Q4 2016 Earnings Call

Company Participants

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

Other Participants

- Alan Devlin, Analyst
- Andrew J. Crean, Analyst
- Gordon Aitken, Analyst
- Marcus Barnard, Analyst
- Oliver Steel, Analyst

MANAGEMENT DISCUSSION SECTION

Rodney Malcolm Cook {BIO 14008420 <GO>}

Right. Good morning, everybody. I'm Rodney Cook, CEO of JRP Group. For those on the phone, I'm joined on my left by CFO, Simon Thomas; and David Richardson, our Deputy CEO. I'd like to thank Numis sincerely for the use of their conference facility this morning, and I do welcome all of you joining us. We appreciate your continued interest.

So, here is today's agenda; as usual, I'll start by giving you a brief update on how we see the business, Simon will take you through the numbers in detail, and David will talk you through the capital position. After that, I'll share with you some perspectives on the future, as well as some words on our exciting new brand, which I think you've seen, Just. As usual, we'll have time for your questions.

Before I get into any of the numbers, and hopefully, it will be for the last time. I should highlight that we are actually talking today and reporting on an 18-month period that finished at December 31 last. But you'll see throughout the presentation that we focused our performance in the 2016 calendar year, and for historic purposes, pro forma calendar years before that wherever we could. From now on, of course, we will report on a calendar year basis like most others.

Moving to the highlights on slide 4, main operating highlight is the further improvement in new business margins which drove a 58% increase in operating profit, to £164 million. We did indicate last month that we expected to exceed the 6% prior guidance and, of course, I'm very pleased to share with you the results of 6.8%. Now, that is more than double the previous year's point and a little ahead of pre-Pension Freedom levels. Importantly, our addressable markets have been growing, but as you'll know, we are not managing for market share and clearly, we've executed the plan with real pricing discipline attached as I hope you'll see these results clearly demonstrate. The 82% jump in new business profitability drove the 58% increase in operating profit.

Now, while we only started the integration program in April of 2016, we've already increased, as you know, our three-year synergy target from £40 million to £45 million per annum, which we expect to achieve by the end of 2018. We recently announced that at the end of last year, we had achieved a £30 million run rate saving, and that's a year ahead of our original plan. Of course, for 2017, that £30 million in savings at least will drop through to the bottom line, and there'll be more to come as we extract further savings.

I should point out that that has not been an easy task, and I do want publicly to acknowledge the significant contribution by all of my colleagues across the Group to the commitment to maintaining our outstanding customer service record that we have had no increase in complaints above normal, and we are still at the top of the industry in terms of quality of service. However, the toughest part of the integration, which is the consultation is over, and the fruits of our labors are becoming visible.

I'll talk to you in a moment about the prospects for our core markets which are very important, but I explained – as was explained a few weeks ago, the outlook, in particular, in Defined Benefit De-risking looks good, including for the below-£250-million market segment which is, of course, where we focus. Meanwhile, our addressable market for Guaranteed Incomes for Life or GIfL is actually growing as some companies are putting open market broking services into place in order to handle their maturing pension business, rather than typically utilizing internal vesting (00:04:30).

Some of you have spotted that our corporate services business which is now a brand that help financial solutions as one or indeed extended a number of mandates recently and that includes the brokings of Prudential, Royal London and Phoenix. We're also a member of the (00:04:54) panel and we hope to see more of these broking services come together during the year. And, of course, as a market leader in the open market, we're well placed to participate in this.

Another highlight there, second from the bottom, on a pro forma basis, the group's Solvency II capital ratio as of June 30, 2016 would have been approximately 151% if you include the hybrid debt that we issued in October. The ratio at December 31, 2016 is estimated to be unchanged at 151%. Now, for us, that's particularly pleasing since during the second half of 2016, we wrote 2/3 or £1.2 billion of our business. The annual TMTP amortization is fully taken into account there, and David will also explain what the ratio would be if we do the unusual step of recalculating transitionals, which of course is not the Solvency II basis.

However, such are the margins of Prudence built into the Solvency II regime and into its application in the UK which is an important point. We believe that the Solvency II ratio at 151% is well in excess of any reasonable economic requirement to manage our business and we will highlight economic ratio as well.

To be absolutely clear, as we said last October, the Board was comfortable with the capital ratio prior to our debt rates. Naturally, they are very comfortable at the current level. I want to highlight to you all that the Board is also comfortable with the expected development of the Solvency II ratio throughout our five-year business plan period. This confidence, I hope, is evident to you all by the Board's decision to recommend to the shareholders at the AGM, a 6% increase in the dividend for this calendar year.

The last thing I'd like to highlight before we move on to the market and the numbers, at the bottom of this slide, the embedded value per share is up 8% at £2.19. So, overall, a very solid year in terms of results and an encouraging start for our new Just Group.

So, let's talk firstly about the huge opportunity, particularly the DB de-risking market is creating for us. Forgive me, I know most of you came along to the presentation a couple of weeks ago that David Richardson and his team held to explain this, so, don't worry, I'm not going to take you through his whole story. I've just picked out here on slide five, four of the charts that David used which underpin our confidence in this growing opportunity.

So, top left, first and foremost, more schemes are closed to new members or closed to future accruals. That, of course, signals the start of a potential de-risking process. Top right, more money than ever has been invested by pension schemes into liability-driven investments, which, of course, is part of the next stage.

Moving to the bottom left-hand chart, this shows, according to Hymans Robertson, an increasing number of schemes will achieve what we call financial self-sufficiency over the next decade, meaning that they will indeed have the wherewithal should they choose to de-risk more of their liabilities

These thoughts drive our expectations shown on the bottom right, that the market could roughly treble, according to the consulting firms, in size over the next decade compared with 2015 levels. But just in case you interpret that to mean we're about to launch an all-out assault in growing in DB sales, could I be very clear. We only get rewarded for profit growth, not volume growth, and profit will remain our focus. But hey, it's normally easier to grow profit if your markets are also growing such as the case here.

So, apart from the actual market opportunity, where does that place us? So, I hope from the DB seminar, it was clear to you that we have both the professionalism and the execution capacity to deliver with our team. The numbers that are clearly there, we have had substantial group of experienced individuals running industrialized processes. That has enabled us to deliver 119 transactions with Catch (00:10:12) at a 10% market share as the new entrant over the last two years, and I believe we've actually led the £20 million to £150 million transaction size sub-segment. Our average deal size has been 25 million and around 60% of those importantly over the two years have been medically underwritten.

Our vision is to be one of the leaders in the small to medium-sized DB transaction segment. Our current target is transactions less than £250 million, and importantly that's whether it's the whole of the scheme or often as it happens, a part of a larger scheme. Why? Smaller deals work better for our IP, and importantly, that is a combination of our ability to assess people's longevity according to medical and lifestyle questions, but also importantly our ability to originate lifetime mortgages, the matching asset for part of those liabilities. And there's every reason to believe that this segment that we will be focusing on, under £250 million, will grow consistent with the expected growth of the overall DB market.

So, finally on DB, we've tried to be a bit clear about the size of our addressable market and I'll just highlight that for you on the right-hand side. The key take away from the table on the right is that we already have an addressable market of over £200 billion. £200 billion. And we're writing £1 billion a year. So, I'm not suggesting we've got 200 years' worth of business ahead of us, but clearly, it shows the £212 billion figure, which are the three dark green boxes, is our estimate of the blocks or pensions already in payment that would add up to less than £250 million. In other words, they're arrangements that we could already deal with.

In addition, we also do partial buy-ins from larger schemes, and to be clear, of the 119 transactions, a full – a quarter of those in – sorry, the business in 2016, I should say, a quarter of all of those deals in 2016 came from larger schemes. So, our addressable market includes part of those paler green boxes from larger schemes.

Look, it's hard to forecast how trustees will actually choose to de-risk a scheme, how they'll chunk it up into manageable amounts, but the fact is we're already receiving a good proportion of our own business from those particular size schemes, so I would put to you that our addressable markets possibly bigger than the £212 billion even of course if it's not the £800 billion shown, which is the grand total.

Right. Moving on to guaranteed incomes for life. This is clearly a page that we've shared with you before. Broadly, the messages are the same from last year. It's a good story. But, hey, for us, it's getting better. So first, the guaranteed income for life market stabilized, as the chart shows, in 2016; it's effectively flat, but for us, our addressable market has actually grown. So, I think you know following Pension Freedoms' actual introduction, which wasn't at the budget time in 2014.

Pension Freedoms were introduced in April of 2015. Consumer propensity to choose a gift or rather than take an encashment or take a drawdown, that seems now to have stabilized at just under half of the pre-Pension Freedoms levels. So, while we expect from this lower level demographics, the shift from Defined Benefit to Defined Contribution should gradually increase that market, that is not our focus.

However, in the short term, what we're excited about is the shift in the distribution patterns that we're observing which could result in more customers shopping around and accessing the other market.

The open market collapsed in 2015, as the chart at the bottom left shows. It went down from a peak of 60%, of a customer shopping around, to around 40%. Clearly, that was not the target or the expectation of the Financial Conduct Authority. Pleasingly, you will see in 2016 that has risen to 45%. Since that time, we have seen a couple of companies change their business models.

This means the change from where a pension provider, insurance provider had a single time manufacturing to setting up open market broking services. And such as those which are provided by our HUB Financial Solutions business in order to give those companies customers access to the open external market. Also a point to note, companies are increasingly putting their guaranteed annuity rate business out to tender as well, and that will cause the open market to grow further. Even though self-evidently there, the customers aren't getting a higher rate, but the insurance companies are not wishing to retain annuity liabilities.

Now, we are excited because we don't see any reason why this OMO market shouldn't increase beyond the 60% that is achieved in the past. As more and more of the captive models move across to open-market broking, the FCA continues to press for improved competition and consumer protection in the retirement income space. So, I think you'll be aware that the latest CP from the FCA feeds the requirement late this year for pension insurance companies to advise customers of competitor's rates alongside their own rates.

And clearly, the objective here is for customers to receive a more competitive rate. Of course, that might mean that our competitors increase the – and improve the outcomes for the customers, which of course, the FCA will also see as fine. But at the same time, it could enable more people to see the benefit of shopping around.

Again, allow me to reiterate that we focused on growing profits, not revenue. So, why is growing the addressable market exciting for us? It enables us to better select the higher-value risk from a wider pool than we would previously be able to fish in.

Right, our third market in which we're also a leader and have been for some time, lifetime mortgages. It is an important investment for our retirement income book, but please understand we see this as an attractive growth market in its own right. On the top left, you will see that during 2016, the market actually increased 34% and very strongly in the last quarter, it is now over £2.1 billion and market commentators and other industry participants are suggesting another further strong growth for 2017.

There are actually good reasons to expect continued growth given the demographics favorable and it is an attractive product for those over 55. Make no mistake, due to the sums in the property wealth held by those over 55 is of the order of £2 trillion and many of those coming towards retirement are bringing with them reduced DB pensions, perhaps inadequate Defined Contribution savings as well and Pension Freedoms may actually mitigate against those people holding on to the money until later in life and therefore, they may exhaust their savings earlier.

Thirdly, quite a number of people are retiring with debts including mortgages for which they have no other repayment vehicle than accessing income from their property asset. This growing demand in 2016 was actually met with increased capacity and new entrants joined the market most notably legal and general, but others are also expressing an interest.

On the top right, you'll see one of our unique capability is that we have a number of distribution channels and capability including the fact that we distribute before ourselves through third-party intermediaries as well as acquiring existing books. It is true, our market share in 2016 dropped from 37% of the total to 19% of the total in the second half of the year. But importantly, we still wrote more than enough LTMs to back of all of our liabilities, and as Simon will explain in a moment, that enabled us to achieve very healthy spread, and that out (00:20:26) achievement continues into 2017.

Now, we use lifetime mortgages together with bonds and cash to fund our outgoing commitments to our DB and our GIfL customers. Now, I'm showing that on slide 8 in the chart. So, the dark-blue line is the typical liability profile for GIfL, and you'll see the dark-red line is the DB profile. The DB liabilities tend to have a much longer tail, as you can see the red line emerging past the dark blue line, and that is usually due to benefit indexation, and that, as you can see, is a very good match for the longer-tail lifetime mortgages.

We are delighted to be participating in a market with strong growth prospects such as LTMs, and we believe we can continue to invest a proportion of our DB and GIfL business in this attractive asset class. There's a clear symbiotic relationship between the retirees with pension assets and the retirees with property asset.

Right. So, we've been pursuing new business margin expansion rather than self-growth. But this is where our relatively young business comes into its own. So, on the left, even though inflows didn't grow on a pro-forma basis in 2016, although of course the sales are much bigger than Just Retirement on a standalone basis, they still far exceeded the outflows, and that is why our reserves on the right have continued to grow.

The left-hand chart clearly shows that net inflow progression has continued. That is the darker pink, and the very last one, of course, there is 6 months, not 12 months. So, you can compare it with the prior 12-month period. That was a major contributor to the reserve growth, although obviously, hey, the merger created that huge jump in the chart at June 30 and also bond holds did enhance the reserves in 2016. While being more selective in the risks taken, we are still growing our reserves, which, of course, is our primary future profit driver.

So, moving on to slide 10. Before I hand over to Simon, just to quickly highlight the key financials. The dark-coral blobs at the top, clearly, a doubling in margin to 6.8%. That drove an 82% increase shown in the next chart of new business profit. And through that disciplined risk selection, we turned that into, I think, a reasonably impressive 58% increase in total operating profit.

And then finally, as I mentioned in the highlights, to the right, an 8% increase in embedded value per share to £2.19.

So, now, I'll pass over to Simon, to explain these numbers in detail and then David will have a lot more details for you on capital. Simon?

Simon George Thomas {BIO 15219564 <GO>}

Thanks, Rodney. Going straight on to slide 12. This slide shows the summary IFRS results. And as usual, Rodney has taken all the best lines, but let me repeat one of them.

Our operating profit grew by 58%, and the underlying operating profit by 43%, both driven by the 82% increase in the new business profit. Now, this is a real vindication of our disciplined pricing approach, and as before any significant cost synergy impact.

Clearly, the new business profit growth was the eye catcher and I'll go into more detail on this in a moment. But further down the P&L, the in-force profit was slightly more than double the first half amount. There was no real change in other group company trends, and the increase in our reinsurance and finance costs shouldn't come as much of a surprise, as it's a direct result of the issue of our Tier 2 debt in October 2016.

Now, these are pro forma figures, and I'll circle back on the below the operating profit lines when we look at the statutory figures later. So, just looking at our sales in a little more detail. Rodney has already explained how we're comfortable with our selective pricing approach in 2016. Although this has driven a modest overall fall in sales, it has also driven margin expansion, which I'll come back to.

I'm actually very pleased to be able to report flat GIfL sales year-on-year. This feels like a market which is back on its feet at the Pension Freedoms, even if it's still well below its former scale. The drop in DB sales is obviously no surprise after the rush to transact in Q4 2015 ahead of the introduction of Solvency II, which then led to a quiet first half of 2016 as we've previously flagged.

Looking ahead, this market appears to be recovering too, with solid second half 2016 volumes and a promising pipeline in 2017. Interestingly, Q3 was bigger for us than Q4 in 2016, contradicting the perception that the market only really comes to life or alive (26:25) as the calendar year-end approaches.

The other area to highlight is that mortgage sales were ahead of our historic 25% of GIfL and DB target. So, although we didn't notice increasing competition later in the year, we still wrote slightly more than targeted. This is a first cost (26:45) problem to have, especially given the good mortgage yields we've been capturing. It's also good to see the PRA talking about the appropriateness of companies with strong risk management having higher exposure to a liquid asset.

Now, just focusing on the key new business margins, obviously, given the small decline in volumes, the step change in new business profitability was driven by the margin. In fact, pro forma margins in the calendar year 2016 of 6.8% were more than double the 3.3% achieved in calendar year 2015 and better than either company had achieved since Pension Freedoms.

The drivers were similar to those we discussed in September. Firstly, we benefited from the market-wide GIfL price increases that took place in Q4 2015. These are generally stocks with pricing discipline being maintained in the market.

Secondly, margins were held by unusually attractive mortgage yields, which have been assisted by falling risk-free rates, which improved the 2016 performance. And finally, you may also recall that low new business volumes depressed Partnership's 2015 margins due to cost overruns, which did create a slightly flattering comparative.

Now, I just want to reiterate that the mortgage spreads in 2016 were unusually high, particularly, in Q3, following the Brexit impact on risk-free rates. Looking ahead, I'd say that in 2017, we'd expect to see a more normal mortgage spread. However, we believe that the new business margins will benefit from our cost synergies. And from what I can see today, that should maintain the margin at around the mid 6%. We will, of course, update you with progress over the year.

Now, just turning to the in-force on slide 15. Our full year in-force profit is actually slightly more than double the £37 million figure we reported for the first half year. And the margin has remained broadly steady at around 55 basis points on gross opening actuarial reserves. The full-year figure is £75 million, was higher by about 6% over the prior year. This growth was broadly in line with the growth in opening reserves of about 5%.

Looking ahead to 2017, I'd expect the in-force earning to fall to around 50 basis points mainly as a result of corporate bond spreads tightening that happened in the second half of 2016 and the influence of interest rate fall that have inflated the opening reserve by about £1 billion.

Finally, from me, I just wanted to look at the statutory result. This chart is the statutory results showing the 18 months of Just Retirement and the 9 months of partnership, compared to the prior 12 months results for JR alone.

I wanted to highlight that below the operating profit items or below the operating profit line items. These include non-recurring expenditure of £21 million, which on the face of it looks to have increased. However, on a run-rate basis has actually fallen, as this amount is for the full 18-month period and includes partnership.

This expenditure includes the Solvency II projects, which was still in full flight, particularly, in the second half of 2015, and accounts for more than half of the £21 million together with new product development and the cost of raising our Tier 2 debt.

The investments and economic profits have seen a significant pickup. This is mainly the results of the combination of the impact to a number of factors. These include the impact of falling interest rates on our surplus assets, which leads to an investment mark-to-market profit.

Actually also, as I mentioned when discussing the in-force, the tightening of credit spreads over the year has led to a release in this line of about £30 million. In this slide, we also see the unwind of the best estimate level of defaults and as we've experienced no defaults in the period, this amount is also released here.

Below that, we have merger integration costs of £41 million. This mainly includes the cost of redundancies, property and project costs. This compares to the run-rate saving of £30 million at the end of December 2016.

We also have the amortization of intangible assets, most of which have been newly recognized in relation to the acquisition of Partnership. Here, we've gone through a full fair value exercise from the Partnership balance sheet, including harmonizing or accounting and reserving basis. Intangible assets recognized as part of that process include the Partnership's debt and other intangibles. This line in the profit and loss account reflects the amortization of those assets with the in-force being amortized in line with (32:03) and represents the largest elements of the £25 million.

That's all from me. I'll now hand over to David.

David Louis Richardson {BIO 18045016 <GO>}

Thanks, Simon. Good morning, everyone. So, first of all, I'd like to talk about our capital position, and we are very happy to report that our SCR coverage ratio rose from 134% at the end of June to 151% at year-end and clearly, this was helped by the 17% benefits from our hybrid debt issue in October, but the underlying stability of the position is encouraging too. Given the amount of business we wrote in the second half of the year and the gyrations of the financial markets during the exceptional geopolitical upheavals that we saw in the second half of the year. So, I'll take you to the moving part shortly on that.

Now, although the figures in the lower chart are not all up-to-date since the reporting season is still underway. I do want to take the opportunity to highlight that our leverage ratio remains conservative and is right at the lower end of the range compared to our sector period. So, you can see the coral bar on the left-hand side there. So, we still have significant hybrid debt capacity whether you consider the regulatory capital limit of 50% of SCR or relative to market norms as we've shown here.

Now, our economic capital level stands at a healthy 216% at year-end. We've now fully harmonized the economic capital basis across the merged group, the first time we've done that. It reflects our unbiased assessment of the amount of capital required to absorb 1 in 200 year risk events and still fully meet our policyholder liabilities. It is significantly hard on our Solvency II capital ratio as it reflects our true economic view. It does not contain a more onerous elements Solvency II, for example, the risk margin.

It focuses on the true economic value of assets which is lifetime mortgages rather than the synthetic structuring required to qualify these assets from matching adjustment under Solvency II. So, I think it reinforces Rodney's point earlier that at 151% SCR coverage ratio we stand well above any reasonable economic requirements to run this business.

Now, on the next slide, I want to reiterate our confidence of the measures we're taking including cost synergies, changing use of reinsurance, improved risk selections, and of course, our pricing discipline are making a real difference to the marginal capital requirements to write new business. This graph explains its relevance in our Solvency II surplus over the second half of the year. Now, there's a lot of information here, so I'll step through each components at a time and also I'll share our view on how we expect each of them to develop in the future.

So, the first step is that Tier 2 hybrid debt which increase the capital position by £250 million growth of expenses as the deal expense themselves have swept off (35:25) in the other column at the end.

In-force surplus over the period, over the six months was £51 million. This represents the gradual release of all the prudent margins Solvency II requires you to hold, including the risk margin and the SCR over the six-month period on business that was in-force as at 30th of June. This figure allows a six-month amortization of TMTP. So, for the avoidance of those (35:56), this means the release of prudent Solvency II margins including the SCR was significantly in excess of the TMTP amortization over the period.

Now, importantly to project this item into the future, you can broadly double it and assume it grows by around 20% per annum over the next few years. Now, the exact development will, of course, depend on the rate at which we write future new business and is also impacted by a range of variables which can impact the balance sheet. We demonstrate some of those on the next slide.

New business strain over the period loaded for post-synergy expense level was £42 million. So, on approximately £1.2 billion of new business, that represents a strain of 3.5% of premium. This figure did benefit from the hard and normal lifetime mortgage spreads that Simon referred to.

Now, as previously explained in our Capital Markets Day, the amount of new business strain is, again, subject to a number of variables such as the customer rate that we charge on GIfL and DB, the spreads on lifetime mortgages, the level of risk-free rates and other economic variables. However, we continue to expect our new business stream to be more typically a mid-single-digit percentage of premium fully loaded for post-synergy expense levels.

Now, as Simon explained, we have made great progress on achieving those expense savings. However, we've not fully achieved them yet. And over the period, there was £18 million of cost difference versus the long-run target. So, you see that called out here. And in addition, there was a £19 million of strain from integration costs or the cost of achieving those cost savings. We expect both of these items to be eliminated over the course of 2018.

The dividend and the interest cost run rates shown here will, in future, be higher given that the second half captures an interim rather than a final dividend, and given the coupon on our new hybrid debt. For 2017, full-year interest costs are expected to be £32 million pre-tax, which you can then net down for tax in your projection for future years.

And then finally, in the second half, we benefited from favorable financial market conditions, most notably a rise in risk-free rates. This contributed to the other column. Now, to give a sense of the impact of these effects, they're not at a level where they trigger a transitional recalculation. However, if we had recalculated the TMTP at the end of the year, it would have reduced the surplus by around £40 million, reducing the capital coverage ratio between 2% and 3%.

And putting all these together, our current expectation remains that the business will be capital neutral in pound terms by the end of 2018. The coverage ratio is expected to reach its low point in 2019, starting to improve around 2020.

Now, of course, there are lots of variables that would impact the actual capital ratio development over time. However, the board remains comfortable with our capital strength both, now and as it is expected to develop over the five-year business plan period.

The next slide summarizes our sensitivity of our balance sheet to the key risks that we're exposed to. So, first of all, we can withstand small falls in interest rates. A 50-basis-point fall from end 2016 levels leaves the SCR coverage ratio at a comfortable 138%. We have positioned our overall investment portfolio, so that the SCR coverage ratio is broadly neutral to changes in risk-free rates after recalculation of the transition. You can see that in the second sensitivity here. This protects the balance sheet against significant fall in risk-free rates.

Now, we've shown here the impact of a TMTP recalculation, following a 50-basis-point fall. To be clear, that fall in itself would not automatically trigger recalculation of the TMTP, but it does allow you to understand the dynamics. The TMTP itself will be recalculated at the end of 2017, regardless of what happens over the year. The PRA have required that it should be automatically recalculated at least every two years.

Now, our principal risk, otherwise, remained property and longevity. Credit spread expansion is actually slightly positive for us in the world of Solvency II since it reduces the SCR which is the denominator in the ratio, that gives us a small boost to the coverage ratio.

Now, those of you who attended our Capital Markets Day may recall that our principal exposure to property risk relates to the no-negative equity guarantee commitment on our lifetime mortgages. We already provide for a 10% drop in property values, and the table here shows the cost of a further 10% fall. So, in aggregate, 20% fall from current property prices would still lead the SCR coverage ratio at a comfortable 138%.

Now, longevity trends are actually favorable currently, judging by the population, statistics and analysis carried out by the CMI Bureau. The 5% uniform reduction on longevity shown here would represent a material shot given the credibility of our accumulated mortality IP.

Now, in addition, as recently announced, we had increased our DB longevity reinsurance. However, the 75% were standard business and we've also recently increased our cover to 75% for GIfL business. So, over time, our longevity sensitivity will proportionately fall as some more years are added under the new reinsurance term. Overall, the picture is of a robust balance sheet with plenty of scope that absorbs stress scenarios and still supports the growth of the business.

Now, on dividends, obviously, we're pleased that the board is proposing a final dividend of £0.024 per share. This is slightly more than the one-third – two-third split that we would have suggested and confirms our confidence in the capital position and its outlook. This means that total payment to shareholders of 2016 will be £0.035, up 6% compared to Just Retirement's £0.033 payout in 2015. This is the first increase since the budget apprised (42:46) three years ago.

Now, the payout ratio is not something we intend to change significantly in the short-term. However, the dividend has always been intended to be progressive. And given continued earnings growth and a satisfactory capital position, there may be more to come in the future.

So with that, I'll hand over to Rodney to wrap up.

Rodney Malcolm Cook {BIO 14008420 <GO>}

Thank you, David. Before Q&A, just a couple of concluding slides, slide 23. So, by now, most of you will have noticed our new trading brand, Just, which we started rolling out at the beginning of this year. We've created a visualized entity that really stands out from the crowd, a fresh, modern brand that can appeal to a wide range of audiences. But of course, many of you will know that that's only part of the story, it's actually the wrapping paper around the present. It's what we do inside that makes the real difference.

Now, we've always been different, if you like, and we aspire to be recognized as a beacon of good practice in financial services by many more people going forward. So, you can expect more of that behavior from our businesses. And at the heart of this brand is a strong social purpose to help many, out of, quite frankly, the millions of people who face challenges as they enter later life (44:28). I'm also pleased on this slide to share with you that we have brought together out two services businesses, The Open Market Annuity Service, or TOMAS, together with Just Retirement Solutions, or JRS, to form this new company, HUB Financial Solutions.

As you've heard me say earlier, HUB Financial Solutions provides business services to many companies in the UK, including the life sector banks, and of course to their customers. We also provide services, you might be surprised to around 25%. It's actually 22% of FTSE 100 pension DC schemes and their members. Now, these services to various clients include software development, regulated advice and guidance for their members, all the way through to complete outsource solutions and access to products from Just, and also from other providers on panels.

We've brought together, if you like, our strong group capabilities into this HUB organization to enable our corporate customers to access the open market and ensure that the new regulatory standards are met and to give, quite frankly, their customers better deals. HUB is an exciting business, and if it's not now clear to you, let me stress that is increasingly important for us in growing our group's addressable market.

For our products – and it enables us to be more selective, as I explained before, if the pool we can fish in is larger than our risk selection comes to the fore (46:21). This is an exciting time for our business and the response to this new Just brand has been very positive so far.

So, in summary, this leads nicely then into our investment thesis (46:38). We are actually growing profits in markets that are growing and remained economically attractive. We have a sustainable competitive advantage within these attractive markets driven by our preeminent medical underwriting skills, and importantly, our mortgage origination capability and we are using those edges, if you like, to improve returns rather than chase sales and market share.

The margin improvements that you've seen, the merger cost savings which we're delivering, but also importantly our changes to risk selections which we've highlighted, most notably our updated reinsurance arrangements which David took you through, all of those are improving our return profile and the effectiveness of our capital utilization which I'm sure you'll agree is important. And that is why at our Capital Markets last October, David was able to share with you and he's repeated the very same messages today, we were talking about future increases in capital generation going forward.

And finally, we are driving growth in profits by delivering the benefits of this excellent merger that I put to the market in August of 2015. In fact, the benefits that we're achieving already are well ahead of what our expectations were at that time.

So, to sum it up, the merger is giving us an exciting opportunity. We're capitalizing on that to build a strong healthy and sustainable business in order to deliver value importantly both for our shareholders, and as you can see in the focus of our brand value for our customers.

So, we will move to questions and could I have the first question from the web (48:47).

Q&A

Q - Gordon Aitken {BIO 3846728 <GO>}

Good morning. Gordon Aitken from RBC. Now, a couple – first on bulks. I mean, it seems there's a huge opportunity out there and other people have talked about it. The organic opportunity for you to grow as big but what if a block becomes available and the strain is lower than available, if you were to grow organically. I mean Partnership was essentially a big block. I just wanted to run your thoughts on (49:20) blocks. And second, moving to a new mortality table. I just want to confirm what you're using, why you didn't move this time around and maybe give us some sensitivity too if you were to move to the 15 tables or even 16 table swap, the increase on operating profit would be? Thank you.

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

Well, if I just start-off with the bulk deals. You're absolutely right, if you have close regards to some of our competitors last year, the benefit of being able to bring across a transitional from a previous insurance company which might make the capital zero or even negative, has a clear and beneficial impact for the overall capital utilization of those businesses. And of course, we didn't do that other than the very point you made that we did a £7 billion transaction if you like.

But the critical element for us is both a benefit and a challenge. Our model is focused on the matching assets with lifetime mortgages. And I don't see how we would find for a £3 billion deal a quarter of those in lifetime mortgages in an overnight. And the regulator requires you to hold credit capital for that until you're fully aligned or you have to align your assets.

What I'm excited about in terms of the potential for insurance, books becoming available and of course, that is a matter for those companies that hold them but there is conjecture in the market. But that will utilize some of the capital from other players. And it will enable us to continue to focus on the very area that I shared with you which is small to medium-sized transactions under £250 million in the actual Buy-in market. So, Gordon, we see that bulk, that potential as positive for us, even if we don't – this is (51:23). But of course, if it was a smaller section, then – or a panel will provide us, then we could certainly play a part because of that crucial zero or negative capital need under Solvency II.

David is a managing director, of course, of bulks, but that (51:47) – and could we have a comment on mortality?

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

Yeah (51:48). I completely agree with your comments on very large bulk deals, that's not really what we're planning on playing. In terms of new – the developments in a longevity improvement, so we do solely use the CMI 2014 tables. The new CMI projections are due to come out later this month. But clearly, we look at trends ourselves rather than just looking at their papers.

And there's really two questions, I think you need to ask yourself. Are the changes and slowdowns – very significant slowdown on mortality improvements that we're seeing at population levels. Are they a blip, or is there a significant change taking place? That's the first question. And second question is then, how does that relate to your particular book of business?

Now, on the first question, we are falling down on the side of – this is not a blip. There has been a noticeable slowdown in improvements. Just to be clear, that's not to say mortality isn't improving. It is improving at a much slower rate than we saw in the first decade of this century. So, we're pretty clear that we think (52:56) it is a significant development.

That is at a population level. How that translates to an insurer's book of business will vary by situation. And so that's something which requires, I think, careful thought and examination particularly for a company like ours with especially impaired book of lives. How will those population statistics translate into your own particular book of business is an involved (53:20) question. And also, indeed, how it translates into DB business as well who are not average population either?

So, our approach to this is going to be evidenced based. We're going to be prudent in our approach, and we're going to be steady. There's nothing in our numbers which reflects any of those trends at the moment. It's something we're going to keep a very close eye on today. But I think it's too early to give an indication to what it might do to earnings, although clearly it's a very positive backdrop.

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

And certainly, it will be important for our regulators because the PRAs always held a view that longevity improvements were somewhat in advance of what the company's felt was their experience. But I think the CMI is the important unbiased, if you like, provider of that information.

Next question, please.

Hello. This is (54:20) from Morgan Stanley. I have about two questions actually. First of all, all about the new business margin. Can I just clarify one thing? So, your new business margin (54:31) sort of doubled in the second year, and that is actually after you reinsure a higher proportion of your GIfL to the reinsurer. Is that correct? So, if – so it's not purely kind of compared apple-to-apple. So, it's slightly different.

And also about the same margin question. Did you actually change the pattern of your profit as well? So, I guess the question is, did you actually see a payback years actually shortened as the result of this improvement of the margin. And another thing about the – the question about lifestyle mortgage. Did you actually set up upper limits in terms of how much you want to sell your lifestyle mortgage in terms of your kind of DB and new GIfL? Thank you.

So, Simon, if you can pick up on new business margin change pattern of profit and David will pick up on the limits on how we balance the asset and liability requirements. But just to be clear, I think you were hinting to the best of our knowledge and yours reinsurers don't do anything for free. And so therefore, if you say decision, if you increase your insurance, you're giving out a potential profit, but, of course, we were doing that for beneficial reasons for capital usage and efficiency. So, that was the decision making, but these are the numbers after those calculations. But Simon, can you pick up the profit pattern?

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

Yes. I mean, clearly the pattern of profits are mostly fundamentally changed over the two years. And I think as I highlighted, one of the key drivers was the change in the pricing on the individual business at the start of 2016, where I think in essence, it's about November-

December 2015 almost to (56:41) every provider for the price of about 5% on the GIfL products. And that essentially - that pricing change was driven by the Solvency II ratio that was coming in and that essentially has been retained. The pricing discipline has been kept on the GIfL side.

Historically, I always described that the GIfL was a lower margin than the DB. And I think with the pricing changes that we saw at the start of this year, start of 2016, I described the - from a patent perspective, the DB margin and the GIfL margin to be broadly similar. Now, it will vary. It will depend on each DB scheme as you go through, as you can imagine, some of them are more competitive or less competitive than others, but they're closer. I would really (57:25) say than they were at the start of 2016.

In terms of the way that we look at the margin, though, we haven't changed the approach in the sense that we back the new business profit with a fixed rate of 25% lifetime mortgages, that's what's included in these. And we have our prudent deductions (57:42) that we have against that new business margin as well and they haven't changed but these are comparable in that respect. But clearly, from a return in our recognition pattern perspective, we are getting a far, far better payback period in relation to this.

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

Yes. I appreciate following last October, some commentators were confused of topic as we'd written a lot more lifetime mortgages. We were using that much higher to back the liability. So, the margin is calculated 25%. If we write more than they saved up and that's beneficial for our future business.

Of course, as David will point out, perhaps when you also go to the lifetime mortgages, that is the point. We showed you that detailed chart, and we are making very clear that the tail of the DB liability profile is an even better match for lifetime mortgages, though that does mean that you could potentially have a higher ratio going forward. So, David?

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

Yeah. That's right. So, I think the fundamental points here is not to think about 25% of a fixed number that we had to adhere to. The key thing we look at is how the cash flows of all the assets we invested, the combination of the corporate bonds, cash deals and the lifetime mortgages, how those compare to the liability profile that we write or expect to write looking forward for the graph that Rodney spoke earlier. And it's kind of balancing that out and transform the optimum mix which give you the best balancing profit capital as well as expecting liquidity (59:32).

And that is something we continually (59:34) look at. As the nature of the business is changing over time, we see that longer tail on DB. And the other point that Rodney touched on earlier, we now, as a combined group, have a much greater number of levers to pull in the LTM market. So, we've got more distribution channels and more types of products. Not all LTM products have the same cash flow profile, some have shorter duration than others.

So, that is the capability to, (01:00:01) what I would call, a more defined approach is something that we're looking at. We're looking backwards the numbers as prepared for 2016 and 2015 both used 25% in the profit recognition.

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

Right. Thank you. Next, Andrew.

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

Thank you. Andrew Crean, Autonomous. Three questions, if I can. Firstly, you talked about the cost savings. Could you actually give us the cost on the pro forma 2016 versus pro forma 2015 so we can understand the base?

Secondly, the other operating companies which lost £12.4 million, could you go into a bit more detail as to where the loss is occurring, give us a sense as to what you think that will happen, what will go forward in the future? And then thirdly, in terms of your Solvency II roll forward, could you give us the impact in pounds million of the amortization of the TMPT (sic) [TMTP] (01:00:58) and the run-off at the risk margin, please?

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

Right. I don't know about that last question which obviously, David, you will seek to answer and Simon, can you talk about...

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

Let me talk about the operating company status (01:01:18). We've got -in these results, we've got about £12 million coming through (01:01:22) and of that, I would probably say that approximately £3 million of that overall loss was from TOMAS and approximately £3 million up to £4 million from JRS, and the rest was from the other group companies. You have the actual high-level JRP Group company effectively so...

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

(01:01:41)?

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

No. No. No. This is a JRP Group, the company itself. And obviously, it's company had a small loss coming through that, that's JRS, say, that will be about £1 million coming through that line as well.

Now, in terms of looking forward on this, obviously, JRS and TOMAS have been brought together into the HUB company that we just described, that Rodney described a few minutes ago. And our anticipation is that these companies clearly are dealing with distributions, that deal with software as well. Our long-term expectation probably over the business plan period is that these will be moving towards breakeven. And we believe, therefore, that that combined £6 million will be extinguished over the period. Clearly, the

JRP Group company itself still has cost and that will still incur cost and that's probably likely to reside for that period of time, Andrew. But that's...

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

So, unfortunately Simon and David and I will not become a profit center any time soon.

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

Yeah. No. Yeah. Andrew the other one ...

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

Just to be clear, we have spent £40 million already to produce the £30 million of savings. So, hopefully that is...

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

Was that your question? Sorry, Andrew...

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

No. No. No. His question was what, about the £12 million...

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

No. No. No. But he also wants to talk about...

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

(01:03:00-01:03:10).

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

Well. We know that what's the proportion now, still 80-20?

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

It's typically if we sort of 70% (01:03:17) and about sort of 90% of the Partnership. So, the property will be lending about 80% of their (01:03:21).

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

(01:03:22).

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

Well, I can probably get for you under a separate (01:03:27) I can't give it to you. But what I would say is that clearly from the synergy perspective, the £45 million, those are operative costs that aren't affecting any of these HUB companies and things like that. These are costs sort of affecting what I will describe as the main operating part of our business. And therefore, you'd expect to see probably about sort of 80% of those going into the new business profit in the future and being captured through the £45 million run-rate when it comes through at the end of 2018.

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

And 20% against the in-force.

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

20% of the ...

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

And once they have been delivered, then the Chief Actuary can decide whether we can capitalize those and take advantage of that.

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

(01:04:06).

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

You need to have delivered that.

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

Okay.

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

Now, the Solvency II roll forward.

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

Yeah. So, on TMTP run-off, we're not disclosing that breakdown here or the risk margin components but the two broadly run-off together. And the TMTP is higher than the risk margin and that's because the risk margin is not the only onerous and maybe unduly conserve development of the Solvency II directive, which is really what we're trying to get to by contrasting the economic capital position versus the Solvency II position.

So, what you see in the £51 million, that total release you're getting off the bank book is the sum of the release of the risk margin. The release of all the other areas are prudent. They are forced to hold the Solvency II and the SCR over at TMTP amortization. And you can double that, grow it at around 20% per annum going forward and that would give you a good fix on how (01:05:06) develop over the next few years.

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

Just to explain partly the business that's written post the January 1, 2016 has a much faster release and higher risk proportion release than past business, and the reason for that is that there's no transitional attached to the new business. So, when we make payments out to customers that have started from 2016, those payments are - or the debt that we recognized, that will release the grand total of the SCR in the risk margin with no offsetting transitional repayment in the passbook then the transitional must be repaid.

But as David said, in our particular case, particularly given our shorter duration in our business, each year's business flowing off from the previous products of 2015 actually releases more than the amount that we have to repay back to the PRA who gave us this nice stuff line (01:06:12). If you can refer to a transitional (01:06:20).

Q - Oliver Steel {BIO 6068696 <GO>}

Oliver Steel, Deutsche Bank. So, the first question, how much flow do you expect to get out of the Prudential panel? Secondly, do you - I can't quite work out whether your investment mix has changed or not. I haven't really looked through the back of your statement yet, but did you envisage any further change in the investment mix? Is there anymore sort of extra margin you can squeeze, I guess, out of the - in terms of new business?

And then thirdly, just coming back to the question about the sort of assumptions you used to the (01:06:56) new business margin. I always thought that taking out more reinsurance actually brought forward the new business or brought forward the profit, in other words, the benefits or the new business margin. So, I'm just wondering if we check your numbers against the EEV (01:07:11) new business margin, and I assume the EEV (01:07:13) new business margin captures the cost savings in full. Then sort of how would it correlate with the doubling of the new business margin on an IFRS basis?

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

Okay.

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

Okay. So, the Pru panel, David has four participants. Yes. So, the Pru panel has more participants that's being published by the Prudential, couldn't comment on the volumes that's really fit for the Prudential. But clearly, they were the largest writer of GIfL once upon a time. So we expect it to be substantial.

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

So, because of (01:07:54) market proposition and we might have a 30-plus percent share of the open market. We don't see any reason why we wouldn't capture a traditional share there? Who's going to take investment mix?

I'll do the investment mix one. So, I mean, over - we're always looking for ways to achieve the best risk-adjusted yield, subject to close assets, liability cash flow matching and prudent risk management. I think what I just like with the LTMs is that we now have more levers to pull in doing that.

And for example, when you look at the different profiles and the GIfL can be matched by a very different type of LTM, maybe older lives or impaired lives than the DB where you might be looking at younger lives and unimpaired lives. So, it's kind of consistent with our overall theme. The more sophisticated your risk selections, the greater the profit and margins that you can drive out and this is just another dimension of that.

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

So, just to round that out, there are drawdown lifetime mortgages, there's lump-sum lifetime mortgages and of course, their profiles are different based on the younger age. That's always based on the younger age in a couple, but there's all that variety of those two, and of course, there's now interest servers, lifetime mortgages available in the market which we also support. So, that's where a person might have a DB pension, they can afford a certain amount to keep their loan to value down, and – but they can't afford to fund the totality. So, effectively, it works like that.

And of course, that produces – even the sophisticated cash flow is a completely different one and then of course, the last one is, is at the moment at least you need to ask, and that is we will underwrite our cases and give higher (01:09:49) values for people who are impaired and have shorter life expectancy. And as David's indicated, that can meet some of those earlier cash flows in what you might have otherwise expected from what is effectively a zero-coupon bond.

Simon, the new business margin question and the comparative with the embedded value, please? Unless David...

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

The reinsurance point, I think, the reinsurance change actually is fairly neutral, actually, to the new business margin this year. We've increased the level of reinsurance as a standard quota share in that sense, but it's been effectively neutral coming through. And from an EV perspective, that would obviously adopt the same approach that's coming through, in terms of the layout for the mortality reserve.

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

Yeah. So, the EV numbers do reflect a new reinsurance and as Simon said, in your IFRS new business margin, it's pretty much neutral, the reinsurance. You do get a reduction in your (01:10:51) in EV on your new business. So, there is reduction in the new business margin and EV of around a percent, give or take.

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

But, of course...

And can someone remind me what is the EV value of new business post tax?

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

Post tax, £142 million last year.

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

(01:11:11).

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

Only what's achieved.

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

(01:11:15).

Yeah. Only what's achieved.

Yeah.

So, to be clear, our consultation, although they didn't finish with staff (01:11:22) until November, so of course there are some small cost savings in 2016, but nevertheless, more proportionate to £30 million that we have declared. But to repeat those two figures, we're reporting £124 million pre-tax IFRS new business profit, and £142 million post tax EV which of course has the release of the more prudent margins included. And apologies for the pre and post tax complications, but you guys are familiar with that. Next question, please.

Q - Alan Devlin {BIO 5936254 <GO>}

Thanks. Alan Devlin from Barclays. A couple questions. First of all on the open market; what size of opportunity do you think this is? Do you think - is there any reason to think that your addressable market couldn't double and the whole market (01:12:19) comes open, particularly to the best insurers that are left have to get bookmarker quotes anyway. And just on that today, is that open market quote going to be in the page 120 in font size 6 or is it pretty - is it over the front with their own code?

And then just second question on capital. Given the - you said the Board was comfortable at 130%, solvency near at 150%-plus, your leverage is below all your peers. If the - I know you said you want to put margin before volumes, but if you do get the margins you're targeting, is there any - why would you not write more volumes in 2018? If the opportunity right there, would you be willing to let your solvency ratio drop on the absolute surplus drop if you're getting paid to take that risk or could you (01:13:07) that risk to kind of balance off the solvency? Thanks.

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

Right. So, perhaps if I take the open market opportunity, so, clearly from the 40% level, if we can get back up to 60% which doesn't seem unreasonable since we've already been there, then that would be a 50% growth in our accessible market. So, that's a good opportunity. But as I was highlighting that just enables more buses to come along, if you like, that we can miss and pick the ones that we want. So, I mean, reselection must mean that you're selecting the risks and picking the ones you want. So, we see it more from that perspective which of course is margin beneficial.

The consultation that the regulator is having with the large insurers, of course, it will have to be resolved; just how they present their offering alongside that if you went out (01:14:17) other companies whether that by name that you could a better deal from. So, I can't tell you today precisely how that would look. Obviously, we would be advocating that it's not on page 90 of the pack and in very small print, but in the end, that's a matter for the regulator but being very public.

And I'm not referring to any companies but some companies have mentioned that they're reviewing their past books of annuities. So, clearly, the regulator has taken a stance on this. They have very clearly stated publically that they want to see more competitive markets. They made a public study that said 80% of all people who stayed with their current company would have been better off shopping around. So, how could they not make that statement and then follow up by trying to take some action, if you like, that would highlight to the customers who are not aware of that situation to become aware? So, I can't predict the future, but we clearly see that as a positive.

So, let me recap on the margin. What both David and I are saying is that in our view and the view of our company and our Board, we do not need to economically run our company at a 216% economic ratio which today is the 151%. We were comfortable at 134%. So, let me be very clear; why did I go to the markets and borrow money? We were very clear with you in October that we expected the ratio to go down in 2016. Now, miraculously, it happened, but we expected it to. It will go down in 2017 because on the charts, you will see that the surplus is expected to be negative.

By the end of 2018, in pound terms, we projected that it would be breakeven. But because we're growing on our underlying business, the ratio would go down again. The ratio would go down a small amount in 2019 even though we would be positive in pound terms. And David has told you today that on our business plan projections, the ratio would increase in 2020. So the release of all of the reserves is starting to overpower even the growth because I need to highlight to all of you, we are not in the same position as other insurers that are running fast to approximately a standstill.

Even last year, we added £1 billion to reserves so you cannot keep adding £1 billion to the bottom line which requires capital without the SCR growing. So, hopefully, we are seeking today and in October and the charts we showed you in October are the same as today, and I apologize to the bottom of the chart in October it said, not to scale. The reason for that was the hatched lines at the beginning in the (01:17:33) where the opening reserves, of course, were not to scale to the pieces moving in between. So the movements we expected are to scale and we have given you the actual numbers and I hope we've helped enough with how you might build it into your models for 2017 and 2018.

So, what I said to you, based on modest growth, strong profit growth that I believe we can deliver to our shareholders, there is no need for any capital movements outside. We will make separate determinations if there's a huge opportunity Alan, we're not silly if an attractive opportunity comes along, but the Board was very clear that 134 they were comfortable then.

The point of making those very clear to you that the ratio would go down, all of you had worked that out, but it would have been going down from 134. Now, it might come down from 151. So, obviously the Board is much more comfortable at that, but we expect to stay well above the risk appetite throughout the business plan period without any external capital.

That is all caveated as we always do. I don't know what the world economics are going to be like over the next how many years. I don't know what Europe might do in Solvency II if Brexit doesn't mean we always got to match control. But there's potential positive. The chief executive of the PRA was very clear that the risk margin is either excessive or at least it doesn't move appropriately. So, if he is able with the UK government to improve that situation, that would strongly benefit us, of course our competitors and the whole industry.

So, the other thing I did want to make clear and I'm sorry if it wasn't clear enough in October, when we talked about returns, and we were not basing them on 100% of SCR, but I want to also make clear today, we are not basing it on 151% of SCR because we believe just to be absolutely clear that the Pillar 2 regime that we operated under was a very strong regime that provided adequate, more than adequate protection for UK consumers at a 1 in 200 year event.

Solvency II has strengthened that hugely at 100% of SCR. So, there is a balance to be had with investors and the PRA if you like and by expert commentators such as yourself is, what is the right level in addition to that because after all, it does have a drag on shareholder return. So, our board feels that 151% is not where we need to be, and the clearest evidence of that is the 216% of real 1-in-200-year event coverage.

So, I should just check if there are any burning question on the phone.

(01:21:06-01:21:09)

There's a question from Ashik at JPMorgan. Can you give us some color on the (01:21:18) new business? Second part is, what's the spread on your earnings in terms of credit over equity swap on new business? And then finally, annual default budget unwound the proportion between the operating line and the below the operating line numbers.

Okay. Well, if I take the first one, in the RNS we published this morning, we reiterated our expectation and target that we would be achieving mid-teen returns when we deliver our synergy savings, and you see the evidence of our progress with respect to that. I've just confirmed to you that that is not at 100% of SCR. I am not going to share with you the board's risk appetite.

It's well north of 100%, but it is not 151%. But we're very satisfied that, from an investor perspective - and of course, I think you will see from the extraordinary six months, we would've actually outperformed that already. And I put it to you that if we've done it already, then there is a chance in 2018 and onwards that we could continue to do it. I can't make a promise because as I've said, I am not going to tell you what the economic and capital requirements of the world are in 2018 and 2019. Can someone answer the question on spreads with respect to bonds and lifetime opportunities? I didn't get the bit about comparison to equity, but...

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

Yeah. So, I think probably it's more useful to quote the combined spreads we're making. So, if you look at the EV disclosures, the spread on new business over the course of 2016 was 262 basis points over swaps. That's the weighted average of our corporate bonds infrastructure and LTM spread weighted by cash flow.

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

Simon, defaults quickly.

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

Defaults. They've tightened as I said towards the end of the year. I think it's about 46, 47 basis points that we have in total and about 26 of that would unwind in the investments in economic variance as a long-term realistic view of defaults coming through. The rest of it, therefore, the extra 20 would come through the end of the line (01:23:54).

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

And you already mentioned, we haven't had any defaults at all that we've seen in 2016.

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

That's right. Yeah. Yeah.

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

We have a question - time for just one last before the end of session.

Q - Marcus Barnard {BIO 2103471 <GO>}

Marcus Barnard from Numis. Just on the LTM market, there's sort of projections of it growing quite strongly, it grew 34% last year. I mean, if you do see this growth continuing to come through, would you be prepared to increase your 25% limit coming higher? I think even the PRA have talked about allowing higher levels of illiquid assets in backing annuity books, is that something you would review or consider?

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

So, to David and his team, to get that, what our new actuarial systems are enabling us to do is to better risk match. And as we indicated, there are a multitude of different types of lifetime mortgages, but what we would seek to do then is to better match them and not be held to any one particular percentage. So, going forward, you can expect us to not be held to the 25%. However, in answering an important question earlier, which was what proportion was in the margin, then obviously Simon had to answer that strictly for 2016, it was exactly 25%. David, just to repeat, going forward, you intend to do what?

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

Yes. So, we're not going to set ourselves any specific limits because it is going to be a function of the mix of liabilities that we can write between GIfL and DB, and, of course, it's not uniform within those markets. And the opportunities that present themselves in the (01:25:41) market as you pointed out, Marcus, grew at 34% last year. Most market forecasts are pointing to really strong growth.

But the opportunity to select the best type of mortgages for our liabilities seems to be growing all the time. But we will always need to do it within approved limits. We will always need to stress test. So, this isn't just a question of the assets and liabilities matching under your central scenario, but also under stress scenarios as well. So, it'll never be a single percentage. I think going forward, it'll be a kind of a risk-based approach.

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

Well, Dave, the one thing that we saw very positively but, of course, Marcus, it only happened two weeks ago, David really stood up and said, well, he might expect over time that annuity providers might back their liabilities with, say, 40% of long-term liquid asset. Now, that's the first time a statement like that comes from the PRA to be fair and we are factoring that into future discussions we will have with them as to how best deliver, but make no mistake, he prefaced it by saying, that would only be available to people with extremely good risk management processes and liquidity-matching processes. We believe we have them, but in any dialogue with the regulator, you need to present your case, but I think going forward, yes, we will use a more sophisticated match than any fixed percentage.

Ladies and gentlemen, thank you very much for your time today and for those on the phone, thank you for joining us.