2014 Full Year Results

3 March 2015

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Agenda

Introduction	Steve Groves | CEO	
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Introduction
Steve Groves

FY14 results summary

	FY13	FY14
New business sales	£1,229m	£791m
New business operating profit	£86m 7%	£39m 4.9%
Total operating profit	£131m	£64m
Economic capital coverage	159%	Proforma 159%[1]
MCEV per share	130p	144p
Final dividend	3p	1p

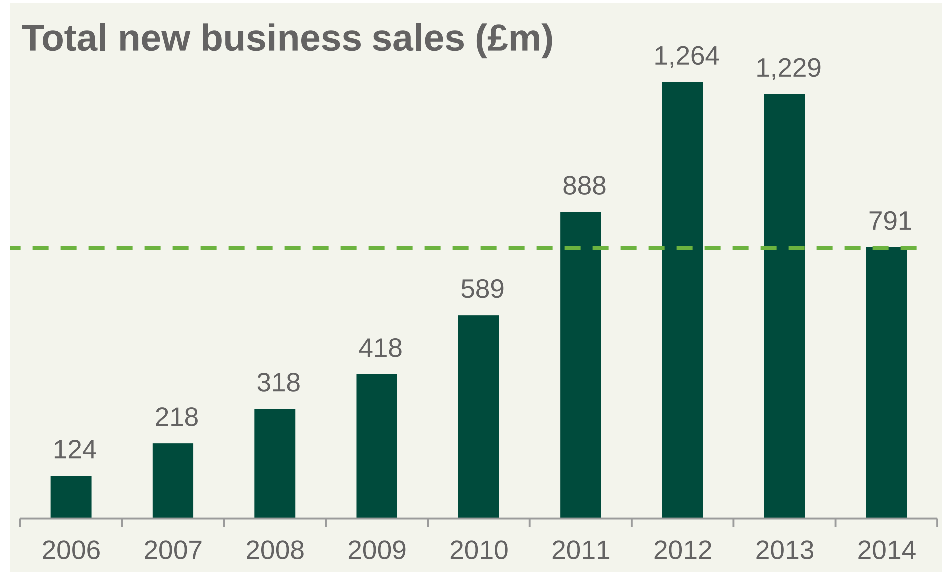
(1)) 134% at year end. Proforma position takes into account £100 million bond issue

Financial review

David Richardson

Challenging year for core annuity product, but encouraging development of DB proposition

£m	FY13	FY14
Individual annuities	1,076	466
DB bulk annuities	84	247
Care	66	76
Protection	3	3
Total new business	**1,229**	**791**



- FY14 individual annuity sales at 43% of FY13, including impact of significant deferrals in advance of new regulations being implemented
- Near 3x increase in bulk annuity sales vs. FY13. Proposition strengthened and extended to include top slicing and selective risk removal
- 15% increase in care annuity sales following advisor education campaign
- FY14 sales levels represent business similar size to FY11; post regulatory changes being implemented, structural drivers in place to deliver growth from revised baseline

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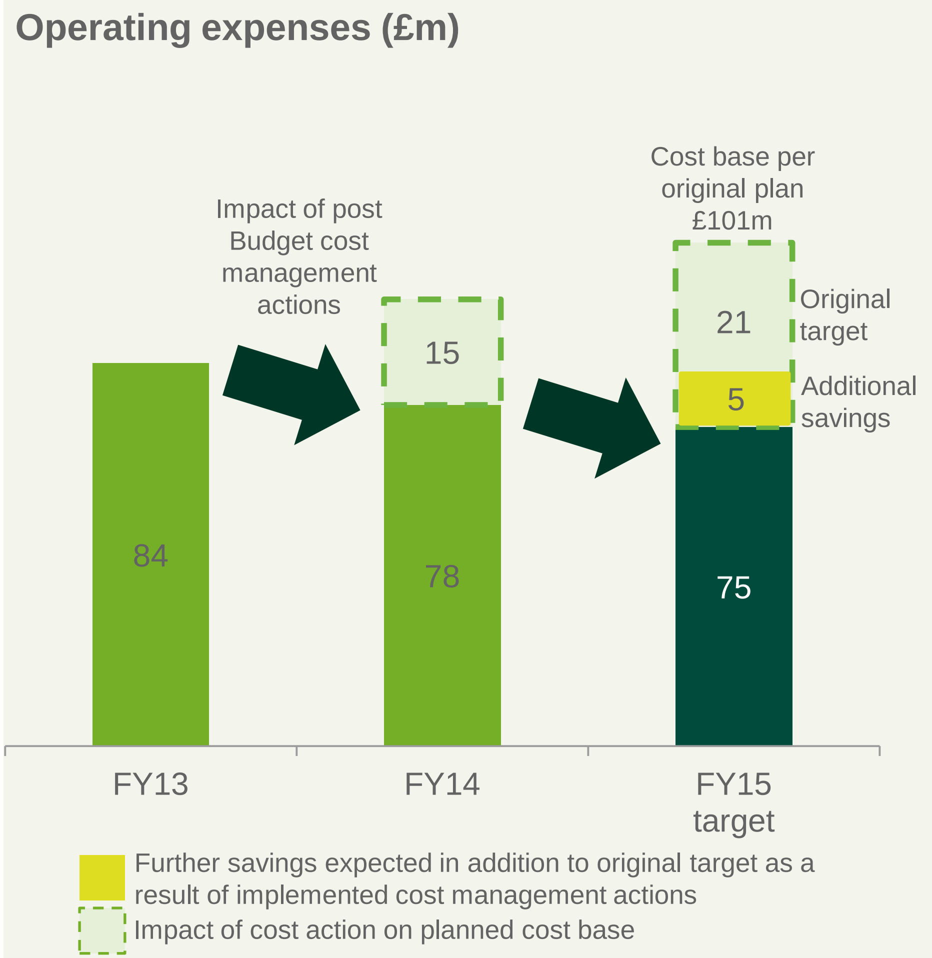
FY15 operating expenses of £75 million now targeted

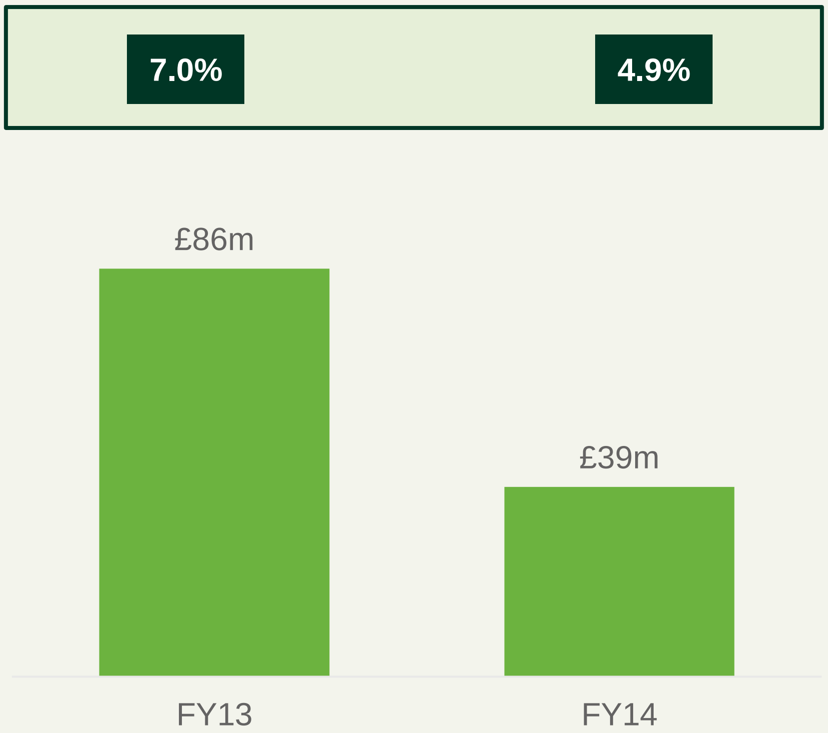


Notes: (1) Not to scale and excludes non-recurring expenditure

- Focus on cost management delivered £15 million reduction in operating expenses in FY14 vs. plan, largely achieved through a headcount reduction of 23%/129 roles between the Budget and 31 December 2014
- Targeted FY15 run rate already achieved, with £78 million of operating expenses incurred in FY14
- FY15 cost base of £75 million now targeted vs. £80 million target announced previously. This represents total savings of £26 million against the planned FY15 cost base of £101 million
- Over 90% of operating expenses allocated to new business, reflecting activity and level of resource required to support in-force vs. new business

Pricing discipline and cost action delivered new business margin of 4.9%

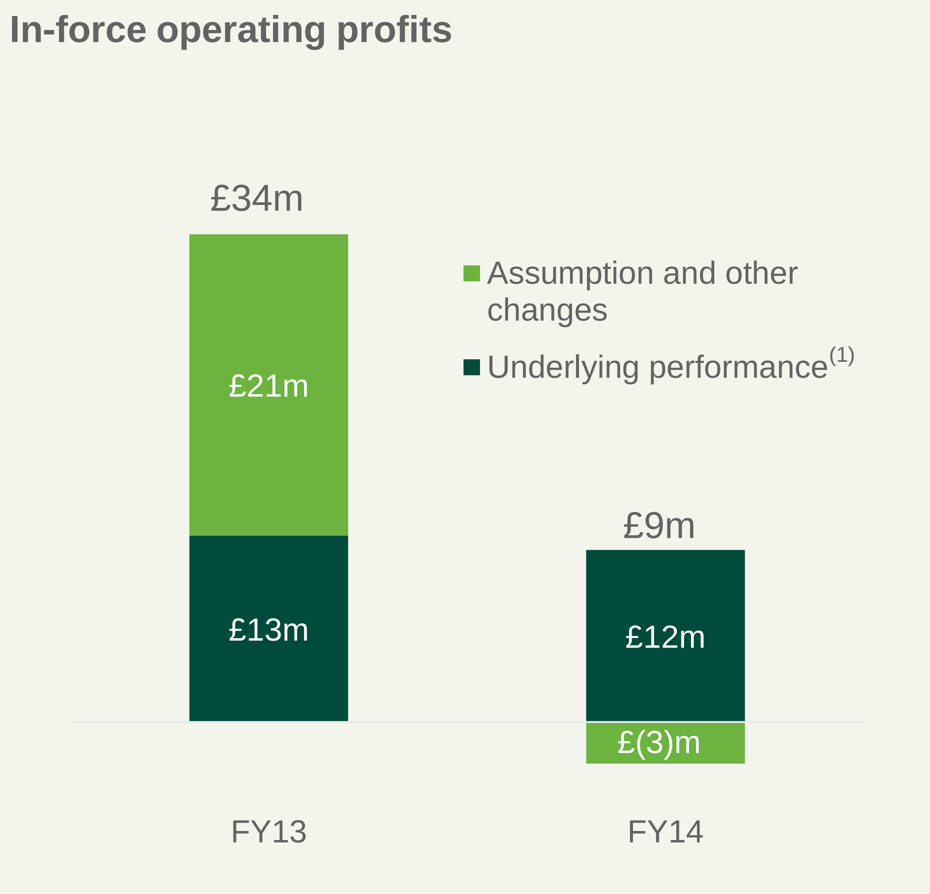
New business operating profits and margin[(1)]



Notes: (1) Calculated as new business operating profit as a percentage of new business premiums

- Strong pricing discipline maintained to ensure new business covers its capital requirement
- To date, no indication of a material difference in profit margins generated on defined benefit transactions vs. individual annuities
- Reduction in new business operating profits and margin vs. FY13 reflects impact of protecting technical capabilities within cost base, in order to more effectively pursue identified growth opportunities

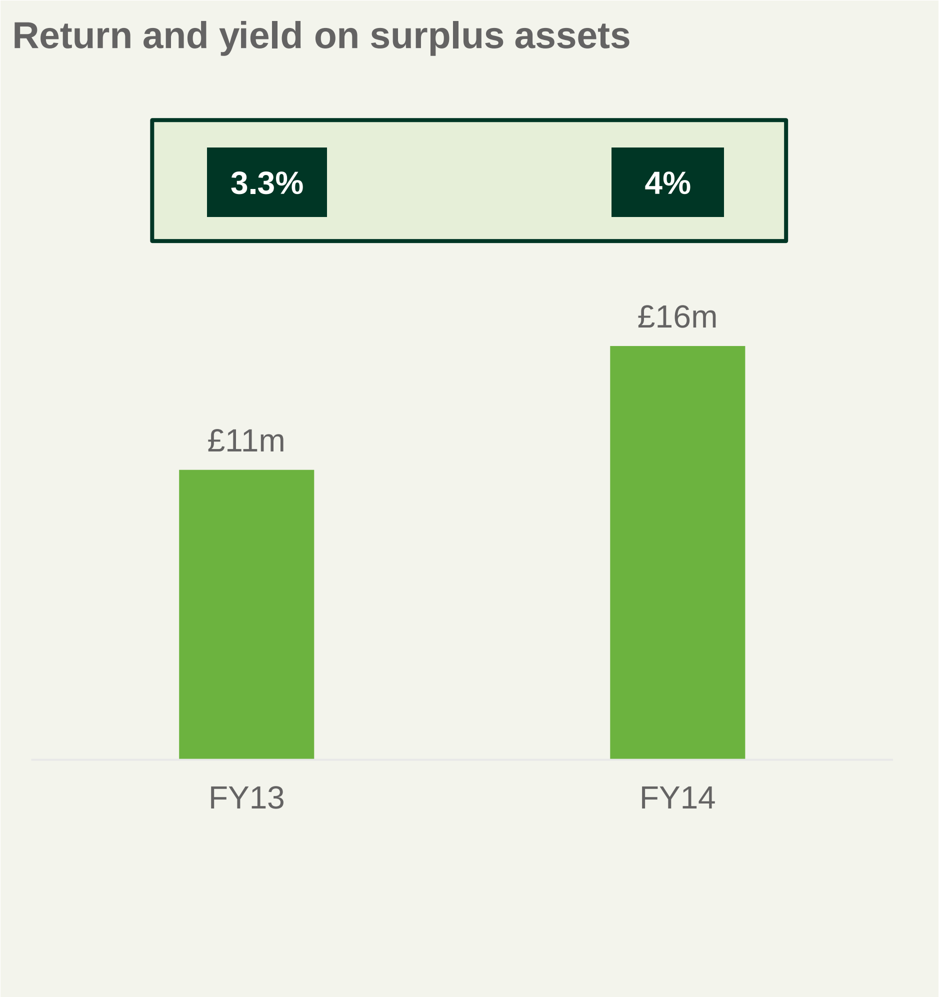
£9 million of operating profit generated by in-force business



Notes: (1) Represents surplus emergence and non-economic experience variances against best estimate assumptions

- In-force business generated £12 million of underlying operating profit, reflecting long term assumptions set at the start of the year
- This underlying performance was offset by £(3) million of non-recurring assumption and other changes e.g. annual mortality basis review and model refinements
- In contrast, FY13 in-force operating profits were enhanced by non-recurring assumption and other changes including
  - Transfer of re-insured block onto in-house admin system
  - Passing ratchet point in TPA agreement
  - New custodian agreement

4% yield achieved on surplus assets



- 4% yield achieved in FY14 as surplus equity release assets were allocated more slowly to new business during the year following the Budget
- The running yield has now reverted to approximately 3.4% as excess equity release assets were utilised in writing Defined Benefit transactions at the end of 2014

Profit before tax impacted by falling gilt yields and widening credit spreads

£m	FY13	FY14
New business operating profit	86	39
In-force operating profit	34	9
Return on surplus assets	11	16
Total operating profit	**131**	**64**
Investment variances	9	(24)
Non-recurring expenses and other items		
cash items	(21)	(8)
non-cash items	(11)	(8)
Interest expense	(25)	-
IFRS PBT	**83**	**24**
Tax	(23)	(5)
IFRS PAT	**59**	**19**
EPS	**17p**	**4.75p**

Notes (1): Subject to rounding

- FY14 £24 million of investment variances primarily due to
  - significant reductions in risk free rates (e.g. 10 year gilts fell by 126bps from 3.02% at FY13 to 1.76% at FY14) and
  - credit spread widening (e.g. the average spread on our portfolio widened by approximately 30bps during FY14)
- FY14 non-recurring cash expenses includes:
  - £2 million of Solvency II related costs
  - £2 million of costs incurred in developing scalable and flexible DB architecture
  - £3.5 million of implementation costs in respect of cost management actions, new initiatives, product development and other items
- In addition, non recurring non cash items were recognised, comprising £6 million impairment of sales infrastructure in H1 and a further £2.5 million of SII related IT development costs, which are being amortised over a 5 year period
- In FY15, non-recurring cash costs of approximately £12 million are expected to be incurred, including Solvency II related costs and the previously announced £5 million to support new initiatives and product development

MCEV increased to 144 pence per share

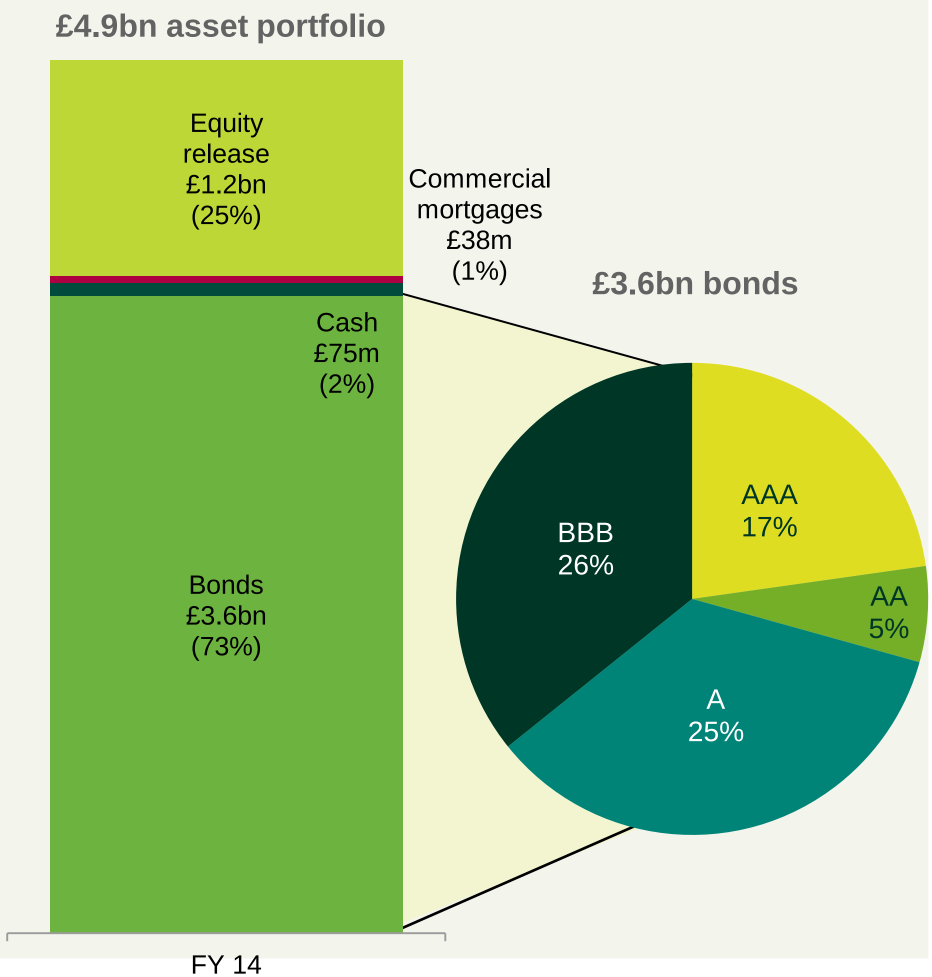
MCEV movement analysis[1] (£m)	FY14
Opening MCEV per share	**130p**
Opening MCEV (£m)	**520**
New business value	56
Expected return on existing business	4
Transfers to free surplus	4
Experience variances and assumption changes	(2)
Investment variances	(4)
Other operating and non-operating variances	12
Shareholder dividends	(14)
Closing MCEV (£m)	**576**
Closing MCEV per share	**144p**

- MCEV increased by 11% during 2014 to £576 million, representing 144 pence per share
- The increase in MCEV relates to £56 million of new business value written during the year
- Adverse investment variances minimised in MCEV as cashflows are closely matched on a best estimate basis and, in 2014, the adverse variances recognised in IFRS were largely offset in MCEV by the positive impact of lower risk free rates on the Present Value of Future Profits
- Other operating and non-operating variances primarily comprises
  - Net of tax IFRS return on surplus assets of £13 million
  - One-off £10 million benefit in H1 from reassessing frictional cost of capital to more accurately reflect assets backing required capital
  - Offset by net of tax IFRS non-recurring items of £11 million
- MCEV remains relatively insensitive to market stresses
- Bond issue is neutral from an MCEV perspective

Notes: (1) Net of tax, subject to rounding

Conservative asset portfolio

FY14 asset portfolio



- Approximately 3/4 of asset portfolio remains in bonds, with majority of remainder invested in equity release
- £38 million invested during H2 2014 under commercial mortgages mandate
- Investments in other illiquid assets (e.g. infrastructure debt) being explored to further diversify asset portfolio and generate well matched higher risk adjusted returns

Notes: (1) All percentages relate to total portfolio, totals subject to rounding

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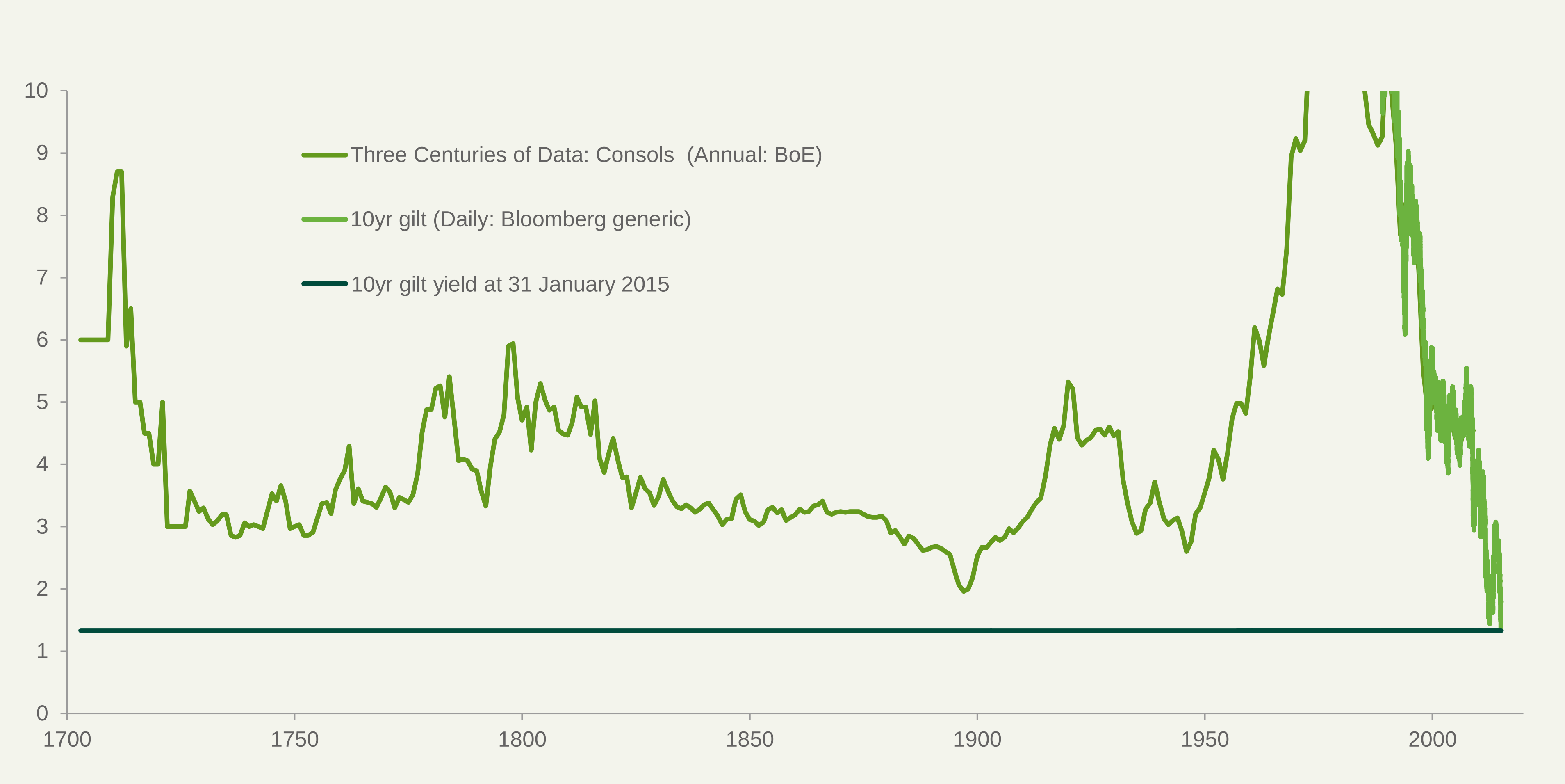
Gilt yields at historic lows



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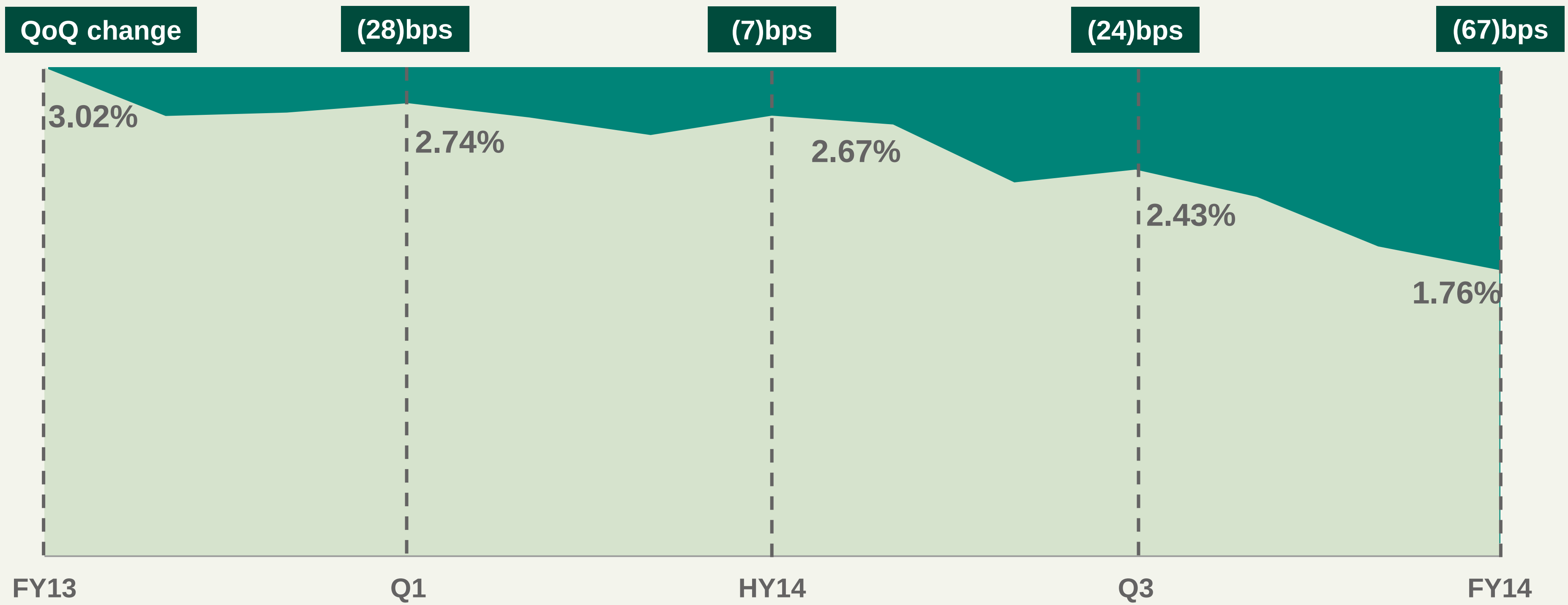
Reduction in gilt yields accelerated into year end…

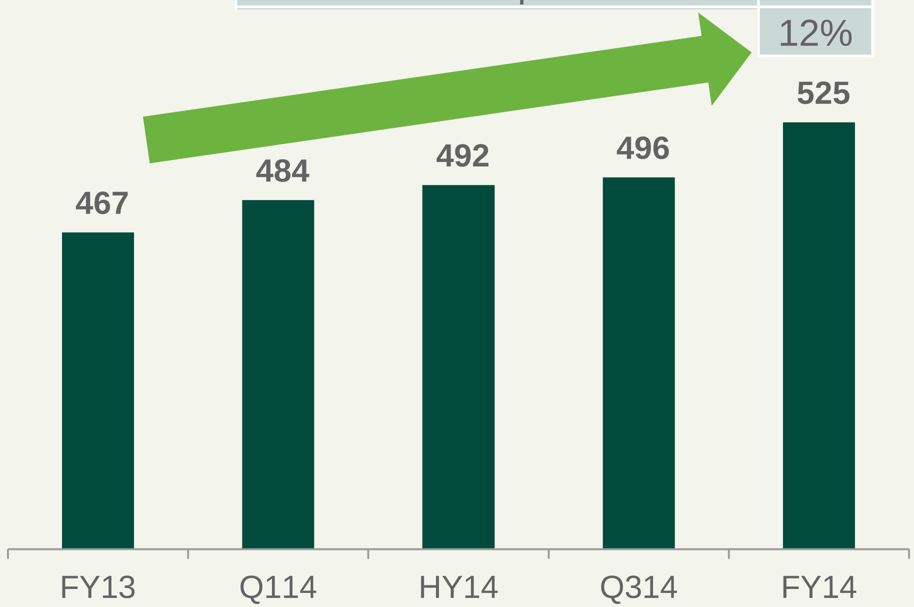
10 year gilt yields



…with a significant impact on capital requirements

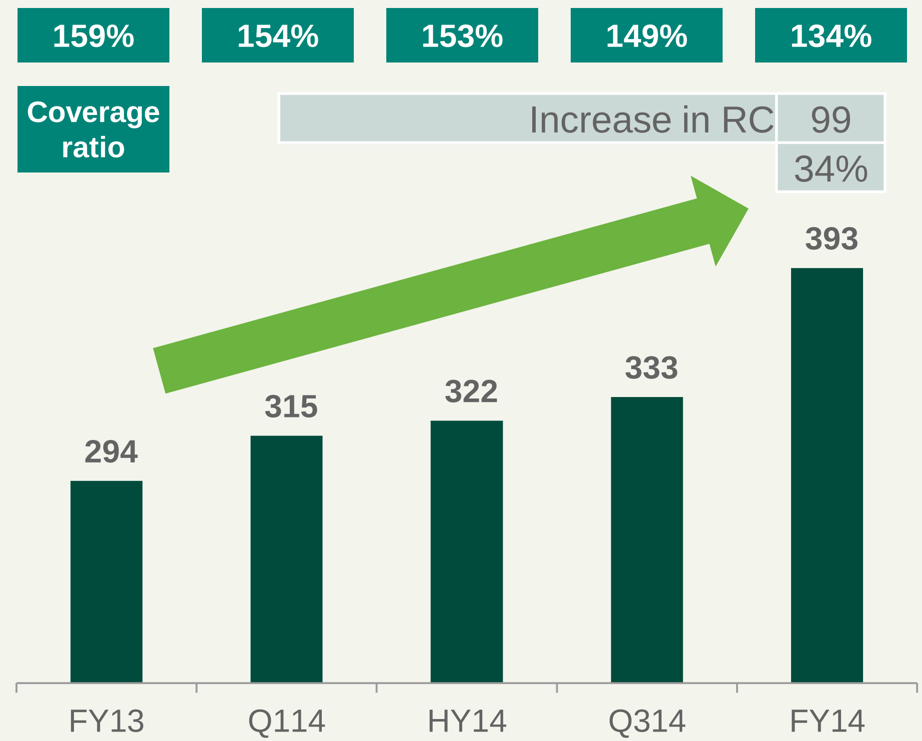
Available Capital (£m)

Increase in AC	72
Shareholder dividends in 2014	(14)
Increase in AC post dividends	58



Required Capital (£m)

Increase in RC	99

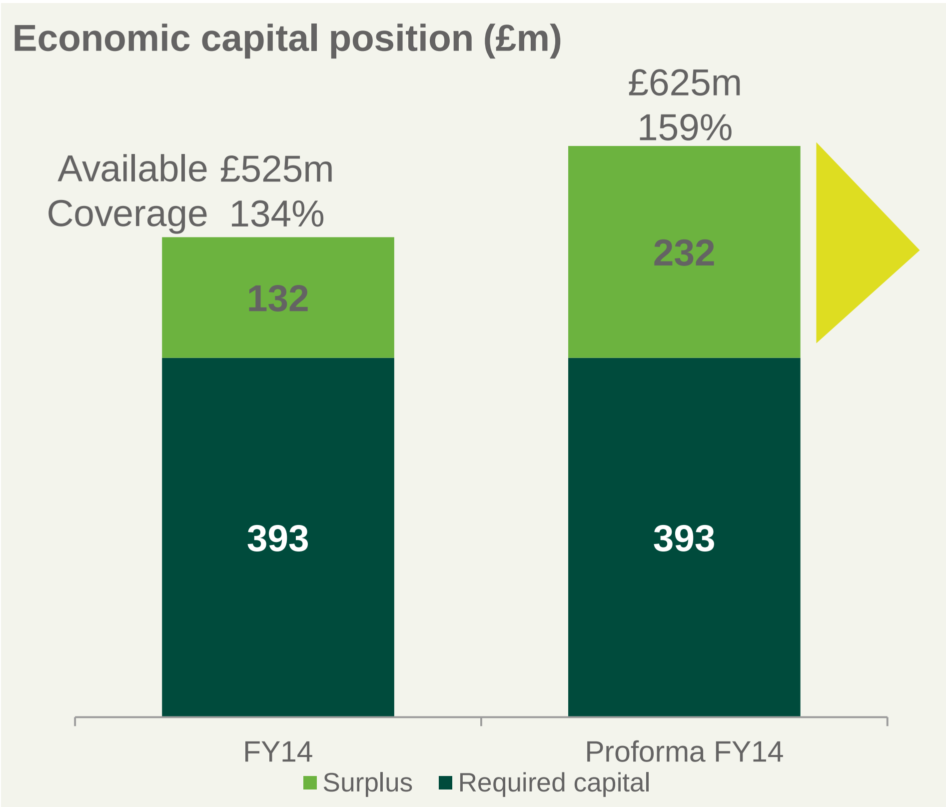


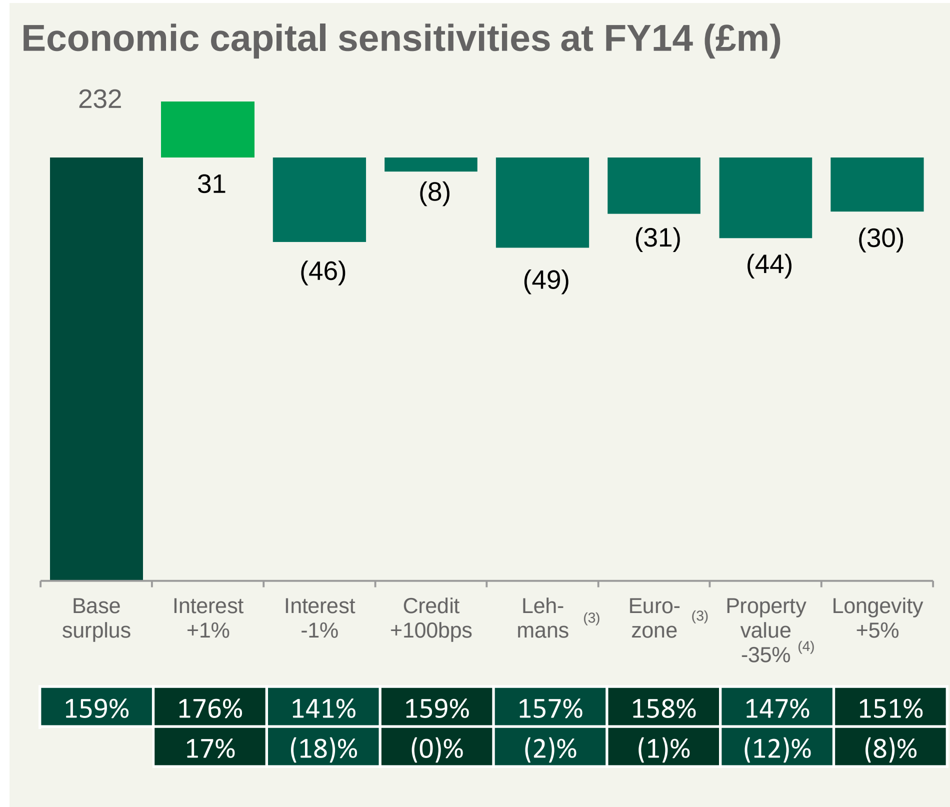
- Close matching of best estimate assets and liabilities limits impact of market movements on Available Capital

Note: Economic capital is Group's own internal risk based assessment of its capital requirement and does not imply capital as required by regulators

- Required Capital increased significantly by falling gilt yields in 2014
- Required Capital is to protect against 1:200 stress. Not expected to be needed and should emerge into surplus over time

Bond issue increases economic capital coverage to 159% and provides additional buffer in stress scenarios





- Board continues to target minimum coverage ratio of 125% under normal conditions
- Hedging arrangements put in place in Q1 to limit financial impact of future reductions in risk-free rates in extreme scenarios

Notes: (1) Proforma for £100 million bond issue excluding costs of issue (expected to be <£1 million), assuming bond issue proceeds held in cash
(2) Economic capital is Group's own internal risk based assessment of its capital requirement and does not imply capital as required by regulators
(3 Lehman and Eurozone crisis scenarios modelled by applying credit spreads of 5 December 2008 and 7 October 2011, respectively
(4) Property stress represents10% decrease in carrying value, equivalent to a 35% fall from current market value

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£100 million 10 year bond issued to Cinven in Q1

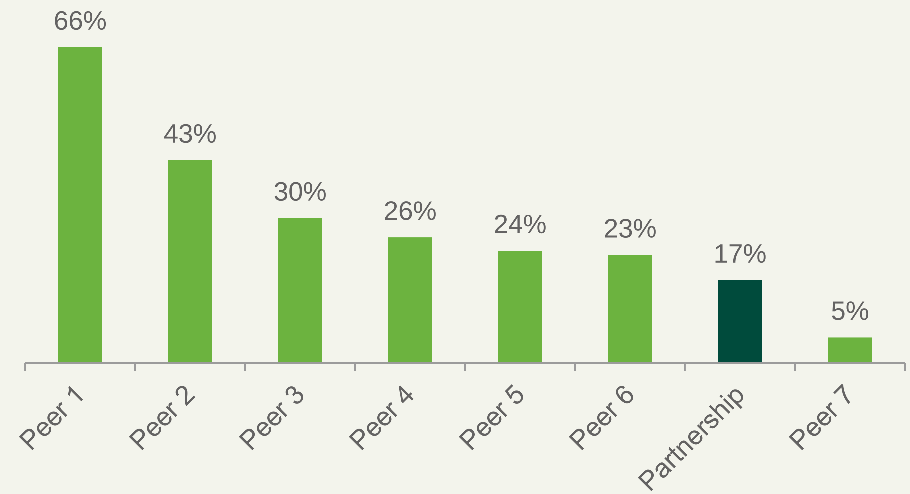
Bond issue rationale

- Provides financial flexibility while individual annuity sales are subdued
- Allows investment in new initiatives as they are developed to grow the business
- Diversifies and strengthens capital structure
- Supports prudent transition to Solvency II regime in 2016

Key terms

- £100 million 10 year bullet, with 5 year call at option of Partnership
- Tier 2 qualifying, Solvency II compliant
- Issued by PAG plc with life company guarantee
- Annual interest rate of 9.5%

Comparison of gearing ratios(1)



- Introduction of prudent level of leverage delivers conservative gearing and strengthens capital position
  - Economic capital coverage increased to 159%
  - Gearing remains conservative at 17%

(1) Gearing calculated as debt/MCEV

Partnership expected to remain well capitalised under Solvency II

SII programme designed to deliver Standard Formula approach

Option of developing internal model under review, with a view to being ready to apply for an internal model for certain risks if and when it is considered appropriate

We expect to continue to measure capital using a risk-based approach and will look to hold capital to cover most onerous requirement

Plans have been developed to mitigate the potential risks in the regulation e.g. matching adjustment on equity release assets

How regulation will be applied in practice is still uncertain. However, based on our current interpretation of the Solvency II regulations, the Group is expected to remain well capitalised

Board recommends final dividend of 1p per share

- Board has recommended 2014 final dividend of 1p, representing total cash cost of £4 million
- Total 2014 dividend of 1.5p
- Dividend policy will be kept under review given on-going uncertainty in individual annuity market, and varying stages of development of DB and US Care propositions

Summary of results

- Total new business sales at two thirds of FY13 levels; similar size to 2011 business from which to grow, and now benefitting from being more diversified
- Pricing discipline maintained & cost management actions implemented, resulting in new business operating profit margin of 4.9%
- Capital structure diversified and strengthened though £100 million private placing
- Proforma economic capital coverage of 159%
  Solvency II programme on track, Group expected to remain well capitalised
- MCEV per share increased to 144p

Business update and outlook
Steve Groves

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Profitable growth opportunities for diversified business

Profitable growth opportunities founded on unique IP

1 UK retail market

- Significant near term uncertainty but structural drivers of at-retirement market intact
- Income guaranteed for life still a priority
- New products under development

2 Defined benefit de-risking

- £1.8 trillion of defined benefit liabilities
- Growth in medical underwriting accelerating
- Partnership proposition gaining traction with Employee Benefit Consultants

3 US care

- $45 billion spent annually on self-funding care
- 300k self-funding entrants into US care p.a.
- Supportive demographics
- Limited competition/alternative products

1 UK retail market

Rationale and drivers

Income guaranteed for life still a priority for vast majority of retirees

£3.5bn of deferrals should equal pent up demand[1]

Continuing transition from DB to DC

DC pension pots continue to grow

Pension Wise and FCA 'Additional Protection' encourages shopping around

Products

Annuities used to secure basic/minimum income using all or proportion of pension savings

Individually underwritten longevity protection provided within retirement account or other new products

Timing

Budget changes to be implemented on 6 April 2015

New product launches expected

IFAs will take time to digest options

Typical lead time from quote to conversion of 2 months

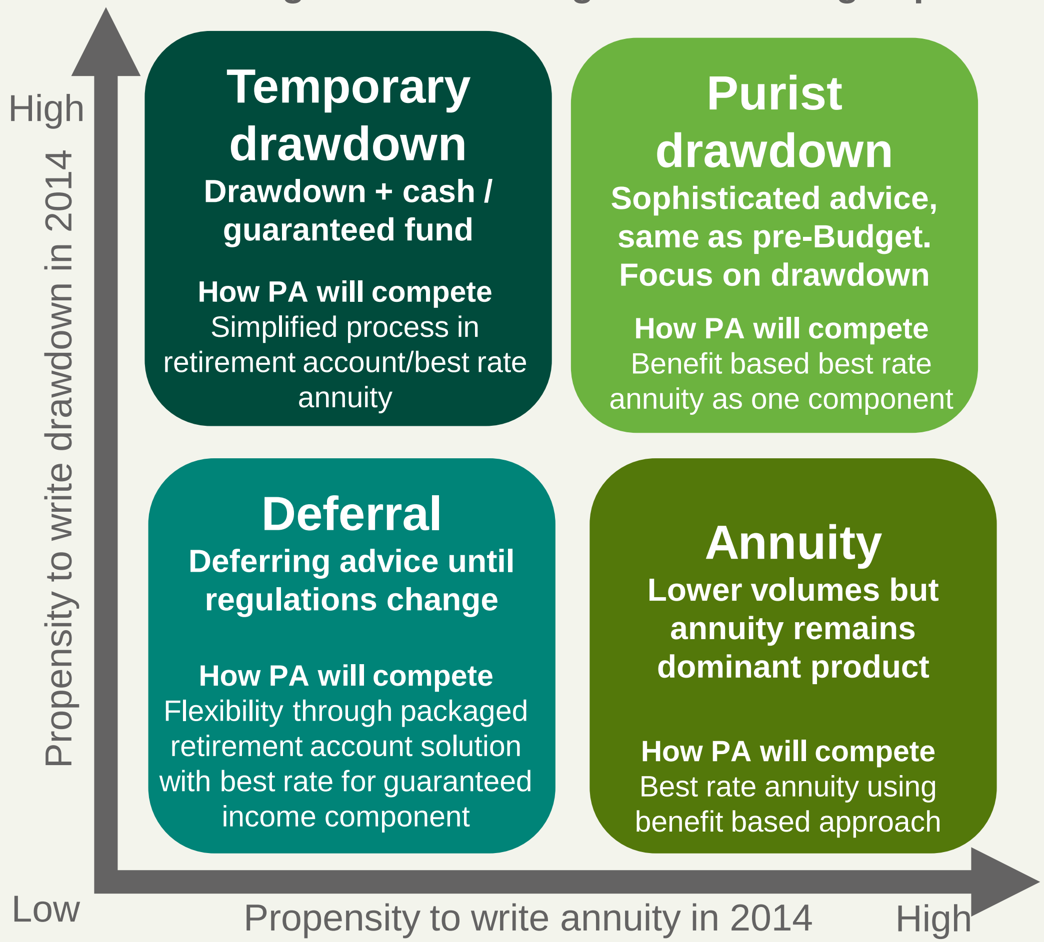
Increase in sales expected to be gradual and unlikely before H2 2015

Making the case for individually underwritten annuities

(1) Calculated as difference between change in size of annuity and drawdown markets in 9 months ending 31 December 2014 per ABI

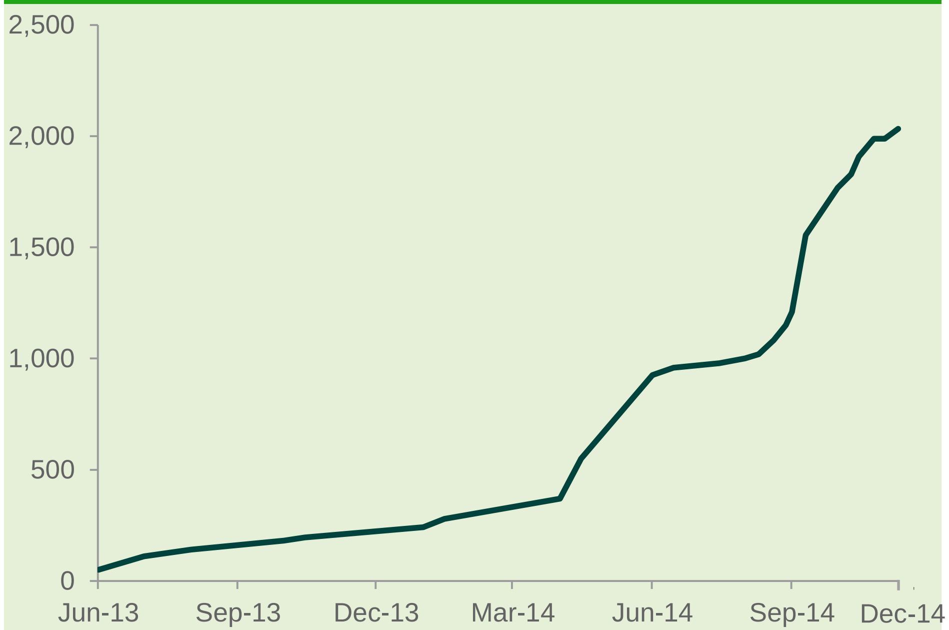
1 UK retail market
Distribution strategy and customer proposition adapted

Over 18,000 firms in the UK segmented and targeted according to post-Budget behaviour



2 Defined Benefit de-risking

Number of pensioners engaged for medical underwriting in bulk annuity deal processes



Source: Morgan Ash. Number of pensioners engaged via Morgan Ash in medical underwriting processes for bulk annuities

- Significant growth during 2014 in transactions considering or going straight down individually underwritten route
- Pipeline includes transactions from 11 different EBCs demonstrating traction of proposition across EBC market
- Focus on making medical underwriting the normal and using unique IP to underwrite and price transactions as this is where our competitive advantage is greatest
- Selective participation in traditional processes only considered in order to convert process to individually underwritten
- Based on current pipeline and market activity, £200m of DB transactions anticipated in 2015. However, quarterly performance will continue to be uneven and completions will remain subject to changes in economic conditions

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3 US Care

- Discussions with potential partners ongoing and progressing well
- Implementation timetable to be communicated when negotiations concluded

Phase 1: Research

Complete

Significant US Care opportunity

IP evaluated, results indicate validity of dataset for US opportunity

2012/2013

Phase 2: Selection of market entry model

Progressing well

In discussions with potential partners

No regulatory roadblocks identified

2014 / ongoing

Phase 3: Implementation

Yet to start, timing remains uncertain

tbc

Three strategic objectives across three key markets

Leverage Intellectual Property	Improve customer outcomes	Maximise risk adjusted returns

1	**UK retail**	• Longer term, structural drivers intact • Deferrals likely to increase in Q1, gradual increase in sales unlikely to begin before H2
2	**Defined Benefit**	• £200m of sales currently anticipated in 2015, although completions will remain lumpy and subject to market conditions • To date, margins not significantly different to retail market
3	**US Care**	• Discussions with potential partners ongoing • Implementation timetable to be communicated when partner selection concluded

Q&A

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