Q2 2016 Earnings Call

Company Participants

- Kerrigan Procter, MD, Legal & General Retirement
- Mark Gregory, Group CFO
- Mark Zinkula, CEO, LGIM
- Nigel Wilson, Group Chief Executive
- Paul Stanworth, MD, Legal & General Capital
- Simon Gadd, Chief Risk Officer

Other Participants

- Alan Devlin, Analyst
- Andrew Crean, Analyst
- Andy Hughes, Analyst
- Andy Sinclair, Analyst
- Ashik Musaddi, Analyst
- Gordon Aitken, Analyst
- Jon Hocking, Analyst
- Oliver Steel, Analyst
- Ravi Tanna, Analyst

Presentation

Nigel Wilson {BIO 1535703 <GO>}

Good morning, everyone. Welcome to our 2016 half-year results. And indeed, welcomed by a photograph of Manchester; one of the cities we are helping to regenerate.

For the UK to grow, it is essential that our great cities replicate the success of London. This includes not just Manchester. But also Leeds, Birmingham, Cardiff and, of course, Newcastle as well as Bristol, etc.

The usual disclaimers apply. (Conference Instructions).

I would like to take this opportunity to thank my colleagues, many of whom are in this room today; others are watching the live broadcast.

It is with great sadness that I tell you that Gene Gilbertson, our CEO of Legal & General America, passed away last month. Gene was an exceptional person; brave; bold;

courteous; intelligent and kind. I was privileged to call Gene a friend and a colleague. He made an immense contribution to our Firm in terms of his roles as CFO and CEO of LGA. And he will be missed by all of us.

This has been another terrific six months of delivery and performance, although as Andrew pointed out in his notes, a bit of a messy beat. But it was a beat all the same.

Net cash generation grew by 16% to GBP727 million; profit before tax, by 23% to GBP826 million; EPS, by 14% to 11.2p. ROE increased to 20.4%. Our Solvency II surplus was GBP5.3 billion; economic capital surplus was GBP8.1 billion; and our dividend of 4p represents 30% of last year's full-year dividend.

In full-year 2008, our net cash was GBP320 million. In the full year 2009, we'd rapidly increased this to GBP699 million. In the first half of 2016, we achieved GBP727 million.

This slide shows the growth in our core KPIs; net cash generation, DPS, EPS and ROE all demonstrate excellent growth.

The annual cash retained has been in the range of GBP413 million to GBP471 million. In the first half of 2016 alone, we retained GBP489 million of cash, despite increasing the dividend by 16%.

One of the results of our cash generation and the retention of cash is the large amount of low-yielding cash that's now in our businesses; GBP2.3 billion in LGC alone. Go on, Mr. Stanworth.

Improving our shareholder returns on this cash has to be one of our future objectives. This return issue sits alongside LGR improving its risk-adjusted returns on its GBP51 billion of assets which Kerrigan is discussing later in the presentation.

We have delivered excellent execution around our five key growth drivers. There were many significant achievements in all areas of our business. LGR's accelerated growth is outstanding. LGIM's DC expansion is impressive. LGC's CALA and Pemberton are powering forward. Our digital direct insurance sales are growing quicker than we expected. The capability of our teams is increasing; cross-divisional synergies are rising. Our execution is improving.

However, we can perform even better. LGIM can accelerate its growth in DC and indeed in Asia. And finally enter South America. LGR can accelerate its growth in its nine profit centers. LGC can deliver higher returns from its three lines of business. And indeed, insurance and savings can commercially digitalize their businesses, their business lines in particular, quicker.

The macro and demographic trends that support our business growth remain valid and probably even more relevant. A 20%-plus ROE is evidence of the successful execution of our strategy.

Whilst our shares did suffer due to the Brexit vote, our businesses didn't. Our balance sheet remains resilient. The credit agencies have reaffirmed our rating; S&P at AA-. They also upgraded our management and governance rating to strong. Well done to Simon Gadd and his team. Risks are being well managed, despite economic uncertainty, political complexity and market volatility.

I remain excited and enthusiastic about the new opportunities we have created to grow our businesses, including the global defined contribution pension market, UK infrastructure and international digital insurance.

We have a slightly different lineup today. As usual, I will be followed by Mark Gregory. However, Simon Gadd, our CRO; and Kerrigan Procter, our MD of LGR, will perform an entertaining and informative double act before again I sum up at the end. Mark?

Mark Gregory {BIO 15486337 <GO>}

Thanks, Nigel. I too would like to add my thanks to our colleagues for all their hard work in delivering the results you see before you today. But also to express my sadness at the recent premature death of Gene Gilbertson.

Nigel has given you the top-line figures. So I will now add some color around the divisional performances, as well as our capital position. I'll start with my usual slide, showing the key numbers in terms of stock of business, cash and earnings and the capital position.

It's been a positive period in terms of the stock of business. 18% growth in LGIM assets under management, now GBP842 billion, with GBP9.6 billion of external net inflows; 18% growth in LGR's annuity assets now GBP51 billion, with more annuity business written in the first half of this year than the whole of 2015; and 28% growth in direct investments, now at GBP8 billion across the Group.

The growth in the stock of our business continues to drive our operational cash generation which, at GBP655 million, was up 5% and net cash generation at GBP727 million, up 16%.

Operating profit was up 10% and profit before tax up 23%, including a positive investment variance of GBP58 million in the six months. All of these factors together meant annualized post tax return on equity increased to 20.4%

And last, by no means least, our Solvency II surplus at June 30, was GBP5.3 billion, representing a 158% coverage ratio of our GBP9 billion solvency capital requirement.

For those looking to do peer comparisons, adjusting for our with-profits fund, our coverage ratio would be 163% at the half-year.

Our strategy is focused on delivering sustainable growth and here, you see how our business stocks have progressed over the medium term; each of our core growth divisions delivering meaningful and consistent growth over many years. Something we intend to keep going.

Of course, simply having the scale is not enough. Here you can see that our businesses are converting their respective scale into profits; all of our divisions making an important contribution to the Group's cash generation and earnings.

Moving now to cover the performance of each of our divisions and I'll start with L&G retirement which had a very successful first half of 2016, its first in a Solvency II world.

Operational cash generation was up 20% at GBP205 million reflected in the increasing size of the back book and with it, the increased level of prudential margin available to be released over many years.

Net cash generation was up 47% at GBP284 million, with GBP3.8 billion of new annuity business written in the first half delivering a new business surplus of GBP79 million.

Operating profit, which was up 44% then further benefited from higher actual annuitant mortality experience compared to our best-estimate assumption. And from a GBP58 million reserve release as we enhanced our modeling of longevity insurance.

On longevity more generally, we have made no change from the year-end to our reserving basis for longevity improvements. We are still using a modified version of the CMI 2013 tables.

And finally for LGR, our successful entry into the lifetime mortgage market continues, with GBP231 million of new advances in the first half, representing around 25% market share and on track to achieve our GBP500 million target for 2016.

Turning to LGIM. LGIM performed strongly, with external net inflows of GBP9.6 billion which were positive across all the main product lines, channels and regions.

Our June 30 total AuM was GBP842 billion, up from GBP746 billion at the year-end.

LGIM delivered many successes in the first half, including international AuM up to GBP152 billion, with new sources of inflows including two partnership agreements in Japan.

We secured our first DC pension mandate in the US. More generally in DC, our total AuM is now GBP50 billion, with GBP17.3 billion and more than 2 million customers on our Workplace Savings platform.

We remain market leaders in the UK and US for LDI mandates and are making significant progress in the fast-growing pooled LDI section of this market. Total solutions AuM was GBP389 billion.

And in UK retail, net inflows were GBP0.7 billion in the first half. That placed LGIM second for market share of net inflows and represents a very significant step forward from our historical performance in the retail market.

LGIM's operating profit was GBP171 million, with a 50% cost to income ratio on revenue up 2%, in part, reflecting the lower market levels in the First Quarter, which meant that the average monthly closing AuM over the six months was GBP784 billion.

Legal & General Capital, delivered a strong performance with operating profit up 17% at GBP135 million, on top of which a positive GBP60 million investment variance meant that profit before tax was up GBP84 million at GBP195 million.

The rationale for our strategy increasing the proportion of direct investments over time is evidenced by the operating profits from our GBP1.1 billion LGC direct investments portfolio exceeding those from our GBP3.8 billion traded portfolio; GBP68 million compared to GBP59 million.

And within the GBP68 million direct investments operating profit, GBP36 million came from operating businesses in the portfolio such as CALA Homes, up from GBP10 million in the first six months of 2015.

And for all these operating businesses, our profit recognition represents our share of actual profits being generated, not a smooth IRR return.

Traded portfolio performed well and delivered a positive investment variance of GBP77 million over and above its operating profit of GBP59 million; the latter being based on a longer-term assumed return for the traded portfolio.

In part, due to our chosen position in the portfolio around the EU referendum, 38% of LGC's GBP5.9 billion of assets at the half-year were in cash or near cash equivalents.

Clearly, we need a significant proportion of these for treasury management purposes. But it does provide us with the optionality to move into higher-returning assets when and where we believe the appropriate risk-adjusted returns opportunities arise.

The level of our cash holdings will have an impact on operational cash narration from LGC in 2016.

Our insurance division includes the market-leading retail protection franchise in the UK. Operational cash generation by insurance was down GBP2 million year on year at GBP159 million, with higher dividends from L&G Netherlands being broadly offset by a lower expected release from our UK protection back book, the latter, in part, reflecting model changes in 2015 to both the quantum and shape of our protection reserves.

Net cash generation benefited from GBP7 million in new business surplus.

Operating profit was down GBP48 million at GBP138 million, with GBP40 million being the pretax impact of the lower expected release from the UK protection back book and GBP18 million being adverse claims experience, mostly arising in group protection.

Other movements year on year in the operating profit was a GBP9 million flood re-levy, before which GI profits were up GBP2 million. This impacted the combined operating ratio by 6percentage points.

There were GBP7 million of profits from L&G France in the comparator, a business we disposed of at the very end of 2015. And we made one reserve change this year in respect of lower maintenance costs for the protection businesses, which added GBP31 million to operating profit.

Net cash generation by our savings business was down GBP14 million at GBP48 million, reflecting a decline in contribution from our mature savings business.

Our platform business made further progress in reducing cash costs, which partially offset the lower profit contribution from mature savings, meaning overall savings operating profit was down GBP6 million at GBP49 million.

We sold our SIPP business, Suffolk Life, for GBP45 million having taken the view that this business was no longer core.

And finally, L&G America. The operational net cash generation from L&G America reflects the level of dividends remitted to the Group. The ordinary dividend for 2016 was up 10%, at $88 million.

Operating profit was up marginally at $62 million, with mortality experienced in the first half being broadly in line with assumption.

Persistency continues to be good, meaning gross written premiums were up 2%, at $601 million.

New business volumes were lower at $41 million APE, as the team focuses on the profitability of new business. But LGA remains a top three provider for term assurance in the broker general agents in the US.

And LGA is also playing an important role to the wider Group in the US by providing the regulatory balance sheet and administration services to L&G Retirement in America and back-office support for LGIM America.

Moving to balance sheet matters and in particular, the Group's capital position at the half-year. The Group's Solvency II surplus was estimated to be GBP5.3 billion, with eligible own funds of GBP14.3 billion and a solvency capital requirement of GBP9 billion, making the Solvency II coverage ratio 158% at June 30.

Removing the GBP650 million of SCR associated with our with-profits fund from both the numerator and the denominator equates to a coverage ratio of 163% on a shareholder basis.

We do not adjust for the GBP90 million SCR associated with our own defined benefit pension schemes.

54% of the Group's SCR, or GBP4.9 billion, related to credit risk at the half-year, with longevity risk being the next largest component at 12%.

Of our eligible own funds, GBP11.6 billion or 81% are Core Tier 1 These assets alone exceeded the SCR by GBP2.6 billion.

The SCR has increased by GBP1 billion to GBP9 billion over the half-year, with the primary driver being the impact of lower interest rates on the valuation of that SCR.

On an economic capital basis, the Group's surplus increased by GBP0.5 billion to GBP8.1 billion. And represented a coverage ratio of 235%.

Given the proportion of SCR which relates to credit, this chart shows the extent to which our Solvency II coverage ratio is sensitive to rate movements, spread widening, rating downgrades and defaults. And Simon Gadd will outline in his presentation our approach to managing credit risk.

I've also shown our exposure to a fall in property values, which is less than people might intuitively think, being because for the sale and leaseback assets in our annuity fund, it is the rental income that has the most of the value, not the residual capital value at the end of the lease.

This chart shows a summary of the GBP0.2 billion reduction in our Solvency II surplus over the first six months of 2016. The expected release from the back book, after six months' worth of amortization and transitional, generated GBP0.5 billion of surplus.

The impact of new business on our Solvency II surplus rounded to zero in the period where we wrote GBP3.8 billion of annuity business as incremental own funds broadly offset the SCR.

The investment variance reduced surplus by GBP0.6 billion as I said earlier, mostly as a result of lower swap rates.

For own funds, the recalculated transitional largely offsets the increase in the risk margin. But the surplus is impacted by lower rates increasing the value of the SCR.

Of the capital movements, a positive GBP0.5 billion represents a mixture of actual experience in the six months and the first phase of management actions, including removing eligibility restrictions around certain assets and removing inadvertent prudence left in our best-estimate liability calculations as we transferred from Solvency I to Solvency II.

As I mentioned earlier, our economic capital surplus at GBP8.1 billion has increased by GBP0.5 billion in the first half, in contrast to the GBP0.2 billion reduction in the Solvency II surplus.

The difference between the two bases has therefore increased from GBP2.1 billion to GBP2.8 billion. And there remain two significant differences between our economic view of our capital position and Solvency II. And both of these have been magnified by lower interest rates.

Firstly on longevity, where the difference in the actual calibration of a one in 200 year stress is unchanged from the year-end. But the pound notes value of this difference has increased due to lower rates.

And secondly, on the credit stress, where we consider the behavior of the Solvency II matching adjustment under stress to be unrepresentative of reality. And again, lower rates have served to increase the value of this difference.

And finally, on Solvency II, as promised, we are providing an estimate of the value of the key lines of new business we have written based on Solvency II capital and cash flows.

We estimate that the present value of future Solvency II surplus generation from new business written in the first half to be GBP382 million for annuities, equivalent to 10.2% of new business premium; GBP81 million for UK insurance, a margin of 11.1%; and $54 million for L&G America, or 12.4%.

These are calculated using the same principles we used previously to calculate EEV. But assumes surplus emergence on a Solvency II basis rather than Solvency I which used to underpin EV.

We no longer calculate EV given we are now in a different regulatory regime, however, in directional terms, the equivalent embedded value margins would have been higher for annuities and lower for protection.

And finally from me, the interim dividend. The dividend policy we announced in March this year remains unchanged; that is a progressive dividend policy reflecting the Group's expected medium-term underlying business growth, including net cash generation and operating earnings.

In terms of implementation of this dividend policy, the Board has decided to adopt a formulaic approach to setting the interim dividend and for future interim dividends, that being 30% of the prior year full-year dividend. The interim dividend for 2016 is therefore 4p per share.

Our Board felt that given the long-term nature of our business, it is more appropriate to have a discretionary increase in the dividend once a year, at the final, rather than twice a year.

As you'll be aware, there is an increasing trend amongst FTSE 100 companies to adopt a similar formulaic approach to setting interim dividends.

And with that, I'll hand over to Simon Gadd.

Simon Gadd {BIO 17956222 <GO>}

Thank you, Mark. CROs and risk functions are paid to worry about the future to ensure we understand, manage and can tolerate the downsides for the risks we take.

My remit covers the full range of financial, operational and conduct risks. I also worry about the external and emerging risks that may disrupt our strategy.

And one live example which is currently playing out is Brexit. Actually, the EU referendum was a great example of an event with uncertain outcomes to analyze and consider the risk mitigations available.

As you'd expect, we were well prepared for the short-term implications of either outcome from the referendum.

L&G have limited direct business exposure to trading in Europe. So our planning focused on our asset exposures and the operational implications for managing these portfolios, derivatives and collateral arrangements.

We ran a variety of scenarios and determined the best blend of risk exposure and hedging to balance out as best we could the impacts on our balance sheet and P&L.

We were fully prepared operationally, including ensuring our property funds were holding high levels of liquidity, which helped LGIM keep the fund open when most of their peers closed.

In the weeks preceding and following the referendum, we maintained a very close engagement with both the PRA and FCA, a constructive dialog throughout.

But Brexit hasn't changed the fact that the largest risk on our balance sheet is credit. As a Firm, our business model involves actively taking credit risk, as we believe this is a rewarded risk.

My job is to ensure the Board understood and articulated its risk appetite. And then ensure our exposure is prudently managed within this appetite.

To extract the reward, we maintain a highly diversified portfolio and deploy considerable capability through LGIM fund managers, working closely with specialists in asset liability matching within LGR to understand, model and manage credit risk.

The most important point to understand is the ALM position of our portfolios. Our liabilities are mostly illiquid, particularly the annuity liabilities. And therefore, we are very rarely a forced seller of assets.

We hold ample gilts and cash to cover extreme liquidity and collateral requirements. But we predominantly hold credit and other fixed-income assets for the cash flows they generate; we are less interested in their current market value.

The Solvency II balance sheet does bring in some artificial volatility due to swap rates and asset price movements which we will need to learn to live with.

This is why we have a surplus buffer. But economically, we are really only interested in defaults, which change the cash flows, or downgrades, which increase the risk of the cash flows not arriving.

We have 30% of our bond portfolio in BBB assets. We have to be particularly vigilant of downgrade risk here. Downgrading a BBB asset to sub-investment grade is most penal from a capital perspective and economically is a cause for concern.

This is where risk selection, diversification and limits of single name and sector exposure are crucial; for example, our strategic decision taken a few years ago to be materially underweight in bank debt.

Ultimately, this is one of the key reasons why we hold a surplus buffer above the 100% coverage ratio; to provide scope; to absorb losses; and give us freedom to take controlled risk.

Although we do have direct property exposure in some strategic projects within LGC, the majority of our property exposure sits in LGR.

It's important to understand that the property is always secured by a long-term lease to high-quality counterparties, or the property is purely security in the event of default of a counterparty to which we provided long-term financing.

So again, we are much more interested in the rental stream which provides most of our cash flows than any short-term property market fluctuations as we are not planning to sell the property.

We are growing our portfolio of direct investments. Critical for me is a robust underwriting process, structuring an internal credit-rating process for these long-term investments in order to avoid unrewarded risks.

The internal credit rating committee sits within my second line function, independent of the dealmakers, with its members having several decades of experience from the mainstream rating agencies.

We live in an uncertain world. So we have a range of monitoring actions and contingency plans in place. As CRO, there are two key issues I continue to monitor.

Firstly, our Solvency II balance sheet will have more volatility to market price movements, particularly falls in the rates curve, than in economically our view of risk.

This will make communication complicated and may distract from the correct mismanagement strategy. We need to explain better what is noise and what is a genuine concern.

Secondly, is a major credit crisis around the corner and if so, how will it manifest itself? We've seen how extreme levels of liquidity and monetary stimulus have. So far, materially dampened down defaults and extended the credit cycle.

Our credit and property exposures are analyzed down to individual names to identify counterparties we believe are most exposed to broad economic slowdown or specific Brexit risks, remembering we can take a long-term view.

We are clearly not immune to a credit-cycle downturn, leading to credit losses above our expectations. However, I have explained how we protect ourselves against this risk and that we have considerable inherent benefits from being long-term investors with minimal liquidity pressures.

And with that, I'll hand over to Kerrigan.

Kerrigan Procter {BIO 15093363 <GO>}

Thank you, Simon. Good morning. You've heard about LGR's financial results from Mark and about the Group's risk management framework from Simon. So I would like to talk about LGR's diversified sources of new business and the management of our back book.

The world's population is still aging. Services to help manage the financial consequences of aging populations are still in huge demand. Private sector-defined benefit pension systems globally are still in runoff. More people need more assistance to accumulate wealth and achieve financial security in retirement.

So what has changed since the EU referendum? Real yields in the UK are expected to be lower for longer. The average pension plan deficit will have increased. But the average across nearly 6,000 pension plans and GBP2 trillion worth of liabilities hides much.

First, a lot of interest rate and inflation risk hedging has taken place and we should know. LGIM's LDI business was created 10 years ago to the month. Over that 10 years, it has hedged interest rates and inflation risk at the rate of around GBP30 billion per annum. And LGIM is just less than half of the LDI market.

The asset allocation to fixed income has increased over the same period from just under 30% to just under 50%. Overall, we estimate that approximately half the interest rate and inflation risk has been removed from the UK's DB system.

It is true that only a small number of pension plans will have removed all their interest rate and inflation risk. However, there is a second trend in pension risk transfer that it is important to understand; namely that of incrementalism. This could be through pensioner buy-ins, longevity insurance, top slicing or medically underwritten bulk annuities.

We are currently quoting on around GBP13 billion of bulk annuity business in the UK and GBP16 billion of longevity insurance business and much of this comes from pension plans taking pension risk transfer step by step.

With an incrementalist approach, not all interest rate and inflation risk needs to be hedged and not all the deficit paid off before pension risk transfer can start.

Legal & General is well placed in such a market. We know the clients. We are financially strong. We are committed to the pension risk transfer market. And uniquely, we offer not only all the steps in pension risk transfer but, more broadly, in pension de-risking.

We're looking to participate directly in the US pension risk transfer market through LGA with a similar commitment and philosophy. We continue to quote on a range of bulk annuity deals. And we'll look to build on our initial success in a measured way.

Our reinsurance hub, L&G Re, A+ rated in the Solvency II equivalent regime and with registered reinsurance status in the Netherlands, allows us to participate as a reinsurer in European pension risk transfer. We're quoting on several deals and are looking to build on last year's new business.

The combination of freedom and choice in pensions and Solvency II has already led to much change in the individual annuity market. We were delighted to work with Aegon in the acquisition of GBP2.9 billion of their individual annuity back book. And to become preferred provider for their new annuity business from October this year. The latter should add just under GBP200 million to our individual annuity volumes in the first 12 months. We expect further industry consolidation.

Looser monetary policy will intensify the hunt for yield. Portfolio management discipline, combined with an ability to self-manufacture attractive assets, will be needed both for new business success and to achieve the full financial potential of LGR's GBP51 billion back book of assets.

Our asset portfolio is a global portfolio of fixed income and real assets, with a portfolio credit risk managed by LGIM's active fixed income team. The team have incentives balanced between increasing yield and minimizing downward credit migration and default. Over the years, this has led to a well-diversified and robust portfolio.

By way of illustration, 63% of the GBP51 billion is A-rated or better, with only 3% in sub-investment grade assets. We hold 12%, that's just over GBP6 billion in gilts; included in these gilts, GBP25 billion of the fixed income portfolio has the UK as country of domicile for the issuer.

The portfolio is well diversified by sector with, for illustration, 4.4% in banks, 4.5% in oil and gas and 3.7% of bonds in the property sector. We have GBP6.2 billion of the portfolio in what we term self-manufactured assets or direct investment. We work with LGIM's real assets team and LGC on the origination of these assets and then structure them to be matching -adjustment eligible as far as possible. Since the EU referendum, we have agreed a further GBP0.5 billion of direct investment.

We also hold just under GBP0.5 billion in lifetime mortgages, where we originated GBP231 million of loans in H1, 2016, to add to the GBP201 million originated in 2015. We see this as a big potential market and expect to meet our GBP500 million target for 2016.

We're pleased to have agreed a five-year arrangement with Santander in July, to distribute lifetime mortgages to their customers, which we anticipate will add GBP100 million of new business annually.

Finally, onto longevity insurance. Our gross longevity risk is GBP56.1 billion, with net risk of GBP43.8 billion. We continue to reinsure over two-thirds of the longevity risk of our new pension risk transfer business in the UK.

However, we chose not to reinsure the longevity risk of the Aegon book of individual annuities. We are comfortable with the risk and we have transitional relief on that book of business.

We will be completing a full review of our back book of longevity risk in the second half of 2016. We have seen higher than expected seasonal mortality over the past few years and we will be considering whether our longevity best estimate should extrapolate the recent variations into a longer-term trend.

I'll now hand you back over to Nigel.

Nigel Wilson {BIO 1535703 <GO>}

Thank you, Kerrigan. Now, returning to our theme of growth. This slide shows example of our investment in the UK; in Cardiff, Manchester, Bracknell and Newcastle.

Our businesses continue to perform well, with an impressive increase in operating profit from our asset management divisions to GBP712 million.

There is a lot of work still to do in replicating the LGIM and LGR success across LGC, across insurance and across savings. These businesses very much remain work in progress.

Congratulations to Mark Zinkula and his team for becoming a global top 10 asset manager by AuM. From where we were 10 years ago, to where we are today. And where we'll be in another 10 years, should be a terrific story. DC has risen from GBP29 billion in H1, 2013, to GBP50 billion today. This could be four or five times larger in 10 years.

Our solutions business, which Kerrigan referred to, was GBP91 billion in 2009. It is now more than four times larger at GBP389 billion. In UK retail, we were not even a top 10 player three years ago. In the first half, we became number two in terms of net sales. Our goal, clearly, is to be number one.

International AuM has risen from GBP52 billion to GBP152 billion, with much, much more to follow.

Real assets is excluded from this slide, as we've already commented on it in many areas. But Bill Hughes and his team have done a great job.

We do recognize that pricing and asset management will become more competitive. And we've already adapted our business model accordingly. In my view, LGC is just starting on its journey. We are building our capability ahead of investing our capital. In housing, we've invested GBP377 million; CALA already delivers around a 20% return on the equity we've invested.

We are confident that we'll replicate the success in build to rent alongside our partners, PGGM. We have started to maximize the value from our strategic land bank. And our investment in modular construction looks promising. Retirement homes should also be a very positive addition.

Infrastructure, this is about investing in new real assets, creating new jobs and delivering great returns. We are really well-positioned across many UK cities.

Across our business, 94%, about 2.4 billion shareholder property is fully let, with only 4% under development. Cardiff, where we have two buildings; one is 100% let, the other 97%. Manchester, all fully let. And Bracknell, about 70% let.

Pemberton's performance in SME debt finance is pleasing. Our goal is EUR1.5 billion by 2017. We intend to add equity in 2016 or 2017 to our SME finance business.

We believe the global insurance industry is going to move from an agency bank distribution model to a much more digital approach, largely. But not completely, via the mobile phone.

We're already experiencing significant increases in digital engagement and digital purchase. IndiaFirst, our joint venture, is using retina recognition. And our new partnership with Vodafone in India will, of course, be a mobile one.

In the UK, via My Account, we're seeing a huge increase in engagement. In the US, our direct solutions have reduced the purchase time for as long as two months to under an hour.

We are replicating the success of our UK business in the United States. LGIM is delivering the growth in AuM and our customer numbers are rapidly increasing. South America will follow soon.

LGR has produced the measured approach we wanted; LGA is fully integrated into our business, our values and our behaviors. LGC will follow. But only at the appropriate time.

We see the world as being full of opportunities. Global economic growth is likely to be 3%-plus. Technology is the most exciting and relevant that I have experienced in my life. Financial markets and customer needs are homogenizing, creating good opportunities for Legal & General. The retrenchment of banks is an added bonus, as is the role we can play in welfare reform and infrastructure.

On the slide are some examples of our successful expansion. Lifetime mortgages in the UK; entering in 2015 and named provider of the year in our first year of operation.

LGIM entered Japan.

We've exciting new projects in Newcastle and Crowthorne and indeed, in modular homes.

We achieved rapid success in the US in our DC business and digital insurance is showing real progress.

We are on track for another successful year in 2016. Once again, thank you to all of my colleagues. Despite the many uncertainties in the world, we believe we can self-determine our success and seize the many opportunities our business model is providing.

We'll now take questions. When you ask the question, can you please give your name for those who are listening via the Internet? We'll start here.

Questions And Answers

Q - Andy Sinclair {BIO 17749036 <GO>}

Andy Sinclair, BofA Merrill Lynch. Firstly on Solvency II. The new disclosure is like GBP 0.5 billion from your first phase of management actions. Just wondered how much more you think you can get through that, as you get more things eligible for matching adjustments, etc.

Secondly, on the 10.2% new business margin for annuities under Solvency II, how would that differ if you were using more of the longevity reinsurance for the more typical new business?

And thirdly, on Solvency II versus the cash flow disclosure. Operating cash generation was GBP655 million. I just wanted to reconcile that against the GBP0.5 billion release under Solvency II and economic capital, if you could. Thanks.

A - Nigel Wilson {BIO 1535703 <GO>}

Remember, we've got lots of other businesses which are not in our Solvency II. So on the management actions, I'll ask Mark to pick that up; and the managing longevity, Kerrigan; and on Solvency II, go back to Mark.

I've been joined on stage, of course, by Paul and Mark Zinkula and by all means, address some of your questions to them.

In management actions, I've been slightly disappointed. I think Mark could have done a much better job in the first half of the year .

A - Mark Gregory {BIO 15486337 <GO>}

Yes. You're quite right. So of the GBP0.5 billion, pretty much all of that was down to management actions in the first half.

So we've got plenty more things in the hopper. Some we can do ourselves and these though, taking a few, it's obvious there are still some liabilities on the annuities which we're not using the MA. They're not the MA eligible, particularly the euro-denominated annuities. We've still got to get -- need to get them into the MA portfolio.

More generally on MA, we haven't yet got MA approval for our lifetime mortgage book. So that GBP440 million of lifetime mortgage hasn't yet -- we don't get MA treatment on that yet.

And more, generally, on the internal model, like all firms, when we're going back in again this year, for what's called our major model change for the year. So there'll be a number of things in that. Some good, some will go the other direction.

But nevertheless, we are looking to optimize and improve the actual internal model calculation of the SCR at retirement because that's a once-a-year process with the PRA in the second half.

So a number of things within our own gift going forwards; a number of things in the internal model, again, I think this will be a multiyear journey in reality before we get to a steady state in terms of the total S2 model in the round.

A - Kerrigan Procter {BIO 15093363 <GO>}

I think on the longevity one it depends. There's clearly some details in that figure, the 10.2% is made up of the Aegon business, where we didn't reinsure the longevity risk; Got a bit of individual annuity business in there that we didn't; And the pension risk transfer business, where, as we said, we reinsured about two-thirds of the longevity risk of that pension risk transfer business, particularly the larger deals.

So if you reinsured a bit more, there'd be lower initial strain and then the payback would be a little bit lower in place of that. So I think we'll see that develop as we go into the future half-years.

So a little difficult to really be precise at this moment; it depends on the price of longevity risk.

A - Mark Gregory {BIO 15486337 <GO>}

Then on the comparison between operational cash generation and the Solvency II surplus generation, they're similar, Andy. But actually, quite different things in reality.

So the operational cash generation, as we define, is the release of prudential margin effectively under the Solvency I regime. But doesn't reflect the capital movements; whereas, obviously, for the Solvency II surplus generation, that is the total release primarily of capital and risk margin and investment returns we make on the own funds in the balance sheet.

So actually, they're not quite as comparable as you might think they are. And clearly, the capital runoff of the SCR and, actually, is quite a long-term major thing. So does run off over. So we will get the GBP9 billion back in due course. But it will take a number of years to get there. So it's quite hard to do an exact side-by-side comparison because they behave in quite different ways.

Q - Ravi Tanna {BIO 16926941 <GO>}

Ravi Tanna, Goldman Sachs. I've three questions please. The first one was on your cash guidance of 5%. I was just wondering what assumption is embedded for LGC returns in order to reach that 5%.

The second one is on the dividend policy. And it may be my mistake. But I was just wondering has there been a change in terms of inclusion of reference to operating profit in addition to cash generation?

And if so, is that the underlying profit ex the Kingswood? Or what kind of growth rate does that refer to in the context of this year?

Then third one was on asset allocation. And I was just looking for broader thoughts please around the Bank of England's term funding scheme and any implications that might have for corporate bond markets and your portfolio.

A - Nigel Wilson {BIO 1535703 <GO>}

Again, Mark, do you want to take the first two; and Kerrigan can take the third one?

A - Mark Gregory {BIO 15486337 <GO>}

Yes. So on the cash guidance, particularly for LGC. The way we bring LGC op cash in, is actually, we use literally each month-end asset portfolio that we have in LGC. For each asset class, we have a projected return for that month. And we rebalance it based on the actual asset portfolio and the mixture of that asset portfolio from one month to the next.

Again, we pointed out in the presentation, we do hold quite a lot of cash within LGC at the half-year. The reason I brought the cash guidance down is the fact we have got more cash than we had assumed when I gave the guidance at the start of the year and clearly, if we put that into higher-returning assets in due course.

So for each asset category we have a different assumption, not particularly racy. So 5%, 5.5% for equities.

Q - Ravi Tanna {BIO 16926941 <GO>}

I was just wondering, the 5%, is it predicated on keeping the same quantum in cash for the second half of the year, is another way of asking?

A - Mark Gregory {BIO 15486337 <GO>}

Very broadly. We've still got some plans. But clearly we're now into August, we haven't invested it yet. So there's a practical limit how much you can get invested in the time.

But certainly over time, we'd expect that money to -- offset more of that money to get invested into real returning assets. But clearly, cash earning diddly-squat right now, we're incentivized to do so. But clearly, we want to do that on an appropriate risk-adjusted basis.

On the dividend policy, no very clearly in March, we announced that operating earnings would be part of our assessment of what is our medium-term expected underlying earnings going forward.

So in that regard, no new factor within that. But when we say underlying, I think we'll be thinking about what is genuinely underlying for the long term.

So things like the Kingswood closure costs. Without prejudging that debate, I would see that as being a one-off item in nature. So it is very much trying to get a view for what we regard as being over, say, a five-year period, the likely growth in the underlying business. So I think we would strip out one-off pluses and minuses from that number. Kerrigan?

A - Kerrigan Procter {BIO 15093363 <GO>}

Yes, I think on the asset allocation, it's probably not just the term funding; it's the corporate bond-buying program. And of course, we're seeing corporate bonds spread tighten significantly over the past few days and quite a lot tighter since June 23, actually before the EU referendum, as I'm sure you all know.

That's really why I referred to the hunt for yield and made such an emphasis on the self-manufacturing of assets. And that's some kind of guide. The GBP0.5 billion we've agreed indirect investments since then, clearly a tilt towards -- it puts you in a strong position if you yourself manufacture your own assets, the increases in lifetime mortgages. So you can definitely see that.

Of course, we have flexibility within our bond portfolio. We have, as you will have seen from the slides, quite an allocation to US credit, which hasn't tightened in the same way. So we have that flexibility to invest in the US and structure that back to sterling cash flows in a couple of different ways.

So those are the sorts of things that we're thinking about. Those are the flexibilities that we have and the strengths that we have to develop our asset allocation with both the corporate bond purchase program as part of QE and the term funding.

A - Nigel Wilson {BIO 1535703 <GO>}

Mark, do you want to add anything in terms of what we're seeing from clients and their views on asset allocation across the world at the moment?

A - Mark Zinkula {BIO 16142450 <GO>}

Yes, certainly. So I think it would be -- because what we had was mostly pension assets, our themes would be similar to what we're doing in our balance sheet. Because the next evolution of LDI, if you will, is now that the hedging strategies are being implemented to varying degrees with different plans. They're now allocating increasingly the illiquid assets. It's kind of the growth assets that are more stable assets than public equities. So very similar trends that we're seeing.

And even post the referendum, we're still seeing demand as well from external clients as well for illiquid assets. So I think the weakness of the currency has certainly probably been part of that. So again, it would be very similar to what we're doing on our balance sheet.

A - Nigel Wilson {BIO 1535703 <GO>}

And one of our keen themes is to stop Mr. Stanworth hoarding his GBP2.3 billion of money and actually get spending it on sensible things.

Can we go down here and then go across to Andrew and then come back to -- I'm trying to alternate between the two sides, don't worry.

Q - Gordon Aitken {BIO 3846728 <GO>}

Gordon Aitken, RBC. Just some questions on the bulk annuities please. Have you noticed any change in appetite post-Brexit, which are either from pension schemes or insurance companies? Just heard Standard Life said that in this low interest rate environment, it didn't make sense for their shareholders to offload the annuity book.

And also, any change in strain? So that's really a question about pricing post-Brexit.

And you talked about quite substantial pipelines in both buy-ins and longevity swaps. What proportion of those typically do you execute on?

A - Nigel Wilson {BIO 1535703 <GO>}

On the general point on Standard Life, I did give Keith a cheeky call but he said that he was holding fire for this morning and it wasn't worth actually getting together. So he's confirming what his private call said to me.

But there's a huge pool of people who are talking to Kerrigan and the team there and I think GBP13 billion is probably the biggest UK pipeline we've ever had. Kerrigan, do you want to add something?

A - Kerrigan Procter {BIO 15093363 <GO>}

Yes, just some thoughts there. More broadly, the change in attitude. I think about the GBP2.1 trillion of liabilities, it's such a huge figure, it's difficult to get your head around. We think that is a two to three decade opportunity and post the EU referendum, it's still a two to three decade opportunity I think.

Within that, the sequencing of which clients de-risk may have changed a bit. So since we're talking to all the clients, not a lot has changed for us on that point of view. But the sequencing of clients might have changed. And within each client, they might have changed slightly the order in which they de-risk. Maybe it's older pensioners first; maybe it's longevity first; maybe it's top slicing first. But since we offer all the different steps to de-risking, not a lot has changed fundamentally for us.

So when you look at that very broad, big picture of such a fundamental market and big long-term opportunity, I don't think the long-term picture has changed much in our way of thinking.

Obviously, the marketing plans, the engagement with clients is a little bit different.

I think the other point in terms of change of strain, probably too early to look at yet. The GBP750 million we did with ICI happened on July 5. We moved very quickly post-Brexit. It was a good opportunity for them, good opportunity for us to make progress with this step-by-step approach.

We're still pricing on a consistent basis, engaging with people. And that GBP13 billion pipeline of buy-ins, some buy-outs, constructively and all parties are working constructively towards executing at some point maybe with us, maybe with others in the market.

So clearly, the pricing change hasn't moved significantly there and I don't think the strain will have changed significantly for us on the Solvency II basis. But quite early days, of course.

Then finally, in terms of the proportion that execute out of that GBP13 billion pipeline, I think it's difficult to say. Some will execute over the next few months and some will execute in three or four years' time as they come to assess and some will get a change in management and decide that now is not the right time for them and it may be five years before they come back.

So most of them, I think all those 6,000 pension plans, will be heading down that route; sooner or later, they will transact I'm sure. But it could be in that GBP13 billion a matter of a few months to a small number of years and then, of course, other people will come in and change that pipeline as we look and so that'd be nearer term in terms of transactions.

A - Nigel Wilson {BIO 1535703 <GO>}

So if you took three percentages, 10%, 50% or 90%, you would say 50% was probably the better of those three estimates?

A - Kerrigan Procter {BIO 15093363 <GO>}

Yes. If you're looking over the next year, I think 50% would be the better.

A - Nigel Wilson {BIO 1535703 <GO>}

Yes, yes. Is there anything you want to add, Paul, on the availability of direct investments and the infrastructure demand we're seeing across the UK?

A - Paul Stanworth {BIO 15495409 <GO>}

Sure. I think in terms of direct investment portfolio, we've still got a huge pipeline that we're working with the UK Government on for regeneration investment offers. They have a pipeline of over GBP100 billion that the UK Government is seeking to invest in over the next five years.

And as you probably know, the infrastructure plan is about GBP480 billion in the UK. They do expect, clearly, a large amount of investment, private investment in these areas. And we see their pipeline, where it's relevant to L&G, predominantly in the areas that we're working in. So energy and a lot of the city regeneration schemes that we're working in.

And I think also in housing, we also don't think that the fundamentals have changed significantly as well. We're still in the low interest rate environment. We still have a housing industry that's not got leverage in it. We'll still be building half the number of houses that we should do and if anything, the changes that have happened in the referendum which, might limit the availability of resources, does play into the hands of our modular factory which we're constructing.

So I think we're still comfortable with our strategy and we still see a huge pipeline that is relevant to L&G.

A - Nigel Wilson {BIO 1535703 <GO>}

Yes, I think we're very encouraged by the progress that we're making in the build-to-rent sector and Bernie's sandbagging his targets for the year yet again at GBP500 million for lifetime mortgages and I'll be really disappointed if it isn't higher by the year-end. Andrew.

Q - Andrew Crean {BIO 16513202 <GO>}

Andrew Crean, Autonomous. Three questions. Mark, could you finish off the answer to the question about the long-term returns you're assuming in LGC? Overall, I think it was 5.3% last year so that's what we're after.

Secondly, could you give in orders of magnitude on a BPA, if you're reinsuring it or not reinsuring it, in orders of magnitude what is the amount of Solvency II free capital generation which you'd expect over the lifetime? I just want to see how that plays out.

Then thirdly, I notice your SCR is only 3% sensitive to interest rates, yet you've got a huge sensitivity to interest rates within the coverage ratio. I think it's gone up to 14 points, which I assume is the sensitivity of the risk margin, which is not very economic.

Couple of points there. Why isn't that entirely balanced off against change in dynamic transitionals? And secondly, if for instance your coverage ratio is to fall to around 140% because of low interest rates which are not economic, how would that reflect on your dividend policy?

A - Nigel Wilson {BIO 1535703 <GO>}

Some really good questions. I was expecting those of Andy, actually, he's busy reshuffling.

On the last question there, if Simon answers that one because he will give you a better perspective from the risk point of view and, Mark, do you want to take -- either you or Kerrigan take the mixture between you.

A - Mark Gregory {BIO 15486337 <GO>}

Yes. I got them all. So just on the first one around the LGC long-term assumptions, in reality, a blended number doesn't really tell the whole truth, Andrew. We do break it down by asset class.

Whatever Paul's got his money invested in, we take the assumption based on that. So if we've got more cash at a point in time, that obviously drags the long-term assumption.

I'm actually (to back solve) the math to work out what it is. But it will be slightly lower based on the fact we do hold more cash. We haven't fundamentally changed many of the other medium-term expected --

Q - Andrew Crean {BIO 16513202 <GO>}

Numbers?

A - Mark Gregory {BIO 15486337 <GO>}

I don't think I've worked it out, actually. We can certainly work it out. But it is -- we haven't changed the basis. We simply said that actually, given our actual split of assets within that, we've just taken it by asset class, the expected return. And that's what drives the blended return for LGC. As I say, having more cash will definitely have brought down the expected return in the short term.

Shall I keep going on the SCR question? So the point around the interest rate exposure as opposed to the wider impact of interest rate. So when we isolate out interest rates in isolation in the SCR calculations, the 3% you allude to, that is simply the impact of rates in isolation. It doesn't reflect the impact of rates on the valuation of other risk items within the SCR calculation.

So I know it's slightly misleading. But actually interest rates there are just that little bit in isolation and there's a much broader impact from interest rates in terms of how they impact on other risks within the SCR.

Your point about risk margin and that being offset by transaction, that broadly is what's happening. So I know we don't disclose it but broadly, the risk margin and the recalculated transitional will probably be taking care of each other. So yes, the risk margin has gone up with lower rates but so has the recalculated transitional.

So the pain of interest rates is all coming through the SCR calculation, not the transitional and the risk margin which sits within the technical provisions.

A - Nigel Wilson {BIO 1535703 <GO>}

Kerrigan, do you want to talk about the profitability, pre and post longevity insurance?

A - Kerrigan Procter {BIO 15093363 <GO>}

Yes. Yes, I think that, as I said, it's early days yet for Solvency II and I think as we've said many times, it somewhat depends on the price of the longevity risk that you get.

I'm not going to precisely answer your question. But just in terms of some of the dynamics going on, you've seen some figures about like the 20% SCR risk margin requirement for Solvency II business.

But if you did everything as you did before in Solvency I, once you've hedged whatever, 75% to 90% of the longevity risk and then readjusted your asset portfolio to be more A+ rated rather than A; rated, you get down to the order of 10percentage kind of figures in terms of SCR and risk margin uses, of which how much strain you get obviously then depends on how much premium you get in from the client. And those are the sorts of variables that we're thinking about in terms of that new business.

A - Nigel Wilson {BIO 1535703 <GO>}

Simon, do you want to pick up on the bits that you got left out of ?

A - Simon Gadd {BIO 17956222 <GO>}

Just to follow up on the question around rates. It is a bit of a complicated subject I'm afraid. If you think about it as asset and liability matching, we're trying to get the interest rate sensitivity of assets to match the interest rate sensitivity of our liabilities. We've only got one set of assets with derivatives. So that's fixed with one choice that we make there.

But our liabilities, the rate sensitivity under IFRS, our profit balance sheet is different to the rate sensitivity of our Solvency II balance sheet.

We've taken the decision to balance the rates' sensitivity at an IFRS level because we think that's closer to our economic view of the risks; whereas in Solvency II, because of the prudence level in the SCR, that creates -- it has more rate sensitivity. And we decided that if we need to balance that, we would then create IFRS volatility which we don't really like.

So we've decided we've got more tolerance for our balance sheet to have some sensitivity to rates than our profits. Clearly, if our coverage ratio was near 100%, we would change that view but clearly it's nowhere near that at this point in time.

So you can only really balance the rate sensitivity of one of your balance sheets, your profits or your Solvency II; we've chosen the profits.

A - Nigel Wilson {BIO 1535703 <GO>}

I think the 140% was an illustrative number. It's by no means the target. Under the scenario you described, that would have no change whatsoever on our dividend policy. Andy?

Q - Andy Hughes {BIO 1540569 <GO>}

Andy Hughes, Macquarie. Three questions if I could. The first one is about slide 19. This is my best guess as to why the stock price is not doing too well today. So obviously, you're showing GBP500 million of operational cash generation, zero from new business and minus GBP600 million from dividends.

Now, Aviva showed GBP200 million positive in their UK business from new business. So could you basically break down the zero in terms of the negatives, presumably from annuities, positive from other stuff and just tell us what you'd expect in a normalized period rather than the H1?

And is there anything weird about the GBP500 million number? I guess that's question number one .

Question number two; I think you said you're going to review the mortality basis at the year-end, particularly long-term improvement rates and CMI 15. Presumably, there's not much you would know on long-term improvement rates between now and the end of the year anyway. So what would the sensitivity of these factors be, in terms of both figures?

And on the third, it's a small question. I think Mark said the property portfolio is not sensitive to market value movements. But is sensitive to other assumptions. Could we have some sensitivity regarding those assumptions, please? Thanks.

A - Mark Gregory {BIO 15486337 <GO>}

Okay. Right. So on the op cash generation, they would say, Andy, clearly it's rounded to the nearest GBP100 million. So like all these things, they are big numbers.

But in terms of additional color, one number we have given, of course, when we did the Aegon back book deal, the GBP2.9 billion, we did say that impacted surplus generation -- sorry, surplus by GBP50 million roughly.

So given the fact that overall, all the investment we wrote in the first half of this year, that was roughly zero. Then you can work out all the rest of it we wrote. So that's the rest of the annuity business we wrote as well as the new business in the insurance world. That came to broadly a positive GBP50 million to offset the GBP50 million surplus it from -- which again, making the point there, it's not just about Crane being some sort of super-profitable deal, actually, we've written all our business on efficient Solvency II terms.

That's not to say there's not an SCR in that. I said in my speech, actually we're getting own funds in to match the SCR. So that does impact the coverage ratio. But in pure surplus terms, we've written new business on terms which pretty much mean we're getting our SCR funded by third parties, either retail customers or by pension scheme trustees.

A - Kerrigan Procter {BIO 15093363 <GO>}

Do you want me to say a few words on the longevity? Well I think you have probably a lot of the facts in that we had -- as we know, mortality is very highly seasonal. So on the cold, dark, winter months, you get a big spike up in mortality and it falls away in the summer months. And what we've seen this year, the winter's just gone higher than expected at seasonal deaths.

Last year, we saw much higher than expected seasonal deaths, with a particular strain of flu virus and a vaccine that was ineffective; and then the season before that, higher than expected flu deaths.

And what we really need to do is make some expert judgment, analyze those figures and actuarial and scientific analysis of mortality, to choose whether those features should extrapolate into a 40 year long-term improvement trend. And that's the work that we're going through in the second half of this year and is in full flight.

Q - Andy Hughes {BIO 1540569 <GO>}

(inaudible; microphone inaccessible).

A - Nigel Wilson {BIO 1535703 <GO>}

Yes. We'll talk about that at the year-end; we're not going to talk about it now. You've made your own estimates in your naught, Andy. So -- but we won't comment on that until we've actually completed all of the work and talk about that in March of next year.

A - Mark Gregory {BIO 15486337 <GO>}

Shall I pick up the property value one?

A - Nigel Wilson {BIO 1535703 <GO>}

Yes.

A - Mark Gregory {BIO 15486337 <GO>}

Okay. So just on the property value, actually there is some disclosure in the pack. So if you look at page 50, we've given some plausible upside and downside valuations for the property portfolio.

Again, I was just saying in my speech, in reality for us, it's the income strip is by far the dominant part of the valuation; as in the rental income strip is by far the dominant part of the valuation when you've got so much exposure to the actual residual capital value at the year-end, it's roughly 70%, 30%. They're not precise numbers. So we're 70% exposed to the rental strip and 30% to the residual capital value at the year-end.

So when you're looking at the L&G, our property valuation, you can kind of scale it back for the fact of what the capital value we're actually exposed to is somewhat less than simply taking a proportion of the total value.

Q - Andy Hughes {BIO 1540569 <GO>}

(Inaudible; microphone inaccessible)?

A - Mark Gregory {BIO 15486337 <GO>}

Yes. We've given that disclosure, haven't we?

A - Nigel Wilson {BIO 1535703 <GO>}

Yes.

Q - Jon Hocking {BIO 2163183 <GO>}

Jon Hocking, Morgan Stanley. I've got three questions, please. Firstly, on the protection business. A lot of moving parts in the protection profits. You've got the adverse mortality and then you've got the change in the shape of the profits. Could you just run through that? I must admit I missed the change in the 2015 statement. That's the first question.

Second question, on the downgrade sensitivity, you've given to capital which is very helpful. So thank you for that. I just wondered, in terms of your investment mandate, if you have a downgrade from, say, A to BBB or from BBB to BB, is there a mandate to sell that ahead of downgrade? And if so, what account have you taken in that sensitivity for any sort of realized loss you might give as a result of the investment mandate? That's the second question.

Then just finally, coming back to Andrew's question on the rates hedging; I'm surprised that you're hedging the profit rather than the Solvency II capital, given that your dividend cover from the annuity block is basically driven by the Solvency II rather than IFRS.

Have you hedged the risk margin at all, the downside risk there, on that basis? Thank you.

A - Nigel Wilson {BIO 1535703 <GO>}

Okay. Do you want to take the last question on the risk margin as well, Simon, since you're our hedging guru today. And well, are you taking both or shall we bring Kerrigan?

A - Mark Gregory {BIO 15486337 <GO>}

So just to give a bit of color to the protection result. So at year-end, I did make the point we had changed the shape, particularly in respect of reinsurance modeling. So as you know, for a lot of our protection business, pretty much all of it, we reinsure the mortality risk off to reinsurers. But because we've moved to this, what's called a risk premium basis, that premium does increase over time. So we've put more prudence into the last years of the contract, to reflect the fact that in theory, at that point in time, we could be paying more to the reinsurer than we're collecting in from the retail customer through their premiums.

It's a prudent assumption. But that's what we assume. And that shifted the shape of the prudence release. So less in earlier years, more put into the tail of those contracts.

In simple terms, we've got a GBP32 million lower release from the protection back book in the UK; and roughly half of it is down to that one-off reshaping of the protection back book.

There's a lot of bits and bobs in there, the loss of the I minus E tax regime, that's a few GBP million; and some other bits and bobs in there. But at its core, that's the main component of the lower protection back-book release.

A - Nigel Wilson {BIO 1535703 <GO>}

Kerrigan or Mark, do you want to talk about downgrades and -- so talk about credit movements. And how we manage an interface between LGR and LGIM?

A - Kerrigan Procter {BIO 15093363 <GO>}

Yes. Well look, I can kick off with the investment mandates just in itself. There is no automatic requirement to sell on a downgrade. We have no expectation of buying sub-investment grade assets, of course. And when they're grounded, there's a cure period or kind of a cure explain period, just as you find in most investment mandates.

The team -- the mandate that we set up, as I described, is a very clear incentive to increase yield but don't increase yield. But don't increase credit risk. Or you can keep the yield the same. And decrease credit risk, i.e., default and downgrade risk as it's measured.

So the portfolio of the active fixed income team that works on it are continually looking to move the portfolio to avoid those downgrades and defaults. So it's a built-in incentive to every day come in and work on that portfolio, to mitigate that risk, which I think is a really key part of how we run the portfolio.

On the capital figures, I'm not sure of the --

A - Mark Gregory {BIO 15486337 <GO>}

That's the way we've done it.

A - Nigel Wilson {BIO 1535703 <GO>}

Do you want to have a go at this, because obviously, you failed the last time. So another go on it.

A - Simon Gadd {BIO 17956222 <GO>}

Yes, okay. Referring to the quickest answer . So the short answer is no, we don't pay out the rate on our risk margin . The long answer is because that would make it even more different to our IFRS position. So you'd add it even -- the risk margin is very long duration, very complicated. So it would be operationally very difficult to hedge it. But actually again, it would take us into hedging more non-economic risk, which actually, we don't think is the right thing to do.

And by the way, the PRA blessed for us and the whole of industry, a recalculation of the transitional, because of the mid-movement in the impact of the risk margin of the rates fall during the first half of the year.

Q - Oliver Steel {BIO 6068696 <GO>}

Oliver Steel, Deutsche Bank.

A - Nigel Wilson {BIO 1535703 <GO>}

We'll take three more questions. There's two and there's one other question, if anybody else. And Alan. So one, two, three. Okay?

Q - Oliver Steel {BIO 6068696 <GO>}

I'll ask three, then.

A - Nigel Wilson {BIO 1535703 <GO>}

And everyone's asked three questions so far, you could ask two or four to be different.

Q - Oliver Steel {BIO 6068696 <GO>}

To follow-up Jon's question on the protection operational cash flow. It's down 30%. You're saying half of that is down to reserve changes. The I minus E, I think is GBP7 million in a full year, which is diddly-squat.

So what's the rest of it? And having changed that reserve profile, should we now be assuming this first-half number is the base for the UK protection profit?

Secondly, you seem to have sort of swiped the actuarial pen in a positive direction on the annuity in-force cash flow. On my calculations, it's gone up from 39 bps to 47 bps at the start year annuity assets under management.

So obviously, there's a reserving change, or a change in reserving assumption coming through there. Again, what have you done? How are you guiding towards the future? How will that change when you look at the data in the second half of the year?

Then third one, nice easy question. You've closed Kingswood. I think I also saw some other restructuring costs. What sort of extra cost savings do you expect from those?

A - Mark Gregory {BIO 15486337 <GO>}

Yes. Sound like all mine, don't they? Okay. So the rest of the color on the protection operational cash generation. So, as I say, roughly half comes from the change to the mortality reinsurance.

As you say, Oliver, correctly, the I minus E is about GBP7 million degrade and we've got other torpedoes of that to come through the system before the seven years is all done. So that's, say, GBP3.5 million/GBP4 million at the half-year.

Insurance did benefit from the tax losses built up in LNG Pensions Limited. Most of that benefit went across to the retirement business. But actually, insurance also got a benefit from that. So again, a couple of million, GBP2 million or GBP3 million is down to that.

We had a lower stock, a lower level of gross written premiums in the group protection book at the start of the year. So again, the expected release from that is somewhat low, it's about GBP5 million of the difference. We got a small amount of dividend in from L&G

France last year. Must be getting close now to roughly reconciling the number. But it's quite of lot of smaller moving parts in the balance of the GBP32 million.

In terms of is that the base going forwards? A couple things I would say, simple points there, actually. Rather annoyingly, the first half and the second half are not symmetrical for a bit of the protection business.

Actually, we get more cash release in the second half for group protection than the first half. So you shouldn't just take the first half and double it up. Actually, we do get of the order of about GBP20 million more op cash from the group protection book in the second half.

It's all to do with second-year renewals. And that creates a strain when we actually write the renewal. But that strain gets released during the course of the year. So it's still a tad complicated. But in terms of where you should think about it, you shouldn't just double-up the first half and think that's the full year. We do get this slightly odd asymmetry between the first half and the second half.

Longer-term, we think we're looking to grow this business. As we said in the presentation, we're writing very profitable protection new business. We want to grow that book of business. The gross written premiums for retail protection were up 7% in the first half. So you might think on new base, yes. But actually, we are looking to grow that. And Duncan and the team have got big plans to grow the contribution for the insurance business going forwards.

In terms of annuity in-force cash flows, it's not quite -- I know it's a simple metric, I look at the kind of op cash release compared to the opening asset. That doesn't quite give the kind of -- clearly, what we're actually releasing here is a level of prudence, or one year's worth of prudence, in the annuity back book.

We're constantly reviewing the prudential margin that we carry. And where we think we've got with clearly -- and therefore, just tweaking and adjusting best estimates as we go.

So there has been an element of that over the years. That's common practice. So there probably is on average a little bit more prudence per capita being released for the annuity back book as we think about the level of our best estimate compared to our technical provisions book.

I wouldn't say there's been a fundamental change in the way we think about the quantum and shape of prudence in the annuity back book. Some of the annuity asset is not the very best proxy for the level of prudence in that back book.

Q - Oliver Steel {BIO 6068696 <GO>}

(Inaudible; microphone inaccessible).

A - Nigel Wilson {BIO 1535703 <GO>}

Yes. It's not -- I don't think there's anything in particular in the second half of the year. There's an ongoing program. Kingswood's not closed yet. That's the costs of closing Kingswood, all brought forward, or pretty much all brought forward, to today. There may be other costs as we go through the process. But that's our estimate as of today.

Q - Ashik Musaddi {BIO 15847584 <GO>}

Ashik Musaddi, JPMorgan. Just couple of questions. One is why is IFRS more important than Solvency II? And if IFRS is important, what measure, cash, operating profit, net earnings, what is relevant. And why, basically? So -- because I don't know if I have heard that from any other company I don't think. That's number one.

Secondly is I thought that you are trying to reinsure longevity. But your slide is suggesting that you're quoting for GBP16 billion of longevity swaps. So what is going on there? On one hand, you're offloading; on another hand, you are taking longevity. So what's that dynamic?

And thirdly, your savings profit was down a bit, 20%, 25%. What is driving that. And is it a good run rate to assume going forward? Because your mature book is running down. And your new business is still Cofunds, I don't know what the profit there is. Thank you.

A - Nigel Wilson {BIO 1535703 <GO>}

Do you want to pick up on the longevity thing, Kerrigan, to start with?

A - Kerrigan Procter {BIO 15093363 <GO>}

Yes. That one's probably reasonably straightforward to explain. We're not accumulating much of that risk on our balance sheet. So we've changed the names of the business. It's pension risk transfer, it's about helping clients define benefit pension schemes, remove their risk in a step by step process.

They definitely want to do longevity insurance as part of that step-by-step process. We can be the direct writer of that and we'll reinsure a lot of that or we'll pass through an intermediate, a lot of that, or broker just some of those deals.

So it's that continuing engagement with the clients now. Of course, they connect with us, we reel them in and then they may do further transactions down the line. But we think it's an important service to give our clients to intermediate in those deals and then find a dozen or more reinsurers around the market.

A - Nigel Wilson {BIO 1535703 <GO>}

I think on the Solvency II, I thought Simon gave a very clear answer to that. We have made a decision and that's what we're going to do, we're articulating it clearly. It may not be what other people are doing and that's fine. We've made our decision and we'll continue it.

We don't particularly want to hedge uneconomic theoretical things that may well change in the future. And whether they change this year or next year or the year after, we would suspect there's quite a bit of change going to go on with those variables in the next two to three years.

We're not trying to develop real expertise in hedging something that we think is very theoretical, uneconomic and will disappear. So that's the reason for that.

And do you want to do the last?

A - Mark Gregory {BIO 15486337 <GO>}

Yes, just on the savings profit. Clearly, the mature book is in decline, I would say the rate of decline 2015, we still had a reasonable level of things like endowment maturities with associated terminal bonus and clearly, shareholders get one-ninth of that and then clearly, that level of maturity profile is evened out now.

So yes, it will still decline. But actually, probably more steadily over a period and clearly, we want the platform business then to step up and fill the void.

A - Nigel Wilson {BIO 1535703 <GO>}

Alan, the last question.

Q - Alan Devlin {BIO 5936254 <GO>}

Alan Devlin, Barclays. A couple of questions. First on bulk annuities, I wonder if you could talk about the relative attractiveness of the US versus UK versus Europe. It does seem to be a little more positive on the UK this time?

Secondly, on Workplace pensions. Your AuM continues to build but is still stubbornly at a loss. When do you think that could actually turn into profitability and start to pick up?

Then just finally, any thoughts on M&A? You've been reasonably quiet of late. And what your thoughts are on that. Thanks.

A - Nigel Wilson {BIO 1535703 <GO>}

Mark, do you want to go first why the dismal performance in Workplace savings, you've continued it in the first half of this year and why you haven't pulled your socks mate ?

A - Mark Zinkula {BIO 16142450 <GO>}

Yes. Absolutely . Okay. And there are different ways that people calculate performance in the Workplace businesses.

A - Nigel Wilson {BIO 1535703 <GO>}

He's not going to tell you that he got stuffed on internal costs. But --

A - Mark Zinkula {BIO 16142450 <GO>}

Thank you for mentioning that though, it would have sounded offensive if I'd said it.

A - Nigel Wilson {BIO 1535703 <GO>}

Jackie Knowles out-negotiated him .

A - Mark Zinkula {BIO 16142450 <GO>}

No but Workplace, that does only reflect the administrative aspect of the business. So when you look at it in a vertically integrated basis, it's very profitable. It's clearly profitable when you look at the asset management revenue and profitability that's attached to that business.

Secondly, just because of onboarding clients, there's front-end loaded costs, we won a lot of large schemes last year, plus it was a very big year for us. So there are going to be costs that are associated with onboarding those schemes, which are just the nature of the business so those are good costs to have obviously. Then the compound and revenue over time will obviously generate the profit.

But we'll continue to invest in the business. I'm not particularly concerned about the profitability short term on just building out the administrative platform; have to look at it on a long-term basis, on a fully vertically integrated basis including the asset management profitability.

A - Nigel Wilson {BIO 1535703 <GO>}

I think our challenge is that we managed to make the LGR platform and the LDI platform completely homogenous globally and so we've seamlessly moved into other markets.

We've done the DC business in America. But we haven't yet got what I'd describe as a global DC platform and the demand for DC around the world is huge. And Mark keeps going on these jollies to various countries and coming back telling me how great the market is and if only we had the proper platform business, we could get a huge amount of business in these .

A - Mark Zinkula {BIO 16142450 <GO>}

Really quick though. And it doesn't include our investment only platform which we only set up a couple of years ago over here, which is very rapidly accumulating assets will continue to and is

A - Nigel Wilson {BIO 1535703 <GO>}

About GBP30 billion?

A - Mark Zinkula {BIO 16142450 <GO>}

Very profitable because we're able to build it essentially from scratch rather than dealing with some legacy issues.

A - Nigel Wilson {BIO 1535703 <GO>}

Yes, I think that's a very important point, you only see half of it, one-third of it, in fact, is in the Workplace; the rest of it is on the investment only platform which is actually twice the size of the Workplace savings one. But given your historic background, we've always produced the information on the Workplace savings platform.

Is that all your questions answered, or?

Q - Alan Devlin {BIO 5936254 <GO>}

No. We haven't done the BPA?

A - Kerrigan Procter {BIO 15093363 <GO>}

Absolutely, still remain enthused on the US annuity market. We're busy quoting on several billion dollars of deals out there of course, unlike the UK we probably don't see all the deals in the US as we do in the UK yet.

It's a market that's more sensitive to nominal yields rather than real yields. But a lot of clients still looking to transact. We can price well on the longevity side assets. We can fully administer deals now. So we're confident to spend quite a lot of time out there with the team and remain very enthusiastic about that market. Yes, probably leave it there.

A - Nigel Wilson {BIO 1535703 <GO>}

On M&A, we're still looking at bolt-on acquisitions. That's very much the theme of the business rather than transformational deals. There's nothing that I would say was imminent at this moment in time but several of the investment banks who are represented by the firms in this room are busy producing blue books for us and we will be considering those blue books over the summer.

Thank you very much for coming today. I realize there's a lot of complexity. This is the first time we've gone through the Solvency II results. They were quite bitty and messy in certain areas that we've tried to highlight and I think Mark's done a terrific job of explaining some of the bits and the moving parts around that.

And Simon contributed immensely to the discussion around why we do what we do in terms of risk management.

It's very much work in progress. We're delighted LGIM's added almost GBP100 billion of assets since the last time we met you guys. Kerrigan's had an incredible first seven months of the year, with a lot more to do in the second half of the year.

LGC, very happy with the work in progress that we've made so far. The retail protection business did very well, incredibly well in the first half of the year.

The group protection business is distorted by the issues that Mark talked about. But could do better, I think it's fair to say. Jackie's done a tremendous job in getting Cofunds in a much better place for us. We've got to manage the maturity decline around those businesses.

We're very much focused at the moment on the UK and the US, not particularly focused outside of the PRT business and the LGIM business in Europe.

And hopefully, we'll continue to deliver great financial returns, strong earnings per share growth, strong DPS growth going forward.

The team will be hanging around to take further questions and either take them in this room or outside for coffee. So again, thank you all.