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## Growing Pains: Taking the Strain

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22 November 2019

### Agenda

- **Opportunity knocks:** de-risking market overview
- **Taking the strain:** capital consumption in BPA
- **Growing pains:** balance sheet projection
- **Investing in BPA:** why invest in BPA?
- **Conclusions**



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## Opportunity Knocks

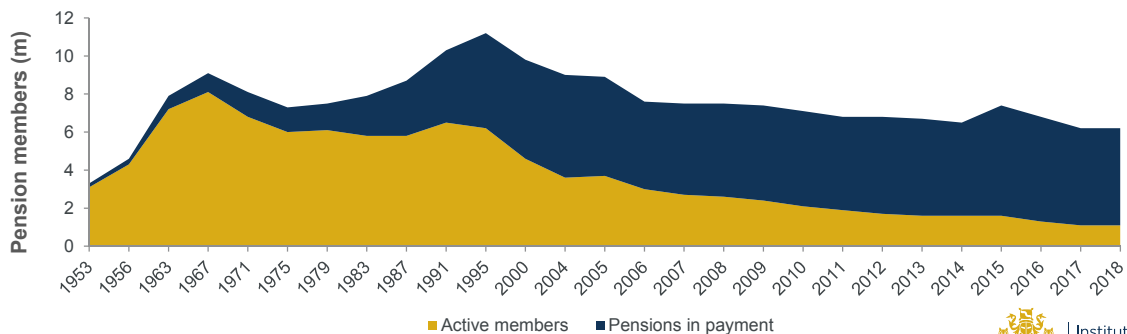
De-risking never looked so good!



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## Times Are A-Changin' | Membership

- **DB pensions** routinely offered by UK corporates in the second half of 1900s
- Majority now **in-payment**:



Source: Occupational Pension Schemes Survey (OPSS), 2018

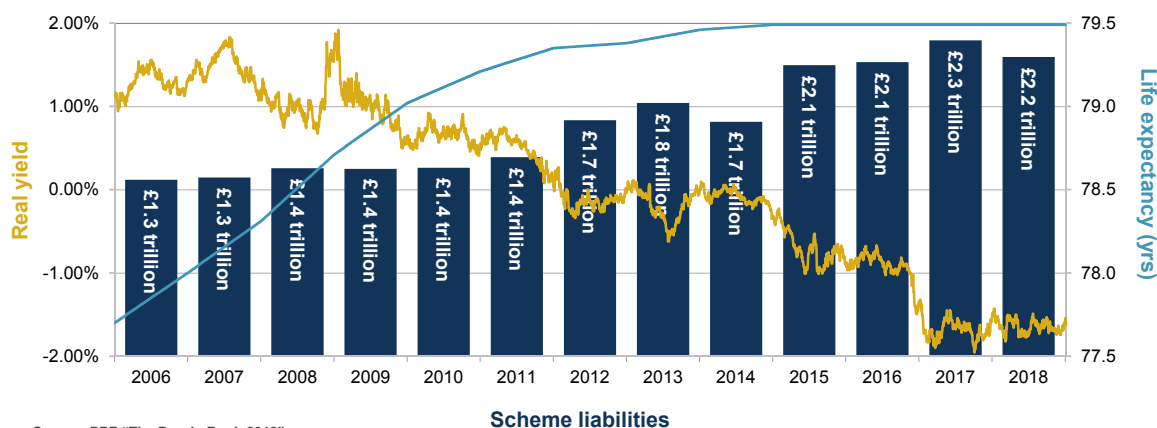


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## Times Are A-Changin' | Demographics and Markets

- Rising **life expectancy** and falling **interest rates** have increased scheme liabilities



Source: PPF 'The Purple Book 2018'

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## Times Are A-Changin' | Trustees and Sponsors

- Trustees and sponsors have responded by **closing schemes**, **increasing contributions** and undertaking **de-risking asset strategies**



Source: Membership and asset strategy: PPF 'The Purple Book 2018'

Sponsor contributions: ONS 'MQ5: Investment by insurance companies, pension funds and trusts: October to December 2018'

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## Pension Scheme Endgame | Why Insurance?

### Regulation

- Different valuation bases
- Restrictions

### Scale

- Investment opportunities
- Administration
- Expertise

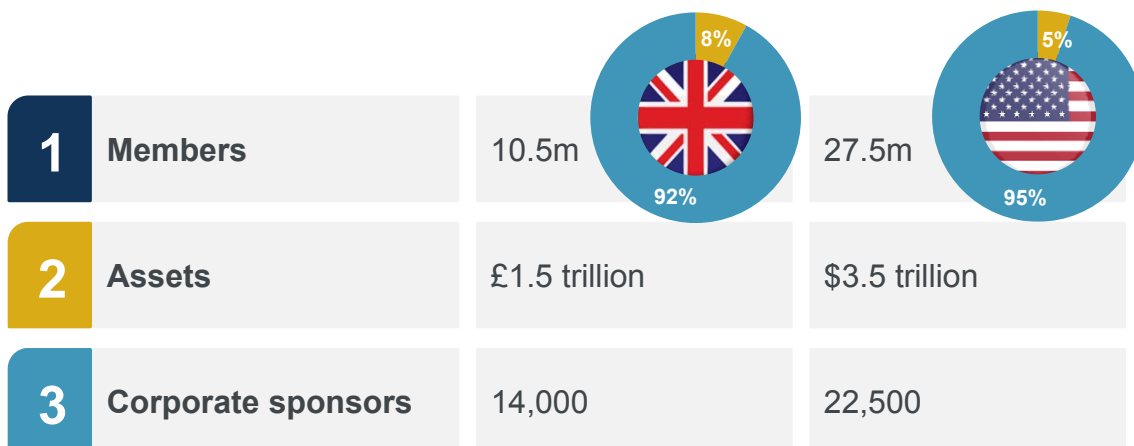


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## De-risking Landscape | Snapshot

■ Transacted  
■ Outstanding

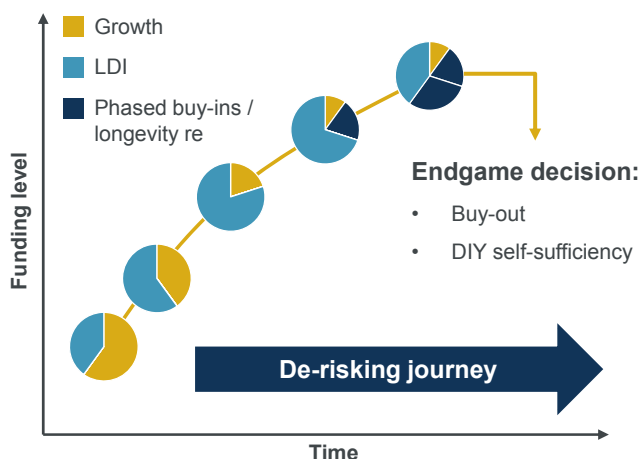


Source: L&G

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## Bulk Annuities | Growth Drivers

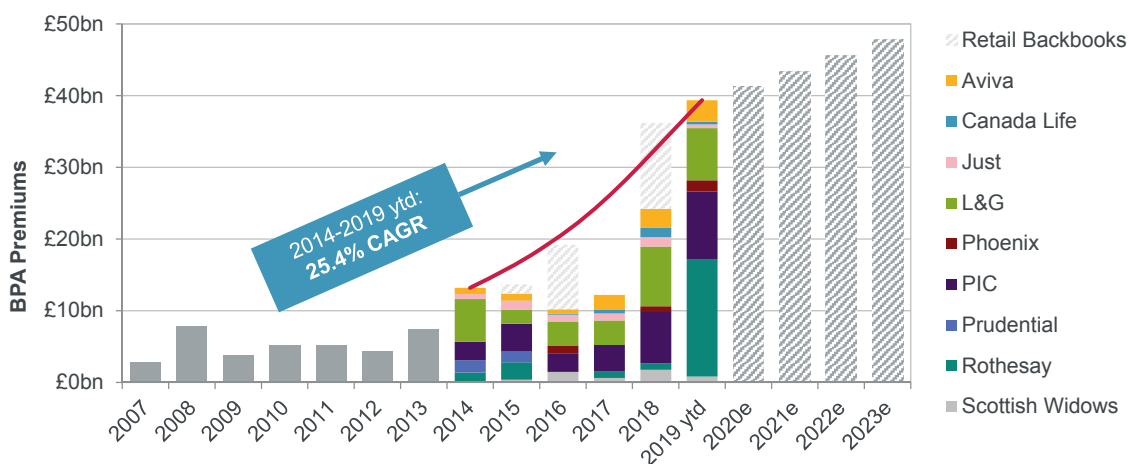


- 1 Interest rates
- 2 Investment returns
- 3 Life expectancy
- 4 Sponsor contributions
- 5 Scheme maturity

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## Bulk Annuities | Market Growth



Source: LCP, Hymans Robertson, company press releases, (e) 5% p.a. future growth

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## Bulk Annuities | Success Factors



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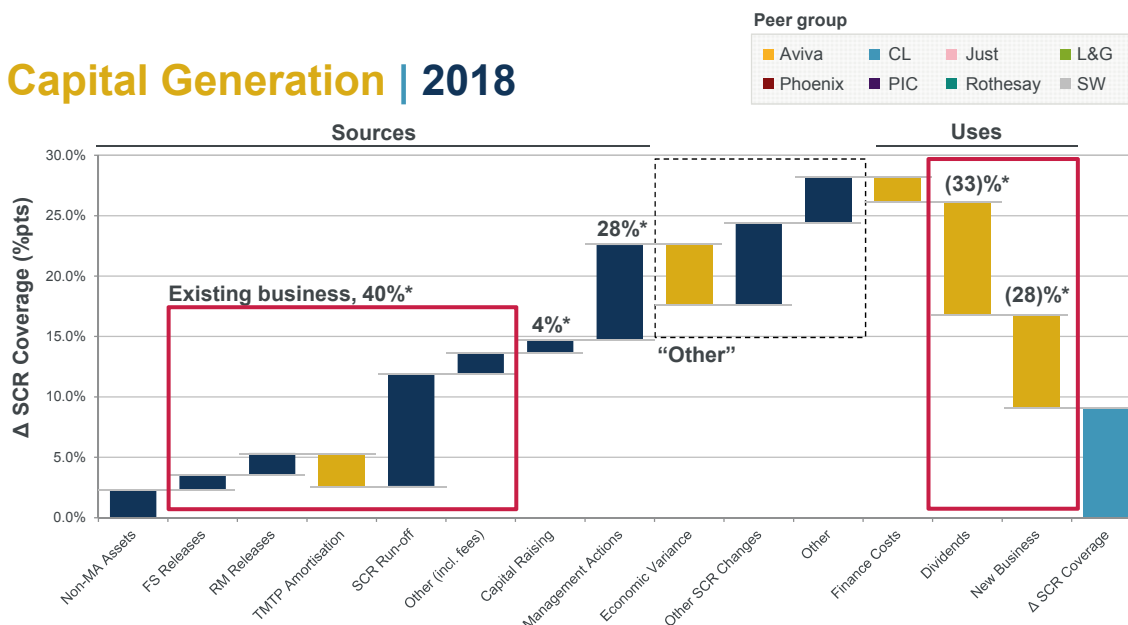
## Taking the Strain

Capital Generation



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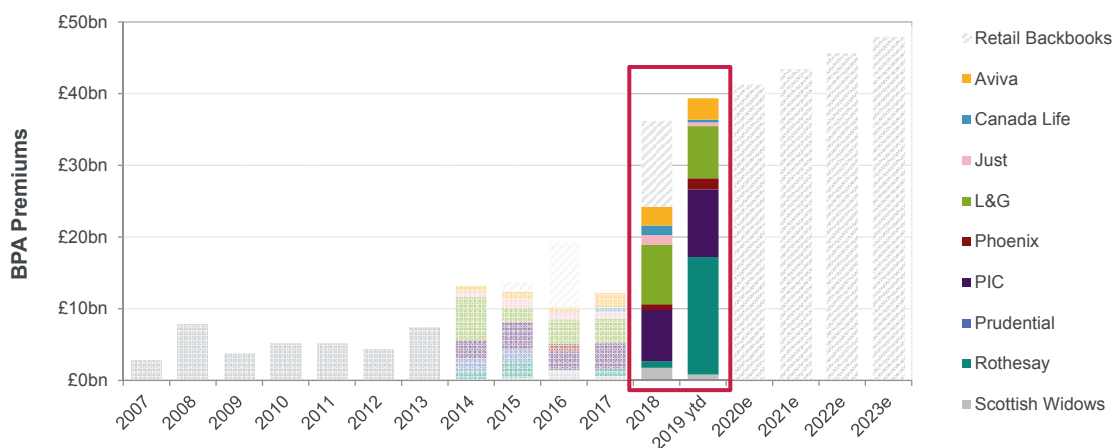
## Capital Generation | 2018



Source: FY17 / FY18 SFCRs, FY18 annual reports / results presentations, NWM estimates  
 % of total capital surplus generated (where “total” is equivalent to 28.3%pts of SCR coverage)

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## Capital Generation | New Business Volumes

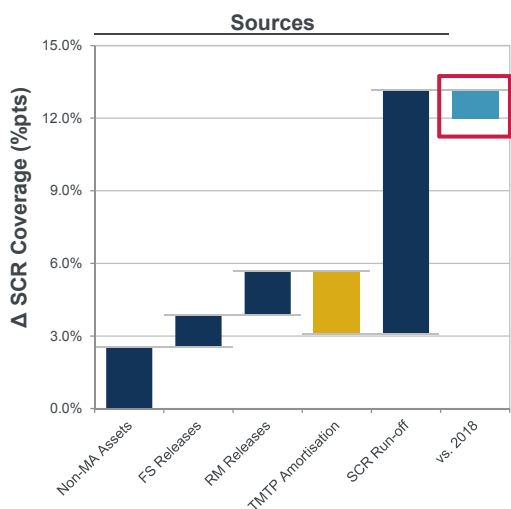


Source: LCP, Hymans Robertson, company press releases, (e) 5% p.a. future growth

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## Capital Generation | 2019 Year-to-Date



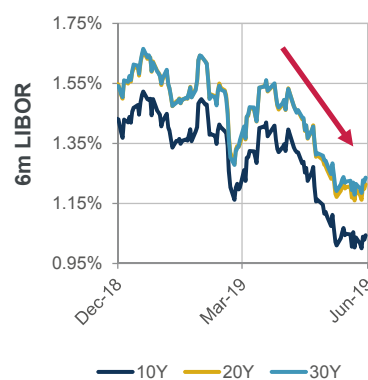
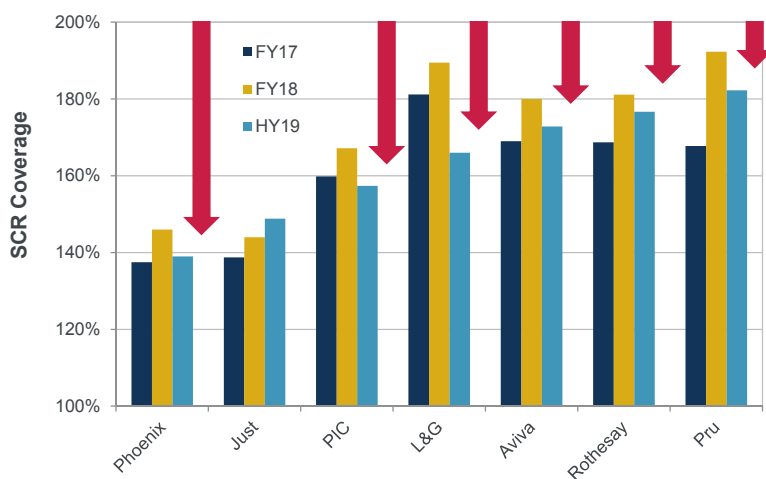
- Capital generated from in-force expected to exceed 2018 levels
- Higher new business volumes
- Over £2.1bn new capital issued year-to-date\*
- Capital destructive headwinds...

\*incl. £700m Rothesay equity injection

Source: FY18 SFCRs, NWM estimates  
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## Capital Generation | Solvency Coverage Ratios



Source: FY17 / FY18 SFCRs, 2019 interim results announcements, NWM

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## Capital Generation | Future Projection

### Question:

Over a **five year horizon** and for:

- a **specific pattern of future new business**, and
- a **target SCR coverage ratio**

how much capital must be **generated** (or injected) to support the **dividend policy**?



## Growing Pains

Balance Sheet Projection



## Balance Sheet Projection | Model

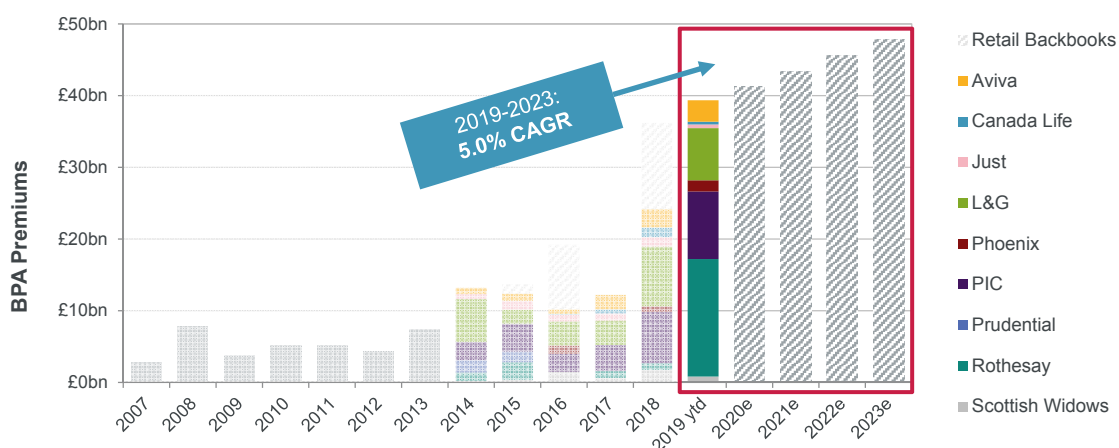
Projected:

- New business premiums
- Organic capital generation
- IFRS profit
- Capital structure

Modelled coverage:  
**76%**  
of BPA market  
(by 2018 new business premiums)



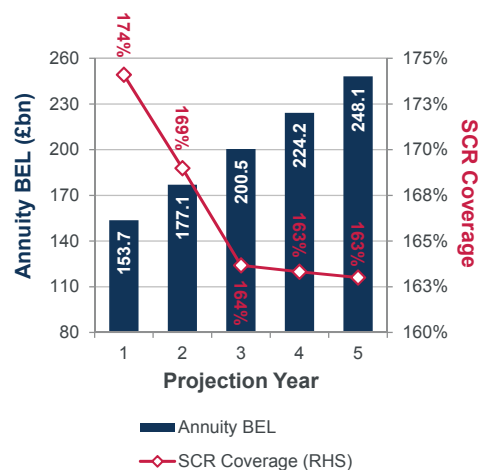
## Balance Sheet Projection | New Business Volumes



Source: LCP, Hymans Robertson, company press releases, (e) 5% p.a. future growth

## Balance Sheet Projection | Solvency II Results

	Proj Year				
Solvency II Capital Generation	1	2	3	4	5
Non-MA asset returns	535	565	598	630	682
Release of prudent margins	744	854	974	1,095	1,218
Amortisation of TMTP	-672	-672	-672	-672	-672
Release of SCR	732	781	839	902	969
Non-annuity business	1,211	1,296	1,387	1,484	1,588
<b>In-force surplus generation</b>	<b>2,015</b>	<b>2,259</b>	<b>2,528</b>	<b>2,809</b>	<b>3,103</b>
<b>New business strain</b>	<b>-2,576</b>	<b>-2,833</b>	<b>-2,975</b>	<b>-3,124</b>	<b>-3,280</b>
Finance costs and dividends	-1,508	-1,589	-1,675	-1,767	-1,866
<b>Capital raised/repaid</b>	<b>2,201</b>	<b>2,325</b>	<b>2,226</b>	<b>3,120</b>	<b>3,165</b>
Other	-653	-733	-801	-872	-946
<b>Surplus generation</b>	<b>14</b>	<b>-5</b>	<b>-100</b>	<b>795</b>	<b>858</b>

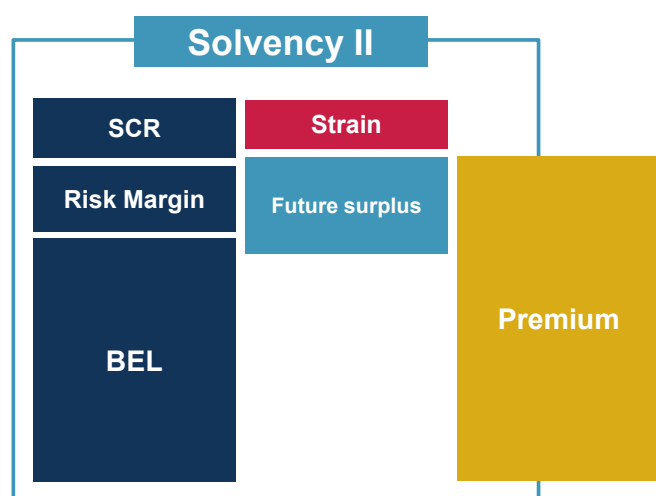


Source: FY18 SFCRs, NWM estimates / modelled results (£m)

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## Balance Sheet Projection | New Business



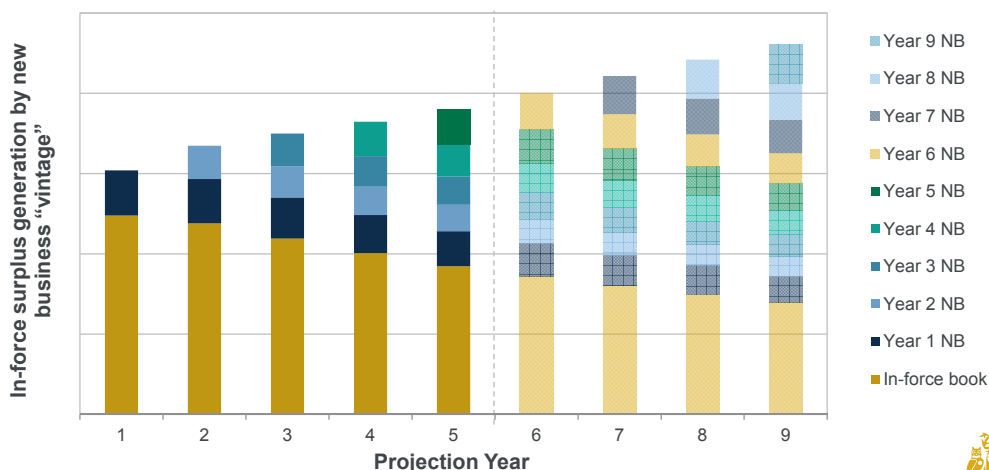
New business:

- Incurs **strain**
- Builds “stock” of **future surplus**

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## Balance Sheet Projection | Growth vs. Decay



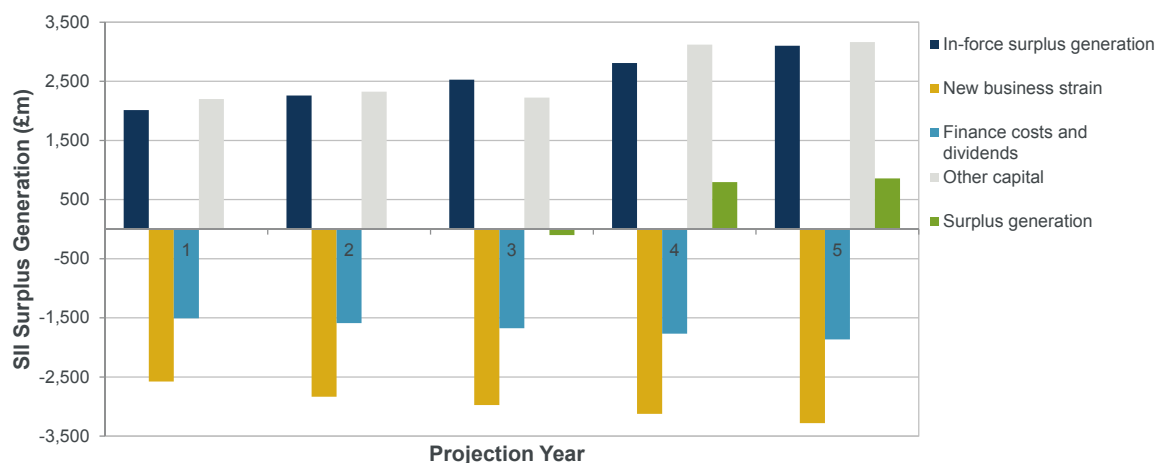
Source: FY18 SFCRs, NWM estimates / modelled results



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## Balance Sheet Projection | Solvency II Results

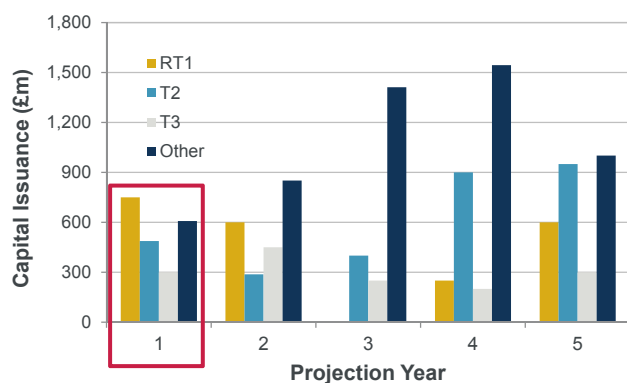


Source: FY18 SFCRs, NWM estimates / modelled results (£m)

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## Balance Sheet Projection | Capital Structure



Constraints:

- Regulation
- Leverage
- Interest cover

Source: FY18 SFCRs, press releases, NWM estimates / modelled results (£m)

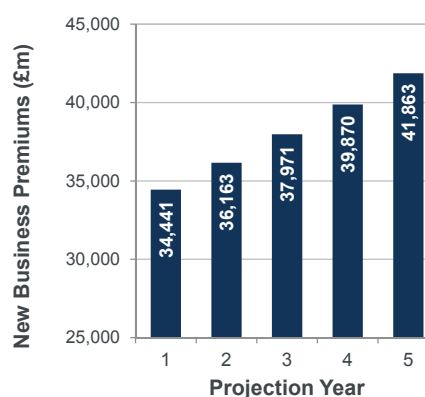
To maintain SCR coverage, "other" capital must be generated from management actions (or equity injections)

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## Balance Sheet Projection | IFRS Results

	Proj Year				
IFRS Profit	1	2	3	4	5
New business profit	1,465	1,538	1,614	1,695	1,780
In-force profit	1,186	1,379	1,573	1,769	1,967
<b>Underlying op profit</b>	<b>2,651</b>	<b>2,917</b>	<b>3,188</b>	<b>3,464</b>	<b>3,747</b>
Finance costs	-440	-559	-600	-689	-818
Other	1,211	1,296	1,387	1,484	1,588
<b>Profit before tax</b>	<b>3,422</b>	<b>3,654</b>	<b>3,976</b>	<b>4,260</b>	<b>4,517</b>
Tax	-650	-694	-755	-809	-858
<b>Dividends paid</b>	<b>-1,151</b>	<b>-1,232</b>	<b>-1,318</b>	<b>-1,410</b>	<b>-1,509</b>
<b>Retained earnings</b>	<b>1,621</b>	<b>1,728</b>	<b>1,903</b>	<b>2,041</b>	<b>2,150</b>
Fixed charge cover	8.77x	7.54x	7.63x	7.18x	6.52x

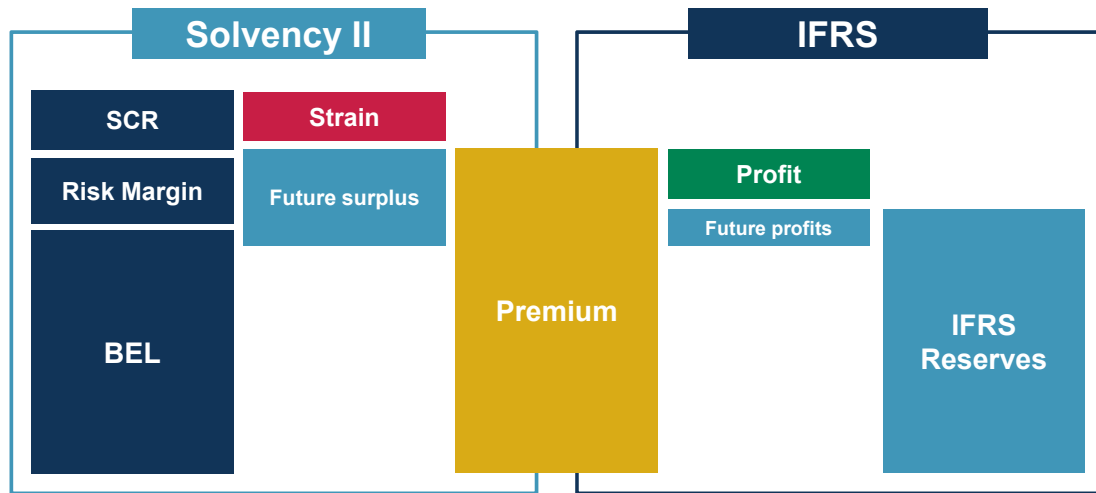


Source: FY18 SFCRs, NWM estimates / modelled results (£m)

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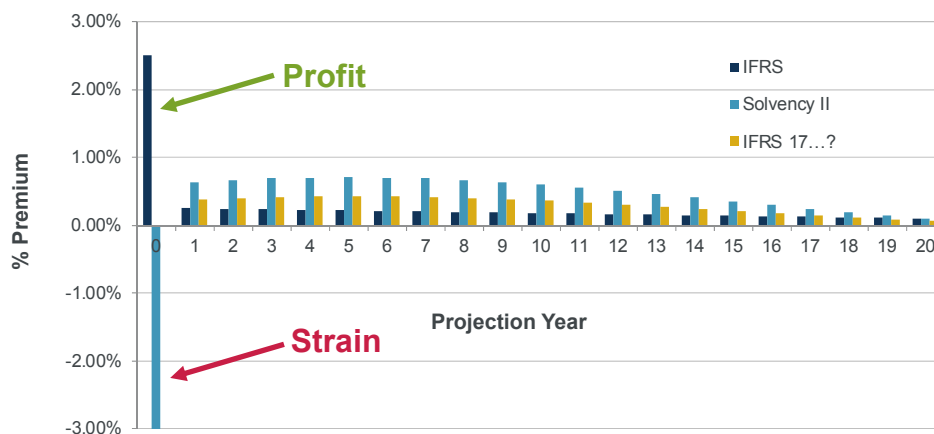
## Balance Sheet Projection | New Business



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## Balance Sheet Projection | Profit Signature



Firms need to manage **constraints** across balance sheets in parallel

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## Balance Sheet Projection | Key Points

Participants need to:

- Grow the **in-force book** to increase (organic) **capital generation**
- Generate **new business profits** to create **distributable earnings**
- Manage **new business strain**
- Manage **leverage** and other **ratings constraints**

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## Investing in BPA

“Give us the money NOW” (1)



(1) RFZ Geldof, 13 July 1985

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## Investing in BPA | Why Invest?

### Annuity businesses provide:

- **scale** and **expertise** required to invest in **illiquid assets**
- the ability **transform** long-dated **fixed income** into (levered) **equity investments**
- access for both **public** and **private** investors

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## Investing in BPA | Accessing Illiquidity Premia

Legal & General commits a further £200m to UK transport infrastructure  
31 Jan 2018

Legal & General finances renewables sector with Dudgeon offshore wind farm  
20 Dec 2018

Phoenix provides £50 million funding to A2Dominion

30/08/2018  
PIC invests £145 million in Durham University

**Rothesay Asset Management US LLC**

During 2017 we opened a new subsidiary in the United States, Rothesay Asset Management US LLC, to help source investment opportunities there. This strategy has begun to pay off during 2018 with Rothesay Asset Management US LLC helping the Group to source a number of investments in the US, including commercial real estate financing, US government-guaranteed loans and asset-backed financing. The currency risk associated with these investments is managed by the use of cross-currency swaps.

The Group is now looking at the potential to replicate this strategy in other geographies.

Source: L&G / Phoenix / PIC press releases, Rothesay annual report

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## Investing in BPA | Public Markets

Public markets investor rationale is often split between those who are:

- Growth-driven
- Yield-driven: “equity trades like debt”

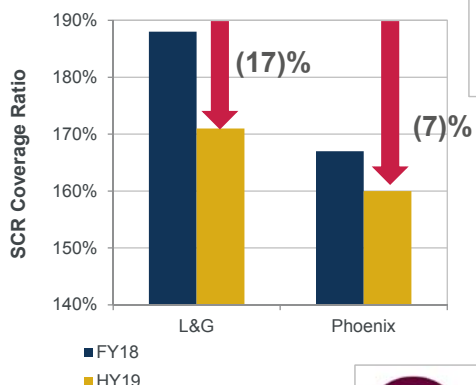


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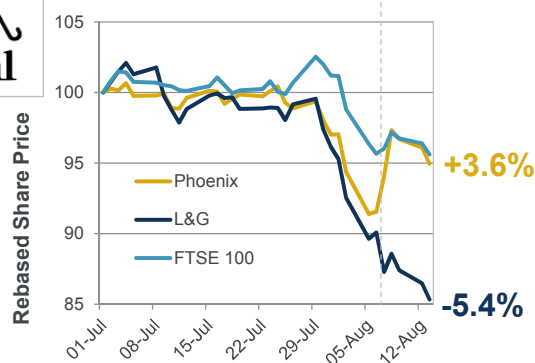
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## The Investor Story | Public Markets

Does public ownership make sense?



2019 Interim Results  
7<sup>th</sup> Aug 2019



Source: FY18 SFCRs, 2019 interim results, NWM



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## Investing in BPA | Private Markets

- Increase AuM
- Exploit specialisms
- Exploit economies of scale



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## Conclusions



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## Conclusions | 2019 and Beyond...

- **Pension schemes** will continue their **de-risking journey**
- **BPA** needs further **capital injections** to become **self-sufficient**, allowing for “new normal” **new business volumes**
- **Management actions** will remain an important capital source
- **The investor story** remains strong, particularly for investors seeking **fixed income-like** returns / access to **illiquidity premia**

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Questions



Comments

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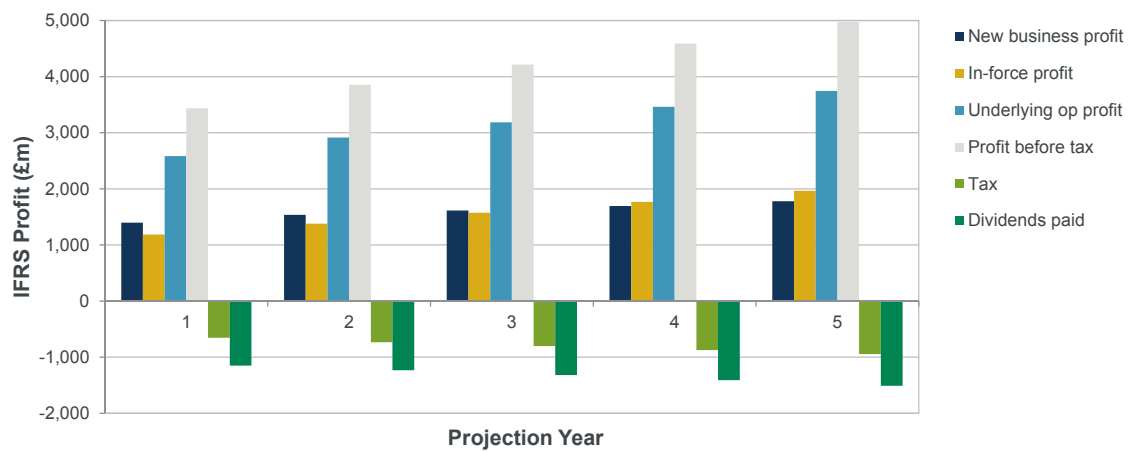
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# Appendix



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## Balance Sheet Projection | IFRS Results



Source: FY18 SFCRs, NWM estimates / modelled results (£m)

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## Balance Sheet Projection | Self-Sufficiency?

	Proj Year				
Solvency II Capital Generation	1	2	3	4	5
Release of prudent margins	744	854	974	1,095	1,218
Amortisation of TMTP	-672	-672	-672	-672	-672
Release of SCR	732	781	839	902	969
<b>In-force surplus generation</b>	<b>804</b>	<b>963</b>	<b>1,142</b>	<b>1,322</b>	<b>1,515</b>
Dividends paid	-1,151	-1,232	-1,318	-1,410	-1,509
<b>Surplus gen / dividend cover</b>	<b>0.70x</b>	<b>0.78x</b>	<b>0.87x</b>	<b>0.94x</b>	<b>1.00x</b>

Additional factors:

- **New business** strain?
- Finance / other **costs**?
- Target **SCR coverage**?

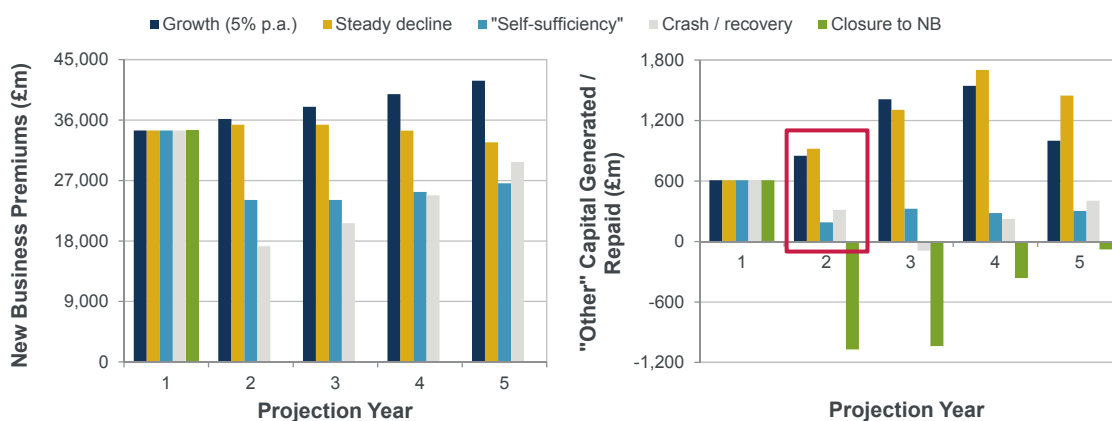
Source: FY18 SFCRs, NWM estimates / modelled results (£m)

At these levels of new business, surplus from other **business lines / capital sources** is required to cover the “additional factors”

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## Balance Sheet Projection | Alternative Scenarios



Source: FY18 SFCRs, NWM estimates / modelled results (£m)

Writing new business creates **hybrid capital capacity**

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