Capital Markets Day

Company Participants

- Andy Briggs, Group Chief Executive Officer
- Andy Curran, CEO, Savings and Retirement UK & Europe and Group Director Scotland, Phoenix Group
- Andy Moss, Chief Executive Officer, Phoenix Life & Group Director, Heritage Business
- Claire Hawkins, Director of Corporate Affairs and Investor Relations Director
- Mike Eakins, Chief Investment Officer
- Nicholas Lyons, Chairman
- Rakesh Thakrar, Group Chief Financial Officer

Other Participants

- Andrew Sinclair, Analyst
- Greg Patterson, Analyst
- Larissa van Deventer, Analyst
- Louise Miles, Analyst
- Oliver Steel, Analyst
- Steven Haywood, Analyst
- Trevor Moss, Analyst

Presentation

Nicholas Lyons {BIO 16348625 <GO>}

Good afternoon, and welcome to Phoenix's 2020 Capital Markets Day. 2020 has been a year of change for Phoenix as we welcomed Andy Briggs as our new CEO and completed the acquisition of ReAssure, making Phoenix the UK's largest long-term savings and retirement business.

Under Andy's leadership, Phoenix is evolving from being a financial consolidator to a purpose-led business with a clear role in society. The Board recognizes that Phoenix has a pivotal role to play as the country navigates the shifting pensions and savings landscape and is committed to putting sustainability at the heart of all that it does. You will hear much more about this shortly. Andy has rebuild and enlarged the executive team that will help him deliver this new vision for the Group. His team brings together the strengths of our legacy businesses with internal promotions being augmented by new colleagues from ReAssure and external appointments, bringing market leading experience to meet the skill sets required to deliver our strategy. Phoenix's transition is one of evolution and not revolution. We are building on our market leading capabilities in managing Heritage businesses and undertaking M&A and integration both to consolidate that and to grow a thriving Open business that supports customer retention and customer acquisition.

As ever Phoenix continues to be focused on cash, resilience and grow. This morning's trading update is evidence of our ongoing delivery with 2020 cash generation complete and above the upper end of our target range. A strong and resilient capital position and on target growth delivered by our Open business.

I'm also delighted that we have today announced our commitment to achieving net zero carbon emissions by 2025 across our operations. And by 2050 across our investment portfolio. In addition to the change we had planned for 2020, we have also of course been dealing with the challenges resulting from the COVID-19 pandemic. Throughout this period, our priorities (technical difficulty) customers, colleagues and to support the communities in which we operate. The Board is extremely grateful for the enormous commitment shown by our colleagues during this difficult time. We continue to monitor the physical and mental health of our colleagues as they juggle working from home with their other personal commitments. Due to the current restrictions, our Capital Markets Day takes a different format from previous years. Andy and his team will be presenting today from our Whithel [ph] office, where our premises is sufficiently large to enable our presenters to comply with social distancing rules. Andy and Rakesh will lead off today and provide an overview of our strategy and of the financial framework that underpins its delivery.

We will then move into a series of deep dives into the core building blocks of our business, which will begin with a more detailed look at our approach to sustainability. We will then conclude with Q&A.

Thank you for joining us today and for the work that you do covering Phoenix and the sector. Stay safe and I hope that you manage to spend some time with your families this Christmas. I look forward to speaking to you again at our full year results announcement in March.

Andy Briggs {BIO 4311809 <GO>}

Thank you, Nick, and good afternoon. Phoenix is the UK's largest long-term savings and retirement business. We are a unique business with a clear strategy. We do three things. Heritage is the bedrock of our business and we're the market leader. Distinctive capabilities built from two decades of consolidation and further strengthened in July with the acquisition of ReAssure.

Our open business has strong foundations and delivers growth, enjoy's unique advantages from operating alongside Heritage. And we're the market leaders in M&A and integration, where our specialist skills and scalable operating model underpin a differentiated capability. This clear strategy delivers the three parts of our financial framework. The first is cash, which is dependable, long-term and supports our dividend. Second is resilience from our unique approach to risk management. This is fundamentally different to other insurers. And, third, growth, with our clear capital allocation framework to ensure what only allocating capital where we will get strong returns.

So, today, we'll spend time looking at each area of our UK strategy in more detail and we will explain why Phoenix is well placed to take advantage of the drivers of change across the long-term savings and retirement market and how we will win in each market.

So I want to start as all good businesses do with our customers and the key macro trends driving profound change. We will grow now with people moving predictably from learning to earning to retirement. These days societal change means the world is no longer linear. Now, we all know we live in an aging society with more people than ever benefiting from a longer healthier life. But increased longevity brings its own complexities and the need to take the right decisions throughout our lifetimes to ensure our futures are fulfilling. At the same time, the world of pensions has radically shifted.

Defined Benefit Schemes that guarantee a fixed income in retirement are vanishingly rare and we've seen strong growth in auto enrolment, tripling the contributions into workplace schemes. People rather than governments are now expected to take the lead in planning for that future.

Financial uncertainty is forcing people not simply to live for today, but to look further ahead. But I find it complex and most just aren't doing enough. And then digital is becoming the normal method of interaction and interest in sustainability is increasingly shaping decisions. People want their money put to good use. As a result, what we're saying is that customer needs are changing as they move through the stages of the life saving cycle.

In early life, they're typically in the accumulation phase with they are most likely to be saving through workplace pensions and looking to protect their family income. In midlife, customers will start to consolidate their pension pots and begin to prepare for retirement. Moving into later life, customer wealth will be decumulating as they draw income for their retirement and provide for social care. And the customer need for guidance also changes across the life saving cycle. This need for guidance is also stronger than ever as people struggle with the complexity of having multiple pension pots and navigating through the choices offered by pension freedoms.

So here at Phoenix, we have a clear role to play in society to address these needs and to help people journey to and through retirement, that's why our new purpose is helping people secure a life of possibilities. This means providing our customers with the right guidance and products at the right time to support the right choices. Our new purpose sits at the heart of Phoenix and acts as our Northstar. It starts with being customer-obsessed and being focused on the outcomes that matter to our customers. It drives our strategy, ensuring we allocate resources to the most attractive opportunities where we have competitive advantage and so we will further enhance our returns for investors and our people are absolutely fundamental. We all know winning businesses have the best people with superior skills and capabilities who are diverse and highly engaged. As Nick has already covered, this is a real strength throughout Phoenix.

Our focus on purpose and our culture has led to a 20 basis point rise in colleague pride and advocacy this year. And what this means is that in the pandemic, our people have been determined to be there for our customer in spite of the move to work from home. As a result, our call answer rates and customer satisfaction scores have remained above 90%. This is a great example of this virtuous circle. I (technical difficulty) this is with the best people focused on their purpose and their role in society deliver better customer outcomes and in turn stronger returns for shareholders.

And we see sustainability being at the core of our new purpose and a key enabler of our strategy. Our sustainability strategy focuses on delivering for our 14 million customers and investing our 323 billion of assets in a sustainable manner, making a meaningful difference to society. We fully embed this into our business activities.

We are committed to reducing our environmental impact, investing in our people and culture, supporting our communities and working ethically with our suppliers. Claire will talk in more detail about our sustainability strategy later, but I am delighted today Phoenix has announced its commitment for our operations to be net zero carbon by 2025 and for our investment portfolio to achieve net zero carbon by 2050.

So what I want to do now is talk about the sector, our position within it, and then go on to set out our strategy. So first, the sector. This exhibits takes the customer life saving cycle which I covered earlier and overlays the various markets for long-term savings and retirement products. It illustrates the large size of the life insurance asset pool as a whole at GBP1.8 trillion with good growth at 7% per annum. And covers the size of each market within that. Here we overlay Phoenix's position within these markets. With GBP300 billion of UK assets under administration. We have a 17% share of the total market. This includes Heritage, where we're the market leader. Our scale is valuable as it drives our strong dependable cash generation. It also shows the strong foundations and hence significant potential for growth we have across our Open businesses.

We're a top 3 player in workplace with an 11% market share. Our customer savings and investment business covers both individual savings and pensions drawdown, where we have a 16% market share. And our retirement solutions business covers annuities, where I see our lower market share relative to peers as a positive, as it means our balance sheet has much lower exposure to credit risk. Now the final build of this slide is to look at the major market trends and hence the significant growth opportunities.

We continue to see insurance consolidating their legacy books of business to release capital and avoid the inefficiencies caused by running these old style products on legacy systems. This represents a GBP440 billion M&A opportunity to our Heritage business in the UK market alone. We're also seeing strong growth in the workplace market with annual flows of GBP40 billion per annum, driven by auto enrolment and growing rapidly with the aging population and the move from Defined Benefit. There are also annual flows of GBP30 billion as individuals prepare for retirement and move into decumulation products. And, finally, corporates are derisking, offloading Defined Benefit Schemes to insurance companies. Flows here are in excess of GBP40 billion per annum.

And this understanding of the stocks and flows in the long-term savings and retirement market underpins Phoenix's strategy and ensures we're well positioned to take full advantage of these industry trends.

So on to strategy, Phoenix has a clear strategy focused on three key priorities, leveraging our leading share of in-force and the major market trends that I covered on the last couple of slides. Our first priority is optimizing what we already have at in-force business across both Heritage and Open customers. Our risk management framework ensures we improve customer outcomes and deliver resilient cash generation. Integral to this is the delivery of both management actions and integration activities, including cost and capital efficiencies. So delivering the Standard Life transition and ReAssure integration are top priorities.

Then our second priority is deepening customer relationships. So engaging them and offering the right products and services to meet their needs across the life saving cycle. This means they will stay with us and consolidate towards us as they journey to improve retirement.

And our third priority is customer acquisition. Here, we will leverage the other industry drivers of change and grow our in-force business by acquiring workplace BPA customers through new business and Heritage customers through M&A. This strategy delivers cash resilience and growth. So we have a clear strategy that is aligned to the industry drivers of change. But to win, we also need distinctive competitive advantages across Heritage, Open and M&A. So let me cover each of these in turn.

Phoenix is the market leader in managing Heritage businesses and it remains the bedrock of our business. Here, our strategy is to deliver customer outcomes and manage the in-force business for cash and resilience. Andy Moss will take you through the deep dive later and explain how our scalable operating model and our ongoing delivery of management actions delivers value.

Our track record of improving customer outcomes and maintaining excellent customer satisfaction are unquestionable, as is the value we created with -- for investors with GBP2.5 billion of cash generation from management actions in the last 10 years. Our competitive advantages in this area are truly market-leading, by far the best that I've seen in my 33 years in the sector.

Phoenix's Open businesses have strong foundations and are central to our purpose of helping people secure a life of possibilities. Here, we are focused on deepening customer relationships and customer acquisition and we have unique competitive advantages from operating alongside our Heritage business. And the current deep dive will focus on the three of our five Open businesses where we see the biggest growth potential. So in workplace, our advantages are our scale and our market-leading cost efficiency from leveraging the substantial Heritage relationship with charter consulting services and our priorities are accelerating our investment in our proposition to benefit from the shift to master trust.

In customer savings and investment our advantage is our 14 million customers. We want to help them journey to and through retirement. And in BPA, our priority is improving capital efficiency where we should be ahead of peers due to our diversification with Heritage in order to grow our market share. Hence, I'm confident we can deliver attractive profitable growth here.

Phoenix has an excellent track record of M&A and integration. Our recent transaction history speaks for itself and has seen us grow to a company which is currently ranked 67th in the FTSE. Cash generation from acquisition is a multiple of the price paid and as Phoenix has grown and built scale, these multiples have increased. Our integration capabilities are market-leading and have been further strengthened through the ReAssure business, which provides us with additional talent and creates the bandwidth to run multiple integrations in parallel.

And, again, we have distinctive capabilities and a set up to win. We provide deal certainty to vendors with strong access to capital markets, proven Part VII capabilities and strong regulatory relationships. We also have a scalable operating model with modern cost efficient technology and our broad range of existing business, enables us to exit greater capital synergies. And finally, we have specialist skills, which enables us to deliver management actions and complex migrations. We continue to see M&A as a core driver of our growth and we are ready to do the next deal. We estimate the Heritage market opportunity to be GBP440 billion in the UK with a further GBP190 billion in Germany and Ireland where our European businesses are based. The UK continues to be our primary focus for M&A as the market we understand the best have a proven track record in and has the greatest near-term opportunities. And whilst our focus is on acquiring Heritage books, we will consider buying open books, where they have a good strategic fit and bring complementary capabilities to our strategy. With GBP323 billion of assets, I think it's essential that Phoenix creates a single asset management team and I'm delighted to have Mike Eakins in the role of Chief Investment Officer to build this. You will hear more from Mike later about our ambition to be a best-in-class asset manager focused on customer centricity, leveraging best in class strategic partnerships with an integrated approach to responsible investment. Our asset management team is an enabler to our strategy, focusing on managing asset risk for resilience through the hedging of equity and interest rate risk and the proactive management of our credit portfolio.

Mike's team are also integral to our ambitions to grow our Open business through the origination of our liquid assets to support BPA. Moving now to our financial framework, which Rupesh will cover in more detail shortly. Cash is king at Phoenix and I've even [ph] inherited an enviable 10-year track record of meeting or exceeding all cash generation targets and it's very much my plan to continue this. We've delivered cash generation this year of GBP1.7 billion ahead of our targets.

And we are on track for just under GBP6 billion of cash generation over the next 4 years. And GBP19 billion over the life of our business. This cash generation significantly exceeds our uses and excess cash will be reinvested into value accretive growth. Long term dependable cash generation that brings certainty to our dividend. Resilience is a critical differentiator of Phoenix. Our unique approach to risk management is the key driver here, where we use an extensive hedging program to manage unrewarded risks like interest rates and equity. An active defensive portfolio management to manage rewarded risks such as credit. This means our financial performance is significantly less volatile than other insurance businesses as evidenced in this exhibit, which plots our sensitivity to market risks. The chart speaks for itself and bring certainty to our stable and sustainable dividend. And finally, we want to deliver growth in cash to make cash sustainable and ideally growing into the longer term.

This simple diagram that we finally call the wedge illustrates this. The wedge highlights that cash generation is typically two thirds organic cash generation and one third management actions. Over time, we expect the composition of organic cash generation between Heritage and Open to change, but we expect our long track record of delivering management actions to continue with or without M&A. Rupesh will talk in more detail about how much new business we need each year to offset the run-off of our Heritage business.

Once we exceed this offset, an organic cash generation is growing, we can consider growing our dividend without M&A. But M&A remains a core part of our strategy. And if we can deliver this on top of everything else, it starts to get really exciting. Dependable cash generation and a resilient capital position drive our dividend. Our dividend policy is stable and sustainable. The M&A has enabled us to make 4 dividend increases in the last 4 years and our dividend has grown at a CAGR of about 4% over the last 10 years, proving the wedge and further M&A provide further opportunities to dividend growth. Our dividend growth is broadly in line with the FTSE 100 pre-COVID. Something many would not have expected from Phoenix. But the resilience of our business is clearly demonstrated in the post COVID period. Our dividend has continued to be rock solid. This is a dramatic outperformance of the FTSE 100 and as a result, we expect to be the 24th largest dividend payer in the FTSE this year.

So let me summarize. Phoenix is a sustainable and growing business. Helping people secure a life of possibilities. Our strategy delivers unique advantages. Our approach to risk management differentiates us from our peers delivering resilience to our in-force business. We deliver high levels of long-term dependable cash generation, which supports our stable and sustainable dividend for many years and our business generates excess cash to invest in a range of growth options aligned to the industry drivers of change.

And at Phoenix, the whole is much greater than the sum of the parts. Our history of cost discipline drives market-leading cost efficiency across both our Heritage and Open businesses, a unique advantage over peers for our workplace business. Our broad diversified range of products give us capital efficiencies that benefit both our Heritage and Open businesses, a unique advantage over our peers for our BPA business.

And, finally, as the UK's largest long-term savings and retirement provider, we have 14 million customers and are therefore best placed to help them journey to improve retirements, a unique advantage for our customer savings and investment business. And it's for all these reasons that I am very confident about our future here at Phoenix.

And, now, I'll hand you over to Rakesh, who will expand on our financial framework. Rakesh?

Rakesh Thakrar {BIO 20549114 <GO>}

Thank you, Andy. This morning, we provided a trading update on our Q3 performance, demonstrating further progress in our three key attributes; cash, resilience and growth. These evidence Phoenix's ability to continue to deliver across all key metrics, despite the enormous challenges posed by the COVID-19 pandemic.

Year-to-date, the operating companies of Phoenix and ReAssure have delivered just over GBP1.7 billion of cash generation on a pro forma basis. 2020 cash generation for the group is now complete and has exceeded the revised target we set back in August of (technical difficulty) to GBP1.6 billion. Our capital position has strengthened materially, increasing from a combined group pro forma surplus of GBP4.4 billion at 30th June to GBP5 billion at 30th September. This equates to a shareholder capital coverage ratio of 159% right in the middle of our target range of (technical difficulty) strong. We have set (technical difficulty) 2019 new business long-term cash generation of GBP483 million.

At our half year results, I signalled that we expected our solvency position to strengthen from the pro forma 30th June balance sheets results presented. The end September position reported today reflects the benefits of the completed Part VII transfer of the LNG mature savings business to ReAssure and the delivery of additional equity hedging and integration synergies.

We have also completed the annual review of longevity assumptions. Whilst it remains too early to make any changes to our long-term assumptions around longevity rates from the pandemic, we have updated our assumptions to the CMI 2019 longevity tables. As a result, we have seen a GBP0.2 billion release of longevity reserves. We remain on track to deliver a number of further management actions in Q4 and expect our full year solvency position to be broadly consistent with the Q3 position having made provision for the 2020 final dividend.

Finally, I want to draw your attention to the economic variances we experienced in the nine months to end September. The waterfall presented on this slide is on a combined group basis and shows that our economic variances were a strain of only GBP0.2 billion, which was partially offset by the higher management actions from the credit trades, demonstrating the resilience that our approach to managing market risks delivers. Phoenix has a clear financial framework in place to supporters in delivering the strategy that Andy has just outlined.

This slide summarizes this framework and we will spend time today exploring each component part in more detail. Our in-force business is cash generative. And, as you know, cash is king at Phoenix. The risk management framework is designed to deliver resilience and we manage our business within clear target ranges for capital, leverage and liquidity.

Resilience brings dependability to the timing of cash generation and certainty to our ability to pay a stable and sustainable dividend to shareholders. Our in-force business is generating surplus cash and capital and we have a robust framework for allocating surplus capital to our range of growth options. Growth delivers incremental cash generation and replenishes our in-force business. This is the wedge hypothesis and if growth can more than offset the in-force run-off, we will be able to consider increasing our current dividend. As I said, cash is king at Phoenix and our in-force business delivers long term predictable cash generation. We set annual cash generation targets, which we frame in the context of a 4 or 5-year target. Since listing in 2010, we have met or exceeded every financial target we have set. These targets are for our in-force business only and therefore exclude any new BPA, other new business and future M&A and only include management actions up to 2023. It therefore acts as a base case for cash generation. We are in the process of finalizing our first full annual operating planning process as an enlarged group and will therefore provide an update on targets with our 2020 full year results in March.

Over the life of our in-force business, we have estimated that our Group will deliver GBP19 billion of cash generation, GBP14.4 billion of this cash generation comes from the natural runoff of the in-force business. In 2020, this organic cash generation was GBP800 million and we would typically see this reduce at around 6% per annum.

It is worth noting that this level of organic cash generation includes a drag from the transitionals associated with Solvency II. When these run out in 2032, we will see a circa GBP250 million kicker to annual organic cash generation, which will reduce by 6% thereafter. We expect management actions including integration synergies to deliver GBP2 billion of cash generation with GBP2.5 billion of cash generation delivered for management actions over the last 10 years, they form a dependable source of cash generation even without any M&A and typically comprise around one third of annual cash generation. We also carry a level of Solvency II free surplus in our operating companies, which will be released over time and enhances the dependability of cash generation. This slide will be familiar to you. It sets out the Holdco uses of cash generation over the 4 years to 2023 and illustrates how secure our dividend is over that period. It also highlights the significant amount of surplus cash that will be generated over this period that will be available, either for growth or for special returns to shareholders. Subject to operating well within the leverage range of 25% to 30%.

Looking further ahead, our in-force cash generation supports a stable and sustainable dividend over the long term. But it is important to remember that this exhibit assumes no new business, no further M&A and no management actions beyond 2023. We therefore plan to do much better.

To improve the clarity of our reporting, we are introducing an additional new metric called long-term free cash. This will quantify the amount of cash within the group that will become available for growth and shareholder returns. As a group-wide metric, it therefore has the advantage of netting out the impact of moving cash from the operating company to the holding company. It's also exclude shareholder debt and therefore provides a quantification of the total cash available to meet group costs and shareholder returns. We will report on this new metric at each reporting period.

Moving on now to resilience. Phoenix has a disciplined approach to balance sheet management, which is articulated through our risk management framework. This framework is unchanged from my presentation at our Capital Markets Day last year. We continue to manage capital within a target solvency ratio range of 140% to 180% to manage Fitch leverage within a target range of 25% to 30% and to manage liquidity by ensuring that we maintain an appropriate buffer.

Turning first to capital. We manage our risk in accordance with our risk appetite, which is approved by our Board. We have a particularly low appetite to equity, currency and interest rate risk, which we see as unrewarded. We therefore have a comprehensive and dynamic hedging program in place, which hedges 80% to 90% of the shareholders exposure to equity risk and uses swaps and swaptions to protect the group's Solvency II surplus to changes in interest rates. We see credit risk is rewarded and actively manage our portfolio to ensure that it remains high quality and diversified and operates within our risk appetite. We also manage our longevity risk through reinsurance. Mike will talk in more detail later about our approach to managing market risks.

This differentiated approach to risk management means that we are more resilient to market risk than our peers. This is evident in this exhibit, which shows the impact of movements in equity rates, credit spreads and interest rates on the Solvency ratio of Phoenix and a number of our main UK and European life peers. It is this resilience that has driven the very low GBP0.2 billion economic variance during the year that I explained earlier and which sets us apart from other insurance companies.

Our target solvency range is 140% to 180% and we are happy to operate at any point within this range. Our priority is always to ensure our policy holders are extremely well protected and we do not want to hold excess capital in the business for long periods of time. This becomes particularly relevant when we think about funding M&A, where it is important that we do not overcapitalize transactions.

An integral part of our M&A due diligence processes is building a view of how group solvency will develop over time. Typically, we therefore see our solvency ratio reduce that completion as we aim to utilize own funds to minimize the amount and mix of capital being raised and increase as organic surplus and synergies begin to emerge from the acquired business.

This slide shows how we use the full 140% to 180% target range to efficiently fund recent acquisitions. As noted earlier, we have seen this play out for the ReAssure transaction with the group ratio increasing by 9 basis points since the low of 150% immediately upon completion at 30th June to 159% at the end of Q3, the midpoint of our range.

We adopt a similar approach with leverage where we seek to utilize the full pitch leverage target range of 25% to 30% when considering the funding mix for each acquisition. The ReAssure acquisition has seen group leverage increased to 28%, similar to the levels following the AXA and Abbey acquisitions back in 2016.

We expect leverage to reduce over time, as synergies emerge and as we utilize surplus cash and capital to repay debt to operate well within our range. We have a rigorous capital allocation framework, which we used to allocate surplus capital first to growth and in the absence of growth as a return of capital. It is worth noting that other than BPA, our Open business is capital-light and is therefore not subject to an allocation of capital. We also fund internal vestings from in-force organic cash generation, therefore our capital allocation framework applies to the allocation of surplus capital to BPA and M&A.

We are looking for deals that are value accretive, support the dividend and maintain our investment grade rating.

As Andy explained earlier, we are also looking for M&A that provides a good strategic fit to the group and supports our aspirations for growth across both our Heritage and Open businesses.

Our BPA business is growing and is in the capable hands of Andy Curran, who will talk more about this business later. My success criteria for the BPA business are crystal clear and our approach to this business continues to be selective and proportionate. Currently, we are achieving a capital strain on BPA business of 8%, which we measure inclusive of an allowance for capital management policy. Andy is focused on reducing this to 5%. At these levels of strain, we will allocate between GBP150 million to GBP200 million of surplus capital to BPA per annum and expect GBP150 million capital investment to deliver circa GBP600 million of incremental long-term cash generation.

This slide illustrates how we evaluate M&A opportunities. Essentially, we identify the cash generation that the acquisition will deliver. This cash generation will be a combination of organic cash generation as the business runs off together with the incremental cash generation that will be delivered from both integration activities and wider management actions. Analyzing the cash generation in this way enables us to determine the IRR and payback of the deal. It also enables us to identify whether the acquisition supports an increase in the quantum of our dividend and enhances dividend sustainability.

Finally, I want to talk to you about growth and the wedge. I first presented the concept of the wedge at our Capital Markets Day back in 2018. A simple hypothesis that the growth of the Open business can offset the run-off of the in-force business and bring sustainability to organic cash generation. This hypothesis is unchanged. Before we talk in more detail about the hypothesis translates into actual numbers, I wanted to set out the possible outcomes of the wedge hypothesis.

The first thing to remember is that the wedge hypothesis focuses on growth. It is therefore looking at cash generation that is incremental to the GBP19 billion we expect our in-force business to generate, which I've already illustrated can support our dividend at the current stable and sustainable level out to 2040. So even if the growth of our Open business is less than needed to achieve an offset to organic cash generation, it will extend the ability of the group to pay its current level of dividend for more years. If a perfect offset were to be achieved, this would mean that we could pay our current stable and sustainable dividend in perpetuity. But if we were to over achieve the offset, an organic cash generation is growing over time rather than staying flat or decreasing, Phoenix can consider growing its dividend. And please remember, there is always the expectation that M&A will create further upside and remains core to our strategy.

We always get asked lots of questions about the maths that sits behind the wedge and how the acquisition of ReAssure and our evolving strategy has changed this maths. I am therefore going to spend time today running you through how we model the wedge internally. The wedge hypothesis continues to be focused on organic cash generation only. Management actions and M&A are additional to this and it does not include free surplus.

I explained earlier that we expect our in-force business to generate circa GBP14 billion of long-term organic cash generation. In 2020, we will see GBP800 million of this organic cash generation emerge and we expect this level of organic cash generation to reduce at around 6% per annum as the in-force business runs off.

This slide shows the gap that the Open business needs to fill through growth to maintain GBP800 million organic cash generation each year. When we write new business, we quantify on day one the amount of incremental long-term cash generation that it delivers over the lifetime of the business. The emergence of this cash generation over time is driven by the type of business being written. With BPA now integral to our Open business and expect it to be a material proportion of new business each year, our wedge illustration assumes that 6% of the cash generation emerges in year one and this amount runs off at 6% per annum consistent with the assumption that we are using for our Heritage business.

You can see, therefore, that if we delivered GBP800 million of long-term cash generation from new business, this would emerge as GBP48 million of incremental organic cash generation in 2021, running off at 6% per annum thereafter. Modeling this forward over consecutive years shows that the wedge hypothesis is proven if our Open business can deliver GBP800 million of incremental long-term cash generation each year. Delivering less than GBP800 million of long-term cash generation is still additive to cash generation, but it will not achieve a full offset in the in-force business run-off. And delivering more than GBP800 million will more than offset the in-force business run-off and would satisfy, one of the two criteria needed for us to consider growing the dividend.

So, the next question is, whether GBP800 million of incremental long-term cash generation from new business is achievable. The simple answer is, yes. Andy Curran will talk through our Open business in more detail later. But by reducing the capital strain on BPA and increasing the capital we are allocating to BPA, GBP250 million, we expect to generate GBP600 million of long-term cash generation per year. And by investing in our workplace proposition and supporting our customers as they journey to and through retirement, we can build on the solid foundations of our existing workplace and CS&I businesses and deliver in excess of GBP800 million of long-term cash generation from new business.

Earlier, I explained that we will be introducing a new cash metric, long term free cash. This is a Group level metric that quantify the amount of cash available in the business for growth and returns to shareholders. Each year, we will report to you, how the amount of long-term free cash has changed. Increases will be driven by the sources of long-term cash, ie, new business and over delivery of management actions. And decreases will reflect the uses of cash at Holdco level, including expenses, interest and dividends. This reconciliation will highlight whether the Group is replenishing the cash that it uses year-on-year. It is not exactly the same as proving the wedge, as it does not focus solely on organic cash generation. However, it will evidence whether the business is growing and in conjunction with growing organic cash generation, will be the criteria for determining whether the business supports a growing dividend.

Before I conclude, I wanted to share with you one final exhibit. I'm often asked whether we would turn away further Heritage M&A because it weakens as the wedge hypothesis and undermines our desire to deliver growth. This could not be further from the truth. This Slide shows how M&A has delivered significant growth to both organic cash generation and to our dividend.

Heritage M&A will increase how much incremental cash generation we need the Open business to deliver each year to offset the in-force run-off. But Heritage M&A also provides the surplus capital needed to fund that growth, enabling us to become a growth compounder.

Our financial framework is supported by clear set of reporting metrics, aligned to our key attributes of cash, resilience and growth. We are supplementing the metrics with the addition of a new long-term free cash metric and we will reconcile the movements in this year-on-year to illustrate whether our business is growing or not.

To conclude, cash, resilience and growth remain at the core of Phoenix's financial framework. Phoenix's resilient cash generation from the current in-force business supports the dividend for many years. We have a clear criteria for allocating surplus capital to growth through BPA and M&A and to enhance shareholder returns in the absence of growth opportunities. New reporting metrics within Phoenix's financial framework will allow us to track the business's growth and proving the wedge alongside growing long term free cash would allow us to consider dividend growth.

I will now hand over to Claire, who will talk to you about sustainability.

Claire Hawkins {BIO 20555563 <GO>}

Thank you, Rakesh, and welcome to the first of today's deep dive sessions. Phoenix published its first sustainability report in March and set out its vision of committing to a sustainable future. We've made significant progress against the broad range of commitments set out in this report and we're on track to complete all of the 2020 actions on time. However, the world we operate in and the needs of all stakeholders are changing and, as a result, our sustainability strategy is evolving at pace. It addresses the critical trends impacting our industry, including the aging population and the responsibility to address global environmental challenges.

Our strategy focuses on delivering for our 14 million customers and investing of GBP323 billion of assets under administration in a sustainable manner. It is fully embedded into our business activities, integral to how we interact with all stakeholders, and underpinned by good governance and risk management.

As Andy explained earlier, we see sustainability as being at the core of our new purpose of helping people secure a life of possibilities and the key enabler of our strategy. And by meeting the needs of our stakeholders, we will attract more customers, retain and attract the best talent and deliver better returns to investors. The impact of climate change is one of the biggest global issues and Phoenix is committed to supporting the goals of the Paris Agreement. Today, we have announced our commitment to becoming net zero carbon by 2050, using science-based techniques.

Our commitment has 2 key components. The first, relates to the impact of our operations, where we are setting a target of being net zero carbon by 2025. And the second, relates to our investment portfolio, where we are setting an overarching target of being net zero carbon by 2050. We recognize that there are many considerations in delivering this investment target and our immediate focus, will be on our equity and liquid credit portfolios, which comprise around a third of our total assets under administration. Our strategy for decarbonization will focus on reducing the carbon intensity of our portfolios, increasing investment in Climate Solutions, such as renewable energy and energy-efficient technologies and Paris aligned stewardship, to influence investee companies to transition to a low-carbon economy. Having set these commitments, we will focus on developing interim targets, which will be reported in due course.

As you have heard, our enterprise strategy focuses on deepening our relationships with our existing customers, and acquiring new customers, by meeting needs across the savings life cycle. Our sustainability strategy aligns fully to this and is focused on helping close the growing savings pension gap. To achieve this, we will focus on product innovation and promoting financial inclusion and education across demographics, with particular focus on supporting vulnerable customer groups. We are in the process of concluding a customer research project, aimed at better understanding the needs of our existing customers, in relation to sustainability. This research will support the ongoing development of a range of ESG products, across the savings life cycle. With the go-live of our workplace, ESG passive default fund, on the 15th of December.

We already support customers in the run-up to retirement, through telephony, digital, face-to-face events and webinars. We will broaden and extend the reach of our financial wellness offering in the future, across life stages and needs. Finally, Andy Moss and Andy Curran will talk later, about our investment in digital across both our Heritage and our Open businesses. We will be increasingly focused on driving forward our digital strategy with the aim of increasing education and engagement and promoting financial wellbeing.

Now, as an asset owner, we act on behalf of our customers to invest responsibly and with a long-term view. Mike will talk later about how it is essential for us to factor sustainability considerations into our investment decisions.

Our net zero commitment demonstrates our focus on decarbonizing our portfolios.

Through our membership at the IIGCC, we are one of the five insurers who took part in a pilot to build and test Paris-aligned portfolios. This has provided valuable insight into how we will implement our net zero commitment. In 2019, we set out our philosophy for responsible investment. Clearly, this requires a different approach for those assets where we have the ability to directly influence decisions and those assets which remain at the sole discretion of our customers. We are committed to establishing robust policies and procedures for understanding and addressing the ESG risks across all portfolios. Active stewardship is critical to the delivery of our ambitions and to meeting on net zero carbon commitment. So we are working in partnership with our asset managers to include sustainability considerations within that mandates. And this will enable an integrated approach to ESG management and investment decision-making.

We continue to make good progress towards reducing the environmental impact of our operations and believe our commitment to achieve net zero carbon by 2025 is market leading. We are preparing a challenging emissions reduction plan in line with signs based techniques to fall our route to net zero, which begins from a baseline of emissions from all 22 occupied premises within the group. Our focus will be to reduce carbon emissions before we engage with any offsetting.

We started our journey by supplying of Phoenix UK sites with electricity contracts that are 100% renewable energy and we will bring all of our occupied premises online during 2021. Where renewable energy is not available, we will use offsetting projects. These are already in place the Phoenix UK sites and will soon be extended to cover all sites, making sure that the programs we choose are impactful, certified and focused on carbon removal.

Similarly, for waste, we will be working to eliminate waste to landfill across all sites through 2021. And having already removed single use plastics from some of our UK catering facilities, we will continue the work to cover all UK sites next year.

We are committed to making Phoenix the best place our colleagues have ever worked. To achieve this, we want to be an organization where diversity of thoughts and perspective is genuinely embraced. We've made strong progress across each of our five areas of focus, and a wide range of pledges and accreditations across social mobility, race, disability, mental health and gender, evidences our commitment. As ways of workings change, we are committed to adapting quickly and providing solutions in the best interests of all colleagues. We've seen this aspiration tested during the pandemic, when our priorities have been to protect colleagues and customers. Whilst our offices have remained open, we continue to have around 90% of all colleagues working from home. And we are in the process of conducting a Group wide employee engagement exercise, to determine our future ways of working.

2020 has clearly been a difficult year for our colleagues and we are extremely grateful to them for the hard work and commitment they have shown. Despite these challenges, we've been delighted that the recent annual engagement survey reported an increase of 10% in overall engagement year-on-year. We remain deeply committed to supporting our communities and continue to have a comprehensive community engagement program. At the heart of this program are all colleagues, who continue to commit both, their time and their skills, to making a difference. These programs have needed to flex during COVID, embracing more remote volunteering and fundraising. Moving forwards, our colleagues will be voting to form a new partnership with a UK wide mental health charity and we will be focused on better understanding the needs of the different communities in which we are based, ensuring that we prioritize our activities by measuring the social value that each initiative delivers.

Working ethically with our supply chain is integral to our sustainability strategy. Our supply chain management framework, takes a multifaceted approach to assessing and managing sustainability risk. Using this framework, we will work in partnership with our suppliers, to focus on the issues which we see as key. These will include, the environmental impact of our supply chain, including decarbonization and health and safety. This work will be done in a phased approach during 2021 based on the importance of each supply to the group and our assessment of the risk that each supplier poses to the supply chain.

Now our sustainability strategy is underpinned by good governance and sustainability risk is fully integrated into our risk management framework. In recognition of the importance of sustainability to the long-term success of the group, the Phoenix Group Board have established a new sustainability subcommittee chaired by Karen Green and comprised solely of non-executive directors. This committee will be responsible for the review, challenge and oversight of the group sustainability strategy.

I'm really looking forward to be an executive attendee of this committee. I believe it will provide the challenge needed to ensure our sustainability strategy, creates value for stakeholders. And our increased commitment to sustainability is translating into improvements in our ESG ratings with recent upgrades from MSCI and the Dow Jones Sustainability Index. Whilst these improvements are encouraging, we still have a long way to travel and expect all ratings to improve further once delivery of the ambitions I have shared today.

To conclude, sustainability is integral to Phoenix's purpose of helping people secure a life of possibilities. Our strategy is focused on delivering for customers and fostering responsible investment and we are committed to becoming net zero carbon by 2050 targeting the significantly earlier date of 2025 for our operations. The newly created Board Sustainability Committee will provide oversight of our ambitions. And by closely aligning our sustainability strategy to our enterprise strategy, I am confident that we will deliver value to all stakeholders.

I will now hand you over to Andy Moss, who will talk to you about our Heritage business.

Andy Moss {BIO 19123183 <GO>}

Thank you very much, Claire; and good afternoon, everyone. Phoenix is the market leader in managing Heritage businesses. We have a number of competitive advantages, driven from the optimized operating model we have developed over a number of years. The business covers a broad range of unit linked with profits and protection products that are no longer actively marketed to new customers and comprises circa 50% of our in-force book with 8.3 million policies and GBP162 billion of assets under administration.

Our strategy here is unchanged, to deliver customer outcomes and manage our in-force business for cash and resilience. The unique and distinctive nature of our Heritage strategy positions us to outperform. At the heart of our in-force business, is our optimized operating model. This model comprises a core digitally enabled customer administration platform, a single set of actuary and accounting processes and platforms, including a single internal model, a harmonized approach to risk management, which delivers resilience of the business and a single investment strategy.

As a team, our time is therefore focused on further optimizing this operating model, which we do by delivering for customers, executing management actions and integrating the businesses that we acquire. As a result of this, we deliver improved customer outcomes and cost and capital efficiencies. This strategy delivers cash, resilience and growth and supports three of the key components of our wedge illustration, being Heritage, management actions and the integration synergies, which are realized from M&A.

As Claire explained, delivering for our customers is central to our sustainability strategy and is fully aligned to our purpose of helping people secure a life of possibilities. By putting customers at the heart of all that we do in our Heritage business, we have developed a long track record of improving customer outcomes, consistently delivering high quality customer service and by investing in our digital proposition, we have improved the ease of interaction for our customers.

Turning to our track record of improving customer outcomes. Our actions here are wide-ranging and show the breadth of our customer service activities. Not only have we delivered strong value for money for customers by reducing charges and investment management fees on their policies, we've also traced and repatriated policyholders with unclaimed life insurance policies. I'm particularly pleased we've taken a very proactive role in preventing pensions fraud and continue to take an active role with government and industry influences, on topics that matter most to our customers, like the pensions dashboard.

We've also demonstrated that we are a safe pair of hands in the remediation of legacy reviews. For example, Abbey Life, which was a business we acquired whilst it was on the FCA enforcement. We continue to target a 90% level of customer satisfaction and have been delighted to deliver ahead of this target for a number of years. This has been particularly pleasing this year, when we have proactively managed the many challenges arising from COVID-19.

In responding to the pandemic, we contacted 1.2 million customers, encouraged them to move to digital interactions and delivered over 80 online enhancements. We introduced COVID-19 dedicated customer support and help Pages online and kept our call centers open at all times. In addition, we encouraged the new attends to accept bank transfers, rather than their traditional method of receiving a cheque and offer premium flexibility to support those suffering from financial hardship.

Phoenix has been invested in the development of it's digital platform for Heritage customers. Our focus to date has been on improving availability and convenience, whilst expanding the journeys that can be completed online. All legacy Phoenix customers can access our website, which provides information help and education to support decision making. We've also developed the logged-in environment, My Phoenix, where our priority has been the introduction of digital journeys for the convenience of our customers. Moving forward, we will continue to expand this offering, with our focus being to provide a service, to meet our customers needs, to engage more easily with customers and to improve efficiency. We are excited about the future opportunities this presents to both the Group and our customers.

Moving now to management actions, the bedrock of Phoenix Heritage capabilities. The majority of our cash generation comes from the emergence of surplus as our in-force business runs off over time and capital on volumes. We call this organic cash generation. However, at Phoenix, we also deliver management actions which are incremental to the organic unwind. These actions either increase our own funds and therefore increase the overall cash flows in the business or reduce risk capital and therefore accelerate the timing of cash flows. Our track record of delivery management actions is unique. We have delivered GBP2.5 billion of additional cash generation from management actions, between 2010 and 2019, with a further GBP0.6 billion, of Solvency II surplus generated by the end of Q3.

Typically, management actions comprise a third of cash generation and our long track record illustrates their dependable nature. Management actions are lumpy, and we do typically see more delivered in the period immediately following M&A, as we integrate businesses together, but they are not dependent on M&A, as our long track record illustrates. Our 2020 management actions also evidence at this point, with a wide range of items including, our liquid asset origination, credit management, asset restructuring and equity risk hedging. Equity hedging is the only action directly attributable to M&A. I wanted to spend a few minutes looking at a couple of management actions in detail, to better explain how we deliver value.

The first example examines the Solvency II benefit driven by liquid asset origination. We calculate the present value of our annuity liabilities using a discount rate derived from the yield on the assets that our cash flow matching the liability. Long-dated or illiquid assets better match the long-dated nature of our liabilities and typically have a higher yield to reflect in a liquidity premium.

Replacing liquid assets with a liquid assets therefore increases the discount rate and reduces the present value of our annuity liabilities. This is the matching adjustment benefit. Against these assets, we prudently hold additional risk capital, which will unwind over time. This year, we have seen GBP265 million increase in own funds from the GBP1.4 billion of liquid assets originated. Mike will talk later about our appetite for liquid assets, but we do expect to deliver significant further value in future years as we move from 24% to 40% of liquid assets against our GBP39 billion annuity book.

The second management action explores the benefit delivered by hedging ratios equity risk. Phoenix views equity risk as an unrewarded risks and uses hedging to manage its exposure. It is therefore commonplace to Phoenix to extend its approach to hedging across future acquisitions from the date of the announcement.

In the case of ReAssure, we took out hedges to increase the hedging of ReAssure equity risk from 40% to 80%. These hedges were initially held at the Phoenix Group level, but have subsequently been passed down to ReAssure. By hedging this exposure, GBP120 million of equity release capital has been released.

Looking to the future, our GBP5.9 billion cash generation target for 2020 to 2023 includes GBP2 billion of management actions. We continue to have a strong pipeline of actions that underpin our confidence in this target, including longevity reinsurance, liquid asset origination, Part VII transfers and further operational efficiencies. We only place value on management actions out to 2023. However, we expect there to be opportunities for management actions over the life of our in-force business. New opportunities for management actions also rises our environment changes. Future M&A is an obvious example of an opportunity for cost and capital synergies, but we also see regulatory change, digitalization under our macroeconomic environment as potential sources of value generation.

Turning finally to our integration capabilities. Phoenix and ReAssure have been leaders in the consolidation market, with six acquisitions split evenly between us over recent years, prior to the businesses coming together in July. ReAssure bring additional skills to the Group which complement our own and additional capacity, which means we'll be ready to undertake further M&A more quickly. Whilst our legacy businesses are different, our approach to integration is consistent. Both Groups have focused on accessing cost efficiencies, by delivering scale to their operating model and unlocking capital efficiencies through accessing diversification benefits and applying a harmonized approach to risk management.

In addition, we both sought to optimize investment returns through a single investment strategy and prioritize delivering in customer outcomes. Whilst our operating models are different, Phoenix favoring an outsourced model for customer administration, using the TCS Diligenta BaNCS platform, and ReAssure having an insource model, using the ALPHA platform, we have both driven cost efficiencies by migrating policies onto a single platform, and utilized reinsurance and Part VII transfers, to access capital synergies.

The similarities in approach are highlighted through this case study of ReAssure's acquisition at the Old Mutual wealth business. For those of you who remember our 2018 Capital Markets Day, this case study is extremely similar to that of Phoenix's acquisition of the AXA Wealth business. ReAssure paid GBP446 million for the business. It had own funds measured in accordance with the Old Mutual underlying assumptions of DBP411 million and a surplus of GBP167 million. By harmonizing assumptions for the business to those of ReAssure, and in particular, reflecting the reduced per policy cost of administration from migrating policies onto the ALPHA administration platform, additional loan funds were created.

Further synergies were accessed by reinsuring the business into ReAssure and applying the Group's hedging policy. These day-one management actions increased the acquired own funds to GBP584 million, and increased the surplus to GBP442 million, supporting a cash release of GBP290 million. Thus the deal that looked like it's being conducted at 109% of own funds, became a transaction at 76% of own funds and illustrates the value that can be created by specialist consolidators of Heritage books.

Part VII transfers, are a key value enabler to consolidators. By moving policies into a single legal entity, we deliver economies of scale and ensure that customers are serviced from the most efficient and optimized operating model. However, Part VII transfers required both regulatory and High Court approval and therefore require significant expertise to execute successfully. The Part VII of the LNG mature savings business completed in September. This was an extremely complex transaction, migrating 1.1 million customers, GBP33 billion of assets under administration from 5 LNG retained platforms and with over 60 different policy types.

Migrations of this nature are extremely difficult to deliver successfully. The ability of the ALPHA platform to perform this extraction of policy evidences our ability to manage both complexity and uncertainty and deliver value for customers and investors alike.

Our integration approach has three phases, which are approached sequentially. So when one integration is complete, capacity is created for the next integration to start. Phase III migration of customer policies onto our administration platforms is the hardest and longest phase of any integration as shown in the timeline and can be the biggest barrier to being ready to undertake further M&A. Having two administration platforms in the form of out from banks is therefore an enabler to the faster integration of acquired businesses.

This slide illustrates that we have the capacity to consider further M&A opportunities now. Phoenix is very much open for business.

To summarize, Phoenix is the market leader in managing Heritage businesses, driven from our distinctive operating model and our unique competitive advantages. Our strategy places customers at the heart of all that we do and we are focused on improving customer outcomes. We have a strong track record of delivery management actions with GBP2.5 billion over the last 10 years and will continue to deliver management actions into the future. Phoenix is also a market leader in M&A and integrations delivering value by integrating businesses onto our optimized operating model.

And, finally, ReAssure strengthens our capabilities, both in the management of the Heritage businesses and for M&A and integration, where they bring complementary skills and additional capacity.

Thank you very much for your attention. I will now pass you over to Andy Curran, who have been unable to travel due to COVID restrictions and joins us today from Glasgow.

Andy Curran {BIO 18816863 <GO>}

Thank you, Andy. I joined Phoenix this summer and took up the role of CEO of our Savings and Retirement business in October. This has given me a great opportunity to really understand the Open business and assess our opportunities to deliver growth. It is clear to me that our Open business has strong foundations and is central to our purpose of helping people secure a life of possibilities. The Open business covers 5 business units and comprises of around half of our in-force pick, with approximately 5.6 million policies and GBP161 billion of assets under administration.

My focus today is on the 3 business units, which we expect to be our major drivers of growth. I will share with you how we are thinking about our workplace, customer savings and investment, and retirement solutions business units, all of which gives us a great opportunity to grow. We have the chance to leverage the competitive advantages we have today, but I do recognize, we have work to do to realize these opportunities and we have set ourselves clear strategic priorities, to achieve our ambition. Speaking of ambition, the cash has outlined, the master underpins the wage. To offset the run-off of our in-force book and bring sustainability to our organic cash generation, our Open business must deliver over GBP800 million of incremental long-term cash per annum. This target is ambitious, but it is also achievable.

In the first 9 months of this year, the Open business delivered GBP472 million of incremental cash generation from new business. While this is lower than the GBP800 million level needed, we expect to be able to close this gap in future years by increasing the capital allocated to BPA, while at the same time reducing the capital stream and by growing our workplace and CS&I businesses, through our investment in products, proposition and people. Three of the key drivers of growth in the long-term savings and retirement industry will help to drive growth in our Open business. Growth in workplace is driven by auto enrolment, aging population and the move from DB to DC. We currently have a 11% share of the workplace market and our strategy here is to protect and grow. Naturally, as the UK population ages, more and more people will be on a journey to and through retirement.

We estimate annual flows of around GBP30 billion into products, supporting this stage of the saving cycle, which aligns to our CS&I business. Currently, we have less than 5% of the flows today, we do however have approximately 14 million customers. The strategy here is to engage and develop relationships with these customers, with ambition that they will consolidate towards us and stay with Phoenix for longer.

And finally, corporates are de-risking, with around GBP40 billion of DB scheme liabilities, transferring to the insurance sector each year. We currently have a 5% market share and our strategy here is to grow and expand. A deep understanding of how each of these markets work, will be critical to our success. And of course we will only allocate resources, where they will deliver strong returns. Delivering a similar share of flows to our share of stocks, will drive significant growth.

Looking at these markets in a bit more detail, I will now turn to our workplace. The workplace market will become the main vehicle for retirement savings in the UK and is forecast to grow from around GBP400 million to GBP1 trillion over the next decade. Within this market, there will also be a major shift to master trust, driven by our raft of changes in pension legislation. This presents fantastic opportunity for Phoenix to pickup existing and new pensions schemes. To be successful, you first have to have a deep understanding of how this market operates. You need a strong modern proposition, you need excellent customer engagement, you also need bidding cost efficiency. All under (technical difficulty) the longer term.

As you will already be aware, we operate in the corporate market under the Standard Life Brand. We are already a skilled player with over GBP41 billion of assets under administration. In this capital-light thin-margin market, skill and ongoing proposition investment, are key attributes to being successful. Our commitment here is evidenced by our rapid proposition development, over the last year, which we will continue to accelerate into 2021. Our proposition there offers a wide range of investment solutions across active and passive funds. Our digital platforms, interactive tools, our automated member communications, all insure excellent, employer, employee, advisor and trustee experience. Our reputation in the market for excellent customer service is well deserved. And our relationship with TCS will help us deliver market-leading cost efficiencies, without compromising on service levels. Our strategy is to protect and grow our workplace business from these strong foundations.

As I've just mentioned, our proposition has improved considerably and we will not stop there. Up and coming enhancements include, time income focus funds, providing a digitally enabled retirement advice service and a salary deductible ISA. As a whole, it is clear that our proposition today, stands comparison with any other in the corporate market. Claire set out the sustainability strategy earlier, which puts customers right at its heart. Aligned to this strategy, we have made great progress in expanding our range of ESG investment solutions. Our new ESG passive default fund, launches this month. The fund has been designed to deliver good member outcomes at retirement, using our blend of approaches, including exclusions, targeting and influence.

On top of this, we are also launching a range of ESG themed active funds. These funds will help support Phoenix in meeting our net zero carbon target commitment. Pricing in the workplace market is competitive. So, efficiency is crucial. Here we have substantial advantages from operating our Open business, alongside our Heritage business. And through our unique partnership with TCS, we will migrate to the digitally enabled BaNCS platform, which will help future-proof our business. It will deliver a modern flexible platform and supports our continued excellent customer service. And gives us important market-leading cost efficiency. To summarize, we are already a skilled player in the corporate market and we are well positioned to deliver and protect and grow strategy.

Moving on to our CS&I business unit. There are a number of key trends driving change across the long-term savings and retirement industry. In particular, pension freedoms have given consumers significantly more choice. With more choice, the industry has found it hard to strike the right balance for the consumer, or the need for more education, information and advice, while making important financial decisions. At Phoenix, we will build on our existing capabilities and become an organization that gives the consumer the support it so badly needs. As an example, this time is no longer a single event, it's a more complex transaction for which responsibility has shifted to the individual. Our customers tell us that they find the journey to retirement confusing and the advice is often too expensive for their needs and require a digital journey and we get the ball rolling many would value cadence to help them understand their options and validate their own thinking.

Few players are capable of engaging customers and providing holistic solutions to help customers secure their income in retirement. Our CSNI business includes, what we have previously referred to as, our retail business and Wrap SIPP. For Wrap SIPP, you provide an insurance offer to the Standard Life Aberdeen platform. This is high volume thin margin business for Phoenix. We also have drawdown products, individual SIPP and buoyancy within this business unit.

Phoenix market share is currently modest. It is an area of significant potential growth. With around 14 million customers, Phoenix has an unique opportunity to deepen our understanding of customer needs and respond to those needs with innovative solutions throughout the retirement lifecycle. Our strategy here is to engage and develop. We will achieve this by focusing on the needs of our customers across the four stages of engagement. This begins with the need for a financial awareness, relates to consideration where customers need the clarity on the options they have, they'd want to support where help is needed to validate thinking and finally to transaction.

We will engage with our customers by helping them make consolidation onto our platform simple and straightforward, by developing more and effective solutions as customers move to and through retirement and where prompt decisions need to be made directing them to advisors.

Andy Moss spoke about the strength of our digital capability and our Heritage business, the same very much applies to our Open business. We have introduced new app features, implemented priority functionality for aging staff and launched a new investment hub. Encouragingly, we have seen increased usage of our digital drawdown solution with over 21,000 customers using online retirement journey by the end of October. This year, it's in 15 million logins so far, 50% of which have been through the app and we are on track to achieve GBP1 billion of new cash through digital channels this year. In summary, the customer savings and investment market is very large, and through improved customer engagement and product development, we see this as a significant growth opportunity for Phoenix.

And finally turning to retirement solutions. This includes both vesting annuities and BPA, the total assets under administration of GBP38 billion. There are over GBP2 trillion of DB pension liabilities in the UK, and it is estimated that GBP1.2 trillion of these liabilities are sufficiently well funded for a buyout or a buy in. We expect to continue to see demand for DB de-risking remains strong. Our CEOs and finance directors of corporates continue to look to focus on their business, rather than their Company pension scheme. Having entered the external BPA market in 2018, Phoenix is now an established player. Having risen GBP5.7 billion of liabilities across both internal buy-ins and external BPA.

Our market share is currently circa 5%. Our ambition here is to grow and expand this business unit. We will fund BPA from own resource and we will allocate GBP150 million to GBP200 million of surplus capital per annum. Subject of course to meeting allocations in expectations, our own returns on capital. And we will target deals in the GBP100 million to GBP1 billion, range. However, we will continue to be selective and proportionate, focused on the value, not volume, and ensuring that annuities do not become an overly dominant proportion of the Group's total product mix. While our deal economics continue to improve, we are still seeing a capital strain of 8%, inclusive of our capital management policy. Our focus is on reducing this capital strain from 8% to 5%, which will be achieved by optimizing capital within the framework of the harmonized internal model, our best-in-class approach to the sourcing and allocation of the liquid assets and by optimizing our approach to the insurance.

With these deal economics, a GBP150 million of capital investment will generate around GBP600 million of incremental long-term cash generation. A significant step on our way to improving the wedge. To grow our BPA business, we must strengthen our capabilities. And Mike will talk next about his plans to build a best-in-class asset management capability that will support our growth strategy. We will also be looking to expand our proposition, develop our operating model and build de-risking partnerships and look forward to welcoming Tom Ground as Managing Director of this business in January.

Before I conclude, I thought I share with you an example of how our ability to build longstanding relationships facilitates follow-on transaction. Our first external BPA or with the M&A scheme back in March 2018. This is a scheme, which uses umbrella contracts to undertake a rolling program of buy-in tranches. Phoenix applied a solutions-focused approach to work with the trustees, recognizing the schemes commitment to reduce longevity risk over time. By working collaboratively with advisors and trustees and reinsurers, we were able to improve transaction efficiency. This approach also allowed us to provide attractive pricing. We have now completed three transactions and issued GBP1.2 billion of liabilities with the M&A scheme, covering 30% of pension liabilities.

So to summarize, our Open business is central to our purpose of helping people secure a life of possibilities. We have strong foundations and are aligned to the industry drivers of change. We are a top three workplace provider and are accelerating our investment in propositions to protect and grow in this market. By deepening our customer relationships, we will retain our customers and they will consolidate towards us as well as helping them joining to and through retirement. We are an established player in the BPA market and are focused on improving our capital efficiency to ensure the capital we allocate deliver strong returns.

Through the delivery of these strategic priorities, I am confident that delivering GBP800 million of incremental cash generation from new business is achievable. We can through the wedge.

I will now hand over to Mike, who will take you through our approach to asset management.

Mike Eakins {BIO 21096986 <GO>}

Thank you, Andy, and good afternoon. I joined the group in July this year when Phoenix's acquisition of ReAssure completed having held the role of CIO at ReAssure for just over 12 months. I am super excited about the shared vision that Andy Briggs and I have for in-house asset management at Phoenix and that is to be best-in-class. The Phoenix Asset Management team brings together all investment activities across both shareholder and policyholder assets, across both Heritage and Open Businesses. Our Asset Management strategy has three clear priorities. One, to manage our asset risk for Solvency II balance sheet resilience, two, to source assets that support our growth aspirations and deliver management actions, and three, to embed the principles of responsible investing in all that we do.

Our ambition of being a center of excellence will be delivered by our people and our operating platform. My team has dedicated shareholder and policyholder teams, who are supported by specialist teams, focused on internal ratings, ALM, sustainability, constant strategies operations and manager oversight. I'm fortunate to been able to recruit some of the best and most experienced talent in the sector, within the Asset Management, and insurance sectors, to ensure we have in-house expertise, across liquid credit, illiquid assets and interest rate markets.

We are investing in operating model, using the latest technology to implement a leading investment platform and risk management system across the Group. Phoenix Asset Management operates as a shared service. We are there to provide investment solutions across the Group. So put simply, my priorities are the priorities of Andy Moss and Andy Curran and therefore totally align to the Group purpose of helping people secure a life of possibilities. But our real competitive advantages comes from our global strategic partnerships, which we can leverage to deliver optimal investment outcomes. Aberdeen Standard Investments or ASI as we refer to them, are a core strategic asset management partner. The strategic partnership fosters collaborative working and I've been extremely impressed with the level of support we have received from all levels of engagement with ASI on a day-to-day basis. We also use a wide range and increasingly large range of other asset management partners and this network is becoming truly global to ensure that we deliver best-in-class performance across all asset classes and geographies.

For example, as it relates to infrastructure debt, we also partner with Macquarie and BlackRock. The flexibility that this network affords us, ensures we can leverage the very best experience available. Now as Claire set out earlier, responsible investing is at the core of our investment strategy and will deliver long-term benefits to policyholders, investors and society. In 2019, we published our responsible investment philosophy, representing a step change in our approach to integrating ESG into our investment strategy. Our philosophy is based on the principles of the United Nations PRI and I am delighted to confirm that we have recently become members of the United Nations PRI.

Our commitment to decarbonize our investment portfolio and be net zero carbon by 2050 is integral to this. But we recognize that commitments are not enough on their own. Delivery is key and delivery will be contingent on the integration of ESG factors into our investment making decisions and it will be dependent upon high quality data and reporting, key areas of focus for us right now.

We also recognize our stewardship responsibilities and will adopt an engagement-first approach with the objective of using our position of influence to bring about change. Inactivity will however ultimately lead to divestment.

Having explained our approach to asset management, I want to spend some time explaining how our asset management strategy delivers resilience through proactive risk management and building on some of the management actions discussed by Rakesh. We decompose market risks into two categories. One, those that we view as unrewarded, such as interest rates, inflation, FX and equity, all of which are managed within risk appetite through systematic hedging. And, two, those that we see as rewarded, like credit and property, which we manage within risk appetite through disciplined investment.

As a result of our approach to risk management, just over 40% of our residual shareholder risk is driven by market risk. This approach to the setting and management of market risk appetite is different to our peers and translates into the low sensitivities presented here. Many of you will be familiar with this exhibit. It sets out the impact on both our Solvency II surplus and coverage ratio of risk events occurring as at the 30th of September. And shows that we remain within our target coverage ratio under all scenarios.

You will note that the sensitivity of our Solvency II surplus to the unrewarded risk of equity and interest rates is negligible and that our proactive management of risks, such as credit and property, means our sensitivity to these risks is also small.

But I wanted to explain how we achieve these low sensitivities. Starting first with equity risk. Here, the shareholders exposure is an indirect exposure it has to the risk profit and unit linked funds. This exposure is largest in the unit linked funds, where a decline in equity markets erodes the value of the unit linked funds and therefore reduces the present value of future profits or ViF.

In total, we carry GBP4.9 billion of ViF on our balance sheet and hedge between 80% and 90% of this exposure through a rolling program of options, futures and forward contracts. The chart on the right-hand side shows how our sensitivity would change if we didn't hedge equity risk. A 20% fall in equity markets would increase the strain on our Solvency II surplus from a negligible amount to GBP0.5 billion.

Moving now to interest rates, where the shareholder exposure is driven primarily from the annuity book. Our objective is to reduce our exposure to interest rates and bring resilience to the Solvency II surplus. We do this initially through cash flow matching in our neutral funds and then you swap some swaptions to hedge the remainder of our interest rate exposure. We have hedged over 85% of our interest rate risk, representing approximately GBP13 million per basis point movement in interest rates. This hedging strategy bring significant protection to shareholder value and without it, our sensitivity to an 88 basis point fall in interest rates would increase from GBP0.2 billion reduction in

Solvency II surplus, to a GBP1.2 billion pound reduction. Our exposure to the rewarded risks of credit and property, are driven from our GBP46 billion share of AXA Portfolio. The assets backing our new -- news liabilities represent GBP39 billion, with the remaining GBP7 billion representing assets backing protection business and other shareholder capital. The shareholder portfolio includes a range of liquid and illiquid assets, and is diversified across ratings, sectors, and geographies.

Our shareholder assets included a GBP35 billion debt portfolio, comprising of Gilson Soopers, corporate bonds, liquid credit, excluding commercial real estate debt and equity release mortgages. We have a dedicated in-house team of market-leading credit experts, who proactively manage this portfolio on a daily basis. The portfolio is defensively positioned with minimal exposure to companies most impacted by COVID-19, in sectors such as airlines, hotel, leisure and traditional retail. The Group's debt portfolio is high quality, with 98% at investment grade and only 2% of the portfolio is sitting at triple BBB-minus. Historically, ReAssure's exposure to BBB was significantly higher than that of Phoenix, and we have been proactively reducing the exposure to BBB throughout the year.

On a combined basis, the BBB and below exposure, expressed as a percentage of our debt portfolio, was at 23.5% at the half year. Through the delivery of management actions, including rotation into US dollar investment grade credit, this exposure has been reduced to 19.7% at the 20th of November. The material reduction in BBB exposure, has, in a large part, been delivered through portfolio block trades. Not only do these block trades help improve our credit quality, but they have supported our ambition to diversify into US dollar investment grade credits and have been a value creating management action. These trades are only possible because of the expertise within the Phoenix Asset Management function.

Portfolios are constructed in accordance with clear investment criteria and their impact assessed on the aggregate balance sheet, prior to execution. We then execute these block trades, with the help and support of our asset management and bank partners. To give you an example of a recent block trade, in September, Phoenix Asset Management rotated GBP210 million out of Sterling credit, into dollar credit, generating Solvency II surplus. It should be noted, that all dollar bonds are hedged back to sterling by using cross currency swap matching the term of the bonds.

The outcome of this management action is limited downgrade experience. The chart shows that the average credit rating of each sector within our debt portfolio has been maintained. As at the 30th of September, only GBP1.6 billion or 4.5% of the bonds in our debt portfolio have been subject to a full letter downgrade and only GBP148 million or 0.4% from our debt portfolio, which is sub-investment grade. 99.3% of all cash flows have been paid on our liquid bonds and 99.9% have been paid on our liquid bonds. This performance is directly driven by Phoenix's approach to managing credit risk and the high quality team we have in place.

Phoenix exposure to property risk is primarily driven by a GBP3.3 billion equity release portfolio. This portfolio is highly resilient and well diversified. We have clearly defined risk appetite parameters for this investment class and our selective approach to origination impose a strict hurdle criteria on rating, duration and diversification. We monitor the portfolio on an ongoing basis through stress and scenario testing and will continue to evaluate the use of no negative, equity guarantee hedging.

Annuity liabilities are long-dated and is therefore optimal to put long-dated our illiquid assets against our unusually liabilities to achieve cash flow matching. Our current GBP9.3 billion illiquid portfolio is well diversified across asset type and sub-sector. In addition to our equity release mortgage portfolio, our illiquid portfolio comprises of private placements, UK local authority loans, commercial real estate and infrastructure debt. The portfolio has a high credit quality with around 75% of the portfolio-rated single or above.

As Andy Curran explained earlier, BPA is a driver of growth for Phoenix and appropriate illiquid assets sourcing is a key enabler to reducing the capital strain we incur from the current level of 8% to the target of 5%. To meet the expected growth of our BPA business and achieve our 40% target strategic asset allocation, we aim subject to prevailing market conditions to source GBP3 billion of illiquid assets per annum. However, we will continue to be driven by value and not volume, quality and not quantity.

As a reference point, over the course of the third quarter of 2020, of the potential illiquid asset investment screened, only 12.5% were invested. We will achieve this increased origination target by expansion of our investment strategies across new assets and geographies with fully integrated sustainability objectives. In 2020, we've originated GBP1.4 billion of illiquid assets across a range of durations with an average credit rating of Single-A. Illiquid asset origination continues to be one of our key management actions, delivering a GBP0.1 billion increase in Solvency II surplus. On a going forward basis, we will be expanding our ability to originate directly with borrowers, so that we can augment the origination through our asset management partners. It is in our illiquid assets sourcing, that we can most easily see the impact of our commitment to responsible investing. With 50% of our liquid asset origination this year, being into ESG assets. And integral to this illiquid asset origination is our program of helping build back Britain better. I've included on this Slide, 2 great examples of this program in action.

The first, Project Albion is a renewable energy portfolio, across onshore wind, hydro and solar power, with investments in England, Scotland, Wales and Northern Ireland. The second, Project TunTum, is a community-based housing association, with a BAME focus, based in the East Midlands, it is approximately 1400 homes, providing affordable housing to over 3,000 people. We really look forward to playing a key role in society over the coming years, putting our assets to good use and supporting our Group purpose of helping people secure a life of possibilities.

So, to conclude, Phoenix is building a best-in-class in-house asset management team, which has the unique advantage of being able to partner with global asset managers and ASI as our core strategic asset management partner. Sustainable investing is integral to our investment strategy and aligned to the Group's purpose. Integral to this is our commitment for our investment portfolio to be net zero carbon by 2050. A key priority is managing market risk. We deliver resilience by hedging un-rewarded risks, like equity, interest rates and FX, and proactively manage rewarded risks, like credit, through a well diversified, high quality, defensively positioned portfolio. Illiquid assets, provide great matching for annuity liabilities and our ability to originate high quality illiquid assets supports the growth of our BPA business and drives capital efficiency.

I'm now going to hand back to Andy Briggs, to summarize.

Andy Briggs {BIO 4311809 <GO>}

Thank you, Mike. I'm incredibly excited about the creation of Phoenix Asset Management. The combination of the right team and the right strategy, means we're very confident of the impact Mike and his team will have on our broader strategic delivery. We've run through a lot of detail today and there has been much to absorb. Before we move to Q&A, I wanted to try and put it altogether. Therefore, if there were 3 things I'd urge you to take away today, they would be asset purpose. As the UK's largest long-term savings and retirement business, Phoenix has a clear role to play in society and that's what underpins our new purpose, helping people secure a life of possibilities with sustainability at our core. I passionately believe that the best businesses have the best people, are customer obsessed and focused on their core social purpose to in turn drive superior returns to shareholders.

A virtuous circle and that's what we're doing here at Phoenix. Second, our clear strategy. This starts by leveraging our market leading share of in-force business in the UK long-term savings and retirement market. And then, we're extremely well placed to take advantage of the major market trends. By deepening our existing customer relationships across our 14 million customers and acquiring new customers through new workplace and BPA business and through M&A.

And third, we will win because we have unique advantages, our resilience, our dependable cash and our excess cash to invest in growth, all of which we've evidenced over a long-time period including most recently through the challenges of the pandemic. And because of Phoenix, the whole is greater than the sum of the parts. Our Open businesses have unique advantages from operating alongside Heritage and given the scale of our Heritage and Open businesses, we can deliver higher synergies and hence more value from M&A. All in all, a unique combination of dependable resilience and exciting growth opportunities. Thank you.

And with that, we'll now move to Q&A. So for the sell-side analysts, now is the time to dial in to the recording, so that you're able to dial into the telephone conference. So you're able to answer -- ask your questions live into the room here. While you're doing that. We also have questions coming through on the webcast.

So Vicky, could we have the first question from the webcast, please.

Questions And Answers

Operator

Thank you, Andy. So the first question. When do you expect to be ready to undertake your next M&A deal. And would you consider buying a 100% open business?

A - Andy Briggs {BIO 4311809 <GO>}

Okay, thanks for that, Vicky. So much as Andy most covered. We are ready to do the next deal now because we're well advanced in the first phase of the integration of Phoenix and ReAssure which is bringing head offices together, but were we to do another deal now, we would need to wait a while before we're ready to do the second and third phases of finance and actuarial and the operations in IT. And as a result of that, we're not currently pounding the streets desperately looking for our next deal, but we are optimistic about the opportunities for M&A in the UK market and if the right opportunity came along, we would be in a position to do it.

In terms of the types of deal, there is probably two observations I'd make. One is that I often hear people say, Phoenix could only do a massive deal that a smaller deal just wouldn't work, but that's just not the case. It's all from my perspective. Yes, we'd be interested in larger deals, but I think Andy Moss gave a great example of the ReAssure deal for Old Mutual wealth where there was well over 200 million of day one synergy benefits delivered on that deal.

So and if you think now that the combined group. We've got seven and half thousand people, we can have a small group of people doing a smaller bolt-on deal every year and if each of those generates a couple hundred million of value. That's really significant in the scheme of an annual cost of dividend of GBP480 million and then the final part of the question, would we consider 100% Open business. So our priority remains Heritage businesses. We think that's where the biggest opportunity lies, but we would consider 100% Open business. Two criteria for that. The first is strategic environment. So, is it going to support the strategic direction will go again as an organization, bring new capabilities that will be valuable to us.

And then secondly, that the clear criteria that Rupesh has set out. So it needs to be value accretive, it needs to support cash generation for the dividend and we need to maintain our investment grade rating. Those three criteria will continue to apply. Okay, so Jess is our operator here today. Jess, do we have any questions yet from the analyst team.

Operator

Yes, we have a few questions in the queue. The first question comes from the line of Andrew Sinclair from Bank of America. Please go ahead.

Q - Andrew Sinclair {BIO 17749036 <GO>}

Thanks, and good afternoon, everyone. Three from me, if that's okay. Firstly, you mentioned that you can optimize capital efficiency for BPA business and that should be better than peers given diversification of Heritage, just really wondered if you could give some context around that. What level of diversification benefit advantage do you think can be achieved and given the 5% extreme [ph] target remains higher than some peers. How will -- can this goes? That's question one. Question two, I know you've talked about partnerships with your and for Asset Management, but with your in-house expertise building to very interested in-sourcing some of the asset management services currently outsourced how much can be done without partners.

And third, was just on Europe. I'm trying not to ask you something candid. But you talked about strategic optionality, just really interested, what would you do with any proceeds if you were to dispose off Europe or anything else for that fact and (inaudible) future M&A get back to shareholders, interested in your thoughts there.

A - Andy Curran {BIO 18816863 <GO>}

Okay. Thanks very much, Andy. So I'm going to get Rakesh to answer the -- your first question around BPA, capital efficiency and diversification with the rest of the book of business. I'll get Mike to answer the second question on asset management partnerships and in-house and I'll pick up the -- your third question, I'll do that but first if I may, on Europe.

So I mean, we've got a significant presence in Europe, established businesses, geographic focus obviously being Germany and Ireland. I've always said that I think that gives us potential strategic optionality whereby we could take our unique M&A capability that we've deployed in the UK and move it internationally, but we have had a number of approaches for those businesses and have concluded the right thing to do is just to stand back and think about our strategic options, very early stages, no decisions made on which option we might pursue and certainly thoughts of early to be thinking about what we may or may not look to do with any proceeds if that was the conclusion we came to needless to say, we will update you as and when there is anything more to say.

Rakesh, do you want to pick up the -- Andy's first question?

A - Rakesh Thakrar {BIO 20549114 <GO>}

Yeah. Thanks, Andy. So your question Andy was around the potential capital efficiency between Open and Heritage. And as I both myself and Andy currently have explained, what we're trying to do is get that 8% BPA strain down 2% to 5% and one of the ways to do that is looking at our capital efficiency and our internal model.

So, currently, as you know, we've got two internal models. We've got approved legacy Phoenix one, and we've got approved legacy Standard Life one. Now you can imagine the Standard Life one is the Open business mostly with the workplace and custom savings and investment within that Standard Life internal model and within the legacy Phoenix one, you've got the primarily the Heritage business, which includes the BPA business.

At the moment what we do is really the sum of the parts, so we are not taking any benefit because it's really just adding the two together. What we are hoping to do with our internal model harmonization program is really offset those risks that are dominant in each of those two different models.

So for example, within the legacy Phoenix, you have longevity and credit given what we're talking about in terms of BPA. But in the workplace you have persistency risk. And you bring those two risk together, you get diversification and that is the benefit of having a Heritage and an Open business.

A - Andy Curran {BIO 18816863 <GO>}

Thanks Rakesh. Mike, do you want to pick up the second question.

A - Mike Eakins {BIO 21096986 <GO>}

Thanks, Andy. And the question was around the -- our use of partnerships and the fact that we're expanding our expertise in-house. Well, look, in response to that, ASI our absolute core strategic asset manager. And we do a number of great things with them. Well, and we've got a real structural advantage because we can partner with organizations like ASI but also we can go anywhere else in the world and partner with other asset management -- managers to tap into their expertise and that's particularly important when we are focused on liquid assets, it's also critically important what we want to be best-in-class in terms of sustainability.

So using -- partnering with asset managers will absolutely be the core, but what I would say is and I referenced this in my presentation, we will build out our liquid asset origination by doing so directly and having relationships directly with borrowers, but that will really augment the liquid asset origination that we do with our asset management partners.

A - Andy Briggs {BIO 4311809 <GO>}

Thanks, Mike. So just to be clear, we will do some -- direct liquid asset origination, there's no plans for any direct Asset Management beyond that consideration. Jess, do we have. Next question please.

Operator

Yes certainly, so the next question comes from the line of Greg Patterson from KBW. Please go ahead.

Q - Greg Patterson {BIO 21641359 <GO>}

Good afternoon, gentlemen, can you hear me. Ladies and gentlemen.

A - Andy Briggs {BIO 4311809 <GO>}

Yes we can. Greg, how are you? Good afternoon.

Q - Greg Patterson {BIO 21641359 <GO>}

Good. Surviving out (inaudible) as well and so. I'll do the traditional 3 questions, the first one is, you talk about GBP440 billion of the UK opportunity. I would like you to explicitly name the top 5 companies that contribute to that GBP440 billion please. The second thing is on workplace pensions.

In terms of the third, discreet third quarter, ignoring the business element. I wonder if you could update us on what the inflow item was and the upflow item. Just trying to get a sense of the COVID-19 headwind on workplace pensions net flows ex to business. And the third one, just in terms of the presentation.

Is it fair to say this is the first time that you explicitly dropping your M&A criteria that the price of a deal had to be below own funds. I note the examples cited in Slide 75 about old mutual wealth. So I just want to know if you formally dropping that criteria. Thank you.

A - Andy Briggs {BIO 4311809 <GO>}

Thanks, Greg. So we have Andy Curran with us in lockdown in Tier 4 in Glasgow. They don't let him out. So I'll get him to take the second question in a moment. I'll get. I wasn't aware we had a criteria that says the M&A would be below own funds, but I'll get Rakesh to answer that one, because he will have the history of what we've said historically probably better than I do. And let me answer the first one in terms of GBP440 billion opportunity. So what we covered in our slides today was to say that kind of roughly half of that opportunity is books of business over about GBP50 billion and roughly half of it is below GBP50 billion. I can judgment in working this out is what basically looking at with profit books of business and we're looking at things like unit linked bonds or old legacy personal pensions what with aren't actively marketed for new business aren't open for new business coming into them.

I'm not going to name specific competitors here, Greg but that's that kind of criteria that leads us to come up with the GBP440 billion as a whole and is a combination of some larger ones, and a lot of smaller books as well.

Andy, do you want to pick up the workplace question please.

A - Andy Curran {BIO 18816863 <GO>}

Yes, of course, I think I heard the question correctly. We currently Greg have -- we have around 11% market share of the workplace market at the moment and we expect that to grow as I said in the -- in my presentation from basically -- we expect the market to grow from about GBP400 million to over GBP1 trillion over the next 10 years, really important dynamic going on in the market, which is that transfer from an own trust master trust, which I think is really, really important. If your question is underlined by a question about how deserve long-term cash generation here with it. Last year's numbers were slightly inflated through the change in contribution rates, significant change in contribution rate for ultra low schemes, whether the base level went up from 5% to 3%. This year we expect to have another solid year in the workplace. But as I said in the presentation, very, very bullish about the proposition going forward. A whole series of interesting developments in our place -- market and we feel really, really positive about it going forward. Andy that was the best you could do. So I couldn't quite hear the question

A - Andy Briggs {BIO 4311809 <GO>}

So the other point that Greg was asking is, what impact is COVID had on the flows in our workplace pensions book?

A - Andy Curran {BIO 18816863 <GO>}

Yeah. Not very high, around at the moment from what we've seen is (inaudible) have dropped by about 7%

A - Andy Briggs {BIO 4311809 <GO>}

And that's probably pretty much a market wide impact, basically the impact, a combination of some level of unemployment, but also a lot of schemes where people have gone on to furlough. Although the -- in furlough, the furlough will cover the auto enrolment contribution, it only covers the minimum 8% level. So schemes are paying at a higher level than that. We've seen the level come down. So the net effect is about 7% impact. So financially on us pretty insignificant. Rakesh, M&A criteria?

A - Rakesh Thakrar {BIO 20549114 <GO>}

The M&A criteria. Just a reminder. So the M&A criteria that we have. So one has to be the strategic fit to the rest of the Group. Second is value accretion. Third is investment-grade rating, maintaining the investment grade rating. And fourth is maintaining our stable and sustainable dividend. Now Greg, as I understand your question was around value accretion. Now usually when we look at value accretion, one measure is looking at the discount to own funds.

But what I highlighted today in my presentation is the way we actually look at M&A internally and then look at the output of that and see what does that mean in terms of the percentage of own funds. So you would have seen that when we look at that calculation. We look at the organic cash generation that the target will bring.

We will then look at the incremental cash generation from the synergies and management actions will have on top of that and then using a discount rate that we -- the weighted average cost of capital and the risk premium on top of that, which will define the uncertainty and the return we want. We will then calculate the IRR, if it meets our hurdle rates. We will then do it. And you saw from Andy Moss's presentation. An example of why you could get a situation when you apply that scenario where with the Old Mutual Wealth example, where although initially it was below -- above own funds in terms of the price paid, by the time you did all those management actions and synergies and bringing it on to your own platform and getting the benefit from a lower expense cost per policy, you end up in a scenario where you actually having paid 76% of own funds.

So I'm not saying, we are dropping that own funds as a metric. What we keeping is value accretion and there's a number of ways to look at that.

A - Andy Briggs {BIO 4311809 <GO>}

And I guess another good example of that in practice has been the way that in the 3 months since half year, our solvency ratio has gone from 150% to 159%. So when we do these M&A deals, we're able to move rapidly in terms of both cash generation and capital synergies and hence improves our capital position. Jess, next question please.

Operator

The next question comes from the line of Steven Haywood from HSBC. Please go ahead.

Q - Steven Haywood {BIO 15743259 <GO>}

Good afternoon and thanks very much. On your UK M&A opportunities, can you give us an idea of what your potential firepower is here without coming to the equity market. And also what the competition is for that books, especially now that you've taken out your base competitor. Second question is on the BPA environment and again on the competitive landscape here. What is the situation and also, how rather discussions or the consultation process with the regulatory going on potential changes to risk margin and the matching adjustment, what could that mean to your new business strain or potential ability to do more BPA in the future.

And then finally from the -- this new long-term free cash generation, I assume it's in undiscounted basis. But I think you've given at the end of 2019 but surely at third quarter 2020 stage is GBP14.1 billion is maybe GBP1 billion higher already due to the cash generation throughout this year. Thank you.

A - Andy Briggs {BIO 4311809 <GO>}

Okay. Thanks so much, Stephen. So I'm going to ask Andy Curran at the moment to talk about the BPA environment, but I'll ask Rakesh to pick up the -- you managed to get five questions and I think this is good effort, Steve and very impressive to pick up the regulatory risk margin elements of that. Rakesh will also pick up the long-term free cash generation point. On the UK M&A, I'll ask Rakesh to talk about the firepower we have. I'll just quickly touch on the competition point. So I mean it is fair to say that the previously the two main players and this would have been Phoenix and ReAssure and obviously, now we've combined together, but there is a lot of private equity interest in the UK insurance market at the moment.

Generally that focus will probably be at the smaller end rather than the larger end, so I'd expect the smaller end would be relatively competitive that the larger end of deals, I think we feel like we're pretty well placed. And I really would emphasize the things we talked about in the presentation. The kind of strength of our credibility as a partner, our track record of doing deals, access to funding, our strong track record of doing Part VII, it does make us a very attractive counterparty for people within this. Rakesh, do you want to pick up the five fire power points, the regulatory risk margin type environment of the long-term free cash, and then I'll come to Andy for the BPA competitive landscape.

A - Rakesh Thakrar {BIO 20549114 <GO>}

Yes, so let me pick up the fire power. So I think, in one of the slides Steven, you would have seen that, how much cash we will have at the end of 2023. And that was 1.8 billion. Now when you are looking at the context of any M&A, you've got to look at what the target is, what the target's leverage ratio is, what is Solvency II surpluses, based on what we think will happen over the next 6, 12 months our fire power, assuming it's in line with our expectations. We could have up to GBP1 billion, GBP1.5 billion to spend on on an acquisition. But as I said, it depends on the target and the characteristics, based on the

Solvency II surplus. The ratio and its leverage ratio. So then moving on to the risk margin landscape. So clearly, we're onset of Brexit and we really welcome the treasuries call for evidence on Solvency II and the framework. Now we don't expect any changes immediately. This will take time, but certainly, as many of us in the industry will be saying, the risk margin is currently at 6% and it's high relative to our interest rates today, and the fact that it has a double impact also on your SCR when you get that movement in interest rates.

So certainly, what we would be looking for is potential reduction in the risk margin, which will then help the industry and also help the BPA market because it means though that new business would mean the capital cost of that would be that much lower. And then, Steven. Just on that final question about the long-term free cash. Yes, absolutely, you're right. It is undiscounted and I think the point you were making is that when there is a cash generation should that GBP14 billion number that we indicated at the start of this year. The GBP14.1 billion. Would that go up? And the reason it doesn't. The answer is it doesn't go up. And the reason is because what we've got in that calculation is that GBP19 billion of cash and we've got the holding company cash as well.

So really what's happening is you just got a transfer of cash from that GBP19 billion to the holding company Group cash. So overall, there should be no change. The drivers of that long-term cash will be when we write new business or when we deliver -- over deliver on management actions and create value accretive management actions. That's not in the original GBP19 billion.

And the uses of that as I said in my presentation will be the debt interest, the dividends, the group expenses et cetera.

A - Andy Briggs {BIO 4311809 <GO>}

Thanks Rakesh. So while he is taking a look at it, is that there is a slide in Rakesh's deck, which effectively shows all -- but it hasn't got numbers on the bars that's the slide we will fill-in in our full year results in March. So it shows you the different components that might move. Andy, I think, you probably didn't hear the last question, particularly well there in Glasgow but Stephen's question was basically in terms of the BPA environment, what was the competitive environment -- like around the BPA markets at the moment?

A - Andy Curran {BIO 18816863 <GO>}

Yeah, I think it's healthy, Steven. We expect the market demand to remain strong. We assess around about GBP2 trillion of liabilities, about GBP1.2 trillion of which are ready for buyout or buy in. So feeling pretty positive about the market and the prospects of the market.

As I mentioned, we are looking to allocate about GBP150 million to GBP200 million of surplus capital per annum in this market. We will always look at value not volume. So, this will not be a market share gain for us and will always be selective and proportionate. But overall, our sense is that this market has many years to go before there would be any significant contraction over the margin.

A - Andy Briggs {BIO 4311809 <GO>}

Thanks, Andy.

Q - Steven Haywood {BIO 15743259 <GO>}

Thank you.

A - Andy Briggs {BIO 4311809 <GO>}

Thanks, Steven. Jess, next question please.

Operator

Your next question comes from the line of Louise Miles from Morgan Stanley. Please go ahead.

Q - Louise Miles {BIO 20765435 <GO>}

Hi everyone. Hope, you are all doing well. Three questions from me as well please. So my first one is on the bulk. So I think you previously said that you won't have about 10% of your asset under management in annuities, and it looks like from one of the slides, you are aiming to write about GBP3 billion of bulk per year, and that looks like it's more than the (inaudible) current annuity book if you see the annuity books running off at 6%.

So I'm curious, did that 10% to get still relevant and I know you said that you don't want annuity to become too dominant part of your business mix, but can you help us to kind of quantify the optimum proportion of annuities within the book, this is first question.

And then on the same topic, looking at your Solvency II sensitivities, should we expect the credit migration and credit spread sensitivities to change as you increase your exposure to annuities on credit risk. And then finally, my final question is on one of the slide, you said that e [ph] ratio of 50% to 60% of the longevity risk to expel counterparties. Can you give us a bit of an overview of how this is across the new business arising and on the back book.

And then on Slide 72, it shows that one of the management actions you're going to do is the longevity reinsurance and does that mean you're going to -- your intend is to increase the percentage of longevity reinsurance across the entire book. Thank you.

A - Andy Briggs {BIO 4311809 <GO>}

Thanks so much, Louise. Yeah, we are all doing very good here. And socially distance with all. But -- so I'm going to ask Rakesh to answer the second question on the credit sensitivities. I'll ask Andy Moss to pick up the third question on reinsurance of longevity and management actions around reinsurance.

In terms of the first one, I mean, yeah, so I have said, I've talked about the fact that annuities got 38 billion of annuities circa 10% of our total balance sheet and we don't want to become overly dependent on annuities, what really matters is actually the proportion of credit risk as a proportion of our total risk in the SCR. And one of Rakesh's slides talked about that being 19%. So that is significantly less than a lot of our major competitors, and I think it's fine if that goes up a bit, because it's still a relatively small proportion of the balance sheet. We just wouldn't want it to end up being a much, much larger proportion in that. Broadly the kind of flows here is the 38 billion of in-force annuities will go down by the circa 6% a year and then, so well that's kind of about 2 billion off and then we're adding 3 billion back on again. So you can kind of see that given our total assets thought to grow as we grow our workplace business and investment returns on the portfolio as a whole, you can see how we wouldn't expect annuities to move massively as a proportion based on the selective and proportionate approach that we're taking. Rakesh, do you want to pick up the -- how the sensitivities might move over time?

A - Rakesh Thakrar {BIO 20549114 <GO>}

Yeah, absolutely, Andy. So I mean, what you've seen in that sensitivity slide, which was within Mike's section. Was that the credit sensitivities. And there were two that we showed, credit spreads widening and also a 20% downgrade across our annuity portfolio. Now, all other things being equal, you would expect if we writing more annuity business and if the total proportion of credits go up, you would expect that sensitivity to increase, but I would make 2 points on that.

One is, as you know, we are also looking at investing a lot of our credit from credit into liquid assets, which Mike has already spoken about, which we're well aware of. And second is Mike and his team actively manage this credit portfolio, they will do whatever it takes to make sure any risk to that is minimized and the sensitivities, we actually disclose do not allow for any management actions. It is a purely formulaic calculation that says if the spreads widened by this much. This will be the impact, but we know in reality there is action we can take to reduce that exposure.

A - Andy Briggs {BIO 4311809 <GO>}

Thanks Rakesh. And Andy, our king of management actions over there. He has done this GBP2.5 billion over the last 10 years with or without M&A, all good stuff, tell us a bit about the reinsurance management actions.

A - Andy Moss {BIO 19123183 <GO>}

Thanks for that great introduction, Andy. So Louise, thanks for the question. So what we've got on our slide though, as you quite rightly point out, we've got an action around looking at our longevity ratio wins next year that will be related to the ratio book, which is at a lower percentage than we have across the rest of our Phoenix book.

So we are absolutely planning to increase that ratio, obviously as we do that, we'll look at the optimal levels balancing off that the risk and the value that we can get from those reassurance deals.

A - Andy Briggs {BIO 4311809 <GO>}

Thanks, Andy. Jess, we go to our next question. But unconscious, we do have a hard stop at 4:30, so I might ask if people could ask their two most important questions, we'll get through more people's questions that way, if that's okay, Jess, who's next?

Operator

Your next question comes from the line of Trevor Moss from Agency Partners. Please go ahead.

Q - Trevor Moss {BIO 1741504 <GO>}

Hi Andy. My two questions then. Although, I'm afraid that they do overlap slightly with other people, but you talk about your Open business and then wanting to build complementary capabilities, which I totally get. What would you say are your top three complementary capabilities that you would like to build, i.e. are they asset origination, different product sets, what are your thought there. Things you'd like. The second thing is relating to one of Steve's question actually. In terms of the competitive environment of the deals, when are now used to be covering resolution back in the day, (inaudible) used to say to me that it was always very helpful to have at least two bidders on the -- sitting around the table because it gave the boards the comfort that they were getting the right price for the deal and the right sort of deal. But having taken out ReAssure, the sort of larger end, you haven't really got anyone competing with you even if you've got PA down at the bottom end. So I mean, how do you address that do you think.

A - Andy Briggs {BIO 4311809 <GO>}

Okay. Thanks, Trevor. So I mean I'll have a -- maybe ask Andy to comment more broadly on capabilities, but if the question related to Open business was around what Open business M&A might we think about, probably the way I'd look at it is to look at that customer life saving cycle kind of diagram. We looked at. So for example, in the early life stage, we said that the customer needs are saving -- starting to save to in accumulating towards retirement typically done through workplace pensions is our top three player in that market, we're well set, but the other need was around protecting their family income and health and well-being.

So a Group Protection business might be attractive as a fit to their but also diversify well with the rest of our group or potentially in the later life stage. One of the key needs was how might people release equity from their property to meet their needs in retirement, be that social care or higher level of retirement income. So that might be another example, which again would also support the illiquid asset origination of the BPA business. In terms of the -- in terms of looking at deals and the two bidders. I think where things have moved down from back decade or so ago is there has been lots of these deals that have happened in the market and that does then give a sense of what market pricing might look like and so ultimately I think my view would be that the strategic desire to offload the back book and refocus the group, any particular group on what it wants to do going forward.

That they can calibrate value and pricing relative to other deals that have been done in the market elsewhere, and therefore satisfy a board accordingly. And so on balance, my judgment will be it won't stop people from taking action on the larger books if that strategically what they want to do. And the other part of Trevor's question, just reference, what are some of the kind of capability builds that you're focused on in terms of the Open business. I know you've got great capability already in the team, but you are bringing more people in a number of areas yeah.

Q - Trevor Moss {BIO 1741504 <GO>}

Yeah on capabilities, as Andy says, we already have decent [ph] capabilities you get to AR already and be pretty successful so great capability, but we have a -- see the ambition as we've discussed. And one of the things I found in my experience working in this market is similar to Andy for well on 30 years now. Is that if you really understand the subtleties of each of the markets really, really well and are able to join up those particular darts from your Brexit to master trust to where the SEE [ph] are thinking about around your stronger nudge for people who are looking for advice and guidance, all of that sort of thing, and that sort of real depth of knowledge is really important to us and is something that we will continue to build out on and I would just echo Andy's points about the adjacencies from a business perspective.

A - Andy Briggs {BIO 4311809 <GO>}

Thanks, Andy. Thank you, Trevor, and Jess, next question please.

Operator

The next question comes from the line of Oliver Steel from Deutsche Bank. Please go ahead.

Q - Oliver Steel {BIO 6068696 <GO>}

Hi Andy, Hi everyone, I've just squeaked in it looks like. I'm going to keep it to 1 or 1.5 questions, which is, can you talk a little bit more about the assumptions within the 800 million of new cash being generated. And particularly the bulk annuity 5% strain figure. So are you expecting to get from this 800 million figure as early as next year.

And secondly, on the bulk strain figure. Can you achieve that as early as next year or when does the new internal model come through. And finally, does that 5% include a full 40% allocation in new business to illiquids?

A - Andy Briggs {BIO 4311809 <GO>}

Great. Oliver. Thank you. Nice to hear from you and Rakesh, do you want to pick those ones out. Please.

A - Rakesh Thakrar {BIO 20549114 <GO>}

Yeah, so let me start with the 800 million from our Open business. So you would have seen from the analysis in order to offset the organic generation runoff, which in 2020 we satisfy 800 million, we would need 800 million of new long-term cash generation. And that long-term cash generation we believe will be done from a combination of getting that -- targeting that BPA strain from currently, the 8% to the 5% together with improving our proposition on workplace and C&I to really get to the above that 800. That is going to be something that we will look to do over the next short to medium term.

And then certainly is on Andy current agenda as is our agenda -- Andy and I agenda as well. In terms of this -- the 5% strain, in order to get to that position as you saw in one of Andy's slide, it's a combination of number of things. If today, we were at 8%. You've got the capital efficiency. You've also got the investment in talent and capability and proposition. The restructuring, the reinsurance and you've also got the investment in the liquid assets and making sure we have the right assets to back those liabilities.

So it's a combination of all those three that will get us from the 8% to the 5%. And then I think just finishing off on the internal model harmonization, this is something we are absolutely working on. It's a complex program, is bringing two as I said approved internal models together and we are the first in the industry to do it.

We're making sure it's absolutely right. And it's really recognizes the benefit of bringing that Heritage and Open business together and we're hoping that application will go in Q1 and therefore allow us to use it later on in 2021 to really support Andy and his -- and Tom Ground in that BPA space as well as the wider organization in delivering our strategy.

A - Andy Briggs {BIO 4311809 <GO>}

So I think, Oliver, I will just very quickly add. Well, so we're not putting time scales of when we'll get to this 800 million long-term new business cash or indeed on when we'll get to the BPA strain just because this is an active competitive market. And we will make objective decisions about recycling our substantial excess cash, based on where it will be value accretive, and therefore, if the market moves around, different things happen, we will be disciplined.

We will put value over volume, which is why if we've got an integration we are doing. It's in our control. So we can say, here is when we're going to do it by and we'll do it by then. When it comes to Open businesses, you're in a competitive external market. We're not going to commit targets and timeframes there because we want to be able to be free to make the right commercial decisions in the best interest of shareholders over time.

And Jess, we probably got time for one final question, please.

Operator

The next question comes from the line of Larissa van Deventer from Barclays. Please go ahead.

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

Thank you very much. Just wanted to bode on the illiquid asset generation, my first question is actually going to be by win. But I believe you just answered that. And the second question is whether you are finding that there are sufficient deals that can meet your hurdle rates, or are you struggling to find deals that the focus returns in the market, and at what rate do you see them coming available for investments?

A - Andy Briggs {BIO 4311809 <GO>}

Okay, thanks so much, Larissa. Mike, do you want to pick that one up.

A - Mike Eakins {BIO 21096986 <GO>}

Thanks for your question, Larissa. So, look, as it relates to the liquid asset origination. As we said, we have very strict criteria over the investment criteria that we apply, and we have many hurdle rates in terms of capital, in terms of pickup versus the assets that we sell. And that's actually an important point just to focus on. When we invest in an illiquid asset, we are selling an existing asset. And typically, we're selling corporate bonds, which have an unsecured exposure, so we can sell a corporate bond invested in an illiquid asset, get a spread pick up, get a greater security and a higher rating. Now in terms of your question, in terms of deal flow, we're seeing significant deal flow. As I mentioned in my slides, we saw several hundred deals shown to us over the course of Q3 2020. We only allocate it to 12.5% of that, so it is really -- it's a numbers game in terms of making sure that we see the deal flow and that's why we're building out our capabilities in a liquid asset origination working in tandem with our asset management partners and building out our ability to do it direct.

A - Andy Briggs {BIO 4311809 <GO>}

Yeah, and I think it also feeds very strongly into our sustainability focus. So of the -- just over 1.5 billion we've invested in liquid assets this year, half of that has been into ESG base assets. So we not support that sustainability focus that we've got. That's all, so I am out of time. But thanks very much everyone for joining us today. It's been great to have you with us. For those of you on the sell-side, if you have any further questions, don't hesitate to get in touch with Claire and team and they will be to handle those. And then for those on the buy side, Rakesh and I are out on the virtual road next week, so from our living rooms we will be -- we've got time put aside for buy side investor meeting, so if anyone wants to follow up on anything, we'd be delighted to do so, but in the meantime. Thank you very much for joining us here today and we'll catch up soon. Thank you.