Legal and General Group PLC Q3 Interim Management Statement Conference Call

Company Participants

- John Pollock, Group Executive Director, Risk
- Kate Vennell, Head of IR
- Mark Gregory, Group Executive Director, Savings
- Mark Zinkula, Group Executive Director, LGIM
- Wadham Downing, Interim Group CFO

Other Participants

- Alan Devlin, Analyst
- Andy Hughes, Analyst
- Ashik Musaddi, Analyst
- Blair Stewart, Analyst
- Gordon Aitken, Analyst
- Greig Paterson, Analyst
- Jon Hocking, Analyst
- Oliver Steel, Analyst

Presentation

Operator

Good morning. Welcome to the Q3 IMS conference call. (Operator Instructions) I'd just like to remind you this conference call is being recorded. And today I'm pleased to present Kate Vennell, Head of Investor Relations. Please begin your meeting.

Kate Vennell

Good morning, everyone. And thank you for joining Legal and General's Q3 update call. Wadham Downing, Interim CFO, will chair the call this morning. And is joined by several of our colleagues. In the room we have John Pollock, Chief Executive for Protection and Annuities and Mark Gregory, Chief Executive for Savings. Also joining us from the US is Mark Zinkula, Chief Executive for LGIM.

They will be delighted to answer any questions you have. But first Wadham will give a short summary of the results.

Wadham Downing {BIO 17627522 <GO>}

Good morning. And thank you, everyone, for making time to join this call.

As you'll see from this morning's press release we have delivered record Third Quarter sales; up 28% in Q3 and up 6% year to date. Of particular mention in the quarter UK Protection is up 30%; and US Protection up 33%; individual annuities up 13% with GBP350 million of premiums received in the quarter.

In our Savings business auto enrolment is now underway. And together with the transfers of existing schemes, has led to net inflows in workplace pensions of GBP429 million. Mark Gregory will tell you more about this during the call.

LGIM is making visible progress in expanding into new markets; America, Europe and Asia, with flows from international clients of GBP5.6 billion so far this year; GBP3.3 billion in Q3 alone.

On financials, our cash performance is strong. Total operational cash at GBP702 million. Within that our business units delivered growing operational cash, up GBP25 million from GBP661 million to GBP686 million.

Net cash at the business unit level was up GBP44 million from GBP556 million to GBP600 million. Total net cash for the Group is both substantial and diversified, up GBP15 million to GPB616 million. And we remain on track to deliver our cash targets we reiterated at the half year.

We continue to strengthen our capital position. You will see in our announcement in September of a further tranche of US capital restructuring, improving LGA's capital position by $200 million and our IGD surplus by GBP88 million; also worth mentioning, no defaults in our LGPL annuity portfolio.

On outlook we remain positive. The businesses are trading strongly. We are excited about playing a bigger part in our infrastructure investment with GBP900 million invested in project year to date.

We are confident our businesses can continue to grow to provide more value for both our customers and shareholders.

I'll now open the call to questions.

Questions And Answers

Operator

(Operator Instructions) Blair Stewart, BofA Merrill Lynch.

Q - Blair Stewart {BIO 4191309 <GO>}

Can I ask three quick questions? Firstly, just an update on the pipeline on the Annuity business, please, as usual.

Secondly, the impact of the changes you're making on the asset side of the balance sheet; perhaps you can talk about the impact that that's having on your expected investment return.

And thirdly, I notice a statement from Nigel talking about accelerating earnings growth. I would imagine that that would need to have some sort of assets under management growth as well. That's not a particularly strong features of these results. There's a lot of inflows. But also some outflows as well. So I wonder if you could comment around what would be -- what would need to be in place now to see an acceleration of earnings growth at the Company. Thank you.

A - Wadham Downing {BIO 17627522 <GO>}

First question, John. And maybe a bit around assets as well, in terms of annuities?

A - John Pollock {BIO 6037447 <GO>}

Yes. The pipeline for Annuities is much as it was. It's a relatively quiet market but, as you know, very lumpy. And we have seen some larger scheme quotes emerging in the market; very often that's price testing. So pipeline of committed sales is always impossible to predict. So it's not a brilliant description.

But the market seems to be reasonably active. But I think it's more about price testing than real commitment. But we're fairly optimistic. Demand is still strong and we're fairly optimistic over the foreseeable future.

A - Wadham Downing {BIO 17627522 <GO>}

You didn't say anything about assets and infrastructure and --

A - John Pollock {BIO 6037447 <GO>}

Well yes, there has been a lot of work on the asset side of the balance sheet. We've been -- we haven't been out there hunting yield; we've been very cautious in the management of the business. As you indicate de-risking gives us certainty of returns.

We're blessed with having the LGIM capability and competency here, where we have been de-risking. But without much impact on yield. So as a consequence, I don't expect there to be much impact on our investment return.

A - Wadham Downing {BIO 17627522 <GO>}

On the shareholder side of assets, Blair, we highlighted at the half year a tax proposition[ph] in cash. Since the half year we've had to reduce cash levels a little bit, diversified our exposure away from concentrated developed markets, reflecting our views in opportunities in more global markets.

Then on the earnings growth, yes, we've been talking around stocks of our businesses, not only assets under management. But premiums. And you'll see the premium growth coming through the press release. And I think you will see us more talking around EPS measures and earnings going forward. We're keen to show the impacts on our financials of the growth we're seeing coming through in our businesses.

Q - Blair Stewart {BIO 4191309 <GO>}

And would it be fair to say, would you agree with that statement that to -- in order to see an acceleration in profits growth you would need to see a pick-up in assets under management growth? Or do you think there's more you can do on the margins?

A - Wadham Downing {BIO 17627522 <GO>}

Mark might want to comment a bit around the mix of -- Mark said, as it were, the mix of businesses coming in. But yes, it'll be growth as stock across our businesses, whether that's assets under management, premiums, or assets under administration.

A - Mark Zinkula {BIO 16142450 <GO>}

This is Mark Zinkula calling in from the US.

I would echo those comments. I think you have to look at, certainly, net inflows, which are up considerably year over year. But we want to increase those over time. But as well as the mix of business. So as we write more, or win more fixed income and ODI mandates, those are higher margin mandates and, ultimately, will contribute to earnings growth as well.

Q - Blair Stewart {BIO 4191309 <GO>}

Okay. Thank you very much.

Operator

Jon Hocking, Morgan Stanley.

Q - Jon Hocking {BIO 2163183 <GO>}

I've just got three questions, if I may. Firstly on capital, you haven't given an update on capital in the statement, unless I've missed it. So if you could just give us some comments on where you sit versus the first half.

Then secondly, I noticed in the statement there's a comment about you want the Solvency II rules to incentivize you for investing in infrastructure and long-term assets. There's a comment there about making long-term equity investments. I just wondered whether you could give any update on where you think Solvency II is going to land, if it's got any chance for lowering equity investment to be an advantaged asset class.

Then, finally, just going back to Blair's question about earnings growth; given the capital intensity of your business, surely it makes more sense to target ROE rather than EPS? I think the -- your sector doesn't have a particularly happy track record of companies focusing on EPS growth rather than book value growth. I wondered if you could comment on that. Thank you.

A - Wadham Downing {BIO 17627522 <GO>}

Okay, certainly. Capital, as you know, we don't issue IGD numbers in Q1/Q3. We do provide with sensitivities in our year-end accounts. So if you take your half-year GBP3.8 million you can work out where we have tracked from there. Then we also -- don't forget our press release in September, which highlighted IGD benefit of GBP88 million.

Q - Jon Hocking {BIO 2163183 <GO>}

So there's no departure from the sensitivity application in the first half, if we do that we're not going to come up with a wildly correct answer?

A - Wadham Downing {BIO 17627522 <GO>}

I don't think you'll come out with anything wildly different.

Q - Jon Hocking {BIO 2163183 <GO>}

Okay.

A - Wadham Downing {BIO 17627522 <GO>}

On Solvency II, yes, we have -- we do make a big thing around infrastructure. We're very keen to demonstrate our social purpose in terms of infrastructure. And we've demonstrated that with GBP900 million in terms of -- in investments so far.

We do require the Solvency II rules to support us in, not only that. But also playing a wider part. And we've highlighted equities as well there as something that we can see a purpose for.

And on the third one, ROE as well as EPS I think you'll see coming forward. We already have ROE within our KPIs. I think EPS you'll see coming through as well. So I think it'll be a combination of all those.

Q - Jon Hocking {BIO 2163183 <GO>}

Okay, excellent. Thank you.

Operator

Andy Hughes, BNP Paribas

Q - Andy Hughes {BIO 15036395 <GO>}

Three questions, if I could. The first one is on the extension and the infrastructure investments. Now, could you possibly break-out the positive impact of investing in the infrastructure projects and the loss that you're making on selling the Bank sub-debt?

The problem here is that, obviously, a big chunk of your annuity profits and cash flow are coming from reinvestment on the annuity portfolio and, as you extend the spread duration, those reinvestment profits disappear. So effectively, you could record pretty much whatever EPS you like by moving into longer duration spread assets through infrastructure. But obviously that's not necessarily sustainable. So it would be good to know what's going on that side?

The other point is following on from Blair's question about asset management growth. It seems that you're basically growing less in the IFA space, in terms of asset inflows. And more in the EBC lower charge space. So could you give us an idea of the fee income on the back book, versus fee income on business you've written during the first nine months?

And the third point was related to that, coming back to my favorite topic of what I describe as a supermarket sweep, where you're mopping up a lot of these defined benefit -- sorry, defined contribution pension schemes post auto enrolment.

Aren't you going to incur a lot of sterling reserve cost, which is not reflected in IFRS and not reflected in operating cash, as a result of writing lots of small ticket pension items, which is a real IGD cost. But not necessarily an IFA cost -- sorry, not necessarily an IFRS cost? And isn't your IFRS and operating cash, therefore, going to over-state the real cash as you write these pension schemes? Thanks.

A - Wadham Downing {BIO 17627522 <GO>}

Okay, sure. The first one should go to John and then to Mark.

A - John Pollock {BIO 6037447 <GO>}

Yes. It is pretty straight forward, Andy. We don't really have too much re-investment risk, because we duration match at outset. So we'll take long duration assets and any interest rate swaps to get to duration matching. So we're not really taking a huge amount of reinvestment risk.

That said, what we think is quite important. And just amplifying what Wadham said, is that this sector can aid with a recovery towards growth in the UK, if we are capable of participating in infrastructure investments. And the government has been making some positive noises about investment banks and infrastructure banks, which we think we may well be able to invest in.

We already invest in things like student accommodation, which are part of the long-term infrastructure landscape of the UK. So we think these are very suitable assets for annuity play, as well as for playing a part in the social usefulness of our organization. So I don't think some of your comments about profits coming from reinvestment risk and whatever are entirely accurate.

Q - Andy Hughes {BIO 15036395 <GO>}

So you don't see -- so when you write an annuity contract and invest in a BB bond that goes on for seven years and you're in a high yield for seven years following that you have to assume risk free, when you get to the end of the seven years and you reinvest that at a higher rate than risk free that doesn't generate a profit for you.

A - John Pollock {BIO 6037447 <GO>}

Well first off, we don't go too far down the yield search in BB, Andy. We've had pretty clear asset disclosures and we don't do that. If we were doing that, we would have an awful lot of money in Greek bonds, which, clearly, we don't. So your hypothesis from the start is slightly flawed there (multiple speakers).

Q - Andy Hughes {BIO 15036395 <GO>}

Okay, no, no. I'm talking about spread duration. So okay forget --

A - John Pollock {BIO 6037447 <GO>}

No. I understand what you're saying. But the principle of what you're saying is we'd be accurate if we behaved in that way. But we don't. As I said at the beginning, we tend to duration match assets and not have large uncovered mismatch risk. So whilst I understand the logic of what you're saying, it's not how we behave in the asset portfolio management.

Q - Andy Hughes {BIO 15036395 <GO>}

So you're saying there's no profit from extending the spread duration on the infrastructure projects?

A - John Pollock {BIO 6037447 <GO>}

I'm not saying there's no profit. I'm saying that the amplification that you're giving is not quite how the overall portfolio management is working.

Q - Andy Hughes {BIO 15036395 <GO>}

Move onto Mark.

A - Mark Gregory {BIO 15486337 <GO>}

Okay, just to pick up on your point around it's a shift from IFAs to EBCs during the course of this period. Clearly, there's a couple of things going on there, Andy. First and foremost, clearly, ahead of RDR, a lot of IFAs are clearly having to adjust their operating model. So in no sense is L&G turning its back on the IFA marketplace and, indeed, we expect that to be -- no, to come back over as it just allied[ph] post-RDR.

But having said that and, clearly, in the short term that's coincided with a strong push in the corporate pensions space. And we've seen the EBC volumes go up at the same time as perhaps our retail IFA volumes have come down.

In terms of your question around kind of what that means in terms of fee income, I think the way to think about it is that they are just very different shapes of business. Particularly for an IFA, we get transactional-type business; a bond here, a pension there, etc., which might look kind of higher gross margin. But I think when we think of our business it's much more in a kind of net margin basis.

So again, we've invested in our corporate pension space to make sure we can handle volume very efficiently. So -- and, again, we're just seeing that as being much lumpier, bigger volumes of business. But coming through with efficient and scale-able systems; meaning that's speeding through to the bottom line. So just a very different shape of business, I think, between retail IFA business and EBC business, generally.

Then onto your subsequent question around the impact of sterling reserves on small pots and, indeed, the floater into IFRS profits, you're quite right to say that they don't feature in IFRS operating profit definitions. But we do include sterling reserves in our definition of net cash. So it goes through the stray numbers. So there will be no hiding of the implications of writing small pot business, maybe I'll make the same point I made on the previous comments. We've invested very heavily to make sure that this business comes on very efficiently. So the level of variables/attributable costs that we expect to allocate to that business won't be -- actually, be that high. We've made the investment and this business is coming on very, very quickly[ph].

Q - Andy Hughes {BIO 15036395 <GO>}

Should we expect a strain then in net cash when auto enrolment starts and this business comes on. I mean even if it's got, I don't know, an GBP8 per year sort of allowance, you're not going to be getting anywhere near the amount of GBP8 of fees for quite some time for some of these people on auto enrolment. So are you going to have a cash impact then if you're reflecting positive sterling reserves in cash?

A - Mark Gregory {BIO 15486337 <GO>}

I'm expecting a non-material impact from sterling reserves.

Q - Andy Hughes {BIO 15036395 <GO>}

Thank you.

A - Wadham Downing {BIO 17627522 <GO>}

Okay. Next question.

Operator

Oliver Steel, Deutsche Bank.

Q - Oliver Steel {BIO 6068696 <GO>}

Two sort of broad questions; the first is on the protection side. At the interim, I thought you said that the sort of surge in public sector group protection buying had been a bit exceptional. But it's, clearly, continued in the Third Quarter and I'm just wondering what exactly is happening there, how big that market could be and where you're positioned in that.

Then secondly, on protection -- I'm sorry, this is developing into three questions. Secondly, on protection is the growth rate in your stock of premiums in UK Protection has gone from, I think, 2% last year to 6% so far this year on a 20% year-to-date growth in new business. And I'm just wondering if you can sort of help us with the translation from new business growth into the stock of premium growth if, let's say, we're looking forward over the next 12 months.

The third question I've got is on LGIM. You've grown very strongly overseas. But I don't think I've seen a quarterly breakdown of the net inflows from overseas. So I wonder if you could just give us that.

A - Wadham Downing {BIO 17627522 <GO>}

Okay, the third one will go to Mark Z. But start off with John.

A - John Pollock {BIO 6037447 <GO>}

Yes, I'm sorry, Oliver, if I implied that there was either a surge or that it was one-off in nature. What I -- if I didn't say this, what I meant to say was that we had started work really off the back of the very strong public sector connections that we have with LGIM in being able to facilitate some product support for them as they are looking for cost savings.

So we've been able to deploy a product into the councils that has gone particularly well. I don't think that it is particularly one-off in nature. It, basically, insulates them from the costs of ill health early retirement. And as a consequence, it looks a little bit like us to our GIP[ph] product.

So we think that's just a sector that is -- that has been opened up by our engagement and I don't really see any particular reason for that market to go away any time soon. So I'm reasonably optimistic about our continued success in that space.

Just turning to stock versus new business, new business is really, you could think about it as determining the rate of growth of stock, because we've always got claims and lapses going off the back book. So they might have new business that we're putting on, determines, if you like, the rate of growth of the overall portfolio. So a strong rate of new business growth, which we have seen, has helped drive up the rate of growth in the stock.

Q - Oliver Steel {BIO 6068696 <GO>}

Okay.

A - Wadham Downing {BIO 17627522 <GO>}

Third question, Mark, do you want to answer the LGIM question?

A - Mark Zinkula {BIO 16142450 <GO>}

Sure, yes. The -- I don't have the numbers committed to memory. But we had strong net inflows in the Third Quarter from overseas. I think as I recall it was -- I believe it was GBP3.3 billion for the quarter. Overall, net inflows were slightly up over the quarter. Again, going from memory, I think it was GBP0.6 billion, as I recall.

So the bulk of the net new business was in the first half of the year. We had a quiet August. It's not unusual for the Third Quarter to be somewhat quiet, given that it's the overlap with the summer months. But we've had a good, strong finish to the quarter; it's continued into the Fourth Quarter.

Q - Oliver Steel {BIO 6068696 <GO>}

Thank you.

A - Wadham Downing {BIO 17627522 <GO>}

Okay. Next question.

Operator

Ashik Musaddi, JPMorgan.

Q - Ashik Musaddi {BIO 15847584 <GO>}

Three questions. If I heard it correctly, you mentioned that the international, the LGIM inflows from international is GBP3.3 billion and the Group inflows for LGIM overall inflows is GBP0.6 billion in this quarter, i.e., there's a big outflow of GBP2.7 billion in the UK. Now can you give some more color on what that is and what kind of margin was that?

The second question would be can you give us some color on the labor turnover in the auto enrolment that you have taken like Sainsbury, ASDA, M&S, etc? And how does that come back with your normal group pension portfolio?

The third one is can you give us some color on the margins on annuities and protection? Is there any kind of contraction in margins you have seen in the Third Quarter, or is it normal or is it going up? Thank you.

A - Wadham Downing {BIO 17627522 <GO>}

Okay. So start with Mark Z, then Mark G and then John.

A - Mark Zinkula {BIO 16142450 <GO>}

Great, yes. So if I interpreted your question correctly, it was in regards to strong international growth. But net outflows on the UK book so -- and we've been pretty open about this and discussed it. Last year is the first year we saw net outflows in our passive book.

So we have the UK DB market is a very mature market. We have a large market share and we're trying to protect our position there. And are successfully doing that, particularly. But most of the outflows are going to be in our passive book.

So correspondingly, we still have persistency rates that are north of 90%, which are outstanding levels. And so we're keeping a lot of clients on the books and, as they're transitioning out of equities and de-risking in the fixed income and LDI strategies, we're doing a good job of transitioning a lot of those clients.

So even though we'll see -- could see net outflows on the UK DB book, if there's slight net outflows on passive mandates and, ultimately, growth in fixed income and LDI mandates, you could still see profit expansion even though it's a very mature market and a soon-to-be declining market, very gradually declining market.

A - Mark Gregory {BIO 15486337 <GO>}

Okay, picking up on your question about labor turnover and auto enrolment schemes, the key point here, Ashik, is the fact that we underwrite every scheme individually. So there's no kind of a take it price out there. So if a scheme's got different characteristics, such as perhaps higher labor turnover, we will price for that accordingly. So that's absolutely part of our underwriting process.

A - John Pollock {BIO 6037447 <GO>}

And yes, just on P&A margins, I am very happy with our margins; very happy, indeed. There's been no particular margin pressure in any of our lines of business during this quarter. So I'm very comfortable.

Q - Ashik Musaddi {BIO 15847584 <GO>}

Thanks a lot.

Operator

Greig Paterson, KBW.

Q - Greig Paterson

Just three quick question. One is am I understanding this correctly? You've now decided you're going to de-emphasize the cash flow metric that you've been trying to get investors to focus on for the last two years and moving back to an embedded value EPS-type arrangement, which -- that's the message that we're getting; anyway, if you can just talk about on that.

Second point is, just workplace pensions, I think if you just look at the consensus and what the actual number was, I think people got a bit sort of -- there was a misunderstanding around how you book the surge in workplace pensions you've won. I wonder if you could -- the stuff you've announced today, to what extent is that going to transition in the Fourth

Quarter or the First Quarter next year and we have to sort of up our numbers from that process? In other words, what have you announced to date and not booked yet?

And the third question is just sort of quarter to date, I wonder if you can talk about on the individual annuity side, whether you had seen any material impacts on people positioning around gender pricing in individual annuities.

A - Wadham Downing {BIO 17627522 <GO>}

Okay, I'll take the first and then pass it onto Mark and John.

No, you haven't -- we haven't moved into that direction, I have to say, Greig. What we're just underlining is that we just want to translate the strong operating performance into strong earnings growth. And we will be promoting up the order some of the other metrics. We're still very focused on cash and our cash targets.

Q - Greig Paterson

Just in particular, because you said that EPS are going into KPIs. Now, there's a strong correlation between IFRS and your statutory cash flow. So I can only understand that as meaning that the EV/EPS are now going to come into the KPIs. Is that a correct understanding?

A - Wadham Downing {BIO 17627522 <GO>}

No. That's not quite what I said either; it's that we have ROE, which is going to be -- I think at the half year, you will have noticed that we promoted EPS and ROE into our headline financials. And I'd expect us to be doing the same in our end of year statement. But that's (multiple speakers).

Q - Greig Paterson

What accounting regime are you going to focus on for the EPS? That's what I'm trying to ascertain.

A - Wadham Downing {BIO 17627522 <GO>}

So this is IFRS EPS (multiple speakers).

Q - Greig Paterson

All right. So there's no re-emphasis of EV?

A - Wadham Downing {BIO 17627522 <GO>}

No. There won't be, I'm afraid.

Q - Greig Paterson

All right. No problem.

A - Wadham Downing {BIO 17627522 <GO>}

Okay.

A - Mark Gregory {BIO 15486337 <GO>}

Just on the -- just to help you with your forecasting, Greig, just to perhaps be clear. So in Q3, just to perhaps go it through it step by step. What we saw in Q3 is the kind of names we put in the press release today.

So we saw the pension scheme transfer of -- for Marks & Spencer during that quarter, as well as their existing pension savers coming across to L&G; so that was in the numbers. Likewise, the conversion of the Sainsbury's pension scheme was in the Q3 numbers.

In Q4, we would expect to see the bulk of the other pension schemes transfer across to L&G during the Q4 period. And we will see the first of the big auto-enrollee scheme; so Sainsbury's will auto enroll during Q4. Then in Q1 next year, we'll see the vast majority of the new auto enrollees will come onto the books. So there is a phasing going on here.

Q - Greig Paterson

What I think has[ph] given magnitude, for the Fourth Quarter, the bulk of the rest of the scheme's coming in, is it, on a par with the Third Quarter, M&S and Sainsbury's, below or above time[ph]?

A - Mark Gregory {BIO 15486337 <GO>}

I prefer not to guide, if you don't mind, Greig.

Q - Greig Paterson

Yes. Well I'm just trying to -- are they similar, just (multiple speakers).

A - Mark Gregory {BIO 15486337 <GO>}

I know what you're trying to do. I prefer not to guide.

A - Wadham Downing {BIO 17627522 <GO>}

Okay. John, did you (multiple speakers).

A - John Pollock {BIO 6037447 <GO>}

Yes, nice try, Greig. Yes, gender pricing impact, the rules are all pretty clear. And I think most of the major players in the market have indicated when they're going to move.

And what we're actually seeing in terms of how the transition on December 21 will take place is people making sure that they're slightly extending their price guarantee period to allow for the cash to move from the ceding scheme into the annuity, just to make sure that people aren't disadvantaged around that period of time.

But in terms of any kind of pre-activity, what you've got to remember -- and I do think I probably say this pretty well every time, the vast majority of people don't have a huge amount of choice over when they retire or when they draw their income. Our pot size is still around 30,000, which indicates the scale of the people that are annuitizing and the demographic that are annuitizing. So we're not really seeing much impact yet from gender price planning. And that doesn't surprise me.

That said, it is possible that some of the market, at the margin -- some of the market growth at the margins is being driven by those people who have a capability to choose in bringing forward their drawdown of their annuity. But it is definitely at the margins, Greig.

Q - Greig Paterson

Sure. Sorry, I'll sneak in a quick other question. I see you've gained market share in UK health. And it's in the light of others gaining market share in UK health. I'm wondering what sort of reduction in the combined ratio -- the pure combined ratio we need to factor in for the full year? Is it going to be large, a little? And how much rate have you given up to achieve that surge in market share?

A - John Pollock {BIO 6037447 <GO>}

Greig, dear oh dear. That is just not how we behave. And you know that. So that's a very cheeky question.

Q - Greig Paterson

Well I moved to you guys (multiple speakers).

A - John Pollock {BIO 6037447 <GO>}

What we have done is, we have deployed some capability and grown particularly in indirect[ph]. We -- so we've opened up our capability and grown the business. But we just are always extremely selective on price. So we're not desperately trying to grow the top line, unless it contributes very much to bottom line growth.

So our growth is not some kind of desperate whatever; it's opening up new channels. We've signed some new distribution arrangements within the broker channel. And the business is growing very nicely. But it is not sacrificing core just to get top line growth.

Q - Greig Paterson

No. It was just worrying me, because my premium halved when I moved to you guys. And I just wanted to acknowledge that it was because I'm a better risk as you obviously see[ph] that's the case, yes?

A - John Pollock {BIO 6037447 <GO>}

Yes. You clearly are, Greig. You, clearly, are not in a flood zone. Even if you were actually, you're tall enough to be able to wade through the water.

Q - Greig Paterson

Well exactly. Excellent. Thank you very much. Cheers.

A - Wadham Downing {BIO 17627522 <GO>}

Thank you.

Operator

Gordon Aitken, RBC.

Q - Gordon Aitken {BIO 3846728 <GO>}

A couple of questions. The first one is a follow-up on asset management, with the successful diversification outside the UK. But outflows in the UK. Now, your traditional strength has always been in the UK managing indexed equities for the UK DB pension schemes. Now, these schemes are closed to new entrants. And in some cases, future accrual. Just wondering, are you seeing the benchmarks of these DB pension funds gradually shifting towards bonds, as they mature? That's the first question.

And secondly on bulks, there's a real lack of supply in the bulk market now. Who are you seeing, who are you up against when a scheme is being brokered?

A - Wadham Downing {BIO 17627522 <GO>}

Okay. The first one, Mark Z and then John.

A - Mark Zinkula {BIO 16142450 <GO>}

Sure. Yes. There's definitely a trend. I'd say, it's not so much of a benchmark -- excuse me, a benchmark change towards bonds as it is toward, I guess I'd describe it as, funded status volatility. So there's clearly been a shift in the UK. And it's now happening in the US.

So our US business model is really built to focus on this phenomenon, where there's a fundamental shift in the way that most plans are thinking about managing the asset risk. And it's less of a weighted average risk mix of market benchmarks. And a traditional whatever it would be, 60/40 or 50/50 split equities bonds. And now, rather it's more of a liability-based benchmark.

And different plans have different tolerance levels on how much volatility that they can sustain around funded status volatility; around that specific benchmark. That's going to be different for each plan because, again, the characteristics are going to be different.

Then, over time, clearly, they're going to be going out of equities and increasingly into fixed income. And LDI strategies; and ultimately, if they can afford it, into annuity strategies.

And so we are -- we've transitioned our business model to be very much of -- from a client service perspective, all the way through the product offerings that we have, in both the UK and the DB market, to accommodate the needs of clients as they go down this de-risking path.

A - John Pollock {BIO 6037447 <GO>}

Yes, hi, Gordon. Just in terms of BPA. Actually, there's still the usual suspects appear on quotes. It's not really for me to comment on our competitors' strategies. But certainly, we're still seeing many of the normal players; PIC, MetLife, Goldmans are all still there. We do still see Pru and Aviva from time to time. And it does depend a lot on the scheme. But mostly, I would say the competition's still the usual suspects.

Q - Gordon Aitken {BIO 3846728 <GO>}

Thank you.

Operator

Andy Hughes, BNP Paribas.

Q - Andy Hughes {BIO 15036395 <GO>}

I realized I wasn't cheeky enough in the previous questions. So I'll have another go. It's just two basic, simple questions.

The first one was a very simple numbers question. On page 10, when you show the tied agent number, that doesn't include the Mortgage Club, or is that the Mortgage Club, because I just couldn't really understand why the tied agent number is falling? And so, given the protection cells are very strong, is -- and then, I thought the Mortgage Club was growing strongly. So maybe you could tell me where that shows -- where you see the L&G Mortgage Club, where that's shown in that disclosure. And how that's doing?

And the second question was about LDI. Have you had conversations with UK-based clients with CPI-related liabilities, regarding the impact of what LDI solutions they may have put in place. And the implications of the changes to RPI, because it seems that quite a few people who have got CPI-related liabilities may have a -- and chose to implement LDI, may have a negative shock from the changes to the way in which RPI is calculated. So could you comment on that, please? Thanks.

A - Wadham Downing {BIO 17627522 <GO>}

Kate, do you want to answer the first one. And then Mark Z on LDI?

A - Kate Vennell

Well John (multiple speakers).

A - John Pollock {BIO 6037447 <GO>}

I'll take the Mortgage Club. What's happening here is a changing mix within the Club. The Club is actually writing ever-higher numbers of mortgages. And that's because we had some DA non-tied members in the Mortgage Club. So we're increasing our share. And those people typically would operate a panel of suppliers.

We had two changes in the network that resulted in slightly lower protection sales, where there was some restructuring of some members from fully tied to DA. And one fairly large supplier decamped from us and moved elsewhere. So there have been slightly lower protection numbers.

That said, that's been offset by the concentration in panel use amongst the DAs. So this is still a very sound flow -- inflow of business for IP. Most of the IP that we have seen, the growth in IP that we've seen has been coming from IFA and our bancassurance sector. So it's just a little bit of mix going on there, Andy. So it's a very strong mortgage distribution and then a couple of member changes that has resulted in slightly weaker protection.

That said, there have been slightly higher sales of investment products through that channel. But that's another story.

Q - Andy Hughes {BIO 15036395 <GO>}

Okay. So the DAs are in there as well or they're in a different line?

A - John Pollock {BIO 6037447 <GO>}

Well the DAs would be reported through IFA, because they are typically IFA even though they're tied to the Club for mortgages. So they're managed through the network line. So it's just a numbers kind of move between the two lines depending on how the mix is happening.

Q - Andy Hughes {BIO 15036395 <GO>}

Okay thanks.

A - Wadham Downing {BIO 17627522 <GO>}

Okay, Mark, the LDI question?

A - Mark Zinkula {BIO 16142450 <GO>}

Yes, sure. In regard to -- I'll take a broader perspective, there are a lot of changes underway in the market right now; you highlighted one. There's a movement towards central clearing and so forth.

So we have to make sure we continue to develop the range of options to accommodate different plans, needs as market conditions change or these dynamics evolve. And we're, clearly, engaged with clients on all these issues. It doesn't -- it's not going to, we don't think, diminish the demand for LDI solutions. But it certainly could result in slightly different solutions or different ways to hedge interest rate and inflation risk, our equity risk and so forth, depending on the underlying asset composition that a plan has. And so we're just continuing to evolve our mix of strategies and solutions as market conditions change.

Q - Andy Hughes {BIO 15036395 <GO>}

Are there people out there who are sitting on a surprise loss from their LDI strategy that you've had to contact and what was their reaction, is it --?

A - John Pollock {BIO 6037447 <GO>}

Getting cheekier now, Andy.

Q - Andy Hughes {BIO 15036395 <GO>}

No, no I'm just interested, because obviously the -- if the purpose of LDI is to hedge your liabilities and, obviously, a lot of people have CPI-related liabilities and obviously the inflation hedge is clearly RPI and RPI could be falling. I'm just trying to work out whether there's a mis-selling liability coming from LDI in the UK and I've just go no way of working it out, whether that's a realistic thing or not?

A - Mark Zinkula {BIO 16142450 <GO>}

We don't provide advice, first of all. In terms of a mis-selling scandal or insinuations of that would be a case here, as conditions change we're just simply working with the plans to help them hedge their risks in the best way that's in accordance with various tolerance level.

A - Wadham Downing {BIO 17627522 <GO>}

Okay, we've probably got time for one more question, any more questions on the queue?

Operator

Alan Devlin, Barclays Capital.

Q - Alan Devlin {BIO 5936254 <GO>}

Just two questions on LGIM, first of all you mentioned in the press release that you've recently received regulatory approval to market passive funds or index funds in the US, that's obviously a huge market but also massively competitive with people like Vanguard, (inaudible), BlackRock having trillions of dollars of assets. So how are you going to tackle that market? And do you have the scale to be successful there?

Then just a second question, a follow-up on LGIM UK, are you trying to say that the gross outflows from the mature UK business are fairly consistent because it's the mature DV plans rolling off but the gross inflows or sales are more seasonal and they tend to be quiet in the August period. So the outflows you've seen in this quarter, if we should necessarily be too concerned about? Thanks.

A - Mark Zinkula {BIO 16142450 <GO>}

In regards to the first question and, you're right, it has been a massively competitive market in the US. We do think that there are -- well, circumstances have changed since we began to build our presence in the US about five years ago. And I'd highlight the main ones being, first of all, certainly post Lehman there's been increased focus on management concentration risk. And we've been getting a lot of reverse enquiries and there appears to be more demand for another large index manager in the US market potentially.

Secondly, companies as they're increasingly -- well, they're increasingly managing their pension liabilities on a more holistic basis globally; global companies are. So we have an opportunity to leverage off our UK client base. So we have several UK clients that have affiliates in the US, typically it's a parent subsidiary in one direction or the other.

Third we now have a presence in the US, we have a very successful business platform focused on fixed income and LDI. So the incremental cost of, obviously, building out the proposition is less and we have a strong reputation already with consultants and so forth. So it was the natural next step in the evolution of our business model in the US.

And finally, I would say that there are for certain plans an opportunity to provide constant management services as part of de-risking plans or exercises that the plans are contemplating.

In regard to your second question, unfortunately I do think just given the size of our book and the fact that we have several large clients there's going to be some lumpiness and flows in both directions, both in terms of outflows and inflows. I think from a quarter-to-quarter basis there will be some lumpiness. I think we expect persistency rates unbalanced to still say very high; they've been around 90% for several years. And we do anticipate that we'll be able to retain a lot of clients as they go out of passive again, into LDI and a fixed income strategy as I mentioned before. But there will be some lumpiness in both directions on quarter-to-quarter basis.

Q - Alan Devlin {BIO 5936254 <GO>}

Okay. Thanks for your answers.

A - Wadham Downing {BIO 17627522 <GO>}

Okay. Thank you very much; we'll close the call there. Thanks everyone for their questions and for dialing in this morning and we look forward to speaking to your later at year end. Thank you.

Operator

This now concludes today's call. Thank you for all attending. You may now disconnect your line.