Q2 2017 Earnings Call

Company Participants

- Bernie Hickman, Chief Executive Officer-Legal & General Insurance
- Cheryl Agius, Chief Executive Officer-General Insurance
- Kerrigan Procter, Chief Executive Officer-Legal & General Retirement
- Mark Joseph Zinkula, Chief Executive Officer, Legal & General Investment Management
- Nigel D. Wilson, Group Chief Executive Officer & Executive Director
- Stuart Jeffrey Davies, Group Chief Financial Officer & Director

Other Participants

- Alan Devlin, Analyst
- Andrew J. Crean, Analyst
- Andrew Sinclair, Analyst
- David Andrew Bracewell, Analyst
- Gordon Aitken, Analyst
- Greig N. Paterson, Analyst
- Jon M. Hocking, Analyst
- Marcus Barnard, Analyst
- Oliver Steel, Analyst

MANAGEMENT DISCUSSION SECTION

Nigel D. Wilson {BIO 1535703 <GO>}

Good morning, everyone, and welcome to our 2017 Half-Year Results. As the title says, our excellent execution has delivered a consistently improving financial performance.

As you move through the building, you will have seen many great images of what we are achieving, Accelerated evolution in practice. Images showing both our investment in physical assets to deliver growth, but also our technological innovation in digital assets which is also delivering growth.

A couple bits of housekeeping. Here are the usual forward-looking statements. Please switch off mobiles. And if there is a fire alarm, the home team will shepherd you downstairs.

This has been an another terrific period of delivering performance. And indeed, once again, I would like to thank all of my colleagues. The key reason delivering accelerated evolution, which drives our EPS and ROE growth, is the increasing capability of my colleagues. That is right across our organization, by division, by function, and by country. We have a positive supportive culture, morale is high, engagement is high, and our Net Promoter Scores from our customers keep increasing. So, thank you, once again.

In terms of our key numbers, operating profit is up 27% to almost £1 billion. Profit before taxes up 41% to £1.2 billion. EPS is up 41% to £0.1594. Net release is up 6% to £724 million. ROE up to 26.7%. And our formulaic dividend is £0.043.

Jeff, Kerrigan in more detail later. Whilst these results are good, in fact they're very good, there is so much more we can achieve. We have the capability, we have the capital, and we have the opportunities to continue to grow.

So much has been written about the accelerated decline of many UK industries. What happened, for instance, on a global scale to the UK's brewing (02:02) industry. What's happening to our retail industry. Legal & General has prospered for 180 years because we manufacture and deliver economically and socially useful products.

It is clear that we've been accelerating on a resolution to several years. Our successful strategy is based around six long-term and increasingly important growth drivers. Aging societies, globalization of asset market, creating new real assets, welfare reform, technological innovation and providing today's capital. The creation and management of long-duration assets and liabilities sits at the heart of our business and sits alongside a positive supportive culture.

We believe in teamwork, and we are indeed a team. This explains how we've created sustainable competitive advantages, resulting in market-leading positions and increasing relevance to all of our stakeholders.

Our key achievements in H1 is shown here. We are making progress in all areas. In aging demographics, Chris Knight and the team have delivered around 100% growth in lifetime mortgages and individual annuities. An extraordinary achievement by Steve Ellis and our colleagues in Solihull. And John Towner and Pretty Sagoo are driving thought leadership in action for pension risk transfer.

In globalization of asset markets, Aaron Meder and the team has seen our U.S. business grow to $164 billion of AUM. That's up 23% in H1.

In real assets, Bill Hughes, Laura Mason and others have grown our direct investment to around £12 billion, with new Build-to-Rent sites, successful urban investments in Cardiff, in Stratford, and in Newcastle. And with last week's announcement, investment into Later Living.

On welfare reform, Paula Llewellyn and John Hyde are helping change attitudes to retail protection with innovative new campaigns driving people to think about the need to protect themselves and their families.

Emma Douglas and colleagues helping the vital growth of retirement savings through our market-leading workplace pension and DC products.

And Jackie Noakes is working very closely with me on accelerating our technological innovations, some of which I will share with you later.

This slide highlights the share of profits led by each line of business and our market share. Our markets are attractive, and they are growing. And we typically have a 25% to 40% market share. And as shown on this slide, we are number one in nine UK markets. Where we are not, like individual annuities, our market share has climbed but is still only 13%.

We are confident as the industry sees more consolidation and the demand for security of income and retirement increases, we will have the opportunity to continue to grow that share.

We've produced a version of this slide at our last set of results. Our ambition for the 2015 to 2020 continues to be ahead of market consensus. We delivered 17% earnings per share growth in 2016. We've made a great start in H1, and we are confident about H2. And we will be increasingly ambitious going forward.

With that, I'll hand over to Jeff with a more detail on the financials.

Stuart Jeffrey Davies {BIO 20023574 <GO>}

Thank you, Nigel. And good morning, everyone. As a mini agenda, I'm going to cover the financials for the first half at a group level, our dividend, the group's capital position, and then the performances of our Insurance, General Insurance and Savings divisions.

Kerrigan will then cover Retirement. Mark, LGIM, before Nigel returns to cover L&G Capital, group strategy, and finally, the Q&A session at the end.

As Nigel noted, it has been a strong half year as a result of our excellent execution and clear focused strategy with all our key businesses growing well. 13% growth in LGIM assets, now £951 billion with £21.7 billion of net inflows; £3.2 billion of new business sales in LGR; 27% increase in LGC's DI with growth from new investments, offset by profitable disposals.

Total group-wide DI is now at £11.8 billion, up 18% since the year-end. And LGI's premiums up 7% to £1.3 billion with the U.S. performance particularly strong.

The 27% increase in operating profit to £988 million benefited from a release of £126 million as a result of changes we've made in our base mortality assumptions following recent greater-than-expected mortality experience. Even without this, the growth in operating profit was a strong 11% at the group level, but there will be more on the outlook for further releases from Kerrigan later.

Our key divisions performed strongly in the first half, contributing to the 6% increase in net release from operations for our retained businesses. An additional £100 million of dividend from the LGAS legal entity to group, in respect to the base mortality release, is not included in the net release from operations. When added together, the group generated £824 million total release, up 13% on first half 2016.

PBT was up 41% on the back of a strong operating profit result, combined with a positive investment variance, and our post-tax return on equity grew to 26.7%. As a high level summary of our Capital division, the group's Solvency II surplus at the end of June was £6.7 billion, up £1 billion since year-end. This was underpinned by good operating surplus generation.

This equates to a coverage ratio of 186%.

And finally, our dividend which shouldn't have been a surprise to anyone given that a year ago, we moved to a formulaic basis for the interim dividend, calculated at 30% of the prior full-year dividend, which gives £0.043.

Turning to operating profit from the divisions, which was up 19%. As already mentioned, LGR grew 40%. And excluding the change in our base mortality assumption, it's up 9% as a result of the excellent 2016 and strong new business sales so far this year in both our retail and institutional subdivisions. LGIM grew 13% whilst maintaining discipline in its market-leading cost-income ratio and against the backdrop of industry-wide fee pressure.

Management fees and costs grew in line with each other by 15%, as we continue to invest in the business.

LGC was up 5%, benefiting from a growth in the overall equity portfolio within the division £3.9 billion traded assets, and continued strong performance in the £1.3 billion of direct investments.

On Mature Savings business contributed a robust £52 million.

And in LGI, two with three sub-divisions performed well, LGI U.S. and UK retail protection. However, these results were offset by decreases in group protection which was affected by adverse experience. In total, the division was flat year-on-year.

Additionally, GI's result was down £15 million from £31 million due to the impact of increased costs from non-weather related claims in Q1, predominantly escape of water in line with industry experience. I'll explain more about how we're addressing these last two items later.

Moving on to PBT, I thought I would briefly take you through some of the key investment variances we had in the half year.

Firstly, LGC saw £52 million positive variance from the traded assets portfolio as performed in the long-term economic assumptions, as well as profit on disposals realized in the direct investments portfolio. At group, the £77 million gain was primarily driven by the group's defined benefit pension scheme reflecting accounting valuation differences arising on annuity assets held by the scheme. The figure was also inflated by some catch-up from last year.

As highlighted last year, the comparative for LGI saw a negative experience of £100 million driven by a large reduction in UK government bond yields.

Moving on to our balance sheet, and in particular our capital position, the group Solvency II surplus increased by £1 billion since the year-end to £6.7 billion. Our Solvency II coverage ratio, calculated on a shareholder basis, increased to 186%, up from 171% at the year-end. As usual, we have recalculated the transitional which actually reduces the surplus by £300 million on this occasion.

Our economic capital showed similar growth as expected. To explain the Solvency II surplus increase of £1 billion, we have provided a bridge. Our operating surplus generation was £0.6 billion, contributing 10% to the coverage ratio and covered the larger of the two dividends paid each year, in this case, the final 2016 dividend. Similar surplus generation in the second half will more than cover the dividend just declared of £256 million.

Within surplus generation, we have included the impact to the amortization of the opening Transitional, offset by the corresponding release in risk margin which cancelled that (11:37). The impact of rising new business in the first half was a strain of £0.1 billion. However, the majority of this figure is in respect of our U.S. term sales. As per last year, we will reinsure and finance this business in the second half, significantly reducing the strain. It is important to note, for the remaining business, the strain was less than £50 million.

As you know, we disposed the Cofunds in Netherlands, which together improved the coverage ratio by 2.5%. The £0.4 billion improvement from other operating variances included the impact of experience variances as well as changes to assumptions, in particular, the change in our base mortality. And it also includes matching adjustment management actions. As previously disclosed, the net sub-debt issue of £0.5 billion resulted in a 6% increase in the ratio.

And finally, on Solvency II, this slide gives you our estimate of the present value of Solvency II surplus emergence from the key elements of the new business we wrote. Our margins continued to be resilient with much of the change from the year-end attributable to changes in business mix. We have continued to maintain good margins and pricing discipline. For a small strain, we have created almost £300 million of value.

In terms of divisional performance, I will start with Legal & General Insurance which combines our UK and U.S. protection businesses. The numbers presented here all exclude L&G Netherlands which was disposed off in April 2017, as we want to show you the contribution from the ongoing business division with the main impact to this exclusion being on net release from operations.

In total, gross premiums were up 7% to £1.3 billion with operating profit flat. However, within that, the U.S. protection growth of 33% was offset by a 13% decrease in UK protection. Let me cover this in a little bit more detail.

Starting with LGI UK, operating profits from the UK businesses was down 13%. As discussed at full year, we've continued to see poor experience in our group protection business. A range of actions have been taken, including pricing action at scheme renewals. However, the impact of these will take time to be fully reflected in our experience. So, we expect some adverse experience to continue emerging but at a reduced level in the second half of 2017.

Our highly automated retail protection business in the UK continued to perform well, with gross premiums up 5% and generating good profits, reflecting the consistent performance of this business and its leading market position with 25% market share in 2016. We are increasingly using predictive analytics and improved underwriting approaches to reduce the time it takes for advisors and our customers to apply for policy.

Our U.S. protection business is the second largest provider of U.S. term life assurance through the brokerage channel and has 1.2 million policies in force. Our premiums increased 3% to £618 million. This was up 17% on a sterling basis. And operating profit grew 16% year-on-year to £72 million, up 33% on a sterling basis. This was due to business growth and favorable mortality experience.

The digital transformation of our U.S. protection business is just beginning, but will catch up fast, fully using the wealth of experience and capabilities we have from digitizing our UK business. Some of you will have seen earlier in our folio (15:23) a nearly launched SelfieQuote which provides a life insurance quote by estimating individual's age and BMI using a selfie photo.

Now, it worked well for all of us, but suspiciously, Nigel was 45 and light as a feather. We are the first in the life insurance industry to roll out this approach, which is an example of how technology can improve the application process for consumers.

Moving to GI, gross premiums increased 11% to £173 million despite the pressures of a competitive market. And our direct business delivered gross premiums of £63 million in the first half, representing 17% growth year-on-year. Now, accounting for 36% of gross premiums.

Operating profit for our General Insurance division did decrease from £31 million to £15 million however. This was primarily due to the impact of increased costs from non-weather-related claims in Q1, predominantly escape of water claims, which was in line with wider market experience. We've taken actions to address this, and so improved claims experience in Q2. We continue to monitor this closely and we'll take further action if required.

FINAL

Bloomberg Transcript

We are continuing our digital innovation here too. Our new Smart Pro (16:41) product will enable customers to achieve a quote for household insurance in about 90 seconds by answering five simple questions. GI has now won five distribution agreements in the last two years with UK financial institutions. And we are on track to increase gross premiums by over 10% by the end of 2017.

Our Savings division now comprises just our mature savings business. Our focus is on customer service while continuing to deliver good profits. Operating profit remains robust at £52 million on our £30 billion of asset, through the introduction of robotics and automation to reduce unit costs.

And with that, I'd like to hand over to Kerrigan to take you through LGR's continued growth and more on our longevity assumptions.

Kerrigan Procter {BIO 15093363 <GO>}

Thank you, Jeff. And good morning, everyone. LGR had a strong first half with net release up 8% to £307 million, and operating profit up 40% to £566 million.

New business flows were particularly strong in the LGR Retail business with total new business up 98% comprised of retail annuity volumes of £345 million and a lifetime mortgage loans with £424 million. UK bulk annuity deal volumes sold directly from UK defined benefit pension plans was £1.5 billion, which compares to £0.6 billion in the first half of 2016. We completed the Aegon transaction in the first half of 2016. So, overall annuity volumes were down. However, new business surplus of £51 million was a strong figure given volumes, as we used the new business flow to fund the lifetime mortgage lending and direct investment at attractive yields.

Our total new annuity sales were £2 billion with new business value add of 8.9% achieved with the regulatory capital strain of less than 4%. This continues to support our expectation of low- to mid-single digit regulatory capital strain in the medium term.

Total new business was £3.2 billion, including £115 million of U.S. bulk annuity business and an £800 million longevity insurance deal with the UK pension plan, which compares to total H1 2016 business of £4 billion.

So, let me now move on to longevity and our longevity relief. LGR's gross longevity exposure is £61.4 billion across annuity and longevity insurance business. We have reinsured £15.9 billion of longevity risk with 11 reinsurance counterparties, leaving a net exposure of £45.5 billion.

In the first half of 2017, we reviewed mortality experience by our overall net longevity exposure. In the light of more than expected actual debt, we have decided to release £126 million of prudent in our reserves. At this point in the year, we have not adjusted our assumptions for future mortality improvement. They remain consistent with those used at the end of 2016. But there is increasing evidence that the high level of recent mortality is in part due to medium or long-term influences rather than short-term events. We will be reviewing our longevity improvement assumptions in the second half of 2017.

For the technicians, (19:59) we moved to an adjusted version of the CMI 2014 model for the 2016 results, and we will be investigating the appropriateness of the CMI 2015 model for longevity improvement in the second half of this year. This review will also cover how our annuity is different from the broader population and to what extent adjustments should be made despite the mortality in the underlying data such as the high death rate in January 2015.

We continue to scrutinize the likelihood of a sustained slowdown in mortality improvement and gain confidence as we see more years of evidence. Based on the current view of the data and level of certainty, if recent mortality experience continues, we would expect to reflect this in our best estimate assumptions in stages over several years.

Our asset portfolio has seen the continuation of the defensive and (20:54) diversified team with, for example, over half of the portfolio in sovereigns, utilities, and infrastructure, £7.2 billion in gilts alone for loans and low percentage of the portfolio in banks and energy, oil and gas.

On the direct investment side, we added a further £1 billion of assets at infrastructure for assets delivering or secured on stable rental income. This is an addition to new lifetime mortgage loans. LGR's institutional business supports the promise of a defined benefit pension to 518,000 people and holds £34.1 billion of assets to back these promises.

Pension risk transfer adds to this business both in the UK from buy-outs, buy-ins and longevity insurance and in the U.S. through buy-outs and buy-ins. Client interest from UK pension plans remain substantial. And LGR's connections with LGIM's institutional business are working well with approximately £1 billion of the £1.5 billion bulk annuity business in the first half, originating from LGIM clients.

The U.S. business is progressing steadily with $141 million across three deals in the first half, meaning that we have now executed over $1 billion of U.S. PRT deals since opening for business in the second half of 2015. The U.S. market looks set to grow in 2017 from the $14 billion market size in 2016, but we will continue with our measured approach to growth in that market.

LGR's Retail business manages £21.5 billion of assets to back pension promises to 541,000 customers with a further 16,000 lifetime mortgage customers. LGR Retail's new businesses are seeing terrific growth this year, and we expect new retail annuity business in the second half to be in line with the first half. The lifetime mortgages has the potential to be a rapidly growing market, and our market share has been steady at around 30% in the past three quarters.

Finally, further industry consolidation seems likely with the potential for annuity backbooks to add to either the institutional backbook as with the Lucida deal we completed in 2013 or to the retail backbook as with the Aegon deal last year.

LGR has seen strong growth in both its Institutional and Retail businesses, but the potential for the markets in which we operate is huge. There are £2 trillion worth of liabilities in the UK private sector defined benefit pension currently transferring to the insurance industry at £10 billion to £14 billion per annum. There are $3 trillion of liabilities in the U.S. private sector defined benefit pensions, of which we expect around $20 billion to transfer to the insurance industry this year, up from $14 billion in 2016. There is £1.5 trillion worth of UK housing equity with over 55, of which we expect £3 billion to be released this year in the form of lifetime mortgage loans, up from £2.2 billion last year.

L&G has a leading role to play in the unwind of this legacy of wealth accumulation. But we also have a leading role to play in it replacement through defined contribution and decumulation with guarantees, as the burgeoning LGIM Retail and LGR Retail work ever closely together.

I'll now hand it over to Mark.

Mark Joseph Zinkula {BIO 16142450 <GO>}

All right. Thank you, Kerrigan. LGIM continues to experience strong and consistent growth, with external net flows of £21.7 billion during the first half of the year and a 13% increase in profit. We continue to grow our UK DB business and remained the largest manager of assets in this market and the largest provider of LDI solutions. We're seeing positive growth in our DC business, and we're now the largest manager of DC assets in the UK. And the UK retail business is also growing rapidly, ranking first to net flows during the second quarter. And we're experiencing accelerating growth internationally with AUM up 31%. I'll focus on all three growth areas in more detail in later slides.

We've maintained a stable margin of around 50% due to the scalable nature of our business model, and fund performance continues to be strong. And our investment in technology and overseas distribution will help us maintain our current positive momentum. In an industry experiencing consolidations and multiple challenges, such as the upcoming Brexit negotiations, MiFID II and the FCA asset management market study, we're well placed to continue delivering for our customers.

Positive flows across virtually all of our channels, regions and investment areas demonstrates the breadth of LGIM's business model. The de-risking of DB schemes and the growth of the DC market are allowing us to increase assets across a range of solutions, which includes LDI and multi-asset strategies and fiduciary management. Our strong performance in active fixed income is leading to increasing inflows, especially from the U.S. and UK institutional clients, while demand is growing in other regions.

Index net outflows are once again due to UK DB clients switching out of equities and into other products, primarily solutions, as they continue to de-risk. However, we had strong net inflows from international and retail clients as our index business expands in new markets.

We're also successfully expanding our product range and factor base and (26:22) ESG strategies and is growing demand for real assets despite of a broader solutions mandate on a stand-alone basis. We made over £1 billion of investments across real estate, infrastructure and corporate debt, and we're experiencing success with our Build-to-Rent fund with approximately £1 billion in capital raised.

Although we're still expanding our presence in the UK DB market, as it continues to mature, it's important that we grow our UK DC and Retail businesses. The DC business had net flows of £1.7 billion, driven by our bundled business which offers investment and administration services to DC schemes. Our Master Trust is the fastest growing in the UK and, together with our other workplace pension schemes, now has over 2.4 million customers. We've seen a 20% increase in customers over the past year and expect this growth to continue. The number of pension schemes supported by the DC business has increased by 29% during the first half. And our investment in Smart Pension, a fintech firm focusing on auto enrollment for small companies, has helped drive this recent growth.

Our retail business is also performing well with £1.7 billion of net inflows, and assets have increased by 25% to £27 billion. We're confident we will continue to benefit from trends in the retail market, such as growing demand for index and multi-asset funds and we're expanding our distribution focus to wealth management in key European markets.

In addition to expanding our presence in the UK, we're also experiencing accelerating growth in international markets. Over the past six months, we had record net inflows in our international businesses of £17.9 billion, and total International AUM stands at £198 billion. Our U.S. business continued its rapid growth with a 27% increase in total assets in the first half of the year.

In Europe , we have £6.6 billion of net inflows and now have £35 billion of client assets. We had £2.5 billion of net inflows from clients in the Gulf, as we deepen our relationships in this region. We've also established a distribution office in Tokyo and trading and fund management capabilities in Hong Kong, and we expect our Asian business experience accelerating growth.

As I mentioned earlier, our U.S. business had a very good first half with net inflows of £8.6 billion. We're now managing assets of £126 billion in the U.S. across a range of strategies. This rapid growth has been driven by thought leadership we provided in the U.S. pension market as DB plans increasingly implement LDI strategies and consistent strong performance in our range of asset fixed income funds.

A more recently established index team is also helping drive growth in the U.S. business. Good progress has been made in raising assets outside of the corporate DB channel, as we begin to target public plan in DC markets, and we're also developing multi-asset and real asset capabilities in the U.S. to support expansion of our distribution strategy and also support LGR's expansion in the U.S. market.

So, to sum up, it's been more the same for LGIM as we continue to broaden our UK footprint and successfully expand internationally with a focused strategy that leverages all our core strengths.

Now, I'll hand it back over to Nigel.

Nigel D. Wilson {BIO 1535703 <GO>}

Thank you, Mark. LGC continues to grow assets and profits, creating new asset classes and attracting co-investors to grow their business. Operating profit for the half year is £142 million that's up 5%, and PBT is £194 million, strong performances from both direct investments and credit portfolios.

In total, we have £2.9 billion of shareholder cash. And today, after the LGAS dividend was cleared, we're now have £3.3 billion, of which £2 billion is held in group. LGC's business model is performing well across all asset classes. Over £200 million has been invested this year including a new £39 million investment into later living as well as scheduled follow-on investments in projects such as the successful Build-to-Rent fund and our energy business.

The operating businesses are developing strongly with Pemberton and NTR expanding rapidly and CALA delivering revenue of over £700 million. That is three times the £241 million it was when we acquired it in 2013. Developments such as Cardiff and Bracknell are exciting and profitable.

Importantly, profits are being delivered from asset sales from LGC to long-term investors, creating real cash flow for Legal & General shareholders and the flow of capital investments to the wider UK economy, investing in real assets, creating real growth and real jobs.

As this example shows, LGC invested £38 million into the early stages of £400 million Cardiff regeneration project in 2015. The LGIM real assets team has delivered attractive matching adjustment assets for LGR and also for LGIM's clients. This investment model is typical with LGC's approach, which has successfully driven investment into much needed inclusive regeneration schemes right across the UK.

LGC is also broadening the opportunities for future growth for Legal & General. By applying their skills and creating successful investment partnerships and capital management, LGC are establishing new attractive asset classes, and there are many more in the pipeline. All three sectors of housing, infrastructure and SME finance suffer from under investments in the UK. Finding long-term investment opportunities to bridge these gaps is essential to align long-term service with socially and economically useful investments.

By investing early, LGC has created huge opportunities for LGR and the LGIM clients to deliver long-term investment opportunities for the group. The environment in which we compete is seeing a rapid change in technology and digital customer engagement. We are making great progress as we continue to invest in technology to ensure our business remain simple, efficient and convenient for customers.

We've reduced processing time using robotics and, in doing so, provided our customers with an excellent service as can be seen through outstanding Net Promoter Scores of 70 or more. Our investment in platforms has resulted in significant increased usage by customers, institutional clients, consultants and administrators. We've seen an 80% increase in customer visits to L&G.com so far this year. And our digital institution client portal has been used by over 2,500 clients.

We're using a combination of technology and data to innovate and drive our business forward. Jeff mentioned earlier, SmartQuote launched in GI (33:14), SelfieQuote in the U.S. using predictive analytics and automation. And we have pilots underway, using artificial intelligence, chat box, virtual reality and many more. Our cloud-first strategy is firmly embedded. And our usage of the cloud has already become business as usual, as indeed with robotics. We're excited by some of the opportunities possible through the use of block chain, and we're exploring its potential in a number of areas across the business.

We have clear goals for the future. Achieve global leadership in pension de-risking, help people achieve financial security, continuing building our world-class international asset management business, become the UK leader in direct investments, become the market leader in the provision of digital insurance and retail investments with the ultimate end to be recognized as a leader in financial solutions with a globally trusted brand.

I'd now like to open up to questions. So, thank you.

Yeah. Gordon and Andy - Gordon, Andy and Greig...

Q&A

Q - Gordon Aitken {BIO 3846728 <GO>}

Thanks. Gordon Aitken from RBC. Three questions on longevity. Firstly, can you talk a bit about - I mean, CMI 2017 will be published in March next year. CMI 2016 underestimated the number of debt in 2016 by 4%. I mean, does your statement about potential future releases reflect the expectation at CMI 2017 when it's published for reduced life expectancy again on top of the reductions we've already seen in CMI 2016 and CMI 2015?

And can you just talk a bit also, second question, about the wider implications of this and of increase in debts for the acceleration of DB schemes looking to de-risk and also maybe other insurance companies who have backlogs looking to off load them?

And the final question on strain, and strong demand for bulks, I mean you've highlighted that. Plus you have annuity backlog that's looking for homes. So, lots and lots of demand, but it doesn't look like there's enough a lot of supply in the sector. What happens to strain from here?

A - Nigel D. Wilson {BIO 1535703 <GO>}

Kerrigan, will you take the first two? And, Jeff, do you want to talk about the backbook acquisitions?

A - Kerrigan Procter {BIO 15093363 <GO>}

Certainly. Well just on the CMI models. As you know, as many people know, we're on the CMI 2014 model at the moment for the 2016 results and it's the the CMI 2015 model, we'll be exploring really in the second half of this year. And just to give you a bit of color on that, and maybe link to some of your other points.

The things that we'll be looking at in some detail are the differences in the slowdown of longevity improvements for different socioeconomic groups, by age group and by gender. Broadly, the slowdown is more marked for the lower (36:07) socioeconomic groups. It's more marked for older age groups, it's more marked for females rather than males if you (36:13) want to kind of visualize that as poor old man really is the unfortunate picture there with that slowdown in...

Q - Gordon Aitken {BIO 3846728 <GO>}

(36:19) for Kerrigan.

A - Kerrigan Procter {BIO 15093363 <GO>}

So, that's the picture that we're really investigating, and you can see those themes applied to our backbook really to analyze that in no great amount of detail and get comfortable with the progress of (36:37) the CMI 2015 model and then see how things progress from there on. I mean, just to elaborate those points a little about where does it go in the longer term. Clearly, there are some things that are coming together here. There's the – a lot of our long term themes, its aging populations meets welfare reformed. If you like, the age of austerity meets the aging demographic. The rate of increase of over-80s is not matched by the rate of increase as financial resources there, so I can see that continuing.

The other element is really, the course of death argument which says that people die of something. So, as we've seen the improvement in circulatory disease treatment for cancers, then you've seen the rise in prevalence of dementia. When you put all those things together, and you can see a potential for a medium-term to long-term trend developing and that's really what we're thinking about. And I think some of that is underlying that CMI 2016, CMI 2017 figures that's starting to come out. So, that's how we think about the overall picture.

And certainly, that's a positive situation also for defined benefit pension plan. So, that £2 trillion worth of liability is clearly impacted by that longevity improvement and the rate of transfer to the insurance industry is clearly impacted by the funded status of all those pension plans.

A - Nigel D. Wilson {BIO 1535703 <GO>}

So, net-net, that's great news on one side and there's a lot more business out there that's coming our way and you're probably going to get a bigger share of it (38:07).

Q - Gordon Aitken {BIO 3846728 <GO>}

I think it's a good summary.

A - Nigel D. Wilson {BIO 1535703 <GO>}

Okay. Kerrigan is another of our people who have PhDs, who certainly give the complete answer...

A - Stuart Jeffrey Davies {BIO 20023574 <GO>}

Yeah. I mean, just in terms of strain and what's out there, obviously, especially believe the press there's potentially large backbooks. We're very pleased with the less than 4% strain that we talked about. That combined with our increase in Solvency ratio, anything increases there in the future from longevity releases, improved cash position, all give us optionality around that.

So, we're very comfortable that we can quote on those large transactions as they come along. And as you say, if supply/demand exceed each other and pricing improve, the strain only goes down. So, we'd be very happy with that. So, yeah, I mean, whether there's £10 billion number or any other number, we're very happy to be in the market for those and there's lots of optionality around it.

A - Nigel D. Wilson {BIO 1535703 <GO>}

Andy?

Q - Andrew Sinclair {BIO 17749036 <GO>}

Thanks. It's Andy Sinclair from BofA Merrill Lynch. Three questions as well. Not on longevity. Firstly, on LGIM's flows, strong again – you mentioned strong consistent growth. I don't really feel this business ever really gets a growth multiple, though. Would you consider some sort of long-term flows target to try and reaffirm that?

Secondly, second with LGIM, expense growth was maybe a little bit higher than I anticipated, doing it pretty much the same pace as revenues. Whether anyone else here driving expenses higher following the (39:39) going forward there.

And, thirdly, kind of just following on from Gordon's question, Jeff, I saw you commented on the media call this morning saying you could easily fund the £10 billion annuity transaction today. Can you give us an idea of where you would see capacity constraints and constraints on capital asset sourcing? Just a bit of color there. Thanks.

A - Mark Joseph Zinkula {BIO 16142450 <GO>}

Okay. Yeah. Certainly. I think the first time I've had two out of three for LGIM, so thank you very much for that.

(40:08-40:13)

The flows have been, I think consistently around mid-single-digit percentage of opening AUM for a while. Obviously, the flows will be lumpy. I talked about this several times in the past, especially the UK DB book because they have a lot of large institutional clients, a lot of large mandates. And so, there will be some volatility in the flows there.

But as time is going on, as you know we've been at pains to point out, the growth under DC business and retail business in all regions is just consistent growth that we're starting from a very low or nonexistent base historically.

So, over time, we do expect those net flows to be clearly positive virtually quarter after quarter for a while here. There'll be quarters in or not, but I think we can still maintain above industry net flows for a sustainable period of time for sure. So, the industry is at around, say, 1% or 1.5% since the crisis, and we are mid-single digits. Collectively, we'll be able to continue that kind of trajectory.

With regards to expenses, yes, we are investing in the business, and we'll continue to invest in the business. We're exceptionally well-placed right now. It's an industry going through consolidation.

We are in a great spot to continue to consolidate when in this consolidation phase. And so, we'll continue to invest predominantly in expanding distribution to support this manufacturing machine that we have as well as a lot of it technology in a variety of different kinds of initiatives. So, I do expect that we'll continue to invest in the business going forward.

A - Kerrigan Procter {BIO 15093363 <GO>}

Particularly, there's a couple of comments that Mark made in the presentation that people may not have picked up. When we transferred the Savings business, Retail business into the Mark's division. We were number 13 in net flows. We were number one in the last quarter. And Honor Solomon and the team had just done an amazing job there. And in the DC space, we've also become the number one player as well which is a great achievement by Mark and, I think, his team. Jeff?

A - Stuart Jeffrey Davies {BIO 20023574 <GO>}

Yes. Just on the £10 billion back-books, I'm not sure quite what I said but sort of true. I mean, yes. So, we are very open to business, and we've done the work around the £10 billion book and what that would look like. And we've talked about the strain figures that are less than 4%. Back book clearly comes with some transitional which helps, but that is offset by the amount of direct investments that you can source at a point in time.

So, we've done that and with – as I said before, with the highest solvency ratio and some of the tailwinds behind that management actions we can take, we feel very well-placed to be able to write that sort of size deal and actually not impact our underlying flow business, and then warehouse that and decide our options for financing and source direct investments over a period of years, which would then start to pick up again in solvency and the (43:04) time. So, we're very comfortable with that solvency as a constraint.

There is clearly a timing issue with the amount of direct investments we can source and that's where Paul, Mark and Kerrigan combined work together to produce those for us.

work together to produce thus far.

A - Nigel D. Wilson {BIO 1535703 <GO>}

Greig, then Jon.

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

Three questions. One is, I wonder if you could give us some - your thoughts on what actions you would take to test your negative rate in S&P's rating?

That longevity swap that you did, I was wondering if you could just tell us how much in terms of sterling million, that's the sale that you don't add to the distribution on operations metric?

And the third question is you mentioned that your XXX reserves are going to be reinsured in the second half. Those will soon going to continue to be reinsured with the profit fund. And I was just wondering where that funds, as I've said burned through and others with a negative surplus, I wonder how much capacity...

A - Nigel D. Wilson {BIO 1535703 <GO>}

(44:11) the right answer, but I think I'll answer first part of the question, which is with the right part, the second half (44:16). Do you want to take one and three? And Kerrigan do two?

Yes. Sure. I mean with a little bit care. But on the S&P stuff, to be honest, it's a bit of more of the same. So, there was an element of change in the way they look as a capital. But if you looked at what they said, they're very comfortable with our strong market position, the profitability of our business and the outlook for it. So, this is actually the first step in what we're going to do and I'll be on the phone for them today or tomorrow to say, we told you so.

And so, it's retaining more capital, building our strong position, continue with the earnings as we are. And obviously, working with them to make sure they fully understand some of the capital loadings that they're adding but you know, we're confident around thus far in terms of the S&P capital rating.

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

XXX?

FINAL

A - Nigel D. Wilson {BIO 1535703 <GO>}

Yeah. The XXX, I mean this is something we did last year. There are strength that goes in there, but it was small. The growth wasn't so big. It isn't reinsured to the LGAS entity at the moment. We will look to optimize that structure. And we discuss some of the PRA (45:21) the best way to optimize it. We always have the fallbacks of what we've done in previous years, but it's just the same as we've always done, as we reinsure it, we work on it during the year to get the optimal structure that will flow through in reducing that strain, but we just haven't show it at the half year.

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

(45:37)

A - Nigel D. Wilson {BIO 1535703 <GO>}

No.

No. No.

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

And then the longevity?

A - Nigel D. Wilson {BIO 1535703 <GO>}

Yeah. Kerrigan is going to answer it.

A - Kerrigan Procter {BIO 15093363 <GO>}

Just on the longevity, so it was – actually, it's an interesting deal. It was new and innovative type of structure in the market where we don't keep any of the counterparty risks that came in from one UK pension plan. We reinsured it and the counterparty risk is taken by the scheme of the reinsurer which we think is a great innovation for the market.

Because it was just one client, I don't feel comfortable releasing the competitive information around the release from operations on that particular deal. It was – we took very little risk because we reinsured all the longevity risk...

A - Nigel D. Wilson {BIO 1535703 <GO>}

Not particularly.

And the counterparty risk. So, yeah.

Not really is the answer to that one. Jon? And as we head back over – let's start with Alan and...

Q - Jon M. Hocking {BIO 2163183 <GO>}

Bloomberg Transcript

Okay. Morning. Jon Hocking from Morgan Stanley. I've got three questions, please. Firstly, on the Solvency II ratio, it's crept up quite quickly since the sort of £150 million or so that you reported sort of out of the box on Solvency II. And I guess with this sort of run rate, you're going to be sort of pushing north of £300 million in the following near future. Can you just comment a little bit about how you think the capital policy will emerge? Because I guess the counter argument to that is actually then you see concentrations increase. So, how should we think about what's sort of hygiene level for that Solvency ratio going forward? It's the first question.

And secondly, could you give a little bit of color about what happened with the margin adjustment optimization in the first half, what we should expect in the second half? And then, finally, individual annuities. Some of your competitors have talked about DB transfers picking up and actually some of it over spilling to individual annuities. I wonder whether you could talk about how durable that individual annuity performance might be. Thank you.

A - Nigel D. Wilson {BIO 1535703 <GO>}

Yeah. Jeff, do you want to take the first one and Kerrigan to answer the second and third one about why haven't we have enough progress on all the management actions compared to the actions for the year.

A - Stuart Jeffrey Davies {BIO 20023574 <GO>}

Yeah. Sure, I mean, obviously, when offsetting a limited, you see this continuing to increase and certainly the master trajectory is on and some of those are the management actions that Kerrigan will talk about, as well as the surplus generation. But as we've said earlier on costs , et cetera, we have an ROE north of 20% and we see growth opportunities across the whole business.

So, whilst we have that, we believe our cash position, our strong performance position gives us that optionality, allow us to invest in bolt-on acquisitions, invest in more LGR business, grow lifetime mortgages, et cetera. So, while there are plenty to invest, then we'll continue to monitor it and look at that and decide at a point in time if we feel it's excessive. But at ROEs north of 20%, we're going to keep going.

A - Nigel D. Wilson {BIO 1535703 <GO>}

Kerrigan, do you want to talk about...

A - Kerrigan Procter {BIO 15093363 <GO>}

Yeah. Just, a little bit on the matching adjustment optimization (48:30) most of our liabilities are matching us from eligible, and we did a lot with maximum eligibility of asset from efficiency through risk restructures intrusion lifetime mortgage structuring. So, we issued a new tranche of lifetime mortgage loans in the first half, and we flattened up (48:45) on some of the structuring around our U.S. dollar assets. So, some made a little bit more efficient. So, lots of incremental small things, nothing major there.

We've got most of our matching liabilities are eligible, but there's a few more there that with the restructure of insurance contracts underlying that we could improve the efficiency there. So, it's an ongoing, at the edge is improvement on both sides really on that matching adjustment optimization.

A - Stuart Jeffrey Davies {BIO 20023574 <GO>}

Individual annuities, so, yeah, there's certainly have been flows from previous schemes with deferred members looking to switch to DC. So, in fact, that's been noticeable. I mean, in the context of the £2 trillion worth of liabilities, it's small. I think actually beneficial because members get something that they like which is the DC pensions and different cash amounts.

And – but the pension plans head towards a more affordable pension funding ratio. So, hence more likely to buy everything. So, I think it's all part of the management and de-risking of this huge $2 trillion industry. So, notable feature for small schemes, but that's for a small number of schemes. We see that probably continuing. We'd see that overall trend in terms of the unwind of DB is positive for us.

Q - Alan Devlin {BIO 5936254 <GO>}

Thanks. Alan Devlin from Barclays. Three questions. First of all, how do you – when you look at the sourcing of direct investments for new business, £10 billion deal, we don't use a lot of direct investments versus increasing your direct investments in the back books and the economics of the two.

Secondly, in general insurance, you're growing premiums in what was a soft market list elevated claims inflation. And what gives you the comfort that actually it is profitable growth you're driving there. I mean just finally at the start, Nigel, you said you – that your ambitions were ahead of consensus and you were getting increasingly ambitious. What do you mean by increasingly ambitious? Thanks.

A - Nigel D. Wilson {BIO 1535703 <GO>}

I think Jeff is getting increasingly ambitious as well. That's just great to see. On the direct investment, I'll do a little bit. And certainly what I'm seeing in wondering around the country is a lot of politicians at a city level and business people at the city level, realizing that there's some negative headwinds from Brexit. And therefore their electorate voted for Brexit. What are they doing to resolve that?

And Jeff, Paul, Laura have all been – their various visits to towns, and the reception that we get when we go there is just of the many things. And there's a huge pipeline. We've got 20/30, 40/50 of investment in all of these areas and we're getting more competent in creating matching adjustment assets and target itself is a 10-phase Phase 1 project. But as you've seen, we're already working on Phase 2 in some of the cities and town.

We're very excited that people like Andy Street have become mayor in Birmingham, which we have made some progress in, but nowhere near the progress that we've made in Manchester or Leeds. But we're doing a lot, but there's a lot more we can do than the trade – what are we putting to front book and what do we do for the back book is always an interesting discussion at our group committees.

Yeah. Just a bit more of that. As you know from various Capital Market Days, we're obsessed with cash flow matching which is likely to have a bit more assets coming in the pension payments every single month. So, when we think about new business, we'll look at what assets sort of available lifetime mortgage maybe at the long end some inflation links, student accommodation, let's say in the middle of some sort of real estate lending possibly at the end with trading credit, you look very closely to that.

And then there's a front book deal then you're talking to consultants and clients about bringing those things together then that can be a great place to put assets to meet the client's needs and really fit with our book to the extent that doesn't really fit for new business, but fits within our back book. Then that's where we'll head that towards the back book. So, cash flow matching is also the angle that we come out really.

I think the other two things. GI I think – with any external business for nine years actually, and then the new team, just an amazing job and it won five out of six bids that we've made and we are very competitive. They are all profitable, good bids. None of them are huge accounts, but they're all very good accounts and we've got a number of other things. We have actually one that's not announced or we think we have a high probability of winning.

In terms of our ambition, I think that reflects the capability of our organization and Elaine is with us today. Elaine is stepping down as Group HR Director, did an amazing job in working with myself, the chairman and others on bringing great people into our organization but also developing some of the has-beens and never-beens in our organization and make them incredibly capable.

On things like the pipeline for the bulk business, I think, Chris DeMarco and Pretty are both here, over here, yes, here earlier and this is – you want to talk about what's actually going on at a micro level, and please, please, feel free to ask them questions afterwards.

But the – just to give an answer to the £10 billion one, the answer last year was we probably need partners to do it. And that's one of the reasons we did £3 billion rather than the £9 billion on the Aegon deal. Our capital position strengthened. Our capabilities strengthened. Our confidence in doing the deals, having been two successful deals, strengthened. And our ability to source direct investments has certainly improved. But you heard Mark talked about LGIM's ambition. And we went on a trip together, both in Middle East and the Far East. And the reception we get there is absolutely truly outstanding. And America, partly because Mark is American, has been I think incredibly welcoming to us as a firm, and the success rate we're having on bids is huge.

So, I would actually encourage Mark to add more people to his organization because actually the rate of success that we're having across our businesses is truly amazing at the moment. We just got to keep it up at that high level.

Andy is going to cheer us up now.

Q - Andrew Sinclair {BIO 17749036 <GO>}

(55:04). Shall I start with the cheer – really cheery thing (55:06)?

A - Nigel D. Wilson {BIO 1535703 <GO>}

Go ahead.

Q - Andrew Sinclair {BIO 17749036 <GO>}

Okay. So, the first question is on the kind of obviously the profit warning from Carillion earlier in the year. And they highlighted a few projects which are going a bit difficult for them. One of the them was the Royal Liverpool Hospital where you're one of the big funders with £150 million debt. How do you view that, and what does that mean for that debt on your balance sheet? Have you written it down in the half-year results?

And the second question on the longevity basis change. So, as I understand it, you're using like a five-year average for mortality on the base tables with some different weights now to the weights you're using before. So, it would be quite helpful to know what the – what number does this come out with relative to experience last year, so if – yeah, and also how much of the £126 million would it – you've earned anyway and in the back earnings? So, should we strip some of that offer at the time? Thanks.

A - Nigel D. Wilson {BIO 1535703 <GO>}

Some of your more optimistic questions there, Andy, and we obviously – we have contractors place different fees from time to time in the industry, and you take that as normal. We've done a pretty comprehensive review of the Carillion position across all of our projects. They're not huge contractors to us overall, and we don't think we have any material exposure to them on any of our projects.

On the longevity one, do you want to pick up the...

A - Kerrigan Procter {BIO 15093363 <GO>}

Yeah. Just a few other details on that. You're right, it's a five year, it's smoothing effectively on base mortality, so the probabilities we apply to people dying today rather than the mortality improvement. So, yeah, we changed some of that and smoothed it more in effect. Released £126 million of prudence there on those probabilities, and that kind of compares to, I think, last year just in terms of actual debt. We have about £40 million worth of positive experience through this. So, kind of put that £126 million in the context of that £40 million, you'd have seen through just actual deaths happening relative to experience.

Q - Andrew Sinclair {BIO 17749036 <GO>}

Okay. Thanks.

A - Nigel D. Wilson {BIO 1535703 <GO>}

Two more questions. Andrew and Oliver, is there anybody else? Yeah.

Q - David Andrew Bracewell {BIO 16394801 <GO>}

Yeah. Hi. It's David Bracewell here, Redburn.

A - Nigel D. Wilson {BIO 1535703 <GO>}

Hi.

Q - David Andrew Bracewell {BIO 16394801 <GO>}

Two questions. I think it's a follow-up. The first one is a follow-up on an answer before. I mean it's just on the kind of allocation of direct investments to the back book and the front book. And the reason I ask is just how much allocating of the lifetime mortgages to the front book are you currently doing. And the reason I ask is just to see if you can improve that 4%, and you've been straining any further or if you're kind of maxing out the allocation of the lifetime mortgages to the front book business there.

And the second question again is on longevity. For the future expectations, I think, and correct me if I'm wrong there, but I think you used a 2-percentage-point-per-annum improvement rate to the – to your base tables. And you did mention that you might be looking at the solution you're making to future improvements to longevity at the year-end. I just wonder if you could give me any sensitivities to potential change to that. Thanks.

A - Nigel D. Wilson {BIO 1535703 <GO>}

Can you two just have a coin as to who (58:09) tricky question.

A - Kerrigan Procter {BIO 15093363 <GO>}

If I could talk something about the allocation of lifetime mortgages there...

A - Nigel D. Wilson {BIO 1535703 <GO>}

That's easy.

A - Kerrigan Procter {BIO 15093363 <GO>}

Yeah. Exactly, exactly, as I stood up first. So, I mean, broadly – and some of it gets into some quite sensitive commercial conversation, so there'll be a limit to the amount I'll talk about. But it really comes back to the ALM points and making sure that we can max cash flows off. So, a lifetime mortgage, as I said, it typically kind of have 17 years duration to the new book. So, you need long-dated flows to max them. So, typically, you might look at maximum, we think we can put 25%, maybe a third of new business could be allocated to lifetime mortgages. So, that's – broadly, that cash flow matching consideration is what we think a lot about when looking at deals.

(59:04) it depends on per size of the deal. But just to give you a feel for what we think about there on the lifetime mortgage first.

A - Nigel D. Wilson {BIO 1535703 <GO>}

Jeff, you want to...

A - Kerrigan Procter {BIO 15093363 <GO>}

Do you want to talk about longevity...

A - Stuart Jeffrey Davies {BIO 20023574 <GO>}

Yeah. I mean, it's difficult to put a quantum on it. And obviously, we show sensitivities. There's deficiencies. And as everyone knows, they're an indication but not necessarily the change of table. There are number of you in this room that have done some pretty good work on what a shift to different tables, CMI 2015, CMI 2016, means and what some of those quantums are. But equally, you come out with quite a range.

But it's fair to say, if we moved up the whole way, there's a good quantum there. But we're going to prudent. We're going to look at it. We're going to follow the process that Kerrigan talked about. But we obviously don't have a number today. Otherwise, we'd be on the front foot with the numbers. So, we have to do that work.

A - Nigel D. Wilson {BIO 1535703 <GO>}

It's a very good answer for our auditors here (01:00:02) that wasn't the answer I gave in the rehearsal. That's why Jeff gave you the answer. And Andrew?

Q - Andrew J. Crean {BIO 16513202 <GO>}

Hi. It's Andrew Crean, Autonomous. Can I ask three questions? First one is, could you give us a sense of what the yield enhancement was on the back book driving the profit on that, relative to just the (01:00:29) size of the book?

Secondly, you said, I think, it was £2 billion of cash at center. What is the amount of cash at center which you would normally like? So, how much is excess cash?

And then, you were talking about bolt-on deals, and you mentioned you could do deals like the Aegon deal you did. But you also then said, you could repeat the Lucida deal. There aren't that many BPA writers left in the game. You're not really looking to take some of those out, are you?

A - Nigel D. Wilson {BIO 1535703 <GO>}

I think the last one is the easiest one, Andrew. In fact, I'll answer that one, Kerrigan, and if you'd answer the tougher ones. In the – there's lots of books. I mean, there's £140 billion of back books, and it's surprising how many people have written bits and pieces of business over the years. And so, we have a long list of contacts. It isn't just the Pru and the

Standard Life. So, we will see more smaller – £1 billion-type deals happening, and hopefully, even one in the second half of this year.

I think on the cash, I mean, in big picture terms, at least £1 billion of that is surplus through anything that we would require from a liquidity point of view across the group. And if you want to...

A - Kerrigan Procter {BIO 15093363 <GO>}

Yeah. I mean, just trying to answer some of the questions on the yield announcement. So, we pick lifetime mortgages, obviously, a very long-dated illiquid asset. And so, you're looking for a reasonable (01:01:58) illiquidity premium there. That sort of market is you're looking at 100 basis points, 120 basis points over a AA, however, AA had taken out (01:02:07) equity risk premiums. So, broadly, that kind of level. For other classes down at private credits, some of the private placements, you'd be looking at a lower yield pickup, you're below half of that probably.

A - Nigel D. Wilson {BIO 1535703 <GO>}

Yeah. I think the question in a sense is that we've got a lot of assets which are not optimizing the back book than the gilts we don't over time and if you – much fewer gilts, and we've looked to – if you look at the enhancement we can still do on the back book. And actually, the separation of the business into the two parts is making us look more seriously at the optimization of both the retail side and the institutional side turns out to be better for producing future surplus generation than we thought when we originate – set it up.

And as Paul's team, Mark's team, and Kerrigan's team work closely together on the DI origination, the further opportunity has optimized the back book and much bigger than we'd actually thought. And the pipeline that we have deals coming into both the back book and the front book from direct investments is much higher. There's a lot more creativity going in. Again, we hired some great people in both markets. All three teams, have hired very good people who are working very collaboratively together to do this. So, there's a fairly substantial upside in that as we go forward.

Oliver. Oliver or Gordon, whichever of you.

Q - Oliver Steel {BIO 6068696 <GO>}

It's Oliver Steel, Deutsche Bank. So, three questions. One, just slightly technical. The new business surplus on protection seem to have dropped versus last year. Yet I think business has increased. So, I'm just wondering what's going on there.

Secondly, I mean, look, on these – I mean, you talk about the escape of water losses, and I know it's an industry problem, equally as you say you've signed quite a lot of new deals. You now got this new policy which asks only five questions. Does one of them include how many bathrooms does it have, and things like that? So, I'm just wondering here about how can you test the quality of your new business you're taking on in that area? And obviously, that has implications, but the quality of new business you're taking on elsewhere if there's an issue here.

Thirdly, the management actions in solvency, so £0.5 billion in total. I know £100 million of that was the longevity issue, roughly £100 million was the Netherlands sale. That £300 million from what you said sort of tinkering around the edges seems to be quite a big figure. And I seem to remember in the past that there was a sort of comment that maximum that you could expect £400 million of additional solvency from management actions. But it feels as if it's a bigger issue, and I'm just wondering how much of that is actually just sort of business as normal, what you can continue to sort of keep that solvency ratio upwards for management...

A - Nigel D. Wilson {BIO 1535703 <GO>}

Okay. Kerrigan obviously will take the third one. And the – I mean, the delta is only £4 million, but I'll ask Bernie to comment on the – in more general about the retail protection business and how it's doing. And then, Cheryl, do you want to talk about the GI and the escape of water?

A - Bernie Hickman {BIO 19334629 <GO>}

Yeah. Thanks, Oliver. Yes, £4 million, I mean the new business surplus is a function of the underlying profitability of the business. It's still highly profitable business. We've got a really strong business model there, which is working really well.

Mix of business actually has quite a place, if you – we provide slightly different mix of business and margin, average margin drops, our new business surplus drops. And it is a competitive market out there. We're not the only one supplying the market. Attractive. We are competing well, but there are other competitors out there.

So, it's going to fluctuate over time. But there's still opportunities in that market, banks and billing societies, distribution opportunities there as well. And we continue to digitize the business, engage with customers. So, we're hopeful to continue seeing growth in top line and bottom line in that business.

A - Cheryl Agius {BIO 20013065 <GO>}

Just on the escape of water. So, in the first quarter of this year, we saw an increase in severity on some of the claims, and our frequency was as we expected. So, we've taken a clear review of this management actions to both increase rates and change some underwriting practices and some claims control. We've not finished repeated in the second quarter, and we believe with these actions, we won't see this into the second half for the year.

With our Smart Quote, we've partnered with Landmark, which has got access to all the surveying data in the market. So, we've got – on each individuals properties, we've got over 400 data points. So, I'm very comfortable we've got real-time access to data and pricing for each of those individual risks.

A - Nigel D. Wilson {BIO 1535703 <GO>}

Yeah. There are some very innovative ideas going on. At some point, we should give a longer debate – discussion around the technological improvements we've made across the businesses because the beginning can make a material impact on both customer acceptance on this and our Net Promoter Scores, some parts of the business have actually gone to – have been really amazing. Kerrigan?

A - Kerrigan Procter {BIO 15093363 <GO>}

Yeah. Just probably trying to give you little bit more color on some of the matching adjustment, that Solvency II management actions. We've got probably about a couple of billion of liabilities, a couple of billion pounds worth of liabilities that are very close to match the adjustment compliant, but not quite in these businesses. It's all or nothing.

So, we're working on whether we could restructure the contracts there slightly or just argue that they could be matching adjustment-compliant. So, that's kind of a £2 billion room there possibly that we need to work on.

And then, assuming (01:07:52) on the asset side, we're exploring new asset classes, new potential with LGIM real assets, of course, the LGC. And as each of these new asset classes come in, we try to get an efficient structure to make that matching adjustment-compliant for properties in construction period. But those sorts of things where we can really explore until we get efficiency.

So, it's coming down towards business as usual. Clearly, as you implement, there's plenty of things to do, and this is a diminishing return. But still plenty of business as usual, moving to business as usual, things we can do to continue to improve that positioning.

A - Nigel D. Wilson {BIO 1535703 <GO>}

Okay. Our last question?

Q - Marcus Barnard {BIO 2103471 <GO>}

Yeah. Marcus Barnard from Numis. One question and sort of two parts for Kerrigan. Firstly, on bulk annuity pricing, are you seeing any pressure from ABCs or Trustees to reflect the worsening mortality in your pricing and maybe capture some of the projected worsening going forward or the loss of improvement? So, the first question is on effect on pricing.

And secondly, are you seeing any – do you feel there's any delays? You've seen bond yields rise a little bit. You've seen equity markets rise. Perhaps with this uncertainty over longevity, are people delaying the decision on doing a bulk annuity or should we expect a strong Q3, Q4 as usual?

A - Kerrigan Procter {BIO 15093363 <GO>}

Thank you. Yeah. On the pricing side, I mean, I think, certainly, as you've seen, we now reinsure most of that longevity anyway. We talked about 80% to 90% certainly over the past two years on bulk. So, I think a lot of that pricing improvement has probably factored into different parts of the reinsurance industry. It wouldn't be all reinsurers have adopted, but because we got a panel of 14 people or so that we go to, then, we can tease out, we think, the appropriate prices from – there's a lot of longevity reinsurers. So, I think it has been somewhat reflected in the price. So, everyone is quite cautious about what it means. And I think, therefore, clients are seeing some of that benefit coming through I think, I believe.

In terms of delays, on the yields point, probably, we've talked a lot about the flow in LDI business, people derrisking and removing the real yield risk the interest rate and inflation risk of that continues at pace, and I think it's at £17 billion or so in H1 just in LDI within LGIM. So, that signifies that people are significantly moving down that room. I don't think that that's a constraint.

I think when it comes back to the first point of people delaying because of the longevity topic, they are thinking about it. But when you explore the reinsurance industry and you see the prices that the people are getting, I think that's in a favorable place, and I believe that we'll continue to see some of the seasonality in bulk annuities that we're seeing over the past several years and looking for strong Q3 and Q4.

A - Nigel D. Wilson {BIO 1535703 <GO>}

Okay. And thank you, everyone, for your interest. I'd just like to thank all of my colleagues for an absolutely terrific first half. As you heard from Mark, we think there's tremendous structural growth in LGC. Kerrigan got many, many opportunities in both the retail side and in the institutional side. Paul has got his fingers in many more pies in the UK at the moment. He's not eating them, by the way. He just got his fingers in them.

Bernie is hyper-excited about all the innovation that we're making in the insurance phase. Cheryl has absolutely assured us all that actually the second half, we're not going to see repeat of the first half in GI. And Bernie finally promised that he will turn around group protection brackets could be in 2018 rather than in the second half of 2017. But the numbers in the second half of 2017 should be – the one should be better than the first half.

So, thank you, all, for your interest and your support. Look forward to seeing you all at the year-end results. Thank you.

Operator

Ladies and gentlemen, thank you for joining the Legal & General interim results August 2017. The call has now finished, and you may now disconnect your lines.