and capital strain reducing to 8%.

We are investing in our capabilities to ensure we become increasingly competitive in this market and are targeting a capital strain of 5%, which we will achieve through the harmonization of the internal model, illiquid asset origination and improved reinsurance.

This focus on deal economics will ensure we deliver value over volume. We were also delighted to reach an agreement with the trustees of the Pearl Pension Scheme, of which Phoenix is the parent sponsor, for a buy-in of the full GBP3 billion of scheme liabilities. We will deliver this through a series of tranches over the next two to three years and it therefore provides a significant contribution to incremental new business long-term cash generation in future years, with GBP172 million, delivered in 2020.

Integral to the agreement was the release of a share charge over Phoenix Life Assurance Limited, which will enable the Part VII transfer of this company to take place in 2022 along with the other legacy Standard Life and Phoenix Life entities. I mentioned earlier. We expect the incremental Part VII capital benefit in relation to the full GBP3 billion buy-in to be in excess of GBP100 million. And this will more than compensate for the slightly higher headline capital strain as seen with the first tranche.

To conclude, Phoenix has a clear financial framework which supports its strategy and delivers cash, resilience and growth. 2020 was a record year for Phoenix with GBP1.7 billion of cash generation and GBP766 million of incremental long-term cash generation from new business. Despite the many challenges of the pandemic, the business was resilient throughout, with both leverage and solvency managed comfortably within our target ranges, enabling us to pay and increase our dividends as planned.

Moving forward, we have set new one year and three year cash generation targets and increased the synergy targets associated with the ReAssure acquisition. We will continue our focus on delivering resilience by operating within our target ranges for Solvency and Leverage. And finally, we will proactively seek to deliver on our growth strategy and bring sustainability to Group long-term free cash. I will now hand you back to Andy.

Andy Briggs {BIO 4311809 <GO>}

Thanks, Rakesh. We have a clear strategy that is focused on three key priorities and leverages the industry drivers of change. Our first priority is optimizing what we have, our in-force business, where our risk management framework, ensures we improve customer outcomes, and deliver resilient cash generation.

Our second priority is deepening customer relationships, as we respond to the increasing demand from people seeking guidance to consolidate and journey to and through retirement. We do this by engaging them, and offering the right guidance and products, at the right time, to support the right choices across the savings life cycle. And our third priority is customer acquisition.

Here we'll leverage both the strong growth in the workplace market, and increasing demand from corporates for BPA transactions, to deliver new business. And we will continue to assess Heritage M&A transactions, as insurers further consolidate in order to release trapped capital and avoid cost inefficiencies. The successful execution of this strategy will ensure we deliver against our financial framework, of cash, resilience and growth

Phoenix is the market leader in managing Heritage businesses, and our priorities in 2021 are consistent with prior years. First is ever improving customer outcomes, be that through delivering value for money, pricing and repatriating loss policies or being proactive in preventing pensions fraud.

Second, is continuing to manage our capital position for resilience through our unique risk management framework, which delivered very low economics variances in 2020. Third, once again delivering value accretive management actions.

We have a clear track record of success here, having delivered over GBP1 billion last year, and nearly GBP3.5 billion of cash generative actions over the past 11 years.

And finally, we will execute on our integration plans, to deliver cost and capital synergies. We have got a busy program of integration activity scheduled in 2021, but are confident in our ability to execute. With our tried-and-tested, three phased, sequential approach, meaning we can safely manage multiple integrations at once.

We have built strong growth momentum in our Open business in 2020. And as Rakesh has outlined, we came very close to proving the wedge last year. We are focused on building on this success, and driving our growth strategy forward in 2021. Our established BPA business was a major contributor during 2020, and we intend to continue pushing forward here.

We are building out a market-leading team and proposition, allocating capital to the business and making further progress on our path to our reduced capital strain target of 5%. We also have further tranches about Pearl scheme buy-in to deliver. And it's good to know that we have already secured this significant boost, to new business cash generation, over the next few years.

Leveraging the newly acquired Standard Life brand is really exciting for us. And I talked earlier about our ownership of the brand and with it marketing and distribution is a key enabler of our growth strategy for Workplace and Customer Savings and Investments. We will also be continuing the investment in our Workplace proposition as we look to build on our top 3 position.

New proposition developments in 2021 include a Workplace ISA, and further expansion of our ESG offering and an increasing focus on digitization, including using data and analytics, to provide a more personalized customer experience.

In our Customer Savings and Investment business, we will be leveraging the insight that we have garnered, from the customer engagement we undertook in 2020, to develop innovative new solutions, through an agile test and learn approach.

Finally, as part of our commitment to the financial adviser market, we have been working with our partner TCS to develop a new and improved digital portal for the retail advisers in the UK.

It will launch later in 2021 and will help advisers work more efficiently and create more opportunities for them with their clients. We also continue to see M&A as a core driver of our growth. As we outlined at our Capital Markets Day in December, we have three very clear criteria for assessing acquisitions, and we remain disciplined in our approach.

Alongside being a good strategic fit, any deal has to be, value accretive, supportive of the dividend; and Enable us to maintain our investment grade rating.

There remains a huge opportunity for us to explore. The UK Heritage market alone is a GBP440 billion opportunity. While our focus remains on acquiring Heritage books, we will also consider buying Open books, if they bring complementary capabilities to our strategy, and meet our three criteria. And if the right opportunity comes along, then we undoubtedly do have both the firepower and capacity to execute.

So let me conclude with our priorities for 2021 and beyond. Again, our story is simple. The key outcomes we deliver for our shareholders are cash, resilience and growth. In 2021, we will deliver those by continuing with the disciplined management of our balance sheet, delivering on our integrations, and by accelerating our Open business growth strategy.

And as a purpose-led organization, we will do this through delivering on our sustainability commitments, and investing to help Britain build back better and greener. Ensuring our customers are at the center of everything we do; and by investing in our people and culture. And with that, we will move to questions.

Can I please, therefore, ask the analysts who are currently watching on the webcast to now log-in to the Zoom call with the details they have been sent by the IR team. I am pleased to say that Andy Curran, Andy Moss and Mike Eakins will also be joining Rakesh and I for the Q&A session.

In terms of the format, for the sell side analysts who are joining the Zoom call please use the Raise Your Hand function and the operator will bring you into our presentation live via video and enable you to ask questions directly to the presenters. For anyone watching on the webcast, please use the Q&A facility and we will come to your questions after we've been to those on the Zoom call. Thank you.

Questions And Answers

A - Andy Briggs {BIO 4311809 <GO>}

(Question And Answer)

A - Claire Hawkins {BIO 20555563 <GO>}

Hello, everyone, and welcome to the Phoenix Group full year 2020 results Q&A session. I'd like to hand you over to Andy Briggs, who will lead you through. Andy, over to you.

A - Andy Briggs {BIO 4311809 <GO>}

Thank you, Claire. Good morning, everyone. Great to see you all. So while we give the analysts a moment or two to dial into the Zoom environment, where they are able to ask their questions live, Andrew Downey has both some pre-submitted questions and the questions on the webcast. So, to give the analysts a moment, Andrew, can we have our first question, please, from the pre-submitted on webcast.

A - Andrew Downey {BIO 20365467 <GO>}

Absolutely. So Andy, the first question is how important is your recent acquisition of the Standard Life brand to delivering on your growth aspirations and proving the wedge?

A - Andy Briggs {BIO 4311809 <GO>}

Thanks, Andrew.

So, look, within our financial framework. Cash and resilience remain as important to us as ever, but growth is also important to us. And I was very pleased with the growth performance of the business last year with long-term new business cash up 59% to GBP766 million. I think the Standard Life brand is really important to us, because previously, whenever our teams wanted to make any upgrades to any propositions or consider any customer marketing and communication materials, we always used to have to go across to our friends in Standard Life Aberdeen and ask them and they would then do that for us.

So, what this deal has done has moved us on from just buying the products and economics to owning all of the life and pensions business of Standard Life, including the brand, marketing, and distribution. And at the same time, the customer service and proposition agreement will be dissolved as well or terminated as well. And that will give us much more freedom to develop a broader range of propositions and think about doing more in the retail adviser space, for example. So I think makes it makes a big difference to us.

I think it's also really pleasing that Standard Life Aberdeen have reaffirmed their commitment to their strategic shareholding, their 14% stake in the Phoenix Group. It's also great that we've a fantastic opportunity to deepen the strategic asset management partnership we have together. And all of this adds to our confidence that we can drive our growth further forward above the GBP800 million level required to prove the wedge. Obviously, that being a key trigger to grow the dividend. So exciting times ahead for us there.

So, hopefully now, our analyst friends have had the opportunity to dial into Zoom. If I can just remind you to use the 'Raise Hand' function to ask your question; and Claire, can we have the first analyst questions, please?

A - Claire Hawkins {BIO 20555563 <GO>}

Yep, indeed. We've got Andy Sinclair. Andy, if you'd like to unmute your mic, please go ahead and ask your question. Thank you.

Q - Andrew Sinclair {BIO 17749036 <GO>}

Thanks and morning, everyone. Three from me as usual if that's okay. Firstly, just on the Pearl transaction. You flagged some more of those transactions could come just really wondered what should we think about for strain and the economics of future transactions compared to the first one. Just any color there.

Second was again on the Standard Life agreement. You brought the brand home to both inroads. Just really wondered if you could tell us what particular products you might be looking to push harder? Are there any particular products you weren't able to look at before that you could do now, saying the IFA space? Does that interest you or direct, perhaps leveraging a workplace platform more? Just any thoughts on that.

And thirdly, it was just really on absorbing the corporation tax change and still being able to increase long-term cash guidance. Just really wondering if you can give us a bit of color on what the tax change means and how you're able to offset and mitigate that impact?

A - Andy Briggs {BIO 4311809 <GO>}

Thanks.

Thanks, Andy. And a very, very impressive lockdown beard there.

Q - Andrew Sinclair {BIO 17749036 <GO>}

Thank you.

A - Andy Briggs {BIO 4311809 <GO>}

Actually, you resemble Jim Hamilton, the former Scotland lock. He's a mate of mine whose son plays rugby with my son, so probably not quite his height, but so I'll get Rakesh to take the first question on the Pearl buy-in and also pick up the question with corporation tax change. And then we'll go to Andy Curran, who can talk a bit about some of our thinking on the Standard Life brand and broader products and propositions. So, Rakesh first.

A - Rakesh Thakrar {BIO 20549114 <GO>}

Thanks, Andy.

So let me start with the first question on the Pearl transaction. So clearly, the Pearl transaction was really important for Phoenix and that it -- not only did we get the first 25% of the GBP3 billion scheme we are now signed up to get the remaining 75% over the next two to three years. So a really, really good transaction for us. It is effectively a zero-sum game because it is our own scheme. So, clearly, if we want to get better terms on that scheme, we to expect to put money in, and we'll get it back anyway. So it is a zero-sum game. So, the fact that we've got the full GBP3 billion is really key. And more importantly, actually unlocks the Part 7 transaction of the Phoenix Life Assurance Limited company, which as I said in the presentation, we will provide a further GBP100 million benefit when we do the Part 7 later in 2022.

So, in terms of straining to answer your specific question, Andy, it will be broadly similar, but consistent with our external BPA transaction that we have announced. We are still trying to target a lower strain and the benefits of the internal model harmonization, the benefits of allocating illiquid assets to the scheme, and also the benefit of longer-term reinsurance will also help reduce that strain as we expected to do for external BPAs. I mean just to give you some context, the current amount allocated in terms of illiquids, so that Pearl transaction was only 20%. When you compare that to the external BPAs. It's quite a bit lower. So we do have some benefit of future management actions of allocating possibly more to that scheme later in the future. On the third point, on the corporation tax. Clearly, this was something that came out in the middle of last week and the increase of corporation tax from 19% to 25%, and really being starting from 2023 onwards.

And if you look at our cash guidance, Andy, it is really from the period from 2021 to 2023 the GBP4.4 billion. So I'm not expecting it to impact it that much in terms of the short-term position. I also have a lot of resilience within the life companies that you would have seen, so not expecting it to impact in the short-term. In the longer-term, we've given the guidance that we think that the long-term free cash will be impacted by GBP0.3 billion.

So, thank you, Andy. Now it's back to you.

A - Andy Briggs {BIO 4311809 <GO>}

To Andy Curran, please, for the second question around the Standard Life brand and the propositions.

A - Andy Curran {BIO 18816863 <GO>}

Yeah. Good morning, Andy.

Yes. The brand clarity is tremendous for us. It gives us that heritage that we have on heritage, a well-respected brand within particularly the pensions market with the EBCs, advisers, trustees, and the feedback we've had since purchasing the brand has been excellent. And internally, we have increased and will see increased operational efficiency.

In terms of, Andy, your specific question around product and product investment. We've already invested quite significantly into our corporate pension solution with Master Trust having in-scheme drawdown ESG Solutions working closely with ASI. We're very happy with the range of investment solutions we have in that space and we'll continue to look to support via a key market who introduced much of our existing pensions solutions to us. So, much work to be done there. We feel that there's a great opportunity for us to continue to support both the corporate channel, as we currently do, focusing on our 14 million existing customers. And making sure that we give the right level of support into the IFP space. Thank you.

Q - Andrew Sinclair {BIO 17749036 <GO>}

Sorry, follow up on what Rakesh, just about the tax point again?

A - Andy Briggs {BIO 4311809 <GO>}

Sure.

Q - Andrew Sinclair {BIO 17749036 <GO>}

I realize the impact of that was very small. I'm really kind of more looking at why, because if you're going from 19% to 25% tax, that's about 7.5% hit. I realize you'll probably beat your expectations elsewhere and offset part of that. But just should I be thinking that you've more than offset the 7.5% hit? Or effectively, is that offset by having actually a lower tax rate on certain elements.

A - Rakesh Thakrar {BIO 20549114 <GO>}

Yeah, no -- Andy, that's a good question. So let me give you some more color around that. So the tax impact of the GBP0.3 billion is on our long-term free cash and therefore long-term cash generation. And just important to remind people and this is just the in-force business only. So we're not allowing enough cash guidance in any future new business. And we've been pretty consistent with that. And then the reason why it's only GBP0.3 billion, and it is probably three or four things I'll probably just highlight. One is the fact that insurance tax generally is a complicated subject. And not all the businesses attract the same marginal rate increase as we've seen from that 19% to 25%. And that's part of the reason. There are certain businesses that are going to attract the same increase in the marginal rate as that corporation tax increase that we've seen.

Second is the fact that within our guidance, we have allowance for corporate group belief and that means that the fact that the corporate costs that we're still incurring and the debt interest costs that we're incurring over that period will give us some shielding in terms of the total tax impact on long-term free-cash. The other two reasons I'd probably highlight. One is that it doesn't come into effect until 2023. So for 2021 and 2022, that is still free of the increase from the tax. And finally the fourth area just probably highlight is the fact that we already have IFRS net assets within the entities that have already been taxed and is already there on a post-tax basis. So that in itself won't incur additional tax either. So, hopefully, a combination of all those four areas, Andy, which means that the impact is only at a prudent GBP0.3 billion level.

Andy, back to you.

A - Andy Briggs {BIO 4311809 <GO>}

Thank you, Rakesh. Claire, can we have the next analyst question, please?

A - Claire Hawkins {BIO 20555563 <GO>}

We can. We have now got the question from Ashik Musaddi. Ashik, if you would like to unmute your mic, please go ahead.

Q - Ashik Musaddi {BIO 15847584 <GO>}

Yeah. Hi. This is Ashik here. Hi, Andy; hi, Rakesh. So, just a few questions I have is, one is on asset origination Slide Number 27. I mean on that slide, you mentioned that you plan to raise about GBP3 billion of illiquid assets this year and then GBP20 billion over five years. You currently have GBP10 billion of illiquid assets. So that will take your illiquid assets to about GBP30 billion. I mean what am I missing here? I understand that there will be runoffs of -- a bit as well. But these are illiquid assets so they should not run off that fast. So, GBP30 billion of illiquid assets by the end of five years looks quite high compared to your 40% target. So what am I missing here? That's the first one.

The second one is on your funding capacity. You mentioned that you have GBP1.4 billion of funding capacity on Slide Number 44. On what basis is that is? And what are the assumptions that goes behind that in terms of inorganic funding?

And the third one is, if I look at your next three-year cash flow guidance, you're suggesting GBP4.4 billion of which let's say, GBP800 million is the run rate for organic, that's about GBP2.4 billion. So, that means you're looking to do about GBP2 billion of management action. Does that math sound right? Yeah, that is three questions would be great. Thank you.

A - Andy Briggs {BIO 4311809 <GO>}

Thanks, Ashik. Good to see you. So Rakesh, do you want to take the second and third questions there, so sort of funding capacity and the maths around the organic and management actions over the next three years. And then hand to Mike, who can talk about our asset origination plans. Rakesh?

A - Rakesh Thakrar {BIO 20549114 <GO>}

Thanks. Thanks and good morning, Mike. Rakesh, so let me take the second question about the funding capacities.

This is GBP1.4 billion, as you've indicated in the slide. What this really thinks about is based on our capital position and based on our leverage position, how much surplus cash do we have then to do an acquisition without -- effectively without going to equity. And clearly, in any transaction will be based on what the target looks like. And I think I mentioned this before, we need to understand the capital structure of the target in terms of this capital position and also in terms of its leverage position. But all other things being equal, if we can go maintain that and previously done and as I highlighted in my Capital Markets Day slides where I'm happy to go up to 30% and then come back down with the synergies this GBP1.4 billion effectively assumes that I could go all way to 30% in terms of additional debt raised and use that surplus cash above my liquidity policy to then invest in an acquisition.

So hopefully, that gives you that color on where that GBP1.4 billion comes from. In terms of the GBP4.4 billion cash generation. So yes, I mean absolutely right, Ashik, if you take three years of organic cash generation. And that's assuming we write new business, because we did say our cash generation targets assume no future in new business. If we write three years of new business that offsets the Heritage, then absolutely, we would be having GBP800 million of organic cash generation because we would have proven the wedge. And that means the balance would then be a combination of, Ashik, from management actions that we will continue to deliver, and you'd have seen that in our BAU management action this year. We did deliver GBP0.7 billion of BAU action. So this gives us confidence, given the past 10 years that we will continue to do that, but we also have GBP2.9 billion of pre-surface within our life entities today. So a combination of management actions and the fact that we have the GBP2.9 billion pre-surface gives me confidence on that GBP4.4 billion. Clearly, if we write more business during 2021 and onwards, we'll be having more organic cash generation.

Now, handing you to Mike Eakins on the asset origination.

A - Michael Eakins {BIO 21096986 <GO>}

Thanks, Rakesh, and then morning, Ashik.

So, just in the context, so that GBP3 billion per annum current illiquid asset strategy. That's in the context of growing our BPA. So, whilst, our current target is GBP3 billion of illiquid assets per annum, we expect that to grow as our BPA business grows. I think there's four other points that I'd just highlight in the context of that. One is diversification. So we're actually able to achieve a significant amount of diversification by selling out of some of our illiquid credits and going into illiquid, and illiquids really highlight that.

The second is really expanding our origination. So we're expanding the asset strategies that we can go into in the illiquids complex, but also the geographies that we can go into and we think there's tremendous opportunity for example over the coming next two-three years of entering the U.S. dollar illiquid assets markets, particularly infrastructure.

The third point is we remain highly, highly selective on the illiquid assets that we go into. We've got very, very strict hurdle criteria in terms of originating illiquid assets. And we pass on many more assets than we actually originate.

And the fourth and final point I'd highlight is just picking up a point Rakesh made in his presentation is that actually we have in-house expertise to originate and manage those illiquids on an ongoing basis. And we would expect to add to that expertise on a going-forward basis. So with that, I'll hand back to Andy.

Q - Ashik Musaddi {BIO 15847584 <GO>}

So, just one follow-up on that. I mean, I still don't get like GBP20 billion of illiquid assets over next five years. I mean, how does that stack up with your target of 40%? Because, see, you have GBP10 billion right now, GBP20 billion over five years that's GBP30 billion. If that's 40% of your total asset base, it means that you would have GBP75 billion of annuities by the end of next five years versus GBP35 billion now. I'm just trying to understand if I'm missing anything on this math.

A - Andy Briggs {BIO 4311809 <GO>}

So I think, Ashik, what we're saying with the GBP20 billion is that sort of level that we would be able to consider. You're right that would well -- that level could lead us to go ahead of the 40%, which is not something I completely roll out. But at the moment, we sit at 25%. And therefore, originating the GBP3 billion in 2021 is -- I think is a positive step forward in support of our growing BPA business. We only had sufficient illiquids last year with over GBP 2 billion of origination. We only had sufficient to put 20% sort of Pearl

Scheme buyouts, as Rakesh just said. So there's definitely the capacity here to grow. And the GBP20 billion, in particular, we're just -- we're very keen that the government takes the Solvency II review very seriously and recognizes the opportunities for insurers to do an awful lot, because a large proportion of this illiquid asset origination is sustainable. And there's a real opportunity for us to do much more around build back better and greener.

But I do want to make one a couple of points just to add to what's been said. Firstly, we will not run any risk to the kind of resilience of our balance sheet by the driving and creating value in annuities. And what I brought your attention to is in the sensitivity page within Rakesh's presentation. One of the sensitivities is what is the impact on our GBP5.3 billion Solvency II surplus from 20% of our credit portfolio having a whole asset downgrade, a whole asset-three notch downgrade. And last time, we published that sensitivity at the half year; that was GBP0.6 billion. That's down to GBP0.5 billion. So what Mike and his team are doing is they're being very thoughtful about the way in which their investment in credit portfolio in order to keep that sensitivity, so that's the key thing to look at. If that starts to balloon up significantly, then we would be taking more risk to our resilience. At the level of GBP0.5 billion. I mean, it's negligible in the scheme of the GBP5.3 billion surplus. So that would be the key point I would draw out. Keep a close eye on that as we go forward. That's something we want to manage carefully.

Q - Ashik Musaddi {BIO 15847584 <GO>}

Thank you, Andy.

A - Andy Briggs {BIO 4311809 <GO>}

The final point I'd just make in terms of the funding capacity for M&A. I would say going forward, far more of our M&A will be done by the very strong levels of cash we are now generating. So historically, Phoenix's M&A has been heavily equity funded. And going forward, that's not to say if a deal was of a sufficient size, that equity would still remain a possible option, but we will be able to do far more through our cash resources.

So, just to remind all the analysts, use the 'Raise Hand' function if you have questions.

Claire, can we go to our next analyst, please?

A - Claire Hawkins {BIO 20555563 <GO>}

Indeed. We have Gordon Aitken. Gordon, if you'd like to unmute your mic, please go ahead and ask your question.

Q - Gordon Aitken {BIO 3846728 <GO>}

Yes. Hi. So yes, a couple of questions, please. First on -- we touched on it there about post Brexit Solvency II reform of the risk margin and the matching adjustment. What's a realistic outcome on that? And secondly, on longevity, can you please split out the GBP369 million longevity gain between base table and improvement assumptions? You mentioned that for the latter, you've moved to see my 2019. Now that was a one month increase in life expense. So did that add or detract? And maybe if you could talk about the smoothing factor. Last time I asked you said it was 8.0, so has it changed? Thank you.

A - Andy Briggs {BIO 4311809 <GO>}

Thanks, Gordon. I'll take the first one and then pass to Rakesh to take the second one on longevity.

So, look, I'm not expecting a material capital release from the Solvency II reforms and there's nothing in our numbers for any expectation around that at all. But what we are hoping for and looking for is two things. Firstly, that we see the risk margin reduces significantly because I think we all agree and Sam Woods would agree with me that the risk margin is very sensitive to interest rates, and therefore it's too high in a low interest rate environment. But if what happens is you end up largely that's offset by transitional. But if you end up with both sides of the balance sheet, the risk margin and the transitionals coming down, I think that's a net positive as far as a generalist investor is concerned looking at insurance stocks.

And so I think that will be positive. And of course, at the moment what we're all doing is we're all reinsuring our longevity elsewhere, because the scale of the impact on the risk margin of longevity, and it'll be nice to be able to make a more economic base decision with the risk margin at a more sensible level. But the big piece that we do think there's a real opportunity for is to look at the way the Solvency II regime works and to look around the matching adjustment, so that to enable a broader range of illiquid assets to be incorporated, because the insurance sector has a fantastic opportunity to support Britain building back better and greener. As I said a moment ago, a large proportion of our illiquid asset origination. So as of last year, we invested nearly GBP900 million in sustainable assets, on social housing, renewable energy, and so on. There's the opportunity for us to do quite a lot more in that space, which is a -- is -- will be great for our annuity business to get the greater diversification Mike referred to, and a better yield and grow that business, support our customers in those markets help those finance directors derisk their defined benefit schemes, and it will also be great for broader society.

And Rakesh, do you want to pick up the longevity question?

A - Rakesh Thakrar {BIO 20549114 <GO>}

Yeah. Thanks, Andy, and good morning, Gordon.

So, on the longevity point. So I think you were -- the GBP317 million you're referring to was on an IFRS basis. So just to give you some further details on that. So in terms of the split between base and improvements about one-third of that roughly was on base and two-thirds, therefore, was on improvements. And you're absolutely right. We move to the CMI 2019. And what I described previously was that within Phoenix, we have a cause of death model, which should be further enhanced during the course of the year, where we've applied our own socio-demographic characteristics of our portfolio onto that taking into account the CMI '19. Now we're normally pretty conservative, Gordon, in our assumptions and moving to the new tables, et cetera. And there's areas, where there is little bit of conservatism. One of it is in the smoothing practice. As you previously noted, we were at 8%. We have then also reduced that to 7.5%. Hopefully, that gives you some more detail on what you're looking for.

Back to you, Andy.

Q - Gordon Aitken {BIO 3846728 <GO>}

Thank you.

A - Andy Briggs {BIO 4311809 <GO>}

Thank you, Rakesh. Thank you for that, Gordon. Good to see you.

Claire, can we have the next analyst, please?

A - Claire Hawkins {BIO 20555563 <GO>}

Indeed, yes. We have Ming Zhu. Ming, if you would like to unmute your mic, please go ahead and ask your question. Thank you.

Q - Ming Zhu {BIO 17001429 <GO>}

Hi. Good morning, everyone. Just three questions, please. I think on Slide 39, there's a comment of your priority in terms of the M&A. And there's a comment of an option to buy Open business with it's complementary capabilities. Are this a type of open business that already have the same way -- are you looking at things already have same product line as your existing, which will give you the scale or you're looking at maybe open business that's products you currently don't write. Because also, I'll try to tie back to previously, I think you had a comment off and you will be interested or looking at an equity release manufacturers in the UK. So has that actually gone out of the way or still remain the case. So, that's my first question on M&A please.

And my second question is on the dividend policy. I think you forgot a comment on Slide 21 around a dividend increase with those two conditions. And like could you just give a little bit color in terms of what do you mean by the dividend increase? Are we looking at a progressive or one off? And looks to me your condition one, you're almost there. And the condition two, you're not too far off either if you exclude the one-off corporate tax, et cetera. I mean, I'm sure, I suspect you already have your own forecast on this. I mean, what are you actually anticipating in terms of the time line, this could be quite realistic.

And my third question is on Europe. What's update on Europe in terms of strategy? And thank you.

A - Andy Briggs {BIO 4311809 <GO>}

Thank you, Ming. Good to see you. So let me take the first and third of those, and then I'll pass the second one to Rakesh. So, I'll do Europe first, that'll be nice and quick. No update today. As I said before, we've had a number of unsolicited expressions of interest that led us to think it made sense to explore a range of strategic options to explore what would deliver the best value for shareholders. That exploration is ongoing. And obviously, we will update when there is more to say.

So, in terms of M&A, I mean, the first thing I'd say is M&A remains a key priority for the Group. So we do our heritage business real resilience and cash generation and drive the integrations, a bit of the benefits of those. We're building a thriving and growing Open business, and we do M&A. All three elements remain very important to us. Our primary focus in M&A would remain a heritage businesses, but we also would consider Open businesses that meet our three key criteria, as I set out on the slides, and where it is complementary to our Open business. I'd also say from an M&A perspective, we would look at smaller or larger deals, so both could be attractive to us.

In terms of the nature of open deals, I think it could be in areas we already play or it could enable us to broaden our proposition. So let me give you a couple of examples. There are most new corporate pension schemes that are set up today are set up under a Master Trust environment. Historically, we are a contract based or own trust increasingly there, so we missed this middle ground of Master Trust. And so -- and there's a lot of Master Trusts out there, and most industry commentators would expect there to be some consolidation of those Master Trusts in due course.

Now, one of the big advantages we have in this market is by running our open and heritage business side by side, the deal we have with Charter Consultancy Services and Diligenta around their banks platform means that we get, by far, a market-leading cost efficiency on our workplace pensions because we negotiated that as part of it sitting alongside what we do on the heritage side. So for us to take subscale Master Trust, and bring them into that very, very attractive platform and cost base could be really attracted to us. Equally, I've mentioned before for example, reproduction is an area where corporates in the UK, a key market for us. We help them do their DB de- risking for our BPA business. We help them with their workplace pensions through our workplace pensions business. The third kind of thing they like to do, three things altogether is protection and well-being. So we could consider acquiring a good protection business as well. But in any of those, sort of adjacent product areas, we will have the option to buy, build or partner and actually reach more views in another area that we would look at. And think about, we would have an option of buy, build or partner, and we would consider what would be the best option in each of those areas.

Probably the final thing I'd say just on M&A and you can see from the slides, we still have a huge book of work on the go. We are, as you can see from our management actions and synergy targets generating huge amounts of cash and value from our integration activity. So I'm still not pounding the streets desperately looking for the next deal at all. If the right deal came along, we would have both the firepower and the capacity to deal with it. So we could do. But if we didn't do another deal in the next year or so, I wouldn't be unduly perturbed given the -- if we did a deal, we would need to leave it sat on the side for a period of time as we make headway through the finishing off the Standard Life transition and with the ReAssure integration.

Rakesh, do you want to pick up the dividend policy question, please?

A - Rakesh Thakrar {BIO 20549114 <GO>}

Yeah, thanks. Thanks, Andy, and good morning, Ming.

So on the dividend policy, as you're aware, I mean, we have a stable and sustainable dividend, which is Board-approved, and that will be the case. Well what we've set out here on '21 is how that dividend vision can potentially grow through organic growth. And we set out these two conditions. First is that we need to be able to prove the wedge. And as you rightly pointed out, we've got GBP766 million, which is a 59% increase from the prior year. So I'm confident that we will be able to grow that GBP766 million further in the future. And the second condition is on the long-term free cash, where the recurring sources of cash has got to be greater than the uses of cash for then the Boards to then consider whether this is sustainable and then whether to grow the dividend. I'm talking here about organic growth rather than going to a progressive dividend. This is more than growing the dividend organically in relation to these two conditions.

Now in terms of that second condition, I mean, again, you rightly pointed out, Ming, that if we ignore those one-offs such as the tax change, the sale of the business to SLA and actually the investment in the growth of the GBP0.2 billion, which again is also a one-off that were broadly flat. So this gives me confidence me confidence about meeting those two conditions. Although I'm not giving a time line on it because what's key is that we maintain our financial discipline. And when chasing the growth that we look at value rather than volume. But certainly, in terms of those two conditions, I am confident about the future.

Andy, back to you.

A - Andy Briggs {BIO 4311809 <GO>}

Thank you, Rakesh. I'm conscious, and I'm largely talking to myself here. We'll try and keep our answers a bit quicker now. So we get through more of the analyst questions. We still got a bit of time left.

So, Claire, can you have the next analyst please?

A - Claire Hawkins {BIO 20555563 <GO>}

Indeed. Andrew Baker. Just two for me, please go ahead.

Q - Andrew Baker {BIO 3694545 <GO>}

Great. Hi, guys. Thanks for taking my questions. Just two from me, please. So, for the BPAs, can you just remind me the runway for achieving the 5% strain target? And then if there's any comments you can make on the strain you've seen on transactions year-to-date as well, that would be helpful. And then on the hybrid model for ReAssure. So you mentioned the ability to integrate multiple acquisitions at once. Are there any other operational benefits for a hybrid model? Just because it seems like it would be cost prohibited to run two systems side by side on an ongoing basis? Thank you.

A - Andy Briggs {BIO 4311809 <GO>}

Okay. Thanks, Andrew. I'm going to ask Andy Curran to pick up the first of those on the BPA runway and the market year-to-date and Andy Moss can talk about the ReAssure integration and model. Andy Curran first, please.

A - Andy Curran {BIO 18816863 <GO>}

Good morning, Andrew. Yes, thank you for your question. As you know, our approach in the BPA market here is to grow and expand and obviously manage that capital strain down to around about 5%. Three main features for that, from my perspective, one, obviously, talking about sourcing of illiquid assets, best in class work with Mike Eakins team, optimizing the internal model for obviously getting as good a capital strain as we possibly can and optimizing our approach to reinsurance. And top of all of that, what we have done is build out the capability in the team.

So this time last year, we were probably quoting in about a third of what we saw in the market. We would now expect to be this year looking at quoting for 70%m 80% of the market, which is good. We'll continue to be selective and proportionate. And we will focus on that making sure that we get the returns that we are looking for. In terms of the trajectory in the market and how it's looking so far this year, it's nothing has surprised me as yet. Our pipeline is reasonably positive and we're feeling pretty comfortable about where we are in terms of what's already been outlined in today's presentation and what we covered at the Capital Markets Day back in November.

Andy?

A - Andy Moss {BIO 19123183 <GO>}

Thanks, Andy. Thanks Andrew for your question. So I think you're asking effectively about the different administration systems we've got with the advantage of having ALPHA with ReAssure banks on our traditional Phoenix business. So, where we are today is the cost of running the systems are relatively similar, but both of the systems very much have integrations, very much in progress at the moment from the previous acquisitions that we've done. So, we're continuing with those. And what it does do is it gives us quite a lot of optionality in terms of any future acquisitions. But it certainly doesn't preclude us looking at that as a longer-term option.

A - Andy Briggs {BIO 4311809 <GO>}

Thanks, Andy. Claire, next question, please.

A - Claire Hawkins {BIO 20555563 <GO>}

Yes. We have the question from Steven Haywood. Steven, please unmute and go ahead.

Q - Steven Haywood {BIO 15743259 <GO>}

Good morning and thank you very much. I've got two questions. One is following on from the previous question on the ReAssure synergies. You say that they don't include the Phase 3 integration. Now I might be barking up the wrong tree here, but can you provide an idea of how much of the Standard Life Aberdeen portfolio, how much of the GBP1.2 billion synergies are in their Phase three synergies if that's possible?

And then the second question is on the internal model harmonization process. Can you give us an update on where you are here and when you expect regulatory approval? Thank you.

A - Andy Briggs {BIO 4311809 <GO>}

So in the interest of time, Rakesh, I'll give you both those, please.

A - Rakesh Thakrar {BIO 20549114 <GO>}

Thanks. And let me start with the internal model harmonization one first. As you know, Steven, this is a complex program. And as I mentioned, this is something that we -- the application will be going in later this month. We've been working really well with the with our regulators and making sure we meet their expectations as well as the expectations of generally having a model that works for our open and also our heritage businesses and getting that diversification. Once the application goes in at the end of March, the regulator has up until six months to get approval. So, we're looking at the end of quarter three before we can start using that model in earnest.

In terms of the ReAssure synergies, so we've already had, in terms of having that hybrid model is no allowance for the customer and IT in relation to that. Clearly, the model with Standard Life was a lot different and we're moving everything with TCS. And about roughly around half of our overall synergy target in the cost element comes from that part Phase three of that model.

Andy, back to you.

A - Andy Briggs {BIO 4311809 <GO>}

Thanks, Rakesh. So -- and that cost synergy target, I think I'm right in saying is GBP75 million. So you're kind of talking GBP40 million per annum, GBP400 million of benefit would be the number roughly on the SLA side.

Okay, next question please, Claire.

A - Claire Hawkins {BIO 20555563 <GO>}

Oliver Steel. Oliver, please unmute and go ahead.

Q - Oliver Steel {BIO 6068696 <GO>}

Hello, Andy. Hello, Rakesh. Well, actually, three questions from me. First is, can you just take me through the maths of the GBP0.2 billion increase in the '21 to '23 cash target? Because I mean you should have got GBP150 million over those three years from last year's new business. You had the longevity release from last year. I think you had GBP700 million increase in the Solvency II surplus in the fourth quarter. I thought that the increase over the next three years should be a lot more than GBP0.2 billion.

Second question is on the sustainability of bulk annuity volumes beyond the next three years. I mean, if you're getting so much over the next three years from your own Phoenix pension fund, are you sure you can actually keep that going? Obviously, that's important for any dividend decision going forward?

And then the third question on the dividend. Just to follow up on Ming's question. You talked about -- Rakesh, you talked about growing the dividend organically, but not progressive. And perhaps you can just explain the subtlety of the difference for me?

A - Andy Briggs {BIO 4311809 <GO>}

Sure. So let me -- I will take the second of those quickly and then let Rakesh cover the first and third. So, in terms of the sustainability of BPA beyond three years, I'm very comfortable indeed, because we've only got 6% market share on external business at the moment in a pretty concentrated market, there's only kind of sort of three or four or three to five other players there. So, with Tom Ground on board and Tom is bringing on board Kunal Sood and others, a very strong team from a range of different places, so a number of people coming from different employee benefit consultants or other competitors in the market.

And as Andy Curran has already said, we've got a 6% share by quoting on 20% to 30% of the market. If we start quoting on more the market, I think we can grow that significantly. But the great news for us is we've got the Pearl buy in. The other 75% will happen over the next two to three years. So we're confident that is there and that gives us the time to continue to deepen our capabilities to grow that share of the external market.

Rakesh, do you want to pick up the first and third for Oliver, please?

A - Rakesh Thakrar {BIO 20549114 <GO>}

Yes. Thanks, Andy, and good morning, Oliver.

So, on your first question on the math. So I think it's just lot -- lot of moving parts. So, I think it's fair to say, I have been conservative in those -- in the increase on the cash generation target. So, just to give you some color, you're absolutely right in terms of the new business growth that we've experienced during 2020. Also the management actions over delivery as well. But I also need to take into account the fact that I am putting back further investment in that growth strategy, like I mentioned, if you take roughly GBP 20 million, or certainly in the short-term it may be slightly higher. If you could take that GBP 20 million per annum over the next three years, that also will offset as well as the impact of the economics. We have seen -- we have had adverse economics of GBP0.2 billion. So that has also impacted on that short-term cash generation target.

And in terms of the assumptions, Oliver, I'd probably just say that longevity absolutely right. In terms of longer time, that will come through. But what you've also got offsetting that in the short-term as you would have seen in our results at half year, we did have a strengthening in our ERM assumptions that we put through when we adjusted the inflation assumptions in that and also strengthened our property volatility in that assumption. And we also looked at the persistency assumptions as well at that point. So we have some offsets within the assumptions line notwithstanding the benefit coming through on longevity. But if you take that overall, those changes, we've increased it by GBP0.2 billion to GBP4.4 billion. As I said, there's a lot more resilience there within the life companies over the next two to three years. We're not taking all the cash out from those life companies. We left a good amount of cash still in the post 2023.

On the dividend point, I think the point I was making is the fact that given this is a stable and sustainable dividend policy that the Board will have a decision to make, and if we've managed to meet those two conditions or whether any increase is sustainable. And therefore, I'm not going to a progressive dividend. What I'm saying is, at that point in time, any increase putting to ensure is sustainable. But if we continue on our growth journey and continue to grow that long-term cash generation from incremental new business, we will continue to review that on an ongoing basis. As organic growth rises, we will then look to see whether that's appropriate to increase that dividend on an organic basis.

Hopefully, that makes a little bit more sense, however.

Q - Oliver Steel {BIO 6068696 <GO>}

Yes. Thank you.

A - Rakesh Thakrar {BIO 20549114 <GO>}

Back to you, Andy.

A - Andy Briggs {BIO 4311809 <GO>}

Thanks, Oliver; great to see you. And yes, I mean, just a quick point to add to what Rakesh has said there. So, one of the slides we have in the appendix shows our Life companies surplus above its capital management policy, and we talked to the Capital Markets Day about that. That actually increased last year. So, in spite of the GBP1.7 billion of cash generation that we had, the surplus actually increased in the Life case. And you can see that in the appendix. So obviously, the resilient cash generation is in very good shape.

Claire, we've probably got time for maybe one or two more analysts before we need to close up. So, next analyst, please.

A - Claire Hawkins {BIO 20555563 <GO>}

We have Larissa. Larissa, if you'd like to unmute, please go ahead.

Q - Larissa van Deventer {BIO 21570130 <GO>}

Thank you, and good morning. Three quick questions. The first one; you mentioned that if you didn't do another deal this year, you wouldn't necessarily be petered. If Phoenix is going to be sitting on cash, how do you deal with the potential drag on ROE to invest those funds near-term?

Second, you previously announced that you didn't want to exceed certain balance sheet metrics on your bulk purchase annuities. With more people coming into the team, would you consider revising that cap upwards?

And last on the illiquids, you did mention that you turned down more opportunities than you accept. Can -- are there enough opportunities out there to meet your new target for illiquid assets?

A - Andy Briggs {BIO 4311809 <GO>}

Thank you, Larissa. Good to see you. So, I'll take the first two and then pass the Mike to the third.

So we think the outlook for M&A is very attractive. And that's because many insurers like ourselves have struggled with their balance sheets, have struggled with cash generation, cash coming up through the Group to holding company levels, struggled with their dividends. And the desire to release track capital to deal with the cost and efficiencies with legacy systems, we think is stronger than ever. And therefore, an M&A remains a core part of our strategy. And therefore, our expectation is we would allow the cash to build up for a period of time, because we think the outlook for M&A is attractive.

But clearly, if we didn't see a positive outlook for M&A, then we would need to think to get on that. But plan A would be as I said a moment ago, if we can do deals for cash without realizing having to raise equity, then the potential for that to flow through in dividends at a higher level more rapidly becomes, I think, really quite attractive.

On the balance sheet metrics and annuities. So as I answered to a previous question, just to quickly recap that. The critical thing to focus on is that sensitivity, the credit sensitivity and the -- within the sensitivities. And that's what we're managing. So I don't mind if our annuity book increases at a reasonable rate provided that sensitivity stays at a modest level relative to the GBP5.3 billion of surplus. So we've given that whole area more thought, and we think that's the thing to kind of focus in on and focus on. And that's where Mike and the team, as I was saying, they did a great job last year. In particular, block trades out of BBB to get that below 20%. And in terms of moving more assets into U.S. Dollar credit and better diversification actually brought that sensitivity down in spite of the annuity growing a little last year.

Mike, do you want to pick up the question on illiquids and are there enough opportunities out there?

A - Michael Eakins {BIO 21096986 <GO>}

Sure. Morning. Thank you, Larissa. Thanks for your question.

So I mean, you're absolutely right. We turned down significantly more illiquid assets than we actually originate, and we really do focus on quality over quantity. I mean there's still significant and reasonable pickup over comparable illiquid bonds in that illiquid space. And we're even seeing that this year when credit markets are sort of going towards, if not at their all-time tights. We're very focused on diversifying our portfolio and that does mean investing in a range of different illiquids, so increasing the asset types and the geographies.

And the last thing I'd say is we really do believe we have a real structural advantage, because we can source illiquids through our global network of asset management partners with ASI being our core asset management partner. And we're also building up the capability to directly originate illiquids. So, we'd say, there is -- it's competitive in the illiquid space. There's no doubt about it. But we think our disciplined approach to origination combined with those structural advantages I just spoke about means that we're in a pretty good place to originate the illiquids we need to back the BPA business that Andy Curran and Tom Ground are originating.

Andy, back to you.

A - Andy Briggs {BIO 4311809 <GO>}

Thanks, Mike. And I think we've got time for one very quick final question. Claire?

A - Claire Hawkins {BIO 20555563 <GO>}

Yeah. Our last question comes from Louise Mills. Louise, if you'd like to unmute, please go ahead.

Q - Analyst

Hi. Hi. Good morning, everyone. Just two very quick ones for me. So the first one is on the European business. I'm just wondering, I think the 2019 FBR for the two businesses in Europe was about GBP550 million. I'm just wondering, obviously, that's a very small amount compared to the Group, the Group context. But what is actually the diversification benefit that's seen between the UK and the European businesses within the SCR? So that's my first question.

And then secondly, it would be really good to hear a bit more about the performance of the ERM book in 2020. And in particular, any impact from any higher than usual redemptions, early redemptions in the year? Thanks.

A - Andy Briggs {BIO 4311809 <GO>}

Okay. I will get Rakesh to take the first one, and then he can either take the second one quickly as well or pass that to Mike. But Rakesh, can you take the first one, please?

A - Rakesh Thakrar {BIO 20549114 <GO>}

The first one very quickly, Louise, and good morning, there is no diversification benefit with the European business. We have -- we are operating two internal models within the Group, within the legacy Phoenix and legacy Standard Life that the business in Europe is on a standard formula basis. So we're really just taking the sum of the parts there. So, there is no diversification on that European business.

I'll hand over to Mike on the ERM book.

A - Michael Eakins {BIO 21096986 <GO>}

Thank for question. Good morning, Louise.

I mean the main dynamic that we saw in the equity release market last year was a significant drop-off in volumes as the first lockdown took hold. But actually, in aggregate, the equity release market held its own with volumes at about GBP3.9 billion. And actually, our market share for 2020 was at 15% compared to 13% in the year before. To-date, we haven't seen significant changes in the underlying consumer behaviors in terms of pre-payments, et cetera.

So with that, I'll hand back to you Andy.

A - Andy Briggs {BIO 4311809 <GO>}

Thank you, Mike. And thanks, Louise, thank you for your questions.

Look, that's out of time, but obviously, more than happy to follow-up with the sell side analysts through Claire and Andrew and team. And equally, the buy side, we're having -- it's a landmark year for us last year in 2020 having completed the ReAssure deal. We're now the UK's largest long-term savings and retirement business. We -- and our resilient models meant we kept paying our dividend. We're the 27th highest dividend payer in absolute terms in the FTSE 100 and we're very keen to talk about it. So on the sell side or the buy side if anyone wants to follow-up, we'd be delighted to do so.

And with that, thank you very much indeed for joining us, and we will catch up again soon. Thank you.