Q2 2015 Earnings Call

Company Participants

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

Other Participants

- Alan G. Devlin
- Barrie Cornes
- Gordon Aitken
- Greig N. Paterson
- Oliver G. Steel

MANAGEMENT DISCUSSION SECTION

Rodney Malcolm Cook {BIO 14008420 <GO>}

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

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

So, this is today's agenda. First, a brief update from me on the events of the last six months, and Simon will then go through the numbers in detail. At last September's meeting, you asked me to give you some idea of what the future would look like. David Cooper will give you our perspective by talking about the retirement income market and how it may develop after consumers get those greater freedoms granted to them by last year's budget announcement, together with, of course, our intended response to those changes. I'll then talk you through the outlook and we'll finish by taking your questions.

Once again, could I please remind you that we have a 30 of June financial year-end, which means that, of course, December is actually our half year rather than our full-year. However, we will try and highlight where it's appropriate on the occasions when we're referring to calendar years or calendar quarters.

This slide in your pack, and on the phone, it's slide number three. When I look at this, I'm astonished at the amount of change we've actually faced in the last year or so. And even though the IPO feels now like ancient history, it was actually less than 18 months ago. These figures that we're going to share with you today, of course, directly benefit from our strength in balance sheet, particularly in the case of the defined benefit market where capital strength is important.

The DB sales that we are announcing today for the last six months are more than three times what we wrote in the entire prior year. Although last September, we announced actual record sales and record embedded value, of course, the consequences of March's budget have still dominated our thoughts. This was particularly so, of course, for the individual business, and the IUA landscape probably won't be completely clear for yet another year.

However, we do remain number one in the individually underwritten annuity market. We have now received our 10th consecutive five-star award for service, and we are on track to deliver more flexible products from April, and we are already benefiting from our next-generation medical underwriting system tool called PrognoSys.

We believe few will have a better starting point than we do for adapting to this new world of retirement incomes in the U.K. We were particularly pleased with the Financial Conduct Authority's announcement in December, not just with respect to the benefits of shopping around, but also their clear view that for many customers, a guaranteed retirement income for life is more appropriate than drawdown. And that's an important message in the IFA community.

We also welcomed their recent January Dear CEO letter, introducing a requirement on product providers to create what's known as a second line of defense. The purpose of this is to ensure that people accessing their defined contribution pension savings do not inadvertently make poor decisions, as has been, of course, the case over the last decade or so. This should, for example, ensure people who would benefit from underwriting do not inadvertently purchase poor value standard products. I can also confirm that we have not been asked by the FCA to investigate our back book, so we can clearly concentrate on the future rather than on legacy issues. So, clearly, calendar 2014 delivered a relentless change for us, although, as you can see, the second half was not quite as momentous as the first.

So if I could refer you then to the next slide, four, which brings me to today's results, and I'm pleased to be announcing resilient sales and operating profit, and yet another record embedded value figure. Indeed, that embedded value has grown a further 7% in the first half financial year, and now equates to £2.05 per share. And, obviously, this captures only the value of the business that we have already written to-date and does not take into account the business that we will add in the future years to come.

As for the sales and profit, new business sales fell by 9% compared to the comparative period as you see, and underlying profit was down by 10%. Within this, our total annuity sales were down by only 4%, and this is combined with the fact that we were seeking to return to our target 25% of mortgages. That rebalancing has created a further break on the total sales, which is the sum of the blue and the gold and the gold bars. Under the circumstances, of a more than 50% fall in individual annuity sales, I believe these are very creditable results, reflecting the benefit of our now more diversified business, including defined benefit, and also the relative resilience of the individual business.

Simon will take you through the numbers in a moment. But I would like to stress my conviction that we remain a growth business. And talking about growth and sales, can I highlight the domestic growth in defined benefit volumes? Admittedly, as you can see from a very small base. It's also worth noting that calendar Q4 sales of individual annuities were modestly up on calendar Q3. Although we don't expect to grow DB business by anything like the 13 times pace shown here because of that tougher comparator, we do have a robust pipeline of business present. The DB unit will continue to grow. It is here to stay and it is an excellent match for our Lifetime Mortgage business.

That dramatic surge in DB business meant that this has actually eclipsed the size of our individual business in the half. And we clearly have a more diverse revenue base to rely upon now than we did a year ago. Although that middle chart only shows new business, if we were to maintain that current mix for a few years, then also our in-force profits would be more evenly split between individual and defined benefit derisking. Our growth trajectory is confirmed, if we look at the third chart on the right, which shows continued strong growth in our total insurance liabilities helped by positive inflows and, of course, market movement.

Unlike more mature insurers, we don't need to write billions in new business merely to make up for maturing policies. And our net inflows in this period remained firmly positive despite those falls in individual business sales. Our liability growth momentum should help us return to a growth trend in profits going forward, assisted by the in-force profit and the stable or perhaps growing new business result. So this is why we continue to be a growth business even if some of the growth drivers have now changed.

Before I let Simon give you the details of the numbers, could I just talk about defined benefit in a little more detail? I think we may have surprised you earlier by pointing out that actually defined benefit was now our biggest revenue generator in the half, in only its second year of trading. Although this may not be the case in every quarter, I expect it to remain a very material revenue generator in the years ahead.

Now within Just Retirement, we weren't surprised and, frankly, given the 179 years of defined benefit experience within Tim Coulson's 22-strong team of experts, we would have actually been disappointed if that hasn't made an impact in this market. But they are delivering more than we had expected and ahead of schedule.

We've consciously aimed in the defined benefit market for a larger number of medium-sized deals, and we actually wrote 17 full schemes in this half year. Also, in the case of larger schemes, we are able to help trustees by top-slicing the liabilities rather than derisking the whole scheme. And this concept is also gaining ground in the marketplace.

We believe that this approach mitigates for us the inherent lumpiness of the product. It ensures scalability and reduces risk for us. Taken together, we believe it makes for a more sustainable business model. And this is mirrored in our distribution approach and we work with virtually all of the employee benefit consultants who manage flows in the defined benefit segment.

As the chart on the right shows, there is significant scope for the defined benefit market to grow. And we expect the medically underwritten percentage of that to continue to increase. So we have a combination. We should expect to be able to compete for a growing percentage of the growing marketplace; so two important factors. Although our addressable market is, of course, really only schemes in a financial position where they can derisk, many years of asset liability matching initiatives by trustees mean that the demand doesn't just disappear overnight following a bad week in the financial markets like it may have done a decade ago.

Now, standard writers can focus on the largest schemes where mortality is more in line with the general population. And the medical underwriters, like us, will give trustees a fairer price if they have below-average longevity amongst their member base. As far as margins are concerned, Simon will confirm the current relative attractiveness for us of defined benefit over individual. So we remain optimistic that our defined benefit product will continue to develop positively.

Anyway, enough of that. Now, Simon, will you take us through the numbers in detail?

Simon George Thomas {BIO 15219564 <GO>}

Thank you, Rodney, and good morning. Let's move straight to the profit and loss account, the summary IFRS results. IFRS operating profit fell 13% to £34.9 million. This feels like a reasonably good result given the aftermath of the budget. Declines in new business profit were partly offset by growth in the in-force profitability.

The 33% fall in new business profit actually compares favorably to the 57% fall in annuity new business volumes. This was due to the very timely fruition of our DB business plan, which offset much of the decline in the individual sales. I would note that even the 57% fall in the individual sales is someway better than the most bearish forecasts after the budget.

I'll talk about margins more in a moment where, as expected, the fall in IUA volumes has led to some margin pressure partly offset by the slightly better DB margins. Nevertheless, measured by high new business profitability, with around half of our overall operating profits coming from the source, we believe that there's significant value in our ability to generate new business and that shareholder value doesn't reside solely in our back book.

Rodney has already highlighted the growth of the insurance liabilities, and this has been the main driver of the 21% increase in the in-force profits. Again, we'll look at this in more detail in a moment, but the key point here is that the in-force profits account for an increasing share of our bottom line, underpinning our profit momentum. So, overall, operating profit has fallen by about 13%, despite this being the first set of post-budget results. Below the operating profit line, we saw increased project expenditure in this half year as we developed our new products for the post-budget environment and incurred continued expenditure on Solvency II.

In terms of economic variances, the majority of this loss relates to two main items. Firstly, the mark-to-market effects in credit spreads on our portfolio, our corporate bond portfolio where they've widened from 130 basis points to 161 basis points over swaps; and secondly, the impact of falling interest rates which affects the HPI curve.

So now, just moving on to the top line in more detail. Total sales were up 22% again for the comparative quarter. So Rodney's right; we remain a growth business. Obviously, individual annuity sales were sharply lower, given the comparative was pre-budget. The fall or the year-on-year fall in Q2 sales was similar to the fall that we already disclosed in Q1. I would note that although Q2 sales were slightly up compared to Q1, I still think it's too early to call a bottom to the individual market. Consumer behavior in April and the effects of guaranteed guidance just makes it all too uncertain at the moment.

In sharp contrast, we enjoyed a significant pickup in our DB sales. Moreover, we have a robust pipeline and there's strong interest in this product. However, as ever, I'd remind you that this is lumpy business, and the underlying rate is probably closer to £200 million per half year once you exclude the two large cases of £75 million and £76 million.

So, overall, Q2 total annuity sales were actually up 39% compared to the prior-year comparative. And total annuity sales were up 13% in the second half of 2014 compared to the first half. You'll also see that we've now reset our lifetime mortgage volumes, so they're now closer to our optimal point of 25% of the annuities. And volumes there should broadly track in line with this level of annuities over time. Yields on the product continue to be attractive.

Now, before we move on, I thought we should just have a little bit of a closer look at the DB derisking. In the first half of our financial year, we wrote almost 4 times the DB premiums written for the whole of financial year 2013-2014 amounting to £355 million and, as Rodney said, across 17 schemes. We believe that the medically underwritten DB derisking is a product whose time has now come. We can help trustees save money especially in small schemes with below-average life expectancy. We also have the capability to write on a non-underwritten basis where our unique investment mix can enable us to compete effectively.

DB is now established as a core and strategically important product for the group going forward. There is a significant market opportunity and, again, although volumes are lumpy, we have a robust pipeline and good momentum. Eventually, we believe that it will become standard practice for all small DB schemes to be medically underwritten.

Now moving on to the IFRS new business margins. As expected, margins for individual annuities deteriorated in the first half as the laws of supply and demand asserted themselves. Put bluntly, you can't experience a halving of market volumes without seeing a fall in the individual underwritten annuity margins unless you see a significant withdrawal of capacity, and that didn't really happen.

Margins on DB, as we expected, were slightly better than those for individual annuities, with no equivalent driver of margin pressure on medically underwritten DB business. And the beneficial mix effect meant overall IFRS new business margins fell to just shy of 3%. I have to say that I wouldn't expect to see any driver for improvements in margins in the second half given the continued uncertainty in the individual market.

Now moving on to in-force margins. In contrast to new business, the in-force profits grew 21% against the comparative six months to December. Obviously, the fact that the opening liabilities were 18% larger than prior year was the dominant driver.

The in-force margin is equated through an annualized rate of about 76 basis points per annum, slightly up from 74 basis points in the H1 2013/2014. This modest increase was a function of the widening of credit spreads, which has slightly increased the amount of spread available, which also increases the level of default reserves emerging into the in-force profit. As we saw before, on the face of the profit and loss account, the valuation effect of the change in spreads comes out in the economic variance line.

Now moving on to another one of our key performance indicators, embedded value. I'm pleased to announce that, for the first time, it exceeds £1 billion. That equates to about £2.05 per share. We saw a 15% annualized rate of growth in embedded value which was helped by the new business contribution of £49 million net of tax, the return on the opening embedded value and net economic effects, particularly caused by the significant falls in interest rates.

And finally, touching on capital and dividends. As the figures show, our capital position remained comfortably in excess of our target cover ratio. We continue to primarily focus on economic capital. And on that basis, our coverage ratio of 171% remains well above our 140% internal target. The fall in the ratio mainly reflects the significant falls in interest rates, bond spread widening and a small impact relating to writing of new business, offset by some asset optimization as we focus more on our Solvency II position.

I'll briefly mention Pillar 1 here, where we've seen a fall in the coverage ratio. Now, for the avoidance of doubt, we don't manage the business on a Pillar 1 basis and, in fact, in the last six months, as I said, we started to move the balance sheet to tune it in relation to economic capital and the expected forthcoming Solvency II position. And as you're probably well aware, both of these bases are essentially calculated on the 1-in-200-year stress. These activities are inefficient for Pillar 1. The impact of which, when combined with the significant falls in interest rates, have led to about a 45% point drop in that ratio.

Now, turning to dividends. We're today announcing a £0.011 interim dividend and in line with our one-thirds/two-thirds approach as applied to our notional full-year payout. Given the level of interim profits and the uncertainty around the budget, the board felt that this was the appropriate level. We fully appreciate that the dividend represents a direct contribution to the shareholder value, and we certainly understand its significance.

Solvency II is nearly upon us and our internal model application is well advanced. I note here on the slide that there are still some significant principles that are yet to be agreed and defined. We have, however, noted the apparently helpful news on lifetime mortgages issued last Friday.

That ends my part of the presentation today. I will now hand over to David who's going to tell you more about our plans for the new world of retirement income.

David Paul Cooper {BIO 15900182 <GO>}

Thanks, Simon. Good morning, everyone. As Rodney explained, there have been a near-constant flow of communiqués from market influences during the past year. The top five takeouts for us are, first, drawdown, when used to generate a sustainable income stream, is not appropriate for a significant number of retirees; second, drawdown and guaranteed income for life solutions operate on the same level playing field from a taxation perspective; thirdly, from April, legislation will enable increased flexibility to make guaranteed income for life solutions more attractive; fourth, customers will be provided with additional protection, product providers and pension schemes will be mandated to work harder to ensure customers do not continue to make poor choices, choices that could be avoided with the active intervention by the product provider or scheme; and finally fifth, the government's guaranteed guidance, known as Pension Wise, will be delivered on time.

During the year, countless research exercises have been undertaken to determine the likely behaviors of retiring consumers in the new world. We have assimilated the output from a number of these studies, which have been conducted by a wide range of credible organizations as shown in the footnote on the slide. We have gathered together similar questions and answers from these studies with the following results.

First, the proportion of retirees who intend to take their entire pension fund as cash was between 7% and 15%. This clearly supports the belief that most pension savers associate their funds with producing some benefits for them in later life, and perhaps not the infamous fast sports car.

Second, the proportion of retirees who stated that a guaranteed income for life was an important or crucial part of what they intended to use their pension savings for ranged between 58% and 75%.

Thirdly, the segment of people prepared to subject their pension savings to investment risk is relatively small, ranging from 5% to 15%.

And finally, the proportion of consumers that stated that they intended to use the government's guaranteed guidance service was between 5% and 90%. I'm not sure consensus is quite the right descriptor there. So that's not particularly helpful. We'll just have to wait and see. We are fairly sure that the telephone channel offered by TPAS will be the preferred route for consumers there, though. So the key takeout is don't expect a revolution, more an evolution in the way that people behave.

So, on to our response, there are four components which make up our new solution which we will start launching in April. Firstly, in the next two weeks, we will launch a comprehensive online resource which guides consumers through the various stages of planning and their options at each stage. This resource will be available to all U.K. consumers and is part of our strategy to build the awareness of the Just Retirement brand. We've also developed a range of planning tools to help people understand, amongst other things, the impact of tax, the effects of longevity and the potential to run out of money and also the way to calculate their essential expenditure and how to ensure that this is covered under any circumstances.

Secondly, we are developing an in-house simplified advice service. This is designed to assist the many thousands of retirees who have never used traditional full-advice services and who have therefore tended buy often poor value annuity solutions from their seeding provider. This service will initially be used by customers of our corporate partners who will promote this service. It will also be used by our subsidiary, TOMAS, for the retiring members of their corporate pension scheme customers. Protecting people from making inadvertent poor choices and helping them to find good value will continue to be a high priority for the industry. We expect to be at the forefront in developing and launching a credible simplified advice solution.

Thirdly, we have developed a state-of-the-art Just Retirement investment platform working with a leading platform provider. In the next few slides, I'll show you how a customer will use this flexible pension plan, but, in summary, this is a solution that enables customers to keep a lump sum of money within the tax-efficient pension environment for future access. The flexible pension plan will initially have a focused range of passive funds designed for that target audience.

Our focus continues to be on middle Britain customers, and our flexible pension plan will be used in conjunction with the next generation of guaranteed income products, which finally takes me to our guaranteed income for life solutions. These have been modernized to take advantage of the flexibility that will be available when the laws change in April.

We will be able to facilitate minimum periods of payment extending to any number of years in order to comfort those worried about early death. And in doing so, create a money-back guarantee which will be attractive to many advisers and their clients. We will be able to facilitate the payment of taxable lump sums in addition to lump tax-free cash for those who want more than 25% but wish to preserve the remainder for income purposes.

Over time and where we identify material customer interest, we will add further features to our guaranteed income for life solutions. These will reflect the HMRC rule changes that permit people, for example, to guarantee payments to increase or fall in the future or that start at a future date. Our retail guaranteed income for life solutions will all be underwritten by PrognoSys, our IP which we have told you about in the past. This means that no person will be turned away. Every retiree will be offered an illustration providing an income rate, including those that have no medical conditions or adverse lifestyle factors.

Right. I'll now show you how all this works in practice. Perhaps I should add that this isn't just how we see it working. We have undertaken our most ambitious customer research and testing to inform our proposition development. This revealed that a significant proportion of retirees value both flexibility and guaranteed income. To-date, the industry has tended to offer drawdowns to those that want flexibility and annuity to those that can't risk having flexibility. By combining a simple fund proposition from our platform with our leading individually underwritten guaranteed income solutions, retirees really can have the best of both worlds. Let me try and bring this to life by the logical thought process that people tend to go through.

Firstly, framing is very important. People think more logically about how to use their assets when they start by figuring out what their essential regular expenditure is. They then start weighing up their central money pots: state pension, any defined benefit pensions and then any defined contribution pension pots. They then start to match these assets against their expenditure, starting with the guaranteed income from the state pension, then any DB and then DC.

Their target, equilibrium and peace of mind; when the income generated from the money pots equals their regular expenditure. Some middle-Britain retirees will have pension assets in excess of those required to match equilibrium. I'll address this in a moment. We discovered, and this is consistent with the other studies I referenced earlier, that three-quarters of people described wanting to use some or all of their pension savings to generate a guaranteed income for life to ensure that they can pay their regular bills.

With people with excess assets, they have a number of choices. They can withdraw them from the pension environment, but, of course, this exposes the customers to the risk of paying excessive income tax, or they can purchase more guaranteed income, or they can keep them flexible within the tax-efficient pension environment for use in the future.

I've called this a flexible fund on the slide or, as I described earlier, the flexible pension plan. This is a simple storage solution with a focused range of passive funds designed for the cautious middle-Britain target audience that I mentioned. I want to distinguish our flexible pension plan from traditional drawdown, where people attempt to generate a sustainable income directly from their investments and subject their pension savings to performance risk.

The flexible pension plan is an essential component of the customer proposition. People have become very interested in keeping some money aside. You might call it a just-in-case fund. I describe it as essential because there will be some people that are not prepared to commit all of their pension savings to generate a guaranteed income for life, regardless of whether they meet full equilibrium. So having this capability will ensure that we continue to meet the needs of our heartland customers, as well as reaching out to customers who want to derisk their drawdown investments.

Finally, in our research and development, we explore how people might use the flexible pension plan going forwards. We use various techniques to do this, but the one that I'm going to show you here is to assume that customer is now 10 years post their initial purchase.

People recognize that the price of bread and milk will have increased and, therefore, they now have created disequilibrium. They recognize that they could use some of their flexible pension plan to regain equilibrium by purchasing further chunks of guaranteed income. We found this very interesting. We know that people don't like purchasing unit-linked annuities, but when in a position of being out of balance, effectively, they are creating the new day zero. They want to reach balance again. Another observation is that they will also benefit from increased age and possibly poorer health when they top up. The other use of the flexible pension plan is more obvious, unplanned irregular expenditure, a solution to the just-in-case need.

So, overall, we believe this approach will discourage retirees from encashing all of their funds just because they don't want to commit everything at a point in time. It will be attractive to those who historically purchase annuities and those who wish to continue with drawdown. It can be accessed by all retirees regardless of health or wealth.

So I hope this is clear to you all. And I'll now hand you back to Rodney.

Rodney Malcolm Cook {BIO 14008420 <GO>}

Thanks, David. Before questions, I'd like to speak a bit about what the future may hold. And I hope, through our results today, you have some insight into our result and how we have achieved growth during adversity.

The market for individually guaranteed retirement income for life remains hard to predict, of course. But David has just given you a taste of our product plans, and I'm sure you will see we are as well positioned as anyone to give customers in our target marketplaces what they want. And although some future retirees say that they don't want annuities, the majority of them, in fact, do want a guaranteed income for life.

So, through our underwriting skills, we can offer many of them a better rate, whatever they happen to choose to call it. And for those with surplus assets, having secured their guaranteed income, we can offer them a flexible product which allows them to leave their money at work in the market until they actually need to draw on it in the future, or, in fact, as David showed, convert it into additional chunks of further guaranteed income.

So, as for the defined benefit market, it was largely unaffected by the budget. Likewise, the lifetime mortgage market was not impacted by the chancellor's announcement. And then there was a positive announcement from the PRA on Friday. So, for two of our three product sets, we have not suffered any regulatory disruption and the outlook is very positive for both of them. On the individual side, the outlook is, as we said, less clear, but we are as well positioned as anybody in the individual space.

So, to the outlook. While the individual market appears yet to have found a stable level, we are optimistic that the growth in defined benefit and mortgages will propel our overall sales activities, although perhaps not at the former growth rates until that individual market settles down and grows again.

We have actually invested a considerable amount in developing the new propositions David has shared with you, and we are optimistic that our customer-led strategy will drive growing retail volumes. As Simon has shown, we've got a nice balance now between profit-driven by our growing back book and the profit from new business. And I remain convinced that we have a strong and valuable new business franchise in addition to that embedded value.

We're not giving any formal guidance today, but I think Simon's comments on what he regards as the more normal levels of DB volumes, together with our sales to-date may encourage you to review your revenue figures up a little. But my key message to you is that we have returned to growth in both revenues and liabilities, and that this should flow through in time to profit growth.

So, before we move to questions, I want to conclude by saying that we believe these are strong results achieved in a highly-challenging market, allowing us to look forward with renewed confidence.

So, to Q&A, please, when we have a microphone. And after the Q&A from the room, we'll move to the telephone.

Q&A

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

If you could, just for the benefit of the people on the phone, say who you are. Thank you very much. Yes.

Q - Gordon Aitken {BIO 3846728 <GO>}

Gordon Aitken from RBC. Just three quick questions, please. One of your competitors says it will only write new business if there's no new business strain. Just wondering where you are on that.

Secondly, you talk about the competition from Aviva and Legals in your space in both individual and bulk. And also on buy-ins, I mean, buy-ins are a massive feature of the standard, I suppose, de-risking market. And longevity swaps (38:17 - 38:21).

Operator

(38:34 - 38:40)

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

Right. So, with regard to new business strain, as Shayne will be able to confirm, our business largely washes its face. We covered that with you in terms of the IPO and post the IPO. However, very clearly, it doesn't cover at the 140% level, which is our economic risk capital. So there is no surprise that new business over time will start to consume that economic capital ratio until the releases from the back book take over.

So, at the current time, our business is also just above the capital consumption point that our competitor's referring to. For the avoidance of doubt, if you ask them, I don't believe they would say that they're writing it as 140% or more of the capital requirement either.

In terms of competitors, it is a very competitive market. Just Retirement's success over the last 10 years has entirely been achieved from the open market. We haven't had advantage of existing customers that we could make offers to, like the large seeding providers do. So we do experience continued competition. And as Simon said, that competition has remained when the – an individual market halved in size, those competitors were still there, and that has had margin pressure and you saw the resulting fall in the margin.

In terms of the defined benefit space, our principal competitor in the underwritten bulk annuity space is Partnership Assurance, although both Legal & General and Aviva will participate. But this is our expertise. As I indicated to you, I recruited a team which is now 22 strong over the last – which is now three years from when we started. So we brought expertise from our competitors. They're fully capable of writing on a non-underwritten basis. And what we have added to their skill set is the ability to underwrite. So, perhaps in that sense, we have slightly less competition than in the individual market.

Gordon, it is the normal process of going firstly to buy-in, where the trustees have the relationship with our company and we provide them with a bulk settlement every month. And then later on, they move to buy-out, where the relationship is direct with the individual members. And then, of course, they have full security for their benefit.

So, although we've only been going a year, we have already had a couple of our plans move to that second phase. So it is our expectation, and it is also the trustees' expectation, that we will make those two steps. But as far as I know, we haven't had any that came in with the concept of buying out on day one. It has been in those two stages. Shayne, just a quick comment on the washing-its-face expression?

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

Not much to add to what you said, Rodney. I think particularly in the individual market, it will be very difficult for anybody to stay in their writing business without any new business strain, where that means literally just looking at the balance sheet relationship between premium and reserve. But obviously, the important thing is how the overall capital position works out.

And as Rodney says, as we've said before, our business, broadly speaking, washes its face on both a Pillar 1 basis, although we're less concerned about that now, and the economic capital basis, but at somewhere between 100% and 140% and, therefore, you do get dilution over time.

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

Right. Next question.

Q - Barrie Cornes {BIO 2389115 <GO>}

It's Barrie Cornes from Panmure Gordon. I've got three questions also if I may. First of all, David, you mentioned about Pensions Wise being up to speed 6 of April. Just wondered how come you're so confident given that a lot of people are very suspicious about when the system will be in place?

Secondly, platform provider. Can you tell us who it is and how it works, the relationship and how they're remunerated? Is it a JV? Is it a policy or whatever?

And the third question is one of your competitors is looking to move and use the underwriting expertise overseas, in the U.S. I think. Just wondered if you've got any plans for the concession? Thank you.

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

On Pension Wise, I'll be honest, I'm principally reiterating what government have stated, or what HMC (sic) [HMRC] (43:47) have stated. I think it's fair to say they will be ready. The question is whether – or the question is what volume they can actually handle over what period of time, so how long will consumers need to wait for their appointment and so on.

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

In terms of the platform provider, we can't announce today the name of the company, but it is behind some of the biggest and strongest and most modern.

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

What we can say, though, as well, is what we have done is a software deal with a provider, not an existing commercial platform provider. So we're effectively paying software license fees and have created our own personal pension plan on that platform, on that software.

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

So we have brought their software in-house. We are proposing then to connect it into all of our systems so that we can give customers, longer term, a joined-up view. And we believe that that will be a longer-term competitive advantage because other companies, with perhaps more legacy systems, will find that a major challenge, just as some are finding it a challenge to be ready for the new legislative rules that come in on the 6 of April, especially if you have more than – I mean, I do feel for them. They do have more than one platform, and as a newer company, we have one platform.

In terms of international, forgive me, the RNS is 51 pages long. But in there, we did announce to the market that we have successfully received a license to transact retirement income businesses in South Africa. I did share with you at the IPO that we have a small beautifully-formed team looking at international opportunities, and that we have a specific opportunity in mind. And clearly, over the last couple of years, we've built that up. So we have a full team of experts in their market in South Africa, about 12 strong. And we have now received a full subsidiary license from the South African regulator. And that market has a number of the unique characteristics in it that we observed from back in 2004 when Just Retirement entered the market there.

At the current time, you might say that their market is about a sixth of the size of the previous £14-billion annuity market in the U.K. Perhaps after April, that percentage will be higher than a sixth. They are also proposing both TCF principles, Treating Customers Fairly principles, which is Just Retirement's expertise and, more importantly, retail distribution review has been carried out in South Africa. So we saw a unique combination of similar characteristics to the U.K. that we felt we could exploit.

Next question.

Operator

Thank you. Alan Devlin from Barclays.

Q - Alan G. Devlin {BIO 5936254 <GO>}

Alan Devlin from Barclays. A couple of questions, first of all, on the pipeline for bulk annuities, which I think you said is healthy. What are the funding levels of those pensions in the pipeline? Do they tend to be already derisked so the (47:26) impact your decision to do you buy-in or a buy-out?

And then secondly, on the new business strain, is there any difference between the new business strain on the DB business and individually on the written business? I know you said the margins are slightly higher in the DB business.

And then a final question on your flexible pension plan. How are people going to access this platform? Is it going to be recommended through IFA? Is it going to be direct? How do you expect people to actually get onto this platform? Thanks.

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

Right. If I can take the first one. So the important point, of course, is it has taken some while to encourage the employee benefit consultants to understand the advantages for their clients. With respect to underwriting, we believe that that has now been achieved and the Hymans Robertson independent survey of that marketplace is predicting percentage growth in medically underwritten especially at the smaller end.

In terms of our pipeline, we have a robust pipeline, which has grown every half-year. So it continues to grow. As you are aware, there are three different stages of the pipeline. There are trustees who are starting to consider a buy-in. There are those that actually go out to proper broking; in other words, they're getting formal quotes. And then there's the third part where you either lose the contract, if you like, or you become exclusive and then you negotiate with the employee benefit and it's often the trustees to conclude the legal documentation. So we have cases at all three of those levels. We're not going to say precisely what the size of the pipeline because at this early stage in our development, we don't have a conversion factor that is established and known.

But as I said, we see two developments. One, the DB derisking market is going to grow in itself, and you saw on slide seven or whatever, that, but also, the percentages that will be underwritten that, therefore, is addressable to us will go up.

The strain. Shayne, can you just clarify the difference between the individual and the DB because of the reinsurance financing?

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

Yeah. Well, the simple answer is there's not much difference. As ever, there's a lot going on behind the scenes because they do differ in the product itself. The DB's got more escalation and, therefore, to the extent that we don't have the exact amount of indexing, there also might be some inflation exposure and so on. But the main differences are in the reassurance structures where we use a completely different approach to DB via a longevity swap, so a slightly more effective risk transfer than we have on the individual, but no financing. Put all other things in the mix, together with the margin difference, which is very slight, and the difference is very, very small, actually, but complicated behind the scenes.

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

So we would say rightly £100 million of DB business would affect that ratio by under 1% to the negative figure being up. Sorry, all other things being equal in the background.

David, just quickly IFA in partners, with respect to...

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

Yeah. And I think it's important to note that the proposition we are marketing to distributors is actually the combined as opposed to just the flexible who, to this point, we're not trying to compete with full-blown drawdown providers. We will be offering it to financial intermediaries for their low-end customers and then also for our own distribution channel, which is supported by rapid (51:38) partners and life companies.

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

Right. One more question before we go to the phones perhaps?

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

Oliver Steel, Deutsche Bank. Three questions. There have been quite a lot of questions on strain. Actually, if I can just ask the question a different way. The ROE you've got is actually quite low. What is the ROE you're expecting to earn on the new business you're taking on at the moment?

The second question is how different is this sort of combined flexible pension fund offering from what you think is potentially going to be offered elsewhere in the market?

And then the third question I've got is really just looking at the sort of breadth of the DB wins you've added for the last six months. So excluding the two big schemes, I think it's 15 schemes that you've won. How many employees benefit consultants have you won those through? What are the arrangements you've got in terms of how you're putting them on to your own book and can your systems cope with that?

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

Right. If I do the second one, I'll come back to Shayne in terms of the return on equity, Shayne. So the combined product, in terms of some sort of guidance with respect to margin, we're expecting to at least make on the guaranteed income part the same or better margins than we're making in the current annuity market, because we expect perhaps less competition, especially in the early days because we do think the combination product will be an early leader.

In terms of the component with respect to the assets within that wholly-flexi account, as David referred to it, we're seeking to break even approximately on that. Obviously, some of that will leave us, because people will spend it. But also, there's the opportunity for them to top up and then, in future years, we would capture the greater margins on further guaranteed income streams.

As I said, our business model for defined benefit was to write a larger number of smaller deals. So the real benefit to us of writing 17 deals is that we have touched, of course more than once, all of the top four players in the distribution space. There's in total about 20 actuarial and more if you regard them as, say, professional IFA firms that work in the corporate market that also may be involved in this.

And the critical thing for any new player is to gain the credibility of the employee benefit consultant. So what we are happy about is that now that we have completed 17 deals in a half-year, and we're not sure how that will compare to how many deals another company does, but each of them is a complete relationship building with the consultant, which is positive. We have completed the business on time, and we are gaining a very good reputation and credibility. And, in fact, we have already had one customer come back and ask for us to do another tranche of their business without further broking to the market because they were pleased with how it all went. So we see that writing the 17 has been much more valuable than if we'd written to, if that makes sense.

Shayne, can you help me with the return on equity question, please, in terms of the strain?

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

Yeah. I'll probably not be totally helpful I'm afraid. I'd answer in terms of return on capital, which is probably the metric that we might apply to new business. The issue is all wrapped up with the new business frankly, because most of the time, there is very little strain. In fact, sometimes it is positive, depending on exactly where margins are in the market. We find it not to be a helpful metric for pricing and we don't use it for pricing.

So I can't quote you numbers off the top of my head because sometimes they'll be infinite, sometimes if there is a small amount of strain, you will see numbers that look sensible or otherwise. So it's very difficult to give you a single answer I'm afraid.

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

But the question behind it is how did we (56:31).

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

Right. Well, maybe we can pick that up afterwards and you can explain exactly where you're measuring that metric, how you're measuring it and I'm happy to answer it.

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

(56:48 - 56:51)

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

Using...

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

(56:52) just taking your tangible book value and taking (56:55).

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

Right, okay.

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

I think, Shayne, you'll explain.

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

I think we'll have a chat with you afterwards.

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

Could I check whether there's a waiting caller online and then we'll come back to conclude with question in the room> There's four people.

Operator

We do have - apologies, sir. We do have a question on the phone line. It comes from the line of Greig Paterson from KBW. Please go ahead. Mr. Paterson, your line is open.

Q - Greig N. Paterson {BIO 6587493 <GO>}

Can you hear me?

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

Yeah.

Q - Greig N. Paterson {BIO 6587493 <GO>}

Welcome from cyberspace here. Just four quick questions. One is in-force margin, that's obviously a key driver of earnings. I wonder if you can give us some guidance for that for the full year, please.

On your income top-ups, will the client have guaranteed terms or will they have to be re-underwritten at each point?

I noted your sensitivities didn't work as you provided low interest rates, which has implied a positive, but you had a negative. You mentioned you've changed the ALM. I wonder if you can just discuss what you actually did and just give us some comfort that the sensitivities you're now providing, actually, are useful to us.

And then this is the fourth question is South Africa. I wonder if you'd just give us a feel for whether there are competitors out there in that market; and maybe you want to talk about AIDS for that, how you think about that in that market?

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

Just, Grieg, on the last one, how we think about what in that market?

Q - Greig N. Paterson {BIO 6587493 <GO>}

AIDS because AIDS is quite an issue in South Africa. AIDS. HIV, AIDS?

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

Yeah. Although I accept that it probably hasn't caused people to live longer.

Q - Greig N. Paterson {BIO 6587493 <GO>}

Yes, but can I just make a point on that? For instance, Old Mutual has made a fortune out of what they call their – they used to be called group schemes, they now call it mass asset, because they charge X, and the client sees that they're more – sees the utility of the product, but the reality is they charge – AIDS has turned out to be very predictable and they've got much lower cost. So I'm just wondering how that dynamic will play into your business model.

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

Right. So, Simon, just quickly the in-force margin, and can you say anything with respect to the full year?

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

Yes. I'll try, Greig. Morning. Clearly, you saw that the in-force margin on an annualized basis picked up to about 76 basis points, as I presented on the slide. Gut reaction for the remainder of this year, where it's a little bit difficult because, of course, credit spreads will probably change. But if they stay broadly where they are, I think that the 76 basis points, around that sort of figure, would be the full-year equivalent as well. So I wouldn't expect any dramatic change coming through there. But obviously, that's predicated upon the bond market.

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

The easy question - answer to the second one is no. We're not offering guaranteed annuity rates. So if a customer comes in 10 years' time, we will give them, of course, a very fair and competitive market quote at that point in time.

In terms of asset liability matching, we have, as Shayne indicated, made fundamental changes to our investment and hedging portfolio over the last six months and continue to do so, which, as Simon indicated, is not as effective in the Pillar 1 area. But of course, we are required very clearly to have a focus on the Solvency II environment in the 1-in-200-year.

Shayne, just a couple of bullets on what you've been doing there?

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

Well, effectively, it's also to do, as you say, with preparation for Solvency II, which uses IFRS fundamentally as its base accounting; whereas in the past, our regulatory capital, both Pillar 1, Pillar 2 and our economic capital have used a fair-value approach to the mortgages wherein when you then look at the liability side of the balance sheet, they're counted at a swap rate. So, as we switch into IFRS and look at the mortgages of actually contributing yield rather than balance sheet value, it becomes far more effective for us to use the mortgages to the maximum extent we can to back liabilities rather than corporate bonds because the spreads are much higher.

So, effectively, that's what we've been starting to do. And that means in this view as well, we've had some surplus short-term credit, which in terms of its contribution to the balance sheet, is inefficient compared with its contribution to the credit-risk capital requirement. So we've been selling quite a lot of short-dated low-spread credit.

So if you look in detail within the pack, you'll see that the amount of gilts on our balance sheet has gone up significantly over the period. And we also have been placing some of those gilts into the longer part of the yield curve in order to help with some of our interest-rate matching.

The sensitivities have moved significantly because the interest rates have moved significantly. We're now in a world which is over 150 basis points different at the long end from where we were at the time of the IPO. But more insidiously behind that, there's been a significant twist. So, if you plot interest rates, the 10-year and the 25-year, you'll see that there was a significant gap between the two at around the time of the IPO, and that has closed, quite significantly, actually predominantly in the period up to around June of last year. But it's continued to drift slightly closer ever since. Now that, because of the way that our hedges were designed, had quite a significant impact in the way that it changes the interest rate behavior of our balance sheet. I can't really go into any more detail than that.

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

Yeah. I think if we need more detail, you'd best do that offline.

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

Yeah. So the world has shifted.

Q - Greig N. Paterson {BIO 6587493 <GO>}

The key question is that you provide sensitivities. I don't know if you've provided it now. But if you have - or can we use them or is just sort of a random thing? I mean, I had plus 30 in and it ended up as minus 30 within the profit pot. So, I mean, how reliable are the - is the sensitivities you're providing now?

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

We've provided sensitivities on an embedded value basis. So we haven't, at this point, provided them on an economic capital basis.

Q - Greig N. Paterson {BIO 6587493 <GO>}

Okay.

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

So just quickly moving onto South Africa, there is the standard annuity market. And clearly, as I said, we would like to have a positive impact on that market by introducing our underwriting. We have a full reinsurer there with South African experience. So that's effectively, Greig, what we are doing. We're bringing the U.K. experience of underwriting guaranteed incomes for life and combining it with the reinsurers' South African experience. We're not assuming that everything we've learnt in the U.K. is directly applicable. So it will take us a little time to combine those two efforts.

Although we don't see anything in South Africa that's suggesting that their population will live longer than the U.K. population, which, of course, for an annuity provider is positive. There is one very small private firm offering some underwriting, but clearly, we want to develop that market further.

Time has got away. Is there one last burning question in the room before we close?

Okay, no. Well, ladies and gentlemen, thank you very much to those on the phone and here in London. Thank you very much.