Q4 2015 Earnings Call

Company Participants

- David Paul Cooper
- Rodney Malcolm Cook
- Shayne Paul Deighton
- Simon George Thomas

Other Participants

- Andrew J. Crean
- Barrie Cornes
- Gordon Aitken
- Oliver G. Steel

MANAGEMENT DISCUSSION SECTION

Rodney Malcolm Cook {BIO 14008420 <GO>}

Good morning, everyone. I'm Rodney Cook, Group Chief Executive of Just Retirement. For those of you on the phone, I'm joined by Simon Thomas, our Chief Financial Officer; Shayne Deighton, our Group Chief Actuary; and David Cooper, our Group Director for Marketing and Distribution.

I'd like to thank Nomura for the use of their conference facilities this morning, and welcome to all of you joining us today. We do appreciate your continued interest.

So, here is our agenda. First, I'll give you a brief update on the events of the last year and then, Simon will go through the numbers in more detail. I'll then talk about the outlook and the progress of our proposed merger of equals with Partnership Assurance. We'll finish then with your questions.

Once again, could I please remind you that we have a 30 of June financial year-end, and we will seek to highlight clearly the occasions when we're referring to calendar years rather than financial years.

Now, even in the context of the incredible pace of change, we've seen, following our IPO in 2013, the six months since we last saw you having been busy. The Defined Benefit De-risking has become our largest product during this year and I think that this is a remarkable achievement given we only completed our very first sale towards the end of 2013. Defined Benefit De-risking is a huge market with strong growth prospects, especially given the traction for medically underwritten segments.

Now, we haven't been sitting on our hands in terms of the individual Retirement Income market either. We've launched new combo products in time for the new rules in April 2015. There are signs that interest is beginning to grow in Guaranteed Income for Life Solutions, but as we're reporting on sales to the 30 of June, any impact is not visible as yet.

And by the way, we have moved on from talking about individually underwritten annuities. Now, we call them Guaranteed Income for Life Solutions, or GIfL. It does what it says on the (2:34) and it better aligns to how customers actually describe the product many of them want in retirement. Now, these product innovations have been achieved against the tumultuous regulatory background of change. Included in that is our submission of our internal model application on time in May, followed by matching adjustment and transitional applications in June.

Frankly, we look forward to a period of regulatory stability from a capital perspective once Solvency II gets (3:08) down in 2016. For many customers, our products offer better value than non-medically underwritten alternatives and the FCA's recent pronouncements on the second line of defense for pension providers should indeed work in our favor.

But, of course, perhaps the highlight by far is the announcement we made on the 11 of August of our proposed merger with Partnership Assurance. I will come back to this later, but at this point, I'd like to say how excited both teams are at this unique opportunity to accelerate our existing strategies and to deliver importantly the very significant financial benefits behind this deal.

But today is really about Just Retirement's results, and I'm pleased to be announcing resilient sales and operating profits and the year-on-year increase in embedded value. So, looking at the chart on the left, there's no escaping of the fact that although the budget set us back a couple of years in terms of both sales and profits, our long-term growth record remain something to be proud of.

Our job, of course, now is to make sure that we grow again from the new base we've established since the budget. Total Retirement Income sales fell just 10%, which I do believe is creditable, given the collapse in the individual sales market post March 2014. And our success in the Defined Benefit De-risking segment has been truly transformational for us.

As I said already that DB to become our biggest product in the very short period since completing our first sale in late 2013 is exceptional. Now, we have managed down mortgage sales and over this period, they represented approximately 28% of total GIfL and DB sales.

Moving now to the right, to the middle chart, although our underlying profit figures suffered a little from both lower sales volumes on the one hand and the lower margins on the other, our scale has meant that new business remained profitable, and margins have actually ticked up a little in the second half, which is positive. You'll note the continuing growth in our in-force profits.

Now, on the right, the final part of the chart shows the embedded value figure, which is the new year-end record high for us. Although Simon will explain financial market headwinds in the second half has had a negative impact since the 31 of December 2014.

Moving to the next slide, underlying growth drivers, as I mentioned just now, our job is to ensure that we harness the demographic and other structural growth drivers within our industry to ensure that we grow again from the new post budget starting point. And, of course, if we can increase our sales and our liabilities, then both new business and in-force profit growth can be expected to follow. Impressively, we are already at the point where this looks possible again.

As the left hand side chart shows, it looks like Q1 was the low point in the sales. Our burgeoning DB business has gathered momentum during the year, meaning that now at the fourth quarter, total Retirement sales were actually up 10% year-on-year and up 28% compared to the third quarter.

Now, as we announced on the 11 of August, the individual quote volumes in the industry are up and they're now translating into individual sales. And I'm pleased to advice you today that we now expect our individual sales in the first quarter of our new financial year. And that is the quarter to the 30 of September just to be clear. We expect them to be approximately 25% up on the prior quarter to June 2015. And also, may I say higher than the same period last year. So, it does seem that the recovery in the individual sales is coming.

Now, as the chart on the right shows our liability growth has been uninterrupted, albeit it has been (7:59) by falls in interest rates over the years. In fact, if you looked at this chart, you wouldn't even notice the budget impact using this measure. Liabilities, in fact, grew 15% during the year. And other things being equal, this bodes well for future growth in in-force profit. So, overall, you see it's not perhaps premature to be thinking of growth again.

Now, if I can refer you to the next slide, which is our usual slide on Defined Benefit De-risking. I know that some of you believe that forecasting markets is a hazard and that's why we have borrowed someone else's forecast on this slide, rather than proffering our own. But, look, whether the market is £10 billion a year or it grows to £20 billion a year, the fact is that at the moment a small minority of the market is medically underwritten. We believe that the potential here is significantly higher and that medically underwritten Defined Benefit De-risking can become the norm rather than the exception for smaller schemes. And on top of that, will also become increasingly common for top slicing arrangements for larger schemes. But can I say, with £1.7 trillion of liabilities to be de-risked over the long-term future, we're clearly just scratching the surface at the moment.

Now, our pipeline of prospects has grown in every single quarter since we started doing business in this segment. And while we first advised our expectations in August, August 11, we are now happy to talk about Defined Benefit De-risking sales prospects of £400 million for the first half of our current financial year.

Now, I must remind everybody that this business remains lumpy. And also, that's seasonally-weighted towards the last few months of the calendar year, as you saw in the numbers.

But with that, I'll pass on to Simon who'll talk you through the figures in more detail. So, Simon, over to you, please.

Simon George Thomas {BIO 15219564 <GO>}

Thank you, Rodney, and good morning. Let's just move straight into the IFRS P&L account. IFRS operating profit fell 16% to £67.6 million compared to last year. This feels like a relatively resilient result given the budget.

In line with the half year, a decline in new business profit was partially offset by the growth in the in-force profitability. The 31% fall in new business profit is a lot less severe than the 57% fall in GIfL volumes, thanks to its new replacement with DB De-risking volumes.

But as we reported at the half year, margins on GIfLs have fallen as volumes have dropped. And although DB margins are a little higher than GIfLs, the overall margin has inevitably dropped. I'll come back to this on the later slide, but would flag that the margin did improve in the second half.

Nevertheless, measured by new business profitability, we remain well above critical mass in our core Retirement Income products. With around half of our overall operating profits coming from this source, we continue to believe that there is significant value in generating new business over and above the value of our back book.

Rodney's already highlighted growth into the insurance liabilities. And that's been the main driver of the 14% increase in the in-force profits. And again, we'll look at this in a bit more detail in a moment.

After allowing for some small operating experienced variances in our normal reinsurance and bank finance costs, this has resulted in the 16% fall in the operating result, despite this being the first full year set of post budget results. Under the circumstances, I think this is a solid outcome.

As for the two below the line items, we saw increased project expenditures this time around as we worked on our new products for the post budget environment, as previously flagged, and of course, Solvency II expenditure.

Unfortunately, financial market headwinds meant that we also incurred negative economic variances mainly due to increasing credit spreads, which widened over the year from 130 basis points to 168 basis points. We have fall in house price inflation at the long end of the curve. And there's a spike in interest rate volatility.

So, most of these charges will unwind over time as the portfolio runs off. And in fact, this year's investment in economic loss of £74 million roughly reverses the £44.1 million of gains reported last year and the £48.9 million recorded in the year before that.

So, let's look at the top line in more detail. Fourth quarter Retirement sales were actually up 10% compared to Q4 2013-2014, and they're up no less than 28% compared to Q3 2014-2015. I know one swallow doesn't make it summer, but it's much nice to be (13:38) talking here about the 10% increase than a 10% decrease.

The star product was obviously DB, which seems to go from strength-to-strength, trebling compared to Q4 2014. This more than made up for the 37% decline in the GIfLs. Although I appreciate that GIfL sales have fallen a long way, this seem to have bottomed out at around the £100 million per quarter level, and as Rodney's just said, momentum has improved in the first quarter of our current financial year.

So, I think it's right for us to mark the resilience of this product. It serves a real customer need for secure income, which hasn't gone away. Q4 was the early days also of our drawdown product, but our rollout with Phoenix is underway, and we'll update you with that further in due course.

The slight drop in mortgages is probably not that significant on its own, but more importantly, we've now got the sales of this product broadly back in line with our 25% of GIfL and DB target for the full year.

Now, let's talk about DB a little bit more - in more detail. As Rodney said, DB is now firmly established as a core product and DB sales eclipsed individual sales in financial year 2014-2015, and on its second year of operation. This is remarkable, confirming our view that medically underwritten DB De-risking is an approach whose time has come. Even on an unadjusted basis, the positive momentum in sales is clear from the blue bars on the chart there.

Every quarter this year was significantly higher than the equivalent quarter in the prior year. But as you can also see on the chart, sales are somewhat lumpy. If we consider the rolling quarterly average, shown by the gold bars on the chart, the growth momentum of the business is clear steel (15:35).

And we've continued to write a number of small and medium-sized schemes, whilst being open obviously occasionally to the big deal, too. In fact, we wrote 29 deals in this financial year, including seven in the final quarter. Our average case size was £21 million and we also remain active with all of the major EBCs. So, we've done what we can to mitigate the volatility of this business.

Looking ahead, the outlook for DB remains very promising and our pipeline continues to grow. We now expect to see sales of around £400 million in the first half of the financial year 2016. However, given the lumpy and seasonal nature of the business, the flow is likely to be concentrated in the second quarter.

Now, just turning to new business margins. As we saw at the half year, margins for GIfLs deteriorated following the budget. Margins on DB have been slightly better than those for GIfLs in the post-budget world. But nevertheless, as you can see here, our margin dropped from 4.4% down to 3.3% for the full year. This actually picked up from the half year stage, when they were at 2.9%, helped by some continuing good returns from the mortgages that we have in our business.

Just looking at in-force margins for a second. In-force profit grew by a healthy 14% against the prior year. The growth here was mainly driven by the 18% opening – a higher level of opening liabilities, partly offset by a 2 basis point decline in margin as shown in the chart. The full year margin of 77 basis points was in line with the half year level, but very modestly down from the 79 basis points in the prior year.

Moving on to embedded value. Embedded value has now grown to just over £1 billion, which represents approximately £2.04 per share.

It's grown at an annualized growth rate of about 8% before dividend distributions. And within that, however, we saw a life operating profit increase of around 19%. And that's been assisted by a strong new business contribution of £98 million net of tax, together with a solid expected return on the opening embedded value.

As you can see, this was partially offset by some experienced variances, which were mainly driven by the one-off costs of Solvency II and our new product developments and were in line with the cost in the IFRS results.

In the economic variances line, and in line with the IFRS, we suffered with an economic variance of £16 million, mainly here caused by bond spread widening. (18:29) interest rates and their effect on our excess long-dated assets.

And finally, just looking at capital and dividends. As the figures show here, our capital position remained strong on both our Pillar 1 and our economic capital basis. We remain primarily focused on our economic capital and on this basis, our coverage ratio of 176% remains strong, well above our 140% internal target, and recovering much of the loss from H1.

The fall in Pillar 1 cover was already cleared at the half year stage and, frankly, won't matter after the 1 of January. As we said then, it reflects management action shifting the asset mix to a more Solvency II friendly configuration together with interest rate falls across the year.

In relation to dividends, the directors are proposing an unchanged £0.022 per share final dividend, and this will make the total for the year to £0.033. We appreciate now the dividend represents a very direct contribution to shareholder value.

And finally the consult (19:38) of Solvency II are finally becoming clearer. And I'm pleased to say that we've submitted our internal model and matching adjustment applications on time. We expect to receive more clarification in December along with the rest of the industry.

Well, that's it from me today and I'll just hand back to Rodney (19:57).

Rodney Malcolm Cook {BIO 14008420 <GO>}

Thank you, Simon. And now, turning to the outlook. You've seen this slide before and I make no apology for putting it in front of you again. You see, our strategy has not changed and the proposed measure with Partnership Assurance accelerates its execution, but our aims remain the same. So, we will continue to offer an IP-led value proposition to retail Retirement Income customers and also to Defined Benefit De-Risking trustees.

Both of these value propositions will also be assisted by the superior investment returns we can achieve through our mortgage books. So, we see no need to change a strategy we believe in. But given the unique chance to accelerate this strategy, we want to do so. And I would now like to talk about the proposed merger.

As we said on the 11 of August, we believe that Just Retirement and Partnership will be stronger together. We submitted the proposed merger. It's both strategically and financially compelling. The strategic benefits start with the exciting growth prospects that being large group we'll have, particularly in Defined Benefit De-Risking segment, due to the proposed increased capital strength and scale of the business. But the merger will also strengthen our competitive position in the individual Retirement Income market, creating a more powerful consumer champion.

The deal brings significant financial benefits as well and we expect meaningful earnings accretion post equity rates to both sets of shareholders, driven by the delivery of at least £40 million of annual pre-tax cost synergies. And on a combined basis, our intellectual property what we believe outstanding, with complementary mortality data sets and underwriting expertise driving further progress in improving our risk selection capabilities.

So just moving to the timetable, which is set out here, and I'll spare you the detail, but the key point is that completion is targeted for December 2015. Now, subject to achieving CMA clearance, we shall post our documents to shareholders in about a month's time from now, and then convene General Meeting for both sets of shareholders in November.

We've also today restated our intention to raise approximately £150 million of fresh equity in order to give the merged company scope to deliver its growth ambition and fund the integration costs. We will give you further details on that at the time when appropriate.

Now, the period between now and completion reflects the various regulatory approval processes that we will need to navigate, including both the PRA, and importantly, the CMA approvals. And as you would expect, we have already completed significant proprietary work on both fronts, including our submission on the 3 of September, as planned to the CMA. And I'd just like to clarify here, given some media commentary that this submission to the CMA is a standard procedure for the transactions of this type.

So, to sum up with a few thoughts as to the future outlook. So, our strategy is essentially unchanged, but it is critical that we are not distracted from it by the challenges of the integration, and David and I are very alive to these risks. The outlook for Defined Benefit De-risking remains positive and promising. And as Simon says, our pipeline has continued to grow. And as I mentioned, we have increased our expectations for DB sales by a further 33% to around £400 million for the first half of this financial year.

So, it is early days with respect to the retail Retirement Income recovery. But as we have said, it looks like sales in the first quarter of this current financial year will be up around 25% compared to the prior quarter.

So, overall, we believe we have an exciting strategic story that we can deliver on against a background, firstly, of improving sales; secondly, a growing market; and, thirdly, firming margins, as Simon covered.

So, I very much look forward to updating the market again in November on our new business results and seeing you once more in February with further news covering our new progress with our proposed merger and our interim results at that point.

So, with that, may I open the floor to questions?

Q&A

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

Yes.

Q - Gordon Aitken {BIO 3846728 <GO>}

It's Gordon Aitken from RBC. Just have three questions (25:26-25:55) just update on South Africa.

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

Right. So, firstly, to the DB, unlike the individual business, we can see further ahead for DB, and we've got a view at least six months into the future. And given the business that we are quoting on and negotiating on at the moment, we felt comfortable to raise the expectation from £300 million to £400 million. So, it is a strengthening pipeline.

Just Retirement does participate in both underwritten and non-underwritten, and there the pipeline for us is split about 50/50, underwritten and non-underwritten. I can't comment on the pipeline for Partnership Assurance. As you would understand, we are fully competing with one another up until the time of the merger completing.

In terms of the cost base, Simon may be able to point to you some detailed figures in the actual announcement, the full announcement.

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

Yeah.

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

But in there, it's very clear, the reduction in staff that we achieved post the budget, and the cost savings, and the reduction in general costs. So, certainly, we delivered on our commitment last year.

Importantly, we have the bases to grow the business without piling on additional cost, Gordon, if that's what you mean. So, these growing sales will lead to the margins. And I think Simon's reasonably comfortable, although he'll use his own words to say that we're probably comfortable with the margin looking ahead around the mid 3% and not going back to last year's 2.9%. Could you just fill that in a bit?

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

Yeah. I'll try and fill a little bit further on that, Gordon. I think you're right to some degree, Gordon, about the fixed cost base. Obviously, quite a bit of the cost base is relatively fixed. We did look to take out £14 million last year, which we did. You can see that's sort of sprinkled across the detailed accounts, if you've got in there. Wages and salaries have fallen from £50.6 million to £46.7 million. Pension costs, for example, have fallen from £4.9 million to £1.6 million. And head count, average head count, which is the way that we do it in the accounts, has fallen from 834 down to 769.

Clearly, some of that cost base has then been offset with the extra cost we've had for Solvency II. And also, the new pension development - the product development, should I say, where we do have invested in new systems and indeed, as you can imagine, the contracted cost in Solvency II are quite expensive.

Going on the way back up though, I'd agree with Rodney, I think the cost base actually is relatively fixed. And in that sense, we can put quite a lot of new business through this cost base. The DB business, for example, is fully outsourced at the moment, so there isn't a huge overhead. And it is something that we can take on a decent amount of volume without making a substantial change to the cost base.

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

So just then turning to the question on South Africa. We have started writing business there. I think just to remind everybody, this is - and I have to put money in the fine box for using the word annuity, but in South Africa, they do call them annuity. We will train them on the term Guaranteed Income for Life. But the South African annuity market is around £3 billion. It is almost completely standard written. So, clearly, the launch of a skilled underwriter is new to their marketplace. We have been accepted on as a full provider for one of the major distributors there and we're pursuing further distribution deals, and we have written our first few policies.

As I said, it's a very low capital-intensive entry. I think the grand total of building the entire business over the last two years, applying for a license and setting up an office and the capital to write the business was less than £8 million investment. So, we see that as a good long-term investment. But, Gordon, early days yet in terms of business.

Next question. Yeah, Andrew?

Q - Andrew J. Crean {BIO 16513202 <GO>}

Thanks. Andrew Crean from Autonomous. On the GIfLs, could you say a little bit about the - your sales, your projections there of about 25%? Is that all underlying demand growth or (30:58-31:03)

And also, what is the challenge for you in terms of Guaranteed Income for Life (31:10-31:27)

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

David, would you like to just talk about how we're seeing the market and the growth?

A - David Paul Cooper {BIO 15900182 <GO>}

Yeah. I mean, it's a very fair question. We don't see the end consumer in quite the way that if you're a direct business. So, as an intermediate, you write (31:42) down. It's less clear precisely what's going on. My sense though is that this is much more about advisor behavior than it is about consumers return into the market. So, I think this is advisors now having cleared all the noise there (32:02) in terms of opening encashments and so on and are now returning to business as usual at Retirement advise. So, I think it's less of a blip coming through from deferrals and more as a return to a normal practice for the advisory industry.

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

So, just to give you, Andrew, a little bit of background. So, as soon as April started, huge volume of encashments, particularly of small customers through our colleagues in the ABI, we get these statistics. Also, interestingly, a very large number of tax-free cash encashments for people who are not retiring. So, this is one of the new post-April phenomena. The people seeking to pay down credit card and other type of debts with no intention to retire to tax-free cash and then let the remainder of the pensions some invested (33:08).

Now, that is also driving the drawdown numbers in our industry because unfortunately that is not what we would traditionally call a drawdown. It isn't someone moving into the concept of drawing an income for the rest of their life call drawdown. So, unfortunately, we've got a huge boost in the drawdown statistics solely because people have taken their tax-free cash. They're not even retiring. They're in their 50s and they will let the balance of that money accumulate till age 67 or whenever the appropriate time is for them.

It is very clear from the FCA reports and from our industry statistics that people are taking cash with small sums. And from our perspective, our average case size went up immediately last year by £10,000 and has gone up further. So, at the current time, our average case size is in the £60,000s where before the budget in 2014, it was £47,000.

So, the reason for this is a lot of small cases under £20,000 disappearing and thereby definition, the average goes up. Can I say, of course, that that is actual more profitable business because you're not writing so many small cases over time? So, from the quote volumes, Andrew, and from what we've seen continuing into September, we think that it is advisors getting back to business as usual.

Clearly, the announcement from the PRA to the advisory community that for people with modest pension pots and annuity or the Guaranteed Income for Life purchased on the open market importantly was a good value proposition. So, that is supporting it. And there's been some recent articles in the newspaper alerting retirees to be careful about taking a drawdown route if they've got a pension of £100,000 to £150,000 in size.

Forgive me, the second part of your question, Andrew, if you could just -

Q - Andrew J. Crean {BIO 16513202 <GO>}

Second part was about threat to GIfLs from (35:38-35:48)

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

The 10-year contracts have actually gone backwards rather than forward.

A - David Paul Cooper {BIO 15900182 <GO>}

Yeah, there's been a few new entrants into the market who are looking to offer those kinds of arrangements. I think from our experience in the market, because we operate in the fixed term annuity space for a period, those vehicles are used to help people defer their decisions.

And to that extent, I think they will – in effect, they won't cannibalize people that want an income now. They're more likely to cannibalize those that would've stayed in France, for example for the next five to 10 years. So I think there may be a marginal impact, but not materially for those who want to maximize their income now, which is what we tend to see as customers.

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

Yes, Oliver. (36:49)

Q - Oliver G. Steel {BIO 6068696 <GO>}

Right. Three questions. First is when you raise the guidance for both GIfL and the drawdown, but I don't think it's really clear for the audience, here. (37:01-38:06)

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

Okay. So, Simon, if you prepare yourself to answer the piece on margin, which I think when you do the sums, it's probably a little higher than 3.7%, but we'll comment on that. And Shayne, the default rates built into the emerging in-force profit.

So, just to clarify, we're only giving one piece of guidance. The other is actually stating an actual sales number, just for the avoidance of doubt. So when I say the sales at the 30 of September will be greater than 25%, I mean, they are greater than 25%. And therefore, that's a statement of something that's happened. Definitely, the DB's guidance of £400 million for this half year is obviously the business not yet completed and that would run through to the 31 of December, 2015.

In terms of the DB, we've done that because we can see ahead and we're not doing it because of some new Russia (39:14) business because of Solvency II on the 1 of January. Our pipeline, as Simon might have mentioned, has actually increased every single quarter since we launched and has had substantial growth since the start of this year, but these schemes do take up to nine months to – from where it will go. So that's why we're reasonably comfortable and confident because of the schemes we're already currently bidding on and negotiating.

As I mentioned, we are bringing business in from both the underwritten and the non-medically underwritten sectors. And I can't comment on Partnership's business. But, obviously, we do actively compete with one another in the medically underwritten part of that segment.

I think the commentary about the merger, we have had either positive or neutral comments in the IFA community. And given that both companies are highly regarded for their five-star service, we've had no pushback, but they see that the quality of that service, if anything, will be enhanced. And it wasn't like combining a five-star with a one-star provider. There was pretty good confidence that two five-star providers would continue to deliver for the IFAs.

In terms of the Defined Benefit marketplace, we've only had positive comments from the consulting actuarial firms and some that have written. Lane Clark & Peacock in particular noted that the combination of Aviva and Friends and Just Retirement and Partnership would bring greater capital efficiency to the market. And, of course, they also mentioned the potential entrants of Scottish Widows and others into this space.

So they see a continuing competitive market. But if I can just remind you without bringing up the slides, Simon said we wrote 29 deals in the small and medium enterprises. There were 4,800 schemes registered there. Not that we individually know the names of them, but some consulting actuarial firms actually know the names of all 4,800 of those schemes and we were pleased with writing 29 in the year. So, yes, we do see an opportunity to grow and over a considerable period of years as well. Margins, please, Simon?

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

Yeah. Oliver, yeah, as you've seen the new margin crept up to 3.3% for the full year against 2.9% in the first half. So we've seen a bit of a stronger performance in the second half of the year. To try and give you a bit more color on that, clearly, IUA pricing, or GIfL pricing, should I say, varies on a daily and a monthly basis when you get composition coming in and going out.

But what I would say, there was a bit more resilience certainly in the final quarter of this year. Whether or not that's going to continue? I don't know. But certainly there has been on the individual side, which has been helpful.

DB schemes are priced individually and their margin does vary quite a bit, but consistently the margin on the DB schemes have been better than the individual schemes certainly for the last two years since the - certainly, since we launched this business and that's continued.

I guess the other point I flagged in the slide was that in this half year the mortgage return, the yield that we're getting on the mortgages, was particularly good in this last half, primarily because swap rates fell like a stone in January and February, and of course, mortgage pricing doesn't keep up with that. So, we're able to pick up a little bit of extra yield there.

Looking forward, I think my guess is that we might expect something in the mid-3%s going forward. That is my guess. But I'm not predicting at the moment to return to those heavy days of 4.4%, not yet.

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

(43:34)

A - Shayne Paul Deighton {BIO 17759794 <GO>}

Yeah. Obviously, our dear friends at the PRA have a huge influence on the subject of default rates, certainly for regulatory reporting, which I suppose which is the start point for everything and (43:46) is broadly in the same area. So, at the end of the year, we're holding about 46% of the spread on our corporate bonds, so the April assumption of Pillar 1.

But, of course, as we move into IFRS, we are (43:59) take a slightly more reasonable view. Although being generally prudent guys, we don't go crazy. We probably say something as you'll refer the way from the announcement we have in the PRA.

So, when we translate that into in-force margin, and I am guessing a bit here, Oliver, (44:19) I reckon it's probably about a third of the overall in-force (44:26) a slightly less. There's definitely that order of magnitude.

Now, of course, you're quite right. Each year, the margin that we see on the in-force is actually a function of the default rate at the beginning of the year. And then to some extent, it influence what will in the year, but it's primarily driven by the start of year position.

So (44:46) spreads has gone up on our portfolio by about 38 bps. We'll get a slightly higher contribution from the in-force for the next year and that's obviously (44:54) decline in the overall spread.

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

All right. Next question. Yes.

Hi, Rodney. It's (45:04). Three questions as usual. Firstly, you're talking about (45:12) so you're clearly forcing on DB deals that will be coming on post Solvency II. Just wondered if you can give any idea of (45:26) material change in the pricing dynamics sort of for the end customer (45:30)

Secondly, there's been some paper and media talk about some – of annuity companies potentially coming to market. So, I mean, have you seen (45:39) any changing in the market dynamics as that's going on? And thirdly, you mentioned about half of the DB pipeline is under (45:49-45:55)

Okay, so just to explain the nine months, because you don't quote actually a price at the start of nine months. What happens is the consultants are starting to talk and testing the market, engaging the clients. When you're getting into actual pricing, you're probably six months away. But just to give you some sense, at the moment, our team has not made any quotes that would be valid beyond the end of this year.

We'll obviously have to continue to work carefully with the consulting actuaries as to how you have that positioned as you get closer to end of the year, but each of the companies will be in the same position with respect to Solvency II. And at this point, we are not quoting for a scheme that would be valid as starting point into 2016 as yet. So, we will work with the consulting actuaries on that.

If you're referring to private companies that are issuing bulk annuities, yes, there has been media coverage that they might be coming to the market. They're already competitors. They're already strong competitors. We usually are not competing against them at the big end of the market, just to be clear. So the schemes that we might quote up to around £300 million and some of the schemes that they have been writing are substantially in excess of that, and our focus is on the small and medium enterprise. We don't – we're not saying that they pose a problem to our particular focus.

In terms of the market, value proposition for investors, well, clearly, we would present ourselves as the best of both worlds with a future DB stream and strong position in the individual market.

And the third part of your question I think was on the bid about 50% being underwritten medically and 50% being underwritten in a normal way. That's just the current positioning that trustees and their advisors are taking. As I indicated, there was no medically underwritten DB schemes just over a year ago, so obviously you have to gradually build that up. So, we do believe for the majority of DB actuarial consultants, we have convinced them of the value, but it is a further process. And forgive me, they do have to win their clients over to that view. But we've got the capability at Just Retirement to quote on a non-medically underwritten basis, so we will satisfy the client one way or the other.

Next question from the floor and then I need to just check – have we got some people on the phone? Have we got it? All right. Well, we've got a method of checking on that. Have we?

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

We've got Barrie here.

Q - Barrie Cornes {BIO 2389115 <GO>}

Thank you. (49:42-50:30)

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

Well, perhaps, if I do that easy but very important question. At the moment, and obviously I cannot speak for Partnership, but clearly we see a longer-term potential for some of our competitors who are taking on very big schemes to further help de-risk their pricing and upgrade their ability to quote a competitive price to the trustees by taking the top group of the bigger slice, which we would underwrite individually. And then, that would give them greater confidence to write the balance of the scheme on a competitive basis.

So I think, over time, the various skill sets of the industry could actually coalesce into a stronger value proposition. And clearly, Partnership wrote a major deal for Taylor Wimpey, which obviously is a multi-billion pound scheme, towards the end of 2014, where for 100 of the largest lies. And that's not by bulk, but by pension liability. We're able to write that for £200 million and then the balance of the scheme, of course, would be, if I could use the word, more average.

Going backwards, Shayne, quickly on longevity.

A - Shayne Paul Deighton {BIO 17759794 <GO>}

Yeah. As I always said, nobody has the crystal ball, and I'm not sure what comments you're referring to. There's always somebody saying something in the newspaper about it. What I can say is that we remain very comfortable. The variance we've had on longevity issue has been absolutely trivial. It's just a little bit of noise basically. I'm not actually (52:21) spot on, but it means it's (52:23) absolutely trivial, so the experience is saying rock solid.

We've taken the opportunity to move the reserves on to the new CMI 2014 model. So we're staying bang up-to-date with that. The medical team and that spoke to you at the

IPO have continued to build out their horizon scanning. So the things that we concentrate on are genuine medical developments in the pipeline 15, 20 years out. And so, we're keeping a very close eye on all of that.

And then, the last thing I'd say is, of course, I'm very excited about getting my hands on Partnership's data as well because, combined, it will be really powerful and just increase our confidence level.

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

Just around that point, because there have been a number of questions from investors that you could help answer if they ask you is, the reason we can combine the data is both companies, for their entire heritages, have actually collected the data. I'm sure, up until about eight years ago, it was in slightly different form. From about eight years ago, each of the companies in our industry used what was called the common quotation form, which happened to be designed by Just Retirement and Partnership eight years ago.

So the fields are the same. They might be stored in different places, but what Shayne's saying is, we're certainly looking forward to combining that data. And the strong heritage from Partnership on the more heavily impaired end of the spectrum, combining with our stronger heritage in the life or impaired in lifestyle, we see a great complementarity in that position.

Just quickly on lifetime mortgage margin, Simon.

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

Yeah, Barrie. I mean, the mix point, the 25% mix point is I think as we've described before, the long-term expectation of where we want to land, surely because of the durational and cash flow matching requirements of the annuity business and the DB business as well.

Last year, the comment about pulling back towards 25% was really competitive last year where we had - if you remember, there's a bulk scheme that came in last year and pushed it well up that percentage. So we're back down to a more normal percentage this year.

In the first quarter of this year, we saw some very decent spreads as I say because of the fall in swap rates, but we can't go too far away from the 25% because of that durational aspect.

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

What we can tell you is, I mean, Equity Release Council has reported that this market continues to grow. I think the government is supporting the need for people in retirement to have access to their accumulated growth in this regard. We believe the FCA will work over time to support a growing market. And so we're quite comfortable with the margins we're getting on that business.

Are there people with questions on the phone?

No questions.

Operator

There are no questions at this time.

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

All right. Go ahead.

(55:24-55:38)

So, just to remind you, we're not competing across the entire spectrum of bulk annuity size scheme. So, because we don't even enter the quote process for those extremely large schemes, I cannot give you a sense of what the very large companies are doing there, but, of course, they report those deals individually. In all the deals we have bid on generally £100 million or less, there are multiple bidders and it's a multiple process. You might start up with eight bidders and then it goes down to four and then a final two with a beauty parade with the trustees.

So, those players, and in the underwriting space, both Aviva and L&G do participate because they have the underwriting ability through their individual business lines as well. It was just from an article in Lane Clark & Peacock that they were posturing that they were new competitors coming into this market space. Andrew.

Q - Andrew J. Crean {BIO 16513202 <GO>}

(56:58-57:12)

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

Well, of course, Andrew, we would be delighted if you would write about us irrespective of our year-end date. But, Simon, have you got a view on that?

Q - Andrew J. Crean {BIO 16513202 <GO>}

(57:19)

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

We will give you enough information on the half to combine.

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

Andrew, clearly, we need to look at this fairly quickly. David and I need to sit down. There are a few implications - practical implications and there may be one or two taxings we need to look at as well, but we'll find it as quickly as we can. All right.

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

Yes.

Q - Andrew J. Crean {BIO 16513202 <GO>}

Yes. Rodney, (57:43-58:39)

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

Right. Well, there's a couple of important points to make clear there. So, firstly, although we haven't been in this market for so many years, it is very clear that the first calendar quarter is lower anyway from seasonality. So, that is very clear. So, you shouldn't – it shouldn't come as a surprise to you that we would all expect that calendar year – that quarter in 2016 would be lower.

We do not have a strong view as yet because we haven't worked through with the PRA on the positioning for Defined Benefit. We are in a slightly better place than competitors because we do individual underwriting. So that gives us greater confidence about our pricing and reserving then on the average, to be fair. There has been mention of the word capital light in Defined Benefit and that was a comment from one large insurer about using reinsurance to lower the Solvency risk capital requirements.

Just to be clear, we already have treaties for both medically underwritten and non-medically underwritten Defined Benefit for Just Retirement. So, we are placing 55% of our longevity risks out to reinsurance. So we believe we already have that capital-light model that other insurers are referring to.

So that will dampen down the impact of what you're thinking about from the 1 of January. But as I said, we don't have any quotes out at the moment that would be valid for starting beyond the 1 of January.

There was a rush in the last quarter, last year, as you saw in our graph. So I wouldn't have made the statement that we had expectations of £400 million unless we fully expected that to be fair. Could it be higher? I suppose it could be higher because we've still got some months to go. But remember, this is very lumpy. It is binary. So, if you're bidding on £100 million scheme or a £50 million scheme, you either win it or you don't. So, the turn is quite a significant thing.

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

Yeah. So, I was going to (01:01:14). Obviously, I mean, it is a lumpy business. And clearly, what we have seen is that the final quarter last year was big, but I think that's mainly – that was certainly driven by people wanting to get the schemes off their balance sheet before the 31 December, their finance directors trying to do that. Whether or not Solvency II will influence this year, I don't know.

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

The problem now for the CFO will not go away.

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

No. No.

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

So, I think it's generally accepted. But in commercial business having large pension liabilities on your balance sheet, which mark-to-market and variable, is not something CFOs at commercial enterprise want to have long-term. So, we don't believe Solvency II will suddenly stop that business continuing to grow.

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

But, I mean, as well, I'd just add on to that is that I don't believe the (01:02:05) double the £400 million for the full year. So, in that sense, what I'm trying to say is that coming through the second half of the year, it will be lighter we think because of that final quarter, and we're talking £200 million to £300 million, something like that for the second half. Okay.

A - Shayne Paul Deighton {BIO 17759794 <GO>}

(01:02:21) I suspect that this whole thing have been over played a little bit because if you look at the way a premium is constructed to DB, the vast majority of it has to do with the longevity assumptions and the interest rate assumptions. The bid (01:02:35) relates to the frictional cost of holding regulatory capital over and above what we believe is (01:02:39) because it's actually really quite small.

So, everybody likes a (01:02:46) it's not surprising therefore that while the EBC has been lot commenting on this supposed (01:02:51) problem. I don't see that there'll be material changes in writing.

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

Our time has expired, ladies and gentlemen. Was there any call?

(01:03:02)

Operator, is there any call on the line?

Operator

There are no questions at this time.

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

Okay. Well, thank you very much for your attention this morning on the line and here in London. Thank you again.