Y 2020 Earnings Call

Company Participants

- Jeff Davies, Chief Financial Officer
- Nigel Wilson, Group Chief Executive

Other Participants

- Andrew Baker, Analyst
- Andrew Crean, Analyst
- Andrew Sinclair, Analyst
- Ashik Musaddi, Analyst
- Colm Kelly, Analyst
- Dominic O'Mahony, Analyst
- Gordon Aitken, Analyst
- Jonathan Hocking, Analyst
- Oliver Steel, Analyst
- Steven Haywood, Analyst
- Unidentified Participant

Presentation

Operator

Good morning or good afternoon all, and welcome to the Legal & General Annual Results Call. My name is Adam, and I'll be the operator for this call. (Operator Instructions) I will now hand you over to Nigel Wilson to begin. So, Nigel, please go ahead.

Nigel Wilson {BIO 1535703 <GO>}

Good morning, everyone, and thank you for joining Jeff and I on this call. And I hope you all enjoyed the video. We feel as though we delivered what we said we would deliver. In 2020, our operating profit is flat, our dividend is flat and our balance sheet is in a stronger position than when we went into the pandemic. We're very excited about the prospects for future growth. We feel as though the agenda in the UK and indeed in the US -- and as you have seen, we're announcing Kerrigan is moving to Asia. So, the prospects for future growth are increasing for the Group. We remain totally committed to our dividend policy, which we articulated last year. And we're feeling very confident about our capability to deliver an exciting future here at Legal & General.

The first question is from Andy Sinclair. And Andy?

Questions And Answers

Q - Andrew Sinclair {BIO 17749036 <GO>}

Thanks, and good morning, Nigel and Jeff. Three from me as usual, if that's okay. Firstly, just on new business margin on annuity is really strong. Just really wondered if you could give a bit more color on that, and how we should be thinking about margins for 2021?

Secondly was on LGIM flows, very nice in a tough year but just really wondered if you could give us some color on the pipeline, how has 2021 started so far in your different regions, different geographies?

And thirdly was just actually on the Solvency II review kind of post-Brexit, we probably heard quite a lot during this result season that this margin change is nice but probably not a game changer. But the expansion of the matching adjustment could be quite helpful. I just really wondered, firstly, if you agree and secondly, if you could tell us practically speaking, what does that really mean? Would you be looking at investing in different assets that you aren't able to at the moment or is it just different treatment for similar assets? Just some color there would be would be really helpful. Thanks.

A - Nigel Wilson {BIO 1535703 <GO>}

Okay, Andy. Jeff is going to take the first one, I'll do the second one and we'll do a double act on the third one.

A - Jeff Davies {BIO 20023574 <GO>}

Hi, Andy. Yeah, new business margin, as you say, looks strong. A couple of things going in there, one we can take credit for which is very much good asset sourcing from the team, traded well when the spreads are wider around credit, obviously just pricing well and we play across the whole market from the smallest deals to the largest and we can really focus where we think there's margin.

And so, we benefited from that asset sourcing and that pricing, and doing everything while the reinsurance, et cetera. And then it was just longer duration as well. So -- and there was a quite a lot of business and that was significantly longer duration than 2019. We talked about that at the half-year, and that's just a business mix thing. But generally, margins are up across the business.

Yeah, will that be repeated? Well, obviously duration will be what it will be but we certainly believe we have competitive advantages in sourcing assets and that stands us in good stead to both right the volume and achieve good margins. And I'm sure we'll cover that further in other questions.

A - Nigel Wilson {BIO 1535703 <GO>}

Yeah, on LGIM, we had GBP20 billion of net inflows last year. I think that was a very solid year and in sharp contrast to lots of our competitors. How are we thinking about the world at the moment? I mean America had net outflows last year, which is very unusual for

America, and that was some technical reasons rather than market reasons. America has got off to a good start this year, good inflows already. We're increasing the product offering in the United States.

It's very much about Michelle's strategy [ph], it's very much about modernizing, diversifying and internationalizing. And a good example of that is in Europe where we are increasing our presence across Europe. We are expanding our sales force across Europe. We're seeing very strong demand for our ETFs across Europe. And in general, we're nudging towards moving into higher priced, higher margin products.

Asia, we've been in Asia for a long time, 10 years. We've got a -- what I'll say is a strong foothold. We haven't made as much progress there as personally I would have liked over the last 10 years and moving Kerrigan across to Asia is certainly a signal of our intent in Asia, not just within LGM but right across the board.

And here in the UK, DC pension flows are continuing to be very positive. We had a fantastic year in 2020 and we got off to a great start in 2021, as you heard. This is a very high growth market and we're market leaders in that with a GBP113 billion of AUM on -- we hope in the next few years to increase that to about GBP300 billion of AUM as the market goes from GBP400 billion to GBP1 trillion here in the UK.

In terms of Solvency II, our industry has had a really good pandemic in many ways, I mean you saw our cash collected of 99.9%. Our strategy, which we very much led on of investing in different types of direct investment assets. We are very pleased with the regulators being very positive on affordable housing and build-to-rent housing. And there is a general theme that the treasury, regulator, ourselves, are all aligned, that our industry -- and I think that's all in our industry, I think if you ask of Phoenix, Aviva and M&G, you get a very similar response right now.

See, there is an enormous demand in the UK for the capital that we have and there is a greater array of investment opportunities. Climate change is a huge opportunity for our industry, indeed for the whole economy. We and our industry can play a much bigger role and we intend that Legal & General play the biggest role in that specific development.

So, what has really pleased me is the fact that the regulator, the central government, the local governments and indeed the treasury were all very supportive, leveling up Build Back Better, the 10-point climate plan, and the role that our industry can play in helping deliver economic growth in the future.

That's all I was going to say at a macro level, but if -- Jeff wants to make few other [ph] comments?

A - Jeff Davies {BIO 20023574 <GO>}

Yeah, just I think there is some misconceptions that somehow insurance industry wants to increase risk with this flexibility around matching adjustment, et cetera. We have actually being able to play in a bigger universe of assets and Nigel sets out all the climate-related ones that are a key focus for us.

And by that, what I mean is there are some which have standard contract features which just makes them ineligible, and the most obvious being things like prepayment risk. With -- the big debate was do cash flows have to be completely fixed or can they be highly predictable? And just moving away from that completely foxed allows some flexibility to make sensible assumption than lots of assets together to get diversification and allows you to compete with other funders on a larger pool of assets, not move down in a risk spectrum and take on more risk associated with it.

A - Nigel Wilson {BIO 1535703 <GO>}

Thank you. Next question is from Andrew Baker -- questions. We're expecting two or three from everyone actually.

Q - Andrew Baker {BIO 20402705 <GO>}

Great, thanks guys. Good morning. I will stick with traditional and go with three as well. So first is on LDC. We saw about GBP60 million negative from COVID in the first half due to the stopping in the housing operations. That was that GBP40 million negative than in the second half. Can you just help explain what the driver of the second half impact was there?

Then on LGI, the GBP110 million provisioning in 2021, are you able to give a little color on what you're assuming in terms of US excess debt and then the timing between the first half and second half, if possible? And then finally, are you able just to provide an update on potential longevity charges in the US RBC framework and any impact you might see on the US PRT market as a whole if these two come in? Thank you.

A - Nigel Wilson {BIO 1535703 <GO>}

Good morning, Jeff. I'll answer the first one and Jeff will answer the second and the third one. On the first one, of the GBP100 million, Cala accounted for GBP84 million. The rest of it is largely in -- part of that was in affordable housing, which again got -- was all to do with construction delays in the housing industry as the -- and that was more by accident than by design. I don't think the government really meant for the housing industry to get closed down quite so much. And as we've seen in the latter half of 2020 and certainly in the first 2 months of 2021,.tThe demand for housing has been very strong and forward owners in the housing business are at all-time high at over 50% right now. Jeff?

A - Jeff Davies {BIO 20023574 <GO>}

Yeah, just on the LGI point, the GBP110 million, as you rightly point out, the vast majority of that is in respect of potential claims in the US. We just thought that was prudent given the range of potential outcomes in the US. That's starting to make better vaccine progress, et cetera. We work directly off the industry and population projections. So, that sort of figure would take you add to -- originally it was April, but actually it looks like that figure would take you out now to round about June time, which is when they would see this trailing off to an underlying core number of deaths in the base scenarios, to the IHME projections around that.

It may well have headroom. Of course, there's prudence in that we're not allowing anything for any potential offset in that -- in the annuity portfolio in UK and US. And so, we're comfortable that's prudent, but we think it's a sensible thing to do with that level of variation that's possible in the US from here to, say, the summer.

And then just on the longevity, yeah, I understand it's moving forward as an industry body. I believe the biggest holder of longevity risk, Profen [ph] is heading that up in terms of the individuals for the committee. There's a reasonable distance to go around that. We're in the discussions in the same way when Solvency II came in the UK, companies adapt or deal with it. And whether reinsurance is a solution, whether it's fully retrospective or only on new business going forward, we will see. But the industry will deal with that as and when it happens. I mean we price our economic capital ourselves, which obviously includes allowance for all these risks. And so, we would expect to just simply flow through to see what happens and adapt to the market.

Q - Andrew Baker {BIO 20402705 <GO>}

Okay. Thank you.

A - Nigel Wilson {BIO 1535703 <GO>}

Next question, Jon Hocking.

Q - Jonathan Hocking

Yeah, good morning everybody. I've got three as well, please. Firstly, on the capital strain in the UK PRT, I think, Jeff, in your presentation you said it's around 4%. Given the margin was very strong last year, should we expect that to get a little bit tougher in 2021, more things being equal?

Second question, on LGIM, just on the flow, I appreciate you said it was too tricky last year and then the US that's exceptional. But you've settled down into what seems like lower level of net flows than historically. I think you've gone back a few years, you used to sort of run pretty sustainably sort of net new money a year. Is that a level that you could expect to get back to or is there a new strategy here, more going for sort of margins over volume. That's the second question.

And then the final question, just on the sort of budget with a higher tax rate coming from 2023, to what extent does that change your capital generation plans in the sort of back-end of the strategic plan you put out last year? Thanks.

A - Nigel Wilson {BIO 1535703 <GO>}

Jeff, you want to take the first one? I'll take the second and you can do the third.

A - Jeff Davies {BIO 20023574 <GO>}

Yeah, no problem. Yeah, capital strain [ph] was actually better than the 4%. So, it was certainly sitting between 3% and 4%. It was probably one of the lower strains but the team performed extremely well on that. And we are obviously very conscious of capital usage, given the level of uncertainty through last year. They did benefit, as I said, on the margins from very good asset sourcing, good use of reinsurance. They are a very small team that adapt to whatever the type of liabilities that are coming to us to optimize that metric.

So, we've historically delivered in and around that level, whether it's 3.5% or 4.5%. We anticipate being able to maintain that sort of level, in and around that sort of 4% level that we've done for many years. It remains to be seen how this year plays out and levels of competition. It's too early to have too many pricing points in that and there is plenty of pipeline. So, we'll see how that plays out.

A - Nigel Wilson {BIO 1535703 <GO>}

Yeah, just amplifying on what I said earlier about LGIM net flow, there is certainly a -- under Michelle's leadership, a slight change in the strategy. There is less emphasis on index and volume and more emphasis on ESG, multi-assets, real assets, high yield, emerging market debt, ETFs. And as a consequence of that, we may see lower absolute net flows. But we're hoping for higher organic growth and higher margins from this modification of strategy our over aggressive international footprint. We'd like to see more growth in America, Europe and indeed in Asia.

A - Jeff Davies {BIO 20023574 <GO>}

Yeah, just on the tax rate, obviously that's the headline in the tax rate. There is obviously other areas that may well be positive for us. Overall, we'd see a number of the tax incentives are extremely positive for encouraging investment. But we wait to see what the details are as they come out later in the month. And so, those would -- those could offset some of the rate impact of that. All things being equal, obviously the rate on its own would take something off the range of potential capital cash generation down the track. But that may well be offset and what we'd expect to do. Given the range we have, the GBP8 billion to GBP9 billion and the sort of materiality of the tax change, we're obviously going to stay with those ranges. And we'd look to still deliver in line with those ambitions.

A - Nigel Wilson {BIO 1535703 <GO>}

Thank you, Andrew?

Q - Jonathan Hocking

Alright, thank you.

Q - Andrew Crean {BIO 16513202 <GO>}

Good morning. It's Andrew Crean. A couple or three questions. Firstly, Nigel, you said you got off to a good and positive start to 2021 and you've given a couple of examples. Could you just elaborate a bit more perhaps in terms of the PRT volumes?

Secondly, UK workplace remains I think marginally in loss. Could you just give us a sense as to when that very large business is actually going to ramp up and make proper profit?

And then thirdly, coming back to the risk margin, I mean I know that a reform of the risk margin could add 5 points to your Solvency. It would also massively reduce the volatility, which is I think being the major problem that you've had over the last 5 years. Does that make you think at all about target levels of coverage and whether you could post risk margin change that should be running with too high a solvency margin? I know that's a slightly different question than you usually get.

A - Nigel Wilson {BIO 1535703 <GO>}

Let's answer the slightly different question that we usually don't get, and I'll answer the somewhat easier first two questions. A good positive start -- I mean right across the board, I think it is -- every part of the Group has had a very positive start to 2020. We've seen strong growth in retail protection in the UK, for example, group protections have been very, very strong, annuity business good flows, as we mentioned earlier, LGIM has had good flows into the business. PRT business seem incredibly busy. There is a lot of quoting on deals going on at the moment.

The absolute volume of deals in the UK, at the end of the year -- end of 2021 depend on whether there are really big deals. I mean we saw the market as GBP28 billion to GBP30 billion, last year we had the largest market share of that. We're expecting market to be similar this year. But it partly depends on whether some of -- and certainly some of our big clients are going to do the multi-billion pound deals in 2020 or will they get broken up and done in bits over the next few years. But we're feeling very good about the start -- as I mentioned earlier, the housing market has been on fire in the first 2 months.

On workplace, that may be a little bit of misunderstanding, I think communication on our part. We're probably [ph] separated in two parts. One of it is the platform which is the number that is the loss-making, which is a sort of GBP80 million to GBP90 million type of business that the DC platform business sits on, which has always been owned by LGAS, so it's slightly in the insurance business. But for a number of years, it was managed by LGIM. LGIM absolutely makes profits of the manufacturing parts of the business, manufacturing the assets. And so, the GBP113 billion or even more now that we've got today is actually very profitable for us as a business activity. The platform itself isn't.

We transferred that in a sense back into LGAS. There it always sat in LGAS from an ownership point of view. It now comes under Andrew Kail who joined us and is part of the pension strategy that we've got there. And so, you will see some more innovations within LGRR around the Workplace Savings platform. And our ambition is very much to make that a profitable part of our business on a go-forward basis.

But it sits in Cardiff. The team are looking at how do we automate more, how do we make it a bigger and more successful part of the Group and hopefully in the future use it as part of our international expansion, because there is hardly a country in the world that doesn't want to have wider (inaudible), the bigger DC business and more efficient platforms.

Jeff, you want to take the third question?

A - Jeff Davies {BIO 20023574 <GO>}

Yeah, just on the risk margin, yeah, you're right, Andrew, that we provide the sensitivity. I think that's on a 66%, two-thirds reduction in risk margin. Obviously, it will very much depend where the final regulation ends up. And when all of our regulation lands, we will reassess one in 20%, one in 50%, one in 200%, what's the sensitivity of our capital and reassess all of our sort of internal tolerances that we work to. And so, that will be a process that we go through. Whether there is a scenario in that where it sufficiently changes the sensitivity to rates, credits, et cetera, that we think we can run with less capital, it remains to be seen. We push on the outcome at this stage and worry about that in -- at a later stage.

Q - Andrew Crean {BIO 16513202 <GO>}

Thanks.

A - Nigel Wilson {BIO 1535703 <GO>}

Colm?

Q - Colm Kelly {BIO 19140684 <GO>}

Hi. Thanks a lot, Nigel and Jeff, got taking the questions. Yeah, so look, two main questions from me. First one is just on the annuity portfolio, becoming self-financing at a GBP100 billion of assets under management, I suppose that at GBP87 billion at the end of this year or with another year of expected new business, you'll be close to that number in terms of assets under management where it becomes self financing. So, where does that timeline fit relative to the 3 years to 5 years that you had indicated before, so maybe if you can discuss that?

And secondly, just on management changes, obviously quite a lot of changes announced today across the divisions, including both CEOs of the annuity businesses and obviously Andrew Kail coming in. Obviously, one was required due to Simon retiring but perhaps the other is a bit less expected. So maybe just the rationale for making so many divisional management changes this year, particularly in the context of it being the continued uncertain trading environment that we're operating in. And maybe (Technical Difficulty) --

A - Nigel Wilson {BIO 1535703 <GO>}

(Technical Difficulty) question.

A - Jeff Davies {BIO 20023574 <GO>}

Yeah, sure. I mean the self-finance, as we said, it was in the range of GBP90 million to GBP110 million [ph]. There is some dependency there on the type of business we're writing, levels of strain, as John referred to earlier. But we're getting close to that sort of range now. We'd said it was at that range, which puts us 2 years, 3 years away potentially from being there. So you're right, that's -- it's GBP87 billion with a good deal of new business. You do get some run-off, of course, of the back book of the order of GBP3 billion, GBP4 billion as it gets bigger. So, we made progress towards that.

We're actually thinking we will -- look, that might be an area we'll be looking to add -- to disclose. We haven't really decided what would be helpful and what we can show on that. But it's clearly something where it would be useful to try and show some progression towards, but it's whether we can produce something meaningful around that, that is something we'll look at.

A - Nigel Wilson {BIO 1535703 <GO>}

Yeah, on management changes, we actually have a relatively stable operating environment and reasonably predictable demand for our products. So, we're feeling pretty good about that. On the specifics, Simon Gadd has been due to retire for a while and we have known about that for a while. Chris Knight, it's always part of his career development that he wanted to become the CRO and has -- the transition been in progress for several months already. Andrew Kail joined us several months ago, officially just started last week. Kerrigan was made Chairman of China quite a long time ago and has been working with me and others on our strategy for Asia. Laura used to run a large part of LGC and so moving her back to LGC, she'll just run the whole of it now and have responsibility for that.

Kerrigan is not going to take up his position until later in the year and Laura is not going to move across until later in the year. We're just flagging these externally. We flagged them internally a while ago, that these moves are going to happen. And it's very exciting to have Andrew join us. It's fantastic that Kerrigan is putting his hand up and he is going to move to Asia because I think it's difficult to do that job, fly in, fly out. It's very exciting for Laura that she's going to move across to LGC. So, we feel as though overall we've got great continuity. We've continued to strengthen the capabilities of the Company. And we've given some new challenges to some of our best and most successful people.

Next is Gordon.

Q - Gordon Aitken {BIO 3846728 <GO>}

Yeah, thanks. Good morning, Nigel. Good morning, Jeff. And three questions please. First on the mortality release of 177, can you split that out between the base table effect and the future projections, as you've done in previous years?

And staying with the mortality, second question, you've said you've conservatively adopted the CMI-18 tables. Now, CMI-18 is -- was a 6-month reduction and less expensive versus 3 months with a smoothing factor. If you can maybe just say how many months did you effectively reduce life expectancy by -- in your release today and maybe comment on the smoothing factor and what it currently is and whether or not it changed?

And just third onto this -- back to this point about the post-Brexit Solvency II reform, in terms of changes in the risk margin, I know you've talked about sensitivity of a 66% reduction. But do you share the views that the ABI [ph] put forward their proposal? And if the risk margin was to be reduced, would you then stick with the previous guidance of you actually retain more longevity risk? Thank you.

A - Nigel Wilson {BIO 1535703 <GO>}

Yeah, I think, Jeff, if you do one and two, I will do (inaudible) on three.

A - Jeff Davies {BIO 20023574 <GO>}

Yeah. I mean the 177 is all trend assumption. There is no -- there was no material base table changes. We did our normal BAU where we just reassessed everything against experience though obviously there is a lot of distortions in 2020 data. So, it's really the move to CMI-18 is that 177. So, it's all trend assumption there. As you say, we say we've been pretty conservatively adopted that. So therefore, we're at the -- much at the lower end of your 6 months. You're talking 1 month or 2 months of change would drive that sort of level for a book of our size.

We just think that -- you can see the CMI-19 data. So, that's fine. We can allow for that. We definitely didn't want to overshoot what that was telling you by any means. And at the same time, there is a lot of noise in 2020. Normally with a book of our size, we will have an early indication of how experience is playing out and what it looks like a couple of years ahead of the table were adopting. But clearly, we didn't have that this time. There are a whole range of new dynamics going on. We don't know whether there's going to be underlying COVID deaths, what will happen to flu or there will be different attitudes to health, more people will look at the impacts of a B2C [ph] exceptional outcome, will there be more funding of health services. So, we want to spend a lot more time looking at that, understanding what the impacts have been before we would move forward with any further releases around that. So, we'll -- keep monitoring it, advance around that.

A - Nigel Wilson {BIO 1535703 <GO>}

Yeah, on the post-Brexit Solvency II, I don't think any of us are thinking that this is going to be a capital windfall for us as an industry. And knowing Simon and the rest of the team that the regulator -- they give it with one hand, they'll take it with another around that. I think on the risk margin and what level will we return greater longevity risk, at 66% it's in that pivotal area. We actually thought and asked for even more than that in the submission that we made to the treasury on this. So we do think there really needs to be a fundamental change in that. And I think everybody in this industry accepts that. And I think that's the big change.

I think the -- what the industry is looking for and what the ABI -- we are not members of the ABI but what we're all looking for is more flexibility and matching adjustment, that we -- I think there is a genuine desire to play a bigger role and to get much more asset flexibility, as Jeff rightly pointed out. This isn't a charge for additional risk for us. It's actually a charge from greater diversification, more relevance as an industry, and that we are allowed to invest in assets. We own 25% of PodPoint which will be the UK's largest electric vehicle charging. That type of asset at some point will be, we think, appropriate to put into pension funds, anything that's got a future stable cash flow.

We own of -- onshore wind is an asset class that we've been interested in and invested in for a long period of time. We'd like to see structures emerge and an opportunity to invest and put that in the annuity portfolio as well. So, that's another one that we want to put in there. Carbon captures, yet another one that we want to include.

As we mentioned earlier, various types of housing, build-to-rent housing, affordable housing, are all things that we want to do. Ironically, we've already got housing for homeless people, which is part of our -- it's part of our (inaudible) included in the pension, in the annuity business. And so, our regulator has definitely accepted this. We have moved on a long way in the last 10 years. We used to have to trot across on a deal-by-deal basis and get the non-objection on a transaction-by-transaction basis.

I think the Bank of England, Andrew and Simon and his team, the PRA, are all realizing that we can play an important role in future policy as an industry and that they shouldn't just be looking at sort of the banks to help out. It's very much our ability to have patient capital and lots of different forms of capital. And the sheer size that we are, w have GBP1.3 trillion of assets under management, so that's going to get bigger. We've put a -- as Colm [ph] highlighted, very close to getting GBP100 billion in annuities. You start investing GBP10 billion, GBP20 billion of that in different types of assets and in new assets, GBP20 billion is 1% growth for the UK economy. As an industry, we can easily achieve that.

Next question, Oliver.

Q - Oliver Steel {BIO 6068696 <GO>}

Hi, good morning. Three questions from me. First is the impact of higher interest rates, I mean you talked about the impact on solvency and to be fair, you've also talked quite a lot about flows today. But I wonder if you can just give us a broader sense, for instance the impact on AUM, whether there is a sort of change of mix because of higher interest rates in terms of LGIM flows, any benefits coming through on the PRT or individual annuity front, LGC and capital generation more widely?

Second question, maybe if Nigel goes just a bit out, but the expenses within LGIM were actually a bit less than I had expected. Is that something you recognize? And can you just remind us of the expense progression that you expect in LGM? And then the third question is on Kerrigan moving to Asia; what are you -- what's the sort of -- can you just sort of take us through what the sort of targets might be -- loose targets might be for that business?

A - Nigel Wilson {BIO 1535703 <GO>}

Yeah, those are interesting questions, Oliver. I think on interest rates, we've highlighted the major changes in interest rate. I think everything else is second order. I mean theoretically, we should see PRT volumes increasing but we -- there has never been much of a correlation between volumes and interest rates in the past.

In terms of LGM flows, as you went through that list that -- I went through the list earlier, there's minor second order impacts on all of those flows. But everything is second order.

On expenses at LGM, yes, we did see some progress in 2020 and we are very aware that LGM's expenses have gone up 10% per annum for quite a long period of time and that's higher than we would like and that the team are working incredibly hard to make the business more efficient.

On Kerrigan to Asia, I mean we've been looking at opportunities over a number of years. We shied away from the insurance opportunity that a lot of other people had. We have various relationships out there that we've had for a number of years that we'd like to scale up now, particularly on the LGR side, on some assets sides for LGR, on the LGIM side where we've been leading with some index funds and fixed income funds in the -- into China and the rest of Asia. We want to particularly increase our share of ESG funds in China, Japan and the rest of Asia.

We recognize that there's huge changes going on in the pension industry and the wealth industry in China. And on the pension industry in particular, we think we have a big role to play, as that -- we're pretty sure that'll eventually move to an auto-enroll pension system out there. DC is going to play an important role. And the richness of our asset base, our experience here, is we again think market-leading, and people are really interested in what we have to say about ES&G because we've invested directly in all of those asset classes.

And so, a lot of our peers in China and the rest of Asia are very interested in what we've invested in. Modular housing is something that doesn't trip off the time [ph] for an insurance company or an investment company in China. But there's a huge amount of interest in particularly that part of our business. And as you may have seen today, we announced in Bristol that we are building modular houses which are affordable, EPC, A rated, they have been manufactured in the north just outside of Leeds. So in terms of leveling up, Build Back Better, having a social conscience, modernization, building affordable, creating assets potentially for LGR, this sort of investment ticks all the boxes and you'll be seeing more of that from us on a go-forward go-forward basis.

Okay, Steve.

Q - Steven Haywood {BIO 15743259 <GO>}

Good morning. Thank you very much. Three questions from me as well. Just following on from your last comment about Asia, have you considered or are you considering inorganic growth there as well by potential bolt-on M&As or joint ventures with partners?

Secondly, you talk about in your results a GBP228 million negative COVID impact in 2020. Now, it'd be interesting to see how much of that you think will reverse in 2021. Obviously the GBP110 million provision and should not come through again in 2021, assuming your assumptions and the vaccine rollout is going in line with that. So it'd be interesting to see what other aspects of this GBP228 million could potentially reverse in the 2021 results?

And then finally from me, on third-party capital in LGC, now it's very interesting because obviously (inaudible) paid for us to see what third-party capital is coming in here. Can you give us an idea of the pipeline of third-party capital? Can you talk about any particular names or types of institutions that are looking to invest with you as well? Thank you.

A - Nigel Wilson {BIO 1535703 <GO>}

The first one -- Jeff will take, the second and I'll do the third. It's very unlikely that we'll do acquisitions in Asia. It is very likely we will do joint ventures in Asia. I think we've had discussions with a number of people over the years on joint ventures. We've got a couple of people now we're working with who we think are much more likely joint venture candidates for us. But you won't be seeing a multi-billion pound acquisition for us in Asia in 2021 or in 2022.

A - Jeff Davies {BIO 20023574 <GO>}

I know from partnerships as well, not traditional legal JVs. There's many ways that you can work with people to -- in partnership to grow in the region.

Just on the second one, yeah, I mean you're right. I mean, we would look at those -- we've hopefully provided for the claims we'd expected to see from COVID in 2021. And obviously, a huge range of uncertainty around that and how it could play out. Cala is having a fantastic time at the moment with strong tailwinds coming into the business. So, we would expect that to experience a very strong 2021. Again all things being equal, lots of uncertainty around that. And we wouldn't expect to see the Group cost elements being repeated either. And so, we're positive to see turnaround in those and we should expect to see a nice increase around that.

Obviously, other businesses need to perform as well. Some of them had exceptionally strong results in 2020 in that environment with good strong new business margin. So everyone needs to continue performing, but we're going into the year confident with a level of uncertainty that you all know about.

A - Nigel Wilson {BIO 1535703 <GO>}

On third-party equity capital coming into the businesses, if you look at slide 13 and 14 in the pack that we sent out, Pemberton clearly -- we set up a number of years ago, we put the actual data on slide 14 showing the AUM growing from not GBP0.5 billion to almost GBP10 billion in five years. We'd expect that trend to continue, that we'd see absolutely further support and further funds coming in from third parties. They have over 100 LTEs already in Pemberton.

In -- so livings and other areas that we think will see third-party equity flowing into that. Build-to-rent we've already got third-party equity in the terms of a partnership with TGM. LGIM has already set up a fund, which has a number of insurance companies and pension funds. So, we're co-investors in that.

NTR has already started on the third-party capital coming into the business. PodPoint is another one where we think we'll accelerate its growth through further third-party financing coming in there. I don't think for the next few years much will come into Oxford. We'll be very much doing that on our own. Bruntwood SciTech, we are still establishing the business. We've got a number of exciting opportunities, and Jeff and I are doing a road trip together very shortly to look at one of those opportunities. The datacenter business, we'll probably bring third parties into those and fund of funds and ADVs will certainly bring third-party funding into those. The exact amounts of that we'll tell you as we make various releases. Some of those will happen as early as the first half of 2021.

Thank you. And next question is Ashik.

Q - Ashik Musaddi {BIO 15847584 <GO>}

Good morning, Jeff. Just a couple of questions, I have maybe three. First of all, how do we think about debt leverage? Now if I look at your peers like M&G, Phoenix, Aviva, everyone is kind of targeting debt leverage as a percentage of Solvency II Own Funds of about 30% whereas you are at about 34%. And if I look at the maturity profile of your debt, I think there is only one bond of GBP300 million coming to maturity of this year. And for next 4 years, 5 years, there is nothing. So, how do we think about that given that your peers are targeting, less than 30%, you're at 34%? Would you use the extra capital because of rising interest rate to reduce leverage on an accelerated basis or you're absolutely fine with this?

Second thing is, if I think about illiquid assets, I mean that is now about GBP30 billion direct investment in total out of GBP120 billion of total assets you have. I mean how would you classify your risk appetite? I mean, it's about 24%, 25% at the moment. Peers are saying, they can go to -- up to as much as 40%. Would you say that more or less that's what your plan is as well?

And thirdly is in terms of assumption changes, if I look at the assumption changes year after year after year, it -- for last 3 years, 4 years, 5 years, maybe it's about, say, 20% of your Group earnings. So how do we think about that going forward, like would it be a consistent feature of your IFRS operating profit or would you say that because longevity releases could now reduce as we have seen this year in 2020, this would be much less prominent feature going forward? Thank you.

A - Nigel Wilson {BIO 1535703 <GO>}

Those questions are all for Jeff actually.

A - Jeff Davies {BIO 20023574 <GO>}

Yeah. And then the debt leverage, I mean we talked about before, we will focus on the rating agency leverage ratios, Moody's adjusted has usually been a number that's been relevant for us. We've said we're at the top end where we'd expect to be at the current time. But as you say, there is a debt coming in July, we'll look at that and what we want to do with that. Obviously, any redemption of that would reduce the leverage. And we have a strong conviction that we will grow our balance sheet. So in many ways, that -- as our business grows, those leverage ratios naturally fall for us and that's what's happened consistently for us over the last 4 years, 5 years, 6 years.

Whenever we go raise a debt we grow the balance sheet, book value again grew 5% this year. The balance sheet continues to grow. And so, our leverage ratios reduce in that way. And so, we drive the growth. That's how we invest and we continue to do that.

On the illiquids, yeah, you pointed out. It's less than 30% at the moment, so plenty of headroom in that. We've talked about a 40% to 50% range and the important point within that is we don't consider all of these assets illiquid by any means. And so, yes, there is a ballpark figure, is it 40% to 50%, but we do a lot more analysis underlying that to work out what do we think is truly illiquid versus what we think is liquid. And it's the liquidity of the total asset portfolio that we look at in determining where we would set that range. But we have plenty of headroom in being able to achieve that to get to those sorts of levels.

Just on the assumption changes, actually the longevity release was up this year to last year, it was 177 versus 155. So, we obviously focus on the numbers exclude in longevity releases for that very reason because it distorts some of the figures. So, then there obviously it helps. But it's not the way we run the business, not what we've shown in our ambitions.

And so, we have regular reviews. We have BAU reviews of mortality across our -- all of our business of persistency, we run through those. There are always areas of modeling that need updating, whether it's discussions with auditors, whether it's just prudence that's built up, and as a line of business grows or an assumption grows it becomes more material and the sort of the more ad hoc version you put it at the start, it needs to be made more accurate and invariably we've been conservative in those. So, we just carry on with that process and that leads to changes along the way as BAU.

Q - Ashik Musaddi {BIO 15847584 <GO>}

Okay, thank you.

A - Nigel Wilson {BIO 1535703 <GO>}

Yeah, the GBP300 million is at 10% coupon, so we saved GBP30 million of interest as well to boost earnings on an annual basis, on a go-forward basis, if we actually do pay back in July. Next question is from Ming-Ju [pj].

Q - Unidentified Participant

Hi, good morning. Just two questions from me please. First, as your US and pension risks transfer, that -- the growth has been excellent. Could you just give a little bit more color in terms of the competition and the sort of competitive edge you have there and what have you done or what more actions are there to do in terms of going forward to capture opportunities in that market?

And my second question is, your credit default was just GBP3.5 billion still unutilized and given what happened last year and there's no default, I mean the assumptions you've got behind to calculate that credit default reserve, I mean is that too conservative? Just two questions please. Thank you.

A - Nigel Wilson {BIO 1535703 <GO>}

Jeff, answer the second question, but I do agree, it's too conservative, but I'm not going to win that argument necessarily. The -- on the US PRT, yeah, we had a fantastic year last year. We've taken a very measured approach in the United States recognizing that so many UK firms have not succeeded in America and so we determined to be very, very successful. And just as an illustration of our success, in the good old days when we were busy building up the team there, we had very few people who really wanted to come and work for us. We had to work incredibly hard to get people to join us.

We advertised for a job a couple of weeks ago, we had 300 applicants, 300 highly competent applications, because people love the fact that we are supporters of inclusive capitalism, for ESG, and so our brand is resonating incredibly well with customers in the United States. I'd say the US is a -- there are more competitors in the United States. So, the competitive intensity is greater in the United States. We're constantly adding to our DI capabilities through -- in America. They're not as good as we want them to be. In 2 years or 3 years' time, we'll have a much stronger DI offering in the United States or DI capability in the United States, and that's part of the strengthening that we've been doing of the team in the last few years.

So, we are very well known now. We get access to most of the deals. We're competitive on deals. There isn't anybody we think has a tremendous competitive advantage over us. It's not quite like the UK where we absolutely have competitive advantages over everyone we think in the UK, and that's one of the reasons we've had tremendous long-term success. But we're very -- working very hard to fill the minor gaps that exist between our competitive position and say the proof in the United States. And certainly, the brand resonates incredibly well.

Jeff, do you want to take the second question?

A - Jeff Davies {BIO 20023574 <GO>}

Yeah, I mean there isn't a lot to say now. We haven't fundamentally changed our methodology for years on that. We take a pretty fixed demand, which is of the order of a sort of a 40 bps or so amount that we put in there. There then is an additional loading on top of that. We benchmark it around the industry. And we think it is conservative. And as you say, the fact that we didn't use it and we haven't used it, there is still uncertainty in how the economy plays out.

There are elements of it that we then are trying to run off over time. But of course, as the portfolio grows and actually with interest rates falling as well, the total amount in the reserve goes up, as you've seen. So, there is a small element around the edges that we're trying to run off, Ming. It's slowed by the business growing. We think it's conservative. It's useful to have that. Investors like having it and we would -- we've talked about we would use it in the event of defaults, et cetera. So, I don't think there's a lot more we can say on that.

A - Nigel Wilson {BIO 1535703 <GO>}

I'd just like to say thank you to our team again for year after year after year, we've had zero defaults and the cash collection on the investments has been truly outstanding and industry leading. And so, we've got a great team. We work together in a very collaborative way. I just -- I can take this opportunity to thank you for them all.

We've got two more questions to come. The first is from Larissa [ph] and the second from Dom.

Q - Unidentified Participant

Thank you and good morning. Two questions; the first one, you had a strong year on bulk annuities in the US. Can you give us a sense of how margins in the US compare versus those in the UK and how you see those evolving in time? The second question, also on bulk annuities, your new business trend, been low at 3% to 4% for some time, as you mentioned earlier. How sensitive is that to inflation? And what happens if inflation reverts back to the 2%-odd or higher that we have seen historically?

A - Jeff Davies {BIO 20023574 <GO>}

Yes, sure. The key determinant for us in pricing the business in the US is a return on economic capital. We think that reflects all the risks. We target the same sorts of returns as we do on the Solvency II capital in the UK. Clearly, we think there is upside in both obviously economies of scale and how much we can spread expenses in that business as it grows. And as Nigel talked about, in the DI capability and asset sourcing, which is nowhere here obviously as efficient as it is in the UK, so both those would give us upsides in those margins. But they are broadly comparable in a capital allocation return on capital sense but not all metrics are equal for other reasons.

So, we're comfortable with that. We're pleased to grow it. It's a competitive market at times. And then we don't allocate capital. We then allocate it to UK deals. And similarly, we were a player in the Canadian market. So, we can look at these and decide where we put capital to make sure that we're getting the right returns on our capital as we put it to work.

On new business strain, yes, that continues to be efficient. It is entirely something -- we don't take inflation risk explicitly on any of those as it does -- obviously do something to the duration. You have the inflation element, so you get typically longer business in UK versus US. But we're not active takers of the inflation risk on that. As Nigel would say, we don't think it's a (Technical Difficulty) risk. We look to hedge and as said, in a similar way to interest rates. And so, it doesn't have a big impact on it. It's much more driven by the strains at the moment around what we do with reinsurance, for example.

Q - Unidentified Participant

Thank you very much.

A - Nigel Wilson {BIO 1535703 <GO>}

Dom?

Q - Dominic O'Mahony

Hello. Hi folks, hope you can hear me. Two questions from me if that's all right. Just coming back to Asia, Nigel, it was interesting to hear your comments earlier about having sort of in the past shied away from insurance risk there. Clearly, LGIM has a real opportunity there. You mentioned, the asset side of the LGR. But would you consider other most of the risk-based growth in Asia? I mean, it may sound like a bit of a wild card but the Japanese defined benefit pension sector, you might think that's right for an emerging PRT market. Is that something you could be interested in?

Second one sort of on the maths really, LGR, the release from operations, just as a percentage of the opening balances, on my math that declined from being in the sort of the mid '90s -- in terms of basis points on the opening balance, where I think for a few years it was something in the mid '80s. Is that essentially some sort of COVID effect in 2020? Would you expect it to get back to something like the mid '90s going forwards?

And then thirdly, just on UK PRT, I understand that there have been some emerging structures that some of your competitors are using that involve sort of full costs that are at risk including asset risk through to insurers in North America. Is this sort of new structuring creating more competition in the UK markets? Is there any sign that actually things are intensifying? Thank you.

A - Nigel Wilson {BIO 1535703 <GO>}

I'll take the first one, Jeff can take the second and the third questions. On Asia, the answer that is we do like to take informed and rewarded risk. That's a big thematic about what we are as a firm. And we felt entering some of the Asian markets before we were taking unrewarded risks, if you like, and with counterparties who maybe didn't always have the capabilities that we'd want to work with. So, we definitely have much more capability now than when we first looked 8 years to 10 years ago at the Asian opportunities, both in the products offerings and the strengths of our specific businesses.

And really our digital capabilities, I think we haven't talked to you about very much on this call, but if you were to ask Jeff and I what really excites us about what we've achieved during the pandemic, our digital capabilities have sold and as a consequence of that we think we have more opportunities for international expansion, including in Asia.

Jeff, do you want to take the other two questions?

A - Jeff Davies {BIO 20023574 <GO>}

Yes, sure. Yeah, I mean I don't think there's anything in particular going on within that release of operations as an element. Yes, of course [ph], there is clearly an element that's COVID. I think you're looking at the two, so total annuity profitability within that would be slightly reduced volumes from LTM, which then less profitability coming through which dragged it down a fraction, which is obviously COVID-related, and also some of the cost of setting up the advice business around the LTM. So, they're small figures, which really is why you get that little dip. So, we're not seeing anything dramatic. We're not expecting changes within that away from the norm I would say.

Yeah, the asset reinsurance, that's something we've talked about a lot. We've done trial versions of that, if you like. We've not done an enormous scale. But we clearly have many counterparties that would be interested in doing it with us. It's a way that we would fund larger volumes in a year if we thought that made sense. So, there is capital that is keen to be put to work in the UK PRT market. We're as well placed as anyone to source the front end of that and to access some of that capital.

So, we continue to talk to all of exactly the same parties. We have some ready to go on the blocks as and when they're needed. And equally, we do some proof of concepts to make sure that we can do everything that's required from reporting to the legal documentation, et cetera. So, I think it's helpful for the market. We all know there is still a huge, huge potential market in the UK and a relatively limited capital pool that can write that business. And so we're always looking at efficient ways and ways to access that, and I think that's helpful.

A - Nigel Wilson {BIO 1535703 <GO>}

Yeah. Again, I'd just like to say a big thank you for all of you on the call. There is over 200 people on this call. So, that shows the very high level of interest and they all weren't [ph] relatives of Jeff and myself. We're very happy with 2020, as I said at the beginning, operating profit flat, dividend flat and the balance sheet stronger.

Jeff made an important point about rewarded and informed risk, which is what we're about. Yet again we had no defaults. We had 9.99% of our cash flow from DI was paid. As Jeff said, we had GBP110 million of COVID costs that we took for -- in 2020 which related to 2021, so that will be hopefully not repeatable. And Jeff keeps telling me those are prudent. And Cala was GBP84 million. Together, those two account for GBP200 million of it. And I think that those will be reversed in 2021. And whilst we didn't mention it here, the LGI investment variance with -- if they stay where they are right now, that will be better than reverse in 2021.

Public policy is moving our way. Our capabilities have increased. We've strengthened our management team. We've got a very focused strategy which is delivered continuously for us over the last 10 years. And we look forward to the future with confidence. And certainly, we've got off to a very good start in 2021. I hope very much that we will see all of you in person. At some point, we'll welcome you all to our office here in Coleman Street. If not, I'm sure there's one or two well known drinking establishments that would more than welcome us at some point in 2021 given that -- the poor customers that they had in 2021. And we're hoping that we and many of us can support the city as the city returns to business and try to re-establish its position or establish -- continue to establish its position as a world-leading center.

So, thank you. Have a great 2021.

Operator

Ladies and gentlemen, this concludes today's call. Thank you very much for joining. You may now disconnect your lines.