Q3 2015 Sales and Revenue Call - Interim Management Statement

Company Participants

- Duncan Finch
- Jackie Noakes
- Kerrigan Procter
- Mark J. Gregory
- Mark J. Zinkula
- Mike Bury
- Paul Stanworth

Other Participants

- Abid Hussain
- Alan G. Devlin
- Anasuya Iyer
- Andrew J. Crean
- Andrew J. Sinclair
- Barrie Cornes
- Colm Kelly
- Fahad U. Changazi
- Gordon Aitken
- Jon M. Hocking
- Oliver G. Steel

MANAGEMENT DISCUSSION SECTION

Operator

Ladies and gentlemen, welcome to the Legal & General Quarter Three 2015 Results Conference Call. My name is Rianan, and I'll be the coordinator for today's conference. Please note all journalists are not permitted access to this call.

I'm now handing it to Mark Gregory to begin. Mark, please go ahead.

Mark J. Gregory {BIO 15486337 <GO>}

Good morning and welcome to our Q3 2015 IMS call. I'm joined here today by Jackie Noakes, MD Mature Savings; Kerrigan Procter, MD of LGR; Paul Stanworth, MD of L&G

Capital; Duncan Finch, MD of Insurance; Mike Bury, MD of Digital Savings; and last but certainly not least, sitting right next to me, Mark Zinkula, CEO of LGIM.

Today's strong numbers show we are growing our business stock. LGIM assets and annuity assets are up, and because of this, we delivered record cash generation at the three-quarter year point. Top-line numbers are: operational cash up 11% to £936 million, net cash up 14% to £943 million, LGIM assets under management up 8% to £717 billion, annuity assets also up 8% at £43.1 billion, savings asset up 2% to £104.9 billion, UK Protection premium up 3% to £1.109 billion, and direct investments up 43% to £6.6 billion.

Turning to our businesses and starting with LGR, Q3 was a quieter quarter for bulks with £92 million of completions, meaning £1.5 billion of total annuity sales year-to-date. Our bulk pipeline remained strong. The expansion of our bulk annuity business internationally is a big strategic opportunity for LGR. We entered the U.S. pension risk transfer market in October with a $450 million bulk deal with Philips, and our progressing plans to enter the European market in the next few months.

Our new Lifetime Mortgage business is exceeding our expectations. The application is now running at around £10 million per week from a standing start earlier this year. And we're targeting to write up to £200 million by the end of this year. Going forward, we believe more and more people will access the housing equity to help finance their retirement.

LGIM is now ranked the 15th largest global asset manager in the Towers Watson research published this week.

External net flows are £21.7 billion excludes the £13 billion National Grid Pension Scheme mandate win announced in September, which we'll receive the assets this month. LGIM's international expansion continues at a pace and it's been led by LGIM America. LGIM's Asia business is also making progress with mandate wins in Korea, Taiwan, and we've just entered Japan.

In the UK, our retail funds business continues to make significant progress moving up into the top three of UK net retail fund sales in Q3. Workplace pensions also grew strongly with assets under administration up 30% to £13.1 billion, with further significant mandate yet to fund. These newly won schemes would add a further 700,000 people to our existing 1.4 million customers by the end of next year.

LGC's investments are focused on four key areas, where we believe limited institutional finance have created attractive investment opportunities. They are housing, urban regeneration, alternative finance and clean energy. Notable investments so far this year in the urban regeneration space include first phases of a £400 million investment in Cardiff and an initial investment of £162 million in Leeds.

In total, direct investments were up 43% on last year at £6.6 billion and we anticipate by then at least two more urban regeneration deals in the next six months.

Legal & General Insurance increased its UK Protection premium by 3% year-on-year to £1.109 billion, maintaining its position as the largest provider in the retail market. Our Savings business, which comprises digital and mature savings, increased its assets under administration by 2% year-on-year to £104.9 billion.

As you know, we closed our with-profits fund to new business in January and are identifying cost efficiencies to compensate for the gradually declining asset base. Cofunds generated net flows of £2.6 billion with total assets under administration up 6% at £73.1 billion.

L&G America delivered year-to-date sales of $86 million in line with guidance at the time of our interim results, where we said we expect new business volumes to be circa 25% lower than for 2015 compared to 2014.

L&G America is important to the expansion of the group in the U.S. providing back-office support to LGR and the balance sheet providing further U.S. pension risk transfer business. I'm pleased to say we're ahead of our group-wide target to deliver operating cost savings of £80 million reducing cost from £1.25 billion in 2014.

And finally, Solvency II, as you know, we've applied to the PRA to use our internal model to calculate our Solvency Capital Requirement, transitionals, matching adjustment, and deduction and aggregation for L&G America. Whilst we've not yet received any feedback in respect to the PRA's decisions, we do expect to obtain approval for these applications. We'll report our Solvency II capital position for the first time as part of our full-year results in March 2016.

So to quickly sum up, our stock (05:44) business and cash are up. Our business has momentum, and we have further growth opportunities.

So now, I'll open the call to questions.

Q&A

Operator

Our first question today comes from the line of Oliver Steel from Deutsche Bank. Oliver, please go ahead.

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

Good morning, Mark. Good morning, everyone. Three questions to start with. It's sort of difficult to know where to start actually with your numbers today. But can you talk a bit more as to why the third quarter cash flow appear to accelerate? I think there's been a rebasing of your assumptions in some of the insurance businesses, as well as underlying momentum elsewhere. Why have you rebased those assumptions upwards? So, what's going on there? So that's question one.

Secondly, on the new business trend, given how little bulk annuity business you wrote in the quarter, it seems a surprisingly positive strained figure. And I'm wondering if that's been driven by either cost savings or maybe the equity release sales that you're generating.

And then thirdly, if you're now writing bulk annuity business in the States, what does that imply for the U.S. dividend to the holding company?

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

Okay. I think probably for the first time I'm taking all those three questions myself. But actually, I'd share the questions out beyond that. So in terms of kind of the Q3 cash flow progression of cash at 11% (07:34) at a three-quarter-year point in terms of what's going on now. I think, seriously there are kind of contributing factors there, Oliver, no one being in isolation. So, clearly in terms of the deployments of the non-insurance businesses clearly within that result, we've got LGIM's profits in there, so we're bringing up LGIM on a post-tax operating profit basis, now clearly LGIM as you can see from the numbers, is trading well and clearly, that's had some benefits.

The likes of our General Insurance business, Q3 has been a reasonably benign period for claims. So, again, in terms of we bring our GI business again in an operating profit after tax basis, so again, that's had some benefit.

And we have gone back and just revisited, as we do every year, just to make sure our calculation of expected release from our Insurance businesses is exactly where it's possible. And again, this year we've done that and it has revealed bits of prudence, which we'll work on - not in the initial assessment, which we have brought into the calculation at Q3. Again, no one factor per se, Oliver, that's driving the increase, just some of the (08:30) and they're all pretty much going in the same direction. Hence, we've got a reasonable uplift overall, but no one thing in isolation.

On the new business surplus and your comment that it's suprisingly positive given the low volumes, you're quite right. Clearly, volumes were massive particularly in the bulk space in Q3. But again, in your question, you've kind of hinted, they're kind of actually the main reasons we have seen benefit in the net cash, in the new business surplus is down to two main factors.

Firstly, as I say, we have been covering a pretty strong rebase of our cost base during the course of 2015. (09:07) but that will come through as an experience there into year-end. But for new business, we do get benefit of any unit cost benefits, do get factored into the calculation of new business trading or surplus. So, it depends which of those cost savings have impacted and benefit the new business. You are getting that benefit through the new business surplus calculation.

(09:30) you alluded to in your question, we do allocate the Lifetime Mortgage asset volumes to new business in LGR and, therefore, tends which we get enhanced spread by credit governance in that space. That additional spread does come through and boost the new business surplus associated with the year-to-date (09:56). It's not just about what's happened in Q3. We allocate that based on the year-to-date new business volumes in annuity. Again, that's been a positive factor there.

To the bulk annuities, and yes, clearly, it's very early days. I just say we are rising that through the U.S. business. I think at this stage, no one deal will make a difference in that regard but clearly in time, as we grow the U.S. balance sheet and as that business grows profitably, then we would expect that to be a benefit to dividend. But again, I wouldn't expect that to be a short-term benefit all over that. That's one – obviously, as we grow that general account in the U.S. and that's when we get the benefit in due course. It's not going to be a day-one benefit in terms of immediate dividend increases from the U.S. business as a result of U.S. bulk annuity transactions.

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

Just to come back on that, would this imply any reduction in the dividends short term?

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

I wouldn't read that into it either.

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

Okay. Thank you.

Operator

Our next question on the phone today comes from Andrew Sinclair from Bank of America Merrill Lynch. Andrew, please go ahead.

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

Thanks. Good morning, everyone. Just three quick questions as usual. Firstly, you seem to be winning a few workplace benefit schemes recently. I just wondered, have you seen any pickup in re-broking of schemes as we approach the (11:09) and therefore, next year?

Secondly, just wonder if you could give us an update on pensions de-risking pipeline and how activity is varying between the UK, U.S. and Europe. And thirdly, I realize it's just a trading update today but I just wondered if you could give any comments on the PRA's commentary yesterday, which seemed relatively positive for Solvency II? Thanks.

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

Okay. Cheers, Andy. So I think Zink could pick up the one on workplace, any re-broking activity in the market. Kerrigan picks up the one on pension de-risking then and I'll come back on your question on Sam Wood's speech yesterday.

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

Yeah, no material change, I think, in activity. It's going to be somewhat sporadic, but I wouldn't say there's any material change. A couple of comments first on de-risking before handing over to Kerrigan, because obviously, there's a continuum (12:08) strategies before some kind of longevity offloading solution.

But we are continuing – again, it depends on – as equity markets rally and/or race back up, it's a very volatile equity markets, but obviously to the extent one or both – we're in a situation where one or both of those environments exist. We will see incrementally an increase in de-risking activity in the LDI pipeline because it impacts on the status of those clients looking to implement de-risking strategies. I'll hand over to Kerrigan to talk about the bulk annuity market.

A - Kerrigan Procter {BIO 15093363 <GO>}

Well, I think that's true on both the UK and the U.S. side and on Europe for the end. We got early signs of what's going on on pensions de-risking space through the LDI businesses and LDI business in the UK and the U.S., and there's absolutely no letup in client demand, if anything, an acceleration of – a continuous acceleration of clients wanting to de-risk and de-risk all the way through to buy-in or buy-out.

So, yes, it's still a very exciting market. The pipeline – our pipeline in the market, pipeline is still strong, as you can see from the Q3 figures. Difficult to predict exactly when those land, but it's a strong pipeline. And our competitive strength in the UK and the U.S. markets, I think particularly the UK market currently is substantial.

Just a touch on the U.S. market. There really is a strong pipeline in that U.S. market. We are currently on a lot of deals there. And that looks like it's going to be strong into next year also. So the U.S. market is – along with the UK market – particularly exciting.

Europe, there's definitely some business to be done in Europe, selectively in the Netherlands in particular. We're very keen to participate in that market. We have the capability, longevity stature and the asset management capability and the administration capability to do that. And we're hopeful that we can demonstrate that to you soon.

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

Okay. Thanks, Kerrigan. Just on Sam Wood's speech yesterday again. I'm sure everyone saw it that Sam gave a speech to the AVI yesterday where he picked up some further comments on Solvency II. Andy, we take that as being positive comments? Actually, there was a lot of stuff he chose to say about the way the risk margins have been offered, I think the fact that he's recognized that we probably have created a non-level playing field there between Europe and the rest of it would probably be a good thing I think after that.

Also that I think he recognizes that the interest rate sensitivity, the risk margin calculation has made it more volatile and people are expecting, I think, generally, probably the risk margin again being bigger that perhaps the PRA expected when the concept first got constructed. So, I think, in that sense, the fact that – looking at kind of what's happened and how it's playing out, in fact, I think that's a beneficial thing for ourselves and other people particularly in the annuity market going forward.

I think one thing I would take exceptionally in Sam Wood's speech, he clearly, at one point, referenced that he was worried about whether the use of longevity reinsurance would actually reduce rather an enhance policyholder protection. Again, Sam is obviously not making close (15:16) how these swaps work in practice. But I would make the point that these longevity swaps are fully collateralized. They are essentially contracts with difference. We pay a float in there and we receive – so, we pay a fixed (15:28) and we received a floating (15:56) in return based on the actual longevity experience. But that difference is fully collateralized.

So, I would strongly disagree with his comment or his inference that maybe in some way, longevity reinsurance weakens the policyholder protection. I would strongly refute that's the case. But again, that issue aside, I think the commentary that Sam came up with yesterday was entirely helpful and we look forward to taking that debate going forward, but again, I'm not expecting any material change before 1 January 2016.

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

Very good. Thank you very much.

Operator

Our next question on the phone today comes from Fahad Changazi from Nomura. Fahad, please go ahead.

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

Hello. Good morning. Could I just chase up on the BOE (16:11) comments on the U.S. bulk pipeline? First of all, given they have a different capital regime versus what we'll have here, do you see any regulatory arbitrage where their people believe to undercut you and how will you respond to that in the U.S., firstly?

And then second, on the BOE (16:26) comments again, they were talking about non-EU companies participating in the UK market. Now, I think you also mentioned reinsurers as well, and I know some of your panel is U.S. reinsurers, so again, could you just comment on that and how you see that developing?

And the final thing is on the LGIM, it's doing very strongly. And even the index funds have net inflows for nine months. Could you just again remind us of what we should be expecting for the index flows going forward given that we're going through a de-risking journey in the UK? Thanks.

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

Okay. Thanks, Fahad. I think, if you don't mind, Kerrigan, pick up those first two, these questions, and obviously, Zink, pick up the LGIM index, even index flows are up. Even (17:10). Go on, Kerrigan.

A - Kerrigan Procter {BIO 15093363 <GO>}

Yeah. So, you spoke about (17:13) different capital regime. Cleary, that's one of the reasons we're applying for a level playing field, deduction in aggregation in the U.S. So, that's clearly an interesting market to play in with the different capital regime. I mean, probably that's all there is to say on that point.

Clearly, linked to your second question in terms of the UK market, frankly, it's in the deals that we've done that there's a flow of longevity risks, particularly with the risk margin in mind but not talking about it from Europe to North American reinsurers and we recognized that exception that we're actively participating in that. So it gets a good result for our clients and increases our return on capital. So, that looks like a sensible thing to participate in and get involved with and just recognize that effect.

You talked a bit about – you mentioned about you take more, you're taking companies involved in the UK market. I mean, just some interesting activities there, a real positive but more reinsurers want to get involved in on the longevity side of that market. So, I see that as a positive. It's a healthy market, plenty of client demand, reasonable competition but not too much.

So, I feel that is a positive vibrant market actually.

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

In relation to LGIM's business, we are seeing as you point out, increasing positive momentum in virtually all parts of the business which is encouraging. It's obviously that can be a straight line in all these markets. But we are at the breadth of the – the strength of the results is really encouraging.

With respect to the index business specifically which you asked about, we do expect to continue to see outflows in the UK DB market because we have mostly passive equity assets. That's what's the continuation of the trend that you're now seeing for several years and that will continue but we are executing better. We invested heavily in the business in regards to expanding the distribution of the index capabilities more broadly. So, we're seeing increasing flows in retail. We'd expect that to continue. We're much more competitive in that space now.

In defined contribution market, again a lot of these assets are coming in as part of multi-asset funds but the underlying funds are – majority of those funds are an underlying index funds. The package is part of multi-asset solutions for the DC market. And then internationally we've entered the U.S. market, starting to see – this is our first year in the U.S. market and starting to win mandates. We have a few clients now and getting seeding for funds. And so, we do expect to see an acceleration of growth there.

And in Europe and Asia, there's positive momentum as well. Money is a bit depressed, some of the sudden wealth funds have had – well, ultimately, we've had net outflows to some funds, as well as other managers. So, again, it's never going to be a positive momentum in all markets at all time. But broadly speaking, we do hope to expect to – again, it's not going to be every quarter, but the trajectory would be a positive net flow situation going forward.

One other thing, just mention also, our product offering, we've expanded its multi-asset funds and leveraging the index capabilities. There's building blocks for a growing array of multi-asset funds for the DC in retail marketing, increasingly DB, but also product development in alternative data space. So, the types of funds that we are offering is expanding and we expect to continue to evolve our product offering in the range of (20:34) into the alternative data space going forward.

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

So, as we work for the UK index funds, but that is not happening elsewhere. Okay. Thank you.

Operator

Our next question today comes from Greg Peterson from PWC (20:50). Greg, please go ahead.

Good morning, gentlemen. How are you doing?

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

Very good. Thanks, Greg (20:56).

Q - Operator

I'll do the traditional three questions. The first two is on the net capital generation. You mentioned in your opening remarks that one of the key factors today was better results (21:09) at LGIM. The run rate - I mean, when I modeled it, I looked to the run rate of LGIM in the first half and I considered that the cash flows had really started improving in the second quarter. But equity markets are down and your costs were controlled. All things equal, that wouldn't have justified the jump in the run rate that you've seen. I mean, what exactly has caused the quarter-on-quarter jump rate in LGIM? That's the first question - in LGIM's contribution on ICT (21:40).

Second one is on the GI side. Did you have any large prior-year leases in the third quarter? And then my third question is when you look at your economic capital model and you strip out one-offs, you adjust for the fact that you're actually trying to run an AA calibration or a BBB calibration. It doesn't look like you - even at the current run rate, you're not - you're basically consuming all the capital that's been released off the back book. I mean, what is the capacity to grow a box and will take on a few large or super bulks in the short term? I was struggling to understand that.

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

Okay. Thanks, Greg (22:17). I'll pick up - probably I'll go all three and then perhaps let Kerrigan add a bit of color to the last one. And in terms of my answer earlier to the question from Oliver, kind of where the growth in the cash has come from, I wasn't implying that it all comes from (22:37) there's been a number of positive. Actually there's some - pretty much all these variances went in the same direction this time around.

Hence, we've ended up with a reasonably meaningful growth in the operational cash growth year-on-year.

So, I wasn't implying for a second that all of the delta you've calculated in your spreadsheet break this down to LGIM or GI or I should be saying that it so happened this time around that all our variances were in the same direction, hence, we ended up with a reasonable outperformance as a result.

So, we clearly haven't given a divisional breakdown of cash generation. Clearly, this is a trading update. We do, of course, we try to give a bit of color around cash of Q1 and Q3, but we don't give a divisional breakdown. So, I'll say the kind of final profit number and this update for our prelims in March, if you don't mind.

A lot goes on GI and nothing untoward there. I hinted in my answer a little bit that we have a pretty benign Q3. In reality, we'd expect kind of – mostly at Q2 and Q3 be pretty benign because that's what the weather does in the summer. But it's been a pretty quiet sort of quarter and therefore, that has benefited GI. But again, nothing untoward going on in terms of fundings in terms of prior releases, et cetera. That's not part of that equation.

On the capital consumption point of bulk, clearly, we are – we said that very clearly at the interims this year, we are very focused now on our capitalized model for annuities and are very aware this is about optimizing our return on capital. I wouldn't say it's then to do with any sort of capital constraint. We're simply as a capital deploy, and we're making sure we get adequate return for the capital we deploy. And that's about all times making sure we have the optimum capital model to do that. You shouldn't interpret that as a mean that we've got some sort of capital (24:14) in terms of what we can and can't afford to. It's simply making sure that when we do deploy capital, we get an adequate return for our shareholders for doing so.

Kerrigan, do you want to add to that in any way?

A - Kerrigan Procter {BIO 15093363 <GO>}

Just in terms of super bulks, there are and there will be super bulk deals out there if the price is right and the average return on capital, in particular, is right. Then we're still very interested in those deals. So, as Mark said, I wouldn't read anything into Q3 figures beyond just quite all.

Q - Operator

All right. Cool. Thank you.

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

Cheers, Greg (24:41).

Q - Operator

Cheers.

Our next question on the phone today comes from Jon Hocking from Morgan Stanley. Jon, please go ahead.

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

Morning, everybody. Just had a couple of questions on bulks. I just wondered what your ratio is going to be in terms of capitalizing the U.S. units and how you think about rate of returns on capital sort of U.S. versus Europe.

And then secondly, the comment in the release about sort of further internationalizing bulk. When you talk about Europe, is that Ireland or is that Netherlands? Thank you.

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

Right. Do you want to answer, Kerrigan?

A - Kerrigan Procter {BIO 15093363 <GO>}

Yeah. Sure. I mean, interesting pipeline in the U.S. as we talked about. In a question earlier we talked about – referred to it a different capital regime, which of course it is. So, the capital consumption is different between the EU and Europe. What we have is we've all talked about a consistent return on capital metric, and we will apply that. And we can choose whether we want to do U.S. deals or UK deals. I think the important thing is that we have that choice and we look across both of those things equally and you'll be able to tell which looks more attractive for us by the deals we write effectively.

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

Sorry. You have to sort of pump (26:02) on the U.S. legal entity or how should we think about locating capital in the U.S.?

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

I'll pick it up. We're not anticipating a material increase in the capitalization of the U.S. business. We are giving too much away, Jon. L&G America, our insurance business there has very, very long mortality. The term insurance writer currently, certainly in terms of the (26:27) basis in the U.S. Writing more longevity business in that insurance business is a very good diversifier. So, we're not anticipating, certainly for the first leg of growth in the (26:50) space in the U.S. to have any material impact on the capital requirement of that U.S. business.

A - Kerrigan Procter {BIO 15093363 <GO>}

And then just following up on your point on international, yeah, really, we talked about the Netherlands there being the largest market in Europe actually came.

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

So, just a follow up on Mark's U.S. point. What proportion in mortality is actually reinsured in the U.S.? What proportion do you keep on your balance sheets?

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

We have to build on the UK. So, in the U.S., we have an excess reinsurance cover basis. So, above a certain line, I'm not giving that number away. But if we are to show above a certain amount, we'll reinsure that to reinsurance market. So, we do retain a reasonable mortality risk on our U.S. balance sheet.

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

Okay. Great. Thank you very much.

Operator

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

Q - Gordon Aitken {BIO 3846728 <GO>}

Good morning. A couple of questions on bulks, please. First, just to follow-up, when you said the bulk pipeline remained strong but I would expect you to say that ahead of Q4. And it's a very seasonal market, this one, the sales mostly in Q4. I'm just wondering, is there an added driver in 2015 due to Solvency II? I mean, the consultants I spoke to a few months ago were certainly pushing trustees to make decisions then in order to get Solvency I pricing.

And secondly, so, in the Dutch market, I mean, it's obviously a different market to the UK and the U.S. and that insurance companies have, in the past, taken on pre and post-retirement liabilities. They even take on active members, in fact. I'm just wondering what your strategy will be there. Thanks.

A - Kerrigan Procter {BIO 15093363 <GO>}

Yeah. Sure. On the first point, we're not seeing a huge pickup into Q4. I think rationally, you would say, trustees probably should've hurried up and got things done before the implementation of Solvency II and the removal of the transitional relief.

But really, from the trustees' point of view, the potential price increase going for next year doesn't look that substantial in the face of big equity market moves or interest rate moves. So, they haven't actually, other than a few odd cases, really got (28:44) to close this year.

So, I'm not expecting a big pickup in market volumes in Q4, particularly. I mean, give or take, there'll be a couple of super-bulk deals in there possibly.

Then on the Dutch model, on the Dutch market, we're really interested in pension and deferred. They're not really active members but pricing as well, UK and U.S. payout businesses, it's that long-stream of virtually well-known cash flows going out we're interested in so we can apply our asset management strategy to that. So, it's a bit similar pension or deferred pension market that we're interested in in the Netherlands.

Q - Gordon Aitken {BIO 3846728 <GO>}

Okay. Thanks very much.

Operator

Our next question today is from Colm Kelly from UBS. Colm, please go ahead.

Q - Colm Kelly {BIO 19140684 <GO>}

Good morning. I have three question, please. On UK bulk, if we look year-to-date, you've written £1.25 billion. But if we take out the additional tranches of the ICI bulk scheme that you wrote in Q1 2014, that looks like it's closer to roughly £250 million of bulks from new pension schemes, new to L&G. So, clearly, it's volatile, but can you give some color specifics on why you think it's a lot quieter than you expect in the context of industry consultants tipping the bulk annuity market in the UK to hit close to £10 billion by full year?

Secondly, on U.S. pension risk transfer opportunity. Obviously, you're positive in the outlook there. Can you give some color on any targets you have in place for that business and maybe any color on the return on equity capital shareholders can expect to achieve on that business over time?

And thirdly, do you expect to maintain IFRS cash generation as a key metric to kind of communicate cash going forward? Clearly, there's two big changes taking place, Solvency II and we're seeing peers move to other Solvency II (30:06) surplus-cash-type numbers. But we've also further down the line the new accounting standard, IFRS 4 Phase II, and there is a particular provision within that to spread profits on any contact over the full duration of the contract, which seem to constrain the ability to recognize more profit up-front on the annuity business over the long term. So, is IFRS net cash the right metric to judge cash on or can we expect that to be changed and then have that communicated going forward? Thank you.

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

Okay. Thanks, Colm. I'll again ask Kerrigan to get the first one about any more color he can give on the UK pipeline and market this year. I'll pick up the one point on the U.S. return on equity targets and indeed your question about cash metrics going forward.

A - Kerrigan Procter {BIO 15093363 <GO>}

Yeah. Just on the UK bulk pipeline of volume, I mean, as you'll know well from the figures, a lot of it is dominated by, I think, fixed rates super bulks. I mean, look at our deals last year, ICI, TRW, a lot of the volume is dominated by that. We've had a pretty steady flow of small- to medium-sized bulks this year, that's really great business for us. It has been a great business for us. I think whether or not it hits the consultants' target of £10 billion to the end of the year, will depend on whether a couple of super-bulk deals out there will close or not. So, it's just the fact that that headline volume of £10 billion that's given to you (32:23) by the consultants is dominated by a couple of super-bulk deals, I think.

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

Okay. Thanks, Kerrigan. In terms of the U.S. pension risk transfer market and any targets we might have, our only target, Colm, is to make sure we maintain our return on economic capital pricing basis. So, the only matter here is making sure we get the adequate return we expect to get when we deploy capital into that market. So, we have no kind of volume targets per se. Clearly, every time we expect that market to be material for us but we don't set short-term targets and telling us to go when and write only one quarter, only one year. We are absolutely disciplined to make sure that when we deploy capital, we get the returns we want from that capital deployment. So that's absolutely our target is to achieve that return.

In terms of kind of metrics going forward, I do expect us and we do plan to maintain our existing IFRS cash generation metrics going into the future, not least because as you say in your question, Colm, we are going to see another change yet again in the future. When finally we're going to get IFRS 4 Phase 2, the new insurance liabilities standard, wherever it comes in probably now it's going to be 2024 (33:34) it comes in. I'm very, very keen we don't end up kind of changing metrics kind of three times in the space of five years.

So, it is definitely my plan to maintain our existing cash definitions going forward, and we all then reconcile those back to, say, the new Solvency II balance sheet going forward as well. So, you can kind of see how the things interact.

But I think in terms of consistency, I'm very keen to maintain the cash metrics we have in the organization already. And when, if and when IFRS 4 comes in in four or five years' time, we'll take the stuff in exactly what that means in terms of the metrics. But for now, I'm keen to maintain consistency.

Q - Colm Kelly {BIO 19140684 <GO>}

Okay. Thank you.

Operator

Our next question on the phone today comes from Andrew Crean from Autonomous. Andrew, please go ahead.

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

Hi. Good morning, all. Could I come back to the first question and could you enumerate the third element of cash generation? You talked about one-off releases in the third quarter. Secondly, could you talk about what's going on in the protection market and whether you think you're growing share or whether after many years, growing share, you seem no longer to be so?

And then thirdly, I'd like you to talk, if you could candidly, about the savings business, which I don't see that you broke out as a separate division. You closed the with-profit business. It's been rumored in the press that you've been trying to sell Cofunds funds and Suffolk Life. I mean, what is the overarching strategy towards these businesses going forward?

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

Okay. Thanks, Andrew. I'll pick up the first one around your comment on one-off releases in the Q3 numbers. Obviously, Duncan can pick up any comments on the protection market, and I'll ask Mike Bury just to comment on - it's actually the Cofunds and Suffolk Life.

In terms of - an enumeration of kind of the - (35:11) I want to give at this point, Andrew. I would - again, I would just comment against the expression of one-off releases. This is a - just a - as we do every year, we just go back and make - as we get more information to go through the year, we just go back and we make sure the accurate calculation of (35:25) goes through into the cash number.

So, you shouldn't see us to be in the kind of a funny one-off. This is simply a - yes, it's coming through in Q3 numbers, but it is essentially a year-to-date impact from the recalculation of the expected release. We're just looking at where the prudence are coming from and making sure we got that property modeled. And as we get to the end of the year, we have a clearer definition of kind of what's actually come through by way of prudent releases during the course of that year. No more than that, is this is not some odd accounting going on in that one-off and actually it's an extra] (35:54) we do every year.

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

No, I just wanted the number, actually. I didn't say it was funny.

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

Yeah. And I'm not going to give it to you, Andrew. Year-end, you'll get the full breakdown as always, the divisional cash breakdown, and then we'll be - you'll be able to see where the - which divisions has generated what cash generation in the year. But until then, you have to wait until March.

A - Duncan Finch {BIO 18966514 <GO>}

Okay. On the protection side, in recent years, we have grown our share of the protection market. We continue to look for opportunities to increase our share of protection market. I think probably in the numbers you're looking at, our share over recent quarters has been fairly stable.

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

Mike?

A - Mike Bury {BIO 18966535 <GO>}

And on Suffolk Life and Cofunds, our approach there is to improve the profits by focusing on operational efficiencies. So, we've gone through – since acquisition of Cofunds, looked into integration benefits with the rest of Legal & General. In 2015, we've also focused more on improving the underlying efficiency within the Cofunds business itself and continue to identify cost savings into there.

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

Could I just come back on that? With a bit more candor, I mean, what has been reported in the press is that you tried to sell Cofunds because I think there was – I think you said that there would be about £125 million to £150 million to re-platform it. Can you talk a little – it looks as though that any disposals or sale process have formed through. Does that mean we may anticipate a big spend to re-platform?

A - Mike Bury {BIO 18966535 <GO>}

I'm afraid I can't comment on the speculation that's been in the press.

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

How about commenting on the spend to re-platform?

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

I think that Mike said n his answer, committees are actually sorting out their kind of day-to-day process in efficiencies at Cofunds, so you shouldn't be expecting any material shiny bright new toy re-platform and proposition to be expenditure from L&G. We're focusing on getting the bread and butter processes sorted out.

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

Thank you.

Operator

Our next question for today comes from Anasuya Iyer from Jefferies. Anasuya, please go ahead.

Q - Anasuya Iyer {BIO 18981555 <GO>}

Oh. Hi. Good morning. I have three questions. The first one was just on the bulk annuity pipeline. And I know you said don't read into Q3, but I just want to understand whether there's any waiting going on there? Because obviously we're seeing index flows coming back to positive, but a quieter bulk annuity pipeline. Is the pensioners just waiting for rate increases and how long is that wait is going to last?

And my second question is just on the reinsurance market and whether – I just want to understand what stops funds from going directly to reinsurers. And will there, at some point, be a direct relationship between funds and reinsurers, which risks some of the longevity business that you do?

And the last one was just on LGIM. I think the investor relations team did say that LGIM is at the top three for UK net retail funds now. And I just want to understand what's driving that. Is it any one fund and is it sort of a trend that we should pay attention to? Thank you.

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

Thanks, Anasuya. Kerrigan, the first two and actually, Mark, pick up on the retail funds and LGIM.

A - Kerrigan Procter {BIO 15093363 <GO>}

Yeah. Sure. On the question, is there any waiting basically on market movements or rate increases. I mean, I think really when you reflect on the market, there's probably about, I don't know, towards to the order of 10% of schemes. It may have been down the LDI mandate and pretty much fully funded. And there, the most like exclusive or the most likely account is to head towards the buy-in or buyout route.

And they're fairly obviously unaffected by equity market swings and interest rate swings. So, not really a waiting point from that point of view. As the ones who are progressing down that route of de-risking, I'd say almost every pension scheme is somewhere on that route of de-risking, then, clearly, to get themselves into the position where they can some contribution from the sponsor for a buy-in or buy-out, then that is somewhat the pension on equity market moves and it moves in the UK in real interest rates, nominal interest rates in the U.S.

So, that will have some impact on the following up group (40:13). But there's a wide dispersion of funds, different stages of the de-risking process with different funded statuses. So, I don't think any of that really affects the day-to-day or quarter-to-quarter or year-to-year interest in clients looking to de-risk.

On the reinsurance market, I think that's a really interesting question and something we think a lot about. Could funds go directly to reinsurers? Well, the answer is in the UK, the UK pension schemes, the U.S. scheme is no they can't. They have to deal with an insurer. But it simply is an interesting thing to work out how we can most effectively service our clients by tapping that reinsurance market. So, if we can be an insurance company instead of a reinsurance company in the middle that can transform risk straight into the reinsurance market then I think that's a very interesting proposition for us in that time.

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

In regards to the LGIM retail flows, the last couple of years we have strengthened our distribution and rationalized our product offering in the retail market. And we ranked currently – I'm not sure where it's at, but 12th, 13th or 14th in AUM in the UK retail market. So, the second quarter being fifth in net flows and the third quarter third in net flows. Obviously, we have aspirations to be significantly higher in the lead tables in the retail space.

Most of the demand over the past year, one to two years, has been in our index funds, our multi-asset funds and our property funds. We have expectations to grow our presence in fixed income in particular. We have a very strong brand in institutional market, and we've been punching below our weight into the retail market over the past several years. And also, with a revised set of equity funds, we're in the process now of building a track record.

So, we do have aspirations certainly to continue to be a more – a larger presence in the retail market. We won't be top three again in every quarter, but certainly, I think direction of travel should be expected to continue.

Q - Anasuya Iyer {BIO 18981555 <GO>}

All right. Great. Thank you.

Operator

Our next question for today comes from Abid Hussain from Société Générale. Abid, please go ahead.

Q - Abid Hussain {BIO 17127644 <GO>}

Hi. Good morning, all. Three questions for Kerrigan, please. The first one is on direct investment. I was just wondering if you could articulate in some way the yield pickup that you expect to achieve net off some to (43:02) asset charges? So that's the first question.

The second one is on Lifetime Mortgages. How do margins on these mortgages compare to – or margins and capital requirement compared to retail annuities? And then the last question is on debt. I think you issued around £600 million of debt during the third quarter. I was just wondering, was that Solvency II-driven. Thanks.

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

Okay. Thanks, Abid. So, Paul, if you can pick up the word to comment on anything you can say on the investment yield pickup. And I'll ask Kerrigan on Lifetime Mortgage, anything you can say on to help the question and I'll pick up the point on the debt issuance.

A - Paul Stanworth {BIO 15495409 <GO>}

Thank you very much. In terms of direct investments, on the annuity funds themselves, there's a pickup of probably between 50 and 100 basis points depending on the sectors that are being invested in. There is an advantage to some of the investments which we are capturing through combined efforts of investing in a broader range of projects. And we expect that to be a bigger portion of what we're investing in the future. But the main bulk of what is playing into the annuity fund is really coming through the LGP direct investment program.

A - Kerrigan Procter {BIO 15093363 <GO>}

Yeah. Yeah. Obviously, I think just adding to Paul's point there is you get a yield pickup for (44:22) risk premium but also with those assets, you get generally a better security and better direct control over that security, so any loss-given default we expect to be quite significantly lower, but certainly the types of investments that we look at. So, lots and lots of reasons to be interested there.

On the Lifetime Mortgages, margins and cash flow comparable to retail, they're certainly beneficial assets but it's a different market they come through in terms of profitability and benefits for us as assets pretty much in the DI camp (44:58).

So, the actual origination and value you see in digital and home finance is not reflective of the whole value to us which is really Lifetime Mortgage as a diversifier in our asset portfolio and an asset that yields an attractive spread relative to our back book or traded credit. So that's where the real benefit comes through. And that is attractive. I mean, we hopefully – I'm trying to strike the right balance between attractive assets and value for money for our clients so I think we achieved that. But it's a very interesting and attractive market to be in.

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

Okay. And the last question, a bit about your question around our debt issuance and whether that was Solvency-related category. No, so what we have here is a – and we have active kind of balance sheet management. And we have a roll-in kind of debt programs. We got first call dates on subordinate debt going forward in 2017, 2019, 2021. And I know we're trying to (45:59) just to manage that – the right proportion of debt as part of our capital funding.

And we're very comfortable with the operating leverage ratio given around 30%, and that's what we look to try and achieve and maintain over the long term. So we went into the market this year as part of that longer term agenda, but definitely not a Solvency II response.

Q - Abid Hussain {BIO 17127644 <GO>}

Thanks. Can I just come back to the first question on the direct investment? How are the negotiations or discussions with the PRA going on the asset charges on the infrastructure? I know you've got some discussions on reducing the asset charges. I was wondering if you could give us an updated comment.

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

Kerrigan?

A - Kerrigan Procter {BIO 15093363 <GO>}

Well – I'll start off and (46:42).

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

(46:43)

A - Kerrigan Procter {BIO 15093363 <GO>}

Yeah. So – I mean, really interesting developments across Europe for this standard formula with our potential reduction in the spread charge for – and hence the (46:57) for infrastructure assets. That's very interesting. Of course, what's relevant for us is the treatment in the internal model. So we will, of course, be exploring internal model treatments for infrastructure assets in a broadly defined infrastructure class, and that will be interesting. But that's separate from the standard formula conversations, of course.

A - Paul Stanworth {BIO 15495409 <GO>}

Yeah. The only thing I would add to that which is the kind of broader asset base of Legal & General is the fact that there are a number of indicators that (47:32) given around asset-like strategic equity or SME loans or infrastructure debt where, as Kerrigan said, the main thing is we are using an internal model. But there are precedents to be set that we can look at within the standard model.

And that's really important for us for LGC's assets, which themselves are progressively moving from traded assets into more strategic assets. And we will look to the type of strategic capital charges that are being used in the standard model when we review our internal model.

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

Thanks, Paul. Thanks, Kerrigan.

Q - Abid Hussain {BIO 17127644 <GO>}

Thank you.

Operator

Our next question from the phone today comes from Alan Devlin from Barclays. Alan, please go ahead.

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

Hi, guys. Thanks. A couple of questions. Just a follow-up on the Lifetime Mortgages. Is the current run rate of volume sustainable and, therefore, the benefit of the new business stream, or new business structure (48:17) sustainable as well? And then just on LGIM. First of all, LDI, you kind of alluded to the fact that if interest rates go up or equity markets (48:27) a strong pipeline of LDI could come on board. Do you know what kind of pipeline you have and how much (48:34) triggers it will automatically come on if certain thresholds are hit? And then just finally on LGIM, the group in Asia, particularly the – what's the focus and opportunity with your Japanese partner in that region? Thanks.

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

Thanks, Alan. Okay, Kerrigan for the first one and Mark the second, please.

A - Kerrigan Procter {BIO 15093363 <GO>}

Yeah. (48:11) the run rate sustainable. What you've seen from the figures is that Q3 year-to-date was just over £100 million based on the Q2 and Q3 figures. We're still guiding towards the order of £200 million (49:05) for this year. Is that Q4 run rate sustainable? Yes. Absolutely. (49:09) that.

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

Yeah. In regards to LGIM, we can't really quantify I guess that precisely the timing of the de-risking activity that our clients will have. We'll have a sense with some of the larger clients, but if you think about how broad and diverse our client base is now and it's growing in the U.S. obviously there's a combination of – increasing in the U.S. new clients coming on board. Within the UK, a higher percentage of the activity would be from existing clients and then we're increasingly winning mandates with smaller clients in some of our pooled offerings.

So, it's – we can't project with that degree of precision. You really have to look more at the percentage of liabilities that still haven't de-risk, that are unhedged, however you want to define it. And that's the potential opportunity still for us to take on new business or transfer business from passive, which is covered in our market and other movement line item. But the timing of that, it's difficult to project.

In regards to Japan, our recently announced agreement with Meiji Yasuda will focus on providing global fixed income products for pension clients in the Japanese market. That could be managed total fixed income.

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

Thanks for the answers.

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

Okay. Thanks, Alan.

Operator

Our next question today comes from Barrie Cornes from Panmure Gordon. Barrie, please go ahead.

Q - Barrie Cornes {BIO 2389115 <GO>}

Good morning, all. Just three questions from me. I wonder if you can talk generally about the outlook for UK pension savings reform and also then go on maybe to talk about current, in the retirement market, focusing on the cash use, its draw-down split.

And thirdly, just want to speak up on cost, you've obviously talked about being ahead of target. Just wonder if that's in terms of the amount or the time scale and whether or not you could look to revise and increase your cost savings, perhaps, in the likes of – areas like Cofunds? Thank you.

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

Okay. I'll pick up the first one and then the third one. Maybe Kerrigan pick up on just the shape of the (51:38) or maybe Jackie and Mike can comment as well. But just on the UK pension savings reform, I think it's now (51:46) in the spring budget rather than the autumn statement. I think that's sensible. Clearly, there's been a lot of people sent back in to that. Now, we're on record of saying our third option is to have a flat rate that's actually been outsourced, that we're advocating basically a tax relief for everyone, 20%, but outsourced and we still want to maintain the exempted tax regime rather than TEE.

Clearly, the Treasury will take all that feedback and (52:15) that consider. I think, at the end of the day, we're pretty (52:19). Overall, we can't guarantee we'll succeed no matter which way we run and go. We just think, for the sake of the market, in terms of growth in that market, we think customers will be more reassured to get a tax relief at source rather than relying on promise of a tax relief, let's say, 50 years' time when they come to retire.

So, it ends up being a pension rather than the current regime, given L&G strength, particularly with LGIM in the camp. We're very sure we can succeed in that as well, but we will further see the existing regime maintain where customers now have absolute confidence that they get the tax relief at (52:50) rather than having to rely on a benign chance in 50 years' time given that – to honor their promise. So, that's where we are coming from in that regard.

Q - Barrie Cornes {BIO 2389115 <GO>}

Thank you.

A - Kerrigan Procter {BIO 15093363 <GO>}

On the post-retirement savings market, I'm not sure if you want to step (53:02) but happy to kick off, if you like, I mean, Barrie, you know the figures very, very well, indeed. I think by numbers of people and some of that 70% post (53:11) have taken cash by pounds, it's more like the third cash, the third annuities, third drawdown. I think on the annuities front, we talked about the market remaining subdued. The reasons they have a particular pickup from that level of annuities than our largest size, there's a bigger further, we're seeing a standard fixed term and enhanced annuities and those proportions will vary over time, I think. But yeah, it's like a fairly stabilized flow for annuities now, but much less exciting than it would have been a couple of years back.

On the drawdown options, well I think we're very excited about the long-term potentials. I think the market has got a long way to go there yet, but I'm very excited about the LGIM multi-asset funds, post-retirement funds, and their two and three retirement funds that they're launching. I think there's a big part for those to play in the future, I think on drawdown proposition as that market develops.

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

I think to answer quickly (53:55) post activity, immediately post pension reform date and kind of where things are settled down. Just a quick comment on this activity a little bit more generally.

A - Jackie Noakes {BIO 17095495 <GO>}

I mean, we've continued to see increased claims volumes through quarter two. And our new norm in terms of the AU is about 500% to 700% up. Customers are taking continued stakes for lump sum and small amounts, effectively.

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

Okay. Thanks, Jackie. Just on kind of wide aspiration for cost, I mean, clearly we are pleased that our run rate currently is to deliver more than £80 million for the current year. Barrie, I think in reality – it's always been part of L&G's DNA to kind of make sure we remain as efficient as possible. I think we (55:00) very clear today that a (54:43) around Suffolk Life and Cofunds we're going to be very focused on that going forward. But I mean, it's part of our wider DNA. Cost management will always be a key part of our agenda. So, it's not just a once-and-gone thing this year. Now, we will always kind of just make sure we have the right cost base for the organization to make sure that's appropriate to the earnings growth we want to deliver from here on in.

So, I'm not going to give any revised cost, just simply to say that it will all remain part of our strategic agenda going forwards.

Q - Barrie Cornes {BIO 2389115 <GO>}

Okay. Thank you.

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

I think, given time is now 10:00. We're probably going to call an end, if you don't mind. And so, thanks everyone for your inputs and lots of questions. We appreciate that and we'll speak to you at the year-end.

Operator

Ladies and gentlemen, that concludes today's conference call. You may now replace your handsets.