Full Year 2014 Results

Tuesday 3rd March 2015

Steve Groves, Chief Executive Officer

Good morning ladies and gentlemen. Thank you for attending Partnership's 2014 results. I'm Steve Groves, the CEO of Partnership. I'm joined here today by David Richardson, our CFO. We also have our Chairman, Chris Gibson-Smith, in the audience and there are a number of members of our management team who will be at your disposal to answer questions at the end.

I'd like to start with the headlines and a quick summary of the key numbers. Then David will take you through the detailed financial review and I'll come back and update you on the business and the outlook.

In summary during 2014 we continued to generate highly profitable new business through careful risk selection based on our unique intellectual property and a conscious decision to prioritise margin over sales volume in this disrupted market. We have now weathered most of the difficult period of market disruption prior to the implementation of the pension reforms next month.

Although our core individually written annuity market has been significantly impacted consumer and adviser research continues to show the importance of an income guaranteed for life and I strongly welcome the FCA's Retirement Income Market Reform proposals which could enhance our market opportunity by providing further encouragement for all retirees to shop around.

Our efforts to develop our Defined Benefits proposition are delivery results. We generated £247m of bulk annuity sales for 2014, a near threefold increase on the prior year, and we have a strong high quality pipeline going into 2015. We have also made tangible progress during 2014 in the development of our US plans selecting a reinsurance based market entry strategy and progressing discussions with potential partners regarding the launch of our Care annuity in the United States.

In terms of the numbers, we generated £791m of sales, that's around two-thirds of the level we saw in 2013 and I think a much stronger performance than some market commentators were forecasting in the aftermath of the budget. On our key profitability metric total operating profits we delivered £64m which includes £39m of new business operating profit. This represents a new business margin of 4.9% which we have maintained by choosing which business we write and taking action on costs.

Economic capital coverage was 159% on a proforma basis taking into account the £100m bond issue we announced this morning which David will take you through in detail shortly.

Market consistent embedded value per share increased by 11% during 2014 to stand at 144 pence at year-end. And finally, the Board has recommended a final dividend of 1 pence per share bringing the total dividend to 2014 to 1.5 pence.

With that I'd like to hand over to David for the financial review.

David Richardson, Chief Financial Officer

Thanks, Steve. Good morning everyone. I'd like to start the financial review with the top line. In 2014 we had total sales of £791m as the fall in the individual annuity market was partly offset by a strong growth in our DB business. We saw sales in the individual annuity market fall sharply by 57% to £466m. But in contrast our defined benefit proposition grew strongly and delivered a near threefold increase in sales to £347m from £84m the prior year.

Following a targeted education campaign amongst advisers we increased sales on our Care line by approximately 15% to £76m. We continue to lead this market and see strong long-term drivers of growth here.

Finally there was £3m of Protection sales giving us total sales of £791m.

To provide a bit of context to that; on the right hand side we show that those sales correspond roughly to where the business was in 2011. We believe the structural drivers of growth in the 'at retirement' market remain firmly in place, and that we're well placed to grow albeit from this revised starting point.

Looking at costs. Immediately following the budget we announced that we were taking cost management action with a target to reduce our 2015 cost base by £21m from £101m to £80m. That's shown on the right hand side bar graph. This was going to be achieved by reducing headcount by 100 and other cost management actions. The proposals were implemented by the end of the third quarter and through the reduction on 129 roles and further non-staff costs we managed to bring the run rate below our 2015 target by year-end.

As a result we've revised our cost target and are now targeting a further £5m reduction in 2015, making that a total reduction of just over 25% to a £75m cost target for operating expenses in 2015.

It's worth reiterating that the decisions we've made around costs and our cost targets have been based on protecting our technical core and our intellectual property because we believe those are essential for us to grasp the growth opportunities which we have identified. Therefore what we have seen in the second half of the year and will see for a period of time yet is a mismatch between our sales volumes and our expense base. This is a conscious decision to allow us to take advantage of those growth opportunities.

However, if the expected recovery in the individual annuity market does not occur we can take actions firmly within our control to align our cost base with wherever sales ultimately settle.

Our total operating profit which Steve highlighted of £64m comprises of three pieces which I'm going to spend a slide on each now.

The first is new business operating profits. During 2014 we delivered £39m of new business operating profits on sales of £791m. We have maintained our pricing discipline and focused on risk selection which means we have resulted in writing business which comfortably covered its own capital requirements pre-expenses in 2014. Together with our cost management actions, that protected our new business profit margin for 2014.

The temporary mismatch that we have in our cost base relative to our sales volume, as I said, is a conscious decision because we believe we need to do that to take advantage of the growth opportunities that we've identified. That means you can expect some continued pressure on new business margins until the individual annuity market recovers.

One other comment on new business: we continue to present that in aggregate, so a single new business operating profit and margin, rather than splitting it by product line because the new product and growth initiatives are at a relatively early stage. Therefore our cost base and most of our business functions are still aligned to support all product lines. So any particular split at this stage would not be meaningful. However, it is worth noting that pre-expenses, the gross margins we've seen in the Defined Benefit business so far have been broadly in line with the individual annuity space.

Moving to the operating profits generated by our existing or back book. Each year in-force profits are expected to emerge as the prudent margins that we hold in our IFRS reserves gradually release into profit. In addition non-recurring assumption changes and non-economic changes come through this line.

During 2014 there was underlying in-force operating profits of £12m. The slight reduction from 2013 which was £13m is due to mechanical or technical aspects, primarily the fact that credit spreads narrowed in the course of 2013 so the margins that related to credit spreads and the prudence we have for those is slightly lower in 2014 than it was in 2013. In addition there was £3m of adverse assumption and other modelling refinements at the year-end in the context of a balance sheet of approaching £5bn these are negligible.

The final component of total operating profit is the expected return on surplus assets. Our return on surplus assets was £16m in 2014 which represents a yield of 4% on a higher quantum of surplus assets than in 2013. The higher yield achieved in 2014 than 2013 is due to the fact that the equity release business that we write was released more gradually to support new business over the course of the year due to the fall in individual annuity volumes.

As we've highlighted in the past we do still expect this running yield to gradually reduce down to 3%. It was 3.4% at the end of 2014 and we expect that to gradually reduce over the coming quarters.

So that gives us total operating profit, our key financial performance indicator, of £64m for 2014, down approximately a half compared to 2013. Below the line we saw adverse investment variances of £24m. This was due to two main factors: the first of those was the significant fall in risk-free rates that we saw in 2014 where, for example, our benchmark ten year gilts we saw those drop by 126 basis points from just over 3% to 1.76% at the year-end. And the second component was credit spreads which widened over the course of 2014 and on our portfolio on average widened by 30 basis points.

However I would emphasise that we do closely match our best estimate liabilities to our asset portfolio. Therefore the variances that you're seeing on an IFRS basis primarily is noise which is impacting the timing of profit recognition rather than the total amount of profit expected to emerge over time.

Moving on to non-recurring expenses. We had non-recurring cash expenses up £8m in 2014 which included items like Solvency II preparations, the development of a flexible and scalable DB infrastructure; and the cost of implementing the cost management actions that I talked about earlier.

In addition we had non-cash non-recurring items of £8m over the year. That included a £6m write-down on IT sales infrastructure that we talked about with the half year results;

and £2.5m in aggregate over the year of software amortisation in respect of software developed for Solvency II which is going to be amortised over a five year period.

Looking ahead in 2015 we expect to incur approximately £12m of non-recurring cash expenses. This will include things like finalising our Solvency II preparations and the £5m previously communicated in respect of product development and new sales initiatives.

We repaid all our debt shortly after the IPO in 2013 so there was no interest expense in 2014 so that brings you to the total profit before tax of £24m. After tax that equates to earnings per share of 4.75 pence for the full year.

Moving on to Market Consistent Embedded Value. Our MCEV increased by 11% from 130p per share to 144 pence per share over the course of 2014 primarily driven by after tax new business value of £56m written during the course of the year. Experience variances and assumption changes as in IFRS had negligible impact. However in terms of investment variances, as I mentioned, we do match our assets to our best estimate liabilities, therefore in MCEV, which is based off best estimate assumptions, you would expect to see lower investment variances typically than on an IFRS basis; and that was indeed the case in 2014 where the MCEV investment variances were £4m compared to the £24m on an IFRS basis.

Finally there was £12m of other MCEV variances. This includes the after tax return on surplus assets which is £13m after tax. There was a £10m benefit recognised in the first half of the year when we removed approximations in our frictional cost of capital calculations, and that was partially offset by the non-recurring expenses that we just stepped through on an IFRS basis.

At the year-end that gives us an MCEV of £576m and the bond issue announced today has a neutral impact on the current MCEV.

Despite the market disruption in 2014 our total assets under management increased by almost 20% to £4.9bn due to a combination of new business written in the year and also falling yields which increases the market value of assets. We've maintained a conservative asset management strategy through 2014, which continues to focus on matching our illiquid liabilities with attractive risk adjusted returns on a fixed income portfolio. 73% of the portfolio comprises corporate bonds, with an average credit rating of single A, with the vast majority of the rest invested in equity release assets, which diversifies our risk portfolio.

On equity release, we completed a £61m bulk acquisition from a building society in December. Equity release's higher risk adjusted returns and illiquidity prove a very good match and an attractive investment to match our long-term illiquid liabilities.

We have put in place plans to address the risks, the matching adjustment risks associated with equity release under Solvency II, which we believe will allow us to continue to benefit from investing in this attractive asset class.

Just to reiterate what I said before, we do not have a target allocation for equity release assets and instead we look at the cash flows from our equity release portfolio, together with our corporate bond portfolio, and ensure that in aggregate it's a good cash flow match to our liabilities. Therefore, we will continue to look for further attractive bulk equity release opportunities that meet these criteria and are economically attractive.

Finally on assets, we also made good progress in looking at other alternative asset classes in the course of 2014. We entered into a co-investment mandate with Rothschild to invest in commercial mortgages, and by year-end had deployed £38m into that asset class. We

continue to look at other opportunities to secure attractive returns in illiquid asset classes, including infrastructure debt.

Now before turning to the economic capital position, I just want to spend a couple of minutes looking at economic conditions to provide some context for that.

In this slide we look back at how gilt yields have developed over the past 300 years, and if you look at the dark green line which represents current ten year gilt yields, you can see that they've recently touched their lowest point in over 300 years. And when you bear in mind that the whole purpose of our economic capital is to hold risk capital to absorb one in 200 year risk events, you can see, at least from a risk-free or gilt yield perspective, we're already in that territory.

Looking at 2014 a little bit more closely, you can see that the reduction in gilt yields over 2014 actually accelerated into the year-end. Again, using ten year gilts as an example, in the first half we saw yields drop by 35 basis points. In the second half, we saw 91 basis points of reduction in the gilt yield skewed towards the fourth quarter. This resulted in a 10-year gilt yield of 1.76% at the year-end, which you see on the right-hand side of the graph.

So what does this mean for our economic capital position in 2014? Well, starting on the left-hand side with available capital. Available capital represents the excess of our assets over our best estimate liabilities. So you can think about it as surplus capital available to absorb stress events.

Over 2014, you can see that, notwithstanding the mismatch between our sales volumes and our expense base, the available capital increased steadily over the year as we wrote profitable new business. In aggregate it increased by £72m, of which £14m was returned to shareholders as dividends. So, net, there was an increase of £58m, or 12%, in our available capital.

As I mentioned earlier, we closely match our assets to our best estimate liabilities, therefore, the available capital is relatively insensitive to changes in risk-free rates. So the fact that gilt yields fell to their lowest point in 300 years had relatively little impact on our available capital position.

On the other hand, our required capital is more interest rate-sensitive and it increases as risk-free rates fall. On the right-hand side here, you can see that our required capital increased by £99m or 34% in the course of 2014, relative to the 12% increase in available capital. Over half of that increase was due to the fall in gilt yields that we saw during the year. In particular, the acceleration of the reduction in gilt yields in the fourth quarter impacted the economic capital coverage ratio in Q4.

In fact, without these economic variances, the business in aggregate would have been capital generative over the course of 2014. However, the impact of the fall in gilt yields meant the increase in required capital outweighed the increase on our available capital and has compressed the economic capital ratio, which you see in the top here, has fallen from 159% to 134% over the course of the year, with the sharpest fall taking place in Q4.

It is worth emphasising that the required capital is 'rainy day' money to absorb one in 200 year events; we don't expect to need that money, and, in fact, to the contrary, we would expect that to emerge into surplus as distributable cash gradually over time. Notwithstanding these falls, the economic capital ratio at year-end was still at 134% in excess of the Board's minimum target of 125% under normal market conditions.

Now the bond issue that we've announced this morning of £100m increases on a proforma basis that year-end economic capital coverage ratio from 134% to 159%. And on the right-hand side, we set out a range of sensitivities of that pro forma economic surplus of £232m to a range of stress events, together with the impact on the coverage ratio.

One point to mention on those stress tests that we show is that the interest rate down scenario does not reflect hedging that we have put in place since the year-end, which protects against further extreme fall in risk-free rates. So actually based on that hedging strategy, we would expect a downside risk to be more like three quarters of the number shown on the slide.

Finally, we haven't set it out here but our IGD coverage ratio remains strong at 209%, increasing to 254% on a proforma basis.

Now moving on to the bond issue itself. Today we have announced a £100m bond issue to funds managed by Cinven, our majority shareholder. Post-issuance, our gearing ratio will remain conservative at 17% of MCEV, putting it at the conservative end relative to our peers, as we show in the graph on the right-hand side here.

The bond issue provides us with additional financial flexibility and gives us the confidence to pursue the growth opportunities that we've identified with a high degree of confidence that we will not be blown off course by market or other stress events beyond our control. The issue also diversifies and strengthens the capital structure, which prior to this was completely debt-free. It also provides a prudent transition to Solvency II regime, which kicks in on the 1st January next year. The bond itself is a 9.5% coupon ten-year bond, with a five-year call at our option. It qualifies as lower Tier 2 capital under the current GENPRU regs and is Solvency II compliant.

Moving on to Solvency II itself, our programme is designed to ensure that we meet all Solvency II requirements when they go live on 1st January 2016. Our programme is designed to deliver a standard formula approach to measuring capital requirements, although we have got the option of developing internal model modules over time and moving to a partial internal model when we believe it is appropriate.

We have plans in place, as I mentioned earlier, to mitigate risks, such as the treatment of equity release in the matching adjustment calculation, and although how the regulations will be implemented and interpreted still has areas of uncertainty, based on our current understanding of the regulations we expect to be well capitalised post-implementation.

Turning to dividends. Despite the ongoing disruptions in our core retail annuity market, the Board recognises the importance of delivering a return to shareholders in the form of a dividend, and so we are proposing a final dividend of 1 pence per share for 2014, bringing the total dividend for the full year to 1.5 pence per share. This final dividend represents a cash cost of £4m and the full year dividend is more than three times covered by the full year earnings year earnings per share. The Board will keep the dividend policy under review.

So finally from me, just to recap the key points.

We have total new business sales of £791m, roughly two thirds of the 2013 levels. We have focused on risk selection to write profitable new business at attractive margins. Together with our cost management actions this has resulted in a new business margin of 4.9% for the year.

We have announced a £100m bond issue, which has diversified and strengthened the capital structure of the Group, and we look forward to using that to give us the financial flexibility to pursue our growth agenda.

Our economic capital position has increased to 159% on a proforma basis, and our Solvency II programme is on track to deliver and to ensure we remain well capitalised once it goes live on 1st January.

And finally, MCEV increased by 11% from 130 pence per share to 144 pence per share at the year-end.

So I'd like to hand you back to Steve now, who will take you through the business update and outlook for the future.

Steve Groves

Thanks David. I know this is a slide which will be familiar to many of you, but I wanted to set out the three key areas of our strategy before delving into each in a little more detail in the coming slides.

The UK retail Defined Benefit and US Care markets are the three markets we discussed at our recent investor day. The 2014 results demonstrate the resilience of the business which, despite facing fundamental changes in its core market, has weathered the majority of this difficult period and delivered a more diversified set of revenue streams.

In total, even though we are within the period of maximum uncertainty in advance of the regulatory changes, sales have held up better than many expected and the business remains profitable.

Now taking each market in turn: first I want to look at the UK retail market. During 2014, we saw sales of individual annuities of £466m. Our market share in the second half was just over 20%, compared to a market share in Q1, i.e., pre-budget, of around 26%. This reflects our focus on risk selection and writing new business, which we judged to be profitable based on our IP.

If we look at the market data points, in the nine months post-budget to the end of December, annuity sales across the market fell by £4.2bn; meanwhile, sales of draw down contracts increased by just £0.7bn. So although, inevitably, some customers are deciding not to buy annuities, the majority have simply deferred the purchase of a retirement income product rather than buying alternative products.

So a large extent this is due to advisers not being comfortable advising customers in advance of the rule changes, largely due to the uncertainty around the regulations and potential new products which may be launched in April.

We continue to believe the evidence points towards a recovery over time. An independent study published in January by the International Centre for Longevity UK showed that 70% of retirees rank an income guaranteed for life as the most important consideration in retirement planning.

The structural drivers of the market, which helped to deliver the growth we saw in the years prior to the budget, have not changed. The switch from defined benefit to defined

contribution schemes is ongoing and the value of defined contribution pension pots is still expected to grow by between 10% and 15% per annum for the next two decades.

Finally, the increased awareness of retirement income options, the introduction of the Pension Wise service and the FCA's "Additional Protection" may prompt more customers to shop around after the budget than before the budget.

Moving on now to look at products. We expect products to develop to meet evolving customer preferences but there is an increasing recognition of the benefits of an annuity being used to secure a basic level of income, guaranteed for life, to cover essentials such as eating, heating and Council Tax.

For our average customer with a pension pot of £50,000 to £60,000 it is likely that, even with our enhanced individually underwritten annuity rates, securing this core level of income is likely to require a very significant proportion of their pension pot. For others a retirement account product which uses a proportion of the customer's pension savings to provide an income guaranteed for life and allows the remainder to be invested in more risky alternatives may be appropriate. We are continuing to work on our retirement account proposition although confirmation of the final product legislation is required for this to be finalised. Whichever way the market and consumer preferences develop we believe Partnership is well placed to use our unique intellectual property to develop individually underwritten alternatives.

Finally, in terms of timing, as expected the level of deferrals has increased the closer we have got to implementation of the pension changes as the cost to customers of doing so has decreased. We expected deferrals to increase further during quarter one and we're seeing this in the January and February activity levels which are down around 15% to 20% on Q4. With the rules changing at the start of April and given the typical lead time of around two months from quote to conversion it is likely that an increase in sales will be gradual and it is unlikely to begin before the second half of 2015.

I want to turn now to look at how we're adapting our distribution strategy and product proposition. We have segmented around 18,000 advisory firms into four main categories depending on their behaviour since the Budget last year and we've adapted our strategy to most effectively target each segment. Our work to develop innovative new products to meet evolving customer needs post-April is continuing. Following the success of our minimal income campaign which encouraged customers to cover their minimum income needs with an annuity we're putting in place systems to allow benefit based quotes to be generated allowing customers to select the value of income they want to guarantee for life.

We're also continuing to develop our retirement account proposition and we will have online resources available in April to help support advisers and enable customers to make informed choices. We have adapted our distribution strategy and our client proposition so however customer behaviour develops we are well positioned to meet the needs of advisers and clients in April.

Now moving on to look at the defined benefit proposition which delivered sales in 2014 of £247m, a threefold increase on 2013. This is a huge market, there are £1.8 trillion of liabilities. We have tailored our proposition so it can benefit even the largest schemes and the £206m top slicing deal we announced in December was the perfect example of this.

The rapid and significant growth that you can see here in the number of pensioners engaged in medically underwriting for bulk annuity deals in 2014 shows how the demand for an individually underwritten approach is now accelerating. All of the deals we have written today

have been medically underwritten and our focus is on making medical underwriting the norm. This is where our competitive advantage is greatest and where we believe we can build a sustainable competitive position. We are seeing more and more deals come straight to the market already having chosen to go down the medically underwritten route.

The number of employee benefit consultants recommending this approach and taking clients through the process is also increasing. We have deals in the pipeline sourced from 11 different employee benefit consulting firms demonstrating the breadth of interest across the market. The relative attractiveness of de-risking pricing compared to other options varies depending on market conditions. While gilt yields are at historic lows relatively speaking de-risking may appear less attractive. As a result there is of course the potential for the DB market to fluctuate over time as economic conditions vary. However, based on the current pipeline and market activity we anticipate DB transactions in 2015 of at least £200m, however the timing of completions remains unpredictable and we will provide updates throughout the year.

And finally I just want to touch on the US Care opportunity. As you know this is a very significant market, $US45bn is spent annually on self-funding care and there are 300,000 self-funding new entrants every year. The demographics are very supportive and there is currently limited competition or alternative options for customers at the point of entering care in the US. We made tangible progress during 2014 in the development of our plans and have selected a reinsurance based market entry strategy which we believe is attractive because it is lower risk and requires less capital than other approaches.

As we said at our investor day in November we have continued to make good progress in our discussions with a limited number of potential partners. We will set out the implementation plan when we have concluded those negotiations. Given the size of this new and untapped market I'm pleased with our progress and it remains something we're taking the time to get right.

So in conclusion, during 2014 we continued to generate highly profitable new business through careful risk selection based on our unique IP and a conscious decision to prioritise margins over sales volumes in a disruptive market. Although our core individually underwritten annuity market has been significantly impacted consumer and adviser research continues to show the importance of an income guaranteed for life and as we look forward we expect a gradual return to long term growth.

Given the time it will take customers and adviser behaviour to stabilise an increase in individually written annuity sales is unlikely to begin before the second half of this year. Our defined benefit proposition delivered strong results in 2014, based on the current pipeline and market activity we anticipate £200m of sales in 2015. However the timing of completions is difficult to predict and sales will continue to be lumpy and subject to changes in the economic conditions.

Finally in the US we continue to progress discussions with a short list of potential partners regarding the launch of a care annuity and we will set out the timetable for implementation once this is complete.

In February we celebrated our 20th anniversary and the structural drivers and ageing demographics which supported our rapid growth in previous years remain intact. Our customers' need for financial security has not changed and the new regulations provide opportunities to utilise our unique intellectual property to develop more flexible products in the new world.

In each of our markets our strategic objective to use our unique IP to do our best for customers and maximise risk adjusted returns position us well to deliver profitable growth and long term shareholder value.

That concludes this morning's formal presentation, ladies and gentlemen and I'd like now to move on to the Q&A session. Would you please wait for the mic to be brought to you and state your name and institution before you ask your question. Thank you. Who wants to go first? Andy?

Q&A Session

Question 1

Andy Sinclair, Bank of America Merrill Lynch

Firstly I just wondered on the new businesses margins, they seem a bit stronger in H2 than they were in H1, I just wonder if you could comment on how much of that came from pricing and how much from investment selection etc.

Secondly, I just wondered if you could give us an update on the loan to value of the equity release book?

And third, just on distribution channels could you give us an update on which have been performing stronger and which have seen the greatest impacts over the last year or so? Thanks.

Steve Groves

Shall I do distribution and then hand over to you, David? Yes, I think the distribution channels have broadly all been fairly significantly affected. I would say that the online specialists have probably held up better than the traditional market and that's largely driven by the fact, that to a greater extent, they've continued on their advertising and lead generation. So I think the more traditional advisers have backed off and the new breed have continued to advertise and have continued to generate leads and that's lead to them outperforming relatively. I don't know, David, if you want to cover new business margins and LTVs?

David Richardson

Yes, so you're absolutely right, Andy, we did see higher margins in the second half of the year to the first half year that reflected predominantly just the mix of business that we wrote. We saw good margins through to the second half of the year, including on the large DB transaction that we completed at year-end. So nothing systemic going on there, I just think normal variability that you'll see from period to period but the key thing is we did maintain our pricing discipline to try and make sure we focused on margin rather than volume.

On equity release loan to value ratio, I have a number in my head but rather than maybe pull the wrong one out of my head we'll get back to you with the details on that. However, I think the important thing is there's not a right or a wrong answer for what your loan to value ratio is, for example on the flow business that we write rather than the bulk equity release that we write a significant chunk of that, the vast majority of it in fact is medically underwritten so we can actually offer a higher loan to value on that than on a standard product because of the shortened life expectancy associated with the mortgagee.

So there's no kind of right and wrong answer, we'll give you the actual number at the year-end so you can see how it's tracking over time.

Question 2

Jon Hocking, Morgan Stanley

I've got three questions please. I wonder if you could comment on whether you think there's any impact for you on the proposal to have a secondary market for annuities, whether you might actually pick up some business that way. Secondly on the US, given that the move in gilts was in the fourth quarter principally impact of the capital position and you've got back to where you started with the bond issue has the scale of ambition in the US changed, given what happened to capital in 4Q?

And then just a follow up question on that, reinsurance structure, is that going to be on the UK balance sheet or are you going to set up a separate balance sheet somewhere else, I think it may be Ireland or something and if so, how are you going to capitalise that? Thank you.

Steve Groves

I think they're probably all questions for me. So I guess the secondary market we see as potentially interesting, there's clearly a lot of water to pass under the bridge before that happens but if a secondary market were to develop then clearly the risk selection that we have been developing and refining for 20 years could be used to compete in that market to buy risks which looked attractive to us. So it's something we maintain a watching brief on but we do think there is the potential over the long term for something interesting there.

The US and the movements in risk-free- no we haven't changed the scale of our ambition for the US, we made a very conscious decision to do the US as a partnership/reinsurance deal rather than capitalising an entity and going out; and therefore actually the cost to a Partnership shareholder of pursuing the US venture should be relatively low and I think it's a huge opportunity that we are very focused on taking.

In terms of the reinsurance structure I think it's certainly likely in the early stages that the business would be written on to the UK balance sheet. I wouldn't rule out that at some point in the future once it became a material part of our business that we would look at what the best place to write that reinsurance is but my expectations are in the early stages we would write that on to the UK balance sheet and therefore there would not be a significant capital requirement for shareholders.

Question 3

Alan Devlin, Barclays Capital

A couple of questions, first of all you mentioned you put in hedging arrangements in Q1, I wonder if you could give us some details about how they work and protect you.

The second question, you're underlying in-force earnings in decline '14 versus '13, even if your book has increased, can you give us some more colour about what's going on there and what you would expect as you build up sales?

And then finally just on asset allocation, is the asset allocation to the DB schemes you run roughly similar to the individual, so 25% equity release and corporate bonds etc? Thanks.

Steve Groves

They're all for you, David.

David Richardson

Okay. Yes, so with the hedging arrangements, Alan, what we've put in place there is something which is largely swaption based but which has other elements to it which protect us against significant falls in risk-free rates. So we're talking about falls of over 75 basis points. There's no perfect hedge out there for an economic capital position which has so many moving parts to it, but the idea is it provides a rough floor to falls beyond that point.

The intention is to bridge us into Solvency II, we haven't tried to go for a long-term hedging strategy that extends beyond the Solvency II regime because making that work is at the moment there's not enough clarity exactly about how the rules would be interpreted before you could put the right type of hedge in place. But the intention is it bridges us through to that time period.

On the second question, in-force operating profit, you're absolutely right, the underlying book grew so the way in-force operating profit works is it's primarily driven from your starting position at the beginning of the period so we had more in-force at the beginning of 2014 than we had at the beginning of 2013. Because credit spreads had narrowed quite considerably in the course of 2013 the actual amount of credit spread margin per unit of risk that was getting released was significantly smaller and that's why you saw a slight reduction. Looking forward, absent market fluctuations you would expect the in-force operating profit to grow in line with the underlying book.

And asset allocation to DB business, we essentially follow the same discipline that I described in general terms to all our business, which is we look at a good cash flow matching of our best estimate liabilities through a combination of all the asset classes available to us, which is primarily at the moment corporate bonds and equity release with a small but growing component of commercial mortgages.

So we don't have any set allocation percentages, but the nature of equity release assets, which tend to be longer duration and effectively more bullet type payments, because you get your money back when the policyholder either goes into long-term care or they die, means that the longer the duration of the business the better match equity release is for it. So DB schemes tend to have slightly longer liabilities than our core individual annuities because a lot of the benefits are inflation linked, which drags out a duration. So typically you can put a bit more equity release to work on DB than you can on individual annuity, although there are some exceptions in both directions.

<u>Question 4</u>

Oliver Steel, Deutsche Bank

The cost of the new debt is roughly a quarter of your new business profit last year, so I've got a couple of questions on that. First of all, was your new business constrained at all by your solvency position during 2014? And perhaps an alternative way of looking at it is, can

you increase your new business by a quarter over the course of the next 12-18 months in order to offset the higher interest charge?

The second, or if you like third question I've got is on the new retirement product, the one with the platform implicitly included in that. How are you introducing the platform? Because obviously this is going to be pretty low margin business, so I'm just wondering how you compete in that market?

Then finally, just to come back on that last question. Does that mean you're not protected up to a 75bps fall in interest rates?

Steve Groves

I'll take the question was our new business constrained by solvency and the retirement account, David if you want to take the other two. I guess the very short answer to was our new business constrained by solvency is no, we applied the same pricing disciplines we have applied since broadly 2005, which is we will only write business which covers its own regulatory capital and looks well rewarded on our IP. In the market that we saw post-Budget, that resulted in us writing lower volumes, but we wanted the same margin targets and discipline as we had before. Had we had more capital we wouldn't have deployed it at a rate that we didn't consider was suitably rewarded.

In terms of the retirement account, we haven't put out in public, but I think it is reasonable to assume that we won't be building our own platform.

David Richardson

On the hedging, you're right in inferring that for the first 75 basis points we're effectively un-hedged. There's a little bit of mitigation but it's relatively immaterial.

Oliver Steel

Sorry, there also a question on would the cost of the debt be offset by new business?

David Richardson

The new business margin, notwithstanding our focus on risk selection and going for the most attractive business in 2014, our new business margin was I still think artificially compressed in 2014. I think that will continue into 2015. So I don't think it's the natural benchmark to compare it against. However, it is fair to say that in terms of the revenue which travels with those significant growth opportunities, we would expect that to far outweigh the debt cost over the medium-term.

<u>Question 5</u>

Barrie Cornes, Panmure Gordon Co Ltd

A couple of questions. First of all, the £200m at least run rate that you mentioned on bulks, does that include anything for large one-offs, or do you just assume a low level of run rate?

The second one, just following up from Oliver's question there in terms of the new product. What sort of timescale have you got for launching into the market please?

Steve Groves

The £200m is based on deals we have in the pipeline, so it's based on what we think will happen to the deals in our pipeline. It doesn't allow for any very significant top slicing opportunities, if they were to come along they would be what I would term 'jam on top'. But I think they're quite hard to guide people to. So that £200m is based off what we think is a stable extraction rate from our pipeline.

In terms of the timescale for the new product, we haven't made a final decision here. I think there's a number of possible strategies we can follow, and we will look at what we think the optimal time to launch the product is. So there are arguments for going very early in April, and there are also arguments actually for holding back a little bit, because we suspect a lot of other people will. So we'll be monitoring the market and the development as we run into it and we'll try and pick the optimal point to launch the product.

Question 6

Andrew Crean, Autonomous

A few questions if I may. Could you explain why you pulled a debt issuance which we were marketing publicly at a 7-9% yield to a private placement at a 9.5% yield?

As I remember it, you were going for a partial internal model on Solvency II, you're now simply going for a standard model. I wanted to understand that.

Thirdly, you made a comment that your dividend policy will be kept under review. I just wanted to understand what you meant by that and whether we could have some guidance on dividend policy, because that could be either up or down.

And then finally, the £3m negative experience variance, could you explain a bit more about this? I'm assuming that your actual mortality was a little bit worse than your assumptions.

David Richardson

Starting with the debt, Andrew. We did test the public markets at 9% in early January, and based on that feedback decided not to proceed with a public market transaction at that time.

Andrew Crean

Why?

David Richardson

Because we didn't think there was sufficient demand at an attractive price for us there. And based on that feedback the 9.5% private placement represents fair value given where we are as a company and given the size and nature of the issue at £100m.

On Solvency II, I think actually what we've said before is our default will be to go with the standard formula, and we will look at cost benefit on a partial internal model. We still have the option of a partial internal model at our disposal, but I guess what we're guiding toward is that the cost benefit is leaning towards a standard formula approach at this point in time.

On dividend policy, it's just really the reality of the situation we have is that given the uncertainty in our core retail annuity market the Board is not in a position where it can give firm guidance on how it expects the dividend to develop over time. We think that's the prudent and responsible thing to do given where we are in the cycle of uncertainty at this stage.

And finally, the £3m impact that you saw on in-force operating profit is a combination of experience variances, assumption changes and modelling refinements at the year-end, none of which were material or significant. On the specific question around longevity experience it was tracking very close to expectations over the calendar year.

Concluding comments: Steve Groves

I guess that brings to an end the 2014 Full Year Results. Thank you for your time and your questions.