PHOENIX: THE NAME IS THE CLUE

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The contrast with the similar history I produced on my own university is doubly instructive, as, with Phoenix, there have not been the bitter and divisive politics I found there. At the same time, there were personal tensions and much drama. These included the competing ambitions of Clive Cowdery and Hugh Osmond, the rescue of Pearl from near death through recapitalisation using a special purpose vehicle, the relationship between Phoenix's banks and the Group, and the journey to refinance the bank debt, as well as the FSA's (subsequently the PRA's) response to Phoenix's over-leverage and Phoenix's long journey to deliver and be rehabilitated by the Regulator. The end result is that Phoenix today is the vehicle of what were over 140 separate companies, each created to solve a problem that is now far better handled at the scale of Phoenix.

There is no perfect way to write any history and especially not this one. Specialists may well chafe at what they see as a degree of simplification and repetition, but many readers will lack their specific expertise, while repetition is necessary both because the subject is complex and because similar points needs to be made in the very different contexts in which they occur.

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1. THE HISTORICAL SWEEP

Introduction

This is a story for all those involved or with an interest (passing or otherwise) in life insurance and its continuing evolution. It will reflect upon the dynamic nature of our industry and its constant adaptation to meet the changing needs and demands of society and the individuals, organisations and communities who form it.

Our story looks to acknowledge that journey with a clear focus on bringing the reader up to date with the changes in more recent decades and, more particularly, the emergence and establishment of the closed life sector and the Phoenix Group's own highly eventful journey within that.

We will start with a brief historical sweep to consider how the industry came about, what social and financial problems it addressed, and who sought protection, how those needs changed and, as a consequence, how insurance providers and the management of the industry changed. We will touch on the successes and failures along the way and illustrate the continued ingenuity and creativity of this industry in adapting over the centuries to many changes. Woven into that will be the wide family of companies which form the backbone of the Phoenix Group today, and the changes/events taking place for them over the years.

Setting the Scene

Insurance responds to a basic human need for protection against misfortune. Throughout time, those risks, and the protection of them, have come in many shapes and sizes; from small local collectives to large multinational organisations, and from covering death to responding to natural disasters.

This opening chapter gives the reader a canter (in places gallop) through the historical backdrop from the sixteenth century up to the early twentieth century against which we set the wider industry story and context for the core twenty-first century Phoenix story to come. The chapter will provide an historical sweep focussing on life assurance, showing the small scale ventures growing, collapsing, and amalgamating, to form the large-scale organisations we know today. This chapter will take the reader from early origins through key developments, such as the establishment of the actuarial profession, to the end of the 1940's when life was generally good for the large life assurance companies who had come to dominate the market. Its conclusion should set the scene for the expansion and consolidation of the industry to come.

The development of the industry reflects societal themes: the changing demographics of the workforce and boards of directors; the evolution of products offered supporting changing priorities of families: at first, simple life protection, but soon becoming blended protection and savings products.

The consolidation story which lies at the heart of Phoenix also reflects themes found elsewhere in the UK economy: the 'Big Bang', deregulation of the City, the availability of debt and equity finance to fund acquisitions, and the rise of private equity entrepreneurs with an eye for stable cashflows and levered investment returns. Whilst consolidation had always taken place between industry participants, the 2000s were to see the rise of ambitious specialist consolidators. Both Hugh Osmond and Clive Cowdery identified the opportunity to aggregate books of closed life business that for a host of reasons were non-core to insurers. This vision leads to the creation in the 2000s of Osmond's Pearl Group and Cowdery's Resolution.

What is Insurance?

Insurance is a key social need. It is a product of humans living in communities and seeking protection through social arrangements against risk and misfortune. Insurance is a solution, a solution to a significant problem, and a solution that has taken very different forms across history, and will continue to do so. As such, the insurance industry is inherently dynamic because it has to be able to address changing needs, and to do so within altering contexts. The core problem that insurance solves, and which determines its importance, flexibility and value, is uncertainty (or risk). Premiums paid to an insurer may never result in a benefit to a specific individual, but the premium-payer has purchased 'peace of mind' that, were such a risk to occur, he or she would be paid a sum enabling them to replace the lost asset. That is the solution to the problem.

The most economical way of providing that protection is to combine with others and pool both the risk and the amount required for the investment. This process helps avoid the risk of single large loss. Like building societies, life insurance companies work in terms of forming a pool for collective protection. The value of the pool is that it makes it much more likely that the experience of the group will average out to something close to the mathematical assumption.

The insurance aspect was the guarantee that the insured sum would be paid even if the premiums did not add up to the targeted sum. The insurer could make this guarantee because of the law of large numbers: not everyone who buys its policies will die prematurely, so that some will live longer and pay more in premiums than their policy will pay. On average, everyone is covered. The insurer built in a profit margin in the premiums it charged so that it also benefited from this pooling solution.

For long, religion was the key element of protection, and (with much else) provided a different form of risk-protection and pooled cover. However, specific needs also developed and were catered for. The earliest forms of insurance included life assurance. It was required for specific purposes, notably costs of burials and the care of widows and children. Life assurance is a form of insurance that is different to that of insurance in the here-and-now against theft or fire, and, if it draws in part on similar psychological drives, these are more complex and profound in the case of life insurance.

Paying for funerals and burials became a particular form of insurance. This was close to a savings programme in that death and the resulting costs were inevitable. The insurance policy guaranteed that a specific sum would be available to meet these costs, so that premiums (prices) could be priced to cover the sum felt necessary.

Life insurance is similar to funeral and burial insurance in that we are all going to die. This accounts for the term assurance for a certain event, as distinct from insurance for an uncertain event such as fire or theft; although that distinction is not widely appreciated and has largely been lost. Life assurance policies were added to the burial policies in order to leave a minimum sum to the policyholder’s dependents. Again this is a form of pooled saving with unpredictable dates for payout, but the law of large numbers again ensures that the dependants of some will receive more than was paid in premiums, while others will receive less.

Given that a life assurance policy could be active for over half a century, in terms of the gap between beginning payment and death, it is better to take out such a policy with a company that looks like it will still be active and solvent in over half a century’s time. That is a key reason why size, visible strength and longevity were, and remain, important aspects in marketing life assurance policies.

Life insurance is essentially a means of deferred protection and, as such, is a product of man being a social being and of the ability to conceive of solutions in the abstract. For most of human history, insurance was provided on the micro-level by the family, by kindred groups, and by the local community in its varied manifestations: geographical, occupational, social, ethnic, and religious. At the macro-level, insurance was provided by the institutions of power and governance, secular and spiritual, notably by the practices of law and order that for example provided protection to the vulnerable, and by belief patterns focused on observance and redemption that included a duty of care. All the great religions have included provisions for this form of insurance, and have encouraged charitable giving and institutional care accordingly. Thus, in Britain (and elsewhere), insurance was as much a matter of the castle and cathedral as of guild-based systems of care.

The development of the precursors of the modern insurance industry were manifold, and, indeed, this industry sits within the currents of modernisation in a very profound way. Phoenix is a product of the current financial revolution, and its history rests in that. At the same time, to understand this revolution and to appreciate some of the issues and prospects for the future, we need to start with the background to the first financial revolution. It helps us evaluate the current one, the second, and also why people purchase life insurance, the basic drive that accounts for the turnover of

Phoenix. Readers, however, who would prefer to start with the second financial revolution, should turn to page xx.

Long-term economic development led to monetarisation and the attaching of monetary values to particular economic outcomes. New financial instruments were designed to ease credit and borrowing, including bills of exchange, which acted as credit contracts. As goods, services and land were commodified, so markets for their trade developed. The recording of transactions and outcomes, a practice in part reliant on bookkeeping, encouraged a quantification of risk. This was as part of a more general engagement with information as a formal means to classify and understand events and to predict trends. A degree of secularisation was relevant. Instead of seeing success, failure, and, therefore, risk, in terms of the workings of divine providence, the actions of prophets and the activities of priests, or the malign doings of diabolical forces, and their earthly intermediaries, such as witches, space, time and events were increasingly appreciated in mechanistic terms, with divine intervention being a more distant process. It was believed that the human capacity to understand a logically conceived universe reflected the divine will, both for humans and for the universe. Rationality and its application were central to what became known as the Scientific Revolution of the seventeenth century, a process closely linked to the mathematisation of knowledge.

So also with economic matters. Intellectual advances provided the sense that certain aspects of the environment could be controlled or better understood. The development of statistics and probability was particularly pertinent, not least as they offered alternatives to astrology and fatalism as ways to understand the present and predict the future. As such, the information deployed, and the analysis offered, were of great importance for capitalism, by fostering informed, and thus efficient, investment. Through probability, prediction could be mathematical, and uncertainties could be reduced to equations of risk and thus invested for, and pooled among riskers and investors.

The use of knowledge for the public good, an idea advocated early in the seventeenth century in Britain by Francis Bacon, was developed by William Petty (1623-87) who applied mathematical reasoning and knowledge in a process he, in 1672, termed political arithmetic. Rationality was presented as grounded in mathematics. A founding member of the Royal Society, itself established in London in 1660, Petty's works included a *Treatise of Taxes and Contributions* (1662).

Petty was not alone. His friend, John Graunt (1620-74), a cloth merchant, analysed London's mortality figures in what would now be called a time series, assessing change through time. Graunt captured the potential of statistics for understanding social developments and he looked towards the use of actuarial statistics in discussion about public insurance in the twentieth century. In medicine, there were calls for a mathematically-minded practice that looked toward the increase in quantitative reasoning in the eighteenth century. Edmond Halley, a noted mathematician, produced the first mortality table.

The development of insurance was a reflection of such mathematisation, and of the appreciation that the commercial market for risk could be improved and systematised as a consequence. The Protestant Reformation had transformed assumptions about social and individual welfare and concerning the related burden of risk. Moreover, the inflation of the sixteenth century tested established values. These developments encouraged a turn to insurance. In London, the devastation of the Great Fire of 1666 was a particular spur to the foundation of insurance companies and practices, for example fire precautions. The Great Fire devastated central London with estimated losses of £10 million, at least £1.5 billion in today's money. Individuals and companies were unable to cover the cost of the rebuilding. This shock event encouraged the development of the fire and, ultimately, home insurance still seen today. Commerce responded to that need for protection and many new companies sprung up. These included the Fire Office established in 1680 by Nicholas Barbon providing property cover in response to growing demand. Early fire insurers ran the first fire brigades. Insured properties displayed plaques and fire marks to identify who the insurer was, as with the symbol of the sun for the Sun Fire Office established in 1708. Other London companies included the Royal Exchange Assurance (1719), and the New Fire Office (1782). The last became Phoenix Assurance in 1813.

Spectacular recurrences of devastating fire, for example at Warwick (1694) and at Blandford Forum (1731), kept the issue as well as reality of fire alive. In the second fire, about ninety per cent of the town was destroyed. Building, heating and cooking materials, and methods, all increased the risk of fire.

Moreover, in England, demand for life insurance grew in, and from, the late seventeenth century ensuring more entrants to the market. They were key instances of the boom in new and creative financial and fiscal solutions in Britain in the late seventeenth and eighteenth centuries that has been termed the Financial Revolution. The most famous solution was the Bank of England, established in 1694, the most notorious the South Sea Company.

These innovations reflected the new constitutional and political situation following the fall of James II in the Glorious Revolution of 1688-9, and the subsequent entrenchment of parliamentary government. The parliamentary-guaranteed National Debt linked to the role of the Bank of England founded in 1694 was the counterpart to the development of the insurance industry, and also to the new solutions followed in overseas trade as monopoly companies, such as the Royal African Company, patronised by the Stuart rulers, found their position challenged and/or overthrown.

It was scarcely surprising that there was a search for new financial methods, both as expedients and as means to profit. Fact- and theory-based approaches to issues of finance and credit were encouraged as the tight regulation and state direction of mercantilism were replaced by a more entrepreneurial and more lightly regulated financial world after the Glorious Revolution. Information was more readily available, and investment and risk could therefore be better evaluated. In 1696, Edward Lloyd, a coffee-house keeper, published a triweekly London paper, *Lloyd's News*, which contained shipping news. In the early eighteenth century, *Proctor's Price Courant,* the *City Intelligencer*, *Robinson's Price-Courant* and *Whiston's Merchants Weekly Remembrancer* were all published; and, in the 1720s, the *Exchange Evening Post*, *Freke's Price of Stocks* and the *Weekly Packet with the Price Courant*.

These were all aspects of a world of public financial news in which personal connections and correspondence were no longer the sole means of operation. The very process of valuing forms of paper credit, such as banknotes, reflected the extent to which money itself was a form of information, as its worth rested on a knowledge of fiscal circumstances, including credit obligations. Moreover, the circulation of information was designed to counter irrationality on the part of the investors, as well as to facilitate the operation of the fiscal system. Information allowed the application of mathematical advances in probability and statistics to the emerging collections of relevant data, whether demographic, economic or financial. In addition, such data sets could be related through information.

The *Ars Conjectandi* (*The Art of Conjecturing*, 1713) of Jacob Bernoulli, Professor of Mathematics at Basle, was the first major work on the theory of probability. His nephew, Daniel, as well as being the formulator of the law of conservation of mechanical energy, applied statistics and probability calculus to determine the usefulness of inoculation against smallpox. He examined the differentiated risk of dying from artificial (as a result of inoculation) or natural smallpox, and, in 1760, produced tables to demonstrate the advantage of inoculation in bringing to productive and reproductive maturity the maximum number of infants born, and thus in preserving the investment made in bringing them up. The statistical evaluation of medical treatments also developed in Britain, as therapies and techniques were assessed quantitatively. These intellectual achievements, key instances of the creative thinking that was to be important to the development of insurance, interacted with the greater reliance on mathematical calculation that had become increasingly prominent in Britain from the seventeenth century.

The rapid changes in need for risk-offset and the interacting development of probability supported commercial activity in a free-market environment characterised by increasing social change and more personal wealth. A range of structural elements in society as a whole created increased need for insurance generally, and also laid the foundations for modern insurance. Industrialisation was important as were the processes of 'improvement' since described as the Agricultural and Transport revolution. Significant contextual factors for the developing turn to insurance included, in the eighteenth century, an increasingly effective communications system based on turnpike roads and postal services, enabled London insurance companies and banks to organise insurance and banking elsewhere by delegating the work to agents in other towns with whom regular contact could be maintained. As a result, an insurance market that had been dominated by London became national.

The need for protection changed with business developing and individuals' way of life changing. In 1782, tired of paying high premiums to others, sugar refinery owners in London founded a joint-stock insurance company, the first to specialise in insuring large industrial risks. This was to be the basis of Phoenix. Business models varied. Groups of likeminded individuals with capital took risk for profit in an environment of zero or limited state involvement. Joint stock companies used privately-sourced capital, usually from local networks of manufacturers and merchants. There was a growth of mutual insurance in the life sector, continuing the original pooling concept for policyholders. This process reflected geographical diversity as local need and wealth drove activity. Centres of commerce, such as London, Edinburgh, Liverpool, Bristol and Manchester, were to be important in the development of the insurance industry. They had people, wealth, liquidity, and entrepreneurs. The general insurance need grew rapidly with commerce and, by 1800, specialist fire, marine and accident insurance companies were commonplace. The Life Insurance Act of 1774 brought a degree of regulation.

Life business was slower to develop. Small groupings of wealthier individuals worked on the basis that members paid an entrance fee and an annual subscription, which were then pooled to form a fund to meet death claims within that group. As a form of insurance, life assurance therefore originally relied on protection in the shape of policyholders each paying in a small amount so that the families of those who died could benefit. As such, it was a self-help variant on post-Reformation social care. General insurance policies, in contrast, were written to cover a specific event, such as fire, and, unlike life insurance, were re-written each year on terms which changed as the insurer saw fit in assessing the risk. The big difference with life assurance was originally that the insured could take out a policy, which would pay out on death at any stage during the rest of the policyholder's life, by paying a level annual premium that was fixed at the time the policy was first taken out and dependent only on the policyholder's age and state of health at that time. This situation resulted in life companies developing systems to collect the premiums on an automatic regular basis, usually annual.

There were problems, and the many abuses included the failure of insurers to pay claims. In consequence of the problems, many schemes failed. Moreover, life assurance was seen by some as gambling, not least because a person's life could be insured without their knowledge. This practice encouraged government regulation. In the eighteenth century, need grew and different strands of business developed. As death was a universal outcome, unlike other risks against which insurance provided safeguards, the life industry companies became a mechanism for long-term saving via the regular premiums. From here, it was a short step to develop the endowment contract, where the payout was on death or at some other fixed date, for example after say 25 years. Thus, it became a long-term savings contract, with additional life cover for earlier death, rather than just a contract which paid out on death. There was the additional advantage that should death occur prematurely, the sum assured would be available even though the accumulated premiums invested so far on that particular life did not match the amount. The policy therefore combined the financial benefits of long term savings and investment with a safeguard in the event of benefits if dying earlier. Pooling assets in this way provided an opportunity for investment practices and prospects very different to those provided by bank deposits.[1]

The significance of communications to the insurance industry has continued to the present. In the nineteenth century, the train and the telegraph were important not just for the transmission of business-relevant information but also for an emphasis on a speeded-up business culture. At the same time, the major and continuous expansion in population in the nineteenth century, as well as the high rates of economic growth, meant that the existing models for insurance could be implemented with greater scale and profitability. The economies of scale brought much greater profit.

In insurance, this was linked to professionalism, notably in the shape of the bureaucratisation of business and data use. Actuarial tables in Britain went back to John Graunt's work in the seventeenth century and underpinned the nineteenth-century production of life tables by the General Register Office. Established in 1762, the Equitable Life Assurance Society is believed to be the first dedicated life insurer to appoint someone who can be seen as an actuary and to have conducted life insurance in much the same way as it is done today.

Professionalisation came in the mid-nineteenth century. The Institute of Actuaries was founded in 1847 to elevate 'the attainment and status and promoting the general efficiency of all who are engaged in the occupation.' The Faculty of Actuaries, the Institute's Scottish counterpart, was founded in 1856 and, thereafter, the two bodies had equal status in the UK, particularly where insurance company legislation required sign-off by an actuary. The two bodies worked closely together, but did not become one, the Institute and Faculty of Actuaries, until 2010.

Life assurance provided and required information, and generated more for what was to come. Alongside data collection and analysis, there were larger books available spreading risk and delivering profit. Insurance also required information for effective investment. To the end of such investment, financial services developed, with improved information linked to the integration and operation of markets. As commerce developed, so did business technical skills and communications which drove changes in corporate behaviour in pursuit of profit alongside the ever-changing nature of customer needs. A range of different demand factors fuelled the growth in insurance. Continued industrialisation meant a need to cover new risk. The rapid growth of the middle classes was important alongside their culture of prudence and appearances. These elements encouraged an emphasis on security and rectitude, one that insurance represented. Population growth was accompanied by urbanisation, larger-scale activity, and mass migration into industrial centres. In this

[1] H.A.L. Cockerell and E. Green, *The British Insurance Business, 1547-1970* (London, 1976).

context, there was a greater lack of lifelines against misfortune than usual, as family and community networks were weaker.

The insurance market responded. There was an expansion of product types, driven by the need to match the expectations of different social groups, varied levels of wealth, and the needs of employers. With Britain at the leading edge of commerce, there was a move to composite companies, providing a broad range of policies. Moreover, there was increased technical efficiency as actuarial knowledge developed on the life side was spread to other areas of insurance.

At the same time, driven by continued actuarial progress, new life assurers specialising in insuring the professional classes had been launched. By 1850, there were about 180 life assurers and about £150 million of life covers in the United Kingdom. As with banking and railway companies, there were challenges. A rapid turnover of companies did not always lead to good policyholder outcomes. Mismanagement and bankruptcies encouraged tighter regulation.

The most active insurance centre was London, but the industry was national and key companies with lasting importance were established outside London. Thus, Royal Insurance was founded in Liverpool in 1845, while what was renamed the Britannic Assurance Company in 1905 was founded in Birmingham in 1866 and named the British Workman’s Mutual Assurance Company.

Regulatory procedures improved. The failure in 1869 of the under-capitalised Albert Life Assurance Company led the following year to the Life Assurance Companies Act which required new companies to deposit a security with the Accountant General as security, imposed the standardisation of revenue accounts and balance sheets, and directed that the insurance funds attributable to life business should be kept separate from other business and should be independently audited every five years. The principles of investment as laid down in the act were clear. In order to provide a regular income, and to be certain of meeting liabilities, there was an emphasis on dated securities with a guaranteed capital repayment, rather than undated ones or ones the value of which could vary. Thus, the emphasis was on debentures, and not on ordinary shares.

In simple terms, two types of life assurer had emerged from the eighteenth century. The first type was targeted at providing life cover plus an increasingly strong element of long-term contractual savings for the middle and wealthier classes. Some of these companies already existed as general insurers. They saw life assurance as a logical extension of their insurance business, indeed as a way to both strengthen and use income streams as well as to consolidate their existing position by taking a role in a developing market. Many more new companies appeared on the scene whose focus was solely on writing life assurance. These included Equitable Life (1762), Prudential (1848), Legal and General, Scottish Widows, Standard Life (1825), and Norwich Union (1806). Many established themselves outside London, including Norwich Union in Norwich, Scottish Widows, Scottish Equitable and Standard Life in Edinburgh, Scottish Mutual in Glasgow, and Yorkshire Life in York.

The second type of life assurance company to emerge developed at the lower end of the market. It was driven largely by the absence of a welfare state beyond the workhouse, and by the desire of the working class to be able to provide for funeral expenses or for a small income following retirement or long-term sickness. Many of these companies began as Burial Societies or Friendly Societies. Their common feature was that their policies were sold directly on a door-to-door basis and that premiums were at very low levels (often only a few pence) and were collected physically by an agent, usually weekly. These contracts involved very high expenses because of the low premiums and the high collection costs. However, in the shadow of fears of the workhouse and the 'pauper's funeral,' huge volumes were sold to the working class. The combination of low premiums and regular personal collections ensured that policyholders were better able to meet their contractual obligations. In addition, in what was very much a shame culture, the penalty of default was too shameful to contemplate. This class of life assurance eventually became known as Industrial Assurance. Early examples of successful Industrial offices were Royal Liver in Liverpool, Prudential and Pearl in London, and what became Britannic in Birmingham.

Alongside the proprietary sector, there was the development of the mutual sector, and each took a significant share of the market. Some of the companies mentioned earlier were mutual friendly societies, including Royal Liver. Successful mutual life assurers which were founded in the nineteenth century thrived until the 1990s included Scottish Widows, Equitable Life, Scottish Provident, Clerical Medical, Scottish Amicable, Friends Provident, National Provident and Scottish Equitable.[2]

The large headquarters of insurance companies were a dramatic demonstration of their significance in Victorian Britain. In London, Alliance Assurance had two large blocks in St James's Street, built in 1883 and 1905, while the Prudential constructed a sprawling one on High Holborn between 1895 and 1901. It is still mainly offices, although no longer for the Pru. The Pearl building on Holborn, built between 1912 and 1919 and now a hotel, is still a very impressive building. With their big, high-ceiling rooms, these headquarters provided the necessary physical accommodation.

On prominent sites, these buildings also offered legitimation and authority for the new financial power and possibilities of the companies involved. As with the expansion of the City's financial sector over the last fifty years, this architecture helped provide a sense of solidity and authority for a rapidly developing and complex financial world. Architecture thus represented an affirmation of stability that appeared to provide symbolic capital.

'We give more than we promise,' the Pearl motto at the beginning of the 1910s, provides a peg on which to consider the situation on the eve of the outbreak of the First World War in 1914. There had been extensive development in range, sophistication and scale. Product developments were

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[2] Johnston and Murphy, 'The Growth of Life Assurance in UK since 1880,' *Manchester Statistical Society* (1956).

important. Endowment insurance had huge success, with demand from the middle class for investment products that did not simply provide life cover. Instead there was a guaranteed payment at the end of a fixed term, or earlier in the event of death. This provided the prospect of a nest egg that could help such expenditure as house purchase. Abolish Rents advertising was a reflection of this offer and by 1913 endowments accounted for 62 per cent of the life business.

The Industrial Life assurance focused on the working class, typically to cover funeral costs, had grown in scale such that by 1914 there were to be 39 million of such policies in the United Kingdom.

As demand continued to grow, insurers looking for growth opportunities sought to acquire smaller expert insurers. This encouraged the rise of the composite insurer, with British insurers moving from a single line of business into composites offering a broad product range including life insurance. This changing business model drove high-level mergers and acquisitions in the early part of the century, and British insurers became bigger and more diverse. The strength of the institutions was reflected in their importance and reputation in society as a whole. This in part reflected the value of mutual insurers to a broad tranche of society.

At the same time, political change was greatly affecting the context prior to the world wars. The National Insurance Act, which worried both the Conservative opposition and the trade unions, reflected the importance of the idea and practice of insurance, but also a new intrusive role for the state.

More seriously, the impression of stability in growth and growth in stability was repeatedly to be torn asunder by the crises of 1914-45. The insurance industry had been a central part of the world described by John Maynard Keynes in 1919:

> 'What an extraordinary episode in the economic progress of man that age was which came to an end in August, 1914…. Life offered, at a low cost and with the least trouble, conveniences, comforts, and amenities beyond the compass of the richest and most powerful monarchs of other ages. The inhabitant of London could order by telephone, sipping his morning tea in bed, the various products of the whole earth… he could at the same moment and by the same means adventure his wealth in the natural resources and new enterprises of any quarter of the world … But, most important of all, he regarded this state of affairs as normal, certain, and permanent, except in the direction of further improvement, and any deviation from it as aberrant, scandalous, and avoidable.'

Two world wars in succession, however, greatly hit value and values. The global system of liberal, free-market, capitalism, the lifeblood of the British world, was gravely compromised by events abroad and at home.

At the same time, the insurance industry was very important to the economy with the assets of the insurance companies equal to two-thirds of the clearing banks' assets in 1938.[3] The 1930s, indeed, saw the companies as relatively strong, which was an aspect of the combination, during that decade, of crisis in the traditional heavy industry and mining sector, with expansion in light industry, services and finances. The growth of suburbia and of car ownership were clear instances.

Like mortgages, life assurance was part of the financial infrastructure of this world. Fiscal policy was important, notably in the shape of tax relief on mortgages, life assurance and pensions contributions, and on the gross roll up of pension fund assets. As a result, there was a steadily growing life assurance industry with a large number of policyholders and a significant number of providers. Legislation in the field of insurance, for example the Industrial Assurance Act of 1923, did not harm these players.

The expansion of the insurance industry in the 1920s and 1930s saw a drive in need, with rising life expectancy, concern with inflation, tax incentives, and increasing purchasing power for salaried workers. As a result, the life market grew further. This included a doubling of industrial life premiums between 1920 and 1939. At the same time, the 1930s presented a new challenge to the industry. It proved difficult writing worthwhile investments when share prices were artificially high and yields correspondingly low, a situation, indeed, that has a modern echo.

Demand for endowments remained strong in the run-up to 1939. Endowment policies being written outnumbered whole life policies, which was a precursor to the post-war expansion. This situation linked increased affluence to the role of life companies. J.A. Jefferson, the Chairman of Britannic Assurance, remarked 'Endowment Assurances are essentially savings and represent one of the chief forms of life savings today.' Separately, demand for company pension schemes increased as a way to manage rising industrial tensions. With significant economies of scale and reduced transaction costs, cheaper rates than traditional life insurance were offered, and this means provided some life insurers with an effective way of increasing pension income with little outlay.

Wartime led to schemes to link life assurance to the government war savings campaign, as in the 1914 Pearl Victory Bonds. The wars also brought encouragement for life assurers to buy War Loan. Indeed, life assurance provided a flow of new money into government securities. With other government dated debt, this then formed a large part of life insurance assets, until George Ross Goobey, an actuary who in 1947 became the fund manager at the Imperial Tobacco Pension Fund, bought heavily into equities on the grounds that their yield (over 4 per cent) was higher than government bonds (gilts, under 3 per cent). Under his lead, the fund moved most of its investments into the equity market. He also took the risk of investing in smaller companies. There had been earlier

[3] P. Scott, 'Towards the "cult of the equity"? Insurance companies and the interwar capital market,' *Economic History Review*, 55 (2002).

investing in equities by the life companies, notably by the Pearl in 1927, but not to any considerable extent. Instead, the insurance companies followed Goobey into equities, although not to the same extent.

Wartime intervention and regulation was followed, after the damage and disruption of the Second World War, by a lack of clarity as to how far the new Labour government would extend its regulatory powers. Alongside the headline nationalisations that are listed in all the books, there were both royal commissions concerning the extension of control over much else and discussion of this outcome. In the event, the situation changed, and essentially due to external features, developments discussed in the next chapter.

Conclusions

By 1939, the UK had established a substantial and profitable insurance industry which was a key part of the private sector and was deeply grounded in society. This industry had evolved, with frequent major developments, from community-based guilds into the monolithic household insurers of the first half of the century. There was an evolution of products to support the change at different levels of society. As a result, against a background of rapid demographic, social and economic changes, the industry met the needs of individuals and commerce in providing protection where none had existed. There was minimal state/government control at the outset, but subsequent measures to curb bad practice and to protect policyholders. The key drivers to success were customer demand based on changing personal and social needs, a commercial business model that matched these needs, and the availability and use of actuarial personnel, processes and skill, to provide and build on early success.

2. TO THE RECENT

Introduction

This chapter covers the continuing social need for insurance and draws out the factors, notably developments in society, individual needs, financial circumstances, and legislation which led to the development of the closed life sector towards the end of the century. These developments included economic changes, increasing postwar wealth, and the rise of consumerism, changes in tax policy, and the growth of investment markets. A series of issues also fed into consolidation, notably increased capital requirements and costs, market crashes, and mis-selling.

At the same time, responses and outcomes were moulded by the ever-present entrepreneurial and technical skills evident in the development of the industry. Those involved in closed life saw an opportunity for an alternative business model to the traditional insurance ones. These themes will be carried forward as threads into later chapters to help the reader navigate the complex and fast-paced events that form the more recent story being told subsequently.

This chapter will be divided into two parts. Part One will cover the initial postwar position of comfortable growth and stability with limited innovation, followed by a period of intense growth fuelled by changing products, needs and sales practices. An increase in competition was matched by new trends, from unit-linked policies to European offices. Part Two will explain the challenges traditional life offices faced, with companies going into runoff, and how closure and consolidation was a response to those challenges. The chapter will introduce the reader to early closed book consolidators.

Part One: Steady and Sure: Growth 1946-60

World war had been the most dramatic external (exogenous) change to affect the economic, fiscal and political situation. World war was not to recur after 1945; but political, economic and fiscal changes within Britain, and economic and fiscal developments at the world scale, were all to be highly significant for the insurance industry. These developments helped ensure that a mostly dull and rather static industry in Britain experienced extensive and profound change over the following seventy years. The future of capitalism itself was unclear in the late 1940s as Soviet power expanded, Communist regimes were established, and corporatism became more significant.

However, in the UK the proposals for, and possibilities of, extended state regulation were cut short by Labour's defeat in 1951. This defeat also led to a very different social protection market to that of the reliance on the state offered by national insurance. Indeed, the limited role and development of private insurance markets in states that went in a fully Socialist direction are highly relevant for any comparative discussion of the British situation, past, present and future.

Secondly, the Conservative governments of 1951-64 sought to dismantle much of Labour's controlled, state-directed, environment and, instead, to focus on satisfying the consumer. This was particularly so with tax cuts, and also with the establishment of independent television in 1955. Purchase tax on consumer durables was cut from two-thirds to half in 1953, as austerity was replaced with affluence and consumer-driven demand.

Moreover, these were the years of the 'Long Boom' of postwar economic growth, in part as new technology, much of it American, was applied and in part due to the growing availability of capital, and a major growth in international trade. In manufacturing, the employment of mass production in new purpose-built plants permitted a more effective introduction of new technology and organisational methods. This boom continued until the oil price shock of 1973 led to a major world recession that hit Britain hard.

As a result of these factors, and of postwar recovery, GDP per capita rose in Britain by 40 per cent between 1950 and 1966. Thanks to the taxpayer-funded state provision of free, or subsidised, healthcare (with the National Health Service), education, council housing, pensions and unemployment pay, rising real incomes, instead, fed through into consumption. Insurance was a form of discretionary consumption, less significant to most consumers than motor cars or refrigerators, but one that, in the context of greatly-increasing demand-potential, was also encouraged by the market and industry trends of the period. There were more items that required protection, and more money available to provide it.

While the stronger economy, and modest taxation in the 1950s, permitted greater provision by individuals and employers for retirement, this was actively fostered and sustained by fiscal policy and insurance industry innovation. Government tax policy, especially Life Assurance Premium Relief (LAPR), which permitted the cost of life assurance to be deducted from taxable income, provided significant incentives for taking out life insurance products. These incentives were extensively discussed in the personal finance pages that were an important innovation across the press. Tax relief on contributions and on pension fund investment returns were both significant. The Solvency requirements under the Insurance Companies Act of 1946, which introduced solvency margins for the relationship between assets and liabilities, were not onerous. Nor was the Act's requirement for a minimum paid-up share capital requirement of £50,000.

Post-war customers sought protection for their developing property and financial interests and business, across all sectors of the life assurance market (mutual, proprietary and industrial insurers), and these sectors remained strong. Between 1946 and 1960, net life assurance premiums increased from £120 million in 1946 to £460 million in 1960. This was consistent across the board as nearly all British offices rose by a factor of 3.8. For one of the life companies, Britannic Assurance, 1947 saw the best results in its history. Insurers remained as the solid institutions of pre-war days, showing financial strength, and providing a confident longevity. The mutual sector thrived and grew into UK-wide operations that were not restricted to their original localities, for example Scottish Widows, Equitable Life, National Provident and Standard Life. Product offering developed, but stable with-profits policies resumed post-war the practice of paying annual bonuses of between 2.5 and 3%, as they had since the 1860s, save for the war years. The endowments of the 1920s encouraging home ownership were protected and invariably formally assigned to the lender, so that risk within the wider system was low. The policies were guaranteed to repay the loan at the end of the term, with any accrued bonus remaining the property of the borrower. Within the companies there was a growing focus on sales and on sales forces, rather than on the actuarial side. There were well-established work forces, and companies looked after their employees with extensive social and sports scenes, which Phoenix today exemplifies on its Wythall site carrying forward the earlier Britannic tradition.

Growth and Change

At the same time, long-term savings products gave consumers exposure to more sophisticated asset classes. This was in the context of long-term equity growth until the early 1970s, growth that both encouraged policyholders' confidence and supported insurers' returns. As life companies moved more of their assets into equities, and then property, they benefited in investment profits. Distributed through annual bonuses, these profits enabled policyholders to benefit from the equity boom, and that, in turn, encouraged new business sales. The growth in profits apparently offered a way to deal with future pension requirements, and at the level of individuals and of the economy as a whole. After the major recession of the early 1970s, equity market growth recurred during the 1980s.

In the 1950s, life insurance was a fairly quiet industry without much competition. This was very much changed in 1961 with the foundation, by the very gifted Sir Mark Weinberg, with an office in St Paul's Churchyard, of the Abbey Life Assurance Company. In the 1960s, Abbey Life, the new entrant, proved a seismic change, by doing things differently. It paid a lot of commission to its large direct salesforce and provided unit-linked policies which offered a specific, clear, asset base, as opposed to the lesser clarity concerning where the money was invested of with-profits funds. Thus, policyholders were not co-mingled with many others in a large pool of assets. Instead, they were individual owners of a specific number of 'units' in that pool, units whose value and number could be more easily understood.

Alongside, however, the transparency of the asset base, the costs of the well-remunerated direct salesforce were recouped through some very heavy charges in the early years, charges which were not always explained well to the clients. These charges increased profitability. Moreover, some life companies had less honourable sales forces than the ones run by Weinberg; which, in the end, in the mis-selling scandal, cost some insurers considerable sums and loss of reputation.

What was particularly significant about Abbey Life was the way in which, for the first time, the management had a very clear view about the profitability of such business, and employed some new actuarial techniques to guide it in knowing which levers could be pulled to increase or reduce profitability. Weinberg reinvented the sector of life insurance and came up with the concept of a consolidator. As with Goobey earlier in investment, he indicated the significance of individual initiative to the development of the industry.

The success of Abbey Life attracted takeover interest, and it was sold to IT&T, an American conglomerate; the sale a key instance of inward investment. They, however, were not able to make it quite so successful again, probably because Weinberg promptly started another company, Hambro Life Assurance in 1970, which in 1985 became Allied Dunbar. This unit-linked company also sold directly to its clients (in other words not through intermediaries), and was able to put right many of the things it had got wrong the first time round with Abbey Life. IT&T sold Abbey Life to Lloyds Bank in 1988, but its time had passed and it was closed to new business in 2000. In 2007, Lloyds sold on the company as a closed book to Deutsche Bank and in December 2016, as discussed in chapter seven, it was acquired by Phoenix. Allied Dunbar became part of Zurich Financial Services and was closed to new business in 2001.

The existing life industry responded in different ways in the 1970s and early 1980s. There were efforts to match Abbey Life's techniques, but also, in contrast, a focus, with Equitable Life and London Life, on targeting the professional classes as high-value customers. The companies did so by headlining the fact that their costs were low. This was important given the higher-than-average premiums of these customers. As a result, cost efficiencies were magnified even after paying significant bonuses to the salesmen.

A number of factors in the 1970s and 1980s combined to create a very favourable environment for life assurers, and business boomed. Economic conditions and government policies were key components. Improved mortality figures generated lower and more attractive premiums, making life products attractive and affordable. A stronger economy, and a rise in real incomes and employment, allowed greater provision by individuals and employers for retirement. Government tax policy provided incentives to take out insurance products.

Meanwhile, another boom, that in property ownership and house values, a boom that led to individuals complaining about being under-borrowed, stimulated the mortgage market and encouraged further growth in the life assurance market. Traditional mortgage lenders, mainly Building Societies, had generally favoured the repayment mortgage, normally over say a 25 year period. This mortgage entailed a set monthly payment which covered both the interest on the outstanding loan and a repayment of some of the capital. In the early years, most of the money went toward paying the interest, but, gradually, the capital outstanding was reduced, and repayment of the loan was accelerated. Additionally, the borrower had to take out a decreasing term assurance to cover the outstanding balance in the event of death as the loan reduced over the 25 years.

It had also always been possible to take out effectively an interest-only loan provided that this was linked to a with-profits endowment with a life company, the Building Society acting as intermediary in the arrangement of that life contract. The Building Society would also take a first charge on that endowment. The basic sum assured on the endowment had to be equal to the loan, so that, during the lifetime of the whole arrangement, bonuses accruing to the endowment meant that, on maturity, there could be far more cash available (perhaps three or four times as much) than was needed to repay the loan, which would help also to provide a smoothed asset return that was less exposed to stock market volatility at the moment of maturity. This was good for the borrower if he/she could afford the premiums on the endowment, but was an expensive way of repaying the mortgage taking only that part of the transaction into account.

Thus, in place of the with-profits endowment, the industry developed the low cost with-profits mortgage endowment which effectively allowed the borrower to take out a with-profits endowment for a basic sum assured that was less than the amount of the loan. How much less was determined by a calculation which took account of how future bonuses might accrue at say 80% of current levels to produce the required sum assured at maturity to pay off the loan. Additionally a calculation would determine how much decreasing term assurance might be needed to cover the early years. In effect, the borrower hoped that, through investment performance, the final value of the insurance policy would pay off the full mortgage outstanding at maturity and still gain some addition surplus at maturity.

Building Societies embraced this new contract, not least because providing funds for the eventual repayment of the mortgage reduced the cost to the borrower of a more traditional mortgage endowment whilst still providing the Building Society or bank with a substantial upfront commission. At this stage, LAPR was still in place so that the cost to the borrower was competitive as compared to a traditional repayment mortgage. As the housing market generally took off through the 1980s, in part greatly encouraged by the sale of council-houses under the 1980 Housing Act, and other lenders, both the banks and others, entered the market, the low-cost mortgage endowment was extensively sold and became a repayment vehicle of choice usually structured as a with-profits saving with a sum assured. The life assurance industry was a key player. It grew strongly on the back of the growing housing (and thus mortgage) market. Endowments outnumbered whole life policies. They were indicative of changing customer needs in the wake of rising incomes and the assurance provided by the welfare state. More generally, the risks customers were seeking protection from changed. It was no longer about protection against a pauper’s funeral, but, rather, longer-term savings for managing personal finances.

The introduction by Mrs Thatcher's Conservative government in 1983 of MIRAS (mortgage interest relief at source) increased demand for policies. Rising equity markets until 1987 supported good returns on insurers' investments. Economic growth and confidence were high after the savage recession of the early 1980s and, with recovery, there were moderate and stable interest rates, high levels of employment, and an increased number of women in the workplace and with financial means and freedom. The basic annual bonus rates of with-profits policies increased for the first time in 150 years, with four, five or even six per cent returns commonplace. Moreover, Life and Critical Illness cover developed into mainstream businesses to support the need to pay mortgages.

Unit-linked products were considered more modern than with-profits ones, as customers chose where to deploy their savings while taking increased market risk. Indeed, in 1977, the *Economist* argued that Weinberg was not really selling insurance at all and that these companies were 'best regarded as an investment vehicle using the medium of insurance for tax purposes.'

These with-profits products were also a crucial underpinning to pension products. Offering a smoothing of otherwise volatile returns, and access to growth asset classes, these products provided relatively unsophisticated customers with access to higher growth assets, such as bonds, shares and property, that they could not buy on their own. The insurance companies thus offered necessary expertise in an increasingly attractive, yet volatile, situation. Light touch and self-regulation allowed life insurers to create new product features. Surrender and sales approaches developed with limited or no Regulatory oversight controls. Separately, improving actuarial techniques ensured that management had for the first time a clear view on the profitability of the business and on the levers to pull to affect the situation, for example different charging structures.

At the same time, the companies were affected by the problems and opportunities of this volatility, which helped ensure that there were to be some very willing sellers of 'books' of existing insurance policies. There were a number of elements in the matrix of problems and opportunities, and no one causal pattern linking them. Important to consider were the effects on equity values of a number of shocks, principally the recessions of the early 1980s and early 1990s. These also affected the ability and willingness of many existing policyholders to continue paying in premiums, as well as the possibilities of taking on new clients.

Recessions interacted with issues in fiscal policy which conventionally had worked to ensure stability in savings. Instead, unemployment was now the key issue. This encouraged government to focus on lower interest rates as a stimulant from the late 1990s: the change from Conservative (1979-97) to Labour (1997-2010) was significant, but so also was the floating of sterling after the goal of remaining in the European Rate Mechanism was perforce abandoned by the Major government in 1992.

As interest rates fell, guaranteed (higher) annuity rates in pension policies started to look generous (which was the case), and companies looked to their reserves. These now did not seem quite so substantial as previously against the falling investment returns. An early casualty was Equitable Life, which had hitherto enjoyed a fabulous reputation as the star performer in the pensions market for professionals, but which came close to collapse in 2000. The Equitable story is not just about falling interest rates. Subsequent enquiries and reports revealed weaknesses in reserving methodology and poor governance, but it was the generous guaranteed high annuity payment levels (ie. payments to retirees) against a background of falling interest rates which provoked its initial problems.

And whilst other life companies were not quite so exposed, some were, for example the National Provident Institution, and high guaranteed annuity rates caused most, if not all, life companies reserving issues which the industry was slow to pick up on. As the reserving issue became more acute (ie not having enough retained profits to make up for the shortfall in investment returns), life offices started to reduce annual bonuses (additions to the value of each policy from investment returns), as well as cancelling completely terminal (final) bonuses. This reduced payouts on with-profits policies from previous levels and had a profound effect on a mortgage industry which had been happily selling low-cost mortgage endowments to repay loans on the basis that bonus rates, broadly, could not go down. Moreover, mortgages provided the advantage in selling life assurance at the same time as building on existing investments and not needing to pursue new clients.

With mortgages looking likely now not to be repayable from the endowment proceeds, there was an inevitable mis-selling scandal, and a much closer look by both the consumer press, and the Regulator, as to how a with-profit contract actually worked. There had already been a big personal pensions mis-selling scandal in the late 1980s, which had weakened some companies. All cases had to be identified and redressed. The Regulator adopted a different approach for endowments, requiring the victim to complain.

More generally, it proved difficult for life companies to keep up with the Regulator and what appeared to be changing requirements. One of the factors which had already made low-cost endowments less attractive had been the withdrawal of LAPR tax relief in 1984 (thereby making life assurance and mortgages more expensive and putting life products on a level playing field with other investments), but this had been conveniently overlooked at the time. The use of Low Cost Mortgage Endowments disappeared virtually overnight.

As commentators looked more closely at with-profits contracts in general, the actuarial profession, and the Regulator became more concerned about the implied risks in vehicles, and the reserving bases were tightened further, putting yet more pressure on bonus rates. Gradually, life assurance contracts were becoming less bundled (life protection plus varied investment returns, plus tax advantages, plus administration), and thus less coherent. As that happened, asset management companies (who were not insurers) saw the opportunity to sell more retail investment products directly to consumers, rather than via life assurance contracts. This was made easier through the introduction of PEPs, ISAs and more self-invested personal pensions. Thus, investment management could now be accessed separately from life assurance – but with the investment risk now transferred from the company to the individual.

The life assurance industry was not alone within the financial services industry in suffering a loss of consumer confidence at this time. Banks and asset management businesses had their fair share of mis-selling issues, but what was going on harmed the life companies more because of the opacity of their product offerings. The consumer became a lot more questioning about financial products in general, and life products in particular, and terminated quite abruptly what had been a long term love affair with the with-profits endowment in its various guises.

Separately, the 1990s and early years of the 2000s had also been a period of long overdue consolidation of the life assurance industry. In addition, membership of the European Economic Community from 1973 had been followed by an increase in overseas insurers operating in the UK. This strengthened competition, especially for composites. Following the 1986 Financial Services Act, the mood throughout the retail financial services industry had been towards consolidation with some element of product diversification. The banks flirted briefly with getting more into Bancassurance, a pan-European fashion for bringing a wide range of customers and products under one enterprise, which had appeared to be enjoying some success in France, Spain and The Netherlands, offering a means to cross-sell to an existing and substantial customer base. In Britain, some banks chose to do it by setting up their own life companies (Barclays, RBS, Bank of Scotland), but these came to little of substance. Others sought to acquire existing life offices, the most notable examples perhaps being Lloyds which acquired Scottish Widows, Abbey National which acquired Scottish Provident and Scottish Mutual, and HBOS which acquired Clerical Medical. The survivors today are the Lloyds/Scottish Widows arrangement and HSBC still having a life company; the others having found the direct ownership of an insurer and the successful distribution of its products to the bank's customers too difficult. It is not clear why this method proved less successful in Britain than on the Continent. In part, it may have been changes in the accounting rules which prevented them taking credit for Embedded Value in their accounts.

Most of the other consolidation in the life industry has been intra-life company. Prudential acquired Scottish Amicable, Aegon acquired Scottish Equitable, Royal London acquired Scottish Life, and AMP acquired Pearl, London Life and then NPI. A slightly earlier consolidation was the rapid merger of three composites, Norwich Union, General Accident, and Commercial Union, to produce a large composite insurer (Life and General Insurance), now renamed Aviva. The two other significant life companies were Legal & General, and Standard Life, the second of which was acquired by Phoenix in 2018.

The sharing of administrative costs was easier for larger companies. That encouraged market consolidation, which had benefits in periods both of growth and of contraction. Economies of scale were significant in each. Consolidation was also encouraged by the example of other aspects of the financial services industry, and by the consequences of de-mutualisation: ie. converting from not-for-profit policyholder-owned companies in a co-operative structure, to commercial shareholder-owned companies. Compared to banking, however, the insurance industry, due in part to the degree of mutualisation, was singularly slow at moving toward consolidation. For example, large-scale amalgamation had led, by 1918, to the formation of the 'big five banks,' and the process subsequently continued. The National Provincial and the Westminster merged. In 1969, Barclays and Martins, both themselves the product of numerous amalgamations and takeovers, merged. Based in Liverpool, the 'port of Empire,' Martins was the last national English bank to have its headquarters outside London.

Specific problems affected the mutual sector. Mutual companies are conceptually attractive because all the profits in the business go to the customers, rather than to shareholders. However, mutual structures face problems, most significantly their inability to raise capital even when they are enjoying success and high levels of profitability. When levels of growth were fairly steady, successful mutuals were able to hold their own against successful proprietary life offices. However, the rapid growth of the life industry during the 1970s and 1980s led to capital constraints which even the successful mutual could not overcome. The proprietary companies proved better able to respond to the growth in the number of assets classes after the 'Big Bang' of deregulation in 1986, and more able to consolidate.

For these and other reasons, there was a wave of demutualisations in the late 1980s and during the 1990s. Some were done from a position of success, for example Scottish Widows and Scottish Provident. However, many more of the demutualisations were from a position of lack of success. Although a mutual could demutualise and acquire a share listing, most mutuals were considered to be too small to do so. Instead, they were acquired by larger players as part of the demutualisation process, with banks using the opportunity to have a share of the action. There were two significant exceptions to the loss of independence – Friends Provident in 2001 and Standard Life. However, the former was subsequently acquired by Resolution in 2009, whilst, in 2018, the life assurance assets of Standard Life became part of Phoenix because the quoted entity decided that its future lay in asset management as part of Aberdeen Standard Investments (see chapter eight).

Support for demutualisation was linked to the attitudes focused on the 'bonfire of regulations' in the so-called 'Big Bang' of 1986. In this, restrictions on the activities of equity market participants were removed or relaxed with, for example, the end of both minimum commissions on the stock market and of banning foreign banks and firms from membership of the stock exchange. Old demarcations were scrapped, and the nature of securities trading moved from 'open outcry' on the exchange floor, to trading on screen. The new situation in financial regulation helped the accumulated skill and entrepreneurial ability focused on banking, share dealing, and insurance, all spheres that expanded greatly. An air of freedom and opportunity focused on the City, with the ability to innovate regarded as a way to generate growth, profits and bonuses. The London capital market became extremely liquid, and with share ownership, both direct and indirect, widely dispersed.[4] The housing boom of the 1980s was also important, both cause and consequence, as endowment mortgage policies were linked to life assurance. With-profits schemes looked particularly attractive as share prices rose.

The City had already proved effective at developing trading in new financial instruments, notably Euro bonds in the 1960s. The City also played a major role in the recycling of oil wealth on the global scale from newly-affluent producers, including Britain thanks to North Sea oil from the 1970s, both to investment opportunities and to those short of liquidity. The restructuring of the insurance industry did not attract the same headlines or contention, but it was part of the same process.

A number of elements came together in this restructuring. Demutualisation proved a sea-change in the insurance and savings industries, although most mutuals did not get as far as the stock market. Demutualisation provided opportunities for reshaping the industry, in particular with the acquisition of companies by larger life companies or by banks, and definitely for both consolidation and inward investment. It made it possible to obtain cheaper capital by going to the stock market; although, on the grounds of their size, very few of the mutuals took advantage of going to the stock market. They chose, instead, to be acquired by larger entities.

There was also the attraction of particular classes of investment. Historically, many insurance companies wrote both life and general business. These are usually referred to as composite offices. Most began as general insurers covering annual risks to property and other items, and added life business in the nineteenth century. However, few of these were to survive as composites. Managements that wished to focus on general insurance wanted to move out of life assurance which was more risky and more difficult to assess than the short-term business of general insurance. The composite insurance practice, of using profits from general insurance to finance the writing of life assurance business, was no longer attractive. It was hit by the economic crises of 1973-4 and 1979-81 and also faced the problems of poor administrative structures and poor costing. The market falls in the economic crises obliged the companies to sell equities. Indeed, Commercial Union was referred to in the USA as ‘the bombers of Wall Street.’ British insurance companies were calculating their solvency margin on a daily basis during the crises.

There were also issues with particular products. With-profits policies fell out of favour with customers and insurers. Customers found the jargon difficult and did not engage with them, while insurers found that they were dealing with expensive guarantees and with customers who had become

[4] R.C. Michie, *The London Stock Exchange: A History* (Oxford, 1999).

disengaged from their products. Unit-linked products were considered more modern, as customers could choose where to deploy their savings, but the customers then took all the market risk, and that at a period when it markedly increased. Indeed, from the 1950s the changing composition of the corporate stock held by insurance firms was marked, with a contraction in fixed-interest, low-risk debentures and a rise in riskier ordinary shares, to close to 45 per cent by the mid-1960s. By the early 1990s, the insurance companies held over 40 per cent of all British quoted equity.[5]

At this stage, everything was in-house, including asset management. That situation appeared obvious in that when people purchased a policy, they would, it was assumed, feel more confident in having the asset management in-house. Indeed, for much of the 1980s, in-house investment appeared reasonable in terms of returns as assets performed well. In addition, assets were not bought and sold very often. That, however, left open the case of whether performance might be better in different circumstances. This was accentuated when the markets fell; as in 1990 when the FTSE 100 fell 12 per cent. However, at this stage, the movement towards using external asset managers was very limited.

The composite offices were to choose to turn their focus back to general insurance and to dispose of their life assurance assets as closed books, whereby existing long-term policies were maintained but no new policies were sold. Indeed, at present (2019), the only significant UK composite is Aviva. Two other companies, Legal and General, and Prudential, are technically composites, but began as life offices and are still dominated by that class of business. Moreover, in May 2019, Legal and General announced the sale to Allianz of its general insurance business, which will take it out of being a composite. The exiting from conventional life assurance helps to explain how the supply of closed life books came about.

Another impetus for consolidation was to cut operating costs per policy. There had already been cases of consolidation and restructuring to reduce costs per policy in the shape of transferring policies from one company to another. Thus, Sun Alliance Insurance was formed in 1959 by the merger of Sun and the Alliance Assurance Company. In 1965, Sun Alliance and London Insurance was formed by a merger of this company and the London Assurance Company. Law Union and Rock Insurance, and Liverpool and London and Globe Insurance, had gone into Royal Insurance in 1964, while Blackburn Assurance and Pioneer Life Assurance had gone into Stamford Mutual in 1974. However, major initiatives were to wait until the 1980s. There were a number of changes then, notably Sun Alliance and London buying Phoenix Assurance in 1984. In the 1990s, mergers and acquisitions gathered pace. FS Assurance joined Britannia Life in 1994 and Abbey Life absorbed Hill Samuel Life Assurance in 1998. Royal Insurance and Sun Alliance merged to become Royal and Sun Alliance in 1996.

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[5] M. Baker and M. Collins, ‘The asset portfolio composition of British life insurance firms, 1900-1965,’ *Financial History Review*, 10 (2003), pp. 137, 160.

Consolidation became more significant as growth was pursued and cost-effectiveness made policies more attractive. The rapidly-growing Australian Mutual Provident Society (AMP), a Sydney company that, from that small base, sought to become a global financial powerhouse, acquired London Life (1989), Pearl (1991), and the National Provident Institution (1999, an acquisition completed in 2000), which had been established in 1806, 1864 and 1835 originally. AMP had operated in the UK since 1858, but had entered the market in a big way in 1989, a point at which it was still considered advantageous to buy UK life companies while AMP had cash to spend. Ian Salmon bought Pearl in the largest takeover of a financial institution in UK history. It then successfully applied to have Pearl's orphan assets (unclaimed policies) released. The logic behind the acquisition of Pearl related to these assets and that Pearl was also doing really well as an insurance provider. In 1997, AMP demutualised to improve its access to capital markets.

Another Australian insurance company, which in 1999 became HIH Insurance Ltd, having purchased the large Australian insurance company FAI Insurance, also tried to enter the British market, but it did not have the success of AMP. Instead, HIH, Australia's second largest insurance company, had only marginal solvency, and went bankrupt in 2001.

Meanwhile, in Britain, as part of the consolidation process, the Prudential in 1997 acquired Scottish Amicable which had a poor investment performance; Aegon acquired Scottish Equitable in 1998; and Royal London acquired Scottish Life in 2000. Norwich Union merged with General Accident and Commercial Union to form CGNU, now Aviva.

The process of consolidation can be traced in the genesis of the modern Phoenix, as the following sequence of events will start to illustrate. In 1990, the Britannia Building Society, a reasonably strong, but small, mutual building society, acquired FS Assurance, a small mutual life company based in Glasgow. After this, Britannia changed its name to Britannia Life which purchased Crusader Insurance in 1991. Britannia Life closed to new business in 1998 and was bought by Britannic in 1999. Britannic stopped selling new business in March 2003. It claimed that this would lead to annual savings of £25 million. Operating profits had fallen from £145 million in 2001 to £86 million in 2002. That March, the company also confirmed that it was deferring its 2002 annual bonus payment to 1.1 million policyholders and would not be paying a final dividend to shareholders. In 2004, it bought the life and pensions business of Allianz Cornhill.

Competitiveness, that sometimes had a personal tinge, played a major role in acquisitions. Thus, AMP had been beaten by Prudential when the latter acquired Scottish Amicable. As a result, more effort was put by AMP into buying Henderson Investors (a funds management group) in 1998, Pearl Assurance Ltd, London Life, and the National Provident Institution, the last in 2001. These acquisitions gave AMP a range. With its massive salesforce, Pearl provided as it were a direct right of insurance to the public. London Life wrote fewer policies, but they had higher net worth than the average Pearl policies. NPI provided a company that got its business through independent financial advisors. AMP merged Henderson with AMP Assets Management to improve its positioning in the growing funds management market.

Moreover, banks acquired insurers believing in the Bancassurance model to enable cross-selling to customers. Lloyds acquired Scottish Widows, while HBOS gained Clerical Medical, and Abbey National acquired Scottish Provident and Scottish Mutual. Lloyds TSB took over Abbey Life wholly in 1996, having acquired a majority stake in 1988.

Contraction

Alongside reasons for buying companies, there were causes for selling them. Life assurance was under pressure. As with every expansion, there comes at some point a contraction and, by the mid-1990s, major cracks were starting to appear in the industry. No single event was responsible for the crisis to come, but a combination of smaller events combined and snowballed into a crisis. In 1998-2002, £16 billion came into the industry in terms of policy payments, but £17 billion was taken out. In 1998-2002, £16 billion came into the industry in terms of policy payments, but £17 billion was taken out. By the late 1990s, in face of realisation that there were too many providers, consolidation was underway. Moreover, in particular in the life assurance sector, factors such as mis-selling scandals, high guaranteed annuity rates, and declining gilt yields were affecting insurers' solvency positions. These factors ultimately led to the creation of a closed life industry with sufficient scale that it provided the opportunity for the dealmakers and visionaries to reinvigorate that business.

The problems arose across a range of elements including the core products in the books of the insurers. The with-profits concept began to suffer in comparison with unit-linked products. Returns on with-profits were seen as much lower. A generation of policyholders who had purchased products such as mortgage endowments in the 1970s were happy with their high returns. But this set the bar high for future customers/investors who purchased policies and did not anticipate the risk of low returns, nor understand the elements of with-profits policies or the nature of 'smoothing.' With-profits were generally marketed as having guaranteed growth, based on the fact that bonus rates had never dropped since the 1940s.

The insurers had built up huge reserves, but some providers increased the bonuses in the face of competition and reduced both reserves and the ability to 'smooth out' future shortfalls, such as those faced in the 1990s. Some with-profits funds became complacent in good times and, as a result, did not keep enough back for the bad times. With-profit products were complex for customers with their complicated charging and bonus structures. Customers found the jargon difficult and were not engaged with the products they had.

When the downturn in investments came in 1990, many life companies had to cut their bonus rate for the first time as reserves were not sufficient. Customers then faced a choice between an increase in contributions or a shortfall (sometimes considerable) in their eventual return. While funds started to close to new investment, insurers exercised huge discretion in relation to surrender and other values. They faced hefty penalties or market value reductions to deter them from cashing in their policies and reducing the remaining funds yet further. Meanwhile, the cost of guarantees spiralled. Generous guaranteed annuity rates (GARs) required the strengthening of life company reserves in the context of an increasingly low interest environment. With-profits business became less attractive as rates of return were reduced, and the guarantees given when interest rates were high were now starting to bite.

Moreover, products just go out of fashion. This was true of mortgage endowments, industrial life business, and with-profits funds. Linked to this, the insurance industry needed to evolve to changing needs. For homeowners, capital and interest mortgages had become the repayment vehicle of choice. For investors, several alternative offerings arose including managed funds and various guaranteed and protected funds. Life assurance was now starting to be unbundled from mortgages and other financial transactions, so there was a choice for the customer as opposed to a condition or a necessity.

Changes in the distribution and operations systems accentuated this point. Large sales forces were no longer required as customers' confidence, needs, and access to cover, changed. High commission payments by insurers to banks and building societies had helped fuel a move towards the indiscriminate sale of endowment mortgages in large numbers in the 1980s. There was competition for savings from asset managers through the provision of ISAs and PEPs. Direct debit replaced door-to-door sales in the industrial business. The Bancassurance model discussed earlier was a threat with access to large existing customer bases.

There was a pronounced downturn for almost all British insurers in the mid-1990s, and that led to suggestions that, by 2000, up to half of the over ninety insurers that were operating would disappear. The market was hit by the pension transfer scandal and also by the impact of lower share prices on the attraction of with-profits schemes. Even unit-linked business lost its appeal as life assurance products became unbundled. On the back of the early success of Abbey Life and Allied Dunbar, many small companies had started. The public perception of the industry changed. With their higher relative cost-base, and the pressure of rising management costs, small companies appeared most vulnerable, which led to a search for critical mass.

There were also specific issues about investment performance. When Pearl was bought by AMP in 1989, AMP had a big expansion drive. It put in what it called a Superstar team, invested a lot of money into asset management with various different techniques, but saw disappointing performance. In part, this was due to problems with managing assets, but the early 1990s' recession also played a role. An asset acquisition spree as a consequence of the 'Big Bang' did not work for AMP. Pearl, which had been consistent, became inconsistent in terms of the returns of its fund management. As a result, AMP pulled out of general insurance in 1993. Instead, Pearl was still strongly writing life policies.

When bought by AMP in 1989, London Life was quite small and was ailing. It was losing out to Equitable Life in the high net worth market which was relatively small. AMP closed London Life completely to new business in 1995, which left it continuing to manage £2 billion of funds on behalf of 90,000 policyholders. This was presented as a way to cut operating costs (and indeed the employee base was dramatically cut), and to focus on a more equity-based investment strategy.

More generally, consumer confidence was shaken by the economic downturn of the early 1990s which was worse and longer than anticipated, with high interest rates, falling house prices and high inflation. Within the industry there was the near-failure of Equitable Life in 2000, endowment policies and with-profits failing to pay off mortgages, causing real distress to the many wealthy clients of the 'white-collar' industry, and the subsequent recognition that with-profit schemes had poor returns. All hit confidence in the industry and popularity. There were many challenges on its fairness to policyholders. Equitable Life's ability to fulfil the payment of guaranteed annuity rates had been undermined by falling interest rates. Problems on the stock market did not help. Exposure to international moves, such as the surprise 1994 rise in American interest rates, the 1997 Asian financial crisis, and the Russian debt-crisis of 1998, all posed problems.

Within Britain, fiscal issues were significant. Life Assurance Premium Relief (LAPR) had gone, which removed the tax incentive to save with life insurance. At the company level, generous guaranteed annuity rates required the strengthening of life company reserves in the context of an environment of increasingly low-interest rates. Moreover, there was competition for savings from asset managers through the provision of ISAs and PEPs.

Growing Regulatory pressure was also an issue. Prior to the 1982 Insurance Act, the insurance industry was relatively lightly regulated and usually as a response to bad practice, but that Act was a response to a couple of failures in the 1970s. The Act also reflected a changing perspective, namely that the insurance industry required regulation, indeed intervention, for the sake of consumer protection. It became necessary therefore for companies to demonstrate that they could pay out, and there was also concern about the details of contracts with policyholders. Linked to the increased and more specialised regulation, insurance, and life assurance in particular, became a more specialised area for Regulators and, therefore, lawyers. It had become more costly to sell policies. The Regulatory regime required the provision of more information to customers, while direct salesforces were heavily regulated. These changes entailed costs.

There were related institutional changes. Oversight by the DTI (Department of Trade and Industry) was replaced by that of the SIB (Securities and Investments Board), founded in 1985, under the Financial Services Act of 1986. This Act envisaged a high degree of voluntary self-regulation, and, under this, Life Assurance and Unit Trusts were regulated by LAUTRO. However, in 1997, as a result of mis-selling scandals, the Securities and Investments Board was replaced by the Financial Services Authority (FSA). This marked the disappearance of any pretence that these industries could ever be self-regulated.

The 1986 Social Security Act had allowed employees to transfer from their occupational pension schemes – state earnings-related pension schemes, which had become operative in 1978. Life companies used this as an opportunity to persuade customers to take out private pension schemes, on the basis that they would get a better deal, which, however, did not turn out to be the reality, and the Regulators ordered redress. 2000 saw both the crisis of the Equitable Life Assurance Society, a watershed moment, and the Financial Services and Markets Act which established the Financial Services Authority (FSA) and changed the tone of regulation with the removal of all self-regulation. In 2002, there was the launch by the FSA of an investigation of the With-Profits industry, ‘a long, hard look at the financial strength of Britain’s life insurers.’ With the introduction of Conduct of Business requirements, this investigation set the ground rules for the way they are managed today. The lack of an integrated supervisor was identified as a factor in the problems experienced by Equitable Life, where the effect of conduct issues was arguably not fully understood. This was rectified in 2013 with the establishment of the PRA and FCA, see chapter six.

Traditional models of making money were challenged. The Mutuals were unable to raise capital, despite being profitable, when growth became more rapid in the 1970s and 1980s. The high price of unit-linked policies was driven by high commissions to sales agents who focused on volume. The products imposed high charges to fund that commission. Customers did not understand the risks taken on, and how market conditions affected that and the risk they were taking. The shortcomings of unit-linking were shown: unlike with-profits policies, there were no reserves to prop up returns during the bad times, and investors were directly affected, with anticipated returns evaporating. Warnings that endowments might no longer be on track to repay policyholders mortgages were given and the FSA stepped in.

Solvency

Solvency was a growing issue in the late 1990s and early 2000s. The size of insurance companies was insufficient if they did not have sufficient capital to cope with unforeseen circumstances during the roughly fifty year periods that policies could be live. Stock markets could crash, epidemics could cause a huge rise in claims for assured sums to be paid out, and costs could skyrocket.

As a consequence, Regulators required companies to have a substantial margin of capital in addition to the sums paid in premiums, this margin to be used if there were not sufficient premiums to pay the claims. Such capital would tend to come from investors who own the insurance company and who benefit from the profits it produces once claims and expenses have been paid annually. Solvency is an insurance term for what banks call capital adequacy. It is difficult to decide how much capital is required by an insurance company that specialises in long-term life assurance because there are so many variables to consider over the fifty years period, variables that do not change to a common pattern. It is assessing these variables, and assigning value and values to them that is the work of actuaries. Ultimately, their objective is to ensure that the company has enough solvency for the many risks it faces – and that therefore all policyholders will get paid.

Assets and Liabilities

A life insurance company has a fixed set of assets and liabilities for any period of time, and relies on a prudent assessment of liabilities. When closed to new business, so that back books or heritage books of life business are established, these assets and liabilities remain, and, indeed, the assets continue to accrue as policyholders pay into their own schemes. The coverage of liabilities is necessary to ensure an ability to meet commitments and operate, to retain solvency, and to meet Regulatory obligations.[6] The assets accordingly are reserves which are based on prudent estimates of likely liabilities and asset values, and thus of the policy liabilities, combined with the statutory minimum provisions based on buffers required to tackle solvency overruns (the first of the buffers). In addition, there are secondary buffers in the shape of more reserves that are required by Regulators to prevent breaches in most eventualities; indeed, down to a one-in-200 year event.

The last is particularly important for a life assurance business, as it ultimately rests on the security of being able to meet its obligations to policyholders in full, and on time. Alongside the somewhat torrid history, at least episodically so, of the Group company that we will offer, the key point throughout is that there was no breach, or risk or suggestion of a breach, as far as the operating companies, and therefore the policyholders, were concerned. The buffer above the Regulatory buffer means that a company can operate in an unfettered way, for example paying dividends as it wished. This capital policy is therefore crucial to shareholder confidence and the related raising of additional finance.

When a company is closed, the extra reserves remain as a form of ‘orphan estate’, but, for each policy, the requirement for the security represented by the size of the reserve declines as the policy nears maturity. Moreover, this is a cumulative process, one that steadily releases more money in the process of run-off. Furthermore, the large asset base means that relatively small managerial

[6] S. Diacon (ed.), *A Guide to Insurance Management* (London, 1990).

improvements could yield significant sums of money; but, conversely, as policies mature, the burden of management costs for surviving policies rose.

Separately, new business ties up capital – as it should. Every time a new policy is written, the company not only has to bear the costs of selling that policy, but also has to set aside some capital against those new liabilities to guard against a rainy day and/or against the assumptions made at the time of writing the business proving wrong. This capital needs to be funded somehow, so selling back books was attractive, as it released capital and, thereby, allowed more business to be written.

Century

Some consolidation was carried out by several private equity vehicles; Windsor Life, Century Life, and, to a lesser extent, Chesnara, which survives, albeit on a small scale. Of these, Windsor Life was the largest, although only slightly larger than Century Life. It was originally owned by New York Life, which sold it to Life Assurance Holding Corporation (LAHC) in the mid-1990s, albeit retaining a minority stake. The driving force behind LAHC was Weinberg: he had plans to benefit from the consolidation of the life assurance industry well before Clive Cowdery and Hugh Osmond did. However, LAHC had a disparate group of shareholders who could not agree on acquisition strategy, and LAHC was sold to Swiss Re and became ReAssure, part of its subsidiary Admin Re. It is now Phoenix's main rival and will be found playing a role several times in the story, not least when turning down a merger.

The history of Century Life is more particularly important to this book. This is partly because of its development of the field, mostly because in 2005 it was acquired by Britannic, and therefore, later that same year, by Resolution. As a result, it is part of the Phoenix heritage. Established in 1984, Century Life developed the concept of buying the closed books of a life assurance company in order to make a profit. The company was the brainchild of two somewhat different individuals who founded, owned and eventually sold it. Michael Bell, a leading actuary, developed the concept. A prudent planner, Bell understood the opportunity offered by a company that was uneconomic to run, or that had policies that were uneconomic to run. In essence, as policies mature, the cost of administering the remainder rises if sufficient profitable new business is not written. At the same time, considerable value is available in the policies, because each year as they near maturity, there is need for less of a reserve and safety margin to cover unexpected contingencies. This value can be unlocked when the policies are acquired if they can be more successfully managed, not least as a consequence of scale. Bell's colleague, Chris Little, was more of an entrepreneur and deal-maker.

It was also argued, and with reason, that closed-book companies could focus on existing policyholders because there was no longer the need to emphasise selling new policies and the volume of policies being written. There had been a tendency to focus on new products and new customers not yet won, rather than existing business. This tendency had been to the detriment of the latter as well as causing tension in the companies involved.

Century's trajectory was different to those of Resolution and Pearl that we will subsequently discuss. It was relatively small scale, and its leverage was comparatively modest. Century demonstrated the feasibility of a business model to which Private Equity methods and bolder financial structures were later to give real firepower in the shape of the Private Equity behind Resolution and the role of SunCap and TDR behind Pearl. Indeed, the key figures, Cowdery and Osmond, had the vision and entrepreneurial skill to build the first large closed life industry consolidators.

With Century, there was not extensive borrowing in order to fund acquisitions on the part of a company that was happy playing at a smaller scale than what was to follow with Resolution, Pearl and Phoenix. Moreover, the Regulators were content because there was an enormous number of companies in the early 1980s, and rationalisation by means of a takeover by Century offered an alternative to the risk of poor administration. Century benefited from the development of a related methodology in the shape of embedded value. It came in as a concept in the 1980s, as a means to assess the future profits that might be acquired from a takeover. This value, a British innovation, offered a way to assess solvency and to assess forward projection. In this context, Century created bespoke systems capable of handling legacy and current business.

Century's first major acquisition was Sentinel Life in 1989, a company which was virtually closed to new business. Over the next year, Century acquired more books, all of which were closed or virtually closed to new business. All its then life assurance interests were transferred into Sentinel Life which changed its name to Century Life. By the middle of 1991, this had funds under management of about £100 million. The scale of what was acquired varied. For example, in April 2000, the long-term assurance business of Hiscox Insurance Company consisted of about 6,000 policies and funds of £18 million, whereas, in December 2003, National Australia Life Company, which had about 75,000 policies, was acquired.

When sold on 6 April 2005 to Britannic, Century Life brought the owners £45 million. Britannic, with a very traditional business model, had already disbanded its 2,000 strong sales force, in 2001, closed to new business in March 2003 (with an estimated £82 million cost savings), had deferred its 2002 bonus payment to policymakers, and not paid a final 2002 dividend to shareholders. In 2000-1, Britannic had created a new financial services group, with a new structure, and had rebranded itself as a broader financial services provider. In September 2003, the Group's operating profits exceeded City expectations and resumed annual bonus payments and dividends. Britannic also saw the potential and was in a position, under Paul Thompson who had been brought in as the new Chief Executive in July 2003, to acquire the closed books of business, including life operations of Cornhill from Allianz in December 2004 for £115 million, and Century Life in 2005.

When announcing merger negotiations with Resolution in June 2005, Britannic was a significant player. Resolution, then a privately owned company, however, in effect on 6 September, took over Britannic, a FTSE 250 company, in a reverse takeover. Thompson continued in post, but the people who took over and moved the new company forward were from Resolution. It is time to turn to the latter.

Conclusions

Century's trajectory should be put in a broader context. From the early 2000s onwards, the life assurance industry has had to think long and hard about its future role within the UK financial services industry, and the major players have had to develop strategies which were well thought through and not based, as had earlier appeared the case, around ever-growing new business from within the luxury of an ever expanding market. Some chose to seek to be acquired, and transferred the problem onto the new owner's shoulders. Those that have remained in the UK market have also had to think, within a closely-regulated context, about what to do with their heritage business, that part of their operations which had perhaps become non-core, or just too distracting or difficult to manage.

One significant development from all of this had been the rise of the companies which focused on the acquisition of now closed books. Indeed, true to the entrepreneurial endeavour and actuarial skill which gave rise to the development of the life assurance industry originally, the problems outlined in this chapter were not the end of the industry. Instead, these problems led to a reconfiguration, albeit in difficult circumstances, in response to the changing needs of a number of stakeholders. The sector was certainly evolving in the early 2000s. Closed life consolidators were not to prove a panacea, but rather, in the end, a proven model with inevitable growing pains, including the bumps in the road we will discuss.

Century came first, but, in the early 2000s, two individuals in particular started to think about this problem, and how it could be made into a profitable business whilst providing a solution to the problems of the ceding (selling) business and offering a safe and well-looked after environment for the policyholders within those books of business. Cowdery and Osmond made it their business to understand the issues of life assurance in detail, and saw opportunities to acquire such books at a discount to embedded value, and then to use management actions and other efficiency gains to drive up profitability.

It should be said that these were not the only ones to see this opportunity. The company which was probably the largest competitor to Resolution and Pearl, Cowdery and Osmond, and is still a significant player, was Admin Re, now a subsidiary of Swiss Re. It, however, was not central to our story. We turn now to Resolution, because chapter three introduces us to what happened to our companies between 2000 and 2005. These years bridged the gap between the small-scale closed book consolidators and the height of turbo-charged corporate activity discussed in chapter four.

3. Over to Resolution

The history of Phoenix begins with the formation of Resolution Life by Clive Cowdery. Resolution provided turbo-charged consolidation. As a result, the early 2000s became the period in which key players defined their roles in a new world of British life and pensions business. Cowdery and Hugh Osmond not only responded to the new environment but also helped shape it. The context of course was crucial. Some companies were refocusing their energies on other areas of business, the Regulator was becoming increasingly active, outsourcing models had emerged, and some key players, notably Australian Mutual Provident (AMP) and Royal Sun Alliance (RSA), withdrew altogether. It is the response to these challenges that is notable.

Born in Bristol in 1963 and educated at Cleveden Comprehensive School where he gained three O-levels and no A-levels, Cowdery, a highly focused individual with a strong social conscience, worked extensively in insurance, co-founding J. Rothschild International Assurance, before becoming chairman and chief executive of General Electric Insurance Holdings in 1998, posts he held until 2003. This company was a UK Financial Services Company that was a wholly owned subsidiary of the American conglomerate General Electric. It did not include any of GE's non-UK financial services businesses.

A confident, highly-articulate and dynamic individual, Cowdery was a prolific dealmaker. Indeed, at GE, Cowdery had considered joining with Pearl to buy Equitable Life when it hit crisis in 2002, although that idea was not pursued. Recognising a market opportunity, and allegedly told to leave GE because he was spending more time on his new venture than running the company, Cowdery established Resolution Life as a roll-up vehicle for closed life funds. It was incorporated on 11 October 2002 and listed in May 2003 and 2003 was spent raising capital. Insurers, often a mix between general insurance and life companies, were closing life businesses because they could not offer new policyholders attractive terms, and Cowdery saw that these could be run effectively to the advantage of policyholders and shareholders.

A visionary entrepreneur with a commitment to fairness, who understood that market developments posed hazards for policyholders and necessitated a managed transition, Cowdery found backers to believe in his vision and to put substantial funds to work. He both achieved high returns for those backers and sought to offer a system of consolidation that worked for the policyholders providing for their reasonable expectations. He proved very good at pricing, at raising money for acquisitions, choosing the right moment to bid, and encouraging shareholders to stay in. Cowdery had a highly professional team, not least a high-quality actuarial group.

A number of institutions and other investors, including Prudential, Royal London, Standard Life, Fleming Family and Partners, and the British Steel and Hermes Pension Funds, together with a number of private equity and hedge fund managers, put up the initial capital of £415 million.

Cowdery put in £500,000 himself. In Cowdery's eyes, the insurance companies were happy to take significant stakes of about ten per cent each as part of a way to solve an industry problem of closed funds; but did not wish to do the job themselves. Cowdery's *modus operandi* was to buy closed businesses at a discount to embedded value in order to drive good returns to his backers and his team. He recognised the significance of back books as a source of continuing capital.

Building on what had been done in Century Life, but being far more ambitious in scale, Resolution adopted the approach that it would not close life books but, instead, argue that those books already closed were not being run as effectively as they might be for the policyholders, which was definitely the case. In particular, they had 'trapped capital,' representing surplus assets that could not be paid to shareholders as dividends because of a lack of distributable reserves. In part, there were inherent inefficiencies in the way in which the reserving methods had developed so that more capital was being held against the liabilities than was necessary. Addressing the issue of 'trapped capital,' or, at least of underperforming assets, through management actions, was a key way in which Resolution planned to operate. Addressing underperforming assets was also a central feature in the 'Big Bang' and in the second financial revolution as a whole.

Resolution's argument was that, when buying closed books, it would pay for this capital, providing funds for the sellers, better policyholder outcomes, and a profit for Resolution, the executives who were to be rewarded as in effect renters. In essence, this was a matter of selling expertise, the key element in a high-end services economy, and one that drew on the City's traditional expertise and applied it in a strategic fashion in an industry that was not stretching its margins intellectually or practically. Resolution correctly argued that it could provide better policyholder outcomes, as well as profits for itself, by cost and capital savings, and, in particular, by improving the capital structure through combining the books of closed businesses.

These books had to hold reserves to cover life insurance policyholders dying early and also living beyond actuarial calculations. By combining, and pooling risk, the risk element posed by each eventuality could be countered more-readily in terms of reduced reserves, so releasing capital on an accelerated basis. Moreover, the inherent bias in the insurance market was that toward prudence: the bias in the algorithms used was toward prudence while, in addition, prudence offers short cuts.

To be precise, in contrast, takes more time in calculations. Thus, releasing the assets tied up to provide this prudent margin was a profitable form of management action. It added to the beneficial equations arising from the running off of policies over time with the resulting shrinking of the capital base.

Another issue was posed by the Solvency One Directive of the European Parliament and the Council of Ministers of 5 March 2002 amending the original 1973 directive with reference to the solvency margin requirements for life insurance companies, a directive that remained in force until the much delayed Solvency Two directive came into effect on 1 January 2016. Although it had less effect than its sequel, and was largely a gathering together of existing regulations, the Solvency One Directive aimed to revise and update the EU solvency regime, and thus replaced the light touch and arcane valuations seen earlier in Britain and across the whole of the EU. Solvency One introduced a set of rules and prescribed the means of calculating liabilities. This provided an improved way to look at the mismatched character of assets and liabilities and to assess how much capital was required to cover the mismatch, although the valuation of liabilities was on a method indirectly related to yields, especially equities.

The changes in regulation introduced by the FSA were more significant. They shone a very bright light into the guarantees in the with-profit funds, many of which were terminally damaged by the 2003 market crash, a crash that encouraged both a better understanding of solvency and more regulation. It was no longer possible to mismatch guarantees with equities, and many funds therefore had no future, and very much disappointed policyholders, not least as they no longer paid bonuses.

The implications were a cause of some companies closing some of their existing books, as well as making takeovers more common. This was both in order to deal with capital requirements and also due to the comparability offered by Solvency One processes. The Regulator, moreover, could more readily ask if there were sufficient funds to cover liabilities, which was a key instance of the increasing burden of regulation. A combination of factors was encouraging the closure of funds and, indeed, of companies. This situation helped make the price more attractive to purchasers.

Resolution also claimed with reason that companies were prone to neglect customer outcomes and relations with those holding closed policies, which, unfairly, were termed ‘zombie funds,’ and that this customer experience could be improved by devising and operating an appropriate business model. Thus, there would be a win/win situation for policyholders and shareholders. The Regulators were sympathetic to this argument, and this helped lead them to adopt a supportive approach, although that was also more generally an aspect of City regulation in the Blair years and, indeed, until the 2008 financial crisis. Closed policies were widely regarded as ‘unloved,’[7] and there was a degree of truth in that view.

More specifically, with-profit funds, with their access to pooled investments, would benefit from mergers as their cost base would be reduced. Resolution therefore created a market for closed funds. In doing so, it benefited from, and encouraged, the taking forward of a relevant conceptualisation and methodology of assessing value and planning for profit. The crucial concept was that of embedded value, a metric applied to establish values and thus to assess likely future profits and risk. This measure permitted the evaluation of future cash flows and thus of shareholder value. Embedded value became part of the public disclosures when acquisitions were discussed. What

[7] Susan McInnes, interview, 10 Jan. 2019.

were termed Market Consistent Embedded Value (MCEV) became a key measure. The percentage of MCEV that was paid when closed books were acquired was an issue in each transaction, and one that was readily compared.

The companies selling closed books were ridding themselves of the many problems (including costs) involved in their management and thus lessening their liabilities, including costs of maintaining solvency reserves; as well as receiving, by means of the sale, a cash infusion to enable them to focus on core business and/or to make new acquisitions. As a result, they were more willing to sell at a discount in the shape of a percentage of MCEV lower than 100. The key purchase was that of the life and pensions business of RSA, which consisted of five life companies, in September 2004, for £850 million, about 65 per cent of MCEV. This was the first with profits fund to be sold to a consolidator. This key deal that kept Resolution going, its first purchase, the UK Life operations of RSA, which comprised approximately 1,700,000 policies, brought Phoenix life policies into the group. Founded in 1782 as the New Fire Office Company, Phoenix had become a subsidiary of Sun Alliance in 1984. In 1996, Royal Insurance and Sun Alliance had merged to become RSA. Neither was particularly strong, and certainly not in managing its assets.

The RSA Board accepted the Resolution bid, rather than a rival and slightly higher one by Pearl, because the latter involved a degree of financial engineering of the policyholder funds that left the Board uneasy. In contrast, Resolution said that it would run RSA in the established manner, merging funds to produce capital and operating cost synergies but not altering the relationship with policyholders. Resolution thereafter was able to continue its acquisitions on relatively attractive terms. Cowdery had provided a private sector solution to a growing public problem, and vindicated the comment of the *Financial Times* when Resolution was listed that ‘an industry lifeboat’ was being launched.

To a degree, the selling companies had forgotten the assets of which they were disposing, so that when closed books were sold, the hidden margins provided more value than anticipated. In another light, the Equitable Life crisis meant that insurance company prospects were undervalued and shares were under-priced. In the face of negative political and customer sentiment, notably over mis-selling, sentiment that was not checked, discounting in order to attract and appeared more attractive.

As a result, a solution to the problems in the life assurance industry appeared to have been worked out. Closed books, instead of being an issue, let alone the ‘unloved funds’ or ‘zombie funds’ could provide the basis for a profitable business. At the same time, a more stable and safer home for the policyholders was to be provided. At the end of 2004, Pearl owned seven closed firms with £28 billion worth of assets in the funds. There was £139 billion of assets in closed firms, the latter figure being 13 per cent of the industry total of £1,065 billion. This compared to £6 billion in closed firms in 1994. There were 27 closures in 1995-99 and 40 in 2000-04.

The closure of firms had strengthened the industry as these firms tended to be smaller, financially weaker, and had a higher proportion of with-profits liabilities. They also tended to have relatively high lapse/surrender rates, which suggested dissatisfied policyholders, and a high maintenance expense ratios. As a result of the need to de-risk, closed firms had lower solvency ratios and a lower risk capital margin as a proportion of their liabilities.[8]

As a background issue, one that is contextually important, there was a shift in the City toward the use of computing power in analysis, both in-house and out-house. Prior to that, it had been difficult to model events, let alone to project the future, although views on the matter vary. Although life companies had been amongst the earliest to take up computers in the 1950s, the paper-based culture, which proved particularly resilient with older staff, was for many (but not all) only slowly replaced by punch-card computers, and then by the occasional personal computers. The level of computing enabled balances to be drawn up, but more effective projections, and the management of prospects they made easier, were to an extent in the future. Whole-fund projection systems, such as Bacon and Woddrow's 'Prophet' were around in the late 1990s, with rudimentary stochastic versions by the early 2000s. Where the industry can be criticised is in not seeing the need to apply the stochastic methods developed by David Wilkie and others in the 1980s to with-profits business, as it considered that in a crisis the solution would always be the same – to cut bonus rates – and would always be adequate. The situation affected the understanding of risk. Liabilities were a function of data and of assumptions; and the latter is affected by the reliability of data.

Acquisitions were followed by reorganisation, financial restructuring, and renaming. In March 2005, for £205 million, 75 per cent of MCEV, Resolution acquired Swiss Life (UK) plc, and its 750,000 policies, which was subsequently merged into Phoenix Life Limited. Sun Alliance and London Assurance Company was renamed Phoenix and London Assurance Company. After a period of unwise expansion had been hit by difficult market conditions, Swiss Life was retreating from the UK to concentrate on its core domestic business.

On 9 June 2005, as the result of the active pursuit of expansion and trading by Cowdery, the merger terms for Britannic and Resolution were announced. The merger was on equal terms and created the leading quoted specialist closed life fund business, valued at approximately £1.8 billion. There were about four million policyholders and £35 billion of life company assets, and the combined Embedded Value was £2.1 billion. Britannic Ordinary shareholders were to represent 54.5% and Resolution Ordinary shareholders 45.5% of the enlarged Group. It was argued with reason that the enlarged Group would be well positioned to be the leading consolidator of closed life funds, and that it represented a stronger platform to develop third party asset management and life insurance administration services. Pre-tax operating benefits of at least £30 million were envisaged, including

[8] Ex inf *The Actuary*.

£20 million expected annual cost saving achievable in full by the end of 2007. Further financial management and capital efficiency benefits had been identified, and these were expected to enhance the operating achieved profit per share for Britannic from the first full financial year after completion.

The positives were also flagged up in terms of a strengthened dividend capacity. On the base of a dividend of 17.85 pence per share in 2004, a 11% pa. target growth rate to 2009 was indicated, albeit accompanied by a review of the dividend policy in the light of the 2005 year end results. The announcement on 9 June 2005 outlined a financially robust group with a strengthening balance sheet, a pro-forma gearing of 21.6%, a strong cash flow, and an intent to access hybrid capital markets. Cowdery, whose stake was valued at £72 million, was to be the Executive Chairman of the enlarged Group, and Paul Thompson, the Group Chief Executive of Britannic, was to be Group Chief Executive of the enlarged Group, a position he held until March 2007 when replaced by Mike Biggs. This was very much a case of two complementary companies pursuing a common strategy.

As a result, on 6 September, the Resolution Life Group merged with Britannic Group to form Resolution plc, thus bringing the old Century Life into the Group. Hit by the crisis of that year, Britannic had closed to new business in 2003. It did not have a new business model, and thus moved into a closed fund deal with Resolution. Of great significance, this transaction was structured as a reverse takeover of Resolution by Britannic, thus enabling the enlarged Group to acquire a stock market quotation and the significant access to investment this offered.

As a reminder of the rate of change, the merger of Resolution and Britannic was one of the first completed under the new listing regime of the Listing, Prospectus and Disclosure Rules that had been effective from 1 July 2005. The prospectus for the merger came into effect that day.

In December 2005, Royal Sun Alliance Linked Insurances were renamed as Phoenix Life Limited. A Part VII Scheme (which comes from the Insurance Companies Act) transferred the life business of Phoenix Assurance, Bradford Insurance Company, and Swiss Life (UK) to Phoenix Life Limited. In September 2006, Resolution acquired the life businesses of Abbey National Bank for £2.6 billion, which enlarged the Group to the point where it entered the FTSE 100. These businesses were Scottish Mutual Assurance, Scottish Provident Limited, Abbey National Life, Scottish Mutual International and Scottish Provident International Life Assurance. Three months later, a Part VII Scheme transferred the business of Alba Life, Britannic Assurance, Britannic Retirement Solutions, Britannic Unit Linked Assurance, Century Life and Phoenix Life and Pensions to Phoenix Life Limited. All the ex-Britannic companies had been rebranded as Phoenix. Lastly, in June 2007, Britannic Retirement Solutions was renamed as Phoenix Pensions Limited. There was a reassurance of annuity liabilities from Phoenix Life Limited, Scottish Mutual Assurance and Scottish Provident to Phoenix Pensions Limited.

Having bought a lot of closed funds very successfully, Resolution was listed onto the Stock Exchange in September 2006 at the bottom end of the FTSE 100. The Regulators were very positive as the Regulatory problem had been solved by Cowdery, who had provided a mechanism to save fairly weak institutions once their liabilities had been crystallised through becoming a closed fund. In particular, Cowdery had taken on with-profits funds as Century Life and Windsor Life had not done. He provided a sense of fairness and trust that was important to the Regulator and to the policyholders, offering in particular clarity as to how the reasonable expectations of the latter could be interpreted in light of the need for a reasonable compromise between policyholders and shareholders. The 2006 Annual Report noted £61 billion under management, a market capitalisation of over £4 billion, and a return on embedded value of 23.5%. Shares had outperformed the FTSE 100 during 2005 and 2006, and the 2006 Report noted ‘Our dividend philosophy remains unchanged, namely that dividends will be paid out of embedded value earnings and not capital releases.’

Meanwhile, Hugh Osmond, who, in effect, became Cowdery’s arch rival, providing underlying emotions and stresses as well as a degree of mutual respect, created Sun Capital Partners as another effective player. Born in 1962, Osmond, a dynamic, bright, hardworking, and highly-focused individual who did not fit into boxes, studied medicine in Oxford. After working in clubs in the USA and joining a small investment bank in Madrid, he made a lot of money from the development and subsequent flotation of Pizza Express in 1993. This was a development that captured his ability to bring in fresh thinking and his commitment to details, and to the value gained by customer satisfaction and product improvement.

Four years later, Osmond was the co-founder of Punch Taverns which he made a major landlord through acquisitions borrowing money secured against the future cash-flows of tenanted pubs. In 2000, Osmond trumped Whitbread in its attempt to buy Allied Domecq’s pubs, derailing an agreement between the two. He was to be branded as the ‘pubs to pizza entrepreneur.’

In 2001, Osmond founded Sun Capital Partners, a London-based private investment house, in order to look for new acquisitions. Rather than being a private equity fund (which raises third-party money from investors called Limited Partners), Sun Capital used the funds provided by its working partners. It was, and is, a private investment office, which invests its own money and does not manage third party funds. Osmond also reached an agreement with DB Capital, the private equity arm of Deutsche Bank, so that funding would be provided for target transactions on a case-by-case basis. From the outset, Sun Capital focused on the financial services industry. Osmond was very interested in the fate of Equitable Life, and by the Penrose Report which he had read carefully. Osmond took advice from Weinberg.

Osmond worked hard to understand the particular issues posed by life assurance and closed books, and gained the knowledge to implement his concept of a transforming and profitable improvement. He acquired a great understanding of capital release mechanisms. To Osmond, life insurance was really a giant derivative, as Equitable Life had found out when it was not hedged, but, he argued, the industry did not really understand derivatives, new business was written in a very haphazard way, and many policies were not financially viable. Fascinated by what could be done, he wanted to manage things better, and notably the huge funds of orphan estate which he argued could be managed better, thus returning benefit to policyholders (in effect distributing the estate earlier) and shareholders. Osmond pressed the case for better risk management, both in open and closed policies, including the elimination of uncompensated risk and the better management of the portfolio. To Osmond and others, orphan estate was a product not only of overly-cautious provisions but also of the past under-distribution of resources.

Osmond stated that Sun Capital would focus on doing between one and four large deals of about £500 million per year. He also hoped to consolidate companies in industries where there were potential targets worth more than a total of £5 billion. For an article published in the *Daily Telegraph* on 27 January 2002, Osmond announced that 'If needs be, Sun will be very hostile,' explaining that Sun Capital's financial structure enabled it to make hostile bids. He had done so when breaking up the agreed deal between Whitbread and Allied Domecq by launching a successful counter-bid for the latter. Competitiveness was in Osmond's DNA, although his purchase of high street Spanish banks from Santander in 2008 aroused considerable scepticism.

Born in 1965, Cambridge-educated Manjit Dale had founded TDR with Stephen Robertson in 2002. A private equity firm, it continues to the present to have an impressive track-record. Sun Capital and TDR formed Life Company Investor Group to buy the Henderson Group's for-sale assets.

Crucially, understanding that he could securitize closed book funds, Osmond acquired what became the Pearl Group in 2005. Pearl was the product of a different trajectory to that through from Century Life and is a reminder of the very varied trajectories that companies followed. Instead, Pearl Group as a major player came from a significant process of reorganisation in the late 1990s and early 2000s. Pearl Assurance had long been an important player in the British industry. Its Australian parent, AMP, was growing very fast at the start of the 2000s, both organically (with all funds open to new business) and inorganically, as a result of the acquisition of other companies' books and in sharing services accordingly.

Indeed, AMP was on a marked trajectory of expansion and rapid growth at the close of the 1990s and start of the 2000s, a period when the market was considered reasonably robust. This expansion was not restricted to life insurance. In addition, among a range of moves, AMP purchased the asset manager Hendersons, and the independent financial advisor company Towry Law (purchased as a distribution network that could act as an alternative to a direct sales force), and an online broker, Interactive Investor. By 2001, AMP was looking at acquisitions in Europe, seeking small life companies with open books.

In late 2001, the market fell after the terrorist attacks in New York and Washington and as a consequence of the deflation of the technology bubble, the dot.com crash. Challenging the idea that equities outperformed other assets, the FTSE index fell by 16 per cent in 2001 and then by 24 per cent in 2002. There was a further significant fall in 2003. These falls challenged company capital ratios under solvency regulations, and, because of inadequate hedging against risk, led to a switch from shares into bonds in order to maintain solvency, even though share prices were falling. This situation encouraged a search for revenue, indeed forced one under Regulatory restrictions.

Yet again, a quest for solutions was a key element in the story. The life insurance companies had invested much of their excess capital in an equity asset portfolio, because it had historically outperformed other assets, but that was definitely not the case in 2001-2. Moreover, both that crash and the 2000 dot.com boom had made volatility a serious issue, and had underlined the complexity of how the market worked, not least with significant short-selling. This and other issues affected the complexity of how the markets worked.

Many of the companies had not hedged their risk sufficiently. With insufficient spare capital, they could not ride the crisis out, but, with a very high level of equities in with-profit funds, had to sell equities at a bad moment close to the bottom of the market, in order to cover their positions by investing in less dangerous assets. As a result, it was not possible to benefit from a subsequent rise in the market, in part because of investment choices were in effect determined by the impact of regulatory pressures. Capital flexibility had declined and with-profits funds appeared particularly compromised. Issues with liquidity and capability led to the health of insurance companies being reconsidered, a position highlighted by the travails of Equitable Life in the face of the mismatch between guaranteed annuity options and rates and falling interest rates. Quantitative Easing (QE) proved a major problem in this context. More specifically, the lower rates from QE forced actuaries to reduce the discount rates for pension fund liabilities, and Finance Directors switched money for investment into supporting pension funds.

The FSA sought to ease the situation by relaxing solvency/resilience tests. These tests, which were carried out at regular intervals, were intended to show the potential effect sharp stock market falls might have on solvency. The rules governing these tests were relaxed twice in 2001 in the wake of the 11 September terrorist attacks, and were eased again on 28 June 2002. As a result, life assurers had to maintain a 15 per cent cushion (rather than 25 per cent) against a fall in share prices. By July 2002, there was growing concern, however, that the repeated relaxation of the rules might allow some life assurers to continue trading while technically insolvent. Indeed, Sun Alliance and London was forced to draw on a £500 million capital guarantee to meet solvency requirements, AMP, to the anger of its shareholders, injected £400 million into Pearl, and Abbey National £150 million into Scottish Mutual. Shares in Aviva lost more than 60 per cent to their value in July 2001-July 2002, and those in Friends Provident nearly halved in value.

Meanwhile, fund performances were too low for independent financial advisors to recommend them. Many had a poor-quality book and a mediocre investment performance. Funds could not close and could not afford the financial strain of writing new policies. New policies were very expensive in liabilities in initial terms vis à vis premiums, and especially so if sold through independent financial advisors. The FSA's concept of realistic balance sheets deliberately factoring in promises as well as contracted limitations produced a more realistic and robust model in terms of meeting capital margins and made it easier to handle the subsequent crash. This capital regime, that of the economic capital model, accelerated the decline of the with-profits funds. Unit-linked funds, which were less capital intensive, largely replaced them, and the capital regime encouraged this process.

These issues, and specifically the fall in revenue, affected the Pearl Group, not least because of its recent acquisition of The National Provident Institution (NPI). AMP had overpaid for NPI. Moreover, it bought a company that had given its policyholders the guaranteed annuity rates of four per cent incorporated into the pension policies, which they could not readily meet and which, over the years as a result of low interest rates, have cost Pearl shareholders hundreds of millions of pounds. The policyholders did very well. Similarly, Equitable Life had over-promised the fund with its guaranteed annuity rates. Guaranteed rates are not really a problem when interest rates stay well above the guaranteed rates as the hedging options will be cheap to buy. However, long-term interest rates fell after the Bank of England became independent in 1997 and inflation was brought under control. This fall in interest rates hit the management of guaranteed annuity rates. Moreover, the bifurcated nature of the regulatory regime had helped ensure that his problem was not anticipated. Prudential regulators had assumed that the companies could not overpromise themselves.

Hoping that Pearl would be a cash cow, AMP had used Pearl's inherited estate to fund its acquisitions. Gradually, however, Pearl, historically a financially extremely strong company with a lot of assets, had been run down to the point where it breached its Regulatory solvency. NPI put Pearl under stress. At that point, the Regulator put in an OIVOP (Own Initiative Variation of Permission) notice, which meant that it could not spend money without getting permission from the Regulator. A number of AMP's funds required additional money during the period of market downturn and difficulties that lasted for a couple of years. The situation was exacerbated because in late 2001, at the same time, the company was introducing a new financial ledger as an operational system.

These problems brought the anticipated process of growth to an abrupt close, which was the first in a sequence of problems for the industry. For Pearl, the problems led to a closure to new business in 2002-3 in many of the Pearl Group's companies, in particular because life assurance represented a drain on capital: more capital was required than in a general insurance policy. In particular, Pearl, which had a large direct sales force, was haemorrhaging money. The cost of the sales force was an important element in the cost of running an open policy. The acquisition of new business was an expensive process. The liabilities generated by new policies were heavy, while, at this stage, the assets were limited because of the high initial costs of getting them onto the books. Clearly the risks of continuing to write new business were greater than those associated with running a closed book.

The Regulator, the FSA, said that the Pearl in particular required significantly more capital. AMP decided to close Pearl to new business. This was a major change in culture. The salesforce had in effect run the business and seen the actuaries as an annoying overhead, but now the actuaries ran the business. Pearl kept a small salesforce aimed at higher net worth policies, but that was closed about a year later. London Life was already largely closed to new business, and when AMP bought NPI. The existing business was put into a closed fund called National Provident Life (NPL). It attempted to sell it in 2003, but were unable to find a buyer, given the tough market conditions and closed it to new business.

AMPs model proved unsustainable. As the result of an expansion that had come crashing down, AMP came to regard the UK market, its biggest foreign investment, as too capital intensive and volatile, both of which affected its operations in its Australian base where it was already having problems and where it had demutualised. As Australian companies had a comparatively small investor base, it was not easy to meet the requirements of the capital-intensive British life insurance industry. Changing Regulatory requirements were a key problem as they compromised the ability of the Pearl Group to act as a cash cow for AMP. The strain of meeting capital requirements in Britain were increased by the weakness of the Australian dollar at this stage. These problems overlay the underlying strains of the Pearl Group, notably the capital strain it had faced in writing new business. AMP was affected from a range of problems including grappling with both Australian and British Regulators, record losses and Board changes. It had ultimately spread itself too thin, and shareholders in Sydney were unimpressed with how they were managing. AMP was forced to write down the value of its UK operations by £1 billion and to incur £100 million of restructuring charges; and thereby had to have a rights issue.

As a result, with its shares falling substantially and rapidly in value, and its Board shedding members, AMP decided to concentrate on its traditional markets of Australia and New Zealand, and in 2003 to disinvest from Britain, beginning Project Dawn to that end. Its UK business was Pearl Assurance, London Life Ltd, the National Provident Institution, Henderson, Towry Law and Interactive Investor. The new asset vehicle, the Henderson Group, which was listed in 2003, a fairly sizeable operation, was listed on the UK FTSE; indeed was in the top 250 at about 116th. The fund manager ran the business. Because AMP had originally been a mutual which had demutualised, many of its shareholders were policyholders and a very high proportion were based in Australia, where the bulk of the AMP mutual business had resided. As a result, when AMP sold the Henderson Group, these shareholders got shares in the UK company, AMP's biggest foreign investment. It had about 900,000 shareholders, many overseas, which meant a lot of work running the company. It was administering closed books successfully, but was not trying to acquire more. This was a tempting prize for those seeking closed books. Moreover, Roger Yates, the Henderson Chief Executive, who was a fund manager by trade, was not particularly interested in life insurance.

At this stage, although they had separate Boards, the subsidiary companies did not have the independence to follow a different course to the parent. Now, such Boards can approach the Regulator, endorsed as a unit, and had a large degree of autonomy to protect the policyholders. That concern with protection existed in 2004, but the parent, Henderson, essentially a fund manager, decided to sell out of life insurance. This was done in order to give Henderson better prospects as an asset manager. This reflected the longstanding tension between asset management and life insurance. Having the two in-house appeared sensible as the life insurance companies provided capital while in-house asset management offered cheaper fees. However, there were significant questions over quality control, flexibility and priorities.

The Henderson Group was approached in December 2004 for its closed books by the partnership of Sun Capital, the vehicle of Osmond, and TDR Capital, that of Dale. The former made the weather, but Dale was also a key player. Henderson readily agreed to sell, but Resolution, under Cowdery, then made a similar approach to Henderson. Henderson was advised that it needed to consider this alternative bid as Life Company Investor Group had not got enough deal protection. Henderson went back to Life Company and asked for more money in order to reject the other bid. Thus, in what in effect had been a bidding contest, the percentage of MCEV being paid was pushed up from 79 to 82. In order to win the transaction, Osmond and Dale offered more money, but on the basis that that was it and Henderson had to agree a break fee of £45 million. Cowdery was shut out. As a result, in a deal agreed in Yates' house in South Kensington in April 2005, Osmond and Dale paid £1.07 billion, £45 million more than anticipated, which, alongside the competition of the bidding, possibly did not improve their relations with Cowdery. However, the purchase was still at a discount as far as the MCEV was concerned, and still at a reasonable price. Henderson felt it got a bit more for its shareholders and was able to move out of the life business. In May 2005, an EGM of the Henderson shareholders approved the deal. Moreover, the rivalry between Cowdery and Osmond, with Osmond allegedly feeling he had lost out over the purchase of RSA, was always somewhat overblown. While the deals would have been less expensive without the competition, there were still a lot of assets to go for, and both men were professionals who were well-aware of the situation.

Osmond and Dale put in £320 million equity, and £765 million of bank debt. They therefore put in a lot of their own capital, but also leveraged up significantly at a time of far higher interest rates than today. Yet, they had a track record in business and, at that rate, the backing of the City. While some greeted Osmond's entry into this market with surprise, he argued that the industry had been in a poor state for a decade and was in need of somebody from the outside. To Osmond, cash rather than embedded value should be the definition of success in life assurance.

The new owners called their holding company the Pearl Group, rather than Life Company Investor Group, on the grounds that they had acquired a fantastic brand with Pearl, one that was very traditional and well-known. The new Pearl Group comprised the closed life books of the companies formerly known as Pearl Assurance, National Provident Institution, and London Life. Its management involved the same tasks as the previous owners, that of administering a book of business efficiently, but with different shareholders and methods. The latter was the crucial point. Century Life had followed a relatively conservative financing policy. Resolution changed the situation by being more leveraged than Century Life, and there was a progression in financing policy, albeit in each case within tight management structures. Resolution was less conservative in its borrowing than Century Life, but more so than Sun Capital.

To Cowdery, the intention as to provide a long-term solution to the problem posed by there being too many life assurance companies. Others were critical, although possibly more reading back from the later sale of Resolution Two. They have claimed, with no evidence, that Resolution's goals were more modest than those of Sun: 'Cowdery wished to buy at a discount, make some rapid changes in financial management, and then move on to the next acquisition. In contrast, Osmond sought to transform companies through more significant changes, and to win greater value as a result.' At any rate, both were believed by critics to be keen on eventually selling.

There was a significant contrast between the situation in the closed book industry in late 1990s and early 2000s, and, on the other hand, the process of acquisition in the mid-2000s, and the first key sign was this purchase of Pearl Group by Sun Capital and TDR. This was acquired in part by the use of bank loans and, once in control, there was a need to refinance the debt. The acquisition loans had been secured against the shares of the top company, not the business, so that policyholders could never have capital reductions. Profits led to significant capital increases which enabled the Group to have the money to buy Resolution. There was a refinancing to £905 million, but only once the MCEV had grown to over £1.5 billion, so that it was leveraged to some 60%. This derisking, however, entailed increasing the scale of the bank loans for the top company which was the holding company.

In order to address the situation and repay the banks, the Pearl Group under its energetic new owners sought to generate cash much faster. This entailed releasing the capital held in the books.

They were still generating profits; the assets were still generating returns. However, because the books were closed, as policies ran off the life companies could also release the capital that had previously been held against those policies. As a result, cash flows always exceeded profits because of the run-off profile.

This release was achieved by a number of means. A deal with TATA, which set up Diligenta, ensured that the cost of running the back books, and thus the back office, could be fixed and hived off which provided a degree of control over costs that had hitherto been absent. In the end, indeed, to look ahead, Resolution Two ended up moving its policies to Diligenta, which is the stand-out operator now.

Actions were also taken to improve the capital position and thereby release previously trapped cash. The investment mechanism and profile also changed. Pearl moved to own and manage its own investment, and no longer to rely on Henderson. This, however, was potentially an expensive solution as it involved another profit centre but with the costs in-house. The investment charges were to be paid by an agreed fee from the life companies.

In order to run the assets more effectively for policyholders and shareholders alike, there was a drive for a high yield on investments. That suited the new owners of Pearl, who brought in highly-skilled staff from hedge funds, options and derivatives, and devoted forensic attention to its workings. With what in part was primarily a forward-investment vehicle, they sought a focus on higher yield and higher risk investments, and not on the traditional asset types and capital backing held by life insurance companies. This strategy worked extremely well for a number of years, the Pearl Group was successfully managed, embedded value greatly increased, and good money was made. Risk was ably managed, and as a market-consideration not on actuarial terms. There was no problem at all in paying the interest on the debt, and in 2005-8 the Pearl Group was a successful operation in managing closed funds, and both for the policyholders and for the shareholders. Hundreds of millions of pounds were distributed to policyholders' funds. This success encouraged confidence and looking forward to new moves. It is too easy to overlook the success by focusing on the period of difficulties that followed.

While the new owners sought to turn Pearl into a higher-yield company, a process that involved much work, the Resolution model was working with sizeable acquisitions, each of which were then followed by a process of working through as restructuring took place in order to provide better value from trapped capital. Being listed after the Britannic merger meant that Resolution had better access to capital than Pearl and was less reliant on debt. As a result, Resolution, which anyway had the confidence of the Regulator and the existing industry, was more attractive in bids. This was significant as leverage as a basis for acquisitions was relatively new in the insurance industry. Moreover, not short of self-confidence, Cowdery proved energetic and adroit in selling himself.

With the effects of the changes of the 1980s, the difficulties of the 1990s, and the crisis of 2000 playing out, the Regulatory atmosphere was favourable for Resolution, Pearl and other consolidators, in part because these changes were regarded as bringing new or at least renewed life into the closed funds. This was significant as part of the context was that of press attacks on the size of the flow of money to policyholders from ‘zombie funds.’ In practice, this was due to there being insufficient capital backing for these funds. These press attacks fed through into complaints to MPs from policyholders and it would be surprising if these did not influence the regulators.

Consolidation and new management offered greater strength as well as more sophisticated hedging and financial management in order to provide protection against downside risk and to give policyholders both a more secure return and more money. The Regulators sought appropriate financial buffers and an understanding of liabilities. Neither was compromised by the search by heavily-leveraged companies to release money through capital efficiencies and other managerial improvements.

Osmond, in particular, emphasised the value of a more effective investment strategy, a better match of assets and liabilities, and a shrewd mix of asset types. These sound easy, but that was far from being the case. In particular, it was necessary to balance the cash short-term liabilities and the longer-term more fixed assets, such as participation in private finance deals, which is the policy followed today under Clive Bannister. Osmond’s skill, energy and determination helped him in delivery, but life assurance was an industry of long-term security not short-term capital gain.

Restructuring always entails a lot of work, but it became more effective and less fraught with time as a degree of streamlining in process management was implemented. This indicated the potential for turnround that had been grasped by Cowdery and Osmond. Thus, the acquisition of Scottish Provident and Scottish Mutual Assurance in September 2006 entailed the application of Resolution’s tried and tested mechanisms. They were acquired for £3.6 billion from Abbey National, which, in response to mistaken expansion, gave up trying to be a bank and insurance company. Having acquired Scottish Mutual in 1992, Abbey had bought Scottish Provident in 2001 for £2.1 billion. Pearl was angry as it wanted the Abbey National life companies. This represented a change in the business model for Resolution which, for the first time, acquired life companies open to new business.

Closed books were still valuable as part of restructuring and continued solvency; but increasing competition meant that the percentage of MCEV that was paid rose, as with the 2006 purchase of the Abbey National life companies. By then, rates of 90 per cent of MCEV were more common. These were less attractive, and to a degree the terms were fudged in public. A £1.54 billion rights issue by Resolution in June 2006 enabled the funding of the acquisition.

Resolution, not Pearl, was making the weather in winning acquisitions and gaining assets, to the frustration of Osmond who was not being invited into bid processes. This helped explain the pricing power of Resolution as a target. The 2006 Resolution Annual Report noted a proposed dividend growth of 15% in 2006 and of 38% in 2007. For Pearl to gain an asset of any scale, it appeared necessary to win Resolution. Resolution was also successfully restructuring in order to release cash. Thus, in May 2007, Resolution outsourced all the ex-Britannic and ex-Abbey Life and Pensions business to Capita Life and Pensions. This entailed an outsourcing of back-office customer services to India.

Conclusions

Cowdery's Resolution and Osmond's Pearl did not appear by chance, but were a result of well-researched, calculated, plans by two highly-intelligent, ambitious and experienced individuals who saw an opportunity to breathe life into books of business considered by many to be dead. They brought investors and partners on board, and were able to sell their model to the press and Regulator, and the Regulator was happy that these policyholders were being looked after. Resolution and Pearl were both able to make use of outsourcing models. By 2005, Osmond and Cowdery managed the two biggest consolidators of closed life books, but two individuals of such high calibre driving this industry forward, undoubtedly led to competing agendas and, eventually, a visible rivalry. This was the human drama that led to the controversial sale of Resolution and is key to the understanding of Phoenix's history.

In the summer of 2007, a projected deal by Resolution with Friends Provident, which had a lot of open book policies, failed because, in order to get the competition and thus increase its own prominence in the industry, Pearl intervened and for Resolution. This proved a crucial transition.

4. The Pearl Takeover of Resolution

Introduction

Pearl Group's takeover was a defining moment in the Phoenix story as well as that of the consolidation of the life industry as a whole. The acquisition was a true pre-Crash of 2008, height of the market, mega deal. It involved six life companies – Resolution, Pearl, Friends Provident, Standard Life, Swiss Re and Royal London, who assumed varying roles, and many of whom would feature later in the Phoenix story. The takeover involved an extraordinary set of events that approximated to a feeding frenzy.

The takeover battle was an advisor's dream. Investment bankers, lawyers and professional services companies relived the twists and turns for many years to come, not least recalling the councils of war that took place at Resolution's head office at Juxon House by St Paul's. The struggle featured a clash of two leading innovative financial figures, as well as top-of-the-market pricing, and innovative financial structuring. This structuring was also controversial, being regarded by critics as burdensome. Yet, this structure was both permitted and compatible with the pre-Crisis circumstances.

On one interpretation, Hugh Osmond and Manjit Dale, through their vehicle, Pearl Group, pulled off a coup by neutralising their main competitor, Resolution. As a result, Phoenix is around today as the leading life company consolidator. That would not have been possible without buying Resolution. Moreover, the total return to investors in Phoenix from start to finish, or even from the date of the acquisition of Resolution, has been much higher than the UK life company index, or the FTSE. Another reasonable view could be that Clive Cowdery sold out at the top of the market, making a personal fortune, while, having bought back the Resolution brand for £50,000, he would go on to establish Resolution Two.

The acquisition not only brought into one group a number of life company brands, but also represented the largest consolidation the life industry had ever yet seen. This chapter tells the story of the takeover that brought together two halves that came to form Phoenix.

The Opportunity

At the time of the takeover, the Pearl Group and Resolution were major players, both competing for similar closed life businesses. There was clearly strategic sense in taking out the main competition. But the business case needed to stack up, and, for both companies, there was a drive to make a good level of return.

The takeover of Resolution was a surprise. Resolution, indeed, had been negotiating to take over Friends Provident as part of its process of building its role as the leading closed-book business. The deal, which had entailed much preparation and long hours for the relevant staff, was announced, and appeared to be both the latest stage of Resolution's steady and measured progress, and in no way the end of the road. On 25 July 2007, Resolution announced a proposed merger, on an all-share, nil premium, basis, with Friends Provident. This was intended to create a new entity, Friends Financial, which would have had a market value of about £9.2 billion. The new company would have a management team drawn from both. Thus, Resolution, a closed book consolidator with some open business (as a result of life businesses bought from Abbey National, the Scottish Provident business) was to buy an open business with a lot of closed books. The scale of the deal, with each FTSE 100 companies, reflected that of Resolution. As it was big, only a big purchase would move the needle. Friends Provident was big enough to do so, and its structure made the deal attractive. Moreover, Friends Provident was in difficulties: its profit growth targets had not been confirmed, its shares were trading below their offer price and the company's cashflow and capital were under pressure.

The opportunity for Pearl came when Resolution agreed to merge with Friends Provident in order to create Friends Financial, as it would be a large open life business. Up to this point, Resolution had presented itself to its public shareholders as essentially a closed-life consolidator, which was a capital-light business model unencumbered by the extra capital that came with selling new business; a situation different to Phoenix today.

Shareholders in both groups, however, were lacking in enthusiasm. The Resolution share price fell 2.4 per cent on 25 July 2007, to close at 616p. There was speculation that AXA, which held 16% of Friends Provident, would counter-bid. It did not do so. In the event, Pearl, arguing to Resolution shareholders that the Friends Provident deal did not make sense, made a hostile bid for Resolution. The deal indeed would have been poor, with huge cash holes and outflows for Resolution. Much of the new business Friends Provident was writing at the time was loss-making, and assumed a break-even over timescales longer than the business was actually staying on the books. That was why the market and Pearl hated the proposed deal. It is instructive that the shares of Friends Provident subsequently did very badly.

As Resolution was publicly listed and subject to the Takeover Code, the ensuing bidding was conducted in a very public fashion. On 26 July, Pearl stated that it had reservations about the merger and also disclosed that it held a 11.28% stake in Resolution. A statement after the market closed declared: 'Pearl believes that there is potential for more value to be created for Resolution shareholders through pursuing strategies similar to those that Pearl has applied to its own business.' Terry Eccles, the Director of Mergers and Acquisitions at Pearl, told Citywire:

> 'We've been building a passive stake in Resolution for some time through cash settled derivatives which is why we have not disclosed it. But we now feel the time is right to take a more activist approach and buy some physical stock. We feel Resolution has more value to extract than has been offered by this merger. The execution risk of putting together these two businesses, which do not have

> great synergies, may outweigh the value for Resolution shareholders so we are puzzled by it. We don't like this deal. We want to sit down with management and explore options.'

The following day, Pearl announced further acquisitions of interests in Resolution, taking its stake in the company to 15.85%. By September, this stake had risen to 16.5%. Osmond argued that the Friends Provident merger did not represent good value for Resolution shareholders, of which Pearl was the largest. Osmond, seeking greater value for his Resolution holding, had tried to win the support of Swiss Re (which, in July 2004, had bought Windsor Life) for a takeover of Resolution, but had failed to do so.

Meanwhile, on 10 September 2007, Resolution and Friends Provident announced a revised merger structure, going on, on 8 October, to publish merger documents. At the same time, there were others coming into play. On 19 September, Standard Life, in response to media speculation, acknowledged that it was monitoring developments, while, on 10 October, Pearl, in conjunction with the Royal London Mutual Insurance Society, announced that it was considering an offer of 660p cash offer per share for Resolution, an offer worth approximately £4.5 billion. Royal London, a life company, supported Pearl in two ways. First, it agreed that Pearl could sell on Resolution's open business. Secondly, it provided £300 million of the purchase financing in equity-like instruments, known as PIK instruments. This offer had been communicated to Resolution's Board the previous day and compared to Resolution's see-through market value of the merger with Friends Provident as approximately 575p at the close of business on 9 October. Pearl commented:

> 'We made a substantial investment in Resolution on the basis that we supported its business model of being a leading consolidator of closed life businesses. We are disappointed that it has decided to abandon this strategy in favour of the currently proposed merger, which we believe will create limited value for Resolution shareholders and carries considerable downside risk. The share price performance of both Resolution and Friends Provident immediately following the announcement of their merger suggests that the market shares this view. Our proposal gives shareholders the alternative of realising full value for their Resolution shares in cash.

That, however, did not end the matter. The Resolution Board rejected this approach on 10 October 2007, while, on 15 October, the Takeover Panel issued a 25 October 'put up or shut up' deadline for Pearl and Standard Life. In turn, Pearl, on 19 October, announced an improved 691p cash offer for Resolution. The Resolution Board rejected this, and continued, instead, to discuss the merger with Friends Provident. Indeed, with the shareholders of the two insurers due to vote on whether to back the merger plans on 5 November, the companies promised to return around £2 billion to investors.

Standard Life and Swiss Re had come into play, enlarging the multiplicity of participants. Standard Life, not long demutualised, teamed up with Swiss Re, a competitor with Pearl and Resolution in the closed life consolidation market. Swiss Re committed to buy from Standard Life the closed life businesses of Resolution for a purchase price of £2.35 billion, payable in cash, leaving Standard Life with the open businesses and assets under management. The Resolution deal would have significantly expanded Standard Life's UK operation. It would have gained new business and distribution, including almost all of Resolution's news business capability, notably its leading protection offering and profitable annuity and drawdown new business opportunity. In addition, Standard Life would gain access to Abbey's nationwide network of more than 700 branches, which would provide access to a further two million potential customers and diversify and significantly enhance Standard Life's distribution capability. Of the £57 billion of assets managed by Resolution as at 30 June 2007, £50 billion would be retained by Standard Life, including £24 billion under a ten-year investment management agreement with Swiss Re. Cowdery, Mike Biggs and David Cooksey were to be invited to join the Board of Standard Life upon completion, with Cowdery as non-executive Deputy Chairman.

On 26 October 2007, Standard Life's bid, £4.9 billion of cash and shares - 517p in cash and 0.715 Standard Life shares (72% cash, 28% new Standard Life shares), equivalent to 113 per cent of MCEV, was recommended by Resolution's Board which called off the merger deal with Friends Provident, agreeing to pay a £49 million break fee. Cowdery was happy to accept the bid. Gerry (Gerald) Grimstone, the determined Chairman of Standard Life, announced on 26 October:

> 'We are delighted to announce this recommended offer for Resolution, which will create significant value for both Standard Life and Resolution shareholders. The combination of Standard Life's and Resolution's complementary businesses will create one of Britain's leading life and pensions and asset management groups and accelerate Standard Life's delivery of shareholder value. We are also very pleased to be working with Swiss Re in this transaction, whose agreement to acquire a substantial proportion of Resolution's closed book assets for cash adds significant certainty for Resolution shareholders.

Cowdery said:

> 'We believe this Transaction represents an attractive balance for Resolution shareholders, who will receive a substantial proportion of their investment in cash while retaining an equity interest in the value expected to be delivered from the enlarged Group. The Board of Resolution, therefore unanimously recommends accepting Standard Life's offer.'

Standard Life's shares, however, fell dramatically as soon as they announced the offer. This reflected the extent to which the market hated the proposed deal.

Pearl, moreover, came back, on 26 October, with an all-cash, knock-out, offer of 720p per share. Moreover, it transpired that, through contracts for difference, a 'shadowstake,' Osmond had been able to acquire 24.18 per cent of the voting rights, while appearing to have a smaller percentage of the actual shares. This stake would have blocked shareholder approval of a merger with Standard Life, which required 75 per cent backing from Resolution shareholders. Thus, Pearl had acquired a form of shareholder veto. In the end, the price of the shares rose on the final day of preparation for the bid, as some of them also were acquired then. Pearl's stake in Resolution rose to 25.9 per cent. Furthermore, the would-be purchasers had sought to win over employees who owned shares. Pearl stated on 26 October: 'Pearl believes that the proposal would expose both Standard Life and Resolution shareholders to significant downside risks from their current level… Resolution would be a poorly conceived acquisition for Standard Life with very limited strategic fit.'

This degree of control meant that the Pearl bid had to be taken very seriously. That was even more the case because of the sum offered, which was about 120 percent of MCEV. Resolution's Board had supported Standard Life's approach, but changed its mind after Pearl came forward with its higher offer. Moreover, Standard Life's bid currency was in part in shares, and they were falling in value and likely to fall further. On 29 October 2007, Resolution withdrew its recommendation for the Standard Life offer which had served to bid the Pearl offer up. Osmond told Iain Dey of the *Daily Telegraph*:

> 'If it's a game of chicken, I think their chicken gets run over first…. I don't want to be too smug about this … Life has a tendency to come and slap you round the head whenever you get complacent. But I think we're in good shape. We've got the stake. We either win the deal, in which case I think it is a good acquisition for us – it is very complementary – or if that does not happen, someone else bides, we make a profit on our stake. Either way we lose a competitor. It feels alright at the minute.'[9]

On 12 November, Standard Life said that the deal had 'strong commercial logic and would have delivered significant financial and operational synergies,' but that it would not be worthwhile at the price required for success. It blamed the price issue. Standard Life's offer was worth just over 691p for each Resolution share, against Resolution's closing price of 723p and Pearl's 720p offer.

Standard Life, which did not push the deal aggressively enough, announced that it would not restructure or improve its offer, and acknowledged that it did not expect the offer to be implemented. Sandy Crombie, Standard Life's chief executive, said: 'We thought we could find a way through – but I can't fail to recognise that against the background of the current market conditions, the currency I have – the share price – is worth less than it was.' Pearl said: 'Obviously, it's very good news. We will be talking to Resolution. And obviously, we will continue with our offer as planned.' In a statement, Resolution said only that it had noted the Standard Life statement, and that it would continue to 'engage with Pearl Group Limited regarding its cash offer for the company.'

On 16 November 2007, the Resolution Board recommended to shareholders the Pearl offer of 720p per share, to be implemented as a scheme of arrangement, while Standard Life withdrew its offer with the consent of the Takeover Panel. The Pearl offer valued the company at £4.98 billion. The statement issued on 16 November 2007 noted:

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[9] *Daily Telegraph*, 4 November 2007.

> 'The price of 720 pence per share in cash is excellent value for Resolution Shareholders and represents: a multiple of 1.20x Resolution's tangible embedded value per share of 602 pence, which is significantly in excess of that paid in recent transactions involving primarily closed life fund businesses in the U.K.; and a premium of 16.9 per cent to the closing Resolution share price of 616 pence on 25 July 2007, the day prior to Pearl's announcement disclosing its interest in Resolution.'

The Royal London Mutual Insurance Society, Pearl's bid partner, had agreed to acquire some of Resolution's businesses, notably Scottish Provident, for £1.26 billion, as well as to provide £0.3 billion of debt financing, and did so. The open business which Royal London bought was the section purchased at a premium to embedded value. That was common at the time, and still is: purchasers are willing to ascribe goodwill to open books as they have a brand which it is thought will generate future economic value, as opposed to closed books, which clearly will not. This is a relevant point in the discussion of whether too much was paid. In contrast, relatively cautious, and ultimately not attractive enough, Standard Life had not been interested in joining the Pearl bid.

The combined Pearl/Resolution group was assessed as likely to have £85 billion of assets under management. Osmond declared that day 'We wish to combine the proven strength and expertise of both teams to create one organisation capable of delivering far more than either of its constituent parts.' This was to be proved correct given the enormous cash flows that transpired from the combination in subsequent years.

In recommending the Pearl bid, the Resolution Board, mindful of their directors' duties, had to acknowledge not only the higher price offered by Pearl, but also the greater level of certainty provided by a cash offer against the more speculative value of Standard Life's cash/share mix. Sensing that the markets were overheating, Cowdery was ready to sell for a very good price. Thus, although the Resolution offer was a hostile bid, it was one that could be recommended to the shareholders as attractive. A 'full price' was being paid. Cowdery made about £150 million, and did better than he was subsequently to do when he sold Resolution Two.

The Resolution/Pearl scheme circular was published on 12 December 2007, and the Resolution shareholder meeting approved the scheme of arrangement on 9 January 2008. However, having been postponed several times, completion of the deal took time. Indeed, there was considerable uncertainty as a result. The Executive Directors' report to the Resolution Board on 5 March noted that Pearl had yet to submit a revised change of control submission to the FSA and that resulting uncertainty meant that it was not possible to predict a completion date for the transaction.

Moreover, the shareholder base changed as a result of an increase of the percentage held by the Arbitrage investors and Index Linked Investors. As of 12 February 2008, 26% was held by Pearl, 19% by Arbitrage investors, 15% by Index Linked, and 1% by Royal London Asset Management Ltd. The Arbitrage investors were actively pressuring the Takeover Panel and the FSA to approve the deal, whereas the Index Linked Investors had a more neutral stance. At this stance, the Executive Directors' report to the Board indicated positive prospects for the takeover. Neither crash nor crisis were in sight:

> 'Through a detailed review of opportunities within the business we have identified opportunities which would free up £250m of cash this year over and beyond our current business plan. Further opportunities to release £400m cash (over and above the £250m) are potentially achievable at a later date subject to finding improvements in our Pillar 1 position…. The expectations for EEV operating profit [for the 2007 results] remain consistent … at £610m, slightly down on the Q4 forecast but well ahead of the 10% target reflecting the benign operating experience in the second half of the year.'

There was a warning about the influence of economic factors on performance as a 'significant issue,' but nothing more. Resolution continued to support Pearl in preparing for the takeover, Project Lynx, notably in preparing materials for its change of control re-submission. However, as noted in the Executive Directors' report to the Board meeting on 28 March, Pearl had reservations:

> 'Hugh Osmond had stated in telephone calls to Clive Cowdery and Ian Maidens that Pearl would not formally restart the process until they had determined that they still wished to acquire the company, and that they needed to see the 2007 results in order to do this. While not accepting this was a reasonable approach for Pearl to adopt…'

The reservations arose from concerns about Resolution's cash flows and the 2007 accounts, and, indeed, that Resolution was not accurately representing its financial position. There was anxiety that there was a black hole in the finances, one that was of considerable scale, and one that threw doubt on the rest of Resolution's presentation. Pearl indeed discussed walking away from the deal, as well as reporting the matter of Resolution's behaviour to the FSA. The Resolution numbers appeared to be changing, the cash flow was not apparently there, and therefore it was unclear that Pearl could afford the external debt. Pearl, indeed, decided to wait on the 2007 accounts.

Concerned, as a result, that the deal might collapse, Resolution, however, had few options and had to wait. In the event, it took the Pearl management through the 2007 results on 17 March 2008. Two days later, Pearl submitted its formal request to the FSA to restart the change of control process. That meant that the completion of the transaction was not expected to take place before the end of April, and could be significantly later. Depending on the FSA decision, it could be necessary to negotiate new conditions with Pearl and, subsequently, the court process was expected to take about two more weeks.

In the meanwhile, Resolution was in tricky circumstances. Business planning was difficult, risk appetite was low, recruitment was proving hard, and morale was beginning to suffer. More specifically, there was a lack of certainty on key developments, such as fund mergers, and the separation for Royal London, and this lack was causing delay and putting delivery into question. Financial management was also affected and it was proving too difficult to move ahead with some of the cost reduction initiatives, in particular the development of a Finance Operating Model, as this was a course Pearl would probably implement in a different fashion. Resolution also noted a change in behaviour by Capita, its outsourced manager, toward a far more ‘contractual’ approach, as Capita repositioned itself for a renegotiation of the contract when functions split between Pearl and Royal London.[10]

In the event, progress was made. The FSA Change of Control Committee met on 9 April 2008. It decided to approve the change of control, but subject to three key conditions. Pearl was to continue the existing Resolution capital management policies, to maintain £100 million of additional cash at holding company level, and not to make changes to its debt facilities.[11] This protection of the change of control process was an early sign of stress for Pearl and the takeover. The protection indicated that Pearl would have to run Resolution more like the Resolution of old, than the Pearl of old.

Pearl, on 16 April 2008, agreed to accept these conditions, and to waive its right, under FSMA (Financial Services and Markets Act), to a period to object to them. That evening, FSA formally approved the change of control. Resolution then notified shareholders of the change of control approval and set out a timetable for the remainder of the transaction. The latter duly became effective on 1 May.

The purchase money came from Pearl, new debt (£2.2 billion), and Royal London, and from cash on the balance sheet that could come straight out. Much of the money arose from the profit already made on Pearl. With close to £5 billion paid by Pearl Group, through its subsidiary Impala Holdings, once the Royal London share is taken into account, there does not seem to be an overpayment of the MCEV for what ended up in Phoenix.

The issue of overpayment, however, can be variously discussed, and it is fair to note that all the factors cited have been mentioned to me. The interpretations, and it is pertinent to note that this was an era of highly-leveraged buy-outs, range from the critical to the supportive. The latter focus on the idea that embedded value is no more than a guide to the possibilities (very much an Osmond view), that good management can make much of the latter, that high-yield investments only became high-risk in particular circumstances, that the developing financial crisis that hit hard in 2008 was unexpected (a key point), that money was cheap, ensuring that debt could be met, that it is necessary to note the role in the purchase of Royal London, and that Pearl was able to renegotiate the bank debt and then complete. In this view, but for the Crash, a huge pool of very conservatively invested assets should have performed better, and to the benefit of both equity holders and policyholders. Osmond had a carefully conceived plan of consolidating the closed funds, outsourcing the management of the policies, and changing the investment asset classes.

[10] Report to the Board, 28 March.
[11] FSA Warning Notices.

Based on the cash flow forecasts they had subjected to due diligence, Osmond and Dale felt that they could make a healthy return from the long-term cash flows of the Resolution group and thus service the debt and return profit. They were confident of this, both due to the cash flow and because of the management actions they would deploy and by improving the return obtained from investments. They were confident they could leverage the investment skills of Sun Capital and TDR, while also releasing capital more speedily from the life companies. Osmond and Dale argued that, as Cowdery and his team had devoted most of their energies to acquiring businesses which had not yet been fully integrated, there were still operational efficiencies to be obtained.

Osmond's view on hedging the liabilities was different to that of the actuaries. He was not in favour, as sometimes claimed, of over-hedging the liabilities. Instead, what had happened (industry-wide) was that the actuaries did not understand the convexity of the liability performance dependent on market moves. This is a term used by derivative experts essentially to capture the non-linearity of performance of a derivative compared to its underlying asset. In Life company terms, they were not seeing that the guarantees embedded in many investment products meant that, as markets fell, the liabilities were not falling in line (the delta was changing) and, by virtue of old-fashioned methods and terminology (for example Equity Backing Ratio), they were holding too high a proportion of equity assets for the liability portfolio they were seeking to match:

> 'What I needed them to do was not over-hedge, but match the actual profile of the liability curve with the right proportions of different assets. The Actuaries decided to understand it as increased hedging, but it wasn't! They were just holding the wrong amount of equity assets relative to their liabilities.
>
> In a different form, it was this same inability to grasp the fact that they had inadvertently written huge derivatives contracts, and then to try to understand how they behaved, that took down Equitable Life.'[12]

Osmond's views on hedging in large part stemmed from the degree to which cash flows from life companies generally improve fairly linearly as interest rates rise and get worse as they fall; Pearl did not need to hedge a rise in interest rates on its debt as that would be doubling the risk, not reducing it: if rates fell, Pearl would lose money twice. Osmond wanted no hedging, but, as a compromise, there was a hedging of about a half. Had the no-hedging policy been followed, Pearl would have been saved several hundred million pounds over the subsequent years.

At Resolution, Osmond brought in some high-powered investment managers in order to exploit the situation and build additional value, although they were to make some expensive mistakes. Pearl Group thought it did pretty well to get Resolution and, whatever he subsequently said, Cowdery, a naturally hyper-competitive figure, and notably so in this context, was disappointed to have lost, and in part because he was seen as a result as a trader rather than a transformer.

[12] Osmond to Black, email, June 24, 2019.

Specific elements marginally pushed up the cost. Due to the share-save scheme, which gave staff a discount, and the potential loss-of-benefit they faced, the staff involved had to be compensated. This increased the purchase cost, but only marginally so.

In contrast, it has been argued that the bid was misconceived because of the price paid, although the points offered above counter that. Specific criticisms can be grouped as follows. First, that Resolution was purchased without an adequate plan and, indeed, without really knowing what to do with the company, although that is not a fair assessment at all of Osmond's acute assessment of the situation and managerial skill. The purchasers wanted to do the same things as they had done with Pearl. Sadly, the large financial crisis blew this off-course.

Secondly, it is suggested that the asset was overvalued in part due to a misunderstanding of the situation by the internal actuaries. This subsequently led to the taking of legal advice over the over-valuation. Looked at differently, there was misrepresentation, and possibly seriously so, notably of pension liabilities. Subsequently, in 2009, Osmond claimed to the FSA that Resolution had misrepresented its situation. This reflected his concern in late 2007 that information had been withheld, concern that had led to the delay of the completion in 2008. There were certainly elements of the public statements that were optimistically shown and many vital valuation elements were below the lines.

It should however be noted that, under Takeover Panel rules, Resolution could only disclose to Pearl the same information it had disclosed to Friends Provident in relation to the proposed merger until after the Pearl bid had become certain. After a probe into the takeover, a probe that was very unwelcome due to the concatenation of problems then facing Pearl Group, the FSA cleared the Resolution principals and, also the former Resolution plc (which was now part of Pearl Group) of any wrongdoing. The FSA's thoughts on the matter can possibly be seen in the fact that they cleared Resolution Two to go on and build another FTSE100 life group. The investigation was about disclosure of information and insider dealing, and not the change in control process itself.

Thirdly, it is argued that Osmond's evaluation of Cowdery as a highly skilled adversary played a role in the bidding, with Osmond disappointed by his earlier failure to win over the Abbey National life companies, and by his having been bid up over Hendersons. There was also the element arising from the (totally legal) way in which Osmond was able to fund the acquisition. In part, he used his own money, borrowing on a personal basis for Sun Capital. In part, it seemed that he might be able thereby to circumvent the regulations for the purchases of insurance companies.

The takeover of Resolution was not welcome to Cowdery. It brought the rivalry with Osmond to the fore. Separately, the takeover exposed issues in the new and developing process of closed-book acquisition. The financial basis was a key issue. Cowdery, a great salesman, of himself, Resolution, and its activities, had many backers and, as a result, could relatively readily write a cheque for an acquisition. Sun Capital and TDR, in contrast, in one light were very heavily dependent on borrowing although not beholden to shareholders. As Resolution was listed, it had better access to capital than Sun Capital/Pearl Group and was less reliant on debt. As a result, Resolution was stronger in its bids. Looked at differently, all the players were dependent on backers, be they equity, bond holders or lenders. They were all backers in the end who needed to be persuaded to issue capital in exchange for some economic return, whether interest, shareholding or a combination.

Credit must go to Osmond and Dale for pulling off the successful acquisition of their key rival and competitor. The acquisition was a roller coaster ride of corporate Merger and Acquisitions twists and turns. However, it is difficult not to conclude that the price was too high when measured against the difficulties that Pearl Group quickly encountered, albeit in totally unexpected circumstances and in ones that posed serious problems across the financial sector, at times to terminal effect.

Overpayment, and 120% of MCEV was (and still is) the high water mark for the percentage, is also a case of by whom? The bid was financed with two-thirds debt and one third equity, which was rather unremarkable in terms of the financing of deals in the 1990s-2010s. The banks had seen money released from the life companies as a predictable flow of cash, which proved to be right, but had failed to price adequately the downside risk. In contrast, Osmond, who understood the situation better, had the upside, but in return for putting up a large stake. Osmond and Dale had found a way to fund the acquisition with very high levels of leverage. The ingenuity was to use bank debt to a very material extent, whilst at the same time employing a financing structure that kept the debt out of the regulatory capital calculation of the acquired regulated group. The FSA had accepted that the debt would be held by an off-shore vehicle. Up to this point, highly-leveraged acquisitions, whilst commonplace in 2007, were uncommon in the acquisition of regulated life businesses.

In adopting this approach, Osmond and Dale knew that small returns to shareholders in absolute terms would be multiplied up by the factor of the leverage ratio. Their financial acumen, and Osmond's forensic understanding of how with-profits policies worked, gave them extra reason to be confident that returns could be made, and that both shareholders and policymakers could, and would, gain. In particular, they saw opportunities to improve the funding level of weak Resolution with-profit funds releasing capital for shareholders.

Pearl issued £2.2 billion of debt, as the Impala facility, which sat in intermediate holding companies within the Group. The purchase of Resolution had left this debt due to a high price, and a purchase that was more leveraged than the earlier one of Pearl, although, in the event, both were ultimately successful. This structure, moreover, was allowed by the Regulator. The debt was secured against the shares of Impala and Pearl Group Holdings, putting the shareholders at risk. In contrast, the capital protecting the policyholders was not at risk, as the banks could not recover money from them.

The structure of the debt, however, was sub-optimal for a life insurance group which required operational flexibility. Post takeover, Phoenix was left with two banking groups, two security charges requiring consent to many normal operational activities, and a schedule of principal repayments that were shorter in term than was comfortable. Moreover, the reality proved somewhat different to expectations. The lending banks had perhaps underestimated the Regulatory risk that the FSA could decide not to allow emerging cash to be 'released' from the regulated life companies up to the Group companies to service debt repayments and pay shareholders. Certainly, no one had envisaged the scenario that would arise later where the FSA would use its enforcement arsenal to retain cash in the life companies.

The syndicate was formed of lenders that were far from homogenous and came with varying levels of understanding of life insurance and differing motivations. Some, such as RBS, saw the longer-term opportunities of supporting the Group. Others had piggybacked off the lead lender's due diligence and wanted a simple return on their capital. This mix of understandings was to create considerable complexity to the next few years in which the Group tried to refinance its bank debt.

The banks did not charge enough interest to cope with short-term falls. Liam Peek sees matters somewhat differently:

> 'Were the banks stooges? Perhaps when they underwrote the Resolution acquisition deal but they did appear hand-picked stooges given the composition of the underwriting group. Did they operate effectively from the moment the initial write off proposal was received? Definitely.'[13]

The overpayment was transformed by the impact of the credit crunch, a crucial change. Pearl's strategy was to take greater investment risk than had previously been typical in life assurance. This risk was calculated, in the main, to reduce the cost of meeting future guaranteed benefits, leaving an increased surplus to be returned to the shareholder. This is not unusual and there are a number of UK life companies pursuing such a strategy today, including Phoenix itself. The key differences in the case of Pearl were the levels of investment risk in the case of some investments and the extreme market conditions that came to prevail after Pearl had embarked on its strategy.

In looking for ways to improve the level of return, Osmond and Dale created Opal Re, a captive insurer in Bermuda which was subject to more relaxed regulation. Opal was able to invest in assets that sought a higher return than those of the UK life companies. Opal invested in a range of Private Equity-type opportunities such as a sale and leaseback of Spanish real estate, hedge fund

[13] Peek to Black, email, 15 Feb. 2019.

opportunities, and the purchase of a portfolio of leveraged loans from Deutsche Bank. The greater risk taken had to be counterbalanced by the holding of increased capital.

The Pearl approach was recognised as innovative by industry bodies. 'It's the Grit that makes Pearl,' a report produced for Pearl by Cazalet Consulting, commented:

> 'The emergence of closed life fund consolidators is bringing in much-needed new blood and fresh thinking into the life and pensions sector, as these new providers of capital seek to improve the position of the funds they have acquired on the basis that upside for shareholders typically should flow from improving the position of policyholders.
>
> Pearl Group's new asset and liability management group, Axial, is noteworthy for taking an integrated approach by combining fund management with asset-liability management, and for its recruitment from leading investment banks and asset management groups of an "all stars" team of big-hitters who now are deploying cutting-edge techniques and powerful bespoke technology as part of the day-to-day management of Pearl Group's policyholder and shareholder funds.
>
> Light years ahead: We note that Pearl Group has invested in excess of £10 million to establish a new unit, Axial Investment Management Limited, which has started to deploy cutting edge intellectual capital as well as relatively highly sophisticated management practices and controls supported by powerful and innovative technology. Based on our investigation and experience, Pearl Group's approach to asset-liability management is considerably more advanced than that used by the rest of the UK life industry in general and the £400 billion with profits sector in particular, so much so that setting Axial alongside its peers seems to us like comparing *Star Trek* to *The Flintstones.*'

In what appeared to be, at one level, a counter-intuitive assertion, Pearl was known to favour buying 'distressed with-profits funds.' These were with-profits funds where the guaranteed liabilities plus the required risk capital exceeded the assets of the fund. Such funds would be paying either no or nominal bonuses going forward and would be aiming to meet the minimum liabilities guaranteed to policyholders only. Pearl reasoned that by taking on such funds with some shareholder capital from the vendor to support the risk capital requirements, it could invest the assets of the fund, plus this additional shareholder capital more aggressively, with the expected outcome that more of this capital would, therefore, be released back to its shareholder. The main reason, however, for Osmond was the understanding that these portfolios behaved like derivatives, with the result that he had a grasp of how best to match assets and liabilities. The outcomes would have been better for both policyholders and shareholders in these funds.

With the benefit of hindsight, the asset selections made were particularly badly impacted by the financial crisis. The value of nearly all assets fell, but those that were most affected were those that were most illiquid. In 2008 and again in 2011, however, global financial markets experienced severe and prolonged stress in the credit markets. In simple terms, this meant that the spreads on all bonds increased very significantly and with increasing severity with decreasing asset quality. The 'spread' is the yield on a bond in excess of what was then known as the LIBOR (or risk-free) rate.

Hence, increasing spread is driven by the price of the falling bond. The spread is a measure of two factors: the risk of default and the price for the illiquidity of the bond, ie the relative ease with which one bond can be sold compared with others. Whilst this period did experience an increase in defaults and write-offs, history has shown that the main driver of the fall in the price of bonds over this period was a lack of liquidity in the market. Put another way, no one was buying bonds, but, equally, no one was selling either at these depressed prices. Other indicators were also poor. The FTSE 100 fell by 15% on 29 September 2008 and the UK entered recession on 11 December 2008. The embedded value calculations were highly sensitive to interest rates, as insurance balance sheets are affected by the view of the return on assets. Lower interest rates meant a much lower return. There was massive discounting pressure on capital such that the ability to sell at value under pressure. The low interest rates sent the pension deficits up.

Life assurance liabilities are calculated as the present value of future outgoings (eg claims) less incomings (eg premiums) discounted using risk-free interest rates. The then regulator, the FSA, required life assurance companies to make a best estimate (but which was, in reality, a prudent) assessment of default risk, but allowed the excess spread due to illiquidity (known as the 'liquidity premium') to be added to the risk-free yield used to discount the future liabilities. The reasoning behind this was that, as the life companies were holding the bonds to maturity to match liabilities falling due, the price of illiquidity was part of their expected return, given they were never going to sell the bonds. Hence, as asset values fell, the liabilities also fell by an equal amount (assuming that both were matched by duration). The fund was, therefore, considered to be 'immunized' against risk-adjusted interest rate risk using an actuarial technique that dated back to the mid-twentieth century.

Unfortunately, things were not that simple. Under Pillar Two of the then prevailing Solvency One regime, life companies were also required to hold capital in respect of 1-in-200 risks, a nebulous concept that was difficult to assess. This element included bond default risk. The net effect of this measure, introduced in 2004, was to increase capital requirements, and thus strain, on companies.

The FSA took (and the PRA still takes) the simplistic view that bond default risk is, in the main, proportional to spread. Hence, in a credit crisis where spreads are increasing and bond credit ratings are under pressure, life companies are required to increase the amount of capital they hold in respect of bond default risk. This served to decrease the reported solvency of the life companies and restricted their ability to release predicted surplus capital to the holding company, which, in the case of Pearl, was required to service its bank debt and it was this failure to do so that became, therefore, the real crisis for Pearl.

With hindsight, it is possible to observe that actual instances of default in excess of the norm during this period were relatively limited and, as spreads returned to more normal levels in 2013 and subsequently, the solvency of the life companies was restored. In spite of that, across the industry, life companies were pressured into taking steps to de-risk portfolios (and, thereby, lock in losses) that would, otherwise, have returned to health as the markets themselves recovered.

Nevertheless, the investment risks taken by Pearl were significant, not least in the case of a large portfolio, £1.2 billiion, of leveraged loans that was acquired from Deutsche Bank at the depths of the credit crisis with around two-thirds of the price funded by a bank loan from Deutsche Bank itself. This created an asset that comprised a diversified portfolio of senior loans to private companies bought at a significant discount because Deutsche Bank was in distress. Not a single one paid Pearl back at less than par, and it was the single most successful investment ever made by the Group.

With higher returns came higher risks, not least in terms of the volatility of the price of the asset through turbulent credit market conditions. The FSA also took the view that the risk capital attributed to the asset was inadequate and required it to be increased to a level where the entire asset value was, in effect, written off to nil for solvency purposes. The Regulator panicked and near doubled the capital base requirement, from £3.35 billion to nearly £7 billion, with a matching burden in regulatory oversight. The former figure reflected the light regulation of the period prior to the financial crash, but the latter was too great to permit the necessary financial engineering to deal with the problems.

The general focus tends to be on those surrounding the purchasers, but that is misleading. In part, there was a crisis in funding due to the life companies being unable to access the money in effect owed by the banks. Bonds issued by the banks were seen as very safe, and the banks who had lent money for the purchase had issued a large amount, only for these to be seriously underperforming. The size of that black hole was, and remains, a matter of contention because future liabilities were of course unclear. Wanting absolute security, the Pearl Pension Trustees arrive at a higher figure than those concerned with likely outcomes. Thus, as part of a life cycle of capital hit hard by a major banking crisis, Pearl was in a very difficult position.

This situation represented an extreme reversal for Pearl, but characterised some of the consequences of its strategy. In spite of this experience, it is worth noting that the recovery in the credit markets had an even more positive impact on this asset than others and, by the end of 2011, the performance of this asset exceeded that of any other fixed interest asset in the entire Pearl portfolio when measured through the credit crisis, ie. from its pre-crisis peak to its value at the end of the 2011. Moreover, during the crisis the banks and shareholders could not access the policyholder funds, or the Regulatory capital that protected them, or the buffers that sat on top of these capital protections. This was a vital part of the policies that were followed, the governance that was in place (including Life Boards and many of the Non-Executives), and the structure established by the Regulator. The new owners did not need a better investment return to deal with the debt taken on, and it was assumed in the plan. Instead, they just needed the predicted cash flows to come through. It was the increasing of the Regulatory base that hurt.

Returning to 2008, Osmond and TDR found themselves in a difficult situation as far as the pension situation was concerned. As soon as they had purchased Pearl, they had been keen to engage with the Trustees of the Pearl Staff Pension Scheme to explore alternative scenarios, but found it took two years for the Trustees to agree anything. Rather than volunteering to pay additional contributions to fund the very small existing deficit, Pearl entered into negotiations with the Trustees to adopt a similar asset allocation strategy to Pearl itself with the aim of providing a safeguard for the Trustees in case the investment performance within the Pension Fund failed to meet expectations.

Looked at differently, the Pension Fund already had a poor and inappropriate investment strategy, one that could not meet its existing liabilities. Pearl tried to persuade it to move into a more effective stance, and this failed, possibly because the Trustees were insufficiently nimble. Whereas the life companies performed well, so that they could service the debt, pension governance appeared too slow, not least in the growing financial crisis. In this, as a result of the government's quantitative easing policy, gilt yields fell from about 4 per cent to close to zero. This led Pension Trustees to drop the rate at which they discount liabilities to close to zero, and that ensured that the liabilities of all pension funds in Britain rose greatly.

In effect, there was a return swap with the Pension Fund, with the latter guaranteed a fixed return in order to hand over the management in an effort to end unhelpful risk. Pearl took control of the scheme's assets in return for guaranteeing a rate of return which would ensure that the scheme would be fully-funded on a gilts-flat basis by 2027.

Losses, however, were sustained due to the global financial crisis resulting in a 'black hole' in the Pension Fund, and thus a substantial liability by early 2009 that Pearl could not afford to pay. Pearl had finally got the Trustees to agree the return swap so that it could manage the assets and hedge the liabilities just weeks before the financial crisis struck. As a result, Pearl got caught having signed the swap but before it had hedged. In hindsight, this was easily the biggest mistake it ever made and ultimately responsible for all that happened subsequently. As a result, the Pension Fund was the key issue: 'the rest was just noise.'[14]

The size of that 'black hole' was, and remains, a matter of contention because future liabilities were of course unclear. Wanting absolute security, the Trustees habitually arrive at a higher figure than those concerned with likely outcomes. The Trustees take actuarial advice which is based on technical standards set by the FRC. There is a degree of conservatism, and *probably* more so in a funding negotiation as happened in this case.

[14] Osmond to Black, June 2019.

However, the main problem with the Pension Fund was the fall in interest rates, and there were issues about money market assets trading below par and therefore incurring a risk that they were not expecting to face. The Pension Fund's shares were lent to short sellers, and the collateral was invested in collateralised debt obligations, many of which lost all their value in the credit crisis. As a result, the Pensions Regulator (TPR) became closely interested in developments.

The funding and investment agreement between the Trustees and Pearl was called a Contract for Difference (CFD). The fact that it guaranteed payments to the Scheme, and that that had created a liquidity issue within the regulated Group, meant that this was of significance to both TPR and the FSA. The banks were initially unaware of the guarantee that Pearl had provided to the Scheme and the massive liquidity issue it unexpectedly and soon created. This liquidity breach threatened a solvency breach. The banks subsequently took legal advice as to whether Pearl could agree the CFD under the terms of its loan documentation. This proved inconclusive, and that only added to the banks' already strong sense of frustration in regards to this instrument.

Having purchased Resolution, Pearl, as planned, sold the open business to Royal London, while Pearl itself took the closed business. Arguably, Royal London, which thereby paid a large part of the cost of the purchase, got the worse of the deal. It certainly lost in the short term. This point provides an opportunity to review the prudence of the purchase from Pearl's point of view. Crucially, the issue that caused most of the stress with the FSA and others was the Pearl Pension Fund, not the purchase of Resolution. Indeed, in hindsight, the latter was very successful, never breached its Regulatory capital, and made a lot of money for shareholders. One reason for the success was that Royal London purchased the risky open business for a good price. The remainder was low risk and had excellent cash flow. The exception was a £1 billion short-term loan to Lehman Brothers the previous management had made, which was recovered by the new owners just weeks before Lehman eventually went bankrupt in September 2008. This excellent cash flow, greatly enhanced by management actions at the level of the Life companies, has repaid most of the debt, and has paid out all the dividends, providing a salve for repeated problems and issues.

The Pension Fund did not move into deficit because of a failed investment strategy, but because of the sudden dive in gilt yields during the financial crisis. This was annoying because the Pearl management team had been gradually hedging this exposure, having inherited a completely unhedged and unmatched fund when it bought Pearl. In hindsight, it should have been quicker, but the crisis was unexpected.

This only became an issue because the FSA declared unilaterally and without warning to count the Pearl Pension Fund deficit as part of the Regulatory capital calculation, plus a contingency. This was without precedent or rationale as the fund was entirely outside the regulated entities.

Juxon House, the London headquarters, was transferred from Resolution to Pearl, and, as was normal at the time of rationalisations, many people left or were pushed out because of the merger, including in the first month. More critically, although at the life company level the Pearl and Resolution teams fitted together neatly, there was a loss of talent at Group level among those who understood how actuarial synergies and cash flows worked. The loss of Ian Maidens in particular was unfortunate. In the recollection of some (but not all), the atmosphere was horrendous in Juxon House for over a year.

Meanwhile, the credit crunch revealed the problems in the underlying finances as well as the operational complexity of the situation. Part of the initial cause of Pearl's problems was the fall in asset values on a mark to market basis. Osmond was catching a falling knife. It has been argued from the Suncap perspective that Pearl's view of backing long-dated liabilities with assets was not too dissimilar to what UK annuity writers are now being encouraged to do under Solvency Two. The difference is that in a Solvency Two world, assets and liabilities are marked to market on a more mutually consistent basis, whereas, previously, assets were more volatile than liabilities leading to greater swings in capitalisation levels in moments of stress. Certain types of corporate bonds could be used to back annuities under Solvency Two, was the case under Solvency One. The UK actually had to fight hard to keep this when Solvency Two was being developed. However, capital still has to be held against default risk. Moreover, the assets Pearl held in Opal Re were problematic under both Solvency One and Solvency Two.

The wider uncertainties had been seen in the report to the Board on 28 March 2008 which noted: 'In comparison with the UK peer group the Group's holdings are of high quality … Resolution has no equity holdings in Bear Sterns. We do hold £14 million of credit instruments – at present we have no reason to believe that these will default.' However, the falling markets, with the FTSE 100 going down 31 per cent in 2008, affected confidence. Shares in insurers fell in 2008-9 because of fears that falling markets could hit their capital reserves. The Pearl Group was well protected against equity falls, but less well protected against the fall in the value of corporate debt as credit spreads (the additional return required to compensate for default risk and liquidity risk) rose.

Resolution had been bought at the top of the market and the Pearl Group hit problems from there. There was the money to meet interest payments to the banks, but the Regulator increased the necessary capital base, thus causing or exacerbating serious problems. There was a focus on the big liability in the Pension Fund, while the value of the mortgage-backed securities involved in the Pension Fund fell. The bonds were a different matter as they were put in place by Resolution management and were unsecured liabilities which no longer had a function in the enlarged group. The new management sought to reduce this liability, but it had no effect on solvency.

Moreover, the balance between Tier One and Tier Two capital, which affected an archaic Solvency One ratio, was hit. As there was a cap on the percentage of Tier Two capital, then the fall in the percentage of Tier One capital meant that some of the Tier Two capital no longer counted towards the Group's solvency. With debt rising and the balance sheet deteriorating, there was a breach in the capital position at the Group level. In November 2008, Pearl informed the FSA that it had become aware that, as a result of market volatility, the Group's capital resources were such that Pearl Group Holdings (No. 2) was in technical breach of certain of the FSA's rules and principles regarding the amount of credit that can be taken for Tier Two capital in relation to Tier One capital. This technical breach, an entirely stupid mistake and one irrelevant to true solvency, was rectified by reclassifying certain Tier Two securities so that they could be counted as Tier One capital, and no new funds were required. The technical waiver required soon after close, however, was a sign of tension.

To explain this question differently, when the acquisition was completed, Pearl's investment in Resolution was partly characterised as equity and partly as regulatory capital qualifying debt. This was not too unusual as it generally eases moving money through a group. However, the amount that can be characterised as Regulatory capital qualifying debt was capped, and, as equity was eroded through mark to market losses on the company's asset portfolios, the amount of regulatory capital qualifying debt began to exceed this cap. This led to additional capital being disqualified, putting more pressure on the Group's solvency ratio. The banks readily agreed the waiver, thinking the matter was behind them. However, the Regulator remained unhappy, which was an aspect of concern about the appropriate capital structure of the group. In practice, there was a technical temporary default due to a mis-categorisation of one class of completely intra-group debt. This was resolved without any restructuring of major issue by correcting the miscalculation. At the same time, the Board on 13 November 2008 accurately noted that procedures to monitor solvency since the Resolution acquisition were inadequate given the extreme market movement.

By the autumn of 2008, the storm clouds were brewing. The Icelandic bank crash and the RBS/HBOS bail outs occurred in the first few weeks of October 2008. This helped increase the regulatory focus, with Pearl placed on the FSA Watch List in October 2008. This set the scene for a febrile year at Juxon House.

As a result of the technical breach, detected on 3 November 2008, the FSA, on 7 November, imposed an OIVOP (Own Initiative Variation Of Permission) notice, a rarely-used enforcement tool. The breach was structurally at a Group level, i.e. above the Resolution and Pearl life companies. Therefore, the reduction of solvency capital was not at a level that could directly impact policyholders whose liabilities were held by life companies. It did, however, reflect a worsening solvency of the Group and was seen as an early warning by the Regulator who responded swiftly and with shuddering impact. The FSA sought to protect policyholders from what they perceived as the risk that the Group would prioritise Group stakeholders (shareholders and lenders) ahead of policyholders. In the FSA's mind, this could occur if the Group pressured the life companies to upstream cash to their parent companies.

The imposition of the OIVOP reflected both the general timing of the restructuring and recapitalisation, and the speed at which problems had emerged after the change of control was approved. As a result, the whole situation was under close Regulatory scrutiny and, arguably, with unfair consequences. The OIVOP notice caught the Group out and prevented the regulated entities in the Pearl Group from making certain payments, moving economic resources around or outside the Group, or undergoing a restructuring, unless the FSA gave its prior approval. The freeze on movements of cash up and out of the Group exposed the competing interests in Pearl. The freeze put in peril bank debt repayments, bond coupon payments, pension scheme contributions, shareholder dividends and money owed to Royal London. A regime focused on safety ensured that the Group could not really operate. Indeed, it was faced by stuck funds, such that it could not repay money.

If the breach was a shock to the Pearl Group, it was a bolt out of the blue to the lending banks which were unsighted as their covenant monitoring did not track this metric. This led to significant consternation among the syndicates who quickly came to appreciate the regulatory risk they had been running in lending to an insurer whose cash flows could essentially be locked in a ‘life company box’ by the FSA. While the IGD breach was to be technically solved via a FSA waiver, it was an early warning of other financial exposures that quickly came to the fore as the Group was hit by a perfect storm of falling asset prices and rising liabilities including the unaffordable CFD exposure. The IGD breach set in train what is commonly referred to in Phoenix as ‘its near death experience’. At the Board meeting on 13 November 2008, there was concern over the potential breach of covenant to lenders.

A further result of the technical breach of the FSA’s capital requirements was that the FSA exercised its powers under section 166 of FSMA and, on 7 November, appointed KPMG to prepare a report on the financial soundness of Pearl Group, known as a ‘Section 166 Skilled Persons’ Report. In its report, on which work began on 8 November, KPMG concluded, among other things, that without management initiatives being undertaken in 2010 and 2011, Pearl Group would experience a shortfall in the level of cash available to meet its principal repayment and interest payment obligations. Indeed, in April 2009 and April 2010, there were not the funds to pay the coupon (interest) for the Tier One bondholders.

The FSA also commissioned an additional Section 166 Skilled Persons’ Report to review and report on the effectiveness of Pearl’s board and its overall governance and decision-making structure, including the effectiveness of committees and subsidiary boards. The FSA, which had found itself in the swirl of the financial crisis, was having to adopt a far more directive approach than it had hitherto taken. This affected its response to the particular issues affecting Pearl. Undertaken by Allen &

Overy, the comprehensive and very expensive report took months of investigation. The report exonerated the Board of mismanagement and also argued that Sun Capital's involvement was beneficial as bringing in stronger management. Osmond had held off the FSA while protecting the vulnerable company under him.

In practice, the FSA never understood why a closed life business could generate so much more cash flow than an open one, and therefore why debts could be covered. Indeed, at no point during the crisis were the life companies under threat, and this was in part due to the asset-liability matching skills of the management. The Regulators had concerns about the debt structure, but it was simply subordinated and provided from outside the EEA, and thus a structure used by many international insurers. Such a structure, which was totally legal, was because UK subsidiaries were being funded with debt lent from outside the UK. The Pearl transaction was funded in such a way that it converted all the bank debt into equity, and so there were never any borrowings in the life companies. This was the reason why the FSA became happy with the structure. Alert to the risks of bank debt and to the risks of disputes between shareholders and their backers, the FSA ensured that a structure was put in place that protected policyholders. Tested under very severe circumstances, this structure worked very well.

Separately, the banks had received little communication from Pearl in late 2008. Instead, the banks felt that they were being kept in the dark, and not being properly considered. Indeed, after much delay, the first formal communication they received from Pearl was the receipt of a proposal on a Friday afternoon in February 2009 inviting them to write off some 40% of their exposure (about £1.2 billion) because of the effect the financial crisis had had on the combined business and noting also that most of the aforementioned effect was actually made up of falls in the value of bonds issued by the banking sector. No dilution of equity was proposed and the alternative to agreeing the write off portrayed as being some form of regulator-managed insolvency where there was little value to banks as secured creditors of a distant holding company. This caused significant consternation within the banking groups. Some had not or did not realise the seriousness of the situation. Some previously had not involved debt restructure teams. Most of such teams were very busy anyway and few had insurance experience.

The issue with the banks was compounded by complications within the bank syndicate involved. In part, tension reflected the timescale involved. Announced in 2007, the Pearl takeover did not complete until 2008 after a protracted change of control process. Furthermore, Pearl then needed a 'technical' waiver shortly thereafter before it became apparent that it required a more fundamental restructure and recapitalisation in 2009.

The reality of this timeline meant that some banks had decided over the period in question that they wanted to exit London which left them with a legacy position and problem to manage, and in some cases without the individuals who originally lent the money and understood the risks. In other cases, these were very concentrated positions needing board-level decisions within the banks concerned, most of whom were undergoing their own stresses. Another consequence of the period was that some banks found themselves within much more difficult positions that they envisaged when they signed off the risk. Some banks indeed had merged or been taken over.

The banks knew they were going to be in for a lengthy negotiation. It was clear that they were going to be negotiating with Osmond and TDR, and not with the Pearl management team. Having decided that the cash flow was not sufficient to meet the debt, Osmond and Dale asked the banks to write off a £1 billion of debt. This represented an overplaying of their hand in asking for too much as they could certainly have got around with a lower write off and still paid dividends.

It also became apparent that the negotiations were going to be multi-dimensional, with both official and unofficial channels, and with pressure being applied via back channels for the lead banks to be compliant. The banks decided that they needed to organise a committee to represent the group to negotiate on their behalf. The three banks chosen were the agents of both silos (RBS and Commerzbank) plus Lloyds as the bank with the greatest exposure. RBS was chosen as the agent, despite having less than 5 per cent of the overall debt. This was because of its expertise in the closed life field, but, also, in effect, a 'reward' for not being so heavily involved in the first place. By luck or judgment, the representatives of the three lead banks had complementary skill-sets and formed a very cohesive team. Commerzbank's Albert Shamash was an actuary and had considerable experience of Pearl, which helped provide confidence for the banking group as well as offering an informed front to Pearl. The syndicate's spokesman, RBS's Liam Peek, also had considerable experience with closed life policies, and proved an adroit negotiator, which helped save the syndicate a lot of money. Lloyds was represented by Mike Densem, a very experienced workout banker.

There were considerable political and organisational problems for the syndicate. RBS and Lloyds, did not want to let any of the individual banks out of the syndicate as that would mean that they would have to commit more funds. The syndicate needed to stabilise the position to allow sufficient time for reports, commissioned from Deloitte and Hogan Lovells, on the commercial diligence and legal aspects of Pearl. These reviews were important and wide ranging as they were necessary to inform the banks how the problems had arose, ongoing risks, how to stabilise the group, about how much new capital might be needed, and what options the banks had under their existing loan agreements. No decisions would be made until these reviews were completed. Deloitte was chosen because Gerry Loftus was a workout lead with experience dating back to the high profile and complex corporate workouts of the mid-1990s, and therefore able to provide direction and confidence in negotiations. Hogan Lovells with Stephen Foster in the lead was chosen as a good workout firm with strong credentials in the insurance and pensions field.

The banks also wanted time for the negotiations with TDR and Sun Capital to proceed in an orderly fashion. This meant that a standstill agreement had to be reached with all the parties, including the various banks themselves, the pension fund and, if needed, Royal London which had provided a loan to Pearl to complete the acquisition. As the regulators did not want a disorderly insolvency, it was important to keep Osmond and TDR incentivised to continue negotiations as they had the ability, as borrowers, to initiate an insolvency process, which was the last thing the banks wanted.

The loan needed to be refinanced, but the banks wanted a reduction of their exposure before they agreed to any refinancing. The need to meet this requirement entailed a trade-off between banks, which wanted a pay-out, and the regulators, who did not. To add to the complexity, there were two debt silos – for Resolution and for Pearl. Some banks, notably RBS and Lloyds, were in both; but some were not. All of the underwriting banks within the Impala (Resolution) silo were unable to complete their sell down of the risk to their desired hold levels.

In practice, the banks were not, as has been suggested, 'money-good' after the crisis. The equity given to them was in lieu of fees for the restructure. The Pearl syndicate members wrote off several hundreds of millions of pounds, which contributed to the attitude some of the banking group had to Pearl, then Phoenix, subsequently. From Osmond's point of view, in contrast, Phoenix repaid the banks: even if some of that payment came by way of equity, it was still money that came back to the banks. In reality, owning a financial asset in the financial crisis was always going to involve problems.

Thus, the amalgamation of the two biggest players in the closed book market had become close to a near-death experience for the new company. The atmosphere was not improved, for either the banks or the Regulator, by the eagerness of the new owners to look after their own investment in the new company, rather than those of the banks. The Regulator put the risk officers under pressure due to the level of debt. The Regulator also put a block on the money coming out of the life companies without its authority. This created serious problems for the owners as they confronted the crisis. The increased regulatory base made it very difficult to pay debt and interest back to the banks.

Moreover, the banks themselves owed the Pearl Life companies over £5 billion. Banks had been the main issuers of long-dated bonds leading up to the financial crisis. Insurers, in turn, had been the main buyers of these assets as they represented some of the longer returning assets that one could buy to meet the insurers' long-dated liabilities. Banks then were also seen as safe. This proved to be totally wrong. In September 2008, Lloyds rescued HBOS. In late 2008, the banks began to default or their bonds fell in value. As such, the bonds that Pearl owned were either defaulting or dropped heavily in price. The banks owed Pearl more money than Pearl owed them. This was part of a more widespread crisis in which the convergence of collapsing equities, tumbling values in commercial property, and ballooning corporate bond spreads that hit corporate bond values, made it difficult to service leverage, as the covenants on borrowing were based on valuations that no longer could be made.

We will consider the consequences of this heavily geared purchase in the next chapter. Here it is necessary to notice that Resolution was not lost as a name when Pearl took it over in 2008. Instead, Cowdery was able to purchase the name for a modest sum and set up what in effect was Resolution Two. Floated in December 2008, this raised £660 million. It continued Resolution One's interest in closed books, but was not restricted to that. Indeed, Resolution Two became in effect a financial services consolidator. Cowdery went on a new programme of acquisitions. He could have tried to buy/rescue Pearl as Liberty did, in effect buying back having made a profit, but looked in other directions. Osmond's complaint to the regulator about the information provided by Resolution One prior to the purchase did not make this possible.

In July 2009, Resolution bid for Friends Provident, but this was rejected by Friends Provident unless it held the balance of power. Friends Provident finally agreed to a takeover in August, and this £1.86 billion acquisition was closed that November. In contrast, Pearl could not bid for Friends Provident as it was under the restraint of the FSA. During this period, Cowdery's relations with Osmond were poor, and the decision by the latter to let Cowdery purchase the name can be questioned.

Resolution Two then moved on in 2010 to acquire AXA UK's life business, and BUPA Health Assurance, and to create Friends Life. This became independently listed and was acquired by Aviva in 2015 at a good price, for about £6 billion. The Resolution management team then moved away. Cowdery was knighted in 2016, primarily for his charitable work with the Resolution Foundation. Having operated with a United States-focused fund, Cowdery moved on to found Resolution Life Group. In October 2018, Cowdery agreed to spend £1.8 billion to buy the life business of AMP, earlier the owners of the Pearl Group. Individuals like institutions recur in the story.

Conclusion

The takeover became part of the wider financial crisis for reasons inherent to the latter not the former. Specific problems arose from the degree of the Pearl Pension Fund hedging and the attitude of the Regulator. However, the fundamentals of the takeover were sound. Moreover, as more generally with the insurance industry, the financial conduct issues were less than those with the banks. Indeed, it was not necessary for it to retrench as it was for the banks. Leverage was a major problem for both the banks and Pearl, and the leverage crisis challenged the survival of the latter in the form it had. However, as the next chapter indicates, there was indeed to be survival as well as crisis.

5. Darkest Hours

Introduction

This chapter tells the story of Phoenix's darkest hours, of how a breach of Group regulatory capital almost led to its break up, how the business had to seek additional capital to shore up its solvency and liquidity, and did so in the most torrid of environments whilst the financial crisis was in full swing. The challenges to achieving this were legion. Multiple stakeholders fighting the dilution involved in the restructuring were a major issue. In addition, the FSA had the option to shut down the business, in order both to lock down cash for the benefit of policyholders and to cope with the complexities in the capital structure. This would have entailed a closing down very different to that meant by closed books.

That a solution was achieved, and that agreement was struck between such a disparate group of stakeholders within seven months of the capital trigger, speaks to the ingenuity, resilience and professionalism of those involved and of some key personalities. The crisis almost finished the Pearl Group, but it also marked the beginning of a long road to recovery which would see the building of a future FTSE 100 group.

The protracted nature of the general financial crisis interacted with that of the Pearl Group which got the keys to Resolution to 1 May 2008. In particular, there was the anxiety felt very strongly by the banks, which held much of the debt, while also owing Pearl a large amount. In the financial crisis, the banks themselves had extremely challenged balance sheets, and were under close, indeed unprecedented, governmental and public scrutiny. The attitude of government to Pearl, indeed, and its impact on the Regulators, is one of the unknowns of the story that follows.

It was scarcely surprising that the banks did not want challenged assets, as a key element of their challenged balance sheets. Many of the banks had not come into Pearl's purchase of Resolution, as long-term investors, while those that had were also unhappy about their treatment. These attitudes spread concern that was already present due to anxieties on the part of other stakeholders, including policyholders. In addition, there were serious issues with the Regulators; who acted as a group, as the Pensions Regulator was also involved as a result of Pearl's Pension Fund. In the event, given the scale and context of the crisis, the stakeholders were to do reasonably well and to be protected during a zero interest rate, and crisis-strewn, environment.

These were to be the major issues in what became a far longer rocky road for Phoenix than had been anticipated, indeed one that in certain respects continued until new acquisitions were begun in 2016. Because the eventual outcome is known, it is terribly easy, as well as convenient, to adopt the standard narrative of crisis overcome and eventual improvement; indeed to see the entire story as a lengthy and difficult but, in the end, necessary and successful, restructuring.

Instead, it is important to understand the extent to which there were continuing, indeed continual, difficulties and therefore, as always, the requirement for a high level of management skill, operating dexterity, and leadership. Correspondingly, those factors, and there were many, that challenged the established situation were particularly grave due to the crisis. This was an aspect of the position then in which simply acting as in the past, and/or as appeared safe, would not have been good enough.

In the event, in a very difficult context, major efforts were made to safeguard the interests of policyholders, pension Trustees and shareholders. There were of course at the same time tensions among the Directors during this period, including over attitudes towards the Regulators. Ultimately, there was a lack of cash in the Group to pay various competing external interest groups, and certainly to pay them as anticipated and on time – a set of stakeholders that had got more complicated as a result of the Resolution takeover. The main drama was the complexity of the rescue and the extremely tight timetable to achieve that rescue.

The various players can be listed in different orders, which intentionally or implicitly suggests contrasting priorities. It is easiest to forget the policyholders. They were 'passive' by the standard of the other players, but should not be forgotten, not least because others sought to act on their behalf, while the letters they were sending to MPs and newspapers created pressures that were diffused into the Regulatory struggle.

The shareholders, Sun Capital and TDR, tend to dominate attention. There were also the bondholders which were inherited from the Resolution deal. Bondholders were already annoyed that as part of the Resolution deal, they no longer held notes in a listed public company, but, instead, in a subsidiary. The banks were divided into two groups, the Pearl and Impala syndicates, which were not aligned. Some banks, notably Nomura, were not happy to be there, but, if they left, other lenders would be required to step in, in an environment where banks were reluctant to lend. The Pearl Pension Scheme was also a key player. Like the banks, the Trustees were able to cause the break up of the Group by calling in the contract for difference debt. Royal London was also part of the equation.

Again, the listing of problems may suggest a clear prioritisation, one leading to a readily apparent solution. That, however, was not the case. Moreover, interviewing some of those active in the period, it is striking to note the range of the different perspectives offered, these differences depending largely on the nature of their expertise and task. This does not amount, however, to clashing views, as might appear on a superficial reading, but, rather, the more commonplace engagement with multifaceted complexity, one that was accentuated both by the aftermath of the takeover and by the financial crisis.

Viability?

In 2008-9, there was the question of Group viability and, by March 2009, the course of administration and break up was being contemplated by the various Boards as it seemed possible that the holding companies of the Pearl Group might go into administration because they were unable to make scheduled payments under the banking facilities. The Pension CFD deficit at 31 December 2008 was 0.5 billion.

More generally, it proved difficult to get the accounts signed off, and audit opinions were qualified. The draft KPMG Section 166 report in circulation in February 2009 showed that about £500 million of capital was required. In particular, the decline in asset values in the fourth quarter of 2008 resulted in Opal Re breaching its collateral requirements. The continuation of Opal as a going concern was in doubt. The FSA was worried that this might lead to a £530 million capital strain on Pearl. Survival contingency plans were being developed. A Board paper from 10 December 2008 showed that cash flows were going to be tight in 2009, and made reference to forthcoming discussion with the lenders. Outside sources of capital were also being considered.

Ultimately, had the Group failed, then there would have been a route to solvency through unbundling and selling the life companies, but this would not have been a good period to sell; instead, the exact opposite. Indeed, that constraint acted as a dampener. To sell would have been to monetarise a loss, and in a way that would have put renewed pressure on the debt structure at Group level. At the same time, the solvency and liquidity of the life companies acted as a fundamental support. Their capital management policy worked. They had no material debt or shareholder borrowings.

One crucial point, and one key issue, emerge at the outset. The crucial point was that, with one brief exception that was rapidly corrected, the life companies, the operating units as far as policyholders were concerned, were never near-death, and never could have been, even though some got uncomfortably close to their stated minimum desired levels of capital. The companies functioned well and safely throughout the period. Indeed, efficiencies were delivered in a planned fashion, providing benefits for both policyholders and for the Group. The latter strongly benefited from money being released upwards so as to address the difficulties in Group finances.

That, however, relates to a key problem. An indebtedness to the banks, and the (understandable) need felt by the latter to receive more than the interest owed, posed a central issue. At the same time, the context was transformed by the Regulatory change such that capital requirements per policy more than doubled in 2008-10. Indeed, in contrast, to the run-off situation discussed in chapter three, the capital aggregate requirements for Pearl went up greatly despite policy numbers falling. This situation forced the resort to Liberty described in this chapter.

There was also a crucial indebtedness to the Pearl Pension Fund arising from the guarantees on the pension liabilities. Alongside this, there was a tension in personality and background between the Pension Fund and the Sun Capital people. The former were older, more cautious, and from an actuarial background; while the latter were younger, happier with risk, convinced that actuaries over-insure and are overly conservative, and were from the financial side that increasingly dominated the industry. The latter were unwelcome to the former, but doubly so in the recession.

Related to this, but also separate, Osmond saw the levers necessary to obtain value, even if the terms of that value for all were up for contest. Critics, in contrast, saw an unwelcome shareholder interference, notably by Osmond, in the running of the life companies and the Pearl Pension Scheme with regard to investment strategy, and decisions leading to exposure to a higher risk than was merited. This tension remains in present-day recollections.

The Life Board took a different perspective to that of the Group. The Life Board worked hard to protect the interests of policyholders both from the financial crisis and from Group requirements for cash in order to repay debt and dividends. The Life Board felt obliged to take independent legal advice as how best to manage both the collapse of the Group and the potential split of the organisation between the two bank silos. The Life Board also took legal action against the Group on one occasion.

Bank Debt

The stakeholders responded to the OIVOP by fighting for solutions that would give them the best deal. This was done under great time pressure and in a threatening context. Thus, at a meeting on 27 February 2009, the FSA stated: 'You need to prepare proper contingency plans to achieve outcomes before you reach a point at which the situation might be taken out of your hands by others – e.g. external auditors, banks. We see this date no later than 4 weeks from now.'

The money owed to the banks created an immediate issue, as no significant new liquidity would be released unless this debt was sorted out. The banks had not anticipated the fall in investment values due to the recession, but they wanted to limit their eventual exposure. There was indeed a gearing level of about 50 per cent, a level that the Regulators saw as a major hurdle. They regarded less than 30 per cent as desirable. In addition, the banks did not like the gearing level.

Moreover, the new Group had features that did not sit well with a regulated insurance group which requires freedom to operate. More particularly, it was structured in two security silos, related respectively to the Pearl and Resolution debts. This situation restricted operational flexibility, for example to undertake fund mergers, and, as a separate problem inducing concern, was relatively short-dated.

Pearl's banking group was quite bespoke. On the old Pearl silo, there was a collection of banks who bought into the Pearl business model in terms of asset allocation. These banks had followed a number of dividend recaps since Sun Capital and TDR acquired the underlying Pearl business from AMP some years earlier during which the economics of the loan (fees and margin) had gradually reduced. Similarly, there were some banks who deliberately were not present and who did not join on subsequent refinancings because of the risk profile. RBS was one of these banks because there was concern about the unmodelled and unknown risk given the newish business model employed.

Furthermore, when the Impala syndicate was formed to help facilitate the acquisition of Resolution, the underwriters did not include the usual American or European investment banks. Neither did this group include any of Resolution's former banks who were major players accustomed to insurance, although some of these (RBS and HSBC) did roll some exposure into the Impala syndicate after being comforted by the outcome of the change-of-control process and the conditions imposed by the Regulator.

Each silo was told, and believed it to be the case, that its lending and exposure was ring-fenced against the other silo. This turned out not to be true, and became an understandable and continuing source of friction for some banks who had deliberately chosen to be in one silo, but not the other, or to weight their exposure one way versus the other. Additionally, as banks chose to acquire (or were forced to acquire) other banks as the financial crisis rapidly evolved, the risk selection strategy of certain banks were compromised as they picked up exposure to individual silos they had turned down by way of the acquisition of a bank that had agreed to lend. One of the banks held its position on its trading book which meant that it had different drives to maturity lenders as they had to mark their position to market.

Liberty

Following the technical breach of the solvency requirements in November 2008, which was a key issue as far as the Regulators were concerned, Pearl's shareholders and management, in consultation with the FSA, determined that it would be appropriate to seek an investment from a third party in order to provide more capital to the group. Sun Capital and TDR sought to identify sources of additional capital for Pearl Group. As a consequence, an approach was made to a number of the shareholders of the Pearl which resulted in discussions culminating in an offer by Liberty Acquisition Holdings. Liquidity for the Group in the shape of providing extra capital that could immediately be used to service the debt and dividends, a doubling of the capital, was thereby provided by an offshore source, but one that was very different to the Australian intervention in the life assurance market in the 1990s, for which see chapter two.

A small group of American private investors, some operating through Private Equity, notably Martin Franklin and Nicolas Berggruen, had, before the financial crisis, created an investment vehicle, a Special Purpose Acquisition Company (SPAC), called Liberty Acquisition Holdings (International). This was listed upfront as a shell on the Amsterdam Euronext market, the pan-European exchange. French-born Berggruen ran Berggruen Holdings and had co-run a hedge firm. British-born, American-based, Franklin, was another active deal-maker. New York hedge funds provided Liberty with most of its liquidity, which was E600 million.

Referred to by Rene Azria, who advised Liberty, as a blank cheque company, a SPAC operated by buying a distressed company, getting a very quick uplift in its value, and exiting speedily. The key element was to get the cash out. Franklin, who had done a SPAC before that, had been quite successful. He was interested in the concept of a SPAC and in repeating the cycle, which, indeed, brought considerable personal benefit in terms of share allocation through a sweet equity structure. Franklin went on to do other SPACs later. While looking for the investment, the money was kept in safe government bonds.

Subsequent SPACs are predicted on a sequence of success, but that sequence depends on the success of each. That helps bring in the funds. The individual investment is of little consequence in itself. Indeed, the SPAC shareholders were to know and care very little about Pearl Group. In contrast, in 2010, when Osmond had a similar idea, in terms of founding the Horizon Acquisition Company, he focused on a longer-term restructuring.

Liberty was looking for a European investment, and was near the expiry period for the vehicle and thus under considerable pressure to act. Otherwise, the money would need to be returned, denying the promoters a possible huge reward. Indeed, Liberty was affected by deal fever. It had hired Azria, a New York investment banker from Tegris Bank, to help sort out its investment options, and, as he had attended a Cowdery presentation in London about raising money for Resolution, he knew what was going on in the industry. Sun and TDR, and not the Pearl management, drove the discussion with Liberty, and this both reflected and enhanced their importance.

Via Lord Edward Spencer-Churchill, a key member of Osmond's team, who had the necessary international connections and approached Berggruen, Liberty was persuaded to invest £486 million into Pearl and to acquire half of the shares. The rest of the E600 million was to be distributed to Liberty's shareholders. On 20 January 2009, Berggruen received a memorandum from Spencer-Churchill describing the potential terms of a possible business combination transaction between Pearl Group and Liberty. Berggruen had previously considered investing in the original acquisition of HHG PLC's closed life companies by TDR Capital and Sun Capital that was completed in April 2005 and led to the formation of Pearl. Although ultimately these discussions did not result in an investment by Berggruen at that time, Spencer- Churchill and Berggruen had subsequently continued their dialogue about the Pearl Group as well as other potential investments.

After a call from Spencer-Churchill, Azria went to London where the Pearl business and situation was explained to him. Having run the calculations, he prepared the proposition for the Liberty Board. An issue was getting rid of some of the debt, and Azria felt that Osmond and Dale were overly optimistic in the degree of forgiveness that the banks would accept, correctly so. Indeed, he suggests that the banks were offended as a result of Pearl overplaying the hand, but Azria also found that the bank group was unruly due to the divisions between the banks, with Nomura proving particularly difficult. In the event, the small banks sold out their position at a discount. Nomura's opposition was overcome after the big banks applied pressure via the Treasury, the Bank of England, and the British ambassador in Tokyo who persuaded the Finance Minister to urge Nomura to cooperate. Its licence to operate in Britain was allegedly threatened, and Nomura then agreed.[15] It took five months to reach agreement.

On 2 February 2009, Franklin, chairman of Liberty's board of directors, met with the principals of Sun Capital and representatives of Pearl Group in London and was provided with a Pearl Group management presentation. Two days later, Liberty and Pearl entered into a mutual non-disclosure agreement. On 5 February, representatives of Liberty and its financial adviser participated in a conference call with principals of Sun Capital during which the preliminary structure and terms of a transaction were initially discussed. On 8 February, Liberty delivered a preliminary term sheet to Sun Capital outlining the preliminary structure and proposed terms of the proposed transaction. From 19 February to 24 February, legal counsel to Liberty and the sellers exchanged drafts and negotiated the terms of a purchase agreement.

Meanwhile, by the end of March 2009, no clear solution had emerged to Pearl's issues. KPMG's 166 report presented to the Board laid out all options. On 26 March, all the parties met at the offices of Clifford Chance. This illustrated the different entrenched positions of the parties. The Banks and the Pearl Pension Trustees threatened to enforce the debts, which would force a total restructuring. Sun Capital and TDR refused to inject fresh capital, and Osmond allegedly attempted to play the two bank syndicates off against each other. The FSA made it clear that a compromise was needed. A Pearl Board paper of the next day outlined the danger that the Pension Trustee position would potentially lead to the administration of the Group. Meanwhile, in a separate direction of crisis, the Tier One bond payment had been deferred on 25 March. A bondholder action group, Abaci, had formed and it met on 17 March. There were some heated discussions between Pearl and Abaci.

Difficulties continued to come. On 14 April 2009, the FSA 'Arrow' risk report stated that Pearl:

> 'poses a high risk to the FSA's statutory objectives. Pearl's business model is more vulnerable than its peers to market turmoil due to its controller's debt obligation, which it is expected to service, and other complex arrangements. Rather than having strong controls frameworks to compensate for higher business risk, Pearl's governance, management and control frameworks exhibit significant weaknesses.'

[15] Ex inf. Azria.

The report set out that there were five principal failures. The first related to capital and liquidity, as the FSA was not satisfied that Pearl's approach to upstreaming capital was sufficiently prudent given the £1.253 billion IGD breach in October 2008. The OIVOP was to remain in place. The second related to governance, principally criticism of shareholder involvement in the Group. This led to the second Section 166 report into Pearl, one focused on governance. Thirdly, there was the issue of management and specifically whether Pearl was now equipped to manage a Group of this size and complexity. The FSA cited 348 outstanding audit actions at the end of December 2008. Fourthly, Group financial control was a worry. The FSA identified deficiencies relating to cash flow forecasts. Lastly, there was concern over control functions in the shape of risk management, internal audit, and compliance.

The underlying attitudes of the FSA were an issue. It had long equated risk with volatility; possibly a practice originating from the control at the top of the FSA by ex-bankers. This practice, however, is more appropriate for banks with their short-term nature and the need to be aware of the possibility of significant short-term withdrawals for depositor assets.

The FSA also worked on the principal that the stock market was a 'random walk.' That may be true in day trading, but is not over longer periods. Regulators could argue that once companies had allowed for a 40% fall in the market, they had to assume that another 40% fall was possible and had to be taken into consideration. This, however, is generally an unwarranted assumption. Separately, as with all Regulators, their reputation was/is of paramount importance and normally above the statutory objectives. The argument is that if the Regulator does not have a good reputation, it cannot meet its other objectives.

Contingency plans meanwhile were pushed to the fore. Led by Mike Eaton, a separate unit was established in Juxon House in order to prepare these plans. A Scenario Contingency plan was presented to the Pearl Board on 21 April given that there was a risk that other proposals would not succeed. This plan set out that, by the end of April, the Group could default on the Impala facility, which would cross-default to the Pearl facility. This would lead the respective syndicates to enforce their security over their respective shares in Pearl and Impala. There would be pre-pack administration of the SPVs and a transfer of assets to third party or bank-funded SPVs. There was the potential for different parts of the Group to be owned by particular syndicates, which would compromise plans for the consolidation of policies and for synergies within the Group, and thus lessen the value of the Group. There was also a knock-on effect on, and from, the Pearl Pension Scheme and the CfD. In particular, it was unclear whether, and if so how, the Pension Regulator would exercise its powers to protect the pension scheme. Separately, the Pearl Trustees could give a notice of intent to exercise the CfD on 30 June, which would entail a cost of about £500 million. The 21 April report noted 'It is unclear whether in these circumstances additional political forces would come to bear or whether a commercial situation would unfold.'

Nevertheless, a solution was emerging in May and June, one of consensus that Pearl was worth rescuing, and that the Liberty deal was the best solution for all parties. Sun and TDR, and their teams, drove the process. Presentations to the banks on 21 April 2009 noted the requirement for £400-500 million of new capital, along with a capital repayment holiday and a debt for equity swap. The spectrum of outcomes stated that, in contrast, 'administration would immediately destroy significant value for all stakeholders.'

The Liberty solution was proposed as the most sensible and consensual one. On the proposed cash-flow forecasts, the banks were told that 'the Liberty proposal is a better alternative for the Banks… Liberty deal is very advanced, meets the FSA's key objectives and should be conducive to removal of OIVOP.'

The 21 April presentations boldly (and unrealistically) stated that the heads of terms must be agreed by 23 April, but that deadline passed without any heads being signed. The next few weeks saw the terms being negotiated between Liberty, Sun/TDR and the banks, culminating in much activity in mid-May in an attempt to agree a deal.

While the prospect of a bid by Resolution Two was regarded as a spoiler and, anyway, slipped away, the Liberty deal grained traction. The winning card in the Liberty proposal, and what Osmond aggressively pushed to the banks, was the £500 million of new equity. The background was that of looming due payments with reference to interest and capital, as well as the CfD. Under that pressure, Liberty signed exclusivity deals with Sun/TDR and the banks on 3 June.

On 22 May 2009 the bank credit committees met, while, on 1 June, a representative of Liberty met with representatives of the FSA in London to discuss the proposed transaction: the FSA had to agree any change of control. The FSA tried to keep a balance between the recapitalisation and, on the other hand, the banks demanding sacrifices and pursuing a new rescue plan of their own. In the event, the approval of the Regulators was obtained. A delay was caused by the Pearl Pension Fund, but it came in because of pressure from the Regulators who (correctly) told the Trustees that this was as good as it gets, and that it was not in their interest to obstruct the recapitalisation of Pearl, and thus run the risk of a disorderly insolvency. The positive impact on the balance sheet of adding capital and cutting debt was about £1 billion, an enormous sum. This sum approximated to that emerging from Resolution being less than Sun/TDR had envisaged,[16] both because credit spreads had risen and due to asset prices falling.

[16] Gupta – interview.

Outcome

The financial context was far from happy. The CfD valuation on 31 December 2008 had shown a £0.5 billion deficit, a Tier One bond payment of £33 million was deferred by Pearl on 25 March 2009, and, on 30 June, a £0.6 billion payment on the CfD would have been due.

Other Options

At the same time, alongside this narrative of reconstruction, there were others being considered and/or pursued. Some had more possibility than others, but all contributed to a strong sense of uncertainty and volatility. Contributing to this, there was no exclusivity in the negotiations with Liberty. In particular, the banks considered a take-over, an issue discussed in the next section. It is one that has been elided from the memory of many, but helps to explain the strong and lasting sense of uncertainty in the City surrounding Pearl and later Phoenix.

The banks were not alone. The Pearl Pension Fund, faced with a potential shortfall that had grown from £360 million, instead of falling, as anticipated, to £300 million, considered the drastic option of pressing for a restructuring that would enable a focus on the issue. That might include Pearl's collapse and a resultant repositioning of its parts.

In addition, Resolution Two, which had been floated in December 2008, and with which a NDA had been signed on 22 January 2009, came into play. It held negotiations with the banks, and, in May, showed a willingness to acquire Pearl, sending a letter of interest to Pearl, Lloyds, RBS and the FSA on 14 May, and intervening. This bid reflected its ability to fund acquisitions. However, in the background, was the FSA investigation into the share dealings of certain Resolution directors, including Cowdery and the alleged non-disclosure by Resolution One of information to Pearl. This was a subject Osmond separately probed with forensic accountants: he was concerned about the accuracy of the shareholder scheme circular. Although the investigation was closed very quickly, with all charges dropped, it did mean that, whilst its matters were being investigated, Resolution Two could not bid for new assets. The Resolution Two interest in Pearl at this stage, which was opportunistic and with not a little mischief, led nowhere. It did not improve relations between Osmond and Cowdery who allegedly made defamatory remarks in order to spoil the Liberty bid. In July, Resolution Two was to bid for Friends Provident.

More significantly, the contrast between the performance of the two companies was widely noted. It suggested that, while closed-book consolidation should, could and would, still work, it would do so with Resolution Two. Indeed, its success and ambition threw much light on Pearl. This was accentuated by the difference in their financial structure. The Regulators could judge Pearl in the context of Resolution Two. This contrast was to be enhanced when Pearl took the Liberty route to restructuring.

The Banks Again

The Liberty cash shell might have appeared to be a white knight for Pearl, but it also proved a complicating factor. This was not least the case for the banks, as Liberty insisted that both Osmond and TDR had to have a significant equity stake going forward even after the banks undertook a debt write off because of the knowledge they had of the business and the value they would add by remaining as stakeholders and directors. The banks in contrast wanted a bigger equity reduction for Osmond and TDR, an outcome that would have provided a bigger stake for the banks.

To provide the banks with negotiating leverage around the discussions with Liberty, the banking syndicates, led by Lloyds who held 25% in each syndicate, decided that they also needed to be able to provide the same amount of new money, and both explore and convince the Regulators that they could take possession of the life companies by way of a pre-pack receivership. This was a significant undertaking. Raising new money from a banking syndicate where some were already over-exposed and some had retreated from London was a delicate task. Equally, persuading the Regulators that the banks could take possession of an insurance group via a relatively untested insolvency process, and then run it without disrupting policyholder behaviour and attracting negative publicity, was also very challenging. And doing it on a timescale that permitted the negotiation of potential tension with Liberty, TDR and Osmond was also important.

Essentially, the negotiations themselves were carried on continuously from March 2009 to when the Liberty deal was announced that July. Despite the banks failing to match Liberty's financial offer, the momentum they created around this, and the progress they made with the pre-pack receivership discussions created the necessary tension to allow them to benefit from the Liberty deal. Some of this progress involving discussions with the Regulators, the Pearl Pension Fund trustees, and the Pearl executives and non-executive directors was very deliberately played out semi-publicly in order further to support the notion that the banks were not takers of any proposed solution.

Success in the Liberty deal required agreement, and all lost something. The outcome, however, was positive. Everything started flowing once the banks appreciated that an outcome was possible and that Liberty was a proper partner. However, requiring consent from all the banks made the consortium difficult to deal with.

There was a final marathon negotiating session, with a bitter quarrel as TDR and Sun Capital tried to get Deloitte and Hogan Lovells to reduce their fees. They offered some reduction, but the question then became was this offer enough. In last-minute abrupt exchanges, the banks made it clear that, if the negotiations thereby collapsed, they would not give the Liberty deal a second look.[17] The deal was signed on 29 June. Liberty's Board finally agreed the transaction on 2 July. Liberty's shares rose in value after the transaction was announced, indicating support. Although not completed until 2

[17] Ex inf. Peek.

September 2009, the Liberty deal had been signed on 27 June and announced on 29 June (a Monday) when the markets opened, and this prospect allowed the signing of a new pension agreement.

Pearl Group reversed up into the new company – a SPAC working through a merger, and was listed again, now on the Euronext. Aside from the new owners, the banks took a stake for writing off some of their debt and extending the loan maturity period, which left Osmond and Dale with much of the equity, but now a minority holding. The Pearl lenders took a £300 million write-off, so that the debt stood at £425 million. The margin was reduced on the Impala facility. The money owed to Royal London was also reduced as it took a write-down on its PIK notes. The CfD for the Pension Fund was removed, but the Trustees and Pearl entered into a new long-term funding agreement guaranteeing contributions by Pearl into the scheme. The Trustees were also granted a share charge over certain Pearl companies as security for Pearl's obligations. Liberty's shareholders got 60% of Pearl, 29.5% went to Pearl's existing shareholders (Sun Cap/TDR) and 10.5% to other stakeholders (the banks, Royal London, and staff). As a key part of a more general restructuring, the Liberty deal therefore was in effect a rescue rights issue. Liberty became part of Pearl with its shares exchanged for Pearl shares. The Group OIVOP notice was lifted.

The Banks and Liberty

The banks had much reason for their concern about developments. Isabel Hudson recalls that at her first Pearl Board meeting, a contributor on the line from New York, declared 'all we need to do is fuck the banks.' This reflected a wider tension within the Board over relations with the banks. More specifically, the short-term investors, the Liberty stakeholders, were not concerned about them, indeed saw them as competitors and constrainers. In contrast, those with longer-term concerns understood that, if Pearl was to have a long-term future, it required good relations with the banks. Thus, the latter were wise to feel that Liberty's recapitalisation scarcely resolved matters.

Liberty itself did not feel completely happy about what it had obtained and had to get new investors in July 2009 as some of the investors in Liberty did not like the deal. The liabilities were greater than appreciated and the timetable different to that anticipated. Liberty felt that the FSA did not appreciate that it had saved Pearl and thought the restrictions, notably on dividend payments, excessive.

A Crisis in Retrospect?

Thus, the IGD breach had prefigured greater challenges for the Group and set in train a near-death experience. The restructuring saved the Group, the battle for cash ending in compromise. However, there had been a complex interlinking of points and breakdown of trust along the way. Pearl was fortunate that Liberty was there, a white knight that was itself facing the acute time pressure of being wound up if it could not do a deal. At the same time, luck had to be made by contacts and hard work: Sun/TDR got Liberty on board.

The financial crisis had exposed weaknesses in the Pearl model. The asset choices had proved highly illiquid and therefore their value was brutally hit by the crisis. The Regulator proved itself capable of being assertive and ready to take action to protect policyholders playing a coordinating role. Less positively, the Regulator, in part under political pressure due to policyholder agitation over low returns, had used the wrong signals, treating volatility as a measure of risk. In practice, the fall in asset prices meant that Pearl could buy assets to offset liabilities, only for the Regulator to contribute to the problem. This led to a lot of strain in the relationship between Pearl and the Regulator, and that was exacerbated when the latter did not follow up on investigating the Resolution-Pearl deal. The FSA is praised by some, but is also heavily criticised on the grounds that it did not like outliers or innovation, and was not willing to understand sufficiently the difference between a stressed business and one that was pushed toward crisis by micro-regulation.

There were also conceptual as well as Regulatory differences and tensions, between the idea that a pension fund should not be allowed to go into deficit when markets fall, and that it can have a deficit, and therefore invest in risk-bearing assets and ride through the cycle. Osmond's analysis of risk applied risk management techniques rather than meeting the Regulator's assumptions. The stress on Pearl was not disproportionate from Osmond's perspective. He saw a long-term business able to bear appropriate risk, and affected by a pro-cyclical Regulator that was increasingly interventionist in what was termed a 'Ladder of Intervention.' In this context, there was no agreement on the stress that might stem from dividend payments.

A Crisis Ongoing

The crisis hit relations with the banks which did not like having to write-off loans, although that was a key aspect of the crisis as a whole. Operationally and optically, there were still many difficulties. The OIVOP was basically still there in all but name, as the Group had to get permission to spend money. Moreover, the change of control meant that £150 million of extra capital buffers had to be held in the holding companies. This sum was necessary for the Opal hedges. Separately, although listed on Euronext, the new structure was complex to investors. And the players had not really gone away. These were stakeholders who were all badly-bruised by the events of 2009. The Group was still on the FSA Watch List and the Regulator remained very muscular in its approach to the Group. Debt still sat outside the regulated Group, which did not count for IGD purposes. The FSA disliked debt being kept off solvency calculations, and this created a set of legacy issues.

The Liberty deal had not ended Phoenix's debt problems. As far as the banks were concerned, the Group still had a huge amount of debt outstanding, the Group was still siloed, and the facility agreements limiting, for example in relation to dividend payments. The lenders had extra control via the lender relationship agreement which gave them rights, such as a Board appointment. Furthermore, in order to assist in any premium lending, it was necessary to satisfy the bondholders. The angry bond group included the very institutions Pearl would need backing from to get afloat. This bond group also had the backing, albeit unofficially, of the Association of British Insurers. In the end, the Tier One bondholders were repaid in late 2010 via a placing, but the Group was locked out of the bond markets until 2014. In addition, a complex pensions net and security arrangement was reached with the Pearl Pension Trustees.

The complex capital structure of the Group ensured that there was a large amount of contingent rights and warrants in issue diluting shares. This initially prevented the premium listing from taking place, which was what the Liberty investors wanted. They had not realised that it would prevent listing. A February 2010 report by J.P. Morgan Cazenove and Deutsche Bank, entitled 'Considerations Regarding Pearl's Next Steps' drew attention to the range of problems. Key points included:

> '…the Liberty holders are not natural holders of Pearl.
> The high percentage of dilutive instruments within Pearl's share structure [46.5%] … prevents a Premium London listing … would need to represent less than 20%....
> A secondary listing was obtained on 17 November 2009, with limited benefits in terms of liquidity and valuation.
> Pearl's valuation has been impacted by a number of items including a complex story and background, a capital structure which is viewed as being, a large number of dilutive instruments, lack of liquidity and index inclusion and a dispute with tier one bond holders. .
> ….A Premium listing which also involves a capital raising would require resolution with the tyier one bondholders and the support of the existing shareholders.'

Reconstruction

The banks were determined on changes in governance in order to prevent problems recurring and had obtained power with their new shares, while the FSA was focused on how best to facilitate a timetable for recovery. A relationship agreement was negotiated whereby the banks obtained Pearl's agreement that its board would contain as many NEDs as non-NEDs, its new Chairman would be bank-approved, at least one of its NEDs would be a bank appointment, and the banks themselves would also have an observer at each Pearl board meeting. This was a hard-negotiated document which the Pension Regulator also had to be comfortable with. Although still dubious about the role of Sun Capital and TDR, and concerned that the Board had insufficient power, the PRA proved quite accommodating because it had the same interest to ensure that the problems of the past were not repeated. David Barnes and Ian Cormack were the NEDs in question.

The reconstruction in September 2009 entailed a major change in governance. Responding also to what the FSA wanted, there were new Board appointments at both Group and Life company levels: Liberty provided two Board members: Azria and Ian Ashken. The FSA was very involved with the set-up of the Board. With the support of the banks and the Regulators, the new part-owners put in a chairman, Ron Sandler, an insurance expert, previously CEO of Lloyds of London from 1995 to 1999, who had carried out transactions with Martin Franklin in the late 1980s, remaining in sporadic contact since.

Sandler's appointment on 24 September led to a different practice of management, with Osmond and Dale having less power than hitherto. The Board began to take a larger role, and there were tensions with Osmond, notably over his willingness to talk to the press and others. The relationship between Osmond and the older Sandler was poor. Aside from personal issues, there were different interests that had to be managed. These included the interest of shareholders in pushing money up the Group in order to increase dividends and improve share value prior to the sale of shares. To Osmond, Sandler lacked the necessary understanding of the details of activities and, in particular, of the holdings.

Pearl in effect was a very large and highly complicated spread sheet, and it was necessary to understand the relevant details, which Osmond could do. The intellectually robust Osmond distinguished his position from the actuaries whom he considered good at capital usage within policies, but bad at investing. He also forced them to explain their language and thinking, which was not always a comfortable process. Ian Reynolds was so impressed with Osmond that he 'came to the view that he would pass the actuarial exams just by turning up!'[18]

Others felt that Osmond paid too highly for Resolution and that this had led to him taking high risks on asset management to the Group's cost during the financial crisis. In that context, it is regarded as hardly unreasonable for Regulators to match capital requirements against risk, whatever the solvency regime.[19]

Though frequently criticised, including in print, as a non-dom, as very highly-paid and as part time, Sandler, who was able and well-respected as well as pleasant and a seeker after pacification, had already acquired considerable expertise in the management of crisis in that, aside from his role at Lloyds, he had been chairman of Northern Rock after its collapse. He had experience of the life business from working for Paternoster and in 2002 had produced at the request of the government a review of the UK's retail saving industry designed to ensure that customers were well served. The government had commissioned the review in June 2001 because it was worried about the savings gap – the failure to provide adequate funds for retirement. The report claimed that many financial services were complex and opaque, that the industry had failed to attract and engage with the majority of lower- and middle-income consumers, and that consumers were unable to drive the market. In

[18] Reynolds to Black, email 28 June 2019.
[19] Michael Urmston to Black, 14 July 2019.

response, Sandler suggested the creation of a range of simple, low-cost, low-risk products. The stakeholder pension was one of these. In effect, this increased the pressure on the insurance industry and, indeed, long-term savings as a whole. Seeking to sort out Phoenix, Sandler brought in new Board members and chose well. Some, such as Isabel Hudson, thought the company was in a worse state than they had anticipated.

Alongside its Board representation, a significant factor, Liberty itself acted as a somewhat dormant investor within the context of aggressively seeking a rapid turnaround and exit. Pearl, however, had changed. It ended 2009 as a Cayman Islands Incorporated, Jersey tax-resident, and Euronext Listed Group. Resolution Two was Guernsey tax resident.

Sandler was convinced that Pearl was fixable as a consolidator. He had had experience of troubled companies and avoided complete basket cases. Sandler was confident that, despite very difficult operational issues at the Group level, Pearl was not in that category and had never been so. Otherwise, he notes, he would not have taken on Phoenix.

As Chairman, Sandler had to keep the Liberty shareholders happy. They put pressure on both him and on Franklin directly, which created a texture of management issues. The shareholders had been sold an investment opportunity that disappointed them. The share price performance was fairly uninspiring even after the primary listing in London. Liberty arguably had not been told enough about the problems with Pearl, and the dividend subsequently offered was unacceptable to the American shareholders. From the outset, Pearl's share price had not kept pace with the UK life insurance index or the FTSE 250 index.

Meanwhile, it was vexatious that Resolution was making the weather. Indeed, the 'Market Report' in the *Daily Telegraph* on 18 February 2010 began: 'Resolution was back in focus as the blue-chip index flirted with the 5300 mark. Traders linked Resolution, the investment vehicle controlled by Clive Cowdery, with a possible offer for some or all of Irish Life and Permanent.' The rest of the life assurance sector was in demand following a better than expected trading update from Legal and General. Prudential and Old Mutual were both mentioned. Pearl was not listed in London, but was not mentioned in this report in any context. Indeed, it was generally not to appear in the press except as a problem. 'Tempus' in the *Times* that day mentioned Legal and General having 'had to fend off Resolution, Clive Cowdery's predatory bid vehicle, in recent months.' Again, there was no mention of Pearl.

From 2009 onwards, Resolution Two, which was 80% owned by other life assurers and banks, acquired Friends Provident, most of AXA's UK life business, and BUPA Life Assurance, merging them together to form Friends Life. The company joined the FTSE100, and the business was then sold to Aviva in April 2015. Phoenix did not make another acquisition after that of Resolution One in 2008 until the acquisition of AXA Wealth in 2016. Arguably, the cost of an overly-leveraged structure, and of the Regulators' response to the crisis, were eight years of lost-deal-making for Pearl/Phoenix.

Alex Brummer, City Editor of the *Daily Mail*, was characteristically scathing in February 2010. Referring to the plan to turn to the Phoenix name, he wrote:

> 'Such nonsense rhetoric will do nothing to persuade policyholders in the zombie companies, now under the Pearl umbrella, that they can look forward to brighter horizons…. This game of pass-the-insurance-parcel…. Successive owners have extracted profits for themselves, while policyholders … have seen returns dwindle … all this grasping for short-term profits… financial cowboys.'

Conclusion

Liberty was valuable, but not a panacea. The Liberty deal stabilised the Group, and the December 2009 Executive Summary for the Board was generally positive, notably for cash flow, embedded value, and Group covenants, although, with continued anxiety about the solvency position as this was behind capital policy levels. Nevertheless, serious issues remained to be worked through: an excessive debt burden which was a poor fit for a life business; and badly-damaged relations between the lending banks and Pearl, particularly its equity backers. Improved governance was still a work in progress. Moreover, the relationship between Phoenix and the FSA would take years to normalise, and this normalisation was very necessary for Phoenix to be removed from the Regulator's Watch List. In the meanwhile, Bannister described the situation as 'thinking of it as a cliff path: there is a drop and Phoenix was leaning on the inside, constantly trying to move boulders out of the way so that it does not fall off.'[20]

[20] Bannister, Steering Committee, June 2019.

6. Phoenix Arrives

As part of the restructuring, there was a highly indicative change of name. Pearl became Phoenix, the latter a name resonant of the history of life insurance. So also with the name Pearl, but it had become closely associated with Osmond, and his altered status in the company was an important part of the new equation. The reconstruction in September 2009 had led to the Phoenix name being chosen as the core brand for the Life Company businesses. This choice reflected the positive vibes associated with Phoenix Life, an old company and old name owned by Pearl. Now the name and brand was to be extended to the Group (parent) company level. In large part, this reflected the extent to which it was sensible to have the same name for the two.

In addition, Sandler and other Board members did not like the fact that the press kept calling the Pearl Group 'Hugh Osmond's Pearl Group,' or, as with moneymarketing.co.uk on 19 and 25 February 2010, 'Hugh Osmond's closed life business.' They felt that that term played to the past too much, they did not like that image, and they still revert to the issue. At this point, Osmond in practice owned 15 per cent of Pearl Group. Thus, the renaming was in part more to do with no longer wanting to be called Pearl than particularly seeking to be called Phoenix. After an EGM on 15 March 2010, the Group traded under the name Phoenix Group Holdings from 17 March.

The new name was followed, on 5 July 2010, as the company completed its Premium Listing on the London Stock Exchange, by a new logo, brand colours, and styles, which were rolled out across the entire business. The Group used the Partners, a branding agency, and Wardour Communications which developed a design for the website. Branding propositions were put to the Board. The logo was a P for Phoenix and a sun coming up. The purple colouring was unusual for a financial institution. A theme was that, with seven million policyholders, the business was more than just a source of cash. Meanwhile, the staff were encouraged to participate by branded gift items and celebrations. They also had a direct stake as, earlier in the year, 64% of employees had joined the company ShareSave Scheme.

As part of the public image, there was a new focus on media relations, with a programme of meetings with senior City media commentators. Phoenix was trying to influence the climate of discussion, not least as it was unhappy with the use of 'vultures' and 'zombie funds' to describe consolidators, a battle that has still not been won as the latter term remained in use in the City press in July 2019.

The policy theme in 2010 was that of Phoenix being responsive and transparent in its relations with customers and the media. The approach taken was that the indefensible was not to be defended, and it was to be accepted that some mistakes happened.

Tensions

Meanwhile, poor relations between Phoenix and the banks were a continuing factor. Difficulties were a matter of style as well as policy. As far as the banks was concerned, Phoenix did not adopt an accommodating approach to the banks or, even more, an accommodating tone. The latter influenced the entire negotiations. Liberty had introduced the new money and Ian Ashken of Liberty ran the negotiation with the banks. His was very much a take-it or leave-it approach as far as handling the money owed to the banks was concerned. There was no smoothing of the way. Another aspect of uneasiness was captured by the Board minutes on 14 December 2009:

> 'The Chairman [Sandler] welcomed Les Etheridge as the Observer for the lending banks and re-iterated his concerns regarding the Board's discussions taking place, knowing they would be reported to the lending banks who were shareholders. He requested … legal advice to provide guidance for the Board for this unusual arrangement.'

For the 1 February 2010 meeting, for which Etheridge was not present, it was noted that the Board papers had been circulated to the lending banks. The minutes for the Board meetings in 2011 noted that the banks' observer was excluded from items where there might be a potential conflict with the Group's lenders.

Nevertheless, new money from the new third-party, American, investors had proved crucial to the handling of the debt, and therefore to an impressive stabilisation of the Group. The banks benefited from the long-term restructuring that was made possible by the Liberty deal. As a result, there was both a rescheduling and, subsequently, a rise in market support. In practical terms, this was not a novelty, but a typical workout of a company in difficulties. There was the need to change management, and this was provided. However, this workout was unprecedented for a company of this type, and that represented a challenge, not least to the expectations of all the stakeholders.

The Regulators

Aside from the banks, the FSA wanted a change of management. This meant changes at Board level, a new CEO, and a new CFO. The FSA was mindful of its responsibilities to the policyholders as well as the reputational risk to itself and to the banks of a Group failure, or at least of an erosion of the buffer protecting the operating companies, and thus the policyholders. The FSA itself had approved the structure of the Pearl Group in the first place, notably the failure to count the holding company debt as part of the operating debt, a structure advanced by Osmond and Dale that reflected the separate status for the life companies, and one not seen in other insurance groups. As a result, the structured Group debt was not consolidated against the total debt.

Thus, the FSA had arguably performed poorly, even very poorly. However, it did not accept the blame for its approval of the structure and leverage. Indeed, some interviewees have been extremely scathing about the FSA's practice in this respect. In part, this practice reflected the light regulation of the pre-Crash years and the FSA's concern about life policies languishing, which had led it to support a more innovative ownership for Pearl.

In the event, the asset restructuring to the profit of Osmond and Dale had left Pearl with limited and hesitant liquidity alongside a continued ability to generate profits. The FSA had then put the Pearl Group on its Watch List and it kept it there, which was a key background to governance and policy issues, as well as to public reputation. To some critics, the Regulator was unhappy with the fact that Pearl was still a business. It would be more accurate to say that the Regulator was uneasy with both the type of business it appeared to be, and with the way in which it was operating, including the taking of management fees. In part, this situation reflected issues on the part of the Regulator, but the consolidation or 'run-off' business had also not made a sufficient case to the Regulators. Moreover, taking capital out of the business, rather than using it to support guarantees, appeared both unwise and unfair. The responsibility of the new owners to the policyholders might appear non-proven or, at the least, requiring ring-fencing; although this is not an assessment accepted by all.

The attitude of the FSA was arguably an unrealistic response to Liberty's rationale, but it arguably captured a tension both in the nature of Pearl and in the character and tone of the life assurance industry, that of patient security as opposed to more impatient profit-taking. The Pearl Board was so busy with crucial issues of solvency that it did not spend sufficient time discussing how to help policyholders.[21] As a result, and with the Regulators having access to the minutes, the Board was not really adequately making the case to the Regulators that the books were better with Pearl. To some Board members, in contrast, notably those representing Liberty, Sun Capital and TDR, the FSA's interventionism was excessive and neglected Pearl's underlying strength. Certainly as a consequence of this interventionism, refinancing was to be very difficult.

The FSA was also moving the goalposts. It had introduced stronger regulations for solvency capital before Solvency Two was defined. Indeed, the FSA's regulation was tighter and nearer to the eventual Solvency Two regulations than those of all the other EU states. Even so, they sought to implement it as rigorously as any other Regulator.

The FSA also demanded the appointment of a Chief Risk Officer. Resolution One had such an officer, who Pearl inherited. However, they fired him, along with most of the other senior team, in the first three months after the acquisition was completed. In turn, in response to the new requirement, Jean Park was appointed in November 2009. Due to prior experience as Risk Management Director of the Insurance and Investment Division of Lloyds from 2000, she had a good reputation with the Regulators. She found, as she put it in 2019, that she had about 170 issues to deal with (many were in practice, as far as Sun Capital was concerned, minor), and, in particular, that, in her eyes, the risk and compliance functions had disintegrated. Indeed, to her, the compliance functions were at war with

[21] Ex inf. Hudson.

each other, due to the silos, and the staff were either going or had burnt out. Park had to get rid of the burnt-out staff and rapidly to appoint new staff, mostly from PWC, and to rebuild the functions. She also founded a Board Risk Committee for the Group, redesigned the Risk Function, and led the redesign of methodologies for Risk Appetite, monitoring and Board risk reporting. It also proved necessary to set up Audit, Nomination and Remuneration committees and to retool IT systems in the face of the many different legacy accounting practices.

The Regulators demanded that the risk and compliance functions be rebuilt, in part because they were anxious to obtain a good deal for both shareholders and policyholders. The Regulators were concerned that the life companies not be bullied into taking decisions that were poor for the policyholders. Uneasy about shareholders making lots of money out of closed fund consolidation, with policyholders doing badly, the Regulators were also afraid that the banks would demand money too quickly or too much, and that this would hit the policymakers.

The extent to which the Regulators noted press commentary was, and is, unclear. That commentary was certainly not restricted to Osmond. Thus, the *Sunday Telegraph,* in its business news on 10 January 2010, referred to Sandler as 'the non-UK-domiciled, German passport-holder,' adding a £450,000 Pearl income and £2.3 million of its shares to his Northern Rock salary of £250,000. Elsewhere he was referred to as a 'fixer.' Other newspapers at the time, for example the *Sunday Times* on 17 January 2010, observed that many Pearl funds were performing even worse than the Equitable Life with-profits funds. In response, Pearl pointed out that closed funds had little prospect of growth because they had switched heavily out of equities to manage their liabilities. The press coverage certainly reflected unease.

At any rate, the Regulators followed a conservative policy in the release of capital buffers. They were concerned that the refinancing of bank borrowing might go wrong, and might lead to a near-death experience for Phoenix. The shadows of Equitable Life and Northern Rock, for many stakeholders, were long and troubling. At the same time, Liberty's representatives found the Regulators' attitude and policy unimaginative and unhelpful; and the attitude strongly survives to this day in present recollection. The views of the policyholders are far less clear.

Concerned in the post-Crash atmosphere to manage crisis and the risk of crisis, the Regulators provided encouragement to both Phoenix and the banks to find a solution, both to avoid public disquiet and to limit possible disruptive consequences. This encouragement was quite direct at times. The Regulators were willing to press the outlier banks to fall into line. The Regulators told the UK banks involved that they expected them to find a UK solution one way or another if all else failed. The attitude of the Regulators long remained an issue. It was not until his 11 May 2017 report to the Board that Clive Bannister, the CEO from 2011, was able to report confirmation that Phoenix was no longer on the Watch List.

The Phoenix Progress Report of January 2010 noted: ‘FSA have requested a substantial amount of data targeted at understanding whether the current operational structures are appropriate to manage the risks inherent in the existing asset portfolios.’ Relations indeed were a continuing issue, and frequent irritant. That February’s report, drawn up by Mike Merrick on 1 March, noted, in a balanced response to FSA advice:

> ‘The fund merger strategy has been discussed with FSA who have indicated certain resource pressures from their perspective. Some of the timings of the fund merger strategy are being reviewed in the context of that feedback. The impact on the fund merger strategy is not expected to be material… FSA relationship appears to be gradually improving particularly with the Supervisory Team. FSA have been invited to attend the With Profit Committee discussion on the London Life estate issue but have re-emphasised the need for a stronger Compliance function… FSA are reviewing a substantial amount of data targeted at understanding whether the current operational structures are appropriate to manage the risks inherent in the existing asset portfolios. Interviews with key individuals are currently taking place.’

The FSA was also involved in the delivery of service, an area where the Group was vulnerable. As the Phoenix Progress Report of September 2010 noted, this was not least because of issues over:

> ‘the ability of outsource providers to deliver change including regulatory change.… Plans continue to be built to make policy projections more accurately reflect the underlying asset mix but we are running the risk of sanction from non delivery by Q4 [Fourth Quarter] 2010. The FSA feel strongly this has been a requirement for many years and there is therefore no excuse for non compliance but the industry as a whole is not in a position to comply for existing business. As a minimum we are looking to deliver incremental illustrations compliantly by doing so manually within Phoenix.’

Meanwhile, prospects for the Group remained depressed, and this situation was to continue for a while. It had many consequences. In particular, a fall in the share price encouraged Liberty investors to exit from their investment. However, there was no liquidity in the shares to enable them to do so. More generally, the overburden of the debt prevented Phoenix from being transactional. Mergers and Acquisitions were effectively off the table, while competitors had not gone away. As a result of these and other issues, there was a major need not only for a restructuring of the company, but also of its assets and its investments. In certain respects, this repeated the position of Sun Capital with respect to Resolution in the early 2000s.

These issues pull to the fore the question of particular investment requirements. Insurance companies rely on a slow liquidity, rather than the all-on-demand system of banks. That means that assets have to be configured carefully. The topic of reliability leads to a preference for the better end of the credit spectrum. That preference had been challenged by the investment policy under Pearl. It had focused on a deliberate rejection of the previous conservative investment policy in order to pursue a better return, for both them and the policyholders. Instead, there was now a need for a reduction in the percentage of higher risk assets, over which Osmond and Sandler fell out. Michael Urmston would later argue:

> 'Osmond has clearly argued that his investment policy was similar to that used by Phoenix today. There is a suggestion that the regulators panicked and added capital requirements. My own view would be that Osmond's investment policy was higher risk than that used today. Today there is a very close matching of assets and liabilities and the capital requirements are known. The decisions are also made by management and not the shareholders!'[22]

The last was a criticism of Osmond, and one that captures different cultural assumptions about shareholder performance and management structure.

The restructuring of asset classes was linked to the need to reduce the volatility of asset values relative to liabilities. The FSA expected this restructuring in part because they did not want any more aftershocks after the banking crisis. In part, however, there was a tension between the FSA's focus on keeping policyholders safe and, on the other hand, the shareholders' understandable drive to recapitalise their investment and to do so relatively fast. The Regulatory requirements on insurance were pushed hard, with quarterly reports on capital availability. There was an anxiety about the Group's life assurance companies being under threat because their parent was struggling; which was not in the event the case at all. The FSA was concerned about both the financial situation of Phoenix and its conduct.

Like some members of the Board, the Regulators felt that the chain was being jerked by the shareholders, in the words of one former Board member. Aside from the issue of his influence over the CEO, Osmond attended investment committees and other bodies; both still aspects of current comment. In particular, the Regulators appear to have disliked Osmond, who had not made friends by saying precisely what he thought, by frequently being correct, and by making money. As Phoenix very much needed to get the trust of the Regulators, this issue was significant.

At the same time, much of the criticism of Osmond reflected a sense that skills honed in dealing with commercial interests should not be applied in the different world of life assurance. The securitisation of cash flows he had shown in the former appeared problematic in a world of policyholder confidence, and the same was the case as far as the debt structures that had been created. To Osmond, these attitudes focused on misplaced conservatism that was conducive to poor performance. Each attitude is still robustly held.

[22] Urmston to Black, 14 July 2019.

Capital Structure

Helped by a series of measures, at both life companies and Group levels, the capital structure was improving, in line with a general slow recovery of many financial institutions after the Crash. However, in the case of Phoenix, there were not sufficient funds at first to repay the banks. At the same time, there was good news at the life companies level. The Phoenix Progress Report of January 2010, at which point the company had £3 billion of debt and less than £1 billion of equity, noted:

> 'The financial condition of all life companies are improving with all above their capital policies except Pearl Assurance which is just £16 million below capital policy…. The solvency position of Phoenix and London Assurance has improved materially. The precise implications will be quantified in the year-end process but it is expected that Phoenix and London will be able to adopt a capital policy at our target standard and release material amounts of capital over the next few years.'

The following month's report drew attention to improvements in policyholder value over 2009 adding:

> 'some of this is due to improving economic conditions, but some is due to management actions… The financial condition of all life companies are stable with all above their capital policies except Pearl Assurance which has improved to being close to its capital policy.'

The report for March 2010, drawn up by Merrick on the 19th, added:

> 'The financial condition of all life companies are stable with all above their capital policies except NPIL which will improve at the end of March as the quality of assets in the collateral account is improved.
>
> The combination of the de-risking programme, favourable impact of actual year-end results feeding through, the imminent sale of NPIL to PLL, and the reduction in hedge fund exposure within the Opal Re collateral accounts means that from the end of March all life companies will be in a position where the worst of the stresses examined in the business planning process will leave all companies meeting their regulatory capital requirements ie back within risk appetite. This position is relevant on the derivative positions put in place to allow time for longer term de-risking actions.'

Ahead of the announcement, on 31 March 2010, of the preliminary results for 2009, the Group provided an update that February. This noted that the Group had had a strong performance in the second half of 2009. As a result, the year's generation of cash would exceed the target of £500 million, instead of just matching it. The update reported there were continued preparations for a Premium Listing on the London Stock Market, and that there was no intention to raise capital then as Phoenix had no need to do due to its performance. There was also no acquisition in sight that would require such capital.

The flow of cash was presented by Jonathan Moss, the CEO, who was very strong on the actuarial side, as demonstrating the predictability of the business model, and thus the underlying value of the Group. Aside from the interest earned on capital, and the release of excess capital, there were policyholder charges and management fees earned on assets. In the end, the Group's operating businesses delivered £716 million of cash in 2009, which was easily enough to secure £3 billion of debt: the £2.2 billion at Resolution and the £800 million at Pearl. The Board minutes on 1 February 2010 attributed the better-than-expected solvency situation to 'favourable market movements.' This was certainly not the depth of crisis.

At the same time, the February 2010 update noted the issues of providing transparency on this value, and, separately: 'Pearl Group is in constructive discussions with its Tier One Bondholders with a view to finding an agreement that would be acceptable to all its stakeholders. However, there can be no assurance at this point that a solution will be found that will resolve all outstanding issues and provide certainty in respect of the conditions under which coupons (interest) would be paid in the future.' In other words, there was the risk of a court action over deferring annual coupons worth £33 million (6.5864%) on £500 million of bonds in March 2009. At the start of January 2010, Pearl offered cash worth 45p in the £, for £100 million of the bonds, and, for the rest, greater protections against future coupons being stopped, in exchange for a cut in the bonds' value to 75p in the £. This proposal amounted to wiping out of a quarter of the value of the investment. The creditors were also asked to write off the £33 million of missed interest. This offering proved unacceptable to the bondholders, in both terms and process. The bonds had been trading at about 55p in the £ before the offer.

The Pearl Board itself was divided, with the Liberty presence not favourable to the bondholders, whereas others wanted a settlement which they understood was necessary in order to move forward. On 27 January 2010, an influential bondholders group led by Zaman Kahn of Abaci Investors, and including Aviva, Axa, Fidelity International, F. and C. Asset Management, Henderson, Aberdeen and Baillie Gifford, overwhelmingly rejected the plan. As seriously, the companies threatened to call on their equity departments not to purchase shares in Pearl's forthcoming flotation unless an acceptable compromise could be met. The bondholder group was threatening to oppose the London listing. Thus, raising additional capital would be problematic. In addition, Osmond and Liberty understandably did not want new shares issued at this time, as it would dilute their holdings.

The bondholder issue was a legacy one, but, like other legacy ones, ensured that Pearl, and later Phoenix, could not refinance as the markets were not open to them. Instead, in what was a more difficult solution, they had to find an investor. The underlying position with assets, however, was stable because the impact of the run-off of the internal funds was offset by new third party funds and by positive market movements. On 31 March 2010, as a result both of this position and of progress in the negotiations, Phoenix was able to announce a citation of consents to a settlement with the Tier One Bondholders. The relevant meeting was held on 22 April, and 99.9% of the votes cast were in favour of the agreement.

Meanwhile, on 1 February 2010, the Board had considered a document entitled 'Group Strategy 2010-2012. A long-term proposition.' This was ambitious in goals and targets. For the first, there was seeking to be '"the industry solution" for the safe, innovative and profitable decommissioning of closed life funds in the U.K.' For targets, there was to be the acquisition of over £20 billion of life company assets by the end of 2012, to generate an added embedded value of £300 million by the end of 2010, and £100 million annually thereafter, to increase asset management profit by £15 million per annum and attain a capital valuation of £500 million, to generate additional cash flows of up to £300 million by the end of 2010 and £450 million by 2012, and to achieve a dividend of 5-7 per cent per annum from 2011. The first target was held to entail beginning acquisition talks with at least two preferred sellers by the end of 2010, a process that required both the strengthening of the existing capital situation and de-risking.

The financial situation, meanwhile, continued to be promising, and on a number of levels. As the capital base rose, and the number of surviving policies fell, the capital per policy rose. On 31 March 2010, the Group had £69.4 billion of assets under management and served over 6.5 million policyholders. In 2010, the Group generated £734 million of cash, against a 2009 figure of £716 million of cash. This was scarcely a crisis.

Management actions produced the greater cash flow above the target, as well as increasing the Embedded Value. These actions included the transfer of the business of Phoenix and London Assurance Limited into Phoenix Life Limited, the restructuring of certain of the outsourcer relationships, the utilisation of previously unrelieved tax losses within the Group, and the resolution of legacy tax and other issues.

London Listing

The capital structure was simplified with the exchange of Contingent Rights (CRs) for Ordinary Shares. As an additional reward, Osmond and Dale had contingent rights to be given shares for free if the share prices rose above a certain figure, which was an issue if Phoenix was to get a premium listing as the rights affected the share prices. This exchange was much to the benefit of Osmond. For every 10 CRs, nine ordinary shares were obtained. Liberty shareholders were angry about this step, but had to agree. Royal London also had a blocking stake that could stop the IPO, and this had to be bought off.

A Premium Listing on the London Stock Market was completed on 5 July 2010, and the Group entered the FTSE 250 on 20 September. Stock market arrangements were significant. Although a London listing was advantageous, dual listing, in London and Amsterdam, posed problems. This was because of the specific requirements of the Amsterdam market, as well as the impact of time differences on the need to get announcements to reach both markets at the same time. The London listing, more seriously, faced the unstable element in the shareholder base created by the sale overhang produced by the justified concern that Liberty would sell its large holding. Thus, the stock was liquid, but not well listed.

Sandler had persuaded the Board that the London listing should come before the restructuring of the management team. He felt that the listing could be done with the existing team, and that the City would see experience as crucial to the credibility of the listing; while the latter, in turn, would, he argued, provide a basis for moving forward. The listing was certainly a device for a more conventional shareholder basis. It was seen as a way to dilute the role of Liberty, and thereby to settle the FSA, which was nervous about Liberty's role and the pressure to remove cash from the business. As a consequence the Regulatory dialogue would it was hoped improve. This dialogue was a characteristic of the successful participants in the consolidation industry such as Resolution. Listing would make the company more accessible to British investors and enable it to pay for acquisitions in shares.

Despite general stock market turbulence, all, indeed, went according to plan. J.P. Morgan and Deutsche Bank had been appointed as advisors to the flotation, which helped ensure added respectability. The listing also required greater transparency in financial reporting, as well as the prospect of increasing market credibility by committing to, and then delivering, against publicly stated objectives. On 17 November 2010, the shares were delisted from the Euronext exchange. However, there was not the increase in the share price that had been anticipated, which was to be a longstanding problem.

Strengthened by the continued appointment of impressive Non-Executive Directors, and by the payment in October 2010 of the deferred coupons on the Tier One bonds, the Board was now perceived in the City as stronger. Experienced members included Charles Clarke, Isabel Hudson, Alistair Lyons, and David Woods, all of whom were appointed in the spring of 2010. Clarke was a KPMG chartered accountant, the senior partner of the Channel Islands branch; Hudson an insurance professional who had been an executive director of both Eureko BV and the Prudential; and Woods an actuary who had been Managing Director of Scottish Provident and Deputy Chairman of Aberdeen Asset Management, and was Chairman of Liver Assurance.

The Board oversaw a reorganisation in the life businesses, with actuarial re-engineering alongside effective outsourcing, and also followed a generally cautious policy. This helped ensure more stable financial conditions and a reduction of the debt. The big story was what a strong underlying business a consolidator is, with the life companies, unlike the Group, being crucial to that situation.

The City increasingly accepted the Board's view that the simplification of the capital structure would ease the process of valuation, and thus increase the attraction of the Group to investors. In turn, this would boost liquidity and make it easier to pursue strategic objectives. The interim results for the first half of 2010 indicated that embedded value had risen 7%, helped by £116 million of management actions, while the first half cash inflows were £335 million, a strong operational performance. This performance was presented as supporting the case for a higher level of leverage than would be appropriate for a life company that continued to write new business and therefore faced greater liabilities. Dividend restrictions linked to the borrowing facilities with Phoenix's lenders were regarded as a key problem, and one that required a restructuring of borrowing arrangements. This argument for greater freedom was seen by its protagonists as enabling and by its critics as risky.

Despite considerable optimism in 2010, including the Group indicating in February that it would be ready to make acquisitions as soon as it floated,[23] the recovery in practice took five years and was a slow process. This reflected the multiplicity of problems facing Phoenix, and the extent, indeed repeated extent, that potentially dealing with one created further difficulties with another. Moreover, with the Regulators, there was a fully-justified sense both that new burdens were created by new industry-wide regulations, and that there were specific issues of distrust as far as Phoenix was concerned, issues that looked back to the Pearl years.

In practice, this concern on the part of the Regulators was pressed for too long, as the new management understood the problems and had worked out the way forward, even if it proved a slow process. The management was keen to buy new (closed) businesses, which, indeed, was a key to long-term profitability, although it took longer for industrial consolidation to Phoenix's benefit to happen than had been anticipated.

In order to buy such business, Phoenix had to recover Regulatory trust and acceptability, and this outcome entailed a restructuring for business that was somewhat different to the structuring for debt seen earlier. In part, this restructuring involved the sale of assets acquired from earlier high-risk investment strategies, a process helped by cash flows from the life companies. Moreover, as part of the simplification of the business, the new management had to rewind some complex financial structures that had been put in place in order to permit the acquisition. This rewinding de-risked, or, rather, clearly de-risked, many of the assets, and thus strengthened the capital position considerably.

N a Board paper of 23-34 September 2010, Moss, outlining four 'potential pathways' for the Group, advocated continuing to pursue acquisitions but also seeking to generate sufficient cash to release the current bank restrictive covenants:

> 'this approach is most consistent with the messages we have given the market to date and is considered likely to deliver most long term value to shareholders. The rapid re-financing of banking arrangements and the associated lifting of the dividend cap are expected to lead to a re-rating of our shares. This will then open up opportunities to undertake further consolidation, where accretive … equity and debt

[23] moneymarketing.co.uk, 19 Feb. 2010.

markets will be open in a way which is not possible to achieve given today's capital structure and the associated constraints.'

Solvency Capital

A major problem, however, arose from the degree to which the standard formula for solvency capital requirement used by the FSA was a 'one-size-fits-all' model that, in practice, did not reflect the particular nature of risk within the Phoenix Group's businesses. This was serious not just because of the specific situation for Phoenix at the moment, but also because the EU was moving toward Solvency Two, a new set of rules governing how insurers were funded and governed. However, although it had been in genesis for over a decade, this regime was not to be introduced until the start of 2016.

Thus, it was necessary to take a position in the meanwhile, and advantageous to do so given that that might affect the eventual outcome. This was more the case because, although the European Insurance and Occupational Pensions Authority was in ultimate charge, it would be down to local Regulators to put the new system into practice, and thus to interpret both rules and their implementation. In particular, the impact of Solvency Capital Requirement (SCR) would be open to interpretation in light of the reporting of solvency positions.

As a consequence, Phoenix backed its own Solvency Two project, the development of an internal model due for implementation in 2013, that was to be presented to the FSA for approval. This model, which cost a very great sum, and was a major, but necessary, distraction of effort, was intended to provide a more appropriate assessment of the capital required to support the business, consistent with how the business was managed. However, as far as Phoenix was concerned, the Regulator often lacked the resources and mind-set to engage adequately with the specific nature of its business. It took a long time for the Regulator to agree the Solvency Two arrangements for Phoenix, and this delay made the economics and practice of consolidation and acquisitions far more difficult.

Yet More Issues

Regulators look at risk which had become a much more major issue as a result of the recession. They sought to provide reassurance, but that placed serious operating and planning, managerial and strategic, requirements on companies. There was an interplay of controls and assumptions about stress. Getting agreement to the internal model affected strategic options, not least debt-listing in the shape of listed bonds.

In theory and practice, a closed book company is capable of carrying more debt than an open book one, as its liabilities are known, and it is therefore more stable. With hindsight, indeed, the Pearl Group, and later Phoenix, were able to handle their debt. At any rate, a key element of the revival of

Regulatory confidence was the renewal of the debt structure with hybrid capital, some long-term and some short.

Less positively, there were issues about some of the specific decisions made by the Regulators. These included an intervention over Freedom Bonds. These bonds, traditional with-profits deferred annuities, had been sold by Pearl in 1986-92 to about 27,000 policyholders. A drafting error in the post-sale schedule had been resolved by Phoenix. However, having expressed some concern in July 2011, the FSA had not replied to correspondence from Phoenix until March 2012, when, again, it appeared clear that the FSA, which did not devote senior staff to the issue, did not understand it. The FSA dragged its feet until late November. The FSA and Phoenix could not agree the contractual interpretation of the issue, and Phoenix, at the FSA's request, sought an urgent declaration on the matter from the High Court. A hearing took place in the High Court on 15 and 16 January, and a strong judgment in Phoenix's favour, and critical of the FSA, was issued on 24 January, after which, on the 25th, the FSA's conduct team confirmed that they would not appeal the judgment.

About £400 million, a major sum, had been in dispute, and this problem delayed an essential debt refinancing by means of an equity issue, Project Goldwing, until 2013, with about a year being lost as a consequence. The refinancing was necessary due to 'bullets' in existing arrangements in 2014-16 in the shape of borrowing facilities in the debt silos expiring.

This was not the sole problem with the FSA, which appeared singularly poorly managed and regulated. In 2014, an unplanned and inopportune FSA announcement over life assurance that shocked the market also caused problems. There were also concerns about the confidentiality of matters handled by the FSA.

Another key element in revival was the outsourcing of the administration of policies, a course very much advocated by Osmond and Sun Capital. A fundamental problem with closed books is that the administrative function is not proportionately scalable. As a result, the cost of administration, a fixed cost, rises as a percentage of the remaining business, as the latter runs-off; with consequent pressures on finances. By outsourcing, in contrast, the costs become predictable in a fashion that does not rise overall. Phoenix used Capita and Diligenta, the latter located in the old Pearl office in Peterborough. Capita did not go well, in part because it tried essentially to sweat the IT; whereas Diligenta, with whom the negotiations were handled by Edward Spencer-Churchill, proved more effective at devising outcomes. A company set up by Tata, it proved successful at IT. Resolution Two also went to Diligenta. The choice of Diligenta proved important to the news and 'noise' surrounding Phoenix, and in a positive way.

There was also the issue of the Pension Regulator and the related pension questions. These were important and the Regulator wanted money moved into the Pension Fund. In the end, the issue was fixed with a relatively small amount of money. This was part of a more general process of selling off some liabilities and de-risking other aspects of the business.

More positively, although the falling share price of Resolution Two in 2009-10 indicated more general investor caution, such that the share model was that of dividends, rather than capital growth (as is still generally the case), the closed-book outcome remained good and one that could be applied to existing holdings as well as to new ones. The need for an effective management of closed books by a specialist operator in the shape of Phoenix or its rivals remained strong. Current operators of closed or quasi-closed funds had to use scarce capital to maintain this line of business. Running these closed life funds off as individual funds was also an issue for policyholders as it created an uncertain future of escalating administrative costs and diminishing expertise to look after these policies. Thus, consolidation provided policyholders with a positive outcome which looked to the future expansion of Phoenix. It had the scale, expertise, and low-cost operating platform, necessary for taking on large closed books of business and integrating them into a larger whole, both reducing costs and diversifying risk by investing in a broader range of asset classes.

In addition, the asset management capability of Ignis, one of the top fifteen UK fund managers, was seen as providing investment opportunities from, and for, the life company assets. In 2006, Britannic Asset Management had been rebranded Resolution Asset Management and, in 2008, after the merger with Axial, Pearl's much smaller Asset Management, this was rebranded Ignis Asset Management. Chris Samuels, who became its CEO in July 2009, helped to direct vigorous growth and rising profits, not least by acquiring expertise in government bonds. At the end of 2009, Ignis developed a presence in Continental Europe, marketing to institutional investors funds registered in France, Germany, Spain, Italy, Switzerland, Austria, and the Benelux countries. At that stage, it had 77 billion Euros under management. The review in the *Daily Telegraph* of 23 February 2010 of Isas worth purchase had Ignis Hexam Global emerging as one of the four recommended global funds.

As of 31 December 2009, however, its sector breakdown by fund holdings was 6.3 per cent by investment grade bonds, but 76.4 by sub-investment grade bonds.[24] In addition, the cost of managing Ignis was high, not least due to salary expectations which greatly irritated Board members. Moreover, most of Ignis did not deliver the returns of the bonds section. These elements were significant. The discussion of strategy at the 14 December 2009 Board meeting had determined:

> 'It was agreed that the extent to which asset management was core to Pearl Group's business, depended on whether it continued to create value for shareholders. It was further agreed that there was too much to be undertaken within the business to consider a near-future sale of the asset management business.'

There were other overlaps between Ignis and Pearl. Thus, as a result of the investment by Pearl of £50 million in the UK Commercial Property Trust in February 2010, it owned 66 per cent of

[24] *Professional Adviser*, 18 Feb. 2010.

its issued share capital. Ignis, managed the Trust, bought and sold retail stock for it, and also assisted it in raising new equity. At that stage, the fund was yielding almost 5 per cent. Ignis, moreover, was involved around the country in handling commercial property. That month, for example, it sold a retail and investment block in Nottingham, and was involved in a complex transaction with BHS over its Swindon store. The six month cumulative performance to 7 February 2010 on Trustnet had George Shaw at Ignis UK Property 49th, with a rise of 18.94 per cent.

The Future

The acquisition and consolidation of books of business continued to offer Phoenix profit in both investment and capital. Smart actuarial expertise, matching assets and liabilities, enhanced profitability. This included looking at new asset classes for the investments, as well as matching back-book and new business. Moreover, fund mergers released shareholder capital. As policies run off, cash was continually being generated by releasing the surplus value of the policy. This was important in both macro and micro terms.

The Annual Report and Accords for 2010 were instructive about what the Chairman, Sandler, referred to as 'a year of considerable progress, both strategically and financially.' Still the largest specialist closed life and pension fund consolidator, the Group had over six million policyholders and £67.5 billion of assets under management, a figure that had risen from £66.9 billion despite the run-off characteristics of the life company assets. Its 'vision' was to be recognised as 'the industry solution' for the safe, innovative and profitable decommissioning of closed life funds. The 2010 report, issued on 28 March 2011, indicated a Group MCEV up 15 per cent at £2,104 million (compared to £1,827 million in 2009, and £1,962 million in the interim report for the first half of 2010) and a gearing ratio of 52 per cent, and an ability to meet all key financial objectives. In stages, leverage went down to a more manageable level. Thanks to strong financial performance, the bank debt fell from £2.7 billion in 2009 to £2.3 billion in 2010. As a result, the Board agreed on a dividend of 42p, a key encouragement to investors. As the CEO's report noted:

> 'Phoenix Group started the year with its main listing on the NYSE Euronext, with a capital structure that included dilutive instruments equivalent to around 80 per cent of the issued shares and Tier 1 Bonds on which a coupon had been deferred. The year ended with dilutive instruments at less than 20 per cent of the issued shares, our Tier 1 Bond coupons fully up to date, a £33 million placing of new shares completed, a Premium Listing on the LSE and membership of the FTSE 250 Index.'

Very differently, but also significant, the improvement of services to policyholders, as a result of major efforts throughout the year, not least pressure on outsource service partners, was such that the number of complaints had fallen by 24 per cent. The transformation of outsource services from legacy systems to modern platforms was identified as a key issue, one important to policyholder satisfaction. Already over four million policies had been transferred in 2010. At this stage, due to the outsourcing of administrative services required by the life companies, the total number of employees was 1,298, of whom 183 were at Group level, 580 worked for Phoenix Life, mostly at Wythall, and 535 worked for Ignis at London and Glasgow.

Compared to £734 million of cash being generated in 2010, against a target of £625-725 million, the target was raised to £750-850 million for 2011, and £810 million, a good sum, was generated. These figures demonstrated that Phoenix had a track record and expertise in creating value through the business integration and financial management of closed life funds. This was important as it operated in a market which was likely to grow significantly once the aftermath of the Crash had settled down, as both regulation and lack of demand for traditional products continued to cause a transformation in the life assurance industry, with some companies closing funds.

New People

In micro terms, there was the strengthening of the skill set, which included both knowledge and working practices, and also a closer relationship with the Regulator and understanding of its requirements. The restructuring of the management team was regarded as necessary. In 2011, brought in by Sandler, Clive Bannister became CEO, replacing Jonathan Moss. To critics, Moss's undoubted expertise in actuarial technicalities, which were very important at the level of the life companies, did not match the skill-set required for the CEO of a listed company with a range of stakeholders, each with requirements that posed serious issues. The critics felt that he had not adequately understood the risks posed by the Regulatory environment, did not appreciate the role of dividends in opening up the capital markets, and did not understand cash issues and bank concerns. These were all clearly crucial at Group level, and each topic captured unease about Phoenix's capabilities.

Many interviews suggest that the appointment of Bannister, who was made a Director at the 28 March Board meeting, was a key development in terms of Group purpose and staff morale.[25] Oxford-educated, Bannister had begun his career at First National Bank of Boston, had been a partner in Booz Allen Hamilton in the Financial Services Practice, and, from 1994 to 2011, worked for HSBC. This involved leadership roles in planning and strategy in the Investment Bank (USA), and Bannister was also Group General Manager and CEO of HSBC Group Private Banking, and, before joining Phoenix in February 2011, was a non-executive director at HSBC Life and Group Managing Director of Insurance and Asset Management at HSBC Holdings plc. Bannister knew the world of vendors and could talk to shareholders. He understood CEOs and takeovers. This skill was to be very important to Phoenix's subsequent progress, not least to winning confidence. Much more than the change of name to Phoenix, Bannister represented a break from the attitudes associated with Osmond and in the resulting impressions.

[25] Harvie, McInnes interviews.

Far more than a change in tone was at issue. Bannister brought forward considerable ambition for Phoenix. He, indeed, went public with bold projections of the eventual operating profits from insurance, although these were not to be realised on the timetable: he had also made such projections at HSBC. For the Board, Bannister produced a report on 28 March 2011, that included first impressions. 'Strengths' began with 'High level of professional skills and genuine collegiality,' both well-merited observations. However, the list of 'Weaknesses' was longer and damning. It began with:

1. 'More of "a balance sheet than a business".
2. Absence of a "shareholder business model" in terms of capital management/planning.
3. No concept of linkage between management actions and share price performance.
4. Low sense of "mission/burning platform".
5. Complex and disconnected compensation (bonus) methodology to business line of sight.
6. Poor level of cost consciousness.
7. Low level of operational/operations management. Plethora of projects.
8. Oversized head office for current mission.
9. Damaged and sceptical FSA relationship.
10. Degree of naivety regarding the ease [with] which the Banks might/may have agreed to Plan A debt restructuring.'

There were seven other points.

The following report, that of 13 May 2011, reported a rapid and unforecast decline of the IGD surplus 'headroom' in April, with a resulting challenge for managing solvency and for debt repayment. Bannister complained of 'a lack of awareness of the implications of certain key business ratios'; a point that echoed the 28 March report. This was very different to the criticisms made of the high-risk Osmond management style, but captured a general sense of weakness. Interestingly, Bannister's perception of weakness matched some of the criticisms offered by Osmond, although several of the points, notably numbers 1, 4 and 9 and 10 might be regarded as a critique of Osmond's policies.

Although he had no experience on the actuarial side, Bannister's career trajectory involved a good track record in growing businesses, and in developing and leading large teams. Having complained, in his 13 May 2011 report, about a need for more rigorous management, in order 'to eliminate "wishful thinking,"' the highly-focused Bannister had, as frequently remarked, the skill of under-promising and over-delivering. This was to be a key pattern that pleased the Regulator, and was crucial to this necessary improvement in relations; crucial because the Regulator was unhappy and there was no room for missteps, whichever of the strategies chosen were followed.

There were alternatives. Bannister had noted three visions on offer in his 13 May report: decline; focus on expansion as a consolidator; and focus on asset management. More urgently, a 15% fall in share value from 16 May to 8 July 2011 did not help.

Another management change was that of Group Finance Director, with the highly-experienced Jonathan Yates replacing Simon Smith in June 2010, although, leaving in February 2012, Yates was not to stay as long as Bannister. In 2009, Yates had been offered the CEO job by Martin Franklin, who wanted Moss out, but he had not been able to accept as Yates was then negotiating his exit from Swiss Re.

Separately, a somewhat tired Sandler, who was increasingly thinking of retirement and of mission accomplished, stood down to be replaced by Howard Davies. Sandler had found Osmond a wearing Board member and was also somewhat fed up with the job. Some Board members felt that he let them down in going.

Davies was not the initial choice to replace Sandler. Indeed, the post was offered to another who, however, turned it down. The politic remark would be to say because of other commitments. In part, this is correct, but the Group's reputation at this stage was far from encouraging. Instead, Davies was appointed.

Taking office on 1 October 2012, Davies brought further credibility with the FSA, of which he had been chairman between 1997 and 2003, and who were pleased by his appointment. Davies also represented a sort of new departure for Phoenix. Sandler brought Davies in. The latter had faced unexpected serious difficulties as Director of the London School of Economics, and was looking for new opportunities in the corporate world. With enormous experience across a range of City and governmental institutions, the perceptive Davies proved a very engaging Chairman of the Board of Directors. A metropolitan figure, he was also very popular at Wythall, which was the centre of much of the running of the life companies.

Less positively, Davies was criticised by interviewees for being overpaid; for taking on too many roles in the City, so that he was only able to be very part-time; and for not understanding the business, notably the actuarial side. The last was to become a common complaint within the insurance industry as power moved from actuaries. None of these criticisms appear reasonable: Davies was an adroit multi-tasker. He remained Phoenix chairman until he moved to the Royal Bank of Scotland, being replaced by W.H. Smith Chairman, Henry Staunton, in September 2015. Among significant Board members, David Barnes understood the banks and helped in the improvement of the relationship between them and Phoenix.

Looking ahead, credibility with the FSA reduced the pressure on Phoenix. There were other positives as well. The listing on the London Stock Market brought capital headroom and confidence, and a bond issue did the same. The proceeds were used to pay back the banks that sought repayment.

The debt ratio, which had been very high, was brought down as a result of hard work and innovation. However, although there might appear to be a seamless link, laying the basis for new acquisitions was not easy. If, after a long, hard slog, it finally succeeded, the process proved very difficult.

In 2011, encouraged by the Liberty shareholders wanting out, there were merger talks between Phoenix and Resolution Two; although the Chairman's Statement for the Annual Report noted that the approach, like others, was unsolicited. Such a merger was seen as a way out for Phoenix, as Resolution Two had access to capital and offered the prospect of higher share prices. Sandler was of the view at this point that the company did not have an independent future, and he was trying to find a home for it.[26] Resolution Two also talked to Phoenix's lending banks. The reported offer price would have valued Phoenix at close to 700p a share. Some of the merger discussions were unpleasant as they required Phoenix to trade at well below its embedded value. Cowdery claimed, in a meeting with Bannister at Freshfield's office, that Phoenix's cash flows were misrepresented by hundreds of millions of pounds. It later transpired that this argument was planned in a pre-meeting. Cowdery had reached the conclusion that Phoenix would fail, and that it would be cheaper for him to buy in nine months' time. According to Bannister in 2019, Resolution was cynical in that it undervalued and underestimated Phoenix's ability to rehabilitate itself, instead seeing it as a wounded animal. Cowdery suggests that the attitudes linked to Sun Capital still then appeared too strong in Phoenix. At any rate, these talks finished, negotiations were never reopened with Resolution.

These talks were leaked, in this case by the FSA to the *Daily Telegraph*, in what became a disturbing pattern of failure of process on the part of the FSA. Resolution, which had promised shareholders no more acquisitions, walked away when the news leaked, saying it had found a lot of problems with Phoenix. This forced a public announcement from Phoenix. The Phoenix share price fell significantly over the six months after the failure to merge with Resolution Two.

CVC Capital, a major English Private Equity vehicle (established in 1981) that was willing to be named, also had a look at Phoenix in January 2012. Announced on 16 January, these discussions about a potential takeover ended with another announcement on 10 February. Bannister declared that the proposed terms 'did not reflect our view of the full value of Phoenix and its stable, long-term cash flows.' CVC's terms were totally unrealistic.

In the meantime, Phoenix had a very difficult time, with the summer of 2012 proving particularly hard. As a result of the failure of the above approaches, Phoenix had to fund its own growth, instead of accessing outside capital. In 2011, moreover, a crisis in European public finances linked to serious issues in the Mediterranean states had proved a major issue in market confidence and this issue continued important into 2012. Whereas £810 million of cash had been generated in 2011, £690 were generated in 2012, although operating profit in the first half of 2012 was £207 million

[26] Ex. Inf. Cormack.

compared to £136 million in the first half of 2011. Much more positively, in July 2012, £5 billion of annuity liabilities were sold to Guardian Assurance. This supported the subsequent refinancing and helped take the share price up at a very difficult moment.

Targets

Yet 2013 still proved difficult. There was a positive revenue stream, and some significant financial restructuring. £817 million of cash was generated, against a target of £650-750 million; compared to £690 million and £500-600 million the previous year. The debt was tackled and restructured, in order to improve the finances and to reduce gearing – from 56% to 50%. Capital of £250 million was raised. Attempts, however, that year to grow were problematic. Restructuring had its limits, which created problems as the Regulator required the refinancing of the debt. The attempt that year to sell the asset manager, Ignis, failed. Moreover, the placing on the stock market had to be heavily discounted. In this very challenging situation, there were tensions within the Board and criticism of the management. The Board Strategy meeting that May noted:

> 'The potential to achieve capital growth through acquisition is now a much higher priority for investors. Due to the lack of recent acquisitions, both by Phoenix and across the market more generally, there is scepticism regarding our ability to acquire at a sensible price and generate value…. Investors have indicated low liquidity is preventing investment due to concerns around exit.'

Concerns around leverage were linked to issues of dividend sustainability. There was a related anxiety within the management that the future prospects would become worse after 2015 if these issues were not resolved. The maturing of policies in the life companies would lead to a declining MCEV, and there would be a lesser scope for meaningful management actions. As a result, dividends would be jeopardised – with a decline to £50 million in 2018-20 envisaged, and, therefore, the prospects not only of raising more money from the stock market, but also of sustaining borrowings, being affected.

At that stage, based on 2011 FSA figures, the closed funds, or quasi-closed, market opportunities for Phoenix were estimated at approximately £215 billion of life funds, with Phoenix already accounting for about £49.5 billion of this total. In addition, there were about £53 billion of closed, or quasi-closed, with-profits funds. This excluded Standard Life as it was regarded as highly unlikely to be divested in the near term. The identified additional opportunities for Phoenix were the with-profits funds of Aviva, Scottish Widows, Aegon and Zurich. As a result, in May 2013, the estimated total market opportunity for Phoenix was £197 billion.

With Project Norton, on which Bannister spent a lot of time, there was an attempt to merge with Swiss Re's Admin Re Business Unit, with announcements on 12 July 2013 and 13 November about discussions and then their end respectively.

There was a series of meetings with Phoenix, to describe the bank debt and explain what could be done. Phoenix talked about issuing internal bonds to Swiss Re, and doing a senior bond, but, instead, Swiss Re kept wanting to talk about issuing a subordinated bond, which was seen as unrealistic, unlike a senior bond. Phoenix kept returning to Swiss Re, but it was never really interested in a deal. Price Waterhouse, which was hired to do the transaction. It took the view that Phoenix would never raise a bond: the silos were still in place, the cash flows per life fund could not be explained, management actions could not be explained, Phoenix claimed Ignis was worth several hundred million pounds but was unable to sell it, the company was still hated by the PRA and the banks, and it remained very vulnerable. As a result, Price Waterhouse advised against the deal. In turn, Swiss Re was cautious and sceptical. It thought that there were too many internal loans in Phoenix and were not prepared to pay a premium to take over a public company. The deal would in reality have been a takeover and not a merger. Indeed, Swiss Re appear to have thought that Phoenix would go bankrupt; a poor assessment.

In the event, these talks were leaked and fell apart that November with some acrimony. Swiss Re said that it was not that keen. Swiss Re, instead, acquired Guardian for £1.6 billion in a deal announced in September 2015, and concluded on 6 January 2016. This was a blow, as Phoenix itself had been in discussions for Guardian which had over 900,000 annuity, life insurance and pension policies.

The discussions with other companies involved attempts to find a deal or new structure that would enable Phoenix to avoid a really painful refinancing. Other deals were also considered, but none came to fruition. Instead, it became clear that there was going to be no external arrangement of this type that would pick Phoenix up. Instead, Phoenix had to solve its own problems, and in a different context.

This issue was exacerbated by continuing issues with the Regulator. Aside from concerns about the Pearl Pension Fund, it had questioned payments from the Life companies into the Group, and was determined that no such money was to be used on something it seemed foolish. Indeed, in December 2012, there was a serious tussle to make sure that the Regulator did not halt the payments from the Life companies. There was a more long-lasting concern that the Regulator permit the dividends in the event of solvency going below a certain level. Regulatory disquiet in part reflected a concern about the interests of the policyholders, but there was not the same grasp of remedies. The PRA was unrealistic in wanting the debt re-termed and considerably extended. It was unwilling to budge on this for a long time, instead pressing for Phoenix to get a ten-year debt. In part, this reflected serious naivety on the part of the PRA about shareholder perspectives and related cultural hostility to dividends as in some way a theft of capital. In the end, a third party view, that of Rothschild, convinced the PRA that a ten-year re-terming was not possible. The Pension Regulator also posed a major obstacle.

At this stage, Phoenix's outstanding bank debt had fallen from £2.7 billion in 2009 to £2.3 in 2012, while MCEV in that period had risen from £1.8 billion to £2.1 and holding company cash from £202 million to £1,066 million.

Meanwhile, there were apparently additional opportunities. These included the additional portfolios of legacy products, for example endowments and unit linked bonds, within open life companies that could be divested. It was argued that it might be possible to unlock value from the mutual sector in future, and that some of the remaining large with-profits books, for example the Prudential, might become available. Moreover, further life companies might close to new business.

'Phoenix Renewed,' the core financial re-planning envisaged in July 2011, when share value was close to 500p, and drawn up internally by the Group team, had proposed a three-stage journey: Restore, Reposition and Redefine. The first, designed to focus on restoring the Group's balance sheet and capital effectiveness, had set out ambitious goals by mid-2013. This was intended as a holistic plan to produce regeneration, not just a year-to-year series of short-term objectives. To improve relations with the Regulators, milestones in the plan were to be reported. The financial targets were, indeed, achieved, and notably in terms of accelerated cash-generation. In addition, the Pearl Pension Fund issues was resolved. Instead of a comprehensive debt rescheduling of the Group's bank facilities, there had been a debt re-terming supported by new equity, in a process organised by Osmond. This had permitted an increase in shareholder dividends and a reduction of mandatory debt repayments, which thereby enhanced financial flexibility. At the same time, MCEV uplift was not yet on track and in December 2012 the Freedom Bond issue (see earlier in the chapter) accentuated uncertainty.

With an additional £100 million of support by Sun Capital and TDR, the £250 million equity issue was underwritten in 2013 for £150 million by Och-Ziff Capital Management, an American hedge fund and investment manager which, under a very different team, had been a significant investor in Resolution One. Sun Capital generated the deal (for which it was not paid), as Och-Ziff was a contact. This was part of the process by which, as seen with Liberty, Sun Capital displayed entrepreneurial characteristics and found sources of capital. Och-Ziff was introduced to Phoenix in February 2012, but the deal took nearly a year to arrange. With this deal, Sun Capital put hard cash into its investment in Phoenix, cash which proved a crucial support, a point emphasised by Osmond.

The Group announced the equity issue on 30 January 2013. It was a significant success. The open offer to existing shareholders had been fully underwritten and 43% of shareholders agreed to subscribe for their entitlements under this open offer. In the event, £170 million was raised that way and £80 million by means of Firm Placings with Och-Ziff. In the winter of 2012-13, Och-Ziff temporarily owned 8-9 per cent of the company, but, with no real effort to be more than a 'dormant investor,' it sold down its stake in early 2013.

The provision of equity helped Phoenix to engage in refinancing and restructuring. There was a £450 million debt repayment and the re-terming of the remaining £1.2 billion Impala debt facility to 2017-2019 with an annual mandatory amortisation of £60 million. The total outstanding debt in both silos (Pearl and Impala) fell from £2.4 billion to £1.9. This measure helped stabilise the share price. Equity dividend caps were lifted to £125 million. The final release of the dividend blocks enabled the payment of a higher dividend for 2012, which greatly pleased shareholders. Each step was important. The banks had delivered an extended maturity in return for a substantial prepayment.

Och-Ziff was paid a lot for its underwriting, indeed 'an unconscionable amount of money' according to Isabel Hudson. This was galling, and contributed to concerns, as well as angering the Regulator. Nevertheless, Och-Ziff was being rewarded for putting in a critical amount of money, and this proved a way to address key issues, notably the Pearl Pension Fund with which a new agreement had been agreed in November 2012 that delivered greater certainty. A highly necessary breathing space had been gained. Debt maturities could be extended and dividends increased. As part of the reorganisation, the Board also set in place the strategy to dispose of Ignis. As the banks had finally recognised that no-one was going to bail them out, and that they were participants in the solution, there was a more positive attitude, with the exception of the still-intransigent Regulator. The normalised relationship with the bank group greatly took the pressure off the re-terming.

Whereas the 2011 Core Plan had envisaged £2.67 billion MCEV by 2016, the revised assumptions in 2013 were of £2.01 billion. At that point, indeed, the ability to execute an acquisition at a sensible price was unproven under the current management. At the same time, meetings with key investors had indicated an acceptance of an equity raise to fund such acquisitions.

The plan was then to move from the 'Restore' to the 'Reposition' stage, one that had to be accompanied by measures to address the relatively low value of the shares, which, on average, were trading at 65% of MCEV. This value consistently underperformed the shares of peer companies. Re-rating was understood to depend on an ability to demonstrate the sustainability of dividends post-2016, as well as the presence of a market belief in Phoenix's acquisition strategy. There were understandable goals, but also significant challenges. The 'Reposition' stage assumed that Phoenix would become the industry lead-consolidator, while Ignis would grow third-party business.

The last, 'Redefine,' stage aimed to resolve many of the inherent 'end of life' challenges with existing with-profits life funds, and to leave Phoenix with a range of simple, 'capital light,' products. In doing so, key benefits for both policyholders and shareholders were envisioned. The former were to benefit from the simplification of with-profits policies, from lower costs, and from increased flexibility; although closed-book providers do not have new contracts to which funds can be moved as legacy pension contracts are older contracts which lack the flexibility and options offered by the reforms introduced in April 2015. So also with death benefits. Under the plan, shareholders were to benefit from accelerated capital release and from providing Phoenix with a unique proposition that placed it in a better position to be the acquirer of choice.

At the same time, while boldly looking ahead, the Group had to address more immediate problems. These included not only those outlined earlier, but also the driving down of costs. The total Group costs fell by £76 million between 2011 and 2012, from £508 million to £432 million; but a continued trajectory was assumed, indeed promised.

To that end a new business operating model was considered. Termed the Streamlined Functional Model (SFM; for universities are not the sole source of the unfortunate plethora of acronyms), this model assumed more of a focus on the old Britannic site at Wythall and, in turn, with a smaller London presence. The latter was still to be capable of supporting mergers and acquisitions and strategic transactions, but the move was intended to lead to an annual reduction in costs of £8 million. If, however, no deals were forthcoming by the spring of 2015, then a 'Run-off Model' (ROM), capable of an annual reduction of costs of £16 million, was to be considered. This model would end the London presence and centre the company in Wythall, removing any deal/transaction capability which was a key London function. Those employed in Peterborough had earlier been moved to Wythall. Consolidation was also a goal and method within Phoenix, both the Group and the life companies.

Selling Ignis

2013 did not readily fulfil these hopes, and indeed there were serious problems, as another aspect of the very up-and-down history of Phoenix in these years. The cost review was completed successfully, but the planned sale of Ignis, the Group's investment management arm, to Standard Life Investments for £390 million was aborted in June 2013. The negotiations, however, continued and, with the intention of the sale announced on 26 March 2014, it was completed at that price on 1 July 2014.

The Ignis announcement was overshadowed by a *Daily Telegraph* interview with the FCA which implied that the Regulator was conducting an industry-wide legacy review in order to control management charges of policies in closed funds, which would hit the profitability of those policies. The market was spooked, and the share price briefly fell 25 per cent that day, and ended the day 10 per cent down. More seriously, the episode suppressed investor interest for the second quarter of 2014. The sale of Ignis, nevertheless, was used to reduce the debt by £250 million. Both the sale and the reduction were required to raise money for acquisition delivery and improved practice, and, thereby, to enhance value on sale and/or merger. The sale of Ignis enabling the sorting out the balance sheet and going to the markets.

The sale of Ignis, for which Sun Capital had long pressed, for example in the 2010 Board discussion on strategy, continues to attract controversy. The end of in-house asset management with

Ignis released capital, but also required courage as it represented the loss of a capability, of a strand in Phoenix, of an element that offered appeal in mergers, and of an important source of income. Separately, Ignis could probably have been sold for more, had a process of competitive bidding been encouraged. However, such a process would have breached confidentiality, led to serious disruption as staff left, notably at the senior level, involved significant additional delay, and complicated issues. These results would have greatly compromised value.

Some of the controversy is of the rather stale 'he would say that wouldn't he' type, reflecting positions taken at the time and reiterated since. Chris Samuels was clearly unpopular with some of his colleagues, indeed most of the Board whom he lectured on the need for higher salaries in his area.

Board minutes capture these issues as for 28 March 2011:

> 'Bannister commented that it was intended to improve alignment between remuneration and achievement. He added that the remuneration plan for Ignis senior executives had been built around a potential sale of the business and was no longer appropriate.'

In turn, Samuels felt, and continues to feel, both that the sale of Ignis was not sensible and, separately, but as a linked critique, that the price was too low. While noting the view that is held that Ignis would always have been sold, some argue that there was a strategic choice over Phoenix's focus that was taken in deciding on this sale, and that the outcome was not inevitable. Separately, others have questioned the wisdom of the sale. An in-house fund management provided fees and control, and permitted the transfer of profit from one asset to another, although that management and process could lead to an argument about fees.

It is interesting to note a tendency to decry Osmond's approach to Cowdery as overly personal, and, at the same time, not to observe the same view about Samuels. As so often, it is wise to move beyond personalities. There were sensible reasons to sell Ignis, and these were not restricted to the pressing need to raise money in order to reduce capital requirements and, therefore, borrowing and, thus, facilitate restructuring. Indeed, from that perspective, Ignis was the major asset that could be sold once Liberty was in, and the real question was when.

There was also the question of the very viability of Ignis as an expensive and not particularly well-performing part of Phoenix. It is less easy to earn money through fund management than might be thought. The attempt to make Ignis a major profit centre had not worked. Each of those aspects attracted attention. So also did the question of whether investment management was better handled in-house or out of house. As reported to the Board on 21 August 2013, the PRA had 'expressed concern that arrangements between the Life Companies and Ignis are too informal and that the Life Companies appear to place too much reliance on Ignis for risk assessment.' Governance issues also meant that in-house fund management was more problematic than in the past. Aviva still has its in-house arm, although it has been less successful than it hoped in generating business other than from

Group companies. At any rate, by 2013, Phoenix did not want to run an asset management company despite the money it produced each year. Ignis was never going to fit into the 'family' for cultural reasons related to compensation and because of a self-confident sense of entitlement. Bannister very much took these views.

The trajectory of Phoenix, including its relationship from 2018 with Standard Life, suggests a lasting commitment to out-of-house fund management as much as any key element relating specifically to Ignis. Yet, as with the use of Och-Ziff in 2013, a crucial breathing space was obtained through the sale of Ignis by the raising of capital through the unlocking of assets. The sale enabled Phoenix, taking advantage of a strong market at the time, to reduce its gearing to 39%, and thus to achieve its 40% target two years earlier than the timescale the Group had set itself. This pleased the Regulator, and ensured that acquisitions would not push up debts so much.

The delayed sale of Ignis hit staff morale there, affected the plan to achieve an investment grade rating for Phoenix by the third quarter of 2014, and became an aspect of the question of how long the process of stabilisation would last. Instead, this plan had to be put back until the first quarter of 2015. Moreover, in the fourth quarter of 2013, the bold 'Vision' project to redefine the industry was curtailed. Alongside the positives of fund mergers and improving relationships with the Regulators, there was also, less positively, a continuing significant increase on the discount of the share price as a percentage of MCEV.

Shareholding and Debt

TDR began to sell down its shareholding in 2013; although Osmond and the other partners in Sun Capital retained an important holding. At the beginning of 2014, the old holders were still significant, but, in July 2014, TDR sold its remaining stake, about 15 per cent, onto the market on the day of the bank refinancing. The share price was able to cope. Sun Capital, which had held 11.5 per cent of the shares on 30 September 2013, held 6.9 per cent a year later; with Berggruen Holdings cutting its holding from 4 per cent to 3.4 over the same period. Sun Capital's percentage declined to 5.7 by 31 March 2015.

As a result of the change in the shareholder profile, Phoenix moved to be a completely public company, with institutional investors, and all the non-executive directors fully-independent. It was necessary to find such investors in sufficient number to respond to the sale of holdings. Reflecting market confidence, this was achieved, and, although there were activist shareholders, no-one tried to build a takeover stake.

There was also a change in bondholder profile as a result of the replacement of the Tier One bond holders by the new Blackbird bond, which produced £300 million. Some potential purchasers brought up the old problem with Tier One bonds, receiving the response that Phoenix had new management and that that was all past history. In the event, the market was so strong during Blackbird that people put reservations behind them and bought the bond. It was a short window in a very strong market. A lot of hedge funds wanted to purchase the new bonds. The debt situation was addressed by Phoenix building up its net worth, and a policy of raising equity, asset sales, deleveraging, and getting into traded debt. The business needed to be financed by bonds, and the best way to issue a ten year bond was to have a sensible acquisition in prospect. Whereas by 2019 Phoenix had the 'firepower to go and do deals tomorrow morning out of our back pocket,'[27] that was very much not the situation in 2014.

Total shareholder debt fell from £3.5 billion in FY 2009 to £2.0 billion in FY 2013 (allowing for the Ignis proceeds of £390 million and the subsequent £250 million debt repayment), while MCEV accordingly rose from £1.8 to £2.6 billion (the highest ever), and the gearing fell from 63% to 39%. Strong cash delivery was a key point, rising from £716 million in FY 2009 to £817 in FY 2013 (against a target of £650-750 million). As a consequence, capital ratios were no longer an issue. Moreover, policyholder project costs continued their significant fall, as did other costs. Thanks to the bond and other measures, the Group's maturing debt profile was extended to 2021. As a consequence, the projected cost of funds fell. The refinancing permitted by cash infusions encouraged shareholders, and the shares rose considerably in the last quarter of 2014, although admittedly from a low base.

Alongside debt reduction, dismantling the silos was necessary in order to gain credibility. This dismantling was a goal prior to acquisitions because Phoenix did not look normal to the outside world. Indeed, it was not normal. Previous silos in holdings and investment in the Pearl structure, essentially between the former Resolution business and the former Pearl one, each separated by different financing, could now be broken down. The Blackbird bond combined with the sale of Ignis (its monetarisation in the jargon), gave Phoenix enough cash to pay down the senior debt to the point that one silo could be completely eliminated. As a result, there was now a single silo transaction, with some of the banks that were in the Pearl silo being brought across. The refinancing of the debt into a single silo £900 million facility in the autumn of 2014 was followed by a significant rise in the share price over the following year. This refinancing led to multiple economies in policy management and in administrative structure, a process more generally seen with the consolidation of policies through Part Seven schemes (schemes which allow life insurance funds to be merged) as the number of different operating companies was cut. After the takeover of Resolution in 2008, there were ten life companies in the Group. By 2016, there were eight. In the end, Phoenix could probably have generated enough cash organically to tackle the debt and restructure the silos. The PRA needed assurance that Phoenix could do both.

[27] Bannister, 11 June 2019, Steering Group.

Looking back at this point, matters only began to start normalising from 2010 onwards once the Liberty transaction had been implemented, thus allowing the share base to revert to a more traditional FTSE 250 basis. This change made the Group appear more normal to investors and Regulators alike, and helped allow the new management team to implement its de-gearing and simplification strategy. This strategy ultimately led to the investment grade rating in 2014 which was really a precursor to Phoenix then being able to make acquisitions again as its financial flexibility improved.

The Guardian, Och Ziff and Ignis deals were important iterative catalysts as Phoenix returned to the land of the living. The various refinancings also allowed unwilling lenders, of which there were several, thus destabilising the situation, to exit. The refinancing allowed willing lenders to continue/increase their exposure. They also permitted new lenders to join. However, this refinancing transition had to be achieved over three deals, rather than one, due to the change in various banks' risk appetite, representation, and the degree to which their losses coloured future business aspirations. Furthermore, it also took a lot of time to improve Phoenix's reputation in the market, and that long continued an issue.

A number of challenges were identified for the Board Strategy meeting on 4 July 2014. First, in terms of cash-flow, could Phoenix continue to generate sufficient cash-flow and management actions to support Solvency Two, and, linked to this, but also separate, to offset increasingly sceptical investors? Secondly, with reference to share price, was it possible to close the discount to MCEV at which shares traded organically? This discount affected the value of the shares in any merger or acquisition. Thirdly, as far as Regulatory relationships were concerned, could Phoenix be made lower-risk in the eyes of the PRA (part of the former FSA) and, accordingly, successfully navigate Solvency Two? This was also crucial to market value and acquisition potential.

Bannister's report of 27 November 2014 for the Board noted a third-quarter negative RAG/Solvency Two letter from the PRA: 'the Group remains Red. The PRA's view is that the programme has slipped further against expectations required to need Internal Model approval.' Indeed, in the spring of 2015, Bannister was told by Andrew Bulley, the Regulator, that Phoenix was well behind the pack, and that it was unlikely to achieve Solvency Two by the end of the year. Bulley's 2019 remarks about his longterm confidence in the viability of Phoenix did not match his stance at the time.

Next, questions arose over future closed life consolidations. There were issues both over whether real deals existed, in the sense that there were willing sellers, and also questions as to whether Phoenix was capable, financially and managerially, of closing a sale. This cut to the quick in terms of the viability of the Group. If there were no deals, there would be a shrinking asset base, which would hit investment prospects and dividends. Cost management also remained an issue, in particular whether it was possible to improve operating efficiency and reduce costs in a meaningful way, without damaging Phoenix's capacity to deliver.

Lastly, there was the question of timetable, of how long there was to strengthen Phoenix and do a deal before investor sentiment turned, and Phoenix, indeed, could no longer be described as a consolidator or an expanding consolidator. In February 2010, when announcing the renaming, the Group had said it would be ready for deals in 2011 and, indeed, immediately after the London listing. Neither timetable had been met. There was confidence that many more British funds would close to new business, pushed by increasing Regulatory pressures on mutual life companies, continued declines in new business sales, and the impact of the Solvency Two directive, which would force life assurers to hold more capital. Deals, however, had certainly not happened for Phoenix.

In contrast, there were other companies that were buying assets sold by insurers, including Cowdery's Resolution Two, Swiss Re, and others. On 6 January 2010, the *Times*, when considering the challenges facing David Nish, the new CEO of Standard Life, noted first 'how to respond to moves by Clive Cowdery to consolidate the industry.' Indeed, Resolution, having bought Friends Provident in November 2009 for £1.86 billion, was seen as having Legal and General, or Aviva, or the insurance assets of Lloyds, such as Clerical Medical, in its sights. In the autumn of 2010, Resolution purchased both AXA Sun Life Holdings and BUPA Health Assurance. In 2011, Resolution merged the UK life assurance operations of its acquisitions under the name Friends Life. Resolution changed its name to Friends Life Group in May 2014. That December, Aviva beat Phoenix to Friends Life after Howard Davies thought that an acceptable merger had been negotiated. In a takeover completed on 13 April 2015, Aviva paid £5.6 billion for Friends Life. Separately, Chesnara, another consolidator, had a dividend yield of 8.7 per cent and was able to buy a 'living' Swedish life assurer at the start of 2010. Meanwhile, having raised £417.7 million in an IPO in 2010, Osmond had focused on Horizon as an acquisition vehicle to purchase a 'consumer-facing firm,' rather than a financial one: APR Energy was bought in 2011. These developments made Phoenix appear somehow redundant, and certainly not a good prospect for investors.

At the same time, alongside future prospects for Phoenix, notably those focused by the removal of the dividend payment restrictions in 2013, there were pressing short-term issues, namely low interest rates cutting the prices insurers might attract for their assets, such that signs that interest rates might rise helped encourage pressure to act. The situation remained both challenging and volatile, troubling and exciting. The Board was comfortable that the logic for Phoenix remained good, but Board members could not see the end of its current problems.

There had been a challenge in keeping the faith as, at any point in time, it could have all collapsed as there were enough critics, vulnerability, uncertainties, challenges, and vying stakeholders, notably two different bank syndicates and bond holders. Events had led to new issues and priorities, so that what was thought to be a good plan would suddenly be blown off track. Although every company had uncertainty, the Regulator was a challenge as the Group could not do anything without Regulatory approval. It was unclear how the Regulator would respond, and all decisions were questioned. There was no freedom of action, and this a proved challenging context for Phoenix, and notably so in comparison with its competitors.

7. The Mid-2010s

If the mid-2010s saw a turn-round, that was not readily apparent at the outset. As far as cashflow was concerned, indeed, there was the need for continued management actions. These had accounted for a third of all cash generated in 2010-13: £242 million out of £734 million in FY2010, 359 out of 810 in FY2011, 209 out of 690 in FY2012, and £332 out of 817 in FY2013. The remainder of the cash generated came from organic cashflows. There were four sources of such actions: risk management; restructuring; outsourcing; and operating costs.

However, there were fewer big opportunities remaining, so that, for 2014-19, the forecasts of cashflow estimated that only about 15% of all cash was to be attributed to such actions. The sense, an understandable one, that the ‘low hanging fruit’ had already been picked worried investors. Throughout, this factor led to pressure for improved performance, and affected share valuations, putting additional pressure on dividend outcomes. For Phoenix, as for other companies, the drive in recent years for lower charges and more disclosure led to more rationalisation as size became more essential in the market.

In this context, pressure on legacy products was particularly serious and encouraged a focus of lowering costs or parting with closed books. This pressure was increased because pensions freedom was announced in March 2014 and implemented in April 2015. Pensioners could take their money as cash, instead of having to buy an annuity, and, as a result, the life companies lost a lot of annuity business. The news of pensions freedom came from a pre-briefing by the FCA to City journalists that led to an article in the *Daily Telegraph*. There had been no prior consultation with the insurance companies. Their share prices fell heavily that day because so much of their income stream and, therefore, value was focused on annuities. There was no clarification till that evening, and a subsequent Clifford Chance report threw light on what had been a cackhanded process in which the FCA displayed poor management, ethos, practices and responses.

This change encouraged a departure from the life industry, to become general insurers, or exit the market and become asset managers. Doing so provided opportunities for Phoenix, but it was hit because annuities provided an annual income stream of £4.5-£5 million. As a result, Phoenix’s share price fell 28 per cent in one day. Pensions freedom was an instance of the exogenous factors with which Phoenix had to deal. The Regulatory shock of industry reviews was another example.

There was also concern that the provisions of Solvency Two would constrain the liquidity of life companies. This concern also encouraged departures from the life industry, creating opportunities for Phoenix while imposing a new problem for its cash flow. This situation was seen as likely to hit future dividends. Indeed, Solvency Two was a very demanding challenge for Phoenix, and one that took longer to obtain than had been anticipated. In response, a need to leverage the asset side of the balance sheet, as much as Phoenix had historically managed its liabilities, was identified. The solvency model was agreed on 1 January 2016, and this agreement was known of by the third quarter in 2015.

Cash generation projections appeared bleak. In addition, the share price issue was particularly serious as Phoenix's market cap provided the primary means to fund a transaction and was not regarded as competitive. Legal and General, Aviva, Standard Life, Chesnara, and Friends Life, were all in a significantly better position than Phoenix. The Phoenix cap, as a percentage of MCEV, had risen from 42 in December 2011 to 74 in July 2013, before falling to 55 on 1 July 2014. The announcement in March 2014 of a Regulatory review of annuities had greatly hit the share price and had not been fully reversed, which was yet another reminder of the potential difficulties posed by the Regulators. As a result of the share price, completing a cash transaction, an acquisition at a premium to the traded share price, and achieving MCEV neutrality, appeared almost impossible. Indeed, in July 2014, Phoenix's share price needed to rise by over a quarter in order to be able to pay cash in a transaction. That would have been to be in line with Friends' Life figures.

The Regulatory relationship at this point was not bad, and, indeed, on certain criteria, improving; but it remained high risk. At the same time, Phoenix was not alone in this situation, such that paranoia on its part, or about it, were not justified. Meanwhile, the Regulatory environment had changed with institutional reorganisation. Under the 2012 Financial Services Act, the FSA had been abolished on 1 April 2013, with the Prudential Regulation Authority (PRA) and Financial Conduct Authority (FCA) now responsible for insurance companies. The PRA's assessment against the Watch List required the supervision team for Phoenix to report monthly to senior management on the progress of the Group against key risks and issues. A leading one was the navigation of Solvency Two.

This process was seen by Phoenix (like other similar companies) as critical, not least as it would have unknown capital impacts of plus or minus £500 million. In his CEO report of 29 January 2016, Bannister complained: 'during 2015 there were 2,500 material pieces of correspondence with the PRA, 150 meetings and 800 action points – a significant increase on our activity in 2014. The burden of capital regulation hit a high in 2015.'

At the same time, there were major positives. The sale of Ignis for £390 million, and the skilful deployment of the proceeds of that sale, unlocked the refinancing of the bank debt into a single unsecured £900 million facility, removing the bank silos and streamlining the banking syndicate. Each of these interacting changes was a major improvement. The sale brought benefits, notably in terms of the reduction of the gearing and the restructuring of the bank debts, as well as leading to a fall in management costs. In June 2014, in a return to the debt markets, the Group issued £300 million of senior unsecured bonds that were due in 2021. The following month, the Group entered into a £650 million Revolving Credit Agreement, removing the 'siloed' facility agreements that were a legacy of the Liberty transaction. As a result of this refinancing of the bank facilities, 2014 was an important year in Phoenix's normalisation.

The end of the asset management link was re-affirmed with the Standard Life takeover in 2018, as asset management was not brought into Phoenix which, as a result of the takeover, became in effect a new company. As such, there was a reflection, both with the sale of Ignis and with the 2018 takeover, of the longstanding tension over the relationship between asset management and life assurance companies. In-house, they could be seen as restricting investment options, and as posing serious managerial issues, because of the market expectation that staff should be paid more, often much more. Out-of-house, however, there were higher costs in running investment and a loss of profit capability. This remains an unresolved issue, but one where companies make contrasting choices.

The question of whether future closed life consolidations were possible for Phoenix led to an identification of only five priority deals: with Aegon, Sun Life UK, Clerical Medical, Admin Re, and Friends Life. However, the motivation of any sale to Phoenix was questionable. In part, this was a matter of the uncertainties of the FCA review and of the Solvency Two process, the second of which involved agreement at EU level. Moreover, none of the priority deals were straightforward. In the event, Aegon was to sell its £9 billion British annuity book in 2016; but not to Phoenix.

In light of Phoenix's situation, it was believed that a 100% MCEV cash bid was probably the sole means to guarantee a successful acquisition. This was an exaggeration, but one that was designed to highlight the challenge faced by the Group. At that point, Phoenix was not financially credible as a takeover partner. It was trading at 55 per cent of MCEV, and few vendors wanted to take the equity. Thus, share issuance would have been highly diluting for the MCEV at the current share price. In these circumstances, there was a challenge to ensure individual investments, let alone, as necessary, to coordinate and manage multiple opportunities.

At the same time, the quality of what Phoenix could offer, both to shareholders as an income stock and to policyholders, was improving, indeed significantly so, and as the consequence of deliberate action. A number of factors played a role, notably growing institutional sophistication. The strength, depth and experience of the internal team was improving. There was also an attempt to enhance the range of external advisers. More generally, in response to the need to possess and demonstrate an ability to unlock situations, there was an engagement with an increased preparedness. In pursuit of the need to handle concurrent and multiple approaches, the 'Phoenix Bible,' emphasising Phoenix's business simplification, was regarded as important.

There was also to be a greater flexibility in funding Phoenix and its hoped-for expansion. Rather than being able to offer shares, there was a drive to be able to offer both cash and shares, and with Standard Life as a co-bidder and/or financier. There was also to be a equity placing. These were clear goals for 2015. Once Standard Life had merged with Aberdeen Asset Management in 2017, producing Standard Life Aberdeen, which managed about £630 billion, then the possibility of Phoenix acquiring the Standard Life life business was voiced in public, as by 'Tempus' in the *Times* on 25 July 2017.

Meanwhile, a search for improved cost management was a continuing part of Phoenix's strategy. Although the number of employees had reduced significantly with the sale of Ignis, a Streamlined Operating Model was required. In 2011, the Life companies had had 610 employees, the Group 201, and Ignis 544, to make a total of 1355. By May 2014, the numbers were 538, 202, 392, and 1132. Post-Ignis, it would therefore be 740, a major fall in salaries, social welfare costs, and management requirements, and a reduction in contention over salaries.

The Streamlined Operating Model assumed a split between London and Wythall; a split to be determined by business considerations and by Phoenix's needs and criteria. The first focused on process efficiency, timing, headcount, functionality and governance. The second related to the maintenance of cash-flow via management actions, the protection of a capability to do deals, and the delivery of Solvency Two which was important to any future acquisitions. The Head Office and Group function reflected the focus on complex restructuring and the growth in risk awareness and monitoring. Management was clearly crucial. Managing the Group's interest costs and principal repayments, which amounted to 73% of total cash use, was the most material way of protecting the dividend, and therefore the capability for expansion.

Phoenix was trying to reduce its debt costs and to extend its annual amortisation. The reduction was to have two main components. The first involved the reduction of the cost of debt into two main components: interest rate step-downs with continued deleverage; and investment grade step-down. There was to be the replacement of remaining senior bank debt and Tier One/Tier Two debt by investment grade bonds at about 3.5-4%. Bonds were to extend maturities, and thereby reduce annual amortisations. Phoenix was far from alone in this trajectory.

The timetable for delivery was also at issue. By June 2016, eight years would have passed without Phoenix having carried out an acquisition. Moreover, MCEV and cash-flow would be waning. In contrast, most big organic events would have been delivered, in the shape of debt restructuring, Solvency Two, the final merged life companies, and the Streamlined Operating Model. Therefore, the excuses had there been no acquisition would have been less obvious and shareholders less happy. In the circumstances, a Run-off operating model, in which there were no acquisitions, appeared necessary alongside the desired standalone operating model.

Deals were essentially necessary to avoid the former, and in particular the dilemma of 'jaws closing' with falling revenues and rising costs, the hazard of run-off. Staunton and Bannister were very opposed to a run-off model and, with the support of the Board, in favour of deals. In the event, the first transaction for eight years was achieved in 2016, in part as a result of the sustaining of the developments outlined above. Indeed, these developments ensured that two acquisitions could be carried out: both AXA Wealth and Abbey Life.

In the meanwhile, 2015 had witnessed continued turbulence, with the Regulator, the PRA, providing a harsh feedback in Q1, and with Phoenix still on the Watch List. Moreover, although Phoenix bid for Guardian Financial Services in 2016, it was beaten to it by a £1.6 billion offer from Swiss Re. This was a significant blow due to the need for acquisitions, and one that was seen by the markets as a defeat. At the same time, the Phoenix Board had had concerns about overpaying for Guardian.

The first half of 2015 produced disappointing figures, in part due to lower investment returns. The Group generated £110 million of cash, compared to £332 million in the same period in 2014, and there was a fall in operating profit in the first half from £266 million to £135 million. The half-year dividend was 26.7p a share, and shares rose on the results to 890p. However, the potential appeared uncertain. Bannister's report to the Board of 17 March 2015 noted that 'cash is the biting constraint throughout 2015' and referred to 'the retention of capital at the Life company level, resulting in a reduced 2015 cash generation.'

Nevertheless, in the event, 2015 witnessed a major change. In the period 2011-15, the management team had restructured the Group debts so as to bring them down to a manageable level. As a result, Phoenix received a credit rating in August 2015: an A- investment grade rating from Fitch at the Group level. Phoenix chose Fitch, rather than the other ratings agencies, because it was prepared to look at the particular circumstances of closed book policies and the relevant debt. It had been necessary to explain to Fitch the specific nature of closed-book insurance as an investment.

The FCA was pleased with the Fitch rating and this increased its acceptance of Phoenix's policies. With the investment grade rating complete, Phoenix was to be able to announce its first acquisition since 2008. Moreover, in 2015, £225 million of cash was generated, compared to a target of £200-250 million. In addition, after long delay, the Solvency Two internal model was approved, showing a surplus of £1.3 billion. This was far better than had been earlier feared. For example, the Phoenix Progress Report of January 2010, drawn up by Mike Merrick on 28 January, had noted:

> '2010 is a key year in the development of the Solvency II framework with significant changes expected to the current proposals as the detail moves from an advisory phase to a political trading environment. The ABI have highlighted the potential impact of the latest proposals being a £70 billion capital requirement across the UK industry. The implications for Pearl is that if implemented as currently formulated we estimate a shortfall of £1.2 billion at a Group level with most life companies unable to meet the regulatory requirements as well. This is understood to be not uncommon across the industry and therefore material changes are expected as the development of Solvency II moves from the theoretical to the practical.'

The PRA had invited companies to apply to present an internal financial model, and it was a badge of honour that Phoenix obtained in 2015. For a long time, Pearl/Phoenix had been a ‘bad boy’ in the eyes of the Regulators.[28] It had clawed its way back into good regard, ending up with very good relations with the Regulators. The approval, in the end relatively easily, by the PRA for the Phoenix internal model for Solvency Two was a major triumph and paved the way for subsequent successful acquisitions. Phoenix knew this in December 2015, and the process began on 1 January 2016.

Solvency Two made it easier to understand the efficiencies that could be obtained, and the capital that could be returned. There was no comparable model in the early 2000s. The internal model made it simpler to appreciate the issues posed by repaying the debt taken on in order to buy a company. PRA approval meant that Phoenix could issue longterm debt. Phoenix’s freedom to pursue a consolidation strategy in effect stemmed from the investment grade rating and from obtaining approval for the internal model. Each represented rehabilitation. Board members were happy with developments, as were the Regulators. Regulatory consent for fresh acquisitions was achievable following the internal model approval provided the investment rating was not threatened.

In a raft of key restructuring events in 2015, each of which displayed a gaining of the initiative, Phoenix had paid down and renegotiated its bank facility to a £650 million Revolving Credit Facility with maturity in 2020 and no mandatory amortisation. Tier One bonds were exchanged. Phoenix also closed Opal Re [for Reinsurance], its internal Bermuda-based annuity reinsurer, which was an ambiguous legacy of past issues and policies. The capital requirements for reinsurance in Bermuda were lower than in Britain. Instead, Phoenix reinsured the £1.4 billion of liabilities, improving its capital efficiency. The relevant agreement, reached on 9 November 2015 with RGA International, involved a reinsurance premium of £1.35 billion to RGA International. This action reduced exposure to longevity risk and thereby greatly aided Solvency Two capital efficiency.

Phoenix, moreover, sold Scottish Mutual International, the Groups Irish subsidiary, to the Life Company Consolidation Group. It was small-scale – there were only 3,000 remaining policyholders - had become inefficient. At the end of 2015, the Group’s closed life funds consisted of around 4.5 million policyholders, and total life company assets of approximately £47 billion. The merger of companies within the Group continued, establishing fresh synergies and releasing funds. In early 2015, the National Provident Life and Phoenix Life Assurance funds merged, which cut the number of UK life insurance companies in the Group to two.

In another direction, Phoenix was gaining the initiative by sponsoring a media report, the *Meaning of Life*. This was the first time that Phoenix had gone out as a media leader. Used in investment material and results, the independent report predicted the expansion of the consolidation

[28] [Quoting Dumbreek.]

industry and, to a degree, was a response to the legacy review announced by the Regulator the previous year.

Solvency Two rules, meanwhile, also put pressure on other life insurance companies. The increased regulatory burden meant that other companies would find it less attractive to maintain closed funds. This was accentuated by the fiscal developments. Low interest rates continued to make it expensive to handle liabilities, but, more significant, were political attacks on lifetime and annual retirement savings allowances which culminated in 2015 by ending the effective obligation to purchase an annuity at retirement, a product in part of the very low annuity incomes arising from low rates. Thus, 'quantitative easing,' the policy and attitude adopted in order to deal with the recession of 2008, and one maintained thereafter, had helped to end the logic of much of the industry.

However, on 11 April 2016, J.P. Morgan Cazenove downgraded its recommendation on Phoenix from overweight to neutral, stating that, while structurally attractive, the stock's current valuation looked full: 'In our view, further upside is mainly dependent on any potential M and A on which we remain optimistic about Phoenix's positioning and discipline concerning participation in UK life insurance consolidation, but timing remains uncertain.' The problems for other companies did not guarantee success for Phoenix. Nevertheless, these problems encouraged a volatility from which Phoenix could hope to benefit. So also did the squeezing of charges which affected older heritage types of business while ensuring that new business was written on tiny margins. As a result, it was necessary to be very large, and middle-sized companies left the industry.

Instead of ending, 'quantitative easing' had continued, indeed being accentuated in 2016 when stock markets were hit badly in a Chinese sell-off. To cope, long-term interest rates in Britain were cut, and the spread Phoenix earned on Treasuries therefore fell. Indeed, on 26 August, it proved necessary to take emergency management actions in order to offset the fall in interest rates. At the same time, Phoenix was trying to raise equity for its AXA and Abbey acquisitions. The life companies rose to the challenge posed by the macro events, notably the decline in interest rates.

In his CEO Report to the Board on 24 August 2016, Bannister noted the failure of life insurance companies to acknowledge the negative earning and dividend consequences of very long-term low interest rates. He added:

> 'Phoenix is not immune to "denial." The offsite highlighted how to run Phoenix in a low interest rate environment but in the Q4 AOP 2017 planning session this will have to become a reality. There have been too many "Pollyannas" – especially in the Life. So Jim and I intend in the third quarter to start "Planning for Zero," anticipating how Phoenix can survive and prosper in a world where interest rates are zero.
>
> As we said at the strategy offsite, Phoenix will have to:
>
> 1. Lower operating/unit costs (eg leverage benefits of scale).

2. Reduce the cost of Phoenix's equity and debt capital.
3. Seek out higher yielding assets.
4. Secure profitable growth via closed life acquisitions and/or new open business.
5. Put in place further hedges to protect the Group's solvency and cashflow.

Failure to do the above – with rigour – will expose the Group to further negative economic shocks *and* the accusation of "sleepwalking to disaster."'

Acquisition strategy was a matter of drive, opportunities, and the understanding and implementation of key metrics. On 1 November 2016, AXA Wealth's UK business, including Sun Life, its direct protection business specialising in the over-50s, and Embassy, its off-platform investment and pension division, was acquired, from the French AXA Group for 84% of embedded value. The AXA life business was subscale. Announced that May, this purchase by Phoenix was for £373 million (£2 million under the sum quoted at the outset) which represented 74% of the MCEV, a reasonable sum that also reflected the need for a deal. Financing was achieved by a 10% equity placing by Phoenix of 22.54 million shares at 860 pence each, which brought in £190 million, a modest equity raise, and by issuing £185 million of short-term debt at Libor+0.85 per cent. Thus, both shareholders and the stock market supported the move. Indeed, shareholder support was outstanding.

The acquisition was expected to offer £0.3 billion of additional cash flow in 2016-2020 and £0.2 beyond, with £0.1 billion obtained above the purchase price. This acquisition took the Group's policyholders up 910,000 to 5.4 million and the total life company assets up £12.3 billion to £59 billion. AXA's platform business, Elevate, went to Standard Life in April 2016, while AXA kept hold of its investment arm, Architas.

The acquisition demonstrated that Phoenix was again a credible as well as willing consolidator, and with good access to the debt and equity finance required to make such moves. The AXA Wealth balance sheet offered the possibility of accessing significant tax losses, as well as the more commonplace capital synergies. The Phoenix Board was happy that the AXA acquisition involved buying some open business. Mortality risk was seen as a perfect diversifier to Phoenix's existing longevity risk, and one that offered a different rate of cash release.

The interim Phoenix results issued on 25 August 2016 indicated that cash generation was above the 2015 figures. The management reiterated its confidence that there would be more consolidation of closed life books, driven by a combination of ongoing regulatory change, cost efficiency, lower interest rates, post-Brexit sterling depreciation, the move to 'capital lite' products, and the pressure on owners of closed life books to access trapped capital. Bannister declared in a call with analysts when the 2016 results were released: 'I continue to believe that the impact of regulatory changes will provide Phoenix with further opportunities, as open life companies reappraise their business models and strategies for their legacy policies.'

Meanwhile, Phoenix's figures were improving, and conspicuously so. The debt outstanding at this point, £1.6 billion, was both very manageable and considerably lower than the figures up to 2013. The share value, over 800 for most of the period from Q1 2015, compared to around 500 (but with a drop to 400) for much of 2012. On 12 September 2016, when the share price was 826p, and the market capitalisation £2 billion, Numis valued the shares at 938p, a major contrast.

The acquisition of AXA was followed by a more active acquisition policy, with Abbey Life following at the end of 2016. In a project codenamed Norton, it was purchased for £933 million from Deutsche Bank. This was supported by the markets, being financed by a £735 million equity issue, a significant issue. The deal was fully underwritten by HSBC, Morgan Stanley, Commerzbank and Natixis. The rights issue involved a discount of 29.11% compared to the Theoretical Ex Rights Price (as opposed to the average of 35% for related rights issues), and the share price rose when the deal was announced because it was seen as a good acquisition, and such acquisitions had been anticipated. The shareholder response was also good. In addition, £350 million of planned bank facilities were used to pay for the all-cash takeover. Phoenix's shareholders subscribed for 141.3 million shares, 97.65% of the offering. The rest were placed with institutional investors in a rump placement that was very quickly oversubscribed, being seen as a very high quality acquisition. As a result of these acquisitions, Phoenix managed assets of £76 billion and handled policies for 7.1 million customers. Abbey Life adding £10 billion and 735,000.

The sale, by French and German companies respectively, of AXA and Abbey Life reflected concerns about the British market that accelerated after the 2016 referendum result for Brexit, not least because it was followed by even lower interest rates in an effort to maintain economic growth. This contributed to a fall in sterling that made UK dividends less attractive. There were also concerns over bond market volatility. The French AXA group was completing its withdrawal from UK life insurance.

At the same time, as a reminder that multiple factors always play a role, Deutsche Bank, having bought too much, was more generally restructuring, in part shrinking in order to raise money. Deutsche's motivation was to sell its non-core business and to focus on an IPO of its asset manager. Conduct issues affected its timetable. Under pressure from falling share values, a lack of market confidence, and Regulatory issues in the United States over mortgage-backed security mis-selling and in UK over the treatment of closed-book life insurance customers, it also sold *Deutsche Postbank* and its stake in HuaXia Bank. Although a significant pre-tax loss, the sale of Abbey Life, and the resulting increase in the capital cushion, caused its shares to rise 2% in Europe.

Abbey's balance sheet held risk assets that counted against Tier One capital. The Bournemouth-based Abbey Life business comprised Abbey Life Assurance Company, Abbey Life Trustee Services, and Abbey Life Trust Securities, and had been acquired by Deutsche from Lloyds

Bank in October 2007, having been closed to new business from 2000. It includes books of business from other companies such as London and Edinburgh Life, Excess Life, Target Life, and Hill Samuel Life. Aside from Phoenix, several companies, including Swiss Re and Legal and General, had shown interest. Swiss Re had not moved fast enough in its bid. The Abbey Life purchase was a very big undertaking. Phoenix got the banks onside, including providing them with security for the purchase.

It was noteworthy that the FCA allowed Phoenix to do two deals in one year. There had been marked improvements in the relationship. The FCA was pleased with Phoenix and did not see stings in the tail. Phoenix had ambitiously achieved its second deal in one year. This had involved significant rights issues as well as taking on conduct issues, notably the threat of an Abbey enforcement action.

The working through of these acquisitions through consolidation was time-consuming, although Phoenix's expertise ensured that it was able to handle the consequences of both transactions in 2017. This was an aspect of a management that was very fleet of foot and good on implementation. Thus, in March, approval was granted by the PRA to incorporate the AXA Wealth businesses in the Group's Internal Model. In June, the Abbey Life Pension Scheme was transferred from Abbey Life Assurance Company to a Group holding company. In October, an application was made to incorporate Abbey Life in the Group's Internal Model, and, in December, there was a reinsurance of the Abbey Life business to Phoenix Life Limited and the completion of the Part VII transfer of the AXA Wealth policies to Phoenix.

The integration of the AXA and Abbey Life acquisitions was completed in 2018, ahead of plan and targets, and delivered annual cost synergy benefits of £27 million, which was more than anticipated. Already, the 2016 figures, announced on 20 March 2017, indicated that the acquisition of AXA had generated £282 million of cash, instead of the original target of £250 million. By then, cost synergies of between £13 and £15 million p.a. were expected instead of the original expectation of £10 million. The acquisitions were crucial so that Phoenix could deliver against market expectations.

This progress alongside Phoenix's strong capitalisation and improved leverage led to J.P. Morgan Cazenove issuing a broker note on 28 February 2017 raising its price target for Phoenix from 783p to 793, and to Fitch in July 2017 raising the rating of two of its principal operating life companies, Phoenix Life Limited and Phoenix Life Assurance Limited, from A to A^+, with a stable outlook. The Group rating rose from A^- to A. As a result of the upgrades, the interest margin of the Group's Revolving Credit Facility fell. 2017 had begun with a Tier Three issue, at Gilts plus 337.56p, the first use of such an instrument by an insurance company. Phoenix was very pleased to have got PRA approval as other insurance companies had failed to do so. The issue was five times oversubscribed.

There were also structural managerial changes. In March 2017, Phoenix announced the forthcoming movement (in June 2018) of the holding company from the Cayman Islands, where it had been registered since 2009 (while domiciled in Jersey), to become a British limited company, which was what the Regulator wanted. Bannister announced:

> 'We want simplification and some investors do not wish to invest in the Cayman Islands. If you are buying a firm and working with a straightforward UK Plc it also makes it easier in a legal sense. .Statement of the bleeding obvious is that we're doing this to streamline and modernise our structure.'

The 2016 figures, announced then, showed £486 million cash generated, as opposed to a target of £450 million; and the operating profit rose from £324 million to £351 million (compared to Numis's estimate of £264 million), up 8 per cent on the previous year. At the same time, the attributable pre-tax loss of £128 million for 2016 contrasted with a profit of £185 million in 2015. This was largely due to falling yields on life funds, and therefore increased margin held within insurance liabilities for longevity risk. Brexit was affecting the price of gilts, while, at the start of 2016, the stock markets fell because of differences between China and the United States. Phoenix also showed £95 million in other non-operating costs, compared to a £49 million gain in 2015. This included £31 million in acquisition costs and £33 million set aside for claims relating to creditor insurance underwritten by a subsidiary company. Nevertheless, the better-than-expected capital surplus led to an increase in the five-year cash generation target for 2016-2020 from £2.0 billion to £2.8 billion, and to an increase of the final dividend by 5 per cent to 23.9p a share, with a similar rise predicted for the 2017 interim dividend. The Solvency Two capital surplus was £1.9 billion, compared to £1.3 billion at the end of 2015 and against the Numis estimate of £1.7 billion.

At this stage, Phoenix could finance a deal of up to £500 million from its own resources. Above that, aside from an enlarged £900 million revolving credit facility, it would need to turn to shareholders and other sources. Bannister predicted £300 billion of opportunities from closed funds, in comparison with Legal and General's estimate of a £100 billion market.

In response to the results, which beat Numis's estimates, the shares rose 6p to 797½p and then to 803p and share tips, for example *Investors Chronicle,* Fool Co., Deutsche Bank, Berenberg Bank, and Tempus in the *Times,* were to buy. Of the eight research firms covering the firm, five issued buy recommendations, two hold, and one sell.

The 2016 acquisitions were followed in 2017 by discussions about five more. Two reached the public domain, but three did not, including the biggest (Project Ghost), a bid of up to £16 billion. That was not pursued because of the increase in the target's share price and the likelihood therefore that a bid would not prove attractive to its private equity shareholders. Enquiry also revealed problems with the other company. On 17 March 2017, Bannister had classified Standard Life's Heritage With Profit Fund as one of six potential 'whales' that could become available over the next two years. The other key targets were Prudential's UK life business, ReAssure (previously known as Admin Re), Lloyds with profit funds, and the BPA (bulk pension annuities) market through an acquisition of either Rothesay or PIC. However, the 2017 discussions led nowhere and Bannister, who became very depressed by what he saw as a waste of a year, planned to resign in early 2018.

The acquisitions of 2016-18, all aspects of the reallocation and redeployment of capital, culminated in the acquisition of Standard Life Assurance in 2018, a larger business for a good price. Phoenix had the advantage of a past relationship, and the transaction benefit that Standard Life, which had a relatively poor financial history, wanted to make the sale, and that Phoenix was the first possible purchaser to move.

Standard Life, which, unlike Phoenix, had been hit very hard by the loss of annuity business, itself was in flux. In March 2017, it had agreed to acquire Aberdeen Asset Management for £3.8 billion, a key step in its movement from insurance to asset management. This ensured that its traditional insurance products did not fit in. By that March, Standard Life was writing very little annuity business, but had a substantial back book with high capital requirements arising from the promises to policyholders. As a result, the back book, which had £16 billion of liabilities out of the £357 billion of assets that Standard Life had under administration, accounted for about 30 per cent of the capital that that company had to hold under Solvency Two capital rules, or just under £1 billion. The sale therefore would release capital, improve the balance sheet under Solvency Two, and reduce management costs, although also cutting the cash flow necessary to support dividends. There were also issues from the perspective of Standard Life shareholders in the recent acquisition, as Aberdeen Asset Management involved risk. Its major offering, Global Absolute Return Strategies, had had a net outflow in 2016. By becoming a pure asset manager, there would be a move to a lighter capital regime.

On 1 December 2017, when discussing another deal, Bannister had lunch with Sir Gerald Grimstone, the Chairman of Standard Life from 2007. Bannister knew that Standard Life was talking about a joint group with Lloyds. This would have involved a merger with Lloyds' subsidiary Scottish Widows. However, this deal had disadvantages from the perspective of being a Standard Life shareholder, as Standard Life would become a junior partner of Lloyds, would not be quoted, would lose the brand, and would give up marketing authority. In return, Lloyds offered the management of all the relevant assets. With about £106 billion (about a third of the Standard Life assets under management), Lloyds had a lot invested in Aberdeen Assert Management. It threatened to take the money away if the merger did not occur, which put great pressure on Standard Life. It did not want to be managed as a part of Lloyds and, due in part to the time spent considering that deal, had not prepared for an IPO.

On 23 December 2017, Keith Skeoch, the Chief Executive of Standard Life, called Bannister and asked him to come back from his holiday. Meeting on 2 January 2018, Skeoch said that Standard Life would not merge with Lloyds and was ready to separate insurance from asset management. At this stage, Phoenix was valued at about £2 billion and Standard Life at about 3. Due diligence was carried out, with both sides being very helpful and agreeable, and the deal was announced on 24 February 2018. Phoenix was the second choice for Standard Life, but not the second-best. In the sale, the vendor proved really motivated.

Phoenix, whose shares moved up on the news, to 781p (compared to a 50 day moving average of 759.26p), was not the only potential buyer of Standard Life's insurance business. Others included Swiss Re, which Bannister mentioned to the Board in his CEO Report of 11 May 2017, Legal and General, Pension Insurance Corporation, and Rothesay Life. The last had carried out a £6.4 billion annuity transfer with Aegon in 2016. In the event, Phoenix, with its positive dynamic, won. Phoenix in early 2017 was already Standard Life's largest third party client as well as being one of the larger clients of Aberdeen through the management of some of the Abbey Life assets.

The Standard Life deal transformed the business. In effect, 950 people took over 3,500. Phoenix had become an asset gatherer. The deal was both a close to a period of the Group's history and a highly dramatic new start. For that reason, it is discussed both here and at the beginning of the next chapter. Phoenix's £2.9 billion acquisition was accompanied by a Strategic Partnership with Standard Life Aberdeen that was the headline acquisition, but there were others. Thus, the capability existed to transfer pension schemes from elsewhere: Marks and Spencers transferred some of its liabilities, as well as £470 million. Separate to this process, but linked to it, were better relations with the Regulator. The PRA was very happy with the Standard Life deal (and thus supportive), seeing Phoenix as a perfectly safe home for the insurance business.

To finance the acquisition of Standard Life, which was a reverse takeover of a larger company, there was a £950 million rights issue completed in July 2018. The terms were 7 for 15 at 517.5p. This was 96.25% subscribed. The rights issue ensured that the number of shares in issue rose from 393 million to 577 million, and with a market capitalisation of £3.8 billion. There was also an issue of 144 million shares to Standard Life Aberdeen as part of the acquisition. It took a 19.99% equity share in the enlarged Group. The acquisition was made without affecting attractive dividend levels: a dividend yield of about 7%. The operating profit is projected to rise rapidly as a result of the inclusion of Standard Life's operating profit. In April 2018, to help fund the acquisition, there was a £500 million Restricted Tier One bond issue and in September a £500 million Tier Two bond issue.

Ironically, the acquisition of Standard Life was another stage in a longer history in relations between the two companies. In part, Standard Life had been spared from problems because Hugh

Osmond had overbid for Resolution in order to thwart a bid from Standard Life. Later, Standard Life had gained the contract to manage Phoenix's capital funds when it sold Ignis.

Given the excellent position of the company for further mergers and acquisitions, a situation underlined by an upgrade to the Group's credit rating from Fitch in July 2017, the lower balance sheet risk compared to an average insurer, and the ability of the disciplined management to implement its targets, the research released by J.P. Morgan Cazenove on 14 November 2018 assessed the valuation of the company on 31 December 2019 at 814p, compared to the current value of 620p. The report noted three key downside risks to the rating and price target: issues around the execution of the Standard Life acquisition; cash flows turning out to be less robust than assumed, making it more difficult to pay down the debt in the company; and the impact, on all insurance companies geared to the credit markets, of any pick-up in UK credit risk.

The running out of an effective model for acquisitions indicated professionalism as well as high morale and determined effort. Each became characteristic of Phoenix, and, linked to this, a potent synergy at decision-making and implementation levels had not only developed but was in play. The Life companies played a critical role in managing the integration of the acquisitions efficiently and with an appropriate pace. Driving the model was outsourcing, AXA and Abbey reinsurance, and Part VII transfers alongside the protection of policyholders.

Alongside the longstanding actuarial effectiveness, came an innovation in assets from about 2013. In part, this was driven by the fall of traditional returns in the shape of gilts and corporate bonds. Instead, an internal team looking for assets was created. Those chosen included equity release mortgages, which are an illiquid asset. A £600 million portfolio of these were acquired in July 2017 as they offered a good return. By the end of June 2018, Phoenix had £1.8 billion of such mortgages, up from £500 million a year earlier. Strict new rules on the way insurers account for the mortgages were announced, however, by the PRA in 2018. These threatened to take £175 million from the capital base of Phoenix. The rules received a lot of criticism from the industry and were ameliorated before being introduced.

There was also investment by Phoenix in infrastructure, including a toll road and a shopping centre. The Regulator favoured investment in British assets involved in building the country. Commercial real estate became another field, with 47.87% of UK Commercial Property Trust Ltd held by Phoenix in October 2016. Local authority loans were another new asset class.

Investment policy had management implications. It was necessary to understand asset classes in terms of the security on the returns and in legal terms. An assessment of legal risk was throughout important. The Financial Management Team in London expanded greatly from about 2012. It proved highly-effective in raising the cash flow from the life companies.

There was also a continuation of the harmonisation of existing policies. This was crucial as it was a method to reduce costs all round. The process, prescribed by statute, is time-consuming and requires expertise in order for it to operate smoothly. There has to be a High Court order, Regulatory approval in the UK, the consultation of relevant foreign jurisdictions, and the establishment of call centres to field calls from policyholders. These calls also have to be monitored. All of these processes require investment and expertise.

Thus, the issues of the early 2000s recurred, which created renewed opportunities for acquisitions, albeit in the context of the effects of Brexit on the price of gilts. Opportunities were also viewed with confidence. In July 2017, looking at end of 2016 figures, Fitch upgraded its ratings of two of the principal operating companies, Phoenix Life Ltd and Phoenix Life Assurance Ltd from A to A^+ with a stable outlook. The issuer default rating for Phoenix Group was upgraded to A from A^-. Phoenix's notes were also upgraded. These upgrades reflected Fitch's perception that Phoenix had very strong capitalisation and leverage (as opposed to strong previously), as well as the progress made in integrating its AXA Wealth and Abbey Life acquisitions and Phoenix's strong debt service capabilities, financial flexibility, earnings and business profile. These upgrades resulted in a 25 base points reduction in the interest margin of the Group's revolving credit facility to 110 basis points. Linked to this outcome, shares rose 1.1% to £7.60.

The figures underlying the Fitch assessment and rating deserve greater attention as they reflected not just a snapshot but a trend. Moreover, this trend provided a commentary on Phoenix's own account, including its projections. The Fitch calculation of the financial leverage showed a fall from 50% at the end of 2012 to 31% at the end of 2015, and 29% at the end of 2016. Fitch expected this percentage to range between 25 and 30 in the medium term. The shareholder capital coverage ratio had risen from 154% at the end of 2015 to 171% a year later.

Fitch also noted the strong access to the capital markets. £929 million of new equity was issued in 2016 in order to fund acquisitions. Moreover, in the first half of 2017, £450 million of subordinated Tier Three notes (£300 million plus a £150 million tap) and $500 million of subordinated Tier Three notes were issued. Fitch calculated the operating return on assets and equity ratios in 2016 as 0.5% and 11% respectively. The total assets at the end of 2016, excluding reinsurance, were £75.4 billion.

For Phoenix, expertise was linked in effectiveness to morale. The Phoenix workplace provided a positive environment, one that was deliberately developed to that end by the management. Prior to the Standard Life merger, Phoenix, in the sense of Phoenix Group, Phoenix Life and Abbey Life, had, as of March 2018, 1,249 staff based on seven operational sites: Wythall, London, Basingstoke, Bournemouth, Bristol, Glasgow and Jersey. The 'Big Conversation' has been designed to take forward morale. The 2017 annual employee engagement survey, in which 88% of employees participated, revealed an Employee Engagement Index of 86 per cent (2013: 76; 2014: 78; 2016: 81), which compared positively to the benchmark in the Financial Services industry. In this survey, 73% of staff noted that they had the ‘opportunity for personal development and growth.’ To enhance both this and supportive networking, the Group established three networks: for Professional Women, for Working Parents, and for LGBT employees. These network groups, which meet in work hours, were intended to provide an opportunity to share issues and a structure for mentoring.

A direct participation was indicated by the extent to which all employees are able to become shareholders. By 2018, over half of the staff were participating in one or more of the share-save or share incentive plans. Moreover, in 2018, 86% of staff participated in the flexible benefits scheme which, from 2009, allowed benefits to be selected that met personal circumstances These included gym membership, a wine club, a motoring package, and a Hi-Line dining club. For 2017, the most popular were buying and selling annual leave. These were followed by childcare vouchers and by insurance related products. From 2018, private medical insurance cover was offered to all staff and their partner regardless of status within the organisation. In 2017, for the sixth consecutive year, Phoenix was listed as one of the UK’s Top Employers.

Talent development was encouraged and developed, in a major attempt to get good people to go to Wythall and to retain staff. In 2010, a leadership development website was launched, as well as high impact training courses. In 2017, Phoenix designed and piloted a range of people management, talent and leadership development programmes, notably the Life Accounting Talent Programme, the People Management Programme, and the Leading Integration Programme. There was also use of development opportunities provided by the Open University Executive Education programme, and an online self-development tool and related learning created in partnership with the Chartered Management Institute.

In 2017, Phoenix also partnered with Moving Ahead and the Institute and Faculty of Actuaries as one of the first ten organisations to take part in a new Actuarial Mentoring Programme for newly qualified female actuaries. At the same time, the scale of the challenge was indicated in a fall in the percentage of female employees, from 593 out of 1,301 in 2016, to 555 out of 1,249 in 2017. Compared to targets of 30, 40 and 22 per cent, the Group had women in 25% of the top 100 roles, 35% of the Group’s green or amber ‘successors’ in the next grades were women, and the Group-wide mean gender pay gap was 23 per cent. In 2017, four of the eleven Directors were women. The figures for Black, Asian or Minority Ethnic were 118 (2016) to 107 (2017), a period in which the workforce fell by 52. The Group now has mandatory unconscious bias training in order further to contribute towards an inclusive workplace.

The majority of the Phoenix employees are at Wythall which very much feels a special place. Phoenix has succeeded in taking forward the positive legacy of Britannic on the site and the specific

Britannic culture with its leadership programmes, longtermism, and local community culture. Britannic had moved there from Mosely in 1996. This is a legacy that is as much cultural and social as architectural. The last, however, repays attention at once. Juxon House, despite the ambition of its curving front and atrium, is architecturally undistinguished. Actually, that is polite, but at least policyholders and shareholders can be pleased to note that their money is not being wasted on an architecturally bold building of the here-and-now. Juxon House, however, has the exulting quality of acting as an *entrée* to a prospect of the west end of St Paul's cathedral that is truly amazing. English Baroque in its most dramatic, seen, as it was designed to be seen, looking upwards, is unmatchable as well as rare.

Well, the exurbs of Birmingham are not quite the same, but Wythall, unlike Juxon House, is architecturally impressive in itself. Moreover, both its immediate surrounds and its prospects are attractive. Each offers greenery, and both are at once pleasing and soothing. The Wythall site's extensive windows, and the actual shape and flow of the building, take you into both the surrounds and the landscape. The latter includes both the grounds and a more distant surround that includes plentiful greenery as well as an impressive nineteenth-century church. The sports grounds are an impressive feature of the Wythall lifestyle. So also with the quality of the food in the refectory and the inclusive mature of the eating arrangements, and indeed the layout. To take a random list, each, however, of which is important for how people identify with the palace as well as providing particular benefits. There is the provision of free fireworks at Wythall. There is a Relaxation Room. There is the network offered by Dementia Friends.

Wythall provides the operational dynamo of Phoenix. It manages the life companies and is the machine that produces the money. There is a very flat structure at Wythall, one that is sustained by a lot of meet and greets, and townhalls; and there is a good tradition of encouraging staff to express their opinions in Employee Engagement Groups, and then in management responding to issues. The union is comfortable with management practices.

The longevity of service is important: twenty, twenty-five, and thirty years' service is not abnormal. This helps make Phoenix a top employer. The HR team has done an excellent job. To that the policies of the Learning and Development team are important as more employable people have a higher morale. There has been a longstanding attempt to build-up morale. The Phoenix Progress Report of August 2010, written by Mike Merrick on 23 August, noted that, in light of attempts, so far unsuccessful, to move the engagement score from 60% to 70%: 'Phoenix Life has held a number of successful charity events over the summer and used the World Cup as a theme to engender competition between teams. These events have built a level of pride in the respective teams and across Phoenix Life – further events are planned for later in the year which should drive the engagement score over the targeted level.' In September 2016, Wythall staged a non-stop 25-hour table tennis to raise money for Midlands Air Ambulance. Two months later, Phoenix received a Highly Commended award from Worcestershire Works Well for its work in promoting physical activity in the workplace.

Conclusions

The situation had been transformed from 2011. In an interacting fashion, the balance sheet had improved, the Regulatory context had been transformed, and governance had been much strengthened. Phoenix had been rehabilitated in the eyes of the FSA thanks to sorting out the debt, building a stronger risk management framework, and having people in charge on whom it felt it could rely.

Normalisation entailed, as for other organisations, freedom of action. That occurred after the rehabilitation, as there were still unresolved issues. Investment grade rating was the first major step. It and the single silo bank debt did not happen until 2015. Reducing the leverage prior to that was very important: Phoenix had to get below 30% leverage before it was allowed by the FSA to do anything that was part of the underlying covenant and acquire a new group of customers. In turn, with Bannister overcoming disappointment on the Board after many earlier setbacks, it was only in 2014-15 that Phoenix began to get to a point where the Board, rather than the FSA, was in charge of the Group. Eventually, however, they had got to the point where the FSA had to say that it was appropriate to move on without being asked about everything.

8. 2018: The New Vision

All events look back as well as forward, and so with Phoenix's major event in 2018. The announcement on 23 February 2018 of the acquisition, for cash and an equity stake totalling £3.24 billion, of Standard Life Assurance, completed on 31 August, was both a vote of confidence in the Group's operating model and a transformational deal for Phoenix that represented a reach towards a more ambitious future and an ability to deliver part of it. This acquisition drew on more general achievements across a range of indices and, in turn, sustained them and strengthened their impression of general success. The Group became much better known as a consequence of the acquisition.

In 2017, Phoenix had become far stronger. Its financial performance was impressive. £653 million was generated from Phoenix Life. Moreover, a bond issue helped capture confidence, such that Fitch Ratings provided a credit ratings upgrade in July 2017, a ratings reaffirmed in September 2018 after the completion of the Standard Life life business acquisition. In 2017, however, all the acquisitions attempted had failed, causing disappointment as well as tensions at Board level. First, Friends First was sold by a Dutch mutual to Aviva. Phoenix came second because it was not willing to raise its bid. Subsequently, Swiss Re outbid Phoenix when buying Legal and General's closed life business, purchasing it at 100% of MCEV.

In the first half of 2018, the financial performance remained strong. £349 million was generated, ensuring that the cash generation target for 2017-18 was exceeded. Delivering the integrations of the AXA and Abbey Life acquisitions ahead of target provided both cost synergies and cash, as well as a better cash flow outlook. This, however, was heritage business in the shape of closed funds and pure run off. In contrast, with Standard Life, there were open funds as well, and thus an open capability yielding more new money. As a consequence, Phoenix could expand organically and not just run off. In terms of the image that was used by Bannister, the swimming pool was now full, and as a matter of scale as well as options. The deal certainly brought scale, with a market cap of £5.5 billion and with a large amount of cash due to emerge. Phoenix was now Europe's leading and best life consolidator, and the deal announcement was followed by the results on 5 March.

The Standard Life Aberdeen shareholders gave overwhelming approval to the deal in June 2018. This approval owed much to the transfer, via a share scheme issue and a share buyback, of much of the money to shareholders, who had been hit hard by falling share values. At the same time, Standard Life Aberdeen was under pressure because of net fund outflows which in 2017 exceeded £20 billion. In particular, the Global Absolute Return Strategies fund launched by Standard Life Investments, had an outflow of over £10 billion due to a continuing poor investment performance. That made the money from the Phoenix deal very welcome.

Yet more than short-term considerations were at play. The sale was also in line with the change in Standard Life's business model after its demutualisation in 2006, and notably the move away from traditional insurance and toward newer fee-earning, capital-light, investment products that had more in common with asset management. The merger with Aberdeen was seen as providing economies of scale to enable it to compete with bigger investment rivals such as Blackrock. In this context, full-spectrum companies were regarded as less attractive, again continuing a long-term...

Having moved very fast to complete, in what was a big and complicated deal, Phoenix had beaten Lloyds to which Standard Life had been thinking of going. As part of the process by which Phoenix, through acquisitions, became in part the solution to the problems of others, and thus a key part in consolidation, Phoenix bought Standard Life's workplace pension book, its legacy insurance products, and its retail SIPP. This meant that Phoenix moved into the market of generating new business and administering the policies of new customers. Standard Life maintained control of the Standard Life Wrap platform for which Phoenix was to be the manager of choice. The partnership agreement had no time limit.

In one view, Standard Life 'owned the shop window and got the customers in,' while Phoenix put the risk capital behind the policies they sold. At any rate, a lot of new clients and money came into Phoenix. This offset runoff, ensuring sustainability and helping the dividend. As a result, the need for new deals diminished, and this helped produce a greater range of options. Phoenix as a result of the Standard Life deal was not a 'zombie fund' that did deals. Instead, it had open books and became more stable as a consequence, with new business offsetting the 'wedge' the way in which the runoff was conceptualised.

The Standard Life deal, codenamed Marvel, meant an increase in assets to £240 billion (two thirds closed, one third open), and in policyholder numbers to ten million. Given the undoubted value of scale in the industry, for both direct business reasons and factors of reputational trajectory, this was a key game change. Scale affected both capital and costs. Generated profits will increase, providing, in turn, more dividends and more funds for acquisitions. At the same time, Phoenix's leverage ratio remained below the target range, which, in part, reflected the cost of money as well as market support. In part, Phoenix financed the purchase, which included £2.2 billion in cash, and one of the biggest rights issues in the UK, by raising £500m of Restricted Tier One (RTI) bonds in April 2018. RTIs are perpetual debt instruments, have discretionary coupon (dividend) payments, and can be written down or converted into equity upon breaching pre-defined capital triggers. The format gives insurance companies a cost-efficient way of raising capital for mergers and acquisitions.

The series of acquisitions in 2016-18 ensured that further ones could be regarded with confidence. In particular, the Group's operating model provided a solid basis for the integration of acquisitions. The clarity of purpose and simplicity of purpose offered by focusing on closed-books provides a strength of expertise. A key basis for the operating model had become the use of outsource partners, notably Diligenta and FNZ, in order to undertake policy administration. This process offered expertise, cost savings, and the handling of volume transactions needed for major acquisitions.

Both Aviva and Prudential were mentioned in late 2018 as possible sellers of closed books, although neither at that stage went the way of Phoenix. Cowdery had launched a new Resolution, and its acquisition of the closed book of AMP Australia, the company that once owned Pearl, demonstrated anew that the process still worked. So also in the United States where Dai-ichi Life Insurance, the second largest company, has been buying closed books, and in Germany where the practice of taking over closed books was being followed by three Private Equity companies. Using its British business as a strong source of cash, Chesnara also operated in Sweden and the Netherlands, buying Legal and General Nederland (an open business) in 2016 for Euro 160 million at a 33% discount on its value. However, this activity was very different in scale to that of Phoenix. In the summer of 2018, Chesnara's economic value was £700 million.

Alongside the competition between consolidators, the underlying reality was that the theory and practice of consolidation were being eased by industry changes. In response to market developments and exogenous events, foreign owners were retrenching, asset managers were focusing on higher multiple businesses, and customer needs required specialists focused on run-off issues.

The Phoenix operating model was crucial, because, in parallel to the closed life fund opportunity, the growing Bulk Purchase Annuity (BPA) market became a complementary source of annuity back books. Pensions created new opportunities for Phoenix, and offered the 'strategic optimality' of focusing on life insurance or the BPA, with the choice guided by returns, as is that between open and closed. The end of final salary schemes reflected a range of problems, one accentuated by the serious risk that many schemes would fall into the Pension Protection Fund (PPF): the lifeboat for troubled schemes but one that paid modest rates. An important development occurred in 2013 when the pension fund of the British subsidiary of the bankrupt Kodak, unable to meet its commitments, persuaded 84% of its pension members to vote for the formation of a new fund that would pay better rates than the PPF, but lower than those originally promised. The other 6% went into the PPF. Kodak's move created a pension fund lacking a corporate sponsor to support it, an example followed by other companies.

This crisis reflected political, fiscal and economic developments from the 1990s. A key one was the end of tax relief on dividends introduced by Gordon Brown in 1997. A classic exogenous factor, this decision represented a major challenge to pension funds. Moreover, it was highlighted from 2000 by the introduction of FRS 17, a new accounting standard that necessitated more transparency for companies and trustees. This situation was compounded by a long period of company pension contributions that failed to meet requirements. That situation, in turn, was exacerbated by the financial crisis. The extremely low interest rates to which it led hit gilt yields and pushed up the liabilities of pension funds. The pension 'reforms' introduced by the government in 2015 caused insurers to re-evaluate their business model. Thus, exogenous developments hit hard as they had done for life assurance.

Launched in 2009, longevity swaps, first seen with Credit Suisse covering Babcock International, enabled pension funds to hedge the risk that life expectancy increased faster than expected, a costly outcome. Under the swap, a bank or insurer agreed to pay the extra cost, although the pension fund loses out if life expectancy goes the other way. By the mid-2010s, the market was a large one, in 2015 involving £9.3 billion of pension liabilities. However, stricter capital requirements from Regulators made banks increasingly unwilling to take this role, Credit Suisse pulling out in 2011, and UBS and Nomura doing so in 2012. These departures increased the pressure for different outcomes.

By the end of December 2016 the 4,340 of the 5,800 private final salary schemes in Britain were in deficit according to the PPF, with a combined shortfall of £223.9 billion. This situation created a major problem for the companies and the PPF.

Regulated apportionment arrangements are a solution. The BPA markets provided employers with the ability to mitigate the risk of their Defined Benefit pension liabilities. The wish of pension Trustees to derisk current pensioner and deferred liabilities ensured that by the spring of 2018 of the roughly £2 trillion in private sector pension liabilities, there was a projected demand of about £550 billion over the following 15 years. That more than matched the £380 billion of closed life assets in the UK.

In May 2018, Phoenix financed its first major bulk annuity purchase. This was a £470 million deal with the Trustees of the Marks and Spencer Pension Scheme, a deal completed that August. This represented a selective approach, as Phoenix had looked at seven deals in 2017, and, indeed, British bulk annuity sales hit record levels in the first half of 2018. At a greater scale than Phoenix, Legal and General did £4 billion of annuity business in 2017, completed on £1.1 billion of deals in the first half of 2018, and was involved, by that August, in talks for another £7 billion of bulk deals. In August 2018, Phoenix anticipated spending £50-75 million pa. on bulk annuity purchases, funding them from its reserves.

As a result of this, and of the Standard Life purchase, Phoenix no longer described itself as a closed business, but as a consolidator of both open and heritage life businesses. This was a major change in strategy that increased exposure to liability risk. On 23 May 2019, Phoenix completed a further £460 million bulk annuity deal with the Marks and Spencer Pension Scheme under the pre-agreed 'umbrella-contract' terms.

At the same time, the bulk annuity business posed problems. Taking over employers' defined-benefit pension promises in return for a premium was an unpredictable matter, not least with issues of capital requirement and assessing profitability. The timespan requirement is problematic. BPA business poses a longevity risk, but Phoenix reinsures about 90% of its business in this field. Anti-senescence drugs, nevertheless, pose a real problem. There are also somewhat different Regulatory and pension concerns.

The acquisition of Standard Life Assurance provided Phoenix with an existing base in Europe in Germany and Ireland, which also extended the market opportunity to £540 billion. The state of play in Germany was indicated in July 2018 when Italy's Generali sold a majority stake in its German life company to private equity.

The Standard Life acquisition established the Group as the largest closed life consolidator in Europe. Phoenix's operating model provided the capability to compete in this market, as well as the BPA one; although it did not guarantee a profit rate. The acquisition of a foreign position offered a geographical diversification that lessened the serious exposure to economic and Regulatory changes in the UK. This diversification compared with the situation of competitors who had long been more diversified. The fragmented nature of the life assurance world in Continental Europe provides numerous opportunities, and Phoenix can now focus on where the price of heritage books may be better.

Phoenix's capability was important not only given current contexts, but also in light of the ongoing and potential reshaping of markets and opportunities. This reshaping reflected both contingent factors, notably the likely triggers of Regulatory changes, including Brexit, and also those posed by the life assurance industry. The pressure to concentrate on specific strengths ensured that the break-up of the traditional assurance company model seen in the 1980s and 1990s was followed by that of the life insurance companies. Within the context of core markets that were mature, competitive, and showing scant growth, the focus among some on less capital-intensive asset management, and of others on particular areas of new business, led to the divesting of legacy portfolios. These factors remain pertinent, as with the restructuring of the Prudential in 2019. As before, there were demands from the insurance industry for the sale of closed books. Insurers found that large portfolios of old insurance policies crimped their growth as Regulators demanded capital be held against them, preventing the capital being used more efficiently.

There were also the long-term problems posed by the impact on cash-flows of improvements in longevity. Average life expectancy for all age groups consistently rose, the major exception being those aged between fifteen and forty-four during the 1980s. Average lifespan increased by an average of two years every decade in the 1960s-90s and has continued to rise since. 'Life Beyond Measure,' an exhibition accompaniment published by the Institute and Faculty of Actuaries in 2014, noted: 'Never have so many people lived for so long and today there are more old-old (people living past the age of 90), than at any time since longevity recording began – a 33% increase to 465,000 between 2002 and 2012… Predicting the future of mortality data is hard to do.' (pp. 11-12).

By 2016, average lifespan had reached 80.96 years (higher for women, lower for men), although there was a stop in improvement in 2017. Nevertheless, the longer lifespan elsewhere, for example in Australia, indicates the room for British rates to improve. This entails huge amounts of judgment when assessing the prospects for life assurance books, as well as demonstrating the problem of guaranteed annuity rates. In the 2013 Annual Report, Bannister had pointed out that the attraction of the sale of annuity liabilities and assets to Guardian Assurance included not only accelerating the release of capital and improving solvency, but also reducing 'our exposure to longevity risk.'

There are also the problems posed by lower interest rates. As assets get a lower yield and interest rates fall, so the cost of meeting liabilities rises in terms of the size of the necessary buffer. As a result, the problems that insurers address have changed. How to hedge inflation was the major problem in the 1980s, but low interest rates was that in the 2010s. The problems posed by guaranteed returns for life assurance policies were seriously magnified by the record-low interest rates and the more stringent European capital rules. It is unclear what the major problem may be in the 2020s. That puts a premium on adroit management.

Phoenix's reconfiguration in 2018 included a 'Strategic Partnership' with Standard Life Aberdeen, one that included the addition of two non-executive directors from the latter to the Board of Phoenix. This partnership was designed to reward and strengthen capabilities and synergies, namely those of Phoenix as a closed life consolidator and of Standard Life Aberdeen as an investment management business. More particularly, Standard Life Aberdeen would continue to manage about 60 per cent of Phoenix's investments, while Phoenix would underwrite workplace pensions and SIPP products which Standard Life Aberdeen would continue to market under its own brand. As of February 2019, Standard Life Investments Ltd (Standard Life Aberdeen) owned 25.7 per cent of Phoenix, and is the largest shareholder. Purchasing Phoenix shares as part of the takeover worked well for Standard Life Aberdeen.

At the same time, Phoenix remains very sensitive to its share price, and feels that it has been consistently under-valued by the market. In practice, given the scale of rights issues, this is not really the case; and certainly not in comparison with shares such as Aviva. At any rate, the issue of valuation has a host of practical consequences, as well as the intangibles such as consequences for staff morale, not least as a result of the staff ownership scheme through share-save. As with many companies, most shares are held by a minority of the shareholders. Keeping shareholders satisfied is a key management task, notably one for the CEO, and not least in the face of concerns about dilution through rights issues and, as a related point, about share prices.

There are key shareholders that have to be got over the line in order to move policy forward, and satisfying Proxy Advisors is an important part of this process. Very few people attend AGMs, which, for several years prior to 2018, were held in a boardroom in Jersey. That, however, does not make shareholder scrutiny less significant. In 2018, the AGM was moved back to Britain: tax residency had been moved from Jersey that January. In accordance with the requirements of the Jersey registration, Board meetings had also been necessarily held in Jersey. Governance circumstances as a whole were more suitable in Jersey while, with a lack of distractions, it was easier to focus on the key issues there. In 2018, the acquisition of Standard Life meant that the Board met in London and Edinburgh.

That December, Phoenix onshored: a new UK-holding company became the listed holdco, replacing the Cayman entity. There were concerns about onshoring as it involved costs in money and time, not least in terms of the need to support solvency arrangements. The regularisation of the debt profile, which involved hybrid debt solutions, was expensive, but ensured that Phoenix was off the Watch List. Moreover, the regulation of debt structures by UK authorities entailed the possibility of more Regulatory interventions. However, onshoring was necessary in order to please the Regulators who had ceased to approve of the offshore structures. Relations with the PRA and FCA were very much happier after Solvency Two, but were not yet completely better. Onshoring was the last stage in the necessary restructuring. It would no longer be necessary to have a PRA waiver.

Although relatively easy in terms of the manner of the merger, the Standard Life merger poses a challenge because acquisitions are always unsettling and followed by a period of staff loss and morale issues. The merger will involve 3,500 transferring staff based in five locations and will lead to an employment base of over 4,500, which is over three times the earlier size of Phoenix. To cover Heritage and Open businesses in Britain, Germany and Ireland, there will be offices in London, Wythall, Dublin, Edinburgh, Frankfurt, Basingstoke and Bristol. The largest will be those in Wythall and Edinburgh. There is the potential for a degree of drag factors, not least political ones, affecting synergies, but there are many positives. Wythall is full of people from elsewhere, due to previous consolidations of closed books, and includes people who have moved from Bristol, Edinburgh, Liverpool and Peterborough. In this, there is a contrast with Standard Life and its more fixed workforce and identity; although both share a pride in place (and building). To get the new structure to work well will require effort and is a major priority, one to which Bannister has devoted much effort.

Phoenix was far from alone in the business, either British or Continental. In 2018, Prudential sold its £12 billion UK annuities book (which it had ceased selling) to Rothesay Life. Meanwhile Swiss Re planned a London flotation of its UK closed book business, ReAssure, which, as of July 2019, had £40.4 billion in assets under management, 3.3 million UK policies, and a market capitalisation value of about $3 billion. The purpose of doing so was to raise capital in order to acquire additional closed books. However, the initial public offering of 26 per cent of the business was abandoned in July 2019 because institutional investors adopted a cautious stance, in part due to fears of sterling falling. In December 2018, the Japanese insurer MS&AD had increased its stake in ReAssure. This was a way for foreign investment in British run-off funds. In Germany, Viridium, a major run-off platform, bought Germany's Generali Leben closed books.

In August 2018, Nicholas Lyons was appointed as Group Chairman of Phoenix, a replacement to Henry Staunton that took effect on 1 September. This was very much an appointment of a financial expert. After reading History at Cambridge, Lyons worked for J.P. Morgan for twelve years: in Debt and Equity Capital Markets, and in Mergers and Acquisitions. He then spent eight years at Lehman Brothers, as a Managing Director in their European Financial Institutions Group, ending his executive career as Global Co Head of Recruitment. He was also a non-executive director of a number of companies including the Friends Life Group, Friends Life Holdings, and the Pension Insurance Corporation. This expertise very much represented Phoenix's direction of travel, in terms of financial not actuarial experience, as well as connections in both the pension field and Europe.

As of 14 February 2019, after a recent rise to £6.56, the shares were still below the price throughout 2017 and most of 2018. At that point, the yearly range was £5.37-£7.37 per cent. There had been three dividend increases in five years. As of 14 February 2019, the institutional ownership was 70.8% of the company, with the top ten institutional holders having 54.1 per cent and 6.7% held by North Americans. After Standard Life Investment Ltd., the next largest institutional investors in order, with their percentage holding in brackets, were:

Threadneedle Asset Management Ltd (4.8)

Aviva Investors Global Services Ltd (4.3)

M. and G. Investment Management Ltd (4.2)

Artemis Investment Management LLP (4.1)

FIL Investment Advisors (UK) Ltd (2.9)

Dimensional Fund Advisors LP (2.4)

Henderson Global Investors Ltd (2.3)

The Vanguard Group, Inc. (1.9)

BlackRock Fund Advisors (1.3)

J P Morgan Asset Management (UK) Ltd (1.1)

Norges Bank Investment Management (1.0).

There were also significant individual owners, notably the former members of SunCap, including Hugh Osmond.

In an equity research paper on 22 February 2019, Panmure Gordon recommended purchase, assessed a true value of the business for shareholders of 832 pence per share, and anticipated a rising dividend from 2020 by up to 5 per cent even if new business sales did not grow. The research paper noted a big discount to shareholder value and high dividend yield. The paper also argued that, by 2029, the Group needed to do another merger and acquisitions deal in order to extend the cash generation profile. That was understandable in light of the heritage business running off at 5-7 per cent per annum, but, in many respects, the growth of the open business will offset this.

At the same time, this issue poses a tension that results from an unresolved difference between the business as a profitable concern and as a growing concern. The former implied a focus on closed-book insurance business as that is most profitable. The latter, the policy followed, entailed including open policies and pension business for which the profit rate is lower. As an investment, the former route is better even though it may lead to the eventual end of the holding. The second route threatens the yield.

The publication soon after of the 2018 Annual Report and Accounts provided a prospectus of success, as of 31 December 2018. The operating companies generated £664 million of cash, the operating profit was £708 million, and the final dividend was 23.4p. This was a 3.5 per cent uplift in dividend per share, to make an annual amount of £338 million. Strong operating profits generated stable and strong dividends. The dividend per share has risen from 32.1p in FY (fiscal year) 2011 and 36.5p in FY2012, to 40.9 in each of FY2013, 2014 and 2015, 41.9 in 2016, 45.2 in 2017, 46.0 in 2018 and 36.8 in 2019. Thus, shareholder patience has been rewarded via dividend increases and Phoenix's greater stability. Phoenix had proved that healthy returns can be made whilst putting the interests of policyholders at the centre of what it does.

£226 billion worth of assets and ten million policies were under administration at the end of 2018, of which £145 billion were unit linked and £56 billion with profits. This was a reduction from the £240 billion pro forma position at the end of 2017, a reduction largely due to negative market movements in late 2018. At that stage, Phoenix's broad range of products was divided into heritage and open. The former were capital heavy products not actively marketed to customers, with the business, valued at £118 billion in the UK and £12 billion in Europe, built through the consolidation of over 100 legacy brands. Growth in this sector was achieved through annuities, which matched the decumulation stage of the customer saving cycle.

In contrast, the open products were capital light and actively marketed to new and existing customers. Annual management charges were earned on unit-linked business. The business, then valued at £85 billion in the UK and £11 billion in Europe, matched the accumulation stage of the customer saving cycle. Growth here was envisaged through the strategic partnership with Standard Life Aberdeen. It was seen as offsetting the heritage run-off.

Thanks to the acquisition of Standard Life Assurance, Phoenix had become the largest life consolidator in Europe. That, however, was not the total of its activities and source of income. Transactions in the bulk purchase annuity market offered a complementary source of growth, so that Phoenix was the largest life and pensions consolidator in Europe. Moreover, aside from the large-scale sale of workplace pensions and self-invested personal pensions through the open business acquired with Standard Life, Phoenix also acquired Sun Life, a market-leading brand that sells a range of financial products specifically for the over 50s market.

The completion of the integration of the AXA Wealth and Abbey Life business ahead of plan and targets provided a good prognosis for the Standard Life acquisition. The trend under Bannister of achieving more than predictions continued. Whereas the cash generation target for 2017 and 2018 was a range of £1-1.2 billion, over £1.3 billion were delivered. Separately, in August 2018, the Lender Warrants, a legacy of the 2009 Liberty transaction, had been redeemed.

Phoenix entered the FTSE 100 Index on 18 March 2019. This entry greatly increased analyst coverage and the requirement for index trackers to hold Phoenix shares. As a separate indicator of success, policyholders also benefited. Phoenix significantly improved the financial position of its with-profits funds, such that, by mid-2018, three-quarters of the policies were paying an annual bonus again.

In May 2019, Bannister outlined a number of criteria in acquisitions.[29] They were to be ‘cash accretive,’ in that they were to be acquired at a discount. The dividend was to be protected. The leverage must not go above 30%, thus maintaining the crucial Fitch rating. Strategic logic was a key element of thinking. The ambition and rationale, as Europe’s leading life consolidator, thus including pensions but not general insurance, was to buy things. Acquisitions were/are in prospect, as Phoenix has money in the bank. The direction of focus in part depends on opportunities, and these are challenged by threats including economic and political instability. Nevertheless, options are now much greater due to Phoenix having both open and closed policies, being in pensions as well as insurance, and having a role in Continental Europe as well as the United Kingdom.

The auspices were good for Phoenix to be a strong successor to the other insurance companies in the past that dominate the discussion of the industry. These companies indeed have in many cases been subsumed into Phoenix. Many were good names, and very successful companies, notably Pearl, London Life, National Provident Life, and Scottish Provident. As the policyholders put money into

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[29] Interview Bannister/Black.

these companies, there is a direct continuity in the case of many people across the history. Closed books therefore are in practical terms living books; they were and they still are.