Q1 2014 Sales and Revenue Call - Interim Management Statement

Company Participants

- John B. Pollock
- Kerrigan Procter
- Mark J. Gregory
- Mark J. Zinkula

Other Participants

- Abid Hussain
- Alan G. Devlin
- Andrew J. Sinclair
- Andy Hughes
- Fahad U. Changazi
- Farooq Hanif
- Gordon Aitken
- Greig N. Paterson
- Maarten Altena
- Marcus W. Barnard
- Ravi Tanna
- Zak Smerczak

MANAGEMENT DISCUSSION SECTION

Operator

Ladies and gentlemen, welcome to the Legal & General Q1 Results Conference Call. My name is Duncan and I'll be the operator for your call this morning.

I will now hand over to your host, Mark Gregory, to begin today's call. Mark, please go ahead.

Mark J. Gregory {BIO 15486337 <GO>}

Good morning, everyone, and thanks for joining the call. I'm joined in the room today by various members of the management team, including John Pollock, CEO of LGAS; Mark Zinkula, CEO of LGIM; Kerrigan Procter, Managing Director of Legal & General Retirement; and Paul Stanworth, Managing Director of Legal & General Capital. Once I've given an opening statement, we'll take any questions that you have.

Today, we've announced another quarter of record results in which we delivered strong growth in cash generation as well as in sales and asset flows, once again benefiting from our responses to the underlying global macro trends of Asian populations, homogenous asset markets, welfare reform, digital lifestyles and bank retrenchment.

Before I give an overview of the Q1 results, I'm going to cover the recent industry developments, following the budget in March, and the subsequent auto-enrolment default fund charge cap announcement. Whilst the timing and the precise nature of these changes was not known to us, the direction and travel towards greater customer choice and fairness has been clear for some time.

We positioned our strategy and our business model to benefit from these trends over the longer term, and so we welcome the changes as they accelerate the evolution of the market. We expect to replace reductions in individual annuity volumes by Bulk Purchase Annuity business. So the total amount of annuity business we plan to write over coming years has remained unchanged pre and post the budget.

The total size of DB pension schemes in the UK private sector is huge, with £1.8 trillion of liabilities on a buyout basis. We, therefore, expect demand for BPA to increase over time. We're agnostic on the outcome of the consultation on individual transfers from DB to DC, as we believe none of the five outcomes being consulted on is likely to materially affect the BPA market.

We support the freedom of choice that allowing such transfers would give, as long as they are subject to appropriate customer protection and fairness safeguards. And in the event those significant transfers do occur, DB schemes are likely to find de-risking solutions more affordable.

For individual pension savers, we plan to provide a simple drawdown facility for customers, backed by a range of LGIM funds, appropriate for savers approaching at and in retirement. We refer to this as account-based drawdown, given its simplicity and similarities to a bank account.

For customers concerned about outliving their finances, we're committed to provide a full range of annuities, from standard to impaired, and level in payment, to investment linked. On corporate pensions, we welcome the government's announcement of a pension charge cap for auto-enrolment default funds, which will focus consumers on our value-for-money products.

We're already operating our pricing no higher than 50 basis points, so would have supported an even lowered cap than the 75 basis points announced by the Pensions Minister. The auto-enrolment charge cap, together with the higher annual ISA limits, will encourage further retail and pension savings and we will benefit from our market-leading workplace savings business, and our ownership of the UK's largest retail savings platform in Cofunds. These developments validate our strategic positioning and we're excited about our future prospects in all these markets.

Turning now to an overview of our business performance. In our Legal & General Retirement division, annuity premiums total £3.3 billion, which is four times higher than the same quarter last year, and included the largest ever UK bulk annuity contract, covering £3 billion of the ICI Pension Fund's liabilities. We continue to see strong quote pipeline for bulk annuities, as pension scheme trustees and their sponsoring employers are increasingly seeing the economic environment as a more favorable one in which to transact. Our leadership in investment management and longevity mean we're well positioned to capitalize on rising demand for Liability Driven Investment, longevity insurance, buy in and buy out.

We expect the individual annuity market to contract by around 50% in 2014 and by around a further half in 2015, as a result of the budget changes. One thing which will remain unchanged in the annuity and longevity market is our pricing discipline. We're very focused on delivering our target return on economic capital.

LGIM now manages £463 billion of assets, up £13 billion from the year end, with total flows for the quarter of £3.8 billion, and an improved persistency of 93%, up 2 percentage points from Q1 2013. LGIM's international expansion continues with £2.6 billion in net flows from international clients. And LGIM's bolt-on acquisition of U.S. based Global Index Advisors, announced in February, is on track to complete this month. And will provide LGIM with scale and distribution in the $6 trillion U.S. defined contribution market. In addition, we continue to build our international presence outside the U.S., particularly in the Gulf, Europe and Asia.

In LGAS, our market-leading UK Retail Protection business delivered new sales of £42 million, 56% up on the prior year, and a new record for quarter one business. The total amount of Retail Protection premiums we receive over a 12-month period now exceeds £1 billion.

Our Savings business had net flows of £1.6 billion, boosted by the addition of Cofunds' net flows, and the continued success of our workplace savings platform, which now has £9.1 billion of assets under administration.

Legal & General America delivered another strong quarter of growth, with 12% increase in sales, up to $38 million. We accelerated the rate of progress in Legal & General Capital, where Paul Stanworth and his team completed £1 billion of new direct investments in the quarter.

We make direct investments to deliver a risk-adjusted yield enhancement which, in turn, supports the wider group, such as the £3 billion ICI bulk purchase annuity deal and to enhance the return on our shareholder funds. Those are the trading highlights for the quarter.

In addition, our net cash generation was up 21% on last year at £301 million, with operational cash growing 6% year-on-year, and a small positive new business cash surplus, driven by the volumes of Annuities and Retail Protection business we wrote in the quarter.

Looking ahead, we're confident that our diversified portfolio of businesses mean we're well-placed to take advantage of the opportunities that are arising from our five identified macro growth trends. And the recent industry announcements will accelerate these trends. We look forward to continue to deliver value to our customers and for our shareholders.

I'll now open up the call to questions.

Q&A

Operator

Thank you. And our first question today comes from the line of Andrew Sinclair from Bank of America Merrill Lynch. Please go ahead, Andrew.

Q - Andrew J. Sinclair {BIO 17749036 <GO>}

Morning all. I've got three questions please. Firstly, on the pipeline for bulk annuities and longevity insurance transactions, can you just tell us how much visibility do you have on future deals and whether you're seeing any increased competition in these markets? Secondly, I think Cofunds has historically been overweight ISAs relative to the other major platforms. Given the increases in the ISA allowances and other changes in the budget, can you tell us how much this changes the prospects for Cofunds?

And thirdly, just could you tell us your thoughts at this early stage on how the transition from accumulation to decumulation is likely to work in the new retirement landscape, and what role you think the free guidance process will play in this? Thanks.

A - Mark J. Gregory {BIO 15486337 <GO>}

Okay. Thanks, Andy. So, Kerrigan, pick up the one on bulk and longevity pipeline visibility. John, do the Cofunds one, and I'll say a few words on the whole guidance process, how that might play out.

A - Kerrigan Procter {BIO 15093363 <GO>}

Great, okay. Just on the bulk annuity pipeline, you talk about visibility and in terms of timeframe for that. It's probably between three months for the smaller deals to nine months for the larger deals, so things are in the pipeline in terms of large deals, we give (08:55) an idea of what's coming through the market probably over the next nine months or so and that obviously shapes our thinking.

In terms of increased competition in the market, your question about there, the answer is no really, in – we haven't seen that yet. I think we talked about this earlier in the year that, really, our area of focus at the moment is probably the larger end of that market. And that's, as we've mentioned several times before, that the skill sets required to be successful in that market are, let's say, hard one; (09:35) it's quite a barrier to entry for other people to enter that part of the market. So certainly no signs of increased competition in there, it still looks a favorable market for us.

A - Mark J. Gregory {BIO 15486337 <GO>}

Great, thank you. (09:45) John?

A - John B. Pollock {BIO 6037447 <GO>}

Hi, Andrew. I'm fairly optimistic about the prospects. And it's not just driven by the NISA. Although it is much nicer, I have to say. Too easy, wasn't it really. I think a number of things that have happened in the market are actually pro-savings. We've seen quite a strong government trend towards encouraging savings, and I think that's clearly going to continue.

And clearly, what that means for us with the Cofunds capability backing a lot of our savings businesses going forward, I'm quite optimistic. You'll see it more in the flows for savings rather than purely in Cofunds, which remains the branded IFA fund supermarket. But utilizing that capability in a broader sphere means I'm pretty optimistic about on-platform savings growth.

A - Mark J. Gregory {BIO 15486337 <GO>}

Okay. Just picking up the last general question on accumulation and decumulation, Andy. I guess on accumulation for me, (10:54) building on what John said there, I think we do take the view now, sitting (10:56) with the liberalization of (10:58) annuitization, et cetera, we do think that DC-based pension savings will become more attractive going forward. So we do expect it to be a further stimulus to the accumulation side aside from just the ISA limit increases.

In terms of the whole kind of guidance, I mean clearly, the Chancellor announced the budget, there is going to be this guidance for every person at retirement, and we're quite engaged in that whole process. Clearly, there's a lot of people speculating on what it might look like and no one knows for sure. And our in-house view is that we do want it to be a genuinely impartial, independent body that gives that guidance, not a product provider. And hence, we think people like the Money Advice Service and/or The Pensions Advisory Service, TPAS, are the very best placed to give that.

Indeed, we are actually working on an active live trial with TPAS, as we speak, to think about how that might work in practice. Clearly, there's a lot of work to do and clearly, it's not going to come in until this time next year, but nevertheless, we are very keen to make sure that works for consumers in the UK and make sure they make the right decision for what will be a critical decision for them.

Q - Andrew J. Sinclair {BIO 17749036 <GO>}

Very good. Thank you.

A - Mark J. Gregory {BIO 15486337 <GO>}

Thanks. Cheers, Andy.

Operator

And our next question today comes from the line of Farooq Hanif of Citigroup. Farooq, please go ahead.

A - Mark J. Gregory {BIO 15486337 <GO>}

We can't here you, Farooq? You're on mute.

Q - Farooq Hanif {BIO 4780978 <GO>}

Hello?

A - Mark J. Gregory {BIO 15486337 <GO>}

Duncan, we're not hearing that.

Operator

Sorry, I'm just sort out Farooq. We can't hear Farooq. Farooq, please go ahead.

A - Mark J. Gregory {BIO 15486337 <GO>}

Move on to the next one, Duncan, we'll see if we can get Farooq back.

Operator

Farooq is now on line. Sorry, Mark.

Q - Farooq Hanif {BIO 4780978 <GO>}

Hi. Really sorry about that. Can everybody hear me now?

A - John B. Pollock {BIO 6037447 <GO>}

We can hear you.

A - Mark J. Gregory {BIO 15486337 <GO>}

Very well now. Thank you.

Q - Farooq Hanif {BIO 4780978 <GO>}

Thanks for taking my questions and being patient. Firstly, I just wanted to ask about your predictions for the individual annuity market. It just still seems a little bit optimistic to me, given the changes, and I was wondering whether you could give us – I mean obviously, Q1 was probably not a fully developed quarter, you've had some cancellations and you have the breathing period. But could you tell us kind of what your experience is in Q2 so far, and whether that's sort of playing out? You had a 50% drop in individual annuity volumes. So that's question one.

Question two is, you talk about kind of thinking about the Savings business as a savings business and in a way, going forward, not kind of separating in our minds the workplace and Cofunds. And obviously, what you're implying is that you're going to use the architecture of Cofunds to back the whole business going forward. And I was wondering when will we start to see more concrete steps, how much will it - will it be a big cost to do that? And do you think the margin benefits are going to be attractive? Thanks very much.

A - Mark J. Gregory {BIO 15486337 <GO>}

Okay. Thanks, Farooq. Well, I think Kerrigan for the first one and then John can have the second one again.

A - Kerrigan Procter {BIO 15093363 <GO>}

Fantastic. Hi, Farooq. Just on the individual annuity predictions, so far, the experience has been almost exactly in line with what we expected, so we talked about 50% volumes. That's what we're seeing post-budget, so that seems in line; gives us some confidence that we're assessing the market appropriately. We still do expect, let's say, a further 50% fall by the end of 2015, as the full changes work through post-April 2015. Certainly, surveys we've seen back that up. And I think one of the important points that we get is that when we talk to individuals and when we talk to IFAs who talk to individuals, they are still really concerned about outliving their finances and really concerned about meeting their bills.

So it's the culture of annuity buying and the whole process through which people buy annuities is well embedded in this country, that may be less so true in the U.S. and Australia. So, we are confident in those figures. I think the other point I'd bring out is that even though we're talking about a lower percentage take-up rate of annuities. Be reminded please, the growth in the DC market, we talk about of £250 billion growing to £3 trillion in 2030. So it's a very important market in terms of overall savings.

And John just said, as I'm sure we all agree around the table, that there'll be even more flows into those savings given the changes. And a lower take-up rate on a much bigger figure, obviously, is a pretty supportive market in the long term for individual annuities.

A - Mark J. Gregory {BIO 15486337 <GO>}

Okay. Thanks, Kerrigan. John?

A - John B. Pollock {BIO 6037447 <GO>}

That's a great question, Farooq. We absolutely - I absolutely see Cofunds at the core of the Savings business architecture. And we already, to some extent, utilize that through our IPS capability, which we deploy in our banks and building societies.

So as we see a transition towards higher customer centricity, away from sort of product administration, so I expect the Cofunds capability to be sitting behind it. What that really means is the investment for Cofunds is more BAU investment, as we change our focus on investing in our IT platforms for the product administration, so we'll be transferring that to the Cofunds and the broader architecture of a savings business.

At this stage, I don't really see it playing a huge part in the workplace savings business. That remains focused on the corporate customers rather than retail customers. But who knows, in the fullness of time, it may have some part to play. So, no fundamental step change in the investment profile on IT. (17:00)

Q - Farooq Hanif {BIO 4780978 <GO>}

Thanks very much. Thank you.

Operator

Our next question today comes from the line of Gordon Aitken of RBC. Gordon, please go ahead.

Q - Gordon Aitken {BIO 3846728 <GO>}

Hey, morning. Three questions please on the bulk market, first on margins. What happens to margins on Individuals and bulks going forward? And do you think that – I mean, you've always said in the past that margins are the same on both. Do you think that continues?

The second question on competition. You've got people like some of the consultants like Towers Watson saying it's expecting new entrants into the bulk market. When you say in your release today that bulks are very different to the individual market, requiring a strong and sustained track record. Just – I mean, how do you sort of square that with the fact that I mean 2013, the two biggest writers of bulks were Pension Insurance Corporation and Rothesay Life , both relatively new entrants into this market and that you were number three? So that's the second question.

And the third on bulks, you didn't tell us exactly what you wrote ex the ICI scheme in the first quarter. And it seemed to be quite a bit down on last year. I'm just wondering was that because you chose not to write bulks because you knew the ICI deal was obviously coming, or because just fewer schemes were brokered in the market? Thanks.

A - Mark J. Gregory {BIO 15486337 <GO>}

Okay. Bob – (18:17) or Kerrigan. (18:20) I think.

A - Kerrigan Procter {BIO 15093363 <GO>}

So first question on – thanks, Gordon, for those. The first question on margins, you talked about – well, individuals and bulk being the same, I think we always – (18:30) but we talk about similar. It varies from year-to-year depending on the precise nature of the market, sometimes higher, sometimes lower, no consistent pattern over those over the past few years.

Yes, we still see that's true going forward and probably the emphasis I wanted to make is when we talk about margins for individual annuities, we're really talking about margins for external market, now we price the same external and internal. Others may have a different experience depending on their internal pricing. But given the external competition that we're always facing on the individual annuity market, we see the balance between bulk and individual swinging backwards and forwards, but not being substantially different over time.

Talking about competition and what's different in that market. I think one of the significant differences between the bulk market and the individual market is the individual market was substantially bought on price. And in the bulk market, the trustees' first duty is for security for the accrued benefits of pensioners. I'm not suggesting that pricing isn't a significant consideration, but it is a slightly different dynamic in that market.

So it is true that people think about, particularly when you look at buyout, they look at name, track record on the market, credibility, creditworthiness, capital and they really do consider those things. I think it's a fair point that there are three main people participating in that market currently, perhaps four. But we really don't see that significantly changing, particularly at the larger end of the market, could be a bit of disruption at the very small end of the market temporarily.

And then on the ICI deal, in terms of volumes written in Q1, yes, you're correct in that we wrote a limited amount of Bulk business beyond the ICI deal. That really was a matter of - predominantly a matter of pricing discipline. The ICI deal was attractive to us, attractive to the client and so that's what we really focused on for the quarter.

Q - Gordon Aitken {BIO 3846728 <GO>}

Okay, thank you.

Operator

And our next question today comes from the line of Greig Paterson of KBW. Greig, please go ahead.

A - John B. Pollock {BIO 6037447 <GO>}

Can't hear you, Greig.

A - Mark J. Gregory {BIO 15486337 <GO>}

Duncan, it's quiet. We can't hear Greig.

Operator

Sorry. I'll just try Greig again, please try again. Greig, please go ahead.

Q - Greig N. Paterson {BIO 6587493 <GO>}

Can you hear me.

A - Mark J. Gregory {BIO 15486337 <GO>}

Yeah, we can hear you, Greig, thanks.

Q - Greig N. Paterson {BIO 6587493 <GO>}

All right. Excellent, I'm interested in – I don't know how would one think about it, but the new business strain on your individual annuities versus the bulk annuities. And also within the individual annuities, it sort of appears to me that you say pricing is similar on the individual versus the bulk in terms of the open market, but your internal vesting stuff must have higher margin. And that's probably the stuff you're going to lose. So I wonder if you could sort of speak about new business strain, bulks versus individual open market versus individual internally, that's what I'm most interested in.

A - Mark J. Gregory {BIO 15486337 <GO>}

Okay, Kerrigan?

A - Kerrigan Procter {BIO 15093363 <GO>}

(22:25) and you'll see it from some of the press commentary. I'm sure, Greig, thanks for the questions by the way. On new business strain, on new business surplus, we talk a lot about the investment strategy and our direct investments supporting that new business strain or new business surplus and why we continue to be able to secure those investments. It's a positive environment for that strain. And because we run our overall annuity book backed by one investment strategy commingled, effectively then I wouldn't particularly distinguish the potential for strain or surplus between individual and bulk. That's not really the way we consider and look at that internally.

Then moving on to your point about within individual annuities – actually, interestingly – I'll come back to the margins point on it – but actually, we've talked before about more like a 75/25 split external to internal, actually, we've seen that shift slightly towards internal, not a big shift and early days to work out if there's a pattern, but actually a slight shift towards internal there, so probably contrary to what you may have been thinking. I think the point was about margins there...

Q - Greig N. Paterson {BIO 6587493 <GO>}

Well, just one second, sorry, on the bulks, you're not answering my question. I want to basically know – I mean you wrote a big bulk and the strain was lower than before. So clearly, this bulk had a different profile to the other bulk in terms of strain. And I mean, if there's going to be a secular shift from individual to bulks, what is the difference? Could you tell us in the first quarter what the individual strain number was versus the bulk strain? I mean it's clearly a material factor.

A - Mark J. Gregory {BIO 15486337 <GO>}

We don't disclose that, Greig. So it's your assumption that kind of the strain was better or worse than what had been in prior quarters. We clearly haven't disclosed that. We've only given the total net new business surplus in the first quarter of this year with that. Again, back to Kerrigan's point, overall, we write this business primarily on a kind of commingled basis. So – and we don't – you shouldn't see it as being kind of a different kind of financial characteristic comparing individual to bulks.

Q - Greig N. Paterson {BIO 6587493 <GO>}

All right. I mean it's something around (24:54) your new business strain. And if those are the key factors of the mix between the two, individual and bulks, and you don't feel that's material.

A - Mark J. Gregory {BIO 15486337 <GO>}

Well, as I said, we haven't actually given the breakdown of new business surplus for the first quarter here. Clearly, at the half year, we'll give more detail you will see....

Q - Greig N. Paterson {BIO 6587493 <GO>}

Well, can I recommend that in the half year, you separate the two, so we could improve our forecasting? Thanks.

A - Mark J. Gregory {BIO 15486337 <GO>}

Greig, good luck. Thank you.

Operator

And our next question today comes from the line of Fahad Changazi from Nomura. Please go ahead, Fahad.

Q - Fahad U. Changazi {BIO 15216120 <GO>}

It's Fahad Changazi from Nomura. Good morning. I suppose if I could just follow-up on Greig's question then on new business surplus. And 2012, there was an even mix of individual premiums versus bulk. And in 2013, it was more a shift towards bulks and new business surplus increased, well, actually doubled. Is there something underlying in terms of 2012 versus 2013 we should be aware of, or can we extrapolate that? Bulks do give you better new business surplus. That's question one.

And also, in terms of – I appreciate you're seeing the experience of 50% drop in annuity sales, that's probably I suspect for your own, (26:04) but in terms of the grand bigger picture, we see the 75% drop in 2015 for the market versus 2013. I mean, where do you see your individual annuity sales going in that respect, all else equal? And notwithstanding that, if you had to choose, would you rather deploy capital in bulks versus individual annuities?

And just finally, could you also provide some insight into the potential new products, income drawdown products you mentioned, which have a portion potentially of guaranteed income as well? Thank you.

A - Mark J. Gregory {BIO 15486337 <GO>}

Okay. I'll pick up the first one, Fahad, and I'll get Kerrigan to pick up the other two. Just on the point around our guide on (26:40) new business surplus being higher in 2013 on annuities compared to 2012. Fundamentally, that's a volume point. We wrote a lot more business in 2013 than we did in 2012, so our total premiums last year were £4.1 billion whereas in 2012, they were £2.3 billion.

So the primary reason that the surplus was higher in 2013 was purely because we wrote more business again. It's not about the mix between bulk and individual, fundamentally, it's actually about writing more annuity business on the right terms, keeping our pricing discipline that we achieve – that's why we achieved a better surplus last year than in 2012.

Q - Fahad U. Changazi {BIO 15216120 <GO>}

Clear. Fair enough. Thank you.

A - Kerrigan Procter {BIO 15093363 <GO>}

Okay. Just on the second point on the drop in annuity volumes in the market, there'll be a (27:23) prediction and others have predicted, and then how will our sales look in individual at that time; would we rather deploy capital in bulks. Addressing that last point first, would we rather deploy our capital in bulks, I think we talked about our unique strength, which is we can choose at any time what's the most attractive markets to deploy our capital in, or deploy our risk appetite, I should say. And if at the time, as is now, we emphasize bulks, then we'll continue to write more in bulks.

We do still plan to remain a significant participant in the individual annuity market and as we're pointing out that there's a reduction in sales, but in the longer term, of course, bigger volumes going into that market but a lower percentage take-up rate still makes it an attractive market, and particularly makes it an attractive market for those people with digital capacity, which we have, and pricing capability.

And I'd make the last point in particular as it shifts from a, let's say, an age 65 purchase to an age 75 purchase in the annuity market as we expect, then those with significant experience on mortality, particularly at older ages, which, of course, we have given our 27 years' experience in the market, will really benefit from having the pricing capability in that market. So we would expect ourselves to have an ongoing competitive strength in that market and to write our fair share, subject, of course, however, to the catch phrase, pricing discipline.

A - Mark J. Gregory {BIO 15486337 <GO>}

Thanks, Kerrigan.

A - Kerrigan Procter {BIO 15093363 <GO>}

Sorry, then there's a income drawdown products that...

A - Mark J. Gregory {BIO 15486337 <GO>}

Yeah.

A - Kerrigan Procter {BIO 15093363 <GO>}

Shall I say a few words about that? I think simplicity is the key here and we think about people as they approach a time in accumulating their funds, accumulating ever more (29:10) funds and really, the point to think about is what will people's behavior be. And we expect people will initially want to draw out their tax free cash from an appropriate fund and then pursue a simple withdrawal of units per month or more flexibly, and that feels to us a little bit like a bank account, populated by appropriate LGIM fund units, of course, but a little bit like a bank account. And we should really help facilitate people withdrawing income flexibly, possibly with some assistance to manage their income tax bill. (29:51)

Q - Fahad U. Changazi {BIO 15216120 <GO>}

Okay. Could you perhaps give some insight in terms of what you're hearing from financial advisors and so on, and whether they are on board with the product development in terms of what you have in the pipeline and so on?

A - Kerrigan Procter {BIO 15093363 <GO>}

They're on board with the product developments, I mean it was something that we discussed a lot. I mean there's a lot of discussion in the market particularly around how the guidance and then the advice regime will shape what people do. And certainly they're on board with the idea that people will accumulate and then start drawing down, some of them possibly later in life and currently start getting concerned about outliving their finances and at that point, look to pursue some kind of guarantee, let's say some kind of guaranteed income for life. And that pattern, I think, is reasonably well agreed amongst advisors and other firms in the industry I believe. Simplicity has got to be the key here though.

Q - Fahad U. Changazi {BIO 15216120 <GO>}

Thank you.

Operator

Our next question today comes from the line of Zak Smerczak from Mirabaud. Zak, please go ahead.

Q - Zak Smerczak {BIO 17189389 <GO>}

My question's been answered. Thanks.

Operator

Hello, Zak, please go ahead.

Q - Zak Smerczak {BIO 17189389 <GO>}

My question's been answered. Thank you.

A - Mark J. Gregory {BIO 15486337 <GO>}

Move on to the next one, Duncan.

Operator

Our next question today comes from the line of Marcus Barnard from Oriel Securities.

Marcus, please go ahead.

Q - Marcus W. Barnard {BIO 2103471 <GO>}

Yeah, thank you. Can you hear me?

A - Mark J. Gregory {BIO 15486337 <GO>}

Yeah, we can. (31:23) Thanks, Marcus.

Q - Marcus W. Barnard {BIO 2103471 <GO>}

Thanks. Mark, in your statement, you said – I think you said you thought the bulk purchase annuity market would be bigger. First of all, can I ask why you think that? Have you got any evidence to back that up? Because I can't see any reason why it would be bigger than it was previously. And secondly, you said you were going to get more of it and this would make up for the shortfall in individual annuities. I mean seriously? You wrote £1.3 billion last year, £1.3 billion the year before, £3 billion-odd of bulks last year, £1 billion-odd of bulks the year before. Are you really thinking you can make up for the shortfall of £1.3 billion of individual annuities by writing more bulks? And if so, how do you think you're going to do that? Are you going to cut prices? How are you going to make up that shortfall?

And finally, bulk purchase annuities tend to be a bit more volatile. I think if I remember back to 2008, 2009, 2010, there was so little business around that, most of your competition went out of business. In fact, I think you ended up buying one of them. So does that mean your trading results are going to be much more volatile going forward because you're dependent on a line of business that's much more volatile? Thanks.

A - Mark J. Gregory {BIO 15486337 <GO>}

Okay. I think I'll give Kerrigan a break, because technically involved but it's tearing him up. (32:36) I'll answer them and we'll give Kerrigan a break. In terms of why the bulk market is growing. Again, I probably alluded to it in the speech, I think there's two big macro forces at play here. First and foremost, most corporate CFOs don't much like having a DB pension scheme liability on their balance sheet. And it does tend to wobble around a bit and occasionally needs extra contributions to go in, et cetera. Most CFOs would rather talk about the trade in their business rather than the next issue of their defined benefit pension scheme. So – and clearly the adoption of IAS 19, the pension scheme accounting standard, has forced corporates to face into this issue. It's no longer a kind of off-balance sheet event. So that's been a trend that's been around for a while.

Again, in terms of a macro environment asset market, I mean clearly, the combination of decently high equity markets – because typically the schemes when they're not in any sort of buyout – or buy-in phase have a higher equity participation than they would have when they move to a buyout effectively, and that's a good place to be in terms of the underlying asset transition cost. Again, it makes the headline (33:42) cost of transition to a buyout arrangement rather less expensive. So we do think there's a growing trend.

I mean broadly, DB schemes are now mature. There's a few open schemes in the UK but most have closed and therefore, I think that it's an inevitable trend, more and more of these arrangements will de-risk into some sort of buyout arrangement going forwards.

Q - Marcus W. Barnard {BIO 2103471 <GO>}

But there's nothing else that's changed that makes you think the DB market will be bigger other than equity markets have gone up and IAS 19's come in?

A - Kerrigan Procter {BIO 15093363 <GO>}

Well, you've also got deficit repair contributions going in at a record rate. And just in terms of the information we have here, bear in mind that we manage DB pension assets on behalf of 40% of the potential clients in the corporate pensions universe through LGIM. And one of the main points of dialogue that we have is their de-risking journey. And if you look at some of the flows going into, let's say, LDI and fixed income as people transition down that journey, we know virtually everything that goes on in that market because we have such a comprehensive coverage of it. And so I'm very confident that we understand where the de-risking trend is and, of course, we should do, given we have by far the lion's share of that market.

Q - Marcus W. Barnard {BIO 2103471 <GO>}

Okay.

A - Mark J. Gregory {BIO 15486337 <GO>}

And your point, Marcus, about kind of why we think we can replace the £1.3 billion of IA volumes should the whole lot go, I mean clearly, we don't think the whole lot will go, but the case in point is that there's a material amount to make up. I mean again, this is a – the bond market is a very, very big market. I mean, I mentioned in my speech, £1.8 trillion of total DB liabilities of which £600 billion represent pensions already in payment. Roughly in the UK, about £50 billion is currently moved to buyouts, so assume that (35:22) less than 10% of the total accessible DB pensions in payment market has moved to buyout already.

So again, there's a big slug still to go at and there are significant barriers to entry. As Kerrigan said, in reality, you've got to be good at this. And you mention the people who've kind of tried previously and gave it a go, you said it kind of – it stopped because the volume has dried up. Actually, it stopped because they weren't good enough at what they were doing, ultimately. They mispriced the risk they were taking on and that's why in the end, they ended up effectively (35:49) blowing up. So I wouldn't accept the point that they went out of business because the volumes were volatile.

It was a classic case that you need to really understand what you're doing and not just on longevity side, you need to do it on the asset side (36:00) as well. I mean skills like asset transitioning from the older rate to the new one is a key skill, and if you get that wrong, you can lose a lot of money. So it's something that L&G with its integrated propositions is very good at doing. You to (36:13) LGIM's skill set in that point as well.

Q - Marcus W. Barnard {BIO 2103471 <GO>}

So you don't think your trading profits will be more volatile going forward?

A - Mark J. Gregory {BIO 15486337 <GO>}

No, again fundamentally, the actual profitability of course is primarily driven by the back book anyway. So at its core, we've got to stop at £38 billion of annuities (36:31) provided that all behaves itself that will flow (36:33) potential margins of profit and cash flow for the next 30 years or 40 years in reality, so, no.

Q - Marcus W. Barnard {BIO 2103471 <GO>}

Okay, well, good luck. Thank you for that.

A - Kerrigan Procter {BIO 15093363 <GO>}

Thank you.

A - Mark J. Gregory {BIO 15486337 <GO>}

Thanks, Marcus.

Operator

And our next question today comes from the line of Ravi Tanna from Goldman Sachs. Ravi please go ahead.

Q - Ravi Tanna {BIO 16926941 <GO>}

Thanks. Good morning. It's Ravi Tanna from Goldman Sachs. Just one question please on the bulk annuity space again, and it relates to comments you've made in the release on DB to DC transfers and the idea that they wouldn't necessarily materially impact the bulk annuity markets.

I'm just curious to know, number one, do you actually expect significant transfers of these types to take place going forward. And based on the discussions you've been having with employee benefit consultants and trustees since the budget, has customer behavior changed or has awareness increased around the possibility to make these transfers? Thank you.

A - Kerrigan Procter {BIO 15093363 <GO>}

Yeah, I mean just on the DB to DC transfers, I think as Mark said in the release that you've read, we have a central case, if you like, that DB to DC transfers will continue to be allowed. There'll be some sort of appropriate advice regime, I think trustees will need to check that people have taken advice. And of course that creates a certain hurdle, in that a gold-plated inflation-linked from retirement and then inflation-linked for your spouse at two-thirds of the rate of the original is a very significant benefit indeed and quite a hurdle for advisors to say to people that they should take something different.

Having said that, I think there will be a slightly larger flow of DB to DC in that central case just pre-retirement. And there are some examples that would be appropriate. But that only makes a small dent in the £1.8 trillion of liabilities. And actually, in pound terms, will make buyout tend to be more affordable. So I think that's a reasonably positive environment.

In terms of employer benefit consultants and consultants talking to their pension scheme trustee clients then they are certainly – we're obviously very well connected in that market given our presence in that market. So we talk to all of them. And they are raising awareness with their clients about the potential for making sure that for those that it is right to transfer should be able to transfer. I don't see anything as significantly affecting the bulk market at all in any of that.

Q - Ravi Tanna {BIO 16926941 <GO>}

Okay, thank you very much.

Operator

And our next question today comes from the line of Abid Hussain from Société Générale. Abid, please go ahead.

Q - Abid Hussain {BIO 17127644 <GO>}

Hi good morning all. I've got two questions based on the bulk annuity market. Firstly, of the £600 billion of DB pensions in payments, what proportion can actually afford a bulk annuity buyout today? That's the first question. My second question is to what extent can you control the flow of bulk annuities being brokered around the market, especially at the larger end of the market? Thanks.

A - Kerrigan Procter {BIO 15093363 <GO>}

Yes.

A - Mark J. Gregory {BIO 15486337 <GO>}

Yes. This will go to (39:52) Kerrigan, Thanks.

A - Kerrigan Procter {BIO 15093363 <GO>}

The £600 billion pension in payments, so how much is affordable. Yeah, that's an interesting question because most – a lot of the business that we see at the moment is actually buy-ins, and you don't need to have 100% (40:11) funded status to pursue a buy-in. If you subsequently want to pursue a buyout, then you need to think about the balance of security between pensioners and non-pensioners, but that doesn't stop people proceeding down the buy-in route. The ICI deal, we did, £3 billion, that was a buy-in deal.

Q - Abid Hussain {BIO 17127644 <GO>}

But presumably, the £3 billion liability that you bought out for buy-ins, that proportion of total liabilities have to be well funded.

A - Kerrigan Procter {BIO 15093363 <GO>}

Well, yes. That – we get the full premium from the clients in those circumstances, yeah. So we assess the £3 billion buy-out -- sorry, buy-in value, or liability value for that on a buy-in basis, and we clearly got the full asset premium there. So I guess the point is that that remains an asset of the pension scheme, rather than being directly paid to pensioners.

So, in theory, all that £600 billion could be in play. But I take your point, there's a wide range of funding levels across schemes, some more than 100% funded, those are the – but the average is probably more like 84%, 85% on an IAS basis, and more like 70% on a buyout basis overall, but there's a wide variety within that. And that keeps a happy control flow of the £1.8 trillion of liabilities. I mean £1.8 trillion, it's an intractable problem in itself, and anything we can do to make it more tractable is a good thing for the market.

Q - Abid Hussain {BIO 17127644 <GO>}

Sure.

A - Kerrigan Procter {BIO 15093363 <GO>}

Sorry, and your second point was – oh, controlling the flow from brokers. It's clearly a market that, as I said earlier, trustees think about security first, and then price second. Don't get me wrong. The price is a very important consideration for trustees and the brokers help the trustees get a fair price for the security they get. But there is a benefit in engaging with clients early...

Q - Abid Hussain {BIO 17127644 <GO>}

Yeah.

A - Kerrigan Procter {BIO 15093363 <GO>}

Help them construct a deal that's appropriate to them, and you can help them find the best prices in your book.

And so it's certainly a benefit that we have, the LGIM link, the link to this 40% of clients, and we can be talking at an early stage about full path to de-risking. So whether that's moving into active fixed income for assuming an LDI mandate, or implementing longevity insurance or buy-in or buyout, because we can offer all those paths along the way, we can engage with those clients and help them all the way along their journey, and that is a real benefit.

Q - Abid Hussain {BIO 17127644 <GO>}

Okay. Thanks.

Operator

And our next question comes today comes from the line of Maarten Altena from Mediobanca. Maarten, please go ahead.

Q - Maarten Altena {BIO 15898902 <GO>}

Yes. Good morning, gentlemen. I have a question regarding also the bulk purchase annuities and the attached longevity risk. I was just wondering how you see that, which percentage of longevity risk you are aiming to reinsure, and whether that will change in a Solvency II environment, or maybe that you take that already into account. Thanks.

A - Mark J. Gregory {BIO 15486337 <GO>}

Kerrigan?

A - Kerrigan Procter {BIO 15093363 <GO>}

Yeah. On the longevity risk point of view, we're comfortable with our stock of longevity risk. The more (43:35) we think we have particular skills in underwriting, given the depth of our historic data and other data that we've accessed in the market. So we like and we make profits out of our underwriting risk, so we like that. However, the reinsurance market for longevity risk has developed substantially over the last two years or three years and, of course, we, therefore, take advantage of that market when the price is right.

So we did a backward deal last year and when the price is right in certain segments of our book, then we'll look to use that reinsurance market more substantially. But it's not really a question of risk appetite substantially, at this point, more a question of the price is right.

Q - Maarten Altena {BIO 15898902 <GO>}

Okay, perfect.

A - Kerrigan Procter {BIO 15093363 <GO>}

Sorry, (44:25) is there a Solvency II follow-up there?

Operator

Our next question today comes from the line of Andy Hughes from BNP Paribas. Andy, please go ahead.

Q - Andy Hughes {BIO 15036395 <GO>}

Hi, guys, last but not least probably. The first question is on the amount of LGIM assets that relate to the local government pension schemes, please. Could you give us a number?

And the second question is about the bulk annuity market. I think you've given some clarification, Mark, in your comments about the economics of these transactions getting better. I must admit, I kind of agree with Marcus, I thought it was exactly the opposite. We had a survey yesterday from Mercer saying that the pension scheme deficits in the UK had increased substantially.

And I'm not really sure I understand the outlook in a quarter when you did, basically, no bulk annuities apart from ICI. So in theory, the cost of these things is getting more expensive because inflation is picking up, interest rates are coming down. And even in ICI's case, for the deal you've done, they had to pay an extra £150 million into the pension scheme to enable this transaction. So I mean, could you give us an idea about what you mean by the pipeline getting better because of the economics, please? Thank you.

A - Mark J. Gregory {BIO 15486337 <GO>}

Okay, on just the local government pension scheme point, Mark can pick up and Kerrigan, I'm hoping (45:40) can do the second one, Kerrigan.

A - Mark J. Zinkula {BIO 16142450 <GO>}

Yes, the vast majority of the assets we manage in the pension space are for corporate pension clients. So we're a major provider of fund management services for local authorities, as you can imagine, primarily in the index space, or index tracking space in fixed income and equities.

If what you're alluding to is the initiative underway for there to be reduced fees and potentially pooling of these mandates, that is something that we would view as an opportunity to - well, there seems to be a movement toward passive mandates in that space, that we think there's an opportunity then to potentially increase our market share and we're heavily engaged in that process.

Q - Andy Hughes {BIO 15036395 <GO>}

I suppose it depends who manages that mandate though. I mean have you seen any outflows from the CIV (46:28) for the local governments that are setting up in London?

A - Mark J. Zinkula {BIO 16142450 <GO>}

We haven't - have we seen outflows? No. But we're engaged. There's a lot of debate and discussion going on right now. It's likely an event we'll - we expect to primarily play out next year and we're heavily engaged in that process.

Q - Andy Hughes {BIO 15036395 <GO>}

Thank you.

A - Kerrigan Procter {BIO 15093363 <GO>}

Just thanks for the questions, Andy. Just on those points, addressing the Mercer survey first, just as a technical point, I think that went from, on an IAS basis, 85% to 84% on average funded. That's a technical feature really of the tightening of credit spreads in the market, which isn't really a feature that's replicated in, say, an economic funding level or a buyout funding level. So I view that really as a technical feature of that market, of that particular measurement of funded status.

More broadly, that we do see a supportive equity market. We have seen that. We have seen inflation lowering actually, so potentially some improvement in radials. (47:28) But I think the crucial thing is, pension schemes, one way or another, will get to fully funded because deficit repair contributions have to go in. They're now going in at a near record rate. I think the previous record was 2007 and they're pretty much at that level, so rapid pace of deficit repair contributions going in. And of course, I think as Mark said, when CFOs put in substantial deficit repair contributions, they don't want to then blow that by taking risk in the equity markets necessarily. They want to see a de-risking progress, which is where you see the LDI mandates come in for example.

And so I think the second point there is there's a wide disparity of funding levels between pension schemes. The ones, let's say, like ICI have done a substantial de-risking program will often be in a better position to move to buyout. And as we said, we have a great visibility of that range of pension schemes there. So it's – confident that the pipeline we talk about is real and present.

Q - Andy Hughes {BIO 15036395 <GO>}

And surely the narrowing credit spreads impacts the cost of these buyouts as well.

A - Kerrigan Procter {BIO 15093363 <GO>}

Yeah, it does to some extent, you are right. It's not quite the impact that of tightening of credit spreads, particularly AA credit spreads, has on the IAS accounting measure. So it's far more marked in (48:51) the IAS basis.

Q - Andy Hughes {BIO 15036395 <GO>}

And coming back on the margins you're reporting today and profits in terms of net cash, as you know, I'm not a fan of the net cash metric for the simple reason that today, you're saying you made £301 million of net cash, a large chunk of which came from a £3 billion bulk annuity that your competitors turned away, presumably because they couldn't get to the same level of profitability hurdles. Now, I think on an economical capital basis, if we looked at that bulk annuity, we'd see a very different number in terms of capital generated in the period. So I mean how should we look at this going forward?

A - Mark J. Gregory {BIO 15486337 <GO>}

Yeah. To be absolutely clear (49:27), Andy, the bulk of our net cash does not come from the new business we wrote in the quarter. The bulk of our net cash comes from the stock of assets and other things (49:34) we've got on books already. Now, clearly, it's a release of the potential margins we have locked up in the back book and we expect that to release largely (49:40) to profit and cash over time. So it's definitely wrong-minded to think that the net cash generation of £301 million has been generated by a one-off.

Q - Andy Hughes {BIO 15036395 <GO>}

No, but there is a definite contribution from the £3 billion bulk annuity though.

A - Mark J. Gregory {BIO 15486337 <GO>}

It was in the new business surplus number of – the plus £4 million we've announced, which clearly is not a huge percentage of the £301 million in there. (50:00) But it's in there, yes, you're quite right, Andy.

Q - Andy Hughes {BIO 15036395 <GO>}

And on the Pillar 2 basis, any idea what kind of capital this deal would have consumed?

A - Mark J. Gregory {BIO 15486337 <GO>}

No – yes, yes, we do know, Andy, and because (50:14) we've got our own (50:14) economic capital model and that's primarily how we price (50:16) these schemes in the first place, so we are very driven by that. And clearly at this stage, certainly, ICA process, it's a private (50:23) basis with the PRA, but we will think about our economic capital disclosure as we try and help you understand the dynamics in a kind Pillar 2/Solvency II world going forwards.

Q - Andy Hughes {BIO 15036395 <GO>}

And bulk data loadings, you used to apply those to these kind of transactions when they came on the books and that depressed the earnings, or at least the strain initially from a bulk annuity. Is there any bulk data loading here or not? Do you know, Kerrigan? (50:47)

A - Mark J. Gregory {BIO 15486337 <GO>}

I'm not aware there's anything in the number in the first quarter, certainly not in the pricing.

A - Kerrigan Procter {BIO 15093363 <GO>}

No, no I think we'll have to point this out. (50:54)

A - Mark J. Gregory {BIO 15486337 <GO>}

I don't think that's been a factor this quarter, Andy.

Q - Andy Hughes {BIO 15036395 <GO>}

Okay. All right, thank you.

A - Mark J. Gregory {BIO 15486337 <GO>}

And you're not last, Andy.

Operator

And our final question today comes from the line of Alan Devlin from Barclays. Alan, please go ahead.

Q - Alan G. Devlin {BIO 5936254 <GO>}

Hey, guys. Couple of non-annuity questions you'll be glad to hear.

A - Mark J. Gregory {BIO 15486337 <GO>}

Really. (51:13)

Q - Alan G. Devlin {BIO 5936254 <GO>}

First of all, just on corporate pensions, I think the flow's picked up to – flows to £500 million in the quarter. I was wondering is there any one-off in that number or is that a good underlying run rate we can look to go forward.

And then also, you've got £9.1 billion of assets in that business now growing at £500 million a quarter, so you're pretty close to your low-double digit £1 billion breakeven target you'd discussed in the past. So I'm wondering if you could comment on how close you are and when we could see that.

And then a secondary question on Retail Protection. You had a very strong quarter there this quarter, and actually, that also contributed to the positive cash gen (51:48) in the quarter, so just wondering what's going on there? Is the positive cash gen (51:54) in that business sustainable? Thanks, guys.

A - Mark J. Gregory {BIO 15486337 <GO>}

Thanks, Alan. Both to you? (51:58)

A - Kerrigan Procter {BIO 15093363 <GO>}

John.

A - John B. Pollock {BIO 6037447 <GO>}

Yeah, thanks, Alan. I'm pleased there's some interest in the LGAS business. So corporate pensions, yeah, we – as you're aware, there's the staging dates for SMEs that come through this year and into next. So the run rate of business, we would hope to be able to maintain for as long as possible. Our 50 basis point charge cap is an attractive offer in the market which we hope will bring more business to us.

Clearly, as we get towards the tail end of staging, you're getting smaller and smaller and smaller schemes, so it's unlikely that we will see the kind of inflows that you've been seeing going off into the long-term future. But at least over the next couple of years, we are continuing to aim at scale.

We're at, as you said, just a little bit over £9 billion. We are still aiming towards low teens, double-digit assets under management to get to our breakeven point and grow from there. As the business is on the books, so we get the increasing premiums as payrolls rise and ultimately as the government changes the contribution rates. So yeah, pretty confident that over the next near term future you'll see flows continuing at this kind of level.

As far as Retail Protection is concerned, the strain figure was changed, if you remember, as a consequence of I minus E, which changed the accounting of the costs on the Retail Protection business. So, for as long as the market competition will allow it, I would expect strain to remain at the kind of levels that we're currently seeing. But it is a competitive market, but we won't see a return to the levels of strain that we saw a few years ago, that's for sure.

Q - Alan G. Devlin {BIO 5936254 <GO>}

Thanks.

A - Mark J. Gregory {BIO 15486337 <GO>}

Cheers, Alan.

Operator

We have no further questions on the telephone lines, Mark.

A - Mark J. Gregory {BIO 15486337 <GO>}

Okay, in that case, thank you very much for your engaged questions this morning and we'll see you soon. Thank you.

Operator

This concludes today's call, ladies and gentlemen. If you would like to hear any part of this conference again, a recording will be made available shortly. Thank you for joining. You may now replace your handsets.