Q2 2014 Earnings Call

Company Participants

- John B. Pollock
- Kerrigan Procter
- Mark J. Gregory
- Mark J. Zinkula
- Nigel D. Wilson
- Paul Stanworth

Other Participants

- Alan G. Devlin
- Andrew J. Crean
- Andrew J. Sinclair
- Andy Hughes
- Barrie J. Cornes
- Fahad U. Changazi
- Gordon Aitken
- Jon M. Hocking
- Marcus W. Barnard
- Oliver G. Steel

MANAGEMENT DISCUSSION SECTION

Nigel D. Wilson {BIO 1535703 <GO>}

Good morning to everyone. This is our 2014 Interims Presentation. The usual arrangements are enforced today, fire alarms, the forward-looking statements and mobile phones.

Today, you'll hear from me. But you'll also hear from Mark Gregory, who's going to take you through the numbers; John Pollack and Mark Zinkula will talk about LGAS and LGIM. And we've got a free feature today. Kerrigan Procter's going to talk about LGR.

This is another very strong month, six months for Legal & General, strong in terms of business delivery, strong in terms of financial results; net cash up 13%, dividends up 21%, and the return on equity of 17.6%. Financial performance of Legal & General is consistent, built on quality of cash and earnings and on excellent execution, not quite a sprint but a heck of a middle-distance peer, especially for a 177-year-old company.

Consistently improving financial results are underpinned by strategic consistency. Our scale and skill drives growth and competitiveness. Our economically and socially useful products and investments improve the security and quality of life for our customers. And our strategic clarity and operational excellence are driving consistent improvement in shareholder returns.

The five mega trends that drive our growth are here to stay. The state pension could cost over £400 billion annually by 2063. That's compared to about £90 billion today. Bank retrenchment continues. On the AQR (01:42) this autumn, we'll take this forward. And after 500 years of print and less than a decade of digital, we are just in the very early days of a long and productive digital journey for Legal & General.

The key to success and our success is not just identifying these trends, it is acting and responding to them. We did this again in H1. Aging populations with retirement solutions, delivering record annuity premiums and rising workplace assets. Digital Platform assets continue to grow and relentless process improvements continue to drive down our unit costs.

Protection continues to grow as welfare reform becomes more pressing. Our ideas for Beveridge 2.0 are moving closer to implementation. These include fairer, flat rate pension tax relief when using the auto-enrolment plumbing to help working age people build rainy day savings against events like sickness and unemployment.

Globalization of asset markets drove the international success for Belgium and made pension de-risking a reality. And bank retrenchment has meant we have continued to expand our direct investments. CALA plans to treble in size to £800 million by 2016, and we've added a £250 million entry point to SME lending through our Pemberton investment.

Here are our five profit centers. One important thing they all have in common is scale. Our businesses are scalable, and we are a simple business in a complex world. When we see growth, we invest to achieve that goal organically or by acquisition. Over the last year, we have demonstrated that we have the capacity and capability to make good acquisitions, from CALA and Banner Homes to Lucida and Cofunds to GIA and the IDOL. We're making good progress in integrating and managing those acquisitions. What the slide doesn't show are our synergies and our teamwork. We are one firm, one set of values and one set of behaviors. We have many examples of great teamwork in Legal & General.

The £3 billion ICI bulk deal is a recent one. This involved 93 people working as a team across LGIM, across LGR, across LGC, and across the group. Our two economies, that's the UK and the U.S., are expected to enjoy some of the strongest growth amongst the developed countries. Investment is coming back, but it still lags consumption. So, our slow money approach is vital to delivering long-term sustainable economic growth that is fair to all.

We've made £4.6 billion of direct investments so far across housing, commercial property and infrastructure. There is student accommodation, distribution centers, hospitals, care homes and energy, and now we've added direct lending. We are creating new asset classes enhancing risk-adjusted yields, reinforcing our role as providers of institutional investment, first with our own money, and later, alongside institutional pension fund and sovereign wealth fund clients.

We're doing these already, and given greater policy and regulatory stability as well as supply side reforms, we intend to deliver much more alongside private and public sector partners including enlightened local authorities and the 39 LEPs or local enterprise partnerships.

In March, I surprised colleagues and perhaps some of you by highlighting some things we need to do better. Here is the checklist. Financially in terms of cash, we are ahead of expectations. We are on track to halve the losses in Workplace Savings this year. We are delivering on the Cofunds under other acquisition integrations, and we've acted to improve our risk-adjusted yields.

After prelims, the budget was something of a surprise, but it hasn't knocked our resilient and robust business off its stride, or diminished the scale of opportunities that we see from Legal & General. The Chancellor's created disruption in annuities will be good news for the customer and good news for Legal & General.

We were an ordinary company. We aim to become an extraordinary company and we've made good progress towards that, our goal in H1.

I'll now hand over to Mark.

Mark J. Gregory {BIO 15486337 <GO>}

Thanks, Nigel, and good morning, everyone. The first half of 2014 represents another chapter in a strong and consistent story. Business growth coupled with cash and earnings growth. The green arrows on this slide are not just up. They're significantly up. Growth in stock today drives earnings tomorrow. And in terms of stock, this was a very strong six months.

The fourfold increase in our bulk annuity premiums drove a 20% year-on-year increase in annuity assets to £38.5 billion. LGIM assets, on either our previous definition of assets under management or the new broader measure, have increased substantially. Savings assets grew 17% with our auto-enrolment proposition driving workplace assets up 30% to £9.5 billion, and Platform assets were up 26% at £67.4 billion.

UK Protection and General Insurance premiums have grown 5% to £921 million and L&G America increased gross premiums by 10% to $553 million. Our focus on cash generation remains. All five divisions delivered operational cash growth. All five divisions delivered net cash growth. Overall, operational cash was up 8% at £578 million, and net cash was up 13% at £567 million. Operating profit was up 11% at £636 million, and earnings per share up 9% at £0.0851.

For a long-term business like ours, having a strong and resilient balance sheet is critical. Our capital base remains strong, but not at the expense of capital efficiency. Our annualized return on equity was 17.6%. We're delivering business growth, cash and earnings growth, dividend growth, and all without compromising the strength of our capital base. Our design principle at the heart of our business is that we drive high-quality growth in stock so as to deliver increasing long-term and highly visible cash flows.

Our business stocks are growing and growing at a healthy rate. This stock growth has, in turn, accelerated the progress in cash and earnings. This is a multi-year story of delivery. The £567 million of net cash generation in the first half of this year is more than 75% greater than the net cash delivered in the whole of 2008.

This slide shows increased net cash contributions from our five divisions. The 13% increase in net cash were driven by an 8% increase in operational cash and a 70% reduction in new business strain. Both L&G Retirement and UK Protection delivered record sales. LGR did so on terms which once again generated a new business surplus and UK Protection's record sales came with £15 million less new business strain.

Across the group, progress on net cash is a result of efficiency and scale. The bullet points on this slide show the correlation between business stock growth and net cash growth, and this is net cash which will be delivered this year and for many years to come. Given Kerrigan, Mark and John will cover the performance of their respective business areas, I'll limit my divisional commentary to L&G Capital and L&G America.

So, L&G Capital. We delivered a 21% increase in net cash from £68 million to £82 million and increased operating profit from £86 million to £102 million. Operating profit and cash generation are calculated using assumed investment returns on the average LGC assets. In the first half, this was 4.4% annualized on £4.7 billion of assets.

The investment variance across the group, a straightforward reflection of the alpha generated versus assumption during the period was positive £26 million for the first half versus positive £42 million for the prior year. The smaller positive was largely the result of total equity returns being lower than long-term assumption in the period.

Turning to direct investments, we completed £1.6 billion of new direct investments in the first half, increasing our total stock to £4.6 billion, up from £2.9 billion at year-end. These are now nearly 10% of the assets in our principal balance sheet. We have to hold assets for solvency capital purposes, and we have to hold assets to back our annuity liabilities. Our strategy, therefore, for the principal balance sheet and particularly for direct investments is to generate enhanced risk-adjusted returns given the relatively low liquidity requirements for the assets we hold.

L&G America. Operational and net cash represents the dividends paid up to group. LGA paid $73 million of ordinary dividends this year compared to $66 million last year. As a reminder, the ordinary dividend from LGA is normally paid in Q1 each year with a further, albeit significantly smaller preference dividend expected in Q4. You can see the compound annual growth rate of L&G America's dividends in recent years. And dividend progression remains a key strategic objective for this business.

In terms of business performance, LGA delivered first half sales of $78 million, up 11% growing its market share. It's now the fourth largest provider of term assurance in the U.S. by premium and the largest provider through broker general agents.

Operating profit was lower, $72 million versus $81 million last year, including high levels of death claims, which were $33 million adverse to assumption. Higher mortality in the first few months of 2014 does appear to have been a feature across much of the U.S. industry. We believe this to be a short-term effect and anticipate mortality returning to assumed levels in the second half.

In the last couple of months, we've introduced a new pricing model which allows us to set assumptions at a more granular level. As a result, we've increased prices in lower profit areas and reduced prices elsewhere. This will lead to a change in business mix and we expect to see a small reduction in new business volumes in the second half against the comparable period last year. But, overall, we expect margins to be broadly unchanged.

Moving on then to the balance sheet. The group's Solvency I IGD capital position remains strong with a surplus of £4.7 billion at the half year. This includes the provision we hold for defaults in the credit assets back in our annuity business, which has now increased to £2 billion.

The components of the movement in the IGD are shown on this slide. £567 million of net cash generation, £588 million of net proceeds from our recent Tier 2 debt issuance, £122 million of capital released from Lucida, following the successful completion of the Part VII Transfer of the business into LGAS. £200 million of net investment for organic growth, and, finally, the cost of the interim dividend announced today.

The result in IGD coverage ratio at 236% is above our preferred longer-term range of 175% to 225%. But it is worth bearing in mind that we have €600 million of existing Tier 2 debt, which is callable at par in June next year. The coverage ratio absent of recent Tier 2 issuance would have been 219%.

Today, we've also disclosed details of our economic capital position as at year-end 2013 and a summary of the position at half-year 2014. I'm aware that the term economic capital means different things to different people. To be clear, our economic capital reflects the amount of capital which the board believes the group needs to hold over and above its liabilities to meet its strategic objectives. It is not a Solvency II balance sheet.

We've used the same modeling framework we intend to use for our Solvency II internal model, but there are many material differences between the two balance sheets. The eligible own funds in our economic capital balance sheet of £11.4 billion at year-end 2013 and £12.3 billion at half year 2014, represent the excess of the value of assets over liabilities. These liabilities are valued on a best estimate market-consistent basis and use an economic margin adjustment for valuing annuity liabilities.

The liabilities also include an allowance for the cost of recapitalizing the balance sheet following a 1-in-200 year event. The economic capital requirement is then the amount of capital required to cover this 1-in-200-year stress in the year following the balance sheet date. Our eligible own funds coverage ratio of the economic capital requirement was 251% at year-end 2013, and 261% at half year 2014 with economic capital surpluses of £6.9 billion and £7.6 billion, respectively.

We've also provided a breakdown of the composition of our economic capital requirement by risk type as at year-end 2013. This is calculated after diversification between risks. Asset market risks, in aggregate, represented 69% of our total economic capital requirement. And within this, credit is our largest risk exposure. Insurance risks comprised 26% of our total economic capital requirement and within this risk family, longevity is our largest exposure. There's lots of new information here. However, the overriding message from both the IGD and economic capital balance sheets is the same. We have a strong and robust capital position.

Finally, on to the dividend. The board has the relative luxury of making its dividend decision from a position of strong cash and earnings delivery and capital strength. The board also shares the executives' confidence in the prospects for the business going forwards. Our dividend guidance remains as outlined at the 2013 prelims announcement. Provided we continue to expect our Solvency II capital surplus to be no lower than Solvency I, then the board will reduce net cash coverage of dividend cost down towards 1.5 times by the end of 2015.

In line with this guidance, coupled with the performance of the business, the interim dividend has been increased by 21% to £0.029. So, in summary, a terrific set of financials and further evidence for our shareholders that we are successfully executing on our strategy of growing the company and delivering enhanced returns.

I'll now hand over to Kerrigan.

Kerrigan Procter {BIO 15093363 <GO>}

Thanks, Mark, and good morning. We have a large cast list of speakers this morning, so I'll be brief in laying out some of the facts about LGR in the first half and then our outlook. This was a strong six months for the business on all metrics: cash, profits, new business volumes, and the growth of stock. We had a surprise event affecting individual annuities, of course, but by that time, our shift in focus in 2013 for the large end of the bulk market meant that we'd already secured the ICI deal. As a result, bulk annuity premiums more than quadrupled to £3.1 billion in the period. The new business margin was unchanged at 8.4%.

Looking more closely at the cash position, you see operational cash rising from £130 million to £146 million, and net cash growing 13% to £166 million. So, rising new business volumes, a growing stock of business, and sustainable margins continue to deliver strong cash flows.

One point to stress is the synergy between LGR, LGC and LGIM where Paul Stanworth, Mark Zinkula and their colleagues are sourcing new assets to match the long-dated liquid nature of our liabilities. This delivered better return for shareholders that allow us to price the business competitively.

The defined benefit of global pensioners transfer to market is a market with huge potential. Globally, the DB market is in the very early stages of de-risking to the order of $10 trillion worth of liabilities that will be de-risked over the next couple of decades. On a buy-out funding basis, £1.8 trillion worth of those liabilities were in the UK.

So the slide illustrates one of L&G's strength in this market, the ability to operate right across the de-risking journey. This is another synergy point with LGIM, our capacity to take the clients through active fixed strategies, LDI and onto longevity insurance buy-in and buy-out.

To be competitive in the bulk market, you need integrated asset management strength, longevity expertise, asset liability management or LDI capability, a new capital and a track record of effective execution. Having these skill sets will continue to set L&G apart.

Our comprehensive product capabilities, matched by almost 30 years of experience in the bulk sector, not only positioning us very strongly for the UK bulk market, but also for global diversification, particularly in North America.

We expect individual annuity volumes to fall by 50% this year. So far, our sales were in line with expectation with first half sales of £383 million versus £754 million last year. We expect a further 50% fall again this year. So, our focus in this market has been on maintaining pricing discipline while the reduction in volume has been replaced several times over with above market.

Turning to the outlook for replacement products and individual retirement, we're moving forward with alternative products that work well within the context of post-April 2015 prelims. We already offer high net worth drawdown products and we're going to extend this to the broader market. We're also developing products that can operate alongside lifetime annuities, and which combine greater investment flexibility with the security of guarantees. We're closely engaged with both the regulatory change that is required and the developing guidance process.

Retirement savings remain too low. So, we think it'll become increasingly necessary to make use of housing assets in retirement. Therefore, we're investigating the feasibility of launching a lifetime mortgage capability in 2015.

Finally, I'm delighted to be able to tell you that Bernie Hickman, well-known to most of you through his Investor Relations activities, will be joining me in LGR as MD of individual retirement. He joins me with effect from tomorrow.

So, I'll now hand over to Mark to talk about LGIM.

Mark J. Zinkula {BIO 16142450 <GO>}

Thank you, Kerrigan. I'd like to begin with our key performance metrics. Our operating profit increased by 5% to £159 million in the first half of the year. This reflects continued strong revenue growth largely driven by net flows in our active and LDI products and a stable cost/income ratio which remains below 50%.

Persistency was in line with a long-term expectation of 90%, despite outflows from our index equity business as defined benefits schemes continue to de-risk. Total net flows for the period were £10.4 billion which - including overlay assets which are derivative positions primarily related to LDI strategies on which LGIM earns a management fee. The inclusion of overlay assets has become a standard market practice and provides a more comprehensive view of our business.

International assets, especially in the U.S., continue to grow rapidly and accounted for over half of the net flows. In the UK, we once again experienced strong demand for expanding range of LDI solutions. And after a successful year in 2013, our property business continues to experience significant growth with AUM increasing by 16% to £12.8 billion. And we're investing in our DC proposition in order to expand our product offering and distribution strategy.

Drilling down a little deeper, our business is becoming increasingly diversified. Over the past five years, the balance between indexed and non-indexed assets has shifted with non-indexed funds now accounting for 57% of total assets compared to 45% in 2009. This has largely been driven by growth in our solutions and active fixed income strategies, as teams de-risk and change their asset allocation.

Property is also experiencing increasing asset flows as we expand our range of capabilities and fund. We're diversifying our asset mix further with the repositioning of our active equity and multi-asset offerings. We're launching additional income and real income growth strategies and our multi-asset team is developing a range of products that leverage our low-cost index funds and asset allocation capabilities.

The UK defined benefit market continues to mature and we're working alongside our clients to help them as they de-risk and ultimately move toward self-sufficiency or buy-out. We're focusing on providing them with innovative new products and solutions designed to make this transition easier.

Over the past year, we've expanded our solutions business to include more competitive offerings in discretionary management, active LDI and pooled LDI strategies. We've experienced significant growth in our solutions business and we're well-positioned to continue this positive momentum.

We also expect growth in the DC market to accelerate and we're expanding our DC business to include an investment-only platform and a broader range of funds to meet client needs as they approach and enter retirement.

As mentioned earlier, our property business has been growing rapidly. It had an outstanding six months with a total of £1.8 billion in transaction, making us one of the most active property investors in the UK. Total net flows exceeded £1 billion for the first half of the year as we benefited from strong flows from UK pension and retail clients and growing interest from Europe and the Gulf.

Our property team is now managing £2.5 billion on behalf of LGR in its sale and leaseback program and is expanding its commercial lending activities. Strong investment performance over one-year, three-year and five-year periods and our expanding range of products has us well-positioned to continue growing this business. Our international expansion continues to gain momentum, especially in the U.S. where performance remains excellent and net flows for the first half of the year reached £4.7 billion.

We're expanding our fixed income product set and broadening our distribution, and our plans to enter the index business in the U.S. are progressing well. We're expanding our team in Asia. We won our first major passive mandate earlier this year. We're successfully executing the first phase of our strategy for the region, and we'll continue to build out our distribution and front office teams in Hong Kong.

Finally, in Europe and the Gulf, we didn't win any large passive mandates during the first half of the year, which is what led to the year-over-year decline in international net flows. However, we saw our first flows on our new SICAV fund range and increasing interest in our fixed income and property capabilities from clients in these regions. Expanding our international business will be a primary driver of growth for LGIM, and we'll continue to invest in all of our focus regions.

I'm going to hand it over to John to talk about LGAS.

John B. Pollock {BIO 6037447 <GO>}

Thanks, Zink. Well, in terms of sheer scale, innovation and flexibility, LGAS is the UK's leader in protection and on-platform savings. And in the first half of 2014 was a further period of growth. Growth in stock with insurance premiums, now standing at £1.038 billion and UK savings assets of £113 billion and financial growth with net cash of £206 million, versus £177 million and good increases in both operating profit and profit before tax.

I'm starting with Protection as it just may be that you've forgotten how good a business this is. In Retail Protection, we are market leaders with over 25% market share, very strong margins, technology that still leads the market, and a customer base of enviable quality. These immensely strong attributes, together with responsive and competitive pricing, over 80% straight-through processing rates, low unit costs and multiple touch points with the customers and intermediary partners enable us to drive profit and cash growth relentlessly.

Our distribution reach is strong and growing stronger with the announcements of new exclusive partnerships with National Australia Bank and TSB amongst others. Our reach includes the mortgage network, which in the first half facilitated £18 billion of mortgages, about one in six of all domestic mortgages in the UK.

Group Protection had a successful first half of the year with gross premiums of £229 million, up 10% on half year 2013, following a series of larger scheme wins. We are innovating in developing the synergy between the corporate businesses. It is working closely with workplace pensions, sharing customers across the corporate sector, and increasingly winning public sector business.

New business margins in UK Protection were 9.3%, a sizable improvement versus the first half of 2013 when we were dealing with the significant changes driven by I-E and gender-neutral pricing. France has a thriving Group Protection franchise and APE there was €57 million, up 30% as we began to leverage the UK strengths in product proposition and broker relationships.

And GI delivered an excellent 88% combined operating ratio and operating profits of £28 million for the half year 2014. This is less than the £39 million for last year. However, the flooding and storms at the start of the year resulted in £12 million of additional claims. Gross premiums for the half year were marginally down at £178 million versus £183 million last year.

The weather in early 2014, notwithstanding, this is a business where we have delivered a turnaround, profitable since 2011, and the direction of travel is good. It is a highly digital business, one of the leaders as far as L&G is concerned, and we continue to grow efficiencies in claims and improve risk selection.

One reason for creating LGAS from the old Protection and Savings businesses was the synergy potential across the 6 million individual customers we service. And this synergy is particularly clear in our corporate client base.

Corporate business consists of Group Protection and Workplace Savings. Again, businesses with scale, £9.5 billion of Workplace assets and rising. Over 1,900 corporate schemes and scalable as unit costs fall in Workplace and we increasingly work in a joined up way across our shared customer base.

The cost message is important across the whole of LGAS. We continue to drive out cost following the creation of the business and are on target for the delivery of £34 million of cost savings by the end of 2014. This efficiency is particularly important in Workplace, where the combination of growth in stock and disciplined management of the cost base means we are on track to have last year's £29 million of losses.

Retail Savings assets under administration at the half year were £100 billion compared with £85 billion a year ago. And Platform assets rose 26% from £53.7 billion to £67.4 billion with net loss of £2.5 billion in the period.

Cofunds is about two things: integrating and updating what we have bought and creating a unique large-scale, good value platform that can deliver multiple products through multiple channels. On the first go, we continue to target an annualized cost saving of £11 million by 2015. And, so far, we have delivered £6 million of those annualized cost savings. And this is primarily from the integration of Cofunds and IPS technology.

At the same time, we've been moving forward on the second larger objective. We now offer four LGIM tracker in mixed asset funds to nationwide customers via the Cofunds technology, and I expect to have a broader D2C capability around the end of this year. But there is more work to do here, but I am very pleased with the team's progress.

Suffolk Life continues to grow with assets of £7.2 billion, up 9% in the half year, and it is very well placed for the developments in the markets following the budget pension's reform. The evolution of the Platform business more than offset the net outflows of £1.5 billion in our mature savings book. These were as expected and in line with our strategy of shifting from the old life and pensions model to a modern digital business. In short, good execution means this is working out for us exactly as we had planned.

This slide encapsulates our strategy for LGAS. Scale and scalability across the division, leveraging of our strengths in protection and broader synergies within LGAS and across the group, driving efficiencies in Workplace and Cofunds, and pushing ahead with a series of deliverables and actions to progress the planned transformation of savings from an analog life and pensions model to a new large-scale digital business.

I'll now hand you back to Nigel.

Nigel D. Wilson {BIO 1535703 <GO>}

Thanks to Mark, Kerrigan, Mark and John. Legal & General has a consistent track record in delivery, and as you heard my colleagues, a very promising outlook. We're only partway through our journey. We're perhaps on the second floor of a large and substantial tower block.

Our outlook is positive. We have the right strategy, our five key macro trends are driving growth and our management team is improving consistently. We are becoming a magnet for talent. My colleagues are indeed stepping up.

Kerrigan outlined the opportunities in LGR and the potential for the Chancellor's reforms to grow rather than diminish our business. John, whose business is undoubtedly the leader in UK Protection, is making great progress in moving to a new model, the digital model.

Zink has positioned LGIM as the LDI leader. He's growing LGIM internationally and stands to benefit from his focus on the huge potential expansion opportunities in DC and in retail. Paul has been successful in housing, in infrastructure, and in urban regeneration with more asset classes to follow. We are still rich in unfulfilled potential. There remains much to do.

Legal & General is a business with a great track record, a great brand, and the reputation for deep thought and powerful execution. We are financially successfully, socially and economically useful and have a strong future.

I'll now open up for questions. And if you could give your name and the organization you represent, my colleagues will hand out microphones. I think if we start and we just work our way across, if you can do that, go on. If you can just pass the microphone down and I think we (37:23).

Q&A

Q - Oliver G. Steel {BIO 6068696 <GO>}

Oliver Steel, Deutsche Bank. Two main questions. One is LGAS pre the non-life business was exactly in line with the cash flow that you projected for the full year. But within that, the split, I was a bit surprised that savings was down, and then you've got this Dutch dividend. So, I wonder if you can just sort of give us a bit more granularity on what is driving the savings cash flow or profits. I assume there are sort of exceptional costs in investing in the business within that, and therefore, the outlook, I guess, for that savings division in terms of profitability. Ditto on the Dutch dividend, is it sustainable? Normally, that comes in the fourth quarter. How much capital have you got in Holland to return?

And then second question, if that isn't a bit too involved, on bulk distribution overseas, you've expanded your sort of target market from £1.8 trillion worth in the UK to $10 trillion, I think it is worldwide. How important should we see the extra multi-trillion dollars' worth of business for you sort of timing on your ability to access that? What sort of distribution actions do you need to take?

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

I think that was three questions, Oliver. So, if I ask John to talk about the Savings business. Mark, can you take the question on the sustainability of dividends for Holland. And, Kerrigan, people like your ambition, but you've got to start walking the talk and not just talking the talk as far as I can see from that particular question. John, do you want to go first?

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

Yeah. Okay. Thanks, Oliver. Yeah. The savings was impacted mostly by the mature outflows, so it's pretty much as we expected with profits drove – is coming off, as I think is very well-known in this room. And actually, it was only very marginally down as we are trying to grow the new business. There has been some investment that has gone in to enable that, but it's pretty much as we expected to happen as the mature outflows are replaced by growing our digital capability in the Platforms and Workplace Savings.

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

Okay. Yeah. On the Dutch dividend, it's a good spot, Oliver. Clearly, we did declare a dividend from our Dutch business for the first time this year. Mostly on (39:48) Holland.

Clearly, Holland is a very difficult market. I mean there's been a lot of political and regulatory impact on the Dutch business, the Dutch market, more generally. And we have seen volumes therefore decline quite substantially.

Clearly, the other side of that equation, we need less capital to invest in new business in the Dutch business going forwards. Therefore, it's freeing up free cash flow which we can dividend back to the center. You certainly shouldn't see the dividend in the first half this year as being any sort of one-off or special. It is very much when we're looking to sustain and if we think there's more capital which can be freed up and dividend back to the center, we will do so.

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

You'll still have the dividend in H2 as well.

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

(40:24). But just in terms of the incremental pace of dividend close going forwards.

Q - Oliver G. Steel {BIO 6068696 <GO>}

(40:29)

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

What? In the Dutch business, we have capital in the insurance business, yes. We're writing less business. We need less capital to support our new business growth. And therefore, it is more of the back book cash is being freed up to pay this dividend rather than investing it into new business in Holland.

Q - Oliver G. Steel {BIO 6068696 <GO>}

So this is being paid for out of the back book cash flows?

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

Certainly (40:48).

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

Kerrigan.

A - Kerrigan Procter {BIO 15093363 <GO>}

So on the bulk annuity fund, actually, I'd like to think of the market more as a global pension risk transfer market and I think it will be dominated by a few small players who are right across UK, U.S., Canada, the Netherlands who can help companies internationally transfer risk from their balance sheets onto their own balance sheets or further into the capital markets.

And I think having that broad canvas gives us an opportunity to participate in markets with different economic cycles, different rate cycles, different competitive cycles I think would be important for – and obviously has a different capital distribution potentially across those markets. So, I think giving yourself a broad canvass, being able to participate as a reinsurer or insurer really gives you the ability to use L&G's risk appetite most widely across the globe.

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

I think that answer meant by the time Kerrigan speaks next time, there will be measurable progress as opposed to – so, if he doesn't, he won't be on the stage and you'd understand. Can we keep passing the microphone now?

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

Hi. Thanks. It's Andrew Sinclair from Bank of America Merrill Lynch. Good morning.

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

Good morning.

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

Three questions as well. Firstly, the economic capital number seems incredibly high. I just wondered if you could put that into context and what you think is an acceptable level and what capacity would you have to deploy the surplus?

Secondly, on the Direct to Consumer platform that we'll see by year-end, can you tell us a bit more about the plans for this business and where that can go over time? And thirdly, on Protection, one of your competitors commented that they've seen some increased competition at the protection market. What's your experience have been the best (42:36) this year, or was it you that was competitors, I suppose?

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

Can I – rather like the previous question, divide that into four, if Mark Gregory takes the question on economic capital. Paul, can you just talk about what some of the ideas we have about deploying the surplus capital and how you will definitely improve the mediocre returns we get on some of that already? If – John, you talk about the D2C platform and, John, why don't we have your usual comments about the qualities of the competition in the protection market which I'm sure everyone will find engaging?

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

Okay. Let's begin on (43:12) economic capital answer. First simply (43:16) is say we have £7.6 billion of economic capital surplus at the half year. And as you intimate, Andy, that's a very healthy position.

We haven't given a range for how we view kind of the coverage ratio we're aiming for EC, primarily because it is not a binding constraint and it currently, Solvency I regulated balance sheet is up (43:33). And I'm actually convinced that our Solvency II when we finally get that agreed will be the binding constraint then as well.

So, I think it's out there for new information for you to help you understand the dynamics and the inherent value of the organization. But at its core, it won't be the binding constraint. So as and when we get clarity on Solvency II, we'll clearly share it with you as soon as we possibly can, but we are still probably a year, a year-and-a-half away from having that final clarity on Solvency II.

A - Paul Stanworth {BIO 15495409 <GO>}

Yeah. In terms of the surpluses, the surpluses have been a very helpful thing to have in terms of – I mean, to widen the asset classes that we've invested in. In the first half, we've used our surplus assets to allow us to buy big sale and leaseback portfolios that have supported the LGR portfolio and we've also invested further in CALA.

But going forward, we're looking at all sorts of areas that are going to widen the asset base that we have when increasingly, the investments that we have are being invested in by our competitors, and we are looking to broaden the investments that we can have. And our surplus capital allows us to increase our capabilities and also allow us to buy assets and bifurcate them effectively through the balance sheet. And we'll be looking at increasing our investments in infrastructure and housing. And we're also looking at other asset classes, including SME lending which we've announced and potentially, in the U.S. aviation finance. All of these areas are areas that banks are retrenching from and offer us the opportunity to improve our risk-adjusted returns.

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

I'm going to stand up for this one and puff my chest out because I think when they're talking about the competitive market in protection, they're talking about us. So, a 25% market share has been growing pretty much every quarter that I can remember for the last decade. We're bigger than two and three put together, and we're delivering margins that are absolutely superb in this business. So, if that's competition, bring it on.

The truth is, we do have absolutely inherent advantages. We have enormous scale, strength. We have customer service quality that is beyond anybody else's. We have standout technology and we have relationships with the reinsurers that bring them very enthusiastically to our door to offer us their capability. So, this market has been competitive for a decade, but actually, we are thriving in that space and I expect that to continue. So, we are the biggest, we are the best, and you can expect that to continue – which is a fantastic segue to D2C.

We bought Cofunds for a capability. It's is not just about being an independent fund supermarket. It's about enabling the digital offering to customers in their savings space. Post-RDR, where the so-called advice gap has expanded, there is an obvious place for a big brand like us to play. We've already delivered at 1st of July into nationwide a Cofunds-based capability. And I expect that to continue to develop.

We have customer pools where we can place our offering. It isn't just about expensively marketed D2C. It's about being able to enable partners to participate in this market, as well as, of course, auto-enrolling pensions customers, the very large book of Protection customers we've got. And we can place this increasingly emerging technology into all of those pools leveraging low-cost access as well as re-enabling customers, which is a social good, to access savings product.

So, watch this space. We are delivering. We will have capability in Q4. I'm not out there trying to go toe-to-toe with existing players. Legal & General's smarter than that. It has pool and capability of customers that it can access better. So, I'm pretty confident that we'll have a lot more to say in this space over the coming 6 months, 9 months, 12 months.

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

That was John's modest answer by the way. For one, he gives the management reason to be a bit more optimistic than that. To be fair to John, I was down in Hove the other day with the bereavement unit and the claims unit down there. They have a Net Promoter Score of 86%, which is almost unheard of in our industry. There's a real commitment to delivering great customer service.

And at the heart of what John's business has done, never mind all the cost economics and everything else, is the service that the customer over a long period of time has been truly outstanding. And for all of this, John was chosen as the Protection Provider of the Decade. I think seriously, they could have given it for the last three decades, but I think they've just given it for one particular decade because I think you've now done 30-years plus with (48:34) Legal & General.

If we just keep working down the line and then if – and you could pass it on to Andrew when you finish, Gordon, Jon and Andrew.

Q - Gordon Aitken {BIO 3846728 <GO>}

It's Gordon Aitken from RBC. Just first question on LGIM. You've talked about these overlay assets, this new disclosure derivative instruments. Just wondering if you can tell us what sort of fees you earned in a bit more detail there.

And second one on cash. I mean, the peer in the UK life sector, which reported this morning, their definition of net cash includes required capital from writing new business. We've had another one recently which put a talk out there, they call it cash after after after which, obviously, excludes new business required capital. Just wondering what your growth in net-net cash would be just so we can compare like-with-like.

And so, the second part to that is, I see from slide 16 your new business capital required is £0.3 billion. Presumably, the bulk that you wrote, I mean, you're looking at sort of 8% capital requirement, so that's going to be about £240 million, so assuming your net-net cash which you'd expect to grow in the second half.

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

Yes. I mean, part of that question is it's very hard to compare like-for-like, I think, which is what you're doing. We just have a consistent approach to it from our point of view. Clearly, we got a lot of cash back through the Lucida number, which was – it continued into H2. I think if you read the – you'll see that we got £200 million back and there's only £100 million odd put into the number that we shown as a group.

We're not big users of capital to grow the business, as you rightly pointed out. It's mainly in the bulk annuity space. As many of you would have noticed, the default provision is now £2 billion, which, I think, in the last five years, we've used about £600,000. So, we're trying to give a consistent definition of cash, which relates to our business. We don't run competitors' business. We run our businesses. If there's some normalization, there's lots of clever analysts in the room who can make the appropriate adjustments.

I don't know whether you want to add to that, Mark.

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

No. But I did show on the waterfall showing the IGD movement, that's where the capital – we define cash as being essentially the release of the potential margins in our technical divisions, and we showed the solvency capital requirements movements between – in both releases and new business range (50:58) through the capital movement. So, the numbers are there, Gordon. I can't remember last year's numbers to give you exact answer. But we have given the disclosure of the movement in the IGD and that does break down the net flow between the existing solvency capital being released and the new business solvency capital being created. So, you can do the math if you – the disclosure is there. I just can't – haven't got it in my packet in front of me.

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

Maybe we can take it offline after. But, Mark, just want to talk about this, in general, about the global pension de-risking market and see the opportunities for LGIM.

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

Yeah. And to your question specifically on the overlay assets, we have disclosed this on an ad-hoc basis for the last several years. We've decided to start disclosing on a consistent basis for a couple of reasons. It is market standard. It's what our competitors do. It's something we feel we should be doing going forward.

And secondly, if you look at any independent studies or comparisons of the size of the major LDI players, it includes total assets managed and liabilities hedged. So, it's something we want to continue to do on a consistent basis going forward.

In regards to the fees, broadly speaking – and this would be a rough comparison – but it would be broadly in line with the fees we get on a passive mandate on a like-for-like comparison, okay? But again, that's going to be an oversimplification because within passive, you have smaller mandates, different size mandates, as well as different requirements at the execution. So a large cap developed market equity mandate will go for lower fees than an emerging market debt mandate, for example. But broadly speaking, that's roughly the fee levels.

Now, keep in mind with LDI – I know there's been some frustration with some of the analysts in the past because we disclosed the collateral we manage, and I would always say, well, we get a fee on the collateral and then we get a fee on these overlay assets, and then we get an execution fee on top of it. So the execution fee which show up not in the ad valorem column, but in the other fees that we would earn over time as plans de-risk.

To the more general topic of pension fund de-risking, we're clearly well-positioned in the UK market. Kerrigan built the LDI business here. We currently have 44% market share in the UK. As I mentioned earlier, that market, as it continues to mature, we're expanding our range of products and solutions to be more accommodative to the small plans who want to implement de-risking solutions via pooled instruments, as well as plans that want to get a bit more value, if you will, and take a little bit more risk from the active managers and our active LDI strategies. So, we think we're well-positioned for the future as well as that marketplace continues to expand.

And last, in the U.S., we're clearly – we've built it as an LDI business just before the LDI market came in vogue so we're very well-placed there. We're growing very rapidly in the U.S. as you heard earlier.

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

Yeah. And we've won quite a number of mandates from the largest clients in the United States as well.

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

(53:52-53:56) largest plans in the U.S.

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

Jon.

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

Jon Hocking from Morgan Stanley. I've got three questions, please. First on economic capital. I wondered if you could tell us what you're assuming – the economic capital number is like very insensitive to spreads. I just wonder what you were assuming in terms of when you see a spread widening event, what proportion of spread widening do you take as a default reserve? And what proportion do you assume as a liquidity premium? And what you're assuming in terms of assets with prepayment risk in that calculation? That's the first question.

The second question. In the U.S. on the Protection business, are you looking at any adjacent product entries in the U.S. I know you're talking about the Bulk business but in retail, is there anything that you can do in terms of expanding the product buckets?

And then just finally coming back on Gordon's question about sort of net cash, looking at that waterfall on slide 17, now there's a lot of rounding in that slide, but it looks like about a third of the cash is being eaten up by movement in capital requirements. I guess some of that's the bulk, as Gordon mentioned. Wonder if you sort of comment to that again and whether you'd have any thoughts about how those cash flow numbers look on your EC numbers rather than on the IFRS numbers? Sorry.

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

I think that gives an - sets a new benchmark in technical - well done, Jon. I'm going to take two, which is that we're not planning at the moment to launch any other products in the United States in that particular space. So I've answered two very succinctly, Mark, I will give you one and three.

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

Yeah. We have given some sensitivity in the economic capital disclosures today, Jon. I would highlight that those are single-risk stresses that we've given you there, so going to clean the wool when things do go bad. They tend to go bad in kind of combinations of risks rather than individuals. I would just make that point.

But the sensitive we disclosed there for spread widening is very much the cost of us then having to re-rate our asset portfolio to trade backup to the required credit rating of the overall portfolio. So that's a stress that we're showing today. I mean clearly - we have clearly have a stress for the defaults in our economic capital calibrations. And clearly, if that's not hard (55:56) enough, then that will come through. But nevertheless, we do recognize that we do have a sensitive default adjusted capital requirement.

Do you want to add to that, Tim (56:05), just in terms of the - don't if you (56:08) want to. Now, don't if you - it's up to you if you can add to that I would...

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

I would describe the downgrade sensitivity...

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

Yeah.

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

...rather than the spread sensitivity, which...

Put the mic. Tim's (56:19) our guru on this, by the way.

I'm certainly not that. I think Mark described the downgrade sensitivity, which is the second one that we've listed. What we're trying to showing in spread sensitivity is just if all spreads widen, does that impact our balance sheet now because it's all about our assumptions about default and downgrade. And that's the second sensitivity that we've given in there.

If there aren't other technical questions, can I suggest that we – of those particular ones, you probably want more detail and why don't we delegate Tim, Simon and Bernie (56:57) to pick those up afterwards. They'd be very happy to answer all those questions.

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

(57:05) just add a bit more color to the movement in capital. Again, back to the answer I just gave me. The capital we show in the IGD movement is the Solvency I Pillar 1 capital requirement and they are very descriptive. I mean, broadly, it's 4% technical provisions for annuities and it's broadly 1% for other unit-linked type insurance contracts. So, clearly, we're growing the annuity book and that absorbs capital value grow in it, but it then releases it over time as well. So again, we have to disclose that information, but it's a very formulaic – Solvency I is a very formulaic basis of capital requirement. Solvency II will be much more of a sensitive basis going forward, so it will look different in the new world.

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

And keep passing the mic down and then – yeah. You've jumped the queue there. You go next Andrew and then pass it back to the two As.

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

Yeah, it's Andrew Crean.

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

The three As now. We've got three As.

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

Yeah, Andrew Crean of Autonomous. Two As. Three questions. Firstly, what's the diversification credit within the required capital on the economic basis? Secondly, on your move onto alternative investments, I mean, there's an awful lot of commentary by the Bank of England about how cautious they are. I see Andy Haldane yesterday was talking about this. I mean, how does that play with you and how are your discussions on that?

And then thirdly on LGAS, you trumpeting the benefits of scale in both the Protection side and on the Platform side. The one area you don't have scale and you're losing money in is DC pensions, Workplace pensions. You've mentioned that you would not be averse to acquisitions. Is that an area where perhaps you could jumpstart the earnings by building scale through acquisition?

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

Yeah. Do you want to go first, Mark?

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

Yeah. Just on the diversification benefit in our EC model figure, I haven't disclosed that number today, Andrew, but partly because actually it's – diversification happens at very many different levels in the modeling, so you get diversification within risk bandwidth and you get between different risk bandwidths. So, it is an important characteristic of the model and clearly, we have got a base (59:14) to do that. We've got a very strong kind of correlation matrix within our EC model. But actually, we haven't disclosed the absolute number. There's (59:21) obviously a meaningful benefit...

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

30%?

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

I won't be led, Andrew. But it's a meaningful aspect that we already see risk (59:29). We've got different types of risk which their mortality (59:34) tend to go in different directions, so there's some natural diversification within our model.

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

On the – Charlie Bean sat beside me at MIT. So, I've spent the last 30 years of discussing various aspects of investment and macroeconomic policy with Charlie. It's great to have Andy doing it now. I'm a great admirer of some of his more enlightening work that he's written over the last few years, The Dog and The Frisbee being a fine example of a piece of research I found particularly interesting.

I think we've taken a very careful and prudent approach to assets. It's taken us a long time. It took us about a year-and-a-half of research to decide to do our first investments and I think Paul and his team have developed a very strong track record. I think all of the investments we have made so far are performing at least as well, if not better, than we'd anticipated. I think it was a very reflective piece that the bank (01:00:36) I know Andy particularly well, so I've engaged with him on lots of economic issues since I (01:00:44) second rate economist myself. True. Certainly true.

But I don't think he's referring to the specifics of a firm like Legal & General. I think there's just a nervousness about people chasing yield unnecessarily in the sector. I think we are fulfilling an economic and social useful function in the types of investment that we've done in the asset classes. And Paul mentioned aircraft leasing. I think we've been looking at that for two years or three years already, and (01:01:18) we've got an open mind as to whether we go into that as an asset class.

I think lifetime mortgages as an asset class, we've been looking at for 10 years, to the best of my knowledge, maybe even longer than that. So there's a lot of research and consideration goes in before we go into any particularly new asset classes. The question was yours, John.

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

Was. Yeah. I'm actually not unhappy with the team's effort in growing the workplace, and we've done quite a lot in their pricing policy. We believe that there's going to be some asset transfers as schemes look at what's being offered by the various players and think about where they want their pensions management to be placed.

If there were clean books of business and they were sensibly priced and that we believe that it would accelerate our growth, then I certainly wouldn't be averse to that. But at the minute, we're doing pretty well, and I can see a reasonably rapid growth ahead of us. So, I'm fairly comfortable. Never rule anything out though.

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

Just keep passing. Who's got the mic now? Who's got the mic? Oh, you've got the mic. If you pass it to Andy then to Alan, that would be great.

Q - Andy Hughes {BIO 15036395 <GO>}

Thanks so much, Andy Hughes, Exane BNP Paribas. A bit worried about being a AAA asset because there aren't that many around the group here. They easily get sold. So, a couple of questions, if I could? The first one, economic capital, obviously, I'm more interested in the Solvency II outcome because that's really where the business is going to end up, and I think you pointed out there's a number of differences between your model and Solvency II.

Could you kind of point out how big the scale differences are or give us an insight as to where the main differences might be? I'm thinking in particular about the recent ABI letter to the PRA outlining your expectations for how you expect Solvency II to come out. I appreciate the PRA is probably going to come back and say, we don't like those. We're going to come back with a much harsher definition, but where does this square up relative to that particular interpretation?

And on the Savings business, after the cost savings in Cofunds, is it now making £6 million in profits in the half year or is still roughly breaking even? Thank you.

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

John takes the second question. I'll just do a bit of a preamble on the first. I mean, the ABI did write, as you know, the PRA (01:03:40) read the letter. There's a sort of strict interpretation of Solvency II, which is supposed to happen on a consistent basis across Europe. We think there's little probability of that happening that every regulator's going to interpret the rules as they see fit, so we'll have a totally inconsistent Solvency II across Europe because we've all started in such very different places, hence, the billions and billions that have been spent in trying to create a harmonizing model.

There's nothing that I've heard on Solvency II that says we're going to get a horrible outcome around this. I think the engagement we've had with the PRA on a number of issues and the FCA on a number of issues has been very constructive. I think there's more sharing of information than has gone on ever, I think, in terms of the approaches, and I'm very much encouraged by that. And certainly, the discussions that we've had with the

Treasury over a long period of time around how we should be managing our capital. Everyone seems pretty happy with the sort of stewardship that we felt (01:05:02) for our capital. I don't know if you want to go on the technical parts.

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

Just to add a little bit more detail for you, Andy. I mean, first of all, of course, the rules for Solvency II haven't been set yet. We have the so-called Level 1 text agreed through the European Parliament in November last year, but a lot of the detail will be contained in the Level 2 text. And we've seen a very early draft of that. We haven't actually seen the formal version out for consultation. That will happen during the course of this quarter and that will go on into next year. So we won't actually get the final Solvency rules probably till the middle of next year. And then there's all the process that Nigel described as around getting our internal model approved with the PRA. So there's a lot to go through at a higher level.

In terms of the detail, I guess at a high level, I would say actually Solvency is very (01:05:39) actually EC is purely economic growth. Solvency will definitely have some non-economic elements within it. In fact, just to illustrate – an example of that would be, I've described our recapitalization cost, when I went through describing how the EC balance sheet works. Solvency II will have a risk margin in it and that will have – contain some probably quite sizable non-economic elements within it. So for example, within the risk margin, there's no diversification within the risk margin itself, whereas in our EC model, we think those risks do diversify, therefore, we allow for that.

Solvency II will set the rules for the whole of the European industry. Therefore, they have set, for example, the discount rate in the risk margin as being 6% above long-term risk-free rates, whereas, in our EC model, we use a lower rate because actually our cost of capital is lower than 6% over risk-free. So they are a team (01:06:29). At a high level, it is the things which are non-economic in Solvency II which will be different to what we've got in our EC. And I think our risk margin is probably the best place where you can kind of think about conceptually how it's going to be structurally different.

Q - Andy Hughes {BIO 15036395 <GO>}

So in terms of the ABI letter approach, so in terms of the benign ABI letter approach, let's call it benign ABI letter because it'll probably end up worse than that. How does that compare to the economic capital roughly? Presumably you've done the numbers on the ABI-suggested approach. And you presume that's worse than the economic capital approach from what you're saying? Do you try to get a scale as to how much capital you think you might have even in a benign Solvency II comparatives to the latest (01:07:08) economic capital disclosures?

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

I know it sounds evasive, Andy, but until we look at the rules and until we run it through our model, it is just misleading to give a number out there because we just don't know. Again, we talk about are we expecting our Solvency II surplus to be no less than Solvency I? And that's still the kind of guidance we give to the market. But clearly the EC is a lot bigger than that. Again, it will probably somewhere in the middle.

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

That's £7.6 billion and £4.7 billion, which are in the packet if you want to read them, Andy, which is a fairly wide range. But I don't think it's going to have a profound impact on our approach to business. I think some of the most complicated areas of Solvency II around equivalence and stuff, which we just don't have as issues for us as a group.

About Savings.

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

You want me to take that? Do you want to take...?

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

Yeah, profits.

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

Yeah. Unfortunately or fortunately, I've got Anneke (01:07:58) who knows a thing or two about the Savings business. So there's no hiding place for me, Andy. We are making money. We're working hard to make more.

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

I think we'll tell everybody what the (01:08:11) profitability is at the year-end...

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

Yeah.

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

...which is kind of a journey that we're on. We'd said with half the losses. We're on track for doing that. We'll give you the (01:08:16) profits at the year-end, regardless of what they are.

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

Hello. Alan Devlin from Barclays. A couple of questions. First of all on L&G America and if you had normal mortality, the results have been very strong, but you refined your pricing and suggested sales would slow in the second half. Is that just a temporary slowdown or is that going to be the new level going forward?

And then just on the annuity margins, which are flat year-on-year, maybe (01:08:43) bulks are much lower margin than the individual but that was recognized, as you said, pre-budget. Do you expect the post-budget bulk margins to come under pressures at 8.4%? That kind of a good runway for us? Thanks.

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

I'll do the summary of those. I think the LGA model we're just refining. We've had a team from the UK working closely with our colleagues. As John said, we've got a great team in the UK, we've got very sophisticated pricing in the UK. Simon, Tim, Bernie (01:09:14) have all spent time out in the U.S. refining our approach to the business out there. And we're happy with the progress that we're making. It wasn't a surprise to us the size of the mortality, particularly in Q1, but it was an industry trend rather than anything specific to (01:09:35) us as a group.

It is clear that people are dying quicker than we thought in our assumptions, both in the UK or the U.S. and indeed in some of the other countries that we're exposed to. So we don't quite know whether that's a trend that we're seeing for a particular period of time or just some one-off event, but we have had very hot – very variable weather conditions and a lot of economic austerity at many different levels in society. As a consequence, we have seen some odd patterns which net-net are favorable to us. But we haven't experienced odd patterns. I don't know whether (01:10:16).

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

(01:10:18) to add to that. I mean, clearly, we have – I say we brought more granularity to the price. And we think that's a beneficial. It's good risk underwriting, good pricing of that risk assessment. I think, therefore, we would expect at this stage the mix to look different – with margin and lower sales, but it's very early days, Alan. It only happened in the last few months and the trend so far look like a margin reduction, but this could just be a little bit of noise. So I'm going to update you at year-end when we obviously have more months of performance to update you on.

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

Kerrigan, do you want to talk about the margins and annuities?

A - Kerrigan Procter {BIO 15093363 <GO>}

Yeah, absolutely. We have a strong quote pipeline. We continue to be quoting on all parts of the bulk market from very small to very large. The volume of quotes we gave in the first half, about £14 billion quotes that were out there. And so, what we're seeing in terms of pricing is margins are expected to be pretty consistent with the (01:11:06) pre and post. In fact, interestingly, the very competitive pricing at the very small end of the bulk market that we saw immediately post-budget seems to be calming down a bit now as well. So, yeah, no particular concerns about developments there.

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

(01:11:20) if we could just – if we go back around the room this side and...

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

Hi. It's Marcus Barnard from Oriel Securities. Can I just ask a bit more about this £10 trillion of retirement opportunities you see around the world because I mean I'm interested where you got that number from, but you don't need to lay that out in too much detail. Just in terms of how you'll do that, I mean will you need to set up new subsidiaries to undertake that type of business or can you write them out of LGR in the UK? I mean what are you planning to do? Is it longevity insurance or reinsurance, or are you doing traditionals or bulk buy-outs, buy-ins?

And also, I mean I think one of the factors you've always said that differentiates you is your experience and expertise in that area. And clearly, you're going something a bit new here. I mean how are you going to get that? Are you just going to apply what you know here across or are you going to buy it in locally or and any – if it's not that difficult, I mean how well protected do you think your position in the UK is? If you can go and expand there, why can't someone come do the opposite and come here?

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

Yeah. I'll save some of the blushes of the team here. We went into the LDI market in America which probably most of you didn't even know exists and it's certainly none of you have written anything on. We are the market leaders. The team won most innovative LDI team in America, and it's just part of the pension de-risking journey. And Mark is too modest to say we've won four of the top 10 pension clients in America straight off the bat.

So the idea that we don't have the expertise is certainly untrue, and we've got great expertise in our business and a lot of them are the same clients, believe it or not. We're actually doing work for some very large European clients other than the same clients in America. So we've got a lot of synergies as a group, and that's proven to be not easy wins, but actually a relatively straightforward conversation because of the close workings across the group.

We have been studying the American market and shadow our pricing, I think, for two to three years now and we work with different partners, been in and out of deals. And it may be that the first transaction we do could be a partnership deal with one of our American, what's it, colleagues or competitors, people who trust our judgment, who are comfortable working closely. But the pipeline is growing in North America and indeed in Europe and the UK at the moment, and we absolutely truly believe we have the capability to execute. Otherwise, we simply wouldn't do it. We're not interested in creating new businesses in lots of countries.

We've learned a lot of lessons from the banks and from other insurance companies, who have expanded way beyond their capabilities. And if anything, at a global macro level, people are shrinking down their portfolios. We're very much focused on the U.S. and the UK. I don't know whether Kerrigan or Mark want to add anything about pension de-risking in the States.

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

I think (01:14:11). So, as Nigel mentioned, we've established our business in the U.S. as an LDI business, as you know with a lot of large plans. So the natural next step for many of these plans is for some kind of an endgame so that might not be - that might just be self-sufficiency, but - and also for increasing our plans, we'll be offloading the longevity risk in a buy-in, buy-out manner depending on what their endgame solution is.

And so, there's a kind of - and obviously, we have the investment expertise. We could have - we think about managing the annuity book essentially informally we kind of call on balance sheet LDI. We clearly have the skill set, which you've observed in the UK market, and we can transfer the same ability to manage risk on balance sheet as Kerrigan expands into the U.S. market.

And on a reverse inquiry basis, some of these plans are inquiring about whether or not we're going to be entering the market and how and so forth because some of them have an eye toward some kind of an endgame solution that's beyond self-sufficiency.

A - Kerrigan Procter {BIO 15093363 <GO>}

You asked about subsidiaries and what type of business, and I think we want a broad canvas. So, we can run business direct out of our U.S. subsidiary or expand on that. We could write reinsurance into LGAS, for example. So, we have broad capability to participate as an insurer or reinsurer, probably in Canada and Netherlands (01:15:47) probably as a reinsurer in the U.S. reinsurer or insurer ultimately.

In terms of type of risk, well, it could be longevity or it could be buy-out. Certainly in some markets like the U.S., it's more likely to be buy-out than longevity only and this is on a reinsurance basis. But all those things are possible. And I think in terms of our skill sets, Mark talked about the asset management capability and I talked about having five things. The asset management capabilities there in space with the LDI and active fixed teams that we have in U.S., so we'll definitely develop that LDI active fixed capability to help us in the buy-out space and the longevity expertise.

It's a different set of data. It's a different country, of course, but it's the same socioeconomic conditions, healthcare infrastructure, drug treatments and the (01:16:35) of aging applied. It's those factors applied to a slightly different market. We have access to a reasonable amount of data in the U.S. so put together asset skills, longevity skills. And then the implementation part on the capital are immediately transferrable.

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

Can we just keep moving the - is Barrie the last question or are there any more questions from anybody? Oops, sorry. Yeah.

Q - Barrie J. Cornes {BIO 2389115 <GO>}

Okay. It's Barrie Cornes from Panmure Gordon. A couple of questions, if I may. First of all, year-end results you talked about expanding your involvement in non-standard annuity writing in the UK. I just wonder if that's all changed as a result of the budget or whether or not you'll continue (01:17:22) in your new product or products, whichever you come out with.

And the second question is on the non-life side, obviously, a very good performance. A lot of your pure non-life competitors in that space has said that some of the competition on UK most (01:17:27) has now transferred over to the household account and just wondered your view on the outlook for household rates, please.

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

I think a combination of Bernie (01:17:47) and Kerrigan if you answer the first question. I don't know whether we should give Bernie (01:17:31) a cut – I mean talk to Bernie (01:18:12) afterwards. But I think to be fair, Kerrigan should answer it because Bernie (01:17:57) doesn't officially start his new job I think until tomorrow.

A - Kerrigan Procter {BIO 15093363 <GO>}

Tomorrow. Yeah.

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

Until tomorrow. I secretly believe he's been doing some work on the side for Kerrigan.

A - Kerrigan Procter {BIO 15093363 <GO>}

Yeah. So non-standard annuity writing, we've obviously talked a lot about that at the last couple of results sessions. And I think we made the comment that within three years we expected the whole market to move to underwritten and we'd invested in the digital capacity to get there. And we had a very successful digital delivery. We really do have the capacity now to underwrite at scale. We just didn't make a big song and dance of it because the budget change pretty much overshadowed that.

But I think it's a real hidden gem that we now have in that going forward, it will probably slightly older-aged people buy annuities and it will be self-selected. So, therefore, the market should go to comprehensively underwritten, I think. And we have the digital scale to deal with that just in terms of figures roughly about just over about 22% of our business, and each one was enhanced annuities. So, yeah, a big thing I think it will continue.

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

John, do you want to just comment on the VI (01:18:57) market?

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

Yeah, I think it's probably true that this first half has seen a slightly more competitive household market than last year. But a little bit like how we're seeing about Protection. It's been a competitive market for a very, very, very long time. And we know how to go about doing it. We're a focused specialist player there with an enormous housing footprint, which allows us to continue to select the risks we want. So, though headline GWP was down a little bit, we're very, very comfortable with profits and the combined operating ratio that we're making. So, yes, a little bit more competitive but not something that is giving me any real cause for concern.

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

Just keep passing.

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

Good morning. Fahad Changazi, Nomura. It's great that bulks more than compensated for individual annuity sales and you speak positively about the pipeline £14 billion of quotes. Could you give any insight or color in terms of how you see overall annuity flows developing in 2014? That's all at this stage.

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

I think the only thing that we've said publicly is that we're confident that we'll exceed the £4.1 billion last year and that I remain confident on that front. I mean, when I talk about £14 billion, clearly some will close this year. Some will have already closed. Some will close next year. Some will close in many years' time. We won't win all of those. But it gives you some flavor that if they're the right price, we're in the market and able to do a little more.

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

In fact, that's usually about £8 trillion to £10 trillion (01:20:39). So, (01:20:40) a little bit bigger at the moment that we've got a bit more international stuff that's going to come – it's going to come through but the £10 trillion is a huge number. There's lots and lots of people who talk about this stuff, but actually getting people on this journey, which LGIM and Mark's team and Kerrigan in his previous role, played such a huge part in doing that. There's a lot of pre-selling in effect for all of this stuff and sometimes, it'd maybe take three years to five years to get from somebody from a discussion into actually doing a transaction.

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

Just a follow-up (01:21:11) I think you said overall you wanted annuity flows to be up this year versus last year...

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

Yeah.

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

...and then retain the guidance after the budget. Could you actually say anything on the annuity flows into the flat, up, down?

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

Well, they're doing better than we thought. At a macro level, there's more in the hopper now than there was at the beginning of the year, so as I said, it was in the £8 trillion to £10 trillion (01:21:32), it's gone up a bit. Whether Kerrigan and his team have the capability to deliver that increased volume, we'll see at the year-end.

I'd just like to say thank you to everyone for your questions. The team will be around. There's many of my colleagues here in the audience to ask any of the specialists for technical questions that anybody has today. And thank you for your support in 2014, and we'll see you at the year-end results.

Operator

This concludes the Legal & General Plc half-year results 2014 presentation. If you would like to hear any part of this conference again, a recording will be available shortly. Thank you for joining. You may now disconnect your lines.