S2 2011 Earnings Call

Company Participants

- John Pollock, CEO, Risk
- Mark Gregory, CEO, Savings
- Nigel Wilson, CFO
- Tim Breedon, Group CEO
- Wadham Downing, Financial Director, UK Insurance

Other Participants

- Andrew Crean, Analyst
- Andy Hughes, Analyst
- Blair Stewart, Analyst
- Duncan Russell, Analyst
- Gordon Aitken, Analyst
- Greig Paterson, Analyst
- Jon Hocking, Analyst
- Marcus Barnard, Analyst
- Nick Holmes, Analyst
- Oliver Steel, Analyst
- Raghu Hariharan, Analyst
- Toby Langley, Analyst
- Tony Silverman, Analyst

Presentation

Operator

Ladies and gentlemen, welcome to the Legal & General Plc half-year results conference call. My name is Lloyd. And I will be the operator for your call this morning. We are now going live to the presentation room, (Operator Instructions).

Tim Breedon {BIO 3157585 <GO>}

Morning. Welcome to Coleman Street for our 2011 half-year results presentation. As usual, Nigel will cover the results, before I return to discuss the strategy and the outlook.

But, first, the usual housekeeping. Fire exits are through the lift lobby, down the stairs; you switch off your mobiles, they interfere with the sound system; and the usual disclaimers about forward-looking statements apply.

Turning to the headline results for another successful six months, starting with cash generation, operational cash generation was GBP498 million. And after GBP71 million of new business strain, net cash generation was GBP427 million. These numbers are up 19% and 14%, respectively, on the first half of 2010; and up 50% and 41%, respectively, on the first half of 2009.

Worldwide new business sales are up 4% at GBP920 million APE; another new record for L&G, up 4% on last year.

IFRS operating profit was GBP523 million; down slightly on last year. But up on the first half of 2009.

Profit before tax was GBP473 million.

So you can see that we continued to deliver good growth on cash generation, underlying IFRS profit. And on sales.

We also delivered on value measures; EEV per share is up from 95p in June 2009 to 139p today. That's a 46% increase over two years. And the creation of GBP2.6 billion of embedded value since 2009.

Capital position strengthened again with the IGD surplus rising to GBP4 billion, with a coverage ratio of 238%.

So, in summary. And as I said in March, strategy is working, business continues to deliver ahead of our planning assumptions, remain confident about L&G's future prospects. And are, therefore, announcing an interim dividend of 1.66p; an increase of 25% over the 2010 interim. And, as we said in the past, we expect cash coverage of the full year dividend to move towards 2 times over the medium term.

Okay, Nigel?

Nigel Wilson {BIO 1535703 <GO>}

Thanks, Tim. Good morning, everyone. As Tim has said, we are building a strong track record of delivery and growth. This slide shows the operational and net cash generation over a longer period; strong double-digit growth per annum in operation cash generation, with the 19% increase in the first half of 2011 above trend. And net cash generation in H1 was 14% up on H1 2010.

Furthermore, we are continuing to diversify our sources of cash generation, which can be seen on this slide. In 2009, Annuities delivered 52% of net cash flow. The double-digit growth in the contribution from LGIM. And Savings, the growth in International and Group, coupled with the reduction in positive Annuities new business strain, means that the Group in 2011 is much more balanced, with only 26% of net cash generation from Annuities.

The contribution from our asset businesses, LGIM and Savings, is up to 35%, from 22% two years ago. And this change has been achieved whilst growing net cash; 41%, from GBP302 million in H1 2009 to GBP427 million in H1 of this year.

Turning now to the detail of today's numbers, all of our businesses have made a healthy contribution to the Group results. We have no businesses that are either weak or operate in strategically-challenged economies or markets.

In Risk, operating profit of GBP236 million is down on last year's GBP310 million. But is still a strong performance, reflecting the economies of scale and the strong market positions we have across our Risk businesses. Profits are again balanced between Protection and Annuities.

The strong momentum in Savings continued with a record GBP68 million of operating profit; up 26% from last year.

Another record performance for LGIM with assets in excess of GBP360 billion; an efficient operating model, coupled with outstanding customer service, leaving its profits up 19% to GBP117 million.

International delivered profit growth of 8% to GBP66 million.

And we continue to grow shareholder funds. The profits in Group Capital and Financing increased to GBP61 million.

After a negative net investment variance of GBP49 million, reflecting market conditions, we delivered a healthy profit before tax of GBP473 million.

Operating earnings per share of 6.7p; and an annualized return on equity of 14.6%; and, as Tim said, an increase in the dividend of 25%.

We had a solid six months in terms of sales with new business APE of GBP920 million. Annuities bounced back in Q2 with a more normal GBP52 million of APE. And we are confident about H2. Protection was up 11%; Savings up 9%; and our US businesses up 58%.

LGIM had another strong period with growth sales of GBP17.9 billion. Net fund flow from Savings and LGIM amounted to GBP4.1 billion. As Tim said, sales volumes are up 23% over two years. And worldwide assets under management have grown by 29% in the same period to GBP370 billion.

I'd like now to spend a few minutes on each of the businesses; first, LGIM. LGIM's assets have continued to grow, up to GBP362 billion at the end of June. This growth in assets, coupled with further revenue growth as clients shift assets from passive UK equity to higher revenue asset classes, has seen profits grow by 19% to GBP117 million; and net cash grew to GBP91 million.

Once again, fee-to-fund ratio is up; this time to 10.9 basis points. And the cost-to-fund ratio remains low at 5.2 basis points, creating a margin of 5.7 basis points.

On this slide you can see the shift in asset mix, which is driving LGIM's revenue improvement. This slide shows the movements in assets and the increasing role that liability driven investments, that's LDIs. And international clients are playing in LGIM's growth.

Over the last 18 months, these two businesses are responsible for GBP16.9 billion of gross new business. And now account for 17% of LGIM's assets under management. That's GBP62 billion of assets from businesses which did not exist four years ago.

And we have numerous mandate wins in the hopper. We are, therefore, confident that we'll continue to grow this business. Mark Zinkula, LGIM's new CEO, has a business with many growth opportunities.

Under Mark Gregory's leadership, our Savings management team has delivered record results. In the first half, operational cash generation was up 24%; net cash was up 53%; and operating profit was up 26%.

Once again, sales rose, up 9% to GBP662 million; and net new business flows were GBP1.1 billion. Assets under administration rose 18% to GBP66 billion. Impressive results for a business that made minimal profits and produced negative net cash two years ago.

This slide breaks down the Savings result into its component parts. In the Investment business, which contains our unit trust business, ISAs, structured products. And our platform businesses, assets were up 9% to GBP25.4 billion. And net cash was GBP12 million. Included in this is the GBP4 billion of assets, out of a total of over GBP30 billion on the core funds platform. And over GBP3 billion on our own platform, IPS, which has grown 23% in the last six months.

With profits delivered GBP35 million of operating profit and GBP26 million of cash, modestly ahead of the guidance we gave for the full year of GBP50 million of cash.

Finally, in insured savings, operational cash of GBP51 million was again in line with our full-year guidance. And strain was down even further to just 2.6% of PV NBP, leading to net cash generation of GBP20 million.

John Pollock and his team had another strong six months in Risk. Operational cash generation was GBP233 million. And net cash generation was GBP193 million, after new business strain for GBP40 million.

We recognize that there is not a great deal of data available to allow you to model Annuities new business strain. I think all of the available historic market data has been provided so far by us.

In the first half of 2011, we wrote GBP760 million of annuities, at a positive strain of GBP1 million, compared to GBP1 billion in the first half of last year, with a positive strain of GBP35 million.

IRRs and payback period remain very attractive. And we remain very happy with the return on economic capital we are achieving on this business.

New business strain is the result of a number of factors including pricing, the mix of business we write. And the nature of the mortality within the BPA schemes we choose to write. Pricing conditions have normalized. But there are many other factors at play in determining the level of strain we may see from year to year.

We are confident of delivering good annuity volumes, earning an acceptable return on capital in H2. And indeed in future years.

After a positive investment variance, Risk profit before task was GBP251 million.

On this slide, we've reconciled the 2011 and 2010 Risk operating profits, which at the headline level were down from GBP310 million to GBP236 million in 2011. What you can see is that the impact of the 10% growth in operational cash generation and the reduction in cost is masked by the impact of three things.

Firstly, Annuities positive new business strain is down to GBP1 million, from GBP35 million in 2010; secondly, we suffered abnormal claims in our Group Protection, which created a negative mortality variance of GBP27 million; and finally, the GBP72 million positive effects of inflation modeling in the Annuities business in 2010 were not repeated in 2011.

We remain very happy with the underlying performance of the Risk business. And we are very confident about H2.

Looking at the breakdown of the Risk business, you can see that the operational cash generation was again in line with full-year guidance at GBP112 million for Annuities and GBP109 million for Protection.

Protection new business strain was down as a proportion of new business premiums at GBP41 million, leading to a 33% growth in net cash from Protection to GBP68 million.

General insurance returned to profitability after the bad weather of December with GBP12 million of cash and GBP17 million of operating profit. And a healthy combined operating ratio of 90%. We expect a better performance in H2 this year than in 2010, assuming no return to the very extreme weather we experienced in December of 2010.

International operating profits were GBP66 million; up 8% on 2010.

New business growth of 9% was driven by a strong performance in the United States; up 58%. New business margins rose in H1 2011 in the US as a consequence of the impact of the 58% increase in new business and its impact on expense recovery and the increasing reinvestment deals.

Operational cash generation by the International division was GBP35 million, representing 10% growth in the underlying dividend from the United States. These underlying dividend flows are expected to continue and grow at a similar rate in future years. And are expected to be incremented by dividends from Europe in the second half.

We have continued to make modest investments in our new emerging market ventures, for example, in India.

Finally, Group Capital and Financing, where we have increased profits from GBP33 million in H1 2010 to GBP61 million in H1 2011. This is mainly due to the 33% increase in assets held at the center, from GBP3.3 billion in H1 2010 to GBP4.4 billion in H1 2011; growth of over GBP1 billion, which is detailed on this slide.

This is in addition to the GBP1.5 billion of shareholder funds reported within the business unit. That's LGIM, General Insurance, Savings, Investments, etc. As we generate more cash, we expect these assets to increase, further strengthening our balance sheet.

This slide shows the link between operational cash and IFRS profits before tax in the first half of 2010. And this slide is the same for the first half of 2011. The strong relationship between IFRS profits, earnings, operational cash. And net cash is similar for the last two years.

As we said at the year end, we have further increased and improved our disclosures. This slide shows details of our asset quality, which is given in a lot more detail in your packs.

Out of total assets under management of GBP370 billion, shareholder assets are GBP35 billion. The breakdown of this GBP35 billion by business unit and asset class is shown on this slide. Of this GBP35 billion, only 1.4% is invested in Portuguese, Spanish, Irish, Italian. And Greek sovereign debt and bank debt combined; and our Greece exposure is just GBP1 million.

We're also protected from the risk of default in the Annuities portfolio, which then makes up the majority of the shareholder funds, by the default reserve, which is unchanged from the year end.

Turning now to our generalist investor slides, by now you will be familiar with the format, although we have added an additional level of detail here, breaking out the Group Capital and Financing section to show how -- both the return on shareholder assets and the interest costs separately. This is important because of the leverage effect of rising shareholder assets on the Group Capital and Financing cash and operating profit.

You can see that the predictions we made in March for cash for our long-term business look robust; GBP300 million of operational cash in six months, versus a predicted GBP600 million for the year.

Once again, the stock of long-term cash flow has increased on both a discounted and an undiscounted basis. And we have given increased disclosure on your pack on the shape of the monetization profile.

You will recall that I said in March that personally I would be disappointed if we did not do much better than the GBP700 million of net cash in 2011. With GBP427 million in the bag at the half year, we are confident that we will deliver growth in operational cash and net cash generation in 2011.

Unsurprisingly, all of this cash generation means that our IGD surplus position has again strengthened, from GBP3.7 billion to GBP4 billion; a growth of GBP300 million. We have shown this in some detail on this slide.

Some key points to note. Net cash after dividend contributed GBP330 million to the growth. Assumption. And expense changes. And negative investment variance had a net zero effect. There was an increase in UK operational cap sovereign [ph] capital of GBP8 million. We are not big users of operational solvency capital.

The result is an IGD surplus of GBP4 billion at the end of June. We would expect another positive six months in the second half of 2011. It is also worth noting that our ICA surplus is larger than the equivalent IGD surplus.

On this slide, we've highlighted the change in the VIF, on both a discounted and undiscounted basis. And the additional disclosure we have provided on the shape of the VIF monetization.

We have shown that the cash flow coming from the back book is predictable. It is also a substantial number, with GBP8.7 billion of undiscounted VIF in total, of which GBP2.9 billion is expected to monetize in the next five years.

If you add in the effect of new business to be written during the period, you can see that we should be able to sustain and grow the expected GBP600 million per annum cash monetization of the VIF.

Group embedded value per share has increased again, ahead of market expectations, to 139p per share.

We've also included in your packs a management estimate of LGIM's value on a discounted cash flow basis. You will recall, in the Group's embedded value LGIM's external business is carried at a net asset value of only GBP400 million. Based on prudent assumptions for persistency and margins, value in LGIM on a discounted cash flow basis.

And excluding any value for LGIM's new business franchise, would add another 21p per share to Group embedded value, increasing the number to 160p per share.

Finally on dividends, the Board decided to increase the interim dividend by 25% to 1.66p, continuing our track record of recent dividend growth. As you know, we aim to get to 2 times cover.

Thank you. I'll now hand back to Tim.

Tim Breedon {BIO 3157585 <GO>}

Thanks, Nigel. So, another strong set of results. They're consistent with the messages about our business model and objectives which we've been emphasizing for several years now. And that demonstrate significant progress against our key metrics and strategic priorities. They represent another step towards creating the balanced Risk, Savings. And Investment Management group, which is our aim.

All our main divisions are now performing well. Sales were higher. We're growing the right business. And we're growing them profitably. Cash generation continues to improve. However, I expect that today most of you will be most interested in how we see the outlook for growth, for cash, for capital, ultimately for dividends. So I'll focus on those areas.

I'll start with growth, specifically with the economic and market factors. Our outlook, at the macro level is understandably cautious. The global debt overhang is still very much with us. And its impact continues to be felt as we suffer the aftershocks of the financial crisis and its incomplete resolution.

Political and regulatory action now threatens to intensify the problem, increasing risks and delaying recovery. Global markets remain volatile, the eurozone looks fragile, confidence is low. And the outlook for UK economic growth, expected by us to be 1.3% in 2011, remains subdued.

This weak macroeconomic outlook, moreover, fits alongside an unprecedented level of uncertainty arising from the raft of changes to regulation facing the UK insurance industry; gender pricing, the retail distribution review, auto enrolment in pensions, changes to the UK regulatory architecture. And of course Solvency II.

Taken together, these developments represent an enormous change to the regulatory landscape in which we operate. And are likely to bring with them operational challenges and strategic uncertainties for all, combined with opportunities. But those opportunities will only be available to those with the necessary scale, diversification, capabilities. And positioning to benefit. We think we're well placed in that respect.

While our outlook for markets is cautious, we're confident about the growth prospects for Legal & General. In particular, economic and social policy developments in the UK play to our strengths. An aging population, a continuing shift from DB to DC pensions, auto enrolment, they create opportunities for our Savings business, particularly in workplace, where we are building scale and have a growing pipeline of new business amongst large employers.

The end of compulsory annuitization will boost SIPPs and drawdown at the top end of the market, while the minimum income requirement ensures that for the vast majority of the population in DC schemes, we estimate well over 90%, annuities remain the right vehicles to fund retirement.

De-risking of existing pension funds here and internationally creates opportunities for LGIM's LDI business. And for Annuities. Welfare reforms, a drive to greater financial self-sufficiency. And an increased willingness by the government to contemplate risk sharing as part of its deficit reduction plans are welcome developments as the state is moving to narrow the individual protection gap by encouraging simple financial products, the possible replacement of Statutory Sick Pay by more effective group income protection arrangements. And examining carefully the scope for private sector involvement in funding long-term care.

In essence, we are leader in the provision of risk products in the UK at a time when risk is being passed from the state to the individual. As the population gets older and has to save more, we've acknowledged expertise and scale in savings and the funding of retirement. We're the UK's largest manager of pension fund assets. And at a time when the Chancellor's stated priorities, an economy built on savings and investment, the long-term saving and investment is precisely what we do.

On the regulatory side, a period of extensive change creates opportunities, as well as risks. We're well prepared for many of the changes. For example, our diversified distribution model, our bank and building society distribution relationships. And no dependence on initial commission-driven IFA sales of savings products positions us very well for RDR.

In short, we see the impact of many of the changes as being greater for competitors, with resulting competitive advantage for us, opening up the possibility of market share gains.

Now I'd like to turn from the growth outlook to cash. Cash is at the heart of this set of results; a metric which we identified early as one of the key disciplines and drivers of success in our sector.

Today's GBP427 million headline number is well ahead of expectations. It's diversified across Risk, Savings, International, Investment Management. It's sustainable, thanks to the pipeline in Risk and Savings, where the value of enforced business continues to increase. And strong customer franchises in our asset management businesses.

So business growth and growth in cash, I hope we have now successfully demonstrated that we can deliver both simultaneously.

Nor do I see a cautious or uncertain outlook for markets or for the broader economy as limiting our progress or changing our focus. There's good growth momentum in the business.

We expect strong levels of cash generation to be sustained. Over time, more cash can be turned into more dividends as we bring the cash cover ratio to 2 times in the medium term. And possibly below that once economic, market. And regulatory uncertainties recede.

The major uncertainty here continues to be Solvency II. Here, the direction of travel remains broadly positive. But it's slow and it's complex. Engagement on the UK's main issue is that capital, eligibility. And contract boundaries, calibration equivalents. And pension annuities continues to be constructive.

The annuity provided for current work by the commissions group on long-term guarantees has the potential to address concerns about the quantum volatility and pro-cyclicality, in particular, of capital requirements for long-term products; defects in the quiz five [ph] basis, which are widely acknowledged, both here and in Europe.

Resolving this issue is important from a social policy perspective. The availability of affordably priced pension annuities is central to the delivery of the government's plans for greater pension saving, the provision of higher pensioner incomes. And potentially part of the solution for long-term care costs as well. The government in UK is well aware of this.

But we are still some way from the final destination on Solvency II. The substantive content has still to be finalized, it has to be scrutinized by the Brussels institutions. And enacted by Omnibus II. The timetable for implementation, which has already probably slipped to an effective start date of 2014, remains vulnerable to further change and slippage. This uncertainty is unhelpful. And it's expensive, not least because it absorbs so much management time.

Meanwhile, we retain very prudent levels of capital reserves, including GBP4 billion worth of IGD surplus and GBP1.5 billion of default provisions for LGPL.

Given the high levels of economic and regulatory uncertainty at present, we feel that it's appropriate to maintain a strong balance sheet. Balance sheet strength provides two things; security for our customers and for our Company in a risky environment. And alongside security further optionality for management.

The business model I've outlined is capable, on its own, of delivering high levels of profitability and growth in sales, cash. And dividends. Capital strength is an added bonus; a substantial further resource which will enable us to ride uncertainties and to exploit opportunities. And it's my view, in a period of profound change in which many of the rules for the industry are being re-written, that new opportunities will indeed arise.

So the picture we have presented today, I believe, combines the following key elements. Business growth and opportunity in an environment in which -- an environment which is uncertain but where the fundamentals are in our favor; cash and dividend growth, both in terms of overall cash generation, the proportion of cash which over time we can turn into dividend; and balance sheet strength, which gives security and equips us well to profit from a fast changing marketplace.

This feels like a winning combination.

Now, I'll end and take questions. And before I do that, I'll ask other members of L&G's Executive team, that's John Pollock and Mark Gregory, to join us on the stage to help answer them.

Questions And Answers

Operator

(Operator Instructions).

Q - Nick Holmes {BIO 3387435 <GO>}

I have a couple of questions on the regulatory situation, which, as you say, is very contentious and rapidly changing. Firstly, Solvency II, wondered if you could give us an update, in particular, on the matching premium concepts for annuities. And whether you're confident that EIOPA is moving to the UK position on this. That's the first question.

The second is looking at the RDR. And I wondered if you could describe for us which products you see as being the winners and the losers. You've mentioned distribution. But I wondered, generically, how you see products being affected. And of course how you see L&G being affected. Thank you.

A - Tim Breedon {BIO 3157585 <GO>}

Okay, I'll take the first one on Solvency II, which I covered partly in the speech. We're still hopeful. But it's hard work. And there's some further negotiating to be done. I think what's really helpful is the alignment of UK behind the preferred solution. And by UK, I mean the UK industry as a whole; the FSA and Treasury. And that is I think a very welcome development at this period. So hopeful. But we're not there yet.

Mark, RDR?

A - Mark Gregory {BIO 15486337 <GO>}

Yes, I guess all products in the Savings space in theory are affected by RDR. So any advisor advising on insurance and other investment products will be caught by the RDR when it comes in on January 1, '13.

But I guess, by definition, those products which currently have a bundle price, i.e., the commission, is bought into the price structure currently, I'm particularly thinking about insured products, will be more affected, I guess, by RDR. (inaudible) unit trusts, where typically the customer pays rather than the manufacturer pay into the -- for the initial advice. So I guess that would be the area where -- so people are more linked and paying higher commission, I guess we'll have a bigger -- bigger stretch to get to the post-RDR world.

Q - Nick Holmes {BIO 3387435 <GO>}

Just following up very quickly on Solvency II, when do you expect EIOPA to make its next pronouncement on the matching premium concept?

A - Tim Breedon {BIO 3157585 <GO>}

I don't think EIOPA is likely to make any pronouncements at all. And the commission is likely to put forward a preferred text. And I think that will happen sometime in the Autumn. What EIOPA does with that and what the Parliament does with that is another matter.

Q - Nick Holmes {BIO 3387435 <GO>}

Okay, thank you very much.

Q - Andy Hughes {BIO 15036395 <GO>}

Just three questions, if I may. The first one I guess is following on from the Solvency II question. I read the response to IFRS Phase II. And in there you were very much against the idea of grandfathering existing liabilities when it came to changing the accounting rules, I'm just wondering whether it's all or none when it comes to Solvency II. Or are you pro the idea of grandfathering in a Solvency II context. But against it in an IFRS Phase II context?

The second question was on the outlook for bulk annuities. Obviously, at the end of Q1, or actually on May 4, you said you'd done GBP200 million of additional bulk annuities, which equates to GBP20 million APE, across the full half year you've only done GBP24 million of APE. And you're still making comments about a strong pipeline going forward. I'm just wondering what happened between May 4. And the end of the year that didn't realize the continuation of that strong pipeline and how things changed given the economic conditions.

And then the third question is about the credits. But obviously the VIF to cash depends on you realizing the assumptions in the VIF. And you're still using a credit spread assumption of 1.7% in your VIF, just wondering what you're investing in to get you a yield of 5.5%, i.e., 1.7% above risk free. Thank you, very much.

A - Tim Breedon {BIO 3157585 <GO>}

All questions in the finance area. Nigel, shall we give the first to Wadham? Have we got a microphone here? Financial Controller, Wadham Downing, on IFRS.

A - Wadham Downing {BIO 17627522 <GO>}

Yes, we've been very closely engaged with both the Standards Board through directly. But also through CFO forum and ABI. We made some good progress, we believe, in terms of the discount rates.

Transition, which I think you were leading to, is probably a long way off and hasn't been discussed in any great detail. But in terms of the progress we've made in the last 12 months, I think we're pleased to [ph] say it was quite positive.

A - Tim Breedon {BIO 3157585 <GO>}

Okay, the second one was on bulk Annuities pipeline, John?

A - John Pollock {BIO 6037447 <GO>}

Yes, every time we talk about this business we remind you it's lumpy. And now you're asking what's happening month on month, well, let me tell you it continues to be lumpy. We didn't quite close out GBP200 million; it was slightly under that, which means that we traded a few more small schemes. So far this year we've done 45 schemes, an average, slightly lower.

We are in continued discussions. We quote on pretty well everything that's available in the market. I am never able to tell you when schemes close. And we continue to exercise our appetite where we see it most appropriate for VIF [ph]. And profit. And returns.

So it continues to be lumpy; it will continue to be lumpy; we still maintain a strong appetite for this business.

A - Tim Breedon {BIO 3157585 <GO>}

About the last one, Nigel?

A - Nigel Wilson {BIO 1535703 <GO>}

In part, we've done a number of sale and leaseback transactions in recent months, which have been quite substantial, generating a pretty high margin on those. And in some places we've substituted a corporate exposure with a sale and leaseback exposure, which has given us a pretty substantial yield pick up. And that's been a significant contributor to the improvement in yields.

A - Tim Breedon {BIO 3157585 <GO>}

(inaudible) I think that would be quite a good one for the second session which we're running, which is answering technical questions in the afternoon. Rather than reach for numbers that we don't actually have available here, could we just take your question and give you an email response, which will be available for everybody, by first thing tomorrow morning? If that's all right. And is that okay?

Q - Andy Hughes {BIO 15036395 <GO>}

Yes. Just to follow up on the Solvency II question, is it -- are you actually pushing for the grandfathering or not, I guess my question was on Solvency II?

A - Tim Breedon {BIO 3157585 <GO>}

Grandfathering, in which respects? (multiple speakers). There are a lot of elements there. If you read the Vance [ph] report, there are a lot of elements where transitioning was mentioned, or is being mentioned at the moment. Are you particularly concerned on the Annuities side, or elsewhere?

Q - Andy Hughes {BIO 15036395 <GO>}

Yes, on the Annuities side.

A - Tim Breedon {BIO 3157585 <GO>}

On matching premium, provided the correct matching premium basis, which is -- has wide support, not just within the UK, we're able to deliver at, I imagine that transitional arrangements will not be required for the Annuities back book.

Q - Duncan Russell {BIO 15944951 <GO>}

Two questions. On the dividend, the -- you didn't really make any progress on the pay out ratio half year on half year, it's still about 22%. And if you look at it another way you're paying out GBP97 million, you've got International cash flow of GBP55 million, which is basically dividends upstreamed. And the investment management profit was GBP91 million. So you could make the argument you're not paying out any of the insurance earnings. And I'm just wondering, are you trying to tell us something about the insurance earnings here? Or is there another reason for that? So if the coverage -- 2 times coverage, is that based on the insurance earnings coming down or them going up?

Second question then is on the cash and capital changes you did. You've -- a couple of one's here. You said that you're now doing a normalized return on equities in the cash and capital. And if you look at the investment term, which I think was about GBP100 million, that's equivalent to about a 7% pre-tax return on the average invested assets; only about 20% of the assets are in equity so just again, I guess linked to Andy's question, how are you achieving that return?

You make the statement that you've now aligned your equity assumptions with other assumptions. So does that mean for bonds and cash you assumed a normalized investment term there as well? And if so, what would that be?

And then on the equities, you've got quite a large part of those equities being level two. And those doubled in the half year. And in the statement it says that there wasn't any change in allocation. So you've had a revaluation on that. So just wondering what that was. Thanks.

A - Tim Breedon {BIO 3157585 <GO>}

Okay, the first one was on dividend. 25% increase in the dividend, movement towards 2 times cash coverage, I think that's all we're trying to say. There's a lot of cash. And there's a lot of growth in the dividend. We're not trying to say anything else.

Regarding rebalancing the interim. And the finals in this case, there's no specific allowance for rebalancing incorporated into the interim dividend that we're announcing today.

The final dividend will be determined next year, taking into account our cash flow, our performance, the business environment at the time. Hopefully, some of the macroeconomic market and regulatory uncertainty will have receded by then and we'll be able to proceed more quickly to our 2 times cash coverage target. And possibly, as I say, beyond.

So nothing in particular regarding the rebalance of the interim dividend this time round.

The next one was on cash and -- I think the remaining ones are yours, Nigel.

A - Nigel Wilson {BIO 1535703 <GO>}

There's a mixture of equity return, which is about 7.5%/8%; and bond returns, property returns, which are 6% to 7%; and some cash returns, which are typically around about 4%. That comes out as a mixture of -- to get you to the 6.8% and 3.4%; 3.4% in the first half.

Quite what it will be in the second half, if I was to make an estimate given on where we are at the moment, I suspect that would be a lower number in the second half than the 3.4% that we achieved in the first half. And it's just a mechanistic calculation that takes place.

Q - Jon Hocking {BIO 2163183 <GO>}

I've got three questions, please. Firstly, can you comment on what gilt yields, at 275, do to your with profits capital?

Secondly, you've got quite a high equity allocation in shareholders' funds, I notice, you've got GBP1 billion or so of equity in the central funds, is that hedged? Is that a sense [ph] of allocation where you're putting new cash at the moment?

And then finally, can you just give us a little bit of an insight into what the fees to funds are for the various buckets, LGIM? What's the LDI fees to funds? What's UK equity? What's International?

A - Tim Breedon {BIO 3157585 <GO>}

Sorry, can you repeat that one?

Q - Jon Hocking {BIO 2163183 <GO>}

Just the fees to funds within the various buckets; LGIM, LDI, International.

A - Tim Breedon {BIO 3157585 <GO>}

Will you do the first one? I'll do the second one and the third. Equity, no; we think it's prudent allocation of equity. They're not hedged.

Secondly is the fee to fund; commercially sensitive, I can't give you that data.

A - Nigel Wilson {BIO 1535703 <GO>}

What's the first one, Jon?

Q - Jon Hocking {BIO 2163183 <GO>}

Just what gilt yields, at 275, do for the with-profits capital.

A - Nigel Wilson {BIO 1535703 <GO>}

Gilt yields, off the top of my head I wouldn't know the answer to that; could try to get it [ph] the technical call.

A - Tim Breedon {BIO 3157585 <GO>}

Okay, move on.

Q - Toby Langley {BIO 15924432 <GO>}

I've got three questions. You beat on the IFRS profits and on cash in a big way was driven by the capital generation and financing line. And that's a function of the fact that you've got an awful lot more of surplus capital at the center, which is also having quite a significant impact on your ROE; that fell 400 basis points year on year. What kind of ROE are you looking to? And how are you going to tackle that if it continues to decline?

The second question is why was the non-insured Savings performance not better year on year? The AUM grew, operating profits weren't ratcheted [ph] down I think.

And then the third question is on the auto enrolment opportunity. Can you give us some sense as to how you're sizing that market now? How many people do you think are going to be picked up by auto enrolment? What level of annual contribution do you think the market's going to benefit from? Thank you.

A - Tim Breedon {BIO 3157585 <GO>}

Well, the second two are for Mark. I'll do the first one, which is on, yes, we're generating a lot of capital. And we're holding onto some of that capital, for the reasons which I described; uncertainty and opportunity. We hope those levels of uncertainty will recede.

At this point, it will enable us to move more quickly towards a 2 times coverage of the dividend going forward; hopefully, leading to a significant dividend growth.

Secondly, we hope to address the IFRS return on equity by making more money with the capital that we've got. And significant opportunities there arise.

I think the return on capital is healthy, in the mid teens at the moment. And I personally have no particular issues with the return on capital at this level, given the strength of the balance sheet, which we feel it is prudent to carry. But those issues are definitely the ones which are in the Board's mind and in management's mind going forward.

The others are for you, Mark.

A - Mark Gregory {BIO 15486337 <GO>}

Okay, dealing with the Savings Investments' results, first, you're quite right, Toby; clearly, we are fractionally down year on year, both in terms of cash and operating profit.

All I would say is underlying that we are definitely making progress. The truth is we have invested money in the first half. And we have expensed that strictly against cash and P&L. So -- and we're investing now for future efficiency or growth. So very content the end line results showing further progress in the Savings Investments line because that's a clear key area for our progression going forwards.

On auto enrolment, we're obviously very excited about the prospects in this space, not just around auto enrolment, just around some of the things that Tim outlined earlier. The whole move from DB to DC seems to be happening in large scale now. And our house view is that we will see, probably by the end of this decade, probably a tripling of the assets held in DC funds; up to somewhere near GBP1 trillion is what we're expecting by the end of this decade.

In terms of annual contributions within that, again, we hope there'll be a several billion increase in the level of contributions. Contributions are probably about GBP10 billion or GBP11 billion per annum, we think, across the sector currently; I would expect that to go up by at least 50% over that same time period.

Again, that's a lot to do with the big effects that play here, particularly around we see DB to DC being a key player, as well as large pick up in the number of people saving via the auto enrolment legislation. So we're very positive on the increase in this market base over the next 10 years. Hence, we're pushing hard to succeed in this space.

Q - Greig Paterson

The first one is -- as I say, three questions. One is could you just quantify the uplift in the net cash generation from including smooth gains? In other words, changing the definition of your cash.

The second thing is there was GBP48 million negative variance in mortality and no assumption change, I was wondering to what extent that is one-off. Or can we expect some kind of assumption change -- sorry, there was aGBP48 million variance, can we expect some assumption change towards the end of the year?

And the final one is an update on the US restructuring. First of all, when can we expect some money to be transferred back to the center? If I'm not mistaken, you've done two phases and there hasn't been a big transfer.

And the second thing is I was wondering if you could give us some color on what the -- you said there was going to be a whole bunch of other phases of restructuring. But I note the XXX debt is pretty low now outstanding. So I was wondering where the opportunities were. And if you can give us some examples there for the other phases.

A - Tim Breedon {BIO 3157585 <GO>}

Thanks, Greig. Good questions. I'll get John to answer the one on mortality because it generally and mostly refers to the Group Protection business; get Nigel to think about the answers on the quantifying the impact of net cash and on the US restructuring program.

A - John Pollock {BIO 6037447 <GO>}

I'll pick up mortality first then, Greig. Do we expect it to translate into assumptions, not necessarily. What we have seen is a relatively small number of very high value claims coming through in the Group Protection life book. There you will be aware that it's 4 times typically a multiple of salary that is insured. And we have seen an increase this year in those claims coming through. One would hope that that would revert to norm.

A - Nigel Wilson {BIO 1535703 <GO>}

On the first question, Greig, the answer's GBP18 million.

On the third question, we've done some modest things in H2 which resulted in a bit of capital being returned to the UK, which was capital that we already had effectively in the hopper.

The next two schemes we're working on, we're in discussion with the regulators on the second scheme and we would hope, subject to various regulatory discussions, that we'll get the second scheme approved sometime in the second half of the year. I think we announced the first one in about March/February of this year. And we expect each one to take six to nine months to complete.

We still plan to do five or six of these schemes. They're all reasonably complicated, require a lot of regulatory approval, in both the UK and the US. And the various approvals across both the US and the UK to some of the changes that we made. So we are making acceptable progress. It's probably not as speedy as I personally would like. But we have to recognize that we have a lot of regulators to keep happy.

Q - Greig Paterson

(inaudible).

A - Nigel Wilson {BIO 1535703 <GO>}

No, each one's different. I'm not sure whether we we're going to do two or three, it will be actually the first one. But the schemes two and schemes three are totally different; each one is unique.

As you rightly point out, we've done a lot of the external ones. There's only one other big external XXX that we could do the same type of structure on. And that's -- we may look at that maybe four, five, or six when we actually come to solve that particular one.

Q - Gordon Aitken {BIO 3846728 <GO>}

Just on the cash generation, you talked about it being more balanced, given a lower proportion coming from annuities, you -- looking forward, I think you see significant expected growth on the retail side. And also on the bulk side. At what point would you be uncomfortable with your annuity exposure? That's the first question.

Second question is co-funds. You have a 25% share in that business, how optimal is that? And what are the pros and cons of being a part owner?

A - Tim Breedon {BIO 3157585 <GO>}

The first one, the scale of the Annuities business, broadly, we don't look at the Annuities business as a kind of market share gain at all.

What we have is we set a risk appetite for this business, taking into account many factors, insurance risk, the balance of the Group. And we aim to satisfy that risk appetite year by year by year. So we're looking to maximize return on economic capital for given risk appetite. And it's a very positive way of looking at it. It enables us to diversify our assumptions across -- business across vintages of assumptions.

As more information from our back book and elsewhere comes about mortality, we can incorporate it. As investment conditions change, we can incorporate those regulatory requirements change. We can incorporate that.

So, broadly, just trying to keep maximized return on economic capital for a given target level, which is set at the beginning of the year. And that is not either increasing or decreasing over the period. So hopefully, it'll give you the answer on that one.

In terms of the ratio, clearly, the more we can grow the other businesses. And we're doing pretty well, I might add, in that area, that issue about balance goes away.

Co-funds, Mark?

A - Mark Gregory {BIO 15486337 <GO>}

Gordon, clearly we've been an investor in co-funds now for six years or so and we've had our roughly 25% equity holding during that time.

It's just worth bearing in mind, clearly, our relationship with the co-funds sits on two levels; one is the equity stake that you referred to; the secondly obviously gives us trading distribution capabilities as well. And we're very content with that debt exposure.

So we have our products on the co-funds platform, being our underlying funds as well as our RAFT [ph] life and pensions products. And they're also -- they provide a bench line technology of our own IPS platform, which we use to market into the banks and building societies' space. So, as I say, we're very content with our holding in co-funds. And it is profitable, unlike many platforms.

Q - Raghu Hariharan {BIO 15133573 <GO>}

Three questions, please, if I may. The first thing is on your back book diluting margins, these have gone from 117 bps to 100 bps. I guess there is nothing about new business strain here. So I was wondering what's driving that. And I don't see any negative results in changing NAV for investment returns.

The second one was on Group Capital and Financing. What was the actual cash that was made, because the operating cash number is obviously an accounts tech number, as Nigel said? I was wondering what are the actual returns that you guys actually made in one half.

The third one was, according to Nigel you made, which was -- you said the ICA was higher that your IGD surplus, does the ICA include the -- are you talking for the full business, including Annuities as well? If you could give us color if there's been change in methodologies, or something you've done around your book that makes the ICA larger than the IGD, please. Thanks.

A - Tim Breedon {BIO 3157585 <GO>}

Talk about the -- I think the back book is, I Raghu, a mechanical calculation. I think the easiest thing, rather than talk, it's simply the earned return divided by the market value of assets. And the market value of assets changes when spreads change and yields change.

It's really just to give an indication of what the -- to put it into kind of bank speak, to give you an indication of the net interest margin, which we're taking for this kind of business.

Can I -- can we come back? If you give us that question by email and we'll come back and give you an exact answer on how we calculate that number. But it hasn't been affected by any actions which have been taken.

Group Capital and Financing is going to be answered by Nigel.

The last question was the --?

Q - Raghu Hariharan {BIO 15133573 <GO>}

ICA.

A - Tim Breedon {BIO 3157585 <GO>}

ICA, no, nothing's changed. This has been the case for a very long time.

A - Nigel Wilson {BIO 1535703 <GO>}

I think the calculation you can do from the data that we give you in the pack. Because there's a negative investment variance of about 47 from the actual experience. So that number's in the pack somewhere. So if you subtract that off the other numbers you'll get the actual return that was made.

Q - Oliver Steel {BIO 6068696 <GO>}

Two linked questions. The issue of the investment return that you're assuming on the Group capital has been asked before. But given that it's going to become an increasingly important number, on the basis you're adding to that every half year, can you talk a bit more about where you are expecting to invest new money? And, therefore, give a bit more detail on how you're mechanistic calculation will change going forwards?

And then linked to that, can you confirm that this new methodology for calculating your cash flow will also stream into the dividend calculation?

A - Nigel Wilson {BIO 1535703 <GO>}

The second is obviously, yes.

And on the first, that is dependent on the advice that we get from our fund managers, LGIM. This isn't a decision that's made without recognition of what's going on in the world. And there isn't a mechanistic formula that decides we'll put X% in any particular asset class.

Clearly, under the current circumstances, we like having a very strong balance sheet, we like having a lot of liquidity. But it's not a decision that's taken by Tim and myself in isolation; we have a wide level of engagement with our LGIM colleagues.

Q - Blair Stewart {BIO 4191309 <GO>}

A couple of questions to pick up on. Just on that Group Protection issue, assuming that it's not a blip, do you have the ability to re-price to reflect the higher severity of the claim?

And then you're going onto Solvency II again, is your expectation that you'll have sufficient clarity, when you come up and speak to us in six months' time, to talk definitively about the balance sheet? Because I'd imagine that maybe 5% of the details on Solvency II will be known. And the extra 5% is not going to be a difference between life and death. I would certainly hope that's the case.

And then, Tim, you talked a lot about opportunity, should we assume that, that opportunity is going to organic, or not?

A - Tim Breedon {BIO 3157585 <GO>}

Sure, Group Protection, yes, these contracts can be re-priced as short-term contracts.

Solvency II, you're optimistic, I think. I think the -- I think it's longer, you're optimistic. I think clarity will emerge over a longer period. I think probably into the beginning of the next year before we have any sense of something we can plan on.

The third one was on organic or non-organic. As you know, we've got lots of growth; it's organic growth. We've got lots of opportunities. We take the view that our strategy does not require M&A for us to be able to achieve our objectives.

Clearly, if there are bolt-on acquisitions out there which would accelerate the -- would increase the opportunity, or accelerate our ability to reach our objectives, we'd certainly look at them.

Q - Blair Stewart {BIO 4191309 <GO>}

Just to come back on that Solvency II issue, I'd imagine that by the time you report your full-year numbers then a lot of the technical specification will be known.

A - Tim Breedon {BIO 3157585 <GO>}

Not so.

Q - Blair Stewart {BIO 4191309 <GO>}

No? So it's not even a question of thinking about how volatile the numbers are going to be. Do you think other companies will have the same approach as you in terms of -- can you afford to wait another year/18 months before you start getting positive messages on the balance sheet?

A - Tim Breedon {BIO 3157585 <GO>}

As I mentioned, the effective start up date looks like moving back anyway. So there is a definitely a year's soft transition, or hard movement going on there, which gives everybody more time to create more uncertainty and change and make fewer decisions, which company managements can plan on. This is why the uncertainty is unhelpful and it is expensive.

I would like the certainty. But not as optimistic as you are regarding where we're going to get it. I'm sorry about that.

Q - Andrew Crean {BIO 16513202 <GO>}

A couple of questions. I just want to follow up on that. When will we get certainty? Because you've got a ballooning balance sheet, you've got more and more cash coming into the center, your IGD surplus is ballooning, you're aiming for a dividend cover of 2 times, which means that you will still be pushing a vast amount of cash into your balance sheet to make 6%-odd return, which, as Toby says, will drive down the ROE.

There's got to be a point at which you come off the fence and say, okay, we think we know what the new situation is, the new capital is. And, therefore, we can pay a different dividend and we can look at our capital structure. When is that point?

A - Tim Breedon {BIO 3157585 <GO>}

I wish I knew exactly when it is. But you're absolutely right; two things are going on. Certainty hopefully is increasing, that's one factor; the other is the balance sheet is getting stronger and stronger. It's the interplay between those two factors.

And we're very cognizant of the fact that uncertainty is not good, having a balance sheet which is over strong in respect of the risks and opportunities we see is also not good. So we're working hard to try and develop certainty.

Obviously, the balance sheet strengthening is proceeding, I guess, with more pace than the certainty over regulatory and market, particularly market, conditions at the moment. So this balancing will have to be done. But we're very aware of it. And we will certainly be making -- forming judgments before we meet you next time.

Q - Andrew Crean {BIO 16513202 <GO>}

The second question I had was on new Group pension schemes. And once you take out the direct costs of putting them on the book what is the basis point margins which you get, on average, on new schemes?

A - Mark Gregory {BIO 15486337 <GO>}

We're not going to give away our absolute pension basis [ph] because that's confidential information. But we don't play, for example, in the commission part of the Group pensions market. So roughly half the market Company is still being approached via [ph] our commission receiving EBCs and IFAs. And we're consciously at this time, in fact the last three or four years, of deciding not to play in that space.

So at least from our point of view we have on the face of it a lower net income because we're not having to recover commission. But clearly that does open up a much wider opportunity when RDR bites. And those same EBCs get caught by the commission ban at the start of 2013.

But we're very content with the -- we've got our cost base under very tight control now. We've got significant operational leverage in our model. So we're able to operate at a point where actually we think we can be very competitive in pricing terms. We've got a very good product offering out there.

So, net-net, we're very content with the returns we think we can get from our pensions business. And that's before we think about the linkage into the annuity book, which clearly we don't put into our pricing or embedded value numbers.

Q - Andrew Crean {BIO 16513202 <GO>}

So put another way, is NESS [ph] going to turn out to be the high-cost provider in this market?

A - Mark Gregory {BIO 15486337 <GO>}

I think for a certain segment of the market it'll look a very attractive player. So I think for the smaller schemes, the micro-employers [ph] in the UK, then I'm sure that'll look like a very attractive proposition. I guess it's fair to say that for the larger employers we're trying very hard to make sure that the private providers look like a much better bet than NESS. And I think we're generally winning that argument at this point in time.

Q - Marcus Barnard {BIO 2103471 <GO>}

I know it's early days but can you say what effect you think PS-1109 is likely to have on your business. And on the industry in general? In particular, could you give us some idea of the level of rebates that you receive at co-funds? And do you pay rebates from L&G -- LGIM? Can you just tell us what sort of impact that could have on LGIM's profitability if it doesn't pay them?

A - Tim Breedon {BIO 3157585 <GO>}

I'll give the first question to Mark. LGIM institutional fund manager, unaffected.

A - Mark Gregory {BIO 15486337 <GO>}

Clearly, our unit trust business does pay rebates to platform operators where we have our firms [ph] on those platforms. So I think I need to work out the exact number; not sure if we can give it away anyway. But if we can give it we'll do it via the email process.

More generally on PS-1109, which clearly its came out on Monday, the FSA's latest thinking on how platforms will get remunerated going forward, I guess we're a little frustrated that it's put the issue a bit into the long grass. Clearly, we're going to keep the current regime beyond the start of RDR now, whereby the cash rebates and bundled pricing can continue.

But, clearly, the FSA has said it is minded to ban bundle pricing and cash rebates from product and fund providers to platforms. But we don't yet know when that's going to happen. So I guess clearly in the short term we're concerned about the planning malaise that might create because it won't be before the start of 2013. Well, let's say it's '14, it may be now literally 18 months or so to actually do it, then suddenly you're into 2016 and beyond, which clearly is quite a long way away from where we are today, therefore, we think that might actually hit in practice.

My candid view on this is, Marcus, actually, at the end of the day, I think if we're offering services and national [ph] platforms which (inaudible) which customers think are good value then they should be prepared to pay for them. So I'm fairly agnostic as to whether we live in a bundled pricing regime or an unbundled pricing regime.

And I think our view is that both our platform exposures, whether it be our IPS platform or co-funds, are at the high volume end of the market. And we think that will look like a very good price point compared to some of the mutual functionality high-end rat [ph] platforms that are out there.

Q - Tony Silverman {BIO 2162363 <GO>}

I just wanted to ask just two questions. One was on the new slide 22, modeling the VIF, where I can see for the Group as a whole the undiscounted VIF, the new column in that slide, from the undiscounted VIF from new business is broadly offset by the release from the existing business. And in general terms that would be taken as suggesting a group that's actually struggling to obtain underlying growth. So I wondered if you could say how you think that balance between those two numbers will go in the future.

The second question was to do with the Risk business, it's on page 33. But note 201E. I know you're probably going to say you'll send it to me in an email. But I think this is a question worth answering, if you can.

There is a persistent negative deferred tax item, which is in operating profits, which has been offset by the valuation broadly -- very broadly offset by the valuation change, positive, which may not be reliable -- so durable [ph] shall we say, going forward. And I was wondering if you could just remind us what those deferred tax negatives are. And if they are likely to persist in the future.

A - Nigel Wilson {BIO 1535703 <GO>}

I think the first one is, you're right in that the balance of the VIF -- undiscounted VIF is about an equilibrium. It's reflecting the amount of new business value that we're creating, which is about GBP300 million per annum, which is equivalent to what's being moved off the back book. And this has been edging up over time. Second half performance will depend on John's Annuities business and delivering on the volumes and margins of that business.

Over time, we've seen both the undiscounted and the discounted VIF just gradually creeping upwards, not by huge amounts, in part because we've been growing the business massively in the LGIM area and a large part in Mark's area, particularly in the unit trusts, which don't come into that calculation. Hence, slide 23, which is just trying to highlight the fact that we're creating a lot of value outside of the insurance business and generating a lot of cash outside of the classic insurance business.

The second one, you're also right; we've got this deferred tax asset that we're writing off over a number of years. We thought it originally ran out in 2012; we now calculate it will run out probably in 2013. The amount shown there in the first half year will probably be repeated in the second half year. And similar numbers for next year. And it will disappear probably sometime in 2013.

Q - Toby Langley {BIO 15924432 <GO>}

I've got a follow-up question to Blair and Andrew's point. Asked a different way, if we were to remove the two lower of the faux [ph] Olympic rings. And we were to paint the scenario where the current uncertainties are removed, can you only reward shareholders for their impatience through the dividend? Or would you consider rewarding them in different ways? Or should you rule that out given the experience of the previous buyback?

A - Tim Breedon {BIO 3157585 <GO>}

No, you shouldn't rule it out. But it's not something for today. Yes, if the uncertainties were removed, the balance sheet looks very healthy indeed.

Q - Toby Langley {BIO 15924432 <GO>}

Thank you.

A - Tim Breedon {BIO 3157585 <GO>}

With that, thank you very much, indeed.

Operator

Thank you for joining today's call, ladies and gentlemen. If you would like to hear any part of this conference again, a recording will be available shortly. Thank you. And have a pleasant day.