Friends Life Group Limited

Q1 interim management statement and update on recent market developments

9 May 2014

FriendsLife

Agenda

Q1 2014 trading update	**Tim Tookey**
Recent market developments	**Andy Briggs**
Impact on guidance	**Tim Tookey**
Q&A	

Key messages

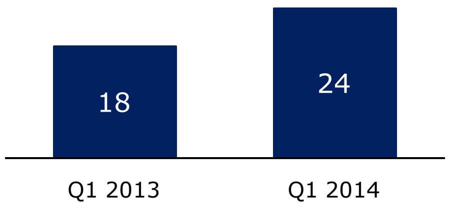
Q1 2014 trading update

- UK division VNB maintained at £35m with strong APE growth of 42% to £201m:
  - Performance supported by strong Protection and Corporate Benefits growth
  - Retirement Income volumes maintained with limited Budget impact to date; contribution reflecting expected margin reduction
- Heritage division preparations for the second phase of the with-profits annuity transfer are progressing well
- International division results reflect challenging market conditions and uncertainty surrounding the potential sale of Lombard
- Discussions regarding potential sale of Lombard are ongoing
- Strong capital position: estimated IGCA surplus £2.3bn

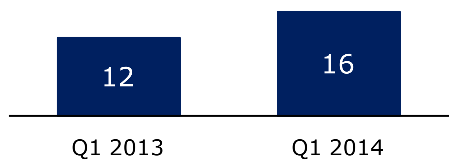
Q1 2014 trading update - open insurance businesses

Protection

APE, £m



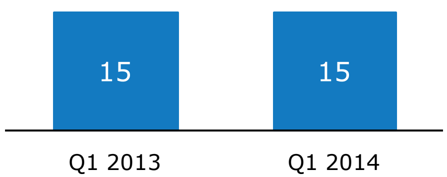
VNB, £m



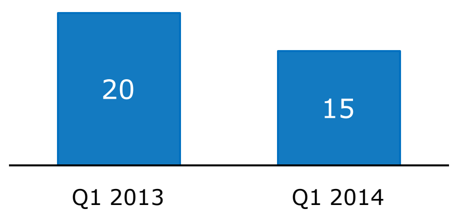
- Sales growth across both the individual and group propositions
- Protection APE and VNB up 33% albeit against a low base in Q1 2013
- Full year VNB expected to be marginally lower than in 2013

Retirement Income

APE, £m



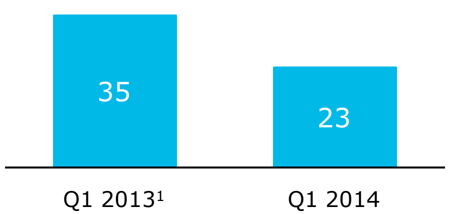
VNB, £m



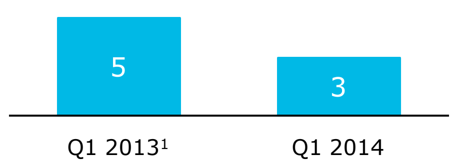
- APE performance reflects strong customer engagement model; VNB reflects expected narrowing of margins
- Post Budget pipeline experience, for non-GAO business, shows 48% of customers are proceeding with their annuity purchase with 15% cancelling and 37% undecided

FPI

APE, £m



VNB, £m



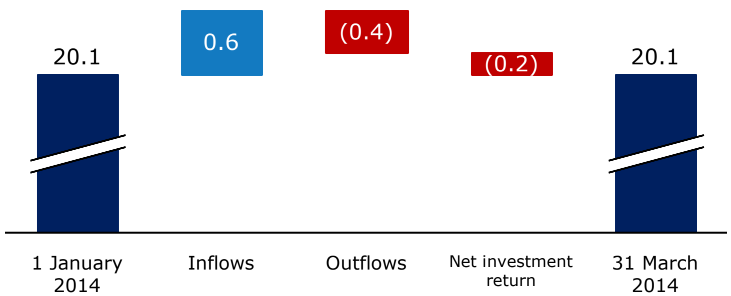
- International results reflect continuing market challenges, particularly in North Asia where the whole unit-linked market is down by circa 1/3rd
- Platform development progressing well, but constraining product development

1. *2013 results have been restated to reflect the transfer of OLAB (non-core International) from the International to Heritage division.*

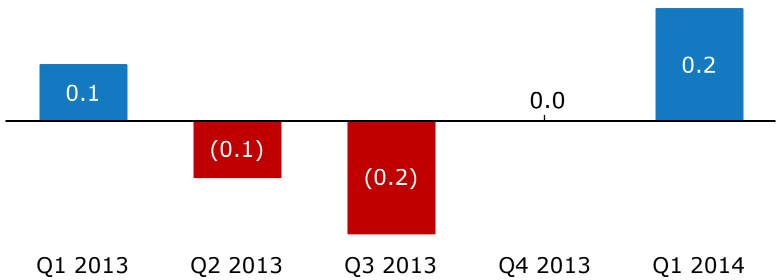
Q1 2014 trading update - asset-based businesses

Corporate Benefits

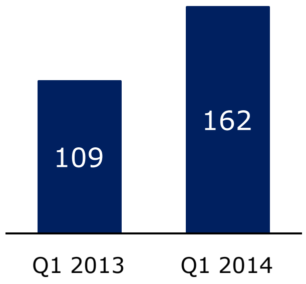
Assets under administration, £bn



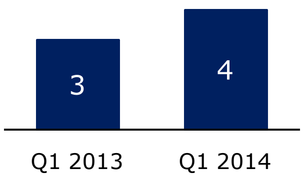
Net fund flows, quarterly progression, £bn



APE, £m



VNB, £m



- Net fund inflows of £0.2 billion reflecting auto-enrolment momentum, with a number of key wins implemented in the quarter
- 187 schemes auto-enrolled in the quarter contributing to 70,000 net increase in total scheme members
- Regular premiums received have grown 6% to £468m (31 March 2013: £442m)
- VNB up 33% on sales growth of 49%

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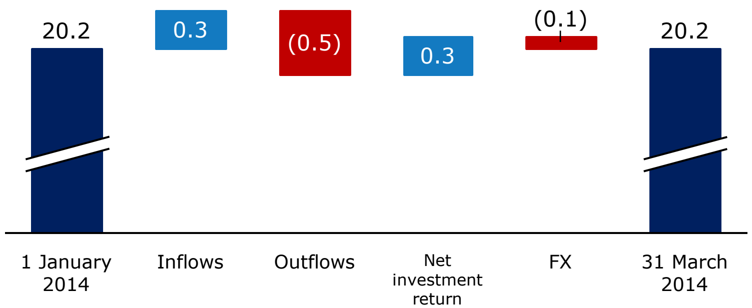
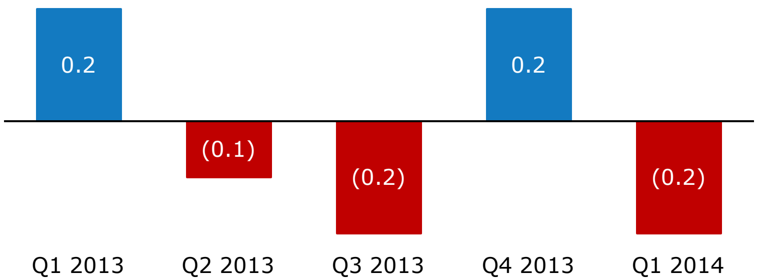
Q1 2014 trading update - asset-based businesses

Lombard

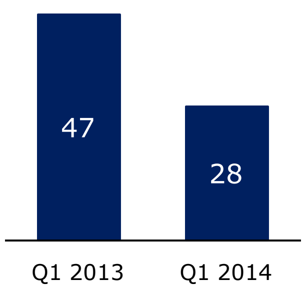
Assets under administration, £bn



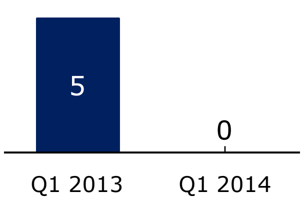
Net fund flows, quarterly progression, £bn



APE, £m



VNB, £m



- Net fund outflows of £(0.2) billion reflecting historically uneven sales profile
- Premium income also reflects challenging market conditions and uncertainty as a result of sales process
- Outflows remain consistent with the 2013 run-rate

Agenda

Q1 trading update	Tim Tookey
Recent market developments	Andy Briggs
- FCA legacy product review	
- DWP pension charge cap	
- March Budget announcement	
Impact on guidance	Tim Tookey
Q&A	

FCA legacy product review

Dedicated Heritage team ensuring customers are treated fairly and provided with good outcomes

- Upcoming FCA enquiry into whether life insurance firms are operating legacy products in a fair way and whether they have adopted strategies that are not in the best interest of existing customers
- Awaiting further clarity on the scope of the review

Heritage business

31 Dec 2013, £bn	VIF	AUA
Unit-linked pensions	0.6	19.3
Unit-linked life	0.7	15.5
Annuity	0.2	9.5
Protection	0.4	0.0
With-profits	0.4	23.7
Total	**2.3**	**68.0**

- Split across a variety of different product types
- Approximately 1/2 of the Heritage business written post 2000, although scope of review not yet defined

We are well placed

Developed key skill set specific to legacy book management

- Standalone Heritage division with no cross subsidy with new business divisions
- Strong governance & TCF processes e.g. With-profits Committee, Investment Oversight Committee, Customer Committee and Customer Experience Forum
- Improving service to customers - investing in migration of legacy products on to modern platforms
- Providing best of breed investment management to customers, including strategic partnership with Schroders
- Active risk management highlighted by completion of with-profits annuity reallocation in 2013
- Regular ongoing product reviews for majority of existing business every 4 to 5 years

DWP pension charge cap

Welcome clarity; limited financial impact

DWP proposals

- A 0.75% charge cap is proposed to default funds of all qualifying DC schemes from April 2015
- The application of Active Member Discounts (AMDs) will be banned from April 2016
- Deductions of commission payments from members' pensions also banned from April 2016

Key drivers

- Vast majority of our pension scheme members are charged at levels below the proposed 0.75% cap for default funds
- All of our AMD schemes have been offered the chance to move their members to a single charge at the current active member rate. No material financial impact to our business for this change

Financial impacts

SFS & IFRS

- No material impacts expected on SFS and IFRS operating result due to potentially largely offsetting benefit of commission ban

MCEV

- Impact on value of in-force business: Driven by lower expected future AMC income; less than a 1% reduction in Group embedded value

One-off MCEV impact in 2014

c.£50m non-operating impact

Capital

- Temporary additional capital expected to be circa £0.1bn in 2015 (less than 5% of current IGCA surplus), following application of the charge cap
- Additional capital expected to fall to zero on a Solvency II basis

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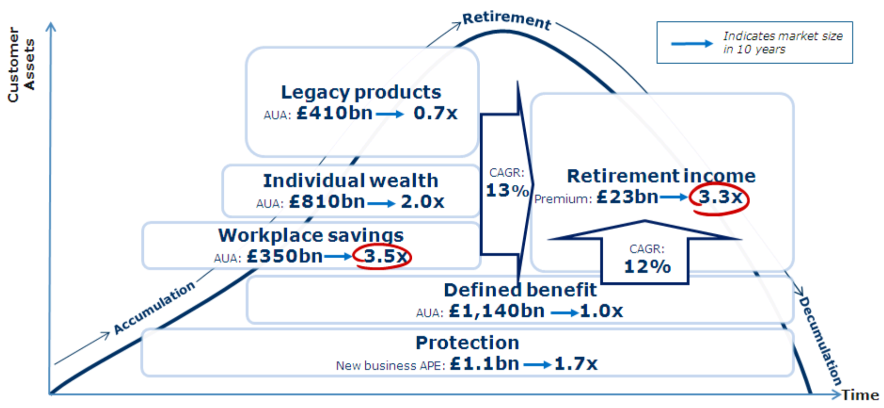
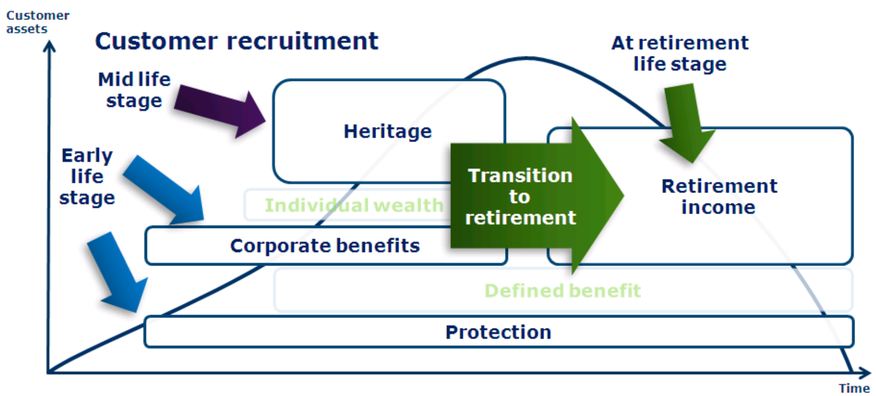
Budget – Impact on market-level asset flows marginal

But major changes to both customer engagement and proposition choices in Retirement Income

Recap: March Strategy Update





Corporate Benefits

- As the No.2 player in the UK, we are well placed to benefit from the growth in the workplace savings market
- This market is now more attractive to savers due to the increased flexibility at retirement
- Logical for customers to decumulate on the same platform used for accumulation

Bulk annuities/longevity swaps

- Considering entry subject to rigorous financial hurdles

Retirement income

- The drivers of growth (demographics, shift from DB to DC) have not changed - still expect the funds coming up to retirement to more than triple over the next decade
- 1 in 9 retiring DC pension customers with us a major advantage
- Customer engagement and guidance will become more critical given the wider range of options
- Customers proposition choices much broader

Customer engagement and guidance - Significant opportunity to help existing mass affluent customers

FL is well placed with 1 in 9 maturing pensions, of which only 30% are estimated to have an active IFA relationship

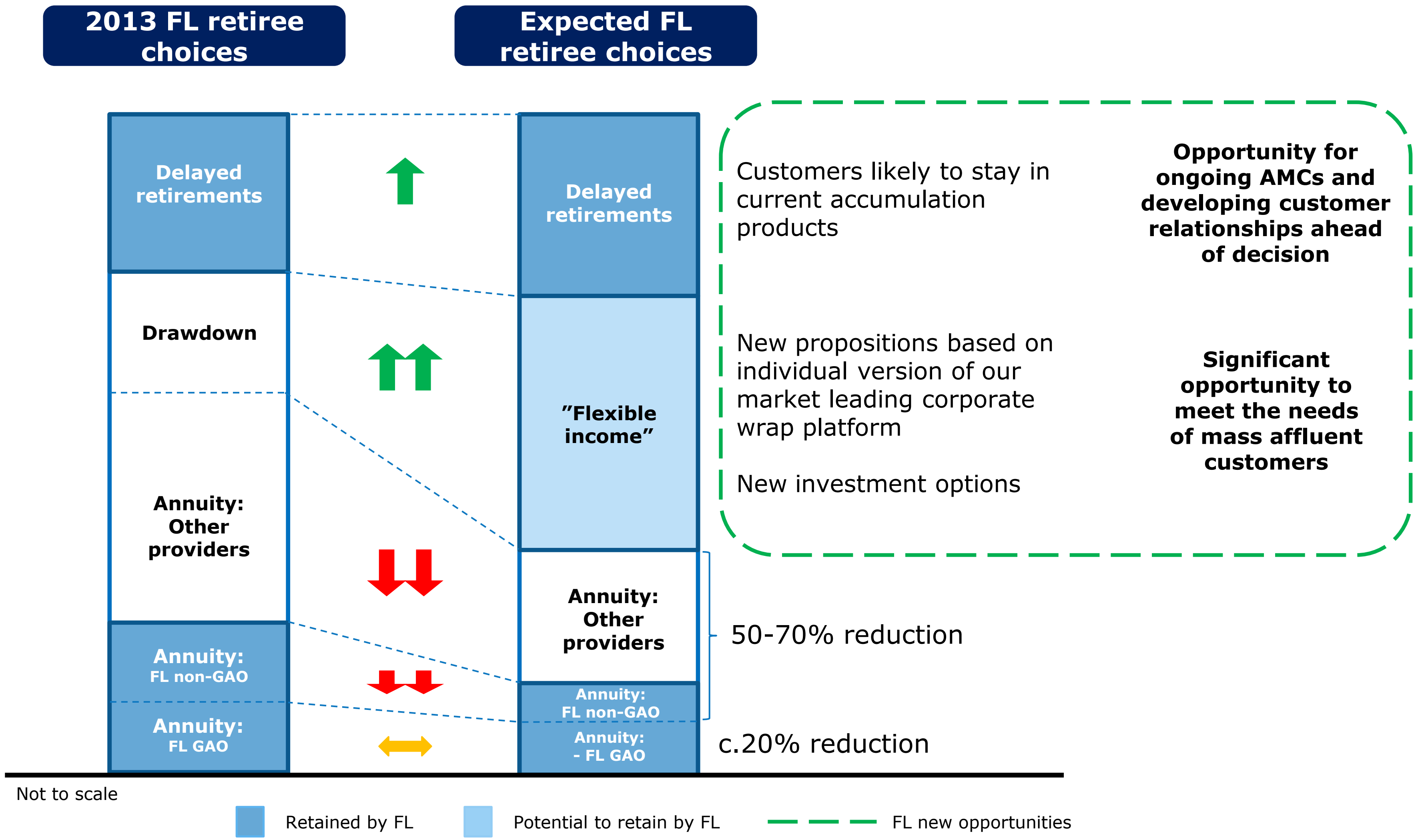
Estimated split[1]			How the market is expected to develop	
FL vesting pensions		FL annuity sales	Current	Future
High net worth: active IFA 30%		5%	IFA selects best platform or OMO	IFA selects best platform. Limited OMO
Mass affluent	Direct 30%	60%	Customer either stays or uses non-advised annuity platform for OMO.	Customer has broader options, hence increased need for guidance. Unlikely to pay IFA fees, and would have high acquisition costs for competitors.
Mass affluent	Worksite 40%	35%	Either employer offers non-advised annuity platform for OMO or as Individual Direct (above).	D2C guidance on options, to include drawdown offer. Logical that this is based on accumulation propositions.

FL primary focus

1. *Friends Life management estimates, for 2013 excluding policies with GAOs*

Customer proposition choices – downside on annuities versus upside from new propositions and deferral

Easy for existing customers to stay on FL platforms – and delay is also advantageous



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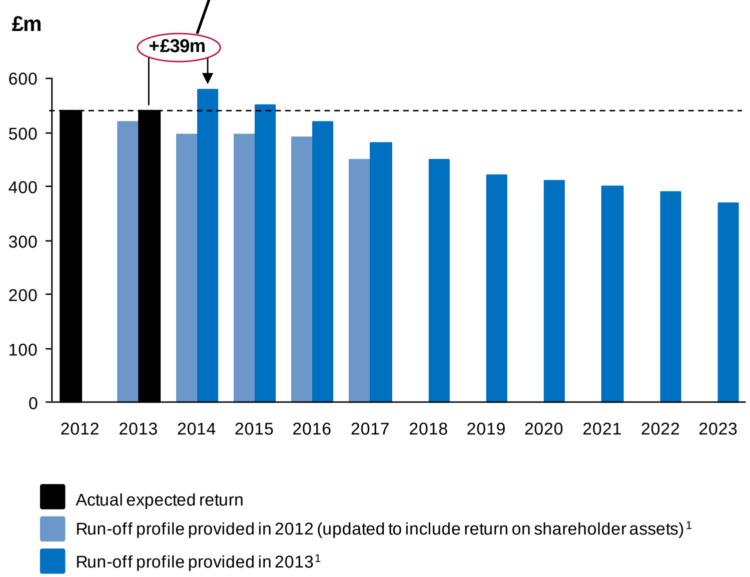
Recap UK & Heritage expected return; £39m uplift confirmed

Confident of growing cash generation

Includes strong cash growth from UK division

- c.£20m of 2014 uplift driven by UK division
- of which £4m contribution from Retirement Income 2013 new business

Recap: March presentation



Shorter term

- Confident that expected return run-off will be exceeded by the contribution of UK new business and Heritage initiatives
- No significant impact from Budget announcement

Medium term

- Broader retirement propositions being developed to offset lost cash contribution from reduced annuity business

Longer term

- Confident that longer term run-off will be exceeded by UK new business growth and new proposition initiatives

1.Based on management estimates and expectations (unaudited)

Performance ambitions

Ambitions largely unchanged; increasing focus on asset-based metrics

Framework

Capital	Cash today	Cash tomorrow
Returns		

Performance ambitions

Capital - *unchanged*

- Maintain a strong capital base, on each measure, at all times

Cash today

- Positive operating leverage on asset-based business - ***unchanged***
- Growing underlying free surplus generation from insurance business – ***no material impact***
- SFS dividend cover of >1.3 times - ***unchanged***

Cash tomorrow

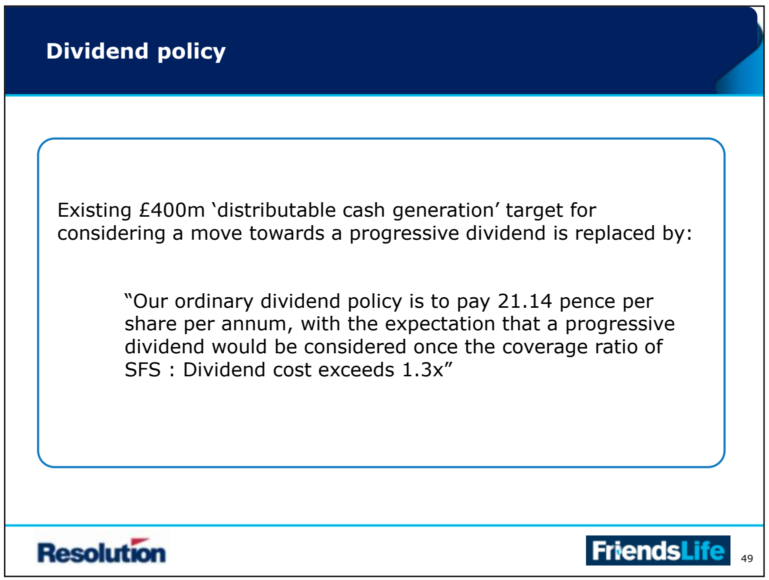
- Asset-based businesses – ***positive***
  - Expected to benefit from changes
- Insurance business – ***challenging***
  - Group VNB 10% growth ambition not achievable in 2014
  - 15% IRR ambition challenging in 2014

Returns - *unchanged*

- 'Cash return' above 25%

Dividend policy unchanged

Recap: March presentation



Dividend policy

Existing £400m 'distributable cash generation' target for considering a move towards a progressive dividend is replaced by:

"Our ordinary dividend policy is to pay 21.14 pence per share per annum, with the expectation that a progressive dividend would be considered once the coverage ratio of SFS : Dividend cost exceeds 1.3x"

- Dividend policy unchanged
- Remain confident of achieving 1.3 times SFS coverage following which the Board will consider moving to a progressive dividend

Recap of key messages

Recent market developments

- March 2014 Budget announcement is a major change for the whole industry, with potential significant impacts in the medium-term:
  - Positive for Corporate Benefits, no change for Heritage or Protection
  - Refocus Retirement Income on existing mass affluent customers from both Heritage and Corporate Benefits, further developing customer engagement and broader propositions – actions underway
- Clarity on proposed pensions charge cap welcomed; limited financial impact
- FCA legacy review - dedicated Heritage management team already ensuring customers are treated fairly and provided with good outcomes

Impact on guidance

- Delivery of 2014 VNB growth ambition now not achievable with IRR ambition challenging
- Ability to deliver £39m uplift in 2014 UK and Heritage free surplus expected returns unaffected
- Dividend policy unchanged; remain confident of achieving 1.3 times SFS coverage, following which the Board will consider moving to a progressive dividend

Q&A