RETHINK RETIREMENT

JUST GROUP – FY 2018 RESULTS

ANALYST PRESENTATION Q&A

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PARTICIPANTS

JUST GROUP

- Rodney Cook (Group Chief Executive Officer)
- David Richardson (Deputy Group Chief Executive & Interim Chief Financial Officer)

SELLSIDE ANALYSTS (IN QUESTION ORDER)

- Greig Paterson – KBW
- Oliver Steel – Deutsche Bank
- Ashik Musaddi – JP Morgan
- Gordon Aitken – RBC
- Barrie Cornes – Panmure Gordon
- Andrew Crean – Autonomous
- Rupert Harcus - Guy Butler

Note: Edited transcript

Greig Patterson: Thank you. Greig Patterson, KBW. Three questions. One is, Aviva said the interaction of the Effective Value Test with the SCR resulted in them increasing the SCR by £200 million? You have a similar amount of equity release, if that was the case here, that would be a very problematic issue. I wondered if you can give us some insight into what's happening there.

Second point is, your Solvency II ratio as previously guided will reduce and then trough and then start climbing, that's the expectation. I want to know when it will trough and at what level it will trough, post the capital actions.

And the third thing, I met with some EBCs the other day and they said something interesting to me. They said, 'Most pension funds don't like top slicing,' because if they provide that data, they only get two people quoting, and they'd rather not provide top slicing data and get eleven or twelve people quoting. So, to me that seems like a major material headwind for you guys in the long run, so I just wondered if you want to talk about that as well?

Rodney Cook: Well, you're obviously going to make David work hard. David, do you want to take top slicing? Just to be clear, we have given you a great deal of insight into how to run your models, so we're not going to do your models for you. So, you can work out how the ratio will go down over the next three years, but David should answer top slicing.

Also a comment on EVT. Clearly, the PRA's consultation isn't even out. Other companies haven't included an allowance and, of course, I think the most important thing is, we do hope that the regulator will take note of the input from the Institute of Actuaries, in terms of the overall conservatism in the NNEG calculation in the next part of their consultation. Could you pick up on that one and on top-slicing?

David Richardson: Yes. So, I'll do top-slicing, that's quite straightforward. It's been a very small part in new business sales, Greig, for a while now. We still do some reasonable volumes of medically underwritten business in the DB space, but increasingly, it's our DB choice proposition, which we set out in our appendix of the slides today. And effectively, that's where we offer an improved price and go down the medically underwritten route, but we only actually conduct the medical underwriting after the pension scheme has chosen to transact with Just, so it avoids the risk you've just described. And, in fact, the launch and success of that DB choice was one of the two reasons we were cited as the winner of the risk solutions provider of the year, it's that type of innovation that really goes down well on the DB market.

With the SCR and EVT and stress, obviously I'm not going to comment on what our competitors have done, I've no insight into their models. We await with interest what the PRA are going to come out with. We really would like it clarified. As Rodney has mentioned, there's a raft of conflicting views out there and comments on this topic, some of which are arguing for much lower capital requirements. There are some outliers out there saying it should be higher capital requirements. So, we'll engage very constructively with the regulator once that consultation comes out, but from our perspective, you just can't call it at this stage, it would be speculative.

Oliver Steel: Oliver Steel, Deutsche Bank. First, can you give us some guidance on the cost overruns in the roll forward of the Solvency II figure? Secondly, I actually think Greig's question on the Solvency II outlook is quite a reasonable question. You're raising almost half your market cap in new debt or equity. It seems quite reasonable to find out what level you see is the minimum level over the next three years. I'd quite like to know what sort of range of solvency you're targeting and secondly, in order to keep within that range, how you see the outlook for new business volumes not just in 2019 but also in 2020 and 2021.

RC: Right, I'll do the second part if you'd like. In terms of your models, think of the business level from the second half of last year. So, maybe 2 billion and growing from there. We intend to husband the fresh capital very carefully. We will utilise it, so for example, if we get breakthroughs in NNEG reinsurance and other such matters, if we can price at less than the 5%, then that would give us potential further growth, but we want to husband that capital very carefully. We've indicated that you should think of a £100 million cost over the three years (from PS31/18), alongside that capital growth. You've got the one-off amortisation element that will be gone in the two years. We've spelt out the amount of that and you can factor in a high single-digit cost on our RT1 instrument and David can talk to you about the cost.

To be clear, the board is comfortable at 136 and the important thing is we also take into account from a market view is Fitch. Fitch in their rating for us, say three things. We'd like to see you keep your Solvency II ratio above 130. We'd like you to keep your coupon coverage above three times and we'd like you to keep your leverage below 30%. Now, going beyond any of them at any one point is not a trigger for a downgrade, but obviously, they would wish to talk to us about what actions we'd take into the future to rectify that.

So, 160 isn't a new board appetite. They're comfortable at 136, but very clearly, the board would be looking at it and I've just indicated the things that will be moving in the next few years. It's timely and one of the critical things here, Oliver, what you guys have been saying to us is, 'Look, the profits look great, but are they sustainable? We always are asking questions about your capital position'. We're saying that we're taking a fundamental and significant step to strengthen our capital position to put the very concerns that you've raised with us, behind us. So, no, we're not targeting 160 or any particular number, I've given you the range. The good thing is Fitch consider the RT1 as equity, so in the first step, we have lowered our leverage. As David indicated, we could look to the tier two market and you fully understand how companies normally use 'business as usual' finance when they're coming up to 're-fi' bonds. You can see that in our accounts and we're well above the coverage. So, I think that's as good as I can give you in terms of how that will trend down. It clearly will and David, importantly, costs.

DR: Yes, so, 2018, I'd say, was an unusually high year for that because we did incur a lot of non-recurring costs associated with our response to the consultation paper. So, as you recall back at the time of the interims, we talked about how we were preparing a range of potential capital actions depending on how severe the outcome might be. The preparation for all those significant capital actions tends to cost a lot of money, remember we mentioned a large in-force reinsurance transaction, that runs up a lot of costs. Also, preparing for some of the potential capital raises also costs money. Any business will always have some degree of non-recurring but I think what you saw in 2018 is highly unusual. In terms of the expense overrun, because we're guiding that we are going to slightly rebase sales in 2019, then grow from that revised base. I think you should assume there will be a degree of expense overrun for the next, say, couple of years, one to two years. But it should not be a significant component of your roll forward, really, beyond that.

Ashik Musaddi: This is Ashik Musaddi from JP Morgan. Just a few questions. First of all, it feels like your SCR went down this year. I was a bit surprised because you have done the new business strain, which should have increased your SCR, but if I look at slide fourteen, it looks like SCR actually went down. So, where is that benefit coming from? That would be great to know. And in which bucket is that? That's the first question. Second one is, can you just give a bit more math on this break-even in 2022, because if I think about your in-force release, say 125 million without extra amortisation, times, say, 15% growth, it would be around, say, 180, 190. If I look about your SCR for second half, 65 million times two, 130 million, that number should grow as well. So, we are breaking even on this one but you still have interest cost of 70 million negative, so how should we think about this break-even over a three, four-year view? And lastly, is dividends. You're still generating negative capital. What's the rationale of paying a dividend at the moment, given that it feels like in three years' time, you will be close to 130, 140% solvency ratio. So, I know it's a token dividend, 1.5p dividend yield would be 1%. That's not material but what's the rationale behind doing that? Thank you.

RC: So, I'll do the dividend one first because I've obviously spoken to a large number of investors this week prior to the launch of the placement. So, all investors want us to husband this capital very carefully and the break-even self-sufficiency is important to them, so yes, a large number of investors said, 'Pay no dividend.' Some said, and this is in the minority, 'Can you keep the dividend?' but overall the consensus was that the discipline of paying some dividend was important. But to put it into clear perspective, with the increased share count and our previous dividend policy, you would be thinking around 40 million per annum over the next three years, that's 120 million out. If we reduce it by a third, that's the 40 million, so the shareholders were very clear with this, 'Do not give us back 120 million when you've asked for 80.' Something much more modest is understandable. When we talked to the debt market, to be clear, they saw the participation from our owners and shareholders alongside themselves and you see 300 versus an 80 million contribution. The debt market saw that as very supportive that the owners of the company were also participating, so that's why I call it a package.

So, look, it's a very difficult call for the board, but our current expectation that we would pay a dividend for that discipline but at a much lower rate. I'll let David explain the SCR, but the easiest one is, at the 2nd July when we read the consultation paper and it came as a surprise to us as much as to all of you in the room. Our DB promises were already made. Of course, we couldn't back away from those in the pipeline. Every annuity custom has at least 30 days guaranteed price, so the make-up is the full flow of business promised in the first half into the second half, and then the pricing changes. And we didn't hit the market on one day with the final price. We made two or three changes between July and September, so that is the reason for the six and a half. We're pretty comfortable with the sort of 5% guidance. Can you help with the other part?

DR: Yes, so just to round out what Rodney was saying there. So, absolutely, you're thinking about it in the right terms, in terms of the in-force surplus, you take the net 125 and grow it at about fifteen percent. But then in terms of working out what the new business strain might look like, it's more a ratio of about a 5% strain on new business, give or take, and then apply that to the volumes. If you do that, you should hopefully get into the right ballpark. With respect to SCR, it actually increased by about 4% this year, so when you get a chance to go through the RNS, you'll see it increased by about 4% from year-end seventeen to year-end eighteen. And that's actually even on a notional TMTP re-calculation. So, there's no interest rate sensitivity going on there, so that reflects the growth of the balance sheet.

Gordon Aitkin: Gordon Aitkin from RBC. Three questions, please. First, reinsurance was an option. David, you just mentioned it. What happened there, why wasn't it chosen? Economic counter ratio of

256%. It just begs the question of why you didn't use a reinsurer, which was outside of the Solvency II regime.

Second question on the assumption changes and I see the 34 million charge is the difference between two items that you said, basically, you got a zero on annuities but you have a negative on lifetime mortgages. You moved to CMI 17, so what was the life expectancy reduction in months on the annuity book and what was it on the mortgage book and if you allow for the voluntary redemptions? You got CMI 18, which is coming. It shows a much bigger six-month reduction in life expectancy. I see your sensitivity analysis makes me think I should have or I should keep the very large reserve release I've got in my numbers, but after this year, I'm not so sure. So, if you could explain that one.

And then just finally, on equity release mortgages, Rodney, you alluded to the Institute of Actuaries' recent research. And they said, historically, volatility on average has been about five percent. Actually, the only in Northern Ireland in one recent tenure period, has it been anywhere close to double digits and that was 10%. Why are you increasing to 13% one year early, one year before you're required to do so? This sounds like being overly prudent and prudence in an insurance is great, but prudence when it causes you to issue equity is not so great. Thanks.

RC: So, I want to be clear. The capital steps that we're taking are with respect to the Solvency II balance sheet, not the IRFS balance sheet. I accept, in hindsight, having a 13% IRFS volatility makes it coincidentally look like it's connected to the PRA's assumption and that was not its purpose and it is not connected. My comments, with respect to the Institute of Actuaries, they have raised some questions about the PRA's model and also the calibrations. You've said they've talked about 5% volatility. Of course, there's idiosyncratic risk that you need to load on top of that, but I appreciate their comment was that something over 10% looks like a stress scenario rather than a best estimate. I think we are responding to questions that people in this room may have asked us about our level of prudence, so we do want to make clear that when we make these prudent changes, that should give in your mind and those of investors that our declared profits are more sustainable. Because we've been asked those questions. David, can you tackle the 256 and the CMI very quickly, because I'd like to give Barry a chance and maybe Andrew, if we have time.

DR: Okay, so, on the longevity, we did a comprehensive review across, frankly, all our retirement income business and all our LTMs, so, it wasn't a simple (x) month change. And a really important thing to bear in mind in our business, is that whilst overall mortality improvements slowing down across population is helpful for us in the round, it's a complicated picture for us because of the impact of medical underwriting. And for medically underwritten business, that interaction between the assumptions you make about the impact of the medical or lifestyle conditions is something that we tailor to each individual that we underwrite. As you know select periods, we've got a relatively young book of business that's still in its select period, and so, that interaction of how the mortality excess runs off over time is almost as important as the underlying change in trends on broader mortality improvements. The impact of CMI 2018, we need to go and look at that carefully. We do anticipate some of these trends, so as you'll know, within the CMI model there is an assumption about the smoothing parameter, which is how much credit do you give to recent information versus smoothing it out over time. You'll pick up from our slides over more than two or three years now, we saw this trend coming for quite some time. And so, we've actually anticipated some of that CMI 2018 change a couple of years ago. So again, managing expectations down on what the impact CMI 2018 will have, we need to have a good, close look at it now that it's come out, and how it interacts with our business.

On reinsurance, yes, we absolutely did look at a large in force reinsurance transaction on back book business, so, pre-Solvency II business. And that transaction might well have made sense, if the consultation paper had been implemented as originally drafted. So, if the rules had been applied to the old back book, without the full TMTP offset, that might have made economic sense to do so. But once that was avoided or averted, from a shareholder value perspective it just didn't stack up. Why the reinsurers, as you say, don't reflect economic capital fully in their pricing, you'll have to ask them. I've seen at least one in the room here today, so you can catch him later. But the pricing, just from a shareholder value perspective didn't make sense. The one thing I will say, though, is a consequence of the new capital requirements on LTMs being so onerous, is that risk transfer solutions around the NNEG risk itself may now look more attractive. And so, that's an area that we are looking at and will continue to look at.

RC: Just an important comment on models. There are many models, as the institute talked about. We can operate, given time on any model that is put to us. We have a real portfolio of real customers. What we announced at the interims, was: if we applied the PRA's effective value test at thirteen one, it produced a NNEG for our portfolio and then we can back solve and work out that for our portfolio, nobody else's, for our portfolio we would need property prices to fall 35% across the board and never recover, in order for our property portfolio in the real world, to deliver that NNEG calculation. So, we've been clear that we think that, that calibration is very conservative indeed, but you've all written that the regulator sets the rules. The consultation hasn't come out. Obviously, we know that they will read carefully the institute's input and we have to wait for that.

Barrie Cornes: First one, Rodney you mentioned about possible hedging of the no neg, I wasn't aware there was a market for that, I think that you indicated there wasn't a couple of years ago. Could you just give an update on that? So, what it might be and what would it cost? And second one, just wondered, going into all this process, I just wondered if the board took a review on strategic options ahead of going into the capital raising again, so if you'd comment on that, please.

RC: Well, let me do the strategic options. Of course, I met with fifty investors after the interims and a number of them said, 'Is your company for sale?' We are listed on the stock market, of course, our company is for sale. The important thing that we undertook from that point on, and we still do, is if our company is for sale that we maximise the price and the value for our shareholders. The capital actions that we're taking today and the discussions with our major shareholders, say, this stabilises our position, gives us the capital strength to show to anyone in the market that we are an ongoing strong new business franchise, its attractiveness has been increased by these capital steps, not diminished. But we're not asking for strategic options, this capital gives us a strong foundation to remain as an independent business, and the market will be the market.

DR: Yes, just very quickly, so, what we've seen out there Barry, is there is a demand, a desire to provide long term economic risk transfer on NNEG risk Long term, and I'm not talking about over a couple of years, but, over 20, 30 years plus. What we're working through at the moment is, can we find the right type of solution that is Solvency II compliant, i.e. you'll not just get the economic risk transfer, but you'll also get the benefit in your Solvency II calculations and make sure, for example, that it all works in the context of this new effective value test. So, that work's ongoing.

RC: Because Barry, as you know, you have to convert the mortgages in a group into notes, before it flows through into your Solvency II balance sheet, so, we're delighted that there are parties interested and we're at the forefront, we believe, in this innovation.

Andrew Crean: Okay, could you say based on IRFS and on Solvency II, if we get flat property markets this year, what would be the impact on those two things? And secondly, you talked about the growth in the BPA market. From what I understand, quite a lot of that growth was on big ticket stuff above the £250 million. What are the growth prospects of your part of the BPA market?

DR: So, on the latter question, we are still seeing a strong growth in our target segment.

Andrew: Is it the same as in the bigger market?

DR: We don't have full visibility on the big market because we don't play there. But the big market's clearly lumpier, yes, so, if a £4 billion transaction comes along, that can make a difference to the growth rate in that market quite significantly. But we're seeing very strong growth drivers, very healthy flow of transactions because pension schemes are improving their funding levels all the time, they're going further along that de-risking journey.

RC: Right, and movements in property prices? And can you cover our experience of the last half of last year.

DR: Yes, so, within the £256 million of in force surplus that we've shown in the Solvency II waterfall, that bakes in our assumed rate of property growth, okay? Which will now be 3.8%. So, you get a positive surplus by achieving that. If you have flat growth, then you don't get that positive surplus emerging, so, it's less that it's a hit of significant quantity, but more that you don't get that surplus emerging. You saw in the first half of this year, that we had a £49 million variance, from what was from memory, just shy of a two and a half percent variance, so, it was a slight negative, so, just below flat. It would be broadly speaking that 256 would be reduced by, I don't know, high double digits, maybe around 100 million, yes.

Second half of last year, it was in line with our assumptions. There were negligible property variants on both on IRFS and Solvency II rates.

RC: And Andrew's question was, the difference between the IFRS and the Solvency II, is there a difference for that flat property market, versus 3.8%?

DR: So, absolutely, yes, because you're holding a lot more margin. We've also published our IRFS sensitivities today, so you'll be able to contrast those versus the Solvency II ones to see the relative sensitivity.

Rupert Harcus: Rupert Harcus, Guy Butler. Just quickly, if I know correctly, were you saying that on the lifetime mortgages that customers will now be able to pay interest rather than it ratcheting up on the LTV?

RC: So, we've launched a suite of interest service, and we've expanded our portfolio, so that people can pay interest. David, it only applies to business written from now?

DR: Yes.

RH: And will that go out on all products?

RC: it's a new option on all new sales.

RH: Does that materially change the dial, in terms of how much capital you have to hold against the product?

RC: Absolutely, because if you service the interest, it might be 5%.

And we give preferential rates if you're servicing the interest, the interest rate is slightly lower than if you're not servicing, so there's all sorts of incentives. Then, the loan doesn't increase at all and the risk is much lower.

RH: Does that mean you'd be prepared to lend higher LTV against that product by virtue of the fact that they're paying annually?

RC: Slightly, but to be absolutely clear, the customers in this market are ones that have got income, so, for example, government employees, DB pensioners, they can't borrow money, but they've got income and they can definitely service. And we can regard a DB pension as better than employment income, in terms of certainty.

Ladies and gentlemen, thank you very much. I'm sorry I've been told that we've overrun, but I do appreciate your time, and I hope that you'll see that these are very positive steps that we've taken today and will be a strengthening for the organisation going forward. Thank you.