S1 2021 Earnings Call

Company Participants

- Andy Parsons, Group Chief Financial Officer
- David Richardson, Group Chief Executive Officer & Managing Director UK Corporate Business
- Unidentified Speaker

Other Participants

- Barrie Cornes, Analyst
- Charlie Beeching, Analyst
- Gordon Aitken, Analyst
- Larissa van Deventer, Analyst
- Oliver Steel, Analyst
- Unidentified Participant

Presentation

David Richardson {BIO 18045016 <GO>}

Good morning, everybody. This is David Richardson, Chief Executive of Just Group plc. And I'd like to welcome you to our Interim Results Presentation. As usual, I'm joined today by Andy Parsons, our Group CFO. I know a lot of you have to cover a few stocks today. So I do appreciate your time and attention.

You'll notice a different tone in our presentation today. This is an exciting time for the business and you'll hear us use the word growth more than we have over the past few years. And that's because we are now shifting our emphasis towards growth. Our shareholders have supported us as we have applied discipline to transform the business and rebuild our capital position, and we now want to reward them for that support by delivering profitable and sustainable growth.

This growth will be subject to the capital discipline we have demonstrated during the last two and a half years. It will be controlled, capital-conscious and sustainable growth, taking advantage of the strong position we have built in our structurally growing markets. Our wider ESG sustainability strategy is the other theme that runs through our presentation, and I'm pleased to provide you with an update on the progress we are making in executing our plans.

Everything starts with our long-standing purpose. It's why we exist. We help people achieve a better later life. We achieved this purpose by delivering outstanding service and value to all of our customers and by having a diverse, talented, and engaged group of colleagues. We have a proud history of using our innovation to positively disrupt markets, so customers receive fair value and better outcomes. Our strong capabilities in product manufacturing, corporate solutions, distribution, and advice focus exclusively on the attractive segments of the retirement income market, and we are now firmly established as the retirement specialist.

Our intellectual property allows us to be selected in the risks we write which helps to deliver high-quality returns for our investors. We achieve our goals responsibly and we are committed to a sustainable strategy that protects our communities and the planet we live in directly and through our supply chains. We do all this to ensure we can fulfill our purpose, both today and tomorrow.

When we last met in March, I outlined how proud we were to achieve our capital self-sufficiency goal, which was a landmark achievement for Just. We are now building on those foundations. We said at the full year results in March we were comfortable with the level of our capital coverage ratio and we remain so today. This means we can now shift our emphasis to growth in the attractive markets we participate in.

But let me emphasize how we are thinking about growth. It must increase shareholder value by being disciplined and capital-conscious and ultimately and must be sustainable. Organic capital generation is the fuel that powers our highly successful new business franchise. Over the past two and a half years, we have more than doubled our fuel efficiency by reducing new business capital strain and the low-strain new business written today is released as the organic capital generation of tomorrow.

Putting this together with a clear focus on business costs and over time reducing finance costs leads us to increasing underlying organic capital generation. This gives us capital deployment options including accelerating growth. And the good news is that our markets and the sub-segments we specialize in continue to offer attractive rates of return. In parallel, we continue to focus on improving the resilience of our capital base, in particular to reduce the balance sheet exposure to property risk.

In summary, having a strong resilient capital base with growing levels of capital generation enables us to grow sustainably and help more customers achieve a better later life. In doing so, we fulfill our promise of increased shareholder value.

So turning to our results now on slide six, I am delighted to say that the momentum from the second half of 2020 has continued into the first six months of this year. New business premiums increased by 22% to GBP909 million. Our DB de-risking business has a strong market position, specializing in the top GBP250 million transaction size segment, and recorded growth of 21% with nine transactions completed.

Activity in the less than GBP250 million DB segment continues at pace and we have a healthy pipeline of opportunities for the remainder of the year. In the second half of 2020, we completed over GBP1 billion of DB business. Subject to market conditions, we expect to continue with similar amount again in addition to securing DB partner business in the larger transaction-size segments.

Our retail business, which includes GIfL, Care, and Secure Lifetime Income recorded excellent results. Sales were up 24% and market share increased. Our industry-leading IP, market insights, and multi-channel distribution model equipped the group with the capabilities to grow our business profitably. The headline capital coverage ratio has improved to 160%, underpinned by increasing underlying organic capital generation of GBP25 million, and this contribution will continue to grow in future.

New business strain at 1.9% of premiums is an excellent result and demonstrates that our transformed new business model is performing well. Furthermore, we continue to identify positive capital management actions and adding these to the underlying number means we delivered GBP43 million of organic capital generation in total during the first half.

Finally, our tangible net asset value per share was GBP1.92, a slight reduction compared to year-end. The strong operating performance has been offset by non-operating items, which Andy will explain later.

Moving on to slide seven, the chart on the left-hand side will already be familiar to you. The pie chart at the top shows the total amount of DB transactions over the last six years. We have been active in one segment of the market, securing a 20% share in that segment. The retail retirement income market continues to be attractive to us. The overall market benefits from two big structural growth drivers. The first is an aging population and the second is the growth of defined contribution or DC pensions with the long established trend of DB scheme closure now helped by auto-enrollment. We plan to grow our profits by deepening our participation in both the DB and retail market.

In DB, you can think of our growth opportunities in three broad categories. First is our existing market segment of transactions up to around GBP250 million in size. There remains a steady flow of opportunities in the segment with less of the lumpiness that you see in the mega deal segment of the market. We can use our low capital strain and improved capital base to grow in that sub GBP250 million segment. This can be supplemented by repeat business and price monitoring, which is a natural extension of our originations having completed well over 200 transactions in the past.

The second cash (inaudible) growth opportunities will be an increased participation in buyouts. We have revamped our deferred member proposition, which will enable us to write more buyout business, which is becoming increasingly important as more schemes approach being able to afford buyout.

And the final category of growth is the GBP250 million to GBP1 billion segment, which accounts for roughly one-third of the total markets, but where we have a market share to-date of only 2%. As we deploy our capital-light DB partnering proposition, we will be able to deepen our participation in this segment. Putting all this together means we believe there is much headroom for us to grow in the DB market over the coming years.

In the retail market, we will continue to benefit from the long-term structural drivers of growth that I mentioned. In addition to this, since pension freedom were introduced six years ago, it is striking that GBP100 billion of retirement savings have migrated to drawdown platforms. We are building foundations today to help those customers in the future by connecting our highly innovative secure lifetime income solution to the investment platform used by regulated financial advisors. This will help those advisors support their clients in developing deccumulation strategies that meet their needs over the coming years.

As for this destination retirement, which has been developed to bring low cost, automated financial advice to the underserved middle Britain consumer, we have a partnership in place with Mercer and are making good progress to on-board additional partners. Together, these new propositions are laying the track for growth opportunities over the medium term. With more choices, we can continue to be selective in the risks we write to meet our new business volume and return objectives, and in doing so, we will increase shareholder value.

Moving to slide eight, again, you'll be familiar with these charts. They show that we maintained our momentum since achieving capital self-sufficiency. As you can see in the top left chart, in 2020, we delivered 12% premium growth with strong momentum in the second half, which has continued through to the first six months of this year. For 2021 as a whole, we expect to grow at a low double-digit rate again. New business strain as a percentage of premium in the first half was an excellent outcome, up 1.9%.

Putting the two together, you get the chart with the green bars on the right-hand side. In the first six months of 2021, GBP17 million of capital invested in new business is expected to generate around GBP110 million of future cash generation, providing a net increase of over GBP90 million. Low strain new business improves future in-force capital generation and comes with a payback period of three and a half years.

We are pleased with the outcome. It's been a lot of hard work across our entire business and has been achieved following the delivery of a well structured package of actions over the past couple of years. Continuing to secure attractive business is deeply embedded in our reward structures across the group to reinforce the disciplined capital conscious growth I mentioned earlier.

Now, moving to slide nine, if we start at the first column on the left, we've added 4 percentage points to the Solvency II capital coverage ratio in the past six months. The outlook for the rest of the year is evenly balanced, which Andy will cover in more detail. Importantly, the material LTM regulatory developments are now behind us.

Moving to the second column, we have been successful in reducing our property sensitivity, which grew to an outsized position after the introduction of new LTM capital rules in 2018. We still have a bit more to do here via both LTM portfolio sales and no-neg hedging. We are presently in advanced discussions to sell a second portfolio of LTMs. We expect this sale will reduce the sensitivity further, add around 1 percentage point to solvency ratio, and result in an IFRS loss of around GBP125 million, which brings me to the third column. Once we have reached our desired level of balance sheet property risk exposure, our reducing new business LTM backing ratio will help keep that in check. This has been gradually tapered from 28% a few years ago to around 22% this year and will fall a little lower thereafter. LTMs still retain the same compelling economic characteristics, and in the first six months, the market grew by over 30%. A larger market combined with a reducing new business banking ratio provides us with more opportunities to select the mortgages that work best for our liability origination.

I'll now turn to slide 10 and move the attention to our investments. We are focusing on diversifying the investments used to back the retirement income promises we provide to our customers. This slide introduces our manager of management model, with further details in the appendix. Our liquid to illiquid asset split is about 50-50. For a retirement income business with long-term predictable cash flows, this is an attractive mix to give us the portfolio yield to pick up and generate shareholder returns.

We anticipate that the 50% illiquid mix will itself gradually change over time as the balance sheet grows and we reduce our LTM exposure. With those long-term liability cash flows, we will invest across a diverse range of investments, including infrastructure loans, commercial real estate mortgages, ground rents and income strips.

Over the years, we've built a portfolio of 10 specialist asset managers, each carefully selected to focus on particular areas of expertise. The opportunities originated by the managers are then assessed by our in-house investment team who selects the most promising investments to pass through our internal screening processes. Illiquid assets excluding LTMs are outsourced and already account for GBP2.6 billion or roughly 11% of our GBP23 billion investment portfolio. We have appetite to more than double this segment to a quarter of the portfolio gradually over time.

You will be well aware that one of the main growth areas for asset managers is responsible investments, in particular green and social illiquid assets. We continue to invest in social housing and indeed that is the largest segment in our dedicated green and social portfolio. Furthermore, we expect local authority loan and income strip opportunities to increase as part of the government's leveling up agenda. So we are seeing many interesting ideas and can add further to our roster of managers as needed.

A combination of the in-force LTM portfolio maturing, lower LTM backing ratio on new business, and portfolio sales will rebound the share of LTM in our investment portfolio to more like one quarter in the future, equivalent to the non-LTM liquids. In doing so, we will build further resilience into our capital position by diversifying our risks, and at the same time, contributing towards the environment and our communities.

I'd now like to take a moment to outline our broader sustainability strategy starting first with the environment. Today, I'm pleased to announce our commitments to achieve carbon net zero. For our own operations, we are committing to be carbon-neutral by 2025. As you'll see in the chart, we've made very strong progress over the last few years and we are confident of reaching our 2025 goal.

The 86% reduction we've achieved over the last three years has come from a broad range of initiatives including having the property footprint, moving to a renewable energy tariff, significantly reduced business travel, and a number of improvements and upgrades to our facilities. For our investment portfolio and supply chain, we are committed to achieving carbon-neutral by 2050 and achieving 50% of that reduction by 2030.

It's an area we've given a lot of thought to over the years and have been making changes to our portfolio for some time. In 2018, we were the first UK insurer to become a signatory to the UN principles of responsible investing. In 2020, we were the first to issue a green bond and we had clear exclusions within our responsible investment framework. Dedicated green and social assets already account for 9% of the GBP13 billion bond portfolio with a 51% increase in these investments since 2019.

For example, over the past 12 months, we funded a number of Spanish, US, and German solar projects and the redevelopment of a commercial property to a green building. The industry has much to do on our journey to carbon-neutral, but I'm pleased with the collaboration taking place to ensure we succeed in meeting our collective goals.

And turning now briefly to social and governance factors, first, social. We have an active engagement program to support our communities, to help people in those communities improve their well-being, whether that be health, wealth or happiness. We are supporting our colleagues to grow and develop and also have an active program to support their well-being, which of course has been critical over the last 18 months.

We have achieved a two-star outstanding rating from Best Companies in recognition of the high levels of engagement we have achieved, and we are actively deepening our diversity and inclusion across the group, which you'll recognize within the Board and throughout the company.

As you'll see on the slide, we are signatories to the Women in Finance Charter, the Race at Work Charter and the program to support 10,000 Black Interns. And these are just a subset of the initiatives we have committed to.

Finally, governance. Good governance starts with the Board ensuring we have a clear and agreed strategy focused on ensuring we have a sustainable and profitable business. The Board is the steward of value creation for shareholders and wider stakeholders, that is the (inaudible) good governance ensures the (inaudible) is clearly established too, and the Board sets the tone to ensure that the group has the right culture and the highest standards of business conduct. We are a purpose-led business and focused on ensuring all elements of our sustainability strategy are advanced.

With that, I'll hand over to Andy to go into the results in more detail.

Andy Parsons {BIO 20726474 <GO>}

Thank you, David, and may I also extend a warm welcome to you all today. We very much appreciate your time and continued interest, and after three rounds of virtual presentations, I'm hopeful that next time we may be able to do this in person.

Turning then to the numbers, and focusing first on the progression of the capital position over the first half of the year and on the waterfall on slide 14. Starting on the left-hand side, our surplus own funds at the end of 2020 were GBP1.1 billion, representing a capital coverage ratio of 156%. The ratio improved over the period by 4 percentage points to 160%, half of which was for organic capital generation, reflecting a strong operating performance from the business.

Our underlying organic capital generation continues to strengthen with GBP25 million of capital generated over the first half, adding 1 percentage point to the ratio, and a further GBP18 million from management actions totaling GBP43 million of organic capital generation.

In addition, outside of organic capital generation, there was an additional GBP36 million added from active credit portfolio management. Property outperformance compared to our 3.3% annual assumption contributed a further GBP41 million. We use the ONS regional data match to our portfolio which lags the Halifax and nationwide indices by around three months. Hence we expect a further tailwind from this source to come through in the coming months.

Other economic movements included a significant rise in long-term interest rates during the first half, tightening of credit spreads and some strengthening of inflation expectations. Most of the impact of credit spread movements is absorbed in the matching adjustment and we actively hedge both interest rates and inflation risks across our Solvency II balance sheet with the aim being to minimize the impact of movements on our Solvency II position.

Finally, the impact from regulatory factors was negligible, and this includes the benefit from an increase in deferred tax assets due to the forthcoming increases to corporation tax rates, offset by the impact of the movement from LIBOR to SONIA on the 31st of July for risk-free rates used to value our liabilities.

On the right-hand side of the chart, we've also provided a pro forma position building in recent developments and latest economics. We're submitting a major model change application for Just Retirement's internal model, which was first approved in December 2015 just prior to the introduction of Solvency II. This major model change incorporates modeling for the LTM rule changes, agreeing appropriate treatment of no-neg risk transfer transactions, and overall will update our model to allow for best practice in the intervening period. We've included in the pro forma position the estimated impact from the model changes we have submitted to the PRA.

We are also, as David has mentioned, well advanced with the sale of a further portfolio of lifetime mortgages, which we expect to provide a small upside to our solvency ratio. Finally, we've included the estimated impact from interest rate movements and property experience during July. Putting all of these four items together combines to an estimated pro forma position of 158%.

Overall, it's been a strong performance over the first half, demonstrating the effectiveness of our hedging program, the growing contribution from the business, and continuing benefits from active risk management of the investment portfolio. Continued growth in underlying capital generation will provide us with further resilience and options in the future.

Now let's move to slide 15, sharing the key components that make up organic capital generation with a key business performance indicator of underlying organic capital generation, highlighted in the center. As you can see from the table, increasing cash delivery from our growing in-force book provides funding for our new business strain financing and other group costs. GBP90 million for the first six months for 2021 was up 8% compared to the prior year. This represents the gradual release of Solvency II margins including risk margin and SCR and includes the cost of amortizing transitionals or TMTP.

New business strain was down 25% compared to the prior year at GBP17 million despite a 22% increase in new business premiums. This represents a strain of less than 2% of premium with our pricing teams in DB and retail again finding opportunities to outperform our guidance of 3% over the first six months. Finance costs have remained steady and incorporate a full run rate of interest for the green bond issued in October.

Over the past three years, we've refocused our efforts on cost reduction efficiency and the fruits of that labor is now evident with expenses down GBP7 million and GBP13 million and within this, costs overrun of only GBP4 million compared to GBP12 million a year ago, very much on track to be eliminated in line with our guidance by the year end. Adding these four items together, our underlying capital generation has increased to GBP25 million, which is a significant increase on the GBP3 million generated in the corresponding period last year.

Finally, management actions and basis changes totaled GBP18 million and included a number of modeling and business refinements. In the past, management actions have played an important role in rebuilding our capital position. As David has explained, we are comfortable with our current capital position, but we will continue to explore and consider a range of potential management actions, should these be attractive or needed to offset future economic or regulatory headwinds.

Putting it all together, organic capital generation over the six months was a very solid GBP43 million with a significant strengthening in the GBP25 million delivered from the underlying business performance. On the next slide, I'll provide further thoughts on the development of our underlying capital generation.

This chart shows the excellent progress over the last three years to improve our underlying organic capital generation from significant consumption in 2018 to a positive generation of GBP18 million last year and now GBP25 million for the first six months of 2021.

As we said in March, our target is to grow underlying organic capital generation to double the GBP18 million we achieved last year by 2022. This target level of underlying capital generation, we believe, represents a meaningful contribution providing resilience and increasing the options from a capital allocation perspective. Our first half result places us ahead of track on that 2022 ambition.

In half two, we continue to target new business strain of below 3%. Noting that this strain will be offset by the DB partnering income we generate in the second half. Factoring in increased new business volumes targeted over half two, we expect to generate over GBP30 million of underlying organic capital generation for the full year of 2021.

Going forward, our ability to write new business at low levels of capital strain enables us to grow our balance sheet, fueling increased levels of underlying capital generation. And in future, we expect to reduce strain and further fuel growth through the addition of DB partnering.

Moving on to slide 17 to touch briefly on our continued positive progress on costs. This slide shows the progress since 2018 to realign the cost base with prior-year savings now contributing to a materially lower half one '21 outcome. Following the positive half one outcome, we expect a further GBP7 million of year-on-year absolute cost savings to be achieved in 2021. This translates to an 18% cost saving over the past three years when we commenced our program.

These savings have been achieved through a combination of actions, including a halving of our property footprint. We tend going forward to adopt a hybrid model for our offices, which provides a flexible working environment for our colleagues and which will deliver further positive financial and environmental benefits.

We have a strong cost focus now embedded across the business with the actions over the past three years helping to right-size the cost base for the future. Going forward, we expect that the premium and income growth will be well ahead of cost inflation and investment in the business and hence we will benefit from operational gearing.

Turning to slide 18, and an update on regulatory developments, which is always of an evolving picture. On the left-hand side of the page, we show in blue the items that are included in our half-year or pro forma capital coverage ratios outlined on slide 14.

First up, we believe we can put in the regulatory changes for lifetime mortgages into the done box. In March, the PRA reconfirmed the end 2021 effective value test or EVT parameters for lifetime mortgages of volatility of 13% and a minimum of deferment rate of 0.5% to be achieved by the end of December.

Presently, in our half year position, we're holding a 63 basis point buffer above that expected minimum deferment rate at year-end. We've also, as I mentioned earlier, submitted a major model change to the payout rate including allowance for the impact of the effective value test in stress.

As discussed earlier, we continue to be committed to action to reduce the sensitivity of our Solvency II balance sheet to lifetime mortgages post these regulatory changes. At our full year results in March, we flagged the upcoming move from LIBOR to SONIA, which officially occurred two weeks ago. The impact of this was a small capital drag, which we've included in our 30th of June position.

On the right-hand side in coral, we have two areas of future regulatory development. Once we've received PRA approval for the Just Retirement internal model changes, we plan to start work to bring the partnership business currently using standard formula onto the internal model during 2022. This is a more suitable model for the partnership business, which holds around 25% of our group reserves, and will allow us to benefit from capital diversification across the two entities.

And at the bottom of the slide, we've noted the HM treasury consultation and plan reform of Solvency II. We recognize this is an area of interest to analysts and investors with the PRA recently launching a quantitative impact study with the industry, which followed responses to the initial treasury call for evidence earlier this year. We expect consultation to be ongoing through 2022. At this stage, it's impossible to predict where the reform proposals will land with HM treasury hoping to improve the ability of insurers to support the government's green and leveling up agendas and the PRA publicly commenting that they believe current levels of capital in the industry overall to be appropriate. We would welcome reform to the risk margin, and hope that changes the matching adjustment, increase the opportunity available to us to invest in a broader range of illiquid assets. However, together with our peers, we will have to wait and see.

On to slide 19 and switching to look at the IFRS results, underlying operating profit for the first six months was broadly flat at GBP118 million. Within this, new business profit increased by 12% to GBP74 million as retirement income sales grew by 22%.

New business margins reduced slightly to 8.1%, reflecting adjustments made to the asset mix back in the new business, tighter credit spreads in particular our lifetime mortgages and an increase of deferred DB liabilities, which are more capital efficient,

But lower margin. For half two, we are continuing to target a 9% margin with operational gearing expected over a higher volume of sales.

The in-force performance was slightly down on prior periods, which was last year boosted by wider credit spreads. A more like-for-like comparator will be the underserved first half of 2019 with the growth in in-force since then a function of reserve growth in the intervening period.

Operating experience and assumption changes were positive GBP26 million and this includes the benefit from mortality experience for the retirement income business due to higher-than-expected debt through the third wave of COVID infections across the UK, which has been partially offset by negative LTM experience. Movements in other group companies' development expenditure were in line with the prior period with reinsurance and finance costs increasing as expected.

So on the next slide, we illustrate the impact of the transformation of our business model since 2018 through a combined IFRS and Solvency II lens. As you can see from this chart, since 2018, IFRS new business margins have reduced slightly. Solvency II new business strain by comparison has fallen dramatically. This means that over the past 18 months, GBP1 of shareholder capital invested in writing new business has resulted in GBP4 of IFRS new business profit compared to 2018 where the equivalent figure was just GBP1.15 of new business profit.

We continue to target growth working to a capital budget of 3% new business strain and expecting to achieve IFRS profit of around 9%, which will deliver new returns comfortably above our mid-teen IRR target. Embedded into the ethos of Just Group is that we innovate to positively disrupt markets and provide better value products and services that customers will value. We have multiple opportunities to grow our business both through further expanding the reach of our existing business lines in the structurally growing markets, and also through new propositions such as DB partnering, destination retirement, and Secure Lifetime Income.

This next slide is a new slide showing the development of our tangible net asset value over the first six months of 2021 in both pound terms and pence per share. Despite the negative impact on our IFRS balance sheet from the significant interest rate movements during the first half, the overall movement in tangible net asset value has been minimal.

Operating profit has had a net beneficial impact of around 8 pence per share whilst non-operating items in contrast had a negative impact of 15 pence. These include a GBP223 million negative from other economics, which is mainly due to a large unrealized loss from the impact of higher risk-free rates, where our hedging of the solvency balance sheet leads to IFRS gains when rates fall but losses when rates rise. We accept this accounting volatility as our foremost priority is to protect the solvency position and the coverage ratio.

Our tangible net asset value per share at 30th of June was at GBP1.92. We've also illustrated on the right-hand side in the gray box that pro forma impact of expected development since the end of June. These include the estimated impact from the sale of a further tranche of close to GBP500 million of lifetime mortgages, which is expected to be slightly solvency capital positive, would be dilutive to the reported IFRS TNAV.

In addition, since the 30th of June, interest rates have fallen slightly and property has continued to be positive. Putting all these together, we anticipate that TNAV would fall by around 4 pence to GBP1.88. Importantly, this sale of a further tranche of lifetime mortgages once complete will mark a significant further step in reducing our property sensitivity.

And with that, I'll hand back to David for his concluding remarks.

David Richardson {BIO 18045016 <GO>}

Great. Thanks, Andy. I'll just turn to slide 23 now. I'd like to start my conclusions by reiterating our goals for the remainder of the year. We are prioritizing sustainable and profitable growth. Our new business premiums grew by 22% in the first six months of the year, and for the whole year, we expect to repeat last year's double-digit sales growth.

Underlying capital generation is expected to be at least GBP30 million for 2021. We judge strain at or below 3% of new business premiums to be an excellent deployment of shareholder capital and it ensures we can enjoy healthy growth while generating IRRs in excess of our mid-teen target. And finally, we said when we met in March that we were comfortable with our capital position. We remain so today as our position is stable and supported by positive organic capital generation. We are committed to further increasing the resilience of our capital position by reducing the sensitivity of the balance sheet to property risks.

The fundamental drivers in our core markets are strong. We have developed solid foundations and are confident in our outlook as we deliver sustainable profitable growth across the group. And this growth will be achieved alongside our commitment to doing Just -- business the Just way, in upholding the highest standards and meeting our environmental, social, and governance commitments.

So we'll now invite questions. If you've joined conference via your computer, you can click on the hand symbol. That will let us know you'd like to ask a question. And if you joined us via phone, you can press star and nine to raise your hand. We'll then invite you to ask your question and we'll unmute your microphone centrally. When you've asked your question, or if you no longer wish to ask a question, please lower your hands by clicking on the hand symbol again, and again, for those on the phone, please press star nine.

So I'll give you all a minute just to work technology and then I'll hand over to Steve to start the Q&A.

Questions And Answers

A - Unidentified Speaker

Thanks, David. We have a number of hands raised. So we'll go to Gordon Aitken, RBC first. So please give Gordon access. Go ahead, Gordon.

Q - Gordon Aitken {BIO 3846728 <GO>}

Hi David and hi Andy. So three questions from me please. Firstly, I really liked the disclosure on slide eight. It's really very simply put that you've invested GBP17 million in the first half and that will ultimately become GBP110 million over 35 years. So that multiple 6.5 times, I mean, you did mention that you expect strain to go back up to 3%-ish. So what would that cash multiplier be in the future? That's the first question.

Second question on -- very interesting on this DB partnering. If you tell us a bit more about that, maybe who are the partners. Are there any other insurers doing this? Because we haven't heard about it. And just going back to that cash multiplier, I mean, the strain on DB partnering must be incredibly low, but of course, you've got to share the profits with someone. So is that multiple similar to normal business?

And just finally, on -- to go back on the strain, I mean, annuities are very price sensitive, and I'm just wondering how you can win business at a 3% strain. We had another insurance company this week talking about a 6% strain. So is it that the small end of the market just isn't very competitive. Thanks.

A - David Richardson {BIO 18045016 <GO>}

Great. Thanks, Gordon. I'll actually -- I'll maybe handle the latter two questions and I'll let Andy speak to the first one. So let me open up. Yeah, on DB partnering, the way to think about that is if you've got that chart on slide eight in front of you is it's a very different type of profile and it generates a positive bar on day one. So we will enter, Just will enter into a transaction, an insurance transaction with the pension scheme. We will then reinsure the longevity and investment risks out to our partner. And they will take the long-term from us and will have probably a cash flow profile similar to ours, and -- that you see on slide eight. What we're left with in partnering is a positive on day one from a fee recharge our partner for origination to business, and there'll be maybe a small series of positive in the future because we need to set aside some capital for things like counterparty risks, but materially it's positive day one with small positives thereafter.

Critically going forward and what it does if you look at the bigger picture, is it gives us more organic capital generation, which gives us options. It gives us options to grow faster so that you can have more cash flow coming back to the business over time, and of course, it gives us other capital allocation options as well.

On the question around price sensitivity, I'll take that in, there's probably three things I'd draw out as to why we're seeing consistently low capital strain on new business. And I'm going to start with kind of the less analytical one, but possibly the most important, which is that we have a very clear and simple strategy in the group and we have the whole organization aligned behind that. It is understood from top to bottom. And as I mentioned in my comments, writing a capital-efficient, high return profitable business is deeply embedded in all our reward structures, our objectives, and it runs through all the communications that are in the rest of the executive team run in the organization. So that's the kind of the norm as it were a technical element to it.

On the other two, let me talk about, as you mentioned, the DB de-risking market. It is the case that at the smaller end of the market, you can tend to get lower capital strain business, but still provide a compelling proposition to the smaller pension schemes, and for us, that's supplemented by repeat business. We said over 200 transactions we see steady, steady stream of repeat transactions. We also do price monitoring where we understand where a scheme might want to transact that. We monitor that and we have the right, say, for example assets in place. We can then transact and optimize that way.

But the third element, I'd just like to draw out, which doesn't get as much attention nowadays understandably because so much of the new business is DB, but our retail franchise continues to be strong. You'll have seen good strong growth in the first half of the year, and of course, there we use our medical IP to select the risks we want to write, and importantly, avoid the risks that we think are mispriced by maybe some of the rest of the market. So that also contributes to low capital strains we're seeing consistently coming through there.

Andy, do you want to pick up the multiple...

A - Andy Parsons {BIO 20726474 <GO>}

Happy to. And I think I'm glad you've highlighted the chart and that multiple because we think that's a big positive from a business perspective. It is something that we also achieved last year. So I think the multiple last year was a multiple of 6 in terms of the cash return on that new business strain. Clearly, if the new business strain was slightly higher, then the multiple would come down, but only to around 5%. So still a very strong multiple on new business strain.

A - Unidentified Speaker

Okay. Thanks, Andy. We'll go to Ming next at Panmure. Please go ahead, Ming. Can we make sure the microphone's unmuted? Go ahead, Ming. Sorry.

Q - Barrie Cornes {BIO 2389115 <GO>}

Can you hear me, Stephen?

A - Unidentified Speaker

Yes, we can. Thank you.

Q - Barrie Cornes {BIO 2389115 <GO>}

Hi, it's -- you'd probably guess. It's not Ming. It's Barrie.

A - Unidentified Speaker

Hi, Barry.

Q - Barrie Cornes {BIO 2389115 <GO>}

I hope you get that. Good morning, everybody. I have three questions, if I may. The first one is really just trying to get a feel for how much of the GBP26 million positive operating variance was mortality. And really maybe if you could give some color and help in terms of the likelihood of that being repeated in H2, maybe a changed assumption at year end.

Second question I had was, you say that obviously you're targeting up to 40% of the lifetime mortgage book being hedged, but at the same time, you're reducing the size of the overall book by disposals. And I just wondered what sort of optimal sized book you would like to have in terms of LTMs going forward longer term. And the third question I had was in terms of development expenses, which, as you flagged, includes IFRS 17 preparation costs. And I just wondered if you could give us a steer on how much you anticipate IFRS 17 is going to cost and how you're going to phase that cost, please. Thank you.

A - David Richardson {BIO 18045016 <GO>}

Okay. Andy, maybe if you go first this time and pick up the specific questions on operational variance and the development expenses, please.

A - Andy Parsons {BIO 20726474 <GO>}

Yeah, certainly. So in terms of the -- your first question on the mortality, so the GBP26 million of operating variances, that -- as always, there is a number of sort of model and basis, smaller basis changes flowing through, but the bulk of that came from mortality in the first half. What we've seen, and that was slightly higher as a positive than we saw actually through the first half of last year. I think what we've seen is a degree of sort of slightly late reporting of some of those from the DB scheme. So they -- some of those can take a bit longer to flow through. But essentially most of that is really the result of wave three of COVID coming through in Q1.

And what we've seen in terms of overall mortality is actually -- I think that levels were significantly raised through January and February, as you'd expect. Actually since then, from March through June, they fell back a bit and were actually below the long-term average from March through June. But even more interestingly, as we've come into July, they've actually ticked back up again and they're now slightly above that long-term average. So that's just interesting.

And I think what that serves to point out is almost that it is quite an evolving picture in terms of overall mortality. And I think it's going to be some time before we have real clarity on wanting to sort of -- or post-COVID or including COVID because obviously we're going to need to live with this going forward, what will that do overall to longer term assumptions.

In terms of what does that do to our -- will we be changing our assumptions for the second half, I think it's unlikely that we will be making major changes to our long-term assumptions in the second half. Clearly, we will review them, but I think with all of the uncertainty at the moment around COVID, making big changes at the moment is probably unlikely.

Picking up the development expenses, so yes, that does include IFRS 17. We -- at the moment it's sort of a fairly small single figure million of pounds that we're spending on IFRS 17. We have, I guess, the beauty of being a smaller organization and it's more straightforward for us to make the changes. So I'm not anticipating next year that that would be a major drag. Certainly it would be -- future costs are probably less than GBP5 million on IFRS in terms of -- IFRS 17 in terms of implementation.

A - David Richardson {BIO 18045016 <GO>}

Thanks, Andy. And if I come back to your question on property de-risking, you can think about this as -- there's kind of three levers we've got to pull to try and bring down our property risk exposure. The first is property sales and we've obviously updated today on the second one being very well advanced. The second is no-neg hedging, and the third is reducing the amount that you use as a back new business.

And we'll use a mix of those, that three tools, over the coming years to bring that down. In terms of the endpoints, I kind of mentioned in the investment slide that you should think roughly in terms of around a quarter of the portfolio might ultimately be LTM, but within that, some of that quarter will benefit from neg hedging. So it could be that your almost effective backing ratio is lower than that. And as you rightly point out, if we do more sales, that reduces the amount that the other two levers have to do whether it's neg hedging or new business backing ratio. But look, we'll be fairly agile on that as we have been to date.

The other thing that we've mentioned before, probably worth reiterating is we have a kind of a rough rule of thumb that we'd like to get that property sensitivity.

So the impact of a 10% property fall to be roughly 10% impact on our Solvency II ratio. Now, that's not rigid. It's very much a rule of thumb, but we're making good progress towards that.

A - Unidentified Speaker

Thanks, David. Larissa, would you like to go next? Larissa of Barclays. Thank you. You could unmute. Thank you.

Q - Larissa van Deventer {BIO 20764470 <GO>}

Thank you and good morning. Just good morning.

A - David Richardson {BIO 18045016 <GO>}

Good morning.

Q - Larissa van Deventer {BIO 20764470 <GO>}

Hi. Gordon and I were actually thinking along the same lines in our questions, but I was hoping that you could elaborate a little bit. So three from me. On the DB partnering, are you seeing demand from partners or has that waned a little bit along with the slightly weaker bulk annuity market that we've seen overall? Is the first question.

The second one, congratulations on increasing your bulk volumes when everybody else has taken -- has had a more sluggish start to the year. Can you please comment on the pipeline and whether you believe that long-term demand is still robust whether you -- you think that may be declining as well?

And then the last one, just on the sales of the LTM portfolios. Is there something that you expect to continue doing or is the second tranche that will happen shortly going to be the last one? Or what would you consider in considering whether you would sell future tranches, please? Thank you.

A - David Richardson {BIO 18045016 <GO>}

Great. Yeah, no, thank you. All good questions. And Andy, I'll let you maybe pick up the last one on LTM sales. I'll lead the (inaudible) on the first two. And first of all, is demand for DB partnering waning? The short answer is no. We are, again, in very advanced discussions with a large international and diversified overseas insurer who we hope to be able to get on-board soon to help us enter Q4, which will be probably a quite busy period for larger transactions to have that in place. So the demand is strong there.

And it kind of does need to be linking to your second question because you are right in that maybe across the DB sector, it was a little bit lighter in the first half than some people were expecting. We are seeing a very good pipeline for the second half of the year and I'll expand on that in a second. But the bigger picture here is that the overall scale of the opportunity is still, choose the adjective, immense, huge, however you want to describe it. But the -- we still think that the industry forecast of around GBP30 billion to GBP50 billion per annum for the next five years is about right. There our forecast of that will grow to GBP100 billion by the end of the decade. And I think that is conceivable.

This thing is. It will ebb and flow in every six-month period and so we are focused on, and hopefully it's come through in our presentation, on setting ourselves up for success over the bigger picture, over the longer term. And that's true for both what we keep on our own balance sheet, but what we also do in partnering.

But I don't want to ignore your shorter term question on the immediate pipeline. We have seen that building up very nicely going into the second half of the year. And we won't chase business just for the sake of chasing business because of what I said about the bigger picture, but I think provided market conditions remain good, pricing is at sensible levels. Then we are confident we can repeat last year's second half of around GBP1 billion of DB business.

A - Andy Parsons {BIO 20726474 <GO>}

And in terms of the -- your question in terms of the LTM portfolios, as David outlined, we are very committed to reducing that property sensitivity. We've got sort of three levers being the new business backing, no-neg hedging and sales of portfolios. And essentially we are sort of looking at all three. So we're clearly trending that new business backing down. We're continuing to obviously look at further no-neg hedging and we continue to look at opportunities in terms of further portfolio sales. So they will all remain under consideration as we move forward.

A - Unidentified Speaker

Thanks, Andy. Thanks, Larissa. We'll go to Charlie next, at KBW. Charlie, please unmute and ask the question.

Q - Charlie Beeching {BIO 21296314 <GO>}

Hi, everyone. Thanks very much for taking my questions, and well done on the clear progress you've been making in the period. Three for me, please. Firstly, I appreciate you are saying you're comfortable at the current level of Solvency II coverage. However, 150 except this does seem a bit below peers, particularly given Just's relatively higher sensitivity. So would you be happy to recommend the dividend at this coverage level? Or if not, at what level do you see it then in order to do so?

And then a follow-up on that. It's great to see the strain, you've been taking tonnes of underlying organic capital generation. You pointed this being above GBP30 million for the full year, but what's your view on the growth level beyond 2021 in order to support investment into growing new business as well as hopefully a dividend? And then finally, some of your peers have talked about heightened competition within the DB market. Is this why you're expecting a higher new business strain in the second half or is there some other dynamic going on there? Thank you.

A - David Richardson {BIO 18045016 <GO>}

Thanks, Charlie. And I'll take the first question and I'll let Andy speak to the second and third. So look, whether it's 160% or 158% or 156%, it was at the year-end, we're comfortable with our capital coverage at that level, particularly as we make progress on reducing our exposure to property risk. So when it comes to the question of dividend, for us, what will really drive those discussions are a consideration of at what level of organic capital generation does that make sense to restart dividends because ultimately that's what supports a sustainable dividend policy, is that underlying capital generation coming in at period in period out.

And of course, the other thing is we will -- it will be informed by the view of our shareholders. And I think it's fair to say there is a range of views there including some top shareholders who are very happy that we're reinvesting the capital in new business at returns, excuse me, in excess of mid-teens. So that will be in the mix as well. But for me, I don't see it being driven by that headline capital ratio unless there is some adverse unexpected development.

A - Andy Parsons {BIO 20726474 <GO>}

And picking up your second two questions then, so in terms of the underlying organic capital generation, so we remain committed to the target that we announced at year-end, which is basically to double the 2020 level of 18 by 2022. So that will be 36. But as I said, we -- our first half performance puts us ahead of that. We've said that we expect with a stronger -- with stronger sales in the second half to hit the over GBP30 million for the full year and that could be higher than that if we are also successful with DB partnering and get some DB partner income as well into the mix in the second half. So that, I think, conveys that -- that's where we're going to -- we haven't produced new guidance in terms of 2022, but clearly we believe we're moving faster along that track to growing that figure than we had anticipated back in March.

In terms of the sort of new business strain guidance for the second half, I guess, there is a natural element of caution in terms of -- we target our new business teams on achieving a 3% or below new business strain and they consistently surprise us on the upside in terms of doing better than that. So I'm not ruling out in any way that they weren't surprisingly a gain in the second half, but I think we're recognizing that there are a variety of deals that will be flowing through and they will be at different levels of new business strain. So I will have that figure being a bit higher than the 1.9 that we've achieved in the first half.

A - David Richardson {BIO 18045016 <GO>}

Yeah. The one thing I'd just like to kind of add on top of that is, Charlie, what we are trying to create here and hopefully what you're seeing created in the first half of this year is that kind of virtuous cycle of growing the organic capital generation at the same time as growing both top line and profit. And that virtuous cycle obviously is, as you grow your new business, that creates more organic capital generation in the future, and then that gives us the capital allocation choices that we talked about earlier.

A - Unidentified Speaker

Thanks, David. Thanks, Andy. Thanks for your question, Charlie. We'll go to Oliver Steel at Deutsche Bank next. Oliver, please unmute and ask your question.

Q - Oliver Steel {BIO 6068696 <GO>}

Yes, good morning. I'll add my thanks to slide eight. Very interesting slide. Three questions. The first is on your new investment mix targets. How long do you expect it to take to get there? I accept (inaudible) in terms of how fast you grow the new business. Secondly, on the partnership internal model, any thoughts on what that might potentially do to your solvency ratio?

And then thirdly, on the dividend front, sorry to keep on asking about dividends. I mean, you said it was really down to -- you said it was really a function of organic capital generation. Do you have any figure in mind or range of numbers in mind as to when that organic capital generation can start funding a dividend? And I suppose linked to that, I'm just slightly wondering if your shareholders are also sort of sensible for the idea that the sort of current dividend you might be able to afford even on a one or two-year view is actually so low in relation to the share price that actually you might as well reinvest the money into new business. Is that a -- is that an issue that is in your minds at all?

A - David Richardson {BIO 18045016 <GO>}

Okay. Yeah. Thank you, Oliver. So maybe I'll speak to the first and the third, and Andy, you can pick up the partnership light model. On the investment mix and how that shifts over time, as you anticipate in your question, it does slowly depend on obviously how much new business we write, but also the investment opportunities that are available as we go along. But you should certainly have in your mind that it's kind of a multi-year journey. It's not something we're going to get to in the next couple of years, but I think it is something that will just naturally evolve over a period of a few years due to the forces I described in my comments, which is how we invest new business with a lower LTM backing ratio and things like the portfolio sales which we reinvest into other assets, which will shift that balance over time.

On the dividend, in terms of what influences our shareholders' view, that's something we'll recap on with the Merc [ph] following these set of results. Certainly back in March, they were very supportive of the message at that stage, which was, look, we're aiming to double organic -- underlying organic capital generation and it's a conversation we should pick up then. They were very receptive to that. It may be, as you say, they have that kind of classic kind of model in their mind of, well, if you can reinvest at higher capital within the group, why not do that, but they do understand also the positive signaling effect of restarting a dividend. So that will all out, I'm sure, enter into the conversation.

A - Andy Parsons {BIO 20726474 <GO>}

And on your question in terms of the partnership internal model, I guess, as you would expect, I can't give you a figure because that is very much a process of flowing through the work required to get partnership onto that model. It will be a far better model in capital terms. And the ability to get that diversification then between the partnership entity and the des retirement entity, that is worth a few percentage points in solvency. It's not going to be game changing in terms of the solvency ratio.

A - Unidentified Speaker

Thanks for your questions, Oliver. We've probably got time for one more question. Could we go to Gion at (inaudible) please. Gion, please unmute and ask your question.

Q - Unidentified Participant

Hi, good afternoon. Can you hear me well?

A - David Richardson {BIO 18045016 <GO>}

Yes, Gion. Thank you.

Q - Unidentified Participant

Thanks for the presentation. Very clear. I have two points for me. First would be on the lifetime mortgage business. So you insisted that the major elements are behind you and I agree with that, but I was just trying to figure out your view on what can be another angle for the regulator to go back on the matter, which is more about the conduct risk and how those products may have been sold to customers. So can you just tell me if this kind of risk is essentially on potentially intermediaries between you and them? Or -- and if not, I'm just trying to think about the various portfolio sales that you made? Is still -- if still the conduct risk materialized somehow, you will still be exposed to quite a big number. So yeah, your thought on that would be quite helpful.

And if I can broaden -- second points to broaden the question on the capital, so you talked about the dividend, but I think in the past, you hinted that you would be potentially -- you will try potentially to optimize the debt. So you did this exercise on the Tier 3, but you definitely have some Tier 1 and Tier 2 that are quite high coupon. And so did you make any progress on this initial thought? Thanks.

A - David Richardson {BIO 18045016 <GO>}

Great. Thank you. So I'll take the first one of those and I'll let Andy speak to the debt. So conduct risk, I'd just talk in the most general sense first of all. Conduct risk is an absolutely key risk for all insurers and advisors to manage carefully. If you think about the purpose of our organization and where we came from, it's very much a customer-centric. Our whole purpose is to help people achieve better later life by getting better outcomes for them. And that's reflected in our conduct risk history, which is exemplary. I don't have the exact number to hand, but I think the total amount of costs we've had to -- or redirect we've had to pay to the Financial Ombudsman since we were founded is in the tens of thousands. So that gives you a sense of how strong our conduct is.

As you apply them to LTMs, which is a more complex sales process, a lot of controls and standards have been adopted across the industry, which is aiming to make sure that that is an appropriate sale, that includes independent legal advice. And we feel certainly very comfortable about all the things that are within our control. And of course, we don't just advocate our response -- our own responsibilities for a business that's sold through intermediaries. We do take a clear interest in their processes, but there's nothing there that's causing concern for us in terms of our exposure at this stage.

A - Andy Parsons {BIO 20726474 <GO>}

And in terms of your question on the debt, yes, as you can imagine, I'm quite aware that there is a high coupon cost on some of our debt at the moment. From our perspective, I think the key point is here we are quite comfortable with the level of debt, albeit it is slightly more expensive than we would like. The good news, I think, as I look at it, is that we do, as we look forward, get to refinancing points on those, on that debt reasonably soon. So it's not that far off before we should be able to refinance. Clearly, there are opportunities to do things earlier, but they do -- they can be quite costly. So that's (inaudible) in the next as well.

A - Unidentified Speaker

Thank you, Andy. Thank you, David. And thanks to all for your questions. David, could I hand back to you?

A - David Richardson {BIO 18045016 <GO>}

Really not much else to add other than thank you for your questions and also more generally for your continued interest. And we look forward to speaking to you again soon.