Acquisition of Annuity Portfolio from Aegon by Legal & General Group Plc Call

Company Participants

- Kerrigan Procter
- Mark J. Gregory

Other Participants

- Andrew J. Crean
- Andrew Sinclair
- Andy Hughes
- Colm Kelly
- Gordon Aitken
- Greig N. Paterson
- Jon M. Hocking

MANAGEMENT DISCUSSION SECTION

Operator

Good afternoon, ladies and gentlemen, and welcome to Legal & General Acquisition of £3 billion U.K. Annuity Portfolio from Aegon. My name is Danielle, and I'll be your operator on today's call. Can I please remind you that this call is not for journalists and any journalist should disconnect now?

I'll now hand over to your host, Mark Gregory, to begin. Mark, please go ahead.

Mark J. Gregory {BIO 15486337 <GO>}

Thank you, and thank you for joining us this afternoon. I know a lot of you had a busy day today, the Standard Life event, so thank you for joining us after that.

So what we're going to cover, we're going to cover a few-ish, give a little bit more detail on the transaction we've announced today in respect of the Scottish Equitable back-book. And then, I'm joined here with Kerrigan Procter as well. And Kerrigan will take you through some of the wider dynamics going on in the annuity market as we speak and how we seek to take advantage of that.

Now, I hope you should have access to a set of slides we just made available on our website. So I will verbally refer to which slide I'm talking to. If you haven't got access, you need to find so very quickly because obviously that will help to navigate the way through the presentation. At the end of that, we'll obviously take questions in the normal way. As we come to that, I'd like to keep it restricted to this transaction and annuity rather than getting on to generic questions. So basically, if you'd like to ask other things, if we can keep today's focus, I will be grateful. Thank you.

Right. So talking to slide two. First, in the pack we just sent out, this gives a little bit more detail on the actual transaction we've announced. So to get to some precise numbers out there to clear any ambiguity, so the actual premium paid, obviously, which we agreed yesterday, was £2.93 billion. So when we talk about £3 billion, for those of who like precision, the real number was £2.93 billion, the ultimate premium paid.

These are all of annuitants in payment, so this was business sold by Aegon, individual business sold by Aegon primarily between the years 2007 and 2010, all the incidents at that point in time. So, the average age on this book is between 70 and 71. So just a little bit more color there in terms of the shape of the liabilities we've taken on.

As we've made clear in our press release and RNS this morning, this is originally by way of a reinsurance contract with Aegon, but we are both parties looking to do a Part VII transfer into the Legal & General Life in due course. So clearly, that does need regulatory and court approval, so we can't presuppose that. But that is definitely the long-term goal that both parties are moving towards. At that point, it will cease to be a reinsurance contract, and we'll take overall the administration of the annuitants at that point in time.

In terms of the pricing of the deal - and, clearly, we're not give away exactly kind of how we priced it from our perspective, but it's fair to say that all our discipline in pricing remains intact. As you know, we have a required hurdle rate where we put capital risk in the annuity market, and this still has certainly met those hurdle rates. So we're not going to get drawn anymore in terms of the exact dynamics and financial deals, simply say that we have at least met our required hurdle rates where we put capital at risk.

Obviously, a little bit more color today in terms of the actual Solvency II dynamics. Couple of things to say there, that the PRA have granted that we can use transitional relief for the risk margin that's set up as a result of this, taken this onboard, so effectively have something akin to kind of pre-Solvency II dynamics in that regard. The risk margin that has been - has been mitigated by the fact we are allowed to create a transitional in respect to this business.

As a result of that, the net surplus strain - I've used the word surplus, so this is a combination of our own funds going up as well as an increase in the Solvency capital requirement. But then, net of those two is an increase - sorry, essentially a decrease in our surplus by £50 million, i.e., the SCR requirement for this deal is £50 million higher than the boost to own funds that it creates. And that calculation by gross in both the numerator in our coverage ratio and our denominator means that it will result in an approximate reduction of 3 percentage points in our coverage ratio as a result.

In terms of kind of wider strategy, I'll let Kerrigan cover this off a little more. But we have been talking about back-book consolidations as one of our nine sources of profits for quite some time. And without getting too excited, there is a mighty back-book of individual annuinants in the UK, which we estimate to be about £100 billion. And that's not to say, for a second, that's all going to come to market. But nevertheless, it does give some indication that there's significant books out there. And so, I think most businesses now are taking the view on whether they want to be in this market or not going forward. So I think Solvency II has created that need for people to clarify in their own minds. Well, that's a key part of that strategy going forwards or not.

And clearly, as well as this one today, we will point to the Lucida deal back in 2013, the £1.4 billion that we took onboard there and, again, a very smooth integration, which worked very well. So again, we believe now exceptional track record in terms of these back-book consolidations.

So much to say on slide two. So moving then to slide three. Again, just a couple of other points fill up the slide three. This part is just to clarify some of the debates we had when we announced our prelims in March of this year. Just a bar chart on the left hand side here, just showing the Solvency coverage ratio, if we calculated it using what we call the peer method rather than the PRA method. And just to be absolutely clear, what we included there, all I've done is simply include the SCR and associated – and equivalent own funds associated with profit funds around £650 million, ultimately deducted that from both sides of the equation. I reduced that from the own funds and taken out of the SCR as well. What I've not done in our case is do the same thing for the circa £80 million of SCR and own funds associated with our in-house pension schemes. I've done – actually, my view is that though the scheme is in deficit, I don't think it holds intellectual logic to adjust the coverage ratio accordingly.

For those of you who want to have a good peer like-for-like with other people in our sector, this £80 million is the SCR associated with our pension scheme, so you can do the math for yourself. But to be very clear, the £175 million we're quoting here on what we call a peer basis only allows for the adjustment after the £650 million or circa £650 million of own funds and SCR associated with profits fund.

I've covered off the point around the impact of this transaction on our pro forma balance sheet. So I think at that point, I'll hand it over to Kerrigan to talk more generally through what's going in the market and L&G's success in that space.

Kerrigan Procter {BIO 15093363 <GO>}

Fantastic. Thank you, Mark. I think I'll just do a quick talk through why LGR has been a growth business and just reiterate our confidence that LGR will continue to be a growth business. Just on slide five, I've laid out some of the figures there, stories that you're familiar with, of course, but I thought it'd be handy to quote the figures all on one page. You can see the growth story in terms of op cash or net cash or our profit live on that page there. I think a really positive story, indeed. Just in terms of a little bit of detail in terms of the Q1 2016 figures on there, £410 million of bulk annuity business written. There was £550 million year-to-date in the press report. Once you add a couple of other deals and individual annuity business, you get to the £550 million year-to-date in total annuities.

Just moving onto slide six. We talk a lot bit about our nine sources of profit. I won't talk about this in any great length because that will take the time for the rest of the phone call. So I'll just quickly canter down the line there.

And I think we try to be helpful on the right hand side by saying how we think of this business in terms of capital usage. So a quick run down the line, back-book for cash. Seeing the size of our annuity portfolio, and we've said for the first time, we expect a growth of £10 billion of undiscounted cash over approximately the next 60 years. Very long runoff, but further on and in the press release, we've talked about in the order of £400 million per annum for the next five years of cash just from the back-book.

That's just prudent seeing they're already clearly, as we work hard on the assets and source, the source of direct investment in self-manufactured assets that we like and have started to grow, then I think there's further upside from that. The point there is we think that was very much like a Solvency I-like release rather than Solvency II because of this existence of transitional relief.

Further point, back book acquisition. So we talked about a £2.9 billion to £3 billion Aegon deal today. I'm sure there are further questions on that, so I'll come back to that later. But just to confirm, that's like the rest of the back-book that's Solvency I-like release, we think, because of the transitional relief.

I'll talk a bit in the future about UK capital-lite front book, but this is £1.8 trillion of defined benefit liabilities in the UK, and we're thoroughly and still enthused about that story. I'll talk a little bit about the U.S. pension risk transfer market which at £2.5 trillion, £2.6 trillion in terms of liabilities is also really interesting market to us.

Longevity insurance is another market that's been quiet recently, but we're still interested in that market and keen to participate helping our clients transfer their pension risk, we're in that market.

Lifetime mortgages, you can see that it's not only the £200 million written in 2015. The press release talked about £150 million written year-to-date in lifetime mortgages new loans in that market. So, that continues to be an additional growth story for us.

We have our global reinsurance hub, so L&GRe A-plus rated, Solvency II equivalence and now with registered reinsurer status in the Netherlands, and again we think that could be an interesting market for growth.

Individual annuities, clearly a market that shrunk a lot, but we see signs of industry consolidation actually leading to, being a little bit more constructive about that market. Clearly, it's not as big as some of the big bulk opportunities or back book opportunities, but again it's a constructive story.

Finish off with the secondary annuity market there. Well, I guess we'll wait and see. We're reasonably positive about that market. But I'm sure more will be talked about that in the months and quarters to come, so I won't say anything more about that here today.

I will touch upon on slide seven, the UK pension risk transfer opportunity. I think it's always interesting, there is a little pie chart at the bottom which shows that somewhat less than 10% of the UK defined benefit pension liabilities that transferred from pension schemes to the insurance sector. So there certainly is plenty of upsides there and plenty of demand from our defined benefit clients to exit their largely legacy pension schemes. And certainly, the messaging around challenges in the retail and steel sector, should we say, I'm sure will reinforce the wish of many people to pass on the risk of their defined benefit pension schemes.

I think there's something very similar going on in the U.S. As you know, we're now participating in the U.S. market, lots of interesting deals, potential pipeline there showed in figures, so £13.2 billion written in the market in 2015. From what we're seeing, it looks like a similar-sized pipeline or slightly bigger for 2016. So, I think a really interesting market. The difference between the U.S. market - many differences, many similarities. But one of the key differences is liabilities, pension benefits in the U.S., private sector pension benefits tend to be not inflation-linked. And so, their valuation seems to change in nominal rates, unlike the UK where most benefits are inflation-linked. Valuation is sensitive to real rates.

So, as we see the potential for that U.S. rate cycle shifting earlier than other markets and certainly nominal rate shifting, then the affordability of pension plans to buy out, we think, will increase. And so, we're keen to be in that market in the long term, but also I think there's some interest in the short term as well in that market.

One of the questions we get asked a lot about is longevity reinsurance, so I'll just touch upon that in slide nine. You saw some of these figures at the end of year results, I think. So, gross exposure of longevity risk on our back book run about £48.7 billion, and after reinsurance, our net exposure of £37.1 billion. And through doing that, we've got established relationships with about a dozen reinsurers and life deals with a subset of those, but it gives us direct access to the reinsurance market.

And I think more broadly, the morale to our clients needs a pension de-risking. We have a lot of skills that we bring to that. And I think behind this, there's a deep global pool of capital, not just back to those existing reinsurers, but more broadly, I've seen a lot of interest in talking to other participants who want to enter the market as a reinsurer in one form or another. So, I feel confident that there will be that deep global pool of capital to back those reinsurance relationships going forward.

In contrast, I've been talking quite a long while now, so I'll just finish off on slide 10, hop back to Mark for a few seconds and then open up to questions. But I just wanted to talk about what we think of as our USPs in the UK. We clearly have the most extensive UK client reach across the firm. There are 6,300 UK private sector schemes and 3,000 are already our clients. Also, we can uniquely offer clients all steps in pension REIT de-risking.

That could be diversification of assets, it could be LDI, it could be longevity reinsurance, it could be buy-in or buy-out or combinations of any of those. We're the only company that can do all those things.

I think the other thing that's important in the market is integrated asset management. So, when I think about this business, it is liability-driven investment in its purest form and we are, of course, leaders in liability-driven investment in the UK and very substantial of that in the U.S. market. You need a global fixed income capability and you need a real asset and self-manufacturing capabilities. You need to bring that together all at speed to deliver to the pace that clients want to work at.

On longevity management, we've had 29 years in the bulk market. That's given us seasoned longevity data and longevity expertise, and we have 25 people dedicated to research and analysis in the longevity space. I'd say rather than just longevity risks, longevity management, I think we're an attractive reinsurance counterparty. We think about our longevity expertise, diversified business, financial strength, balance sheet size, client reach and structuring skills. And I'm sure you can see that lots of reinsurers are keen to work with us as a preferred counterparty.

And the barriers to entry in the UK DB market are quite substantial. We have, over those 29 years, I think seen virtually every type of complex defined benefit pension there is, and we can administer all of them. But no simple task there.

And then, finally, I think through our brands and through our demonstration of deal execution, that pace of meeting with client's needs in various deals, clients can have competency and execution in working with us. So I think those are our USPs in the UK, and we are rapidly trying to recreate those in the U.S.

With which, I hand over to Mark.

Mark J. Gregory {BIO 15486337 <GO>}

Great. Thanks, Kerrigan. So, just to finish off that on slide 11 again, here just trying to help you a bit, just thinking about the future dynamics of the financials of this business that we have for today disclose the first time, if you like, the risk value in-force of our L&G Retirement business, which, based on year-end 2015, December 31, 2015, £5 billion on a discounted basis and £10 billion on an undiscounted basis. Not precise numbers, but close enough to give you a directional feel.

And is that undiscounted with which we would expect to flow through and feed the operational cash going on forward. As we said in our press release and indeed as we said in our introductory comments, we're expecting that to be of the order of £400 million per year for the next five years. But as Kerrigan said, that runs off over something like £60 million as in total. It does run down a bit over that time.

A couple of obvious points to add on top of that. That is based on some reasonably prudent assumptions based at year-end. We do think there's scope to augment that, particularly on the asset side, by sourcing more attractively priced direct investments, increasing our proportion of lifetime mortgages and that we just started that first time just over a year ago now. We reached £150 million so far in 2016 and have a target of £500 million for lifetime mortgages this year to add to the £200 million that we wrote last year.

Further upside, I mean, we still have reasonably cautious assumptions around the long-term default provisions. Again, we would expect some of that to do better than that in terms of how we incentivize our fund managers. So, again, we would hope on the credit side of the equation, we could do better than the depo allowances we allow for in our best estimates.

And clearly, the last effect is, as we augment with new, new business, so the graph at the bottom here, for example, will benefit from the £3.5 billion of annuities we've written so far this year. So that run-off there is purely based on the 31 December 2015 position sent, which we've written profitable business thereafter that will augment the expected release in the year subsequent to any new business that we write. So, again, that should also be a source of augmentation to this monetization profile which showed at the bottom of page 11.

I think with that, we wanted to get across in our presentational piece. At that point, I'll open up the call to any questions that you may have. Thank you.

Q&A

Operator

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

Q - Gordon Aitken {BIO 3846728 <GO>}

Hi. Thank you. First, three quick questions, please. First on strain. There's a very lower level of strain in this transaction 1.7%, quite a bit lower than I understand as usual in large DB bulks. Why is it lower? And is this something to do with the lack of competition at that very large end? Secondly, on just the mechanics of how this works on the asset side, I mean, how did the assets come across, is it cash, is it in-specie transfer, and for assets would you look to invest in?

And third, I mean, this back book has quite different characteristics to the £6 billion book that was bought by Rothesay, so it's quite a different book. This is open market. Why did you either win or choose to win this not the other? And is it something to do with the open market experience with the strain of being materially different on the other book? If you can comment on that. Thank you.

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

Right. Before I come back to you, Kerrigan sit next to me. I'll let Kerrigan answer all three, but if he gets stuck, I shall butt in.

A - Kerrigan Procter {BIO 15093363 <GO>}

Very good. Yeah. Gordon, I think on the first point, yes, it is an attractive strain and I think an attractive premium. We worked for long time with Aegon to make sure that we're both happy with the transaction and we're certainly happy with that premium that we charge.

Just in terms of the asset side. These are mostly coming across from Aegon in-specie that actually you can imagine later diversified book of mainly serving credits, mostly names that we were happy with, got a little bit of transitioning, but effectively, instantly, we have the credit spread risk that we wanted and interest rate risk that we wanted, because these were individual annuities. As such, no inflation risk in them.

So, they weren't pretty much hedged and they had pretty much dropped into the back book and it's working on getting some upside through increased allocation to self manufacture assets direct investment over the coming years. So, very familiar in-specie asset that's come across and leaves us with very, very little transition risk at all.

I think really important to talk about the different characteristics of this book and the longevity risk on this book. As Mark said, these were annuities sold in the open markets that Aegon many in the years 2007 to 2010, so individual annuities in that market.

Now, I think the important thing is that, this is clearly, this external open market option is clearly a market that we've been participating in strongly for many years and, indeed, we're participating in during that period. So we were able to compare the mortality, the experience, the characteristics of that book in huge detail against our own portfolio and really get to grips with the longevity risk thoroughly on that book of Aegon's.

And really you could only have done that if you were alive and very active in the external markets during that period. And so, clearly, if you think of the people who have might have been interested in the book and the people who are able to do that, that pretty much narrows down to, well, I think just one participant basically. So, we got very comfortable with that risk, but it would have been harder for people without that experience on back book to get comfortable with I think.

Q - Gordon Aitken {BIO 3846728 <GO>}

Thank you.

Operator

Our next question comes from Jon Hocking from Morgan Stanley. Jon, please go ahead.

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

Afternoon. Two questions, please. I wonder if you could elaborate a little bit on the hurdle rate for the VOE, so in line with sort of your usual hurdle rate. Are you loading the 150% Solvency II capital against this AA capital, how are you thinking philosophically about the capital loading?

And then, secondly, really, this is a transaction where you benefit from the transitionals. But on the go-forward basis, if you're going to do a chunky transaction in Solvency II world, where are the PRA sitting at the moment in terms of longevity reinsurance, obviously about motivations in terms of risk margin, et cetera? Do you think it's an opportunity to do some of the large deals with longevity reinsurance that don't benefit from transitionals? Thank you.

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

I'll pick up the first one on hurdle rate, perhaps let Kerrigan comment on generally the ease of longevity reinsurance and PRA's views on it. On the hurdle rate, Jon, I understand why you want to know. I think we have to take the view that is commercially-sensitive from outside. As I'm trying to reassure in the past, we do recognize this business is not without risk. We are deploying shareholder capital to back this business. Therefore we are very minded to achieve an appropriate return on that capital and I think I would say, it's an attractive return from a shareholder's perspective. But I'm not predicated away, Jon because that's the sort of thing which EBCs never rises in the market, then knew what our pricing base is once they would use that against us.

So, kind of just reassure you that we recognize this shareholder capital, we recognize this business is not without risk, and therefore we want to ensure we get an appropriate return for the risk we are taking. We do believe we can manage that risk very well and realize that into real profits, but I'm not prepared to give away our precise hurdle rate that we are trying to achieve.

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

Okay. Is the hurdle rate the same for annuities versus other business you might write across the group?

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

Yeah. So, the actual risk capital we set aside is actually is adjusted for the actual risk of each risk we take on. So, essentially, we have risky business that has a higher capital charge and vice versa. So, having got the right level of risk capital, we're assigning, then the hurdle rate for that risk capital remains the same. But clearly, the actual quantum of risk capital does vary based on the nature of the risk we're bringing on to our balance sheet.

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

Okay.

A - Kerrigan Procter {BIO 15093363 <GO>}

And, Jon, just on the other point, clearly I can't comment on private conversations with CRAs, so I guess you might – broader thoughts on that. What we're looking at here is, when we use longevity reinsurance, we're talking about genuine risk reduction. So, I think no surprise if genuine risk reduction leads to reduced risk-based capital, ISCR, and reduced risk margin and I don't think there's any particular strong objection to that.

And then in terms of counterparty risk, well, I think all parties, ourselves included, and I'm sure you, too, are keen to know that we have robust kind of party management in place. So we think a lot about due diligence, really the three Ds, it's due diligence, diversification of counterparties and daily collateral, and that's what we resolutely stick to. And I think all participants and all stakeholders agree that that's very sensible framework to work within. So, I don't think anybody's talking about anything surprising and left field genuine risk reduction and sensible counterparty management wins the day.

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

Okay. Thank you.

Operator

Our next question comes from Greig Paterson from KBW. Greig, please go ahead.

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

Hello, gentlemen.

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

Hello, Greig.

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

Good. Two questions. I mean, they've done this deal, how much economic value has been created and, i.e. what's the price? Now, you've dropped embedded value margin on the starter business going forward. I mean, how are we going to judge whether you've paid too much or too little or what the economic merits of those? I'd like your thoughts in that regard.

Second question is given the importance of the strong credit rating on your marketing message to trustees, what would enhance the appropriateness of say, AA S&P model? What would be that strain that we feel has resulted versus the £50 million on a Solvency I BBB basis?

And the third thing is one of your competitors told me recently that pricing and capacity by reinsurers to take on longevity risk has deteriorated for the primers like yourself recently. And is that the reason why you had decided not to un-sell some of the risk like you decided to last year on this particular deal?

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

Okay. Thanks, Greig. I'll pick up the first one and say a few words about the second one, perhaps let Kerrigan again talk about why we haven't, at this stage at least, reinsured any of the longevity on this transaction.

On the embedded value created by this deal, we clearly made a couple of points there. One, we haven't disclosed, and secondly, your point around about we clearly have – we are proposing to drop EV reporting going forwards.

I would say on that last point, to reassure you, we are working hard to think about giving the market a value-creation metric in a Solvency II world. I'm working hard to try and have that in a robust state for the half year. We do recognize it, some sense of value creation. It's an important metric and certainly one we think about a lot internally.

So provided that work gets to a robust enough state at that time we do our interims on the March 9 – sorry, not March, August 9. I would hopefully be able to give you some indication to which the new business we've written during the quarter and the reporting period has created value in a Solvency II world.

So that would look – that will have many consistencies with embedded value, but clearly we will factor in the cost of capital associated with Solvency II rather than S-I, which underpinned our EV disclosure. So we would try and help you by way of value creation.

On this particular deal, Greig...

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

(28:11) not going to drop embedded value. You're going to do is – embedded value...

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

For new business, we're working very hard for new business to give you some sense of a new business value-add, which is we won't be giving you, though, Greig, the full EV balance sheet with all the other features.

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

How do we judge the merits of the assumption fit if we don't have the detailed parameters?

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

As I said, Greig, we'll try and make sure it's as robust as possible, and if it's robust, we will make clearly make sure it's easy enough for you to interpret how we come up with that number. So that means divulging some of the underlying assumptions. We will do that as well.

The team is working very hard currently just to find the robust places for doing that for external reporting purposes, and that's certainly the ambition as we sit here today. So, I can't commit to it fully at this stage, but we will certainly try and help you understand. We understand the question you want to have answers. We will try and help you answer it come the half year and beyond that.

In terms of the importance of our credit rating to S&P and Moody models, et cetera. Now, clearly we haven't taken this deal precisely through them, but I would say in the overall scheme of things, you've seen the strain it creates from an IFRS perspective and the Solvency II perspective. In the overall scheme of things for this particular transaction, Greig, this is not the one that's going to create much of a delta between what we disclosed on our S-2 impact compared to how that will be interpreted by the credit rating agencies.

Now clearly, we're mindful of our credit rating, and we know it's a source of some competitive advantage to us and, therefore, we are cognizant of the impact it may have, but say this deal has got quite attractive commercials. So, we would not expect this to have any material impact on the way that the main credit agencies actually think about our balance sheet.

A - Kerrigan Procter {BIO 15093363 <GO>}

Yeah. I think, Greig, just on the longevity risk, well, I think a couple of things. Firstly, as I said earlier, we got ourselves very comfortable with the longevity risk on the scope, number one. Secondly and importantly, the existence of transitional relief removed some of the desire to remove that you see on the pure Solvency II business.

And really in the presence of those two things, it looks and feels just like a further part of our back book. As you can see from the slides, we've reinsured roughly 25% of our back book. It drops into the back book and we'll – we can choose which part of the back book that we want to reinsure in the future, but certainly no huge desire to necessarily reinsure large parts of the back book further from the 25% reinsurance we got. So really, the point is, it sits into the rest of the back book and we'll pick and choose which part of that we want to reinsure in the future, but no real incentives to reinsure that right now.

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

And there is pricing, what – I mean, do you recognize that point that the pricing has tightened a bit by the reinsurers? Does that make sense?

A - Kerrigan Procter {BIO 15093363 <GO>}

No. Obviously, we talked in the press release about a further £300 million ICI deal, 90% reinsurance on that. Pricing, absolutely fine. So, our evidence doesn't support that particularly.

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

And so, the £550 million, you've basically reinsured a good portion of that?

A - Kerrigan Procter {BIO 15093363 <GO>}

Yes, we have, particularly the £300 million ICI deal.

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

Not the individual stuff within that, Greig, just a bulk.

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

Yes. So I'm saying, of that £550 million, what sort of percentage must we think about as being reinsured, of the £550 million year-to-date you mentioned?

A - Kerrigan Procter {BIO 15093363 <GO>}

What I think about the £300 million ICI, 90% of that.

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

All right, cool. Thank you. Cheers.

Operator

Our next question comes from Andy Hughes from Macquarie. Andy, please go ahead.

Q - Andy Hughes {BIO 15036395 <GO>}

Hi, guys. I guess, I'm looking at the Aegon press release, which seems to have a bit more information than yours and I just want to ask you a couple of questions. So, if I take the £275 million Solvency II benefit and knock off your £50 million strain, does that give me the transitional, which is sort of £225 million?

And I guess, the second question is, their IFRS loss is £215 million on sale. Does that mean, assuming your IFRS base is similar, you're going to record an IFRS gain of £215 million on the other side?

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

Yeah. A couple of things I'd say to that, Andy. First of all, it's clear that they have their own model, been known in accounting, and therefore, you shouldn't assume just because it's the same risks and the same assets that it appears equivalent in our balance sheet. Clearly, we didn't give components on the Solvency II number, so commercials of £50 million surplus impact. Clearly, that is a combination, say, of own funds going up as well as the SCR going up.

Now, clearly, we've got our own internal model to calculate our SCR. Likewise, Aegon will have their own internal model and, likewise, we have our adjustments portfolio approved by the regulator. Again, the M&A treatment isn't uniform between different models. In the overall scheme of things to an order of magnitude, the numbers are not a million miles apart, but you shouldn't assume that just because they've released £275 million of capital, that means that we have an upside. The £275 million is equivalent number in our case. But in the overall dynamics to the balance sheet, as Gordon said in his question earlier, the strain here, net equates to about 1.7% of the total premium. And we're very content not being a good place to get the efficiency of our balance sheet, too, and is probably something we wouldn't should expect fully to achieve in every case, going forward.

In terms of their profit, they've – sorry, the losses they've announced on the transaction. Again, you shouldn't expect that to all come through our balance sheet in a year or so as some of that will be potential margin we set aside to be released in the future. Again, our number is not exactly the same as the £215 million. But even if it were to be, that wouldn't all be released in years there. The point is that we would set up potential margins and then release that through operating cash as they experience coming through in line with our best estimate. So that wouldn't be a year one profit release in our case, but we will see a benefit in the new business service but not to the level of £215 million.

Q - Andy Hughes {BIO 15036395 <GO>}

All right. I just wanted to check I understood the bit about transitional. So, obviously, they do ex transitional. So the £225 million was just, obviously, you said the strain is very low, but the strain is very low because of the transitional benefit. I was just wondering where the strain would be ex transitionals. Is it fair to add the £225 million back on to the strain ex transitionals?

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

No, no, not precisely. I feel, on your point, are our transitionals beneficial? Yes, they are. I'm not going to deny that. It's true. Because they say that the missing bit in the middle is all transitional is incorrect, as well, any transitionals either now or in our balance sheet more generally. So would love to give that away. But I would say, typically, it's beneficial to this transaction the fact that it comes with transitionals.

Q - Andy Hughes {BIO 15036395 <GO>}

Okay. Thank you.

Operator

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

Q - Colm Kelly {BIO 19140684 <GO>}

Hi. And thank you for taking my questions. Three questions, please. And I'm following up from Andy's question. Aegon indicated capital generational flips of about £30 million per annum – a decline of £30 million per annum. Again, is there a similar impact in magnitude for yourselves? And also, on the Solvency surplus and ratio, can you indicate whether or not there'll be an impact following the Part VII transfer, and that's the first question.

Second question, is there any co-funds and whether there's any provision within this deal for the transfer of co-funds in the opposite direction or any info you can give us to that? The third question is on US Bulks. And I'm mindful that I think last year in the 2015, industry number was around 300 cycle contracts for under $100 million, which is a supply chain you would have been operating in. Clearly, it takes time to develop a business in that market. But can you talk through some of the specific constraints that you're seeing in that market? Haven't seen you pick more of those contracts in 2015, please. Thank you.

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

Okay. Thanks, Colm. I'll get the first two questions and let Kerrigan talk about the US Bulk market. So I'm going to pick that perfectly. In terms of Aegon clearly, Aegon had given their impact on their IFRS capital releases, going forward. Again, I wanted to exactly to say no, how we've written business and we expect to be profitable going forward, yes, we have. So, in that sense, you can do your own analysis in terms how you think it might play out. In our case, we would have slightly different assumptions and, therefore, it will release profit in a slightly different way than what the way Aegon may have had in their numbers. But as I say, just to reassure you, we have written this business to be profitable for us, going forward. Therefore, we would expect a benefit coming through our cash indeed further down the P&L account, going forward.

In terms of any subsequent benefit through a Part VII transfer when that comes through from that point of view, I'm not sure we expect that to be near-term from our perspective. I suspect that Aegon having to hold some sort of counterparty risk capital against L&G, and clearly in our case, that isn't true. So our point of view is there may be some very small second order effects when it gets into our wider, long-term fund. But it really is second, so I wouldn't expect a second benefit when the Part VII transfer goes through. From a pure Solvency II perspective, there will be some cost benefits at that point that we have to do once reinsurance will fall away. But from a pure capital perspective, there won't be a subsequent benefit when the Part VII transfer materializes.

On the question about co-funds, obviously, a very cheeky question, Colm. So, as always, I'm going to no comment again in that regard and pass on the question. Sorry.

A - Kerrigan Procter {BIO 15093363 <GO>}

Yeah. Just on the U.S. bulk front, as you'll see, we closed our first smaller bulk deal, $65 million in the U.S. The way the U.S. cycle works, as some of you on the call may understand well, there tends to be less - fewer deals in the first half of the year and more of a flurry as you go into the third quarter and fourth quarter.

We are actively participating in bidding for quite a few bulk schemes in the U.S., certainly at the smaller end also. We have confidence in our longevity pricing. We have the asset management skills through LG managed cargo, of course. And you might say that we built our administration capability out of LGA banner in Maryland. So we're up and running, ready to go, going through safest available annuity, pricing competitively on these deals. Now, of course, we go into that mindful that we don't want to win every single deal that we go in upfront. So we're testing the water, finding out where the pricing lies, but really getting a good feel for where the market sits there, and pretty encouraged by what we see.

Q - Colm Kelly {BIO 19140684 <GO>}

Okay. Thank you very much. I appreciate that. That's useful.

Operator

Our final question comes from Andrew Sinclair from Bank of America Merrill Lynch. Andrew, please go ahead.

Q - Andrew Sinclair {BIO 17749036 <GO>}

Afternoon, everyone. Three quick questions, if that's okay. Firstly, you previously talked, I think, about £10 billion of bulk annuity transactions that you were currently quoting on. I just wonder where that number stands today. And does that include the Aegon transactions, both for the one that you've taken and the one that went through obviously and how much is outstanding?

And secondly, just wondering if you could give just a general comment on what you've seen with individual and bulk annuity pricing since the full year and since the introduction of Solvency II.

And thirdly, just wondered if you've got any comments on the potential recalibration of the risk margin. The PRA commentary seemed to suggest that they'd like to see that recalibrated. Just wondered if you had any commentary on what you've heard. Thanks.

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

Okay. Cheers, Andy. So I'll let Kerrigan talk to the first two, then I'll pick up on maybe, I think, we can say about the risk margin recalibration.

A - Kerrigan Procter {BIO 15093363 <GO>}

Fantastic. Yeah. So the £10 billion pipeline that we'd talked about, I mean, we think of pension risk transfer business in the round, so whether that's what I will call buy-ins, buyouts, longevity, UK, U.S., and I really think of those things together. Clearly, when we made that comment before that we were mindful of the Aegon deal. And what you see with this market is there's always a pipeline of large schemes looking to talk. Sometimes, those turn into deals this year and sometimes they turn into deals in the next couple of years and sometimes, they go away for a few years.

So I think there's – Aegon has a chunk out of the market, but it's still a very substantial pipeline that we're – that the market is looking at, not exclusively with us, but the market is looking at. So, yeah, I feel confident in the sorts of figures that we're talking about in the slice of £10 billion to £12 billion this year. That's certainly feasible, I think, in terms of the deals that are out there, somewhat depends on precise timing and conditions over the year. But yes, it's a strong market, strong client desire.

I think in terms of individual and bulk pricing, then there's been a little tightening of pricing, so maybe pension and pricing up a little bit; preferred pricing up a little bit, probably preferred pricing up a little bit more than pension and pricing. But from the client's perspective and, therefore, they're willing to transact, I think that's been completely outweighed by the widening of credit spreads, for example, over the year compared to last year and somewhat offset by the level of rates. But really when you think about it, this pricing difference that we're talking about is tiny compared to the swings in equity markets or interest rates or credit spreads So, no significant reaction from clients just to indicate a lack of desire to transact. And obviously, we transacted with last year. We did a big deal in 2014. They were there working with us, hitting their targets earlier this year.

Q - Andrew Sinclair {BIO 17749036 <GO>}

Can you just comment on the risk margin recalibration potential? I think it's fair to say there's been a lot of engagement with politicians and regulators around where the risk margin is being calibrated and the impact that is happening.

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

I think, generally, the acceptance of this probably something that needs to be done in due course. So all I would just comment, just caution is even with some following wins, this is enshrined in primary legislation in Europe and, therefore, it's kind of just quite difficult to kind of see a quick fix for our – I think that in due course we may well see a slightly better outcome than we have currently for the risk margin we have some quite ominous hardwired calibrations factored into the legislation.

But I wouldn't hold to it. I think, actually, that could well take note of (43:00) capital market review of 2018 or so to put that into a better place. We hope to find a solution to it before that. But I think in all likelihood and just to kind of manage investors' expectations, I think probably it will take a couple of years for that to come to fruition. And again, I can't kind of speculate on exactly what shape that might take.

But I think to say if there's an acceptance that perhaps that has been cut in the wrong place in terms of a calibration. So we would hope that would be beneficial, but exactly by how much and by when, I'm loath to get too much assurance on. But it is fair to say there is engagement going on in that regard as we speak.

Q - Andrew Sinclair {BIO 17749036 <GO>}

Very good. Thanks, gents.

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

Cheers, Andy.

Operator

We do have a final question from Andrew Crean from Autonomous. Andrew, please go ahead.

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

Afternoon, all. I just want to ask questions to how you see the market about annuities this year, whether it will be a second half orientation, particularly whether Brexit is something which is holding back transaction and whether your capacity to do deals is being constrained at all by this.

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

Okay. And I think...

A - Kerrigan Procter {BIO 15093363 <GO>}

Yeah, I didn't I didn't quite hear the last word of it.

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

Is our capacity for this year in any way constrained by the...

A - Kerrigan Procter {BIO 15093363 <GO>}

Okay. Yeah. Sorry. Great.

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

Exactly.

A - Kerrigan Procter {BIO 15093363 <GO>}

So, is the market for both of this year more of a second half market? Well, certainly, I mean, you've seen our update for the year in terms of Bulks. It's certainly - we had a flurry of deals December last year as you know that were probably brought forward with people wanting to get in before some Solvency II came in clearly made Q1 a little bit quite - briefly quiet. So, yeah, we'd expect more happening in H2.

The point about Brexit, I mean, the early point of that was Brexit is if you're worried about transition in the middle of the referendum, which probably you should be a little bit worried about in interest rates and FX during that transition, so that would need to be managed very tightly as it was, of course, with the Aegon deal that we just did. But it's very much a UK domestic run-off problem and New York global capital and UK insurance capital on the other side. So it's not a fundamental issue.

And in the context of these deals where a quarter is more like 25 years than three months than just a few weeks to the referendum is no time at all, and it won't - whichever result you get, it won't particularly upset that market.

And the final point in terms of capacity because of Ukraine, well, I think it's back to Mark's point, we have return on capital hurdle rates and if I bring up deals that look attractive enough for those rates and there's a positive desire to look at those deals.

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

Okay. Thank you.

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

Cheers, Andrew.

Operator

We have no further questions.

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

Okay. In that case, thank you very much for your interest. And I know that you'll be in touch. If you got any other questions into the IR team, and we'll try and get back to you in due course. But thanks for taking the time this afternoon. We appreciate it. Thank you.

Operator

Ladies and gentlemen, that concludes this afternoon's call. You may now disconnect your lines.