# Q4 2017 Earnings Call

## Company Participants

- Bernie Hickman, CEO-Legal & General Insurance
- Chris Knight, Chief Executive Officer-Legal & General Retirement, Retail
- Kerrigan Procter, Chief Executive Officer-Legal & General Capital and Executive Director
- Laura Mason, CEO-Legal & General Retirement (Institutional)
- Mark Joseph Zinkula, Director, CEO-Legal & General Investment Management
- Nigel D. Wilson, Group Chief Executive Officer & Executive Director
- Simon Gadd, Chief Risk Officer
- Stuart Jeffrey Davies, Group Chief Financial Officer & Director

## Other Participants

- Andrew J. Crean, Analyst
- Andrew Sinclair, Analyst
- Angel Kansagra, Analyst
- Barrie Cornes, Head-Research
- Colm Kelly, Analyst
- David Andrew Bracewell, Analyst
- Gordon Aitken, Analyst
- Greig N Paterson, Analyst
- Jon M. Hocking, Analyst
- Oliver Steel, Analyst
- Ravi Tanna, Analyst

## MANAGEMENT DISCUSSION SECTION

### Nigel D. Wilson {BIO 1535703 <GO>}

Good morning, everyone. Welcome to our Annual Results Meeting for Full Year 2017. The usual housekeeping announcements first. There are no fire drills planned, please turn mobiles off, understand the disclaimers apply to forward-looking statements.

2017 financial highlights were formidable. Operating profit up by 32% to £2.06 billion, PBT also up by 32% to £2.09 billion. EPS up 50% to £0.3187, and ROE of 25.6%. Our results do include a mortality reserve release of £332 million for the full year, that is £274 million post tax. This led to an additional £250 million of dividends from our LGAS entity to group, increasing remittances.

There was a one-off boost to EPS from the reduction to the U.S. corporate tax rate, which was positive for our U.S. insurance business. Legal & General is strongly cash generative with net release from continuing operations also up 9% to £1.4 billion. And we are structured to enable cash to flow easily up to group without trap cash or trap capital in subsidiaries. Remittances were £1.6 billion, up from £1.1 billion for 2016. We're therefore confident in recommending a 7% in the full year dividend to £0.1535, another terrific year.

I would, of course, like to thank all of my colleagues and thanks particularly to Steve Ellis, who's sitting in the second row here and the team in our lifetime mortgage business. In less than two years, they've created a market-leading business with a 30%-plus market share and it is based in Solihull. Proving you can grow new entrepreneurial businesses in financial services outside of London, a model we've also replicated in Barnsley.

This slide captures medium-term trends in our financial performance, showing consistent delivery of strong financial metrics. Our goal is to make our medium-term trends our long-term trends. Operating profit has grown by 12%, net release by 9% and return on equity has grown from 14.9% to 25.6%. Net release retained after payment of the dividend has averaged over £500 million over the last three years.

You should also not the book value per share has also grown by 7% and grew 13% last year. So, in 2017, 7% DPS growth, coupled with 13% increase in book value per share, was over 20%. Although we have reported a £0.32 of earnings per share, if you take of the effects of the 2017 mortality release and the one-off, one-off change in the U.S. tax rates, we delivered a £0.231 of EPS, and 9% growth on last year which is in line with our stated long-term EPS ambition.

We've been busy for several years at Legal & General shaping our company for the future, enabling us to focus on our core businesses, which can drive real earnings growth for shareholders, and which are economically and socially useful in our chosen markets. This has included de-cluttering or disposing of sub-scale legacy or non-strategic businesses. Our disposals include our old-fashioned businesses in the Netherlands, France, Germany, Egypt, Gulf, Bahrain, Ireland, and our less successful acquisitions, Suffolk Life and Cofunds. Some of this has also been strategic, with the most important later step being the sale of our Mature Savings business announced in December for £650 million.

We also secured an ongoing long-term investment management agreement for LGIM. And with Swiss Re, we have a great partner for our longstanding customers. We have significantly reshaped the group over the past few years to a simple, focused, modern business model. This reshaping has allowed us to redefine our strategy. It is unchanged overall, straightforward, and consistent, but we've clarified and simplified what we do. The strategy is effected in three broad business areas: investing in annuities, investment management, and insurance.

Our strategic purpose is unchanged; to improve the lives of our customers, to build a better society, and in doing so, create value for our shareholders. By aligning these interests, we create the inclusive capitalism of our annual reports. Our divisional structure is retained, and I'm fortunate to have an outstanding leadership team: Laura, Chris, Cheryl, Mark, Kerrigan, Jackie, and Bernie, are all here today sitting in the front row. And we are delighted to have added Jeff Davis, Paul Miller and Emma Hardaker-Jones to our leadership team, as well as welcoming John Godfrey back from his sabbatical advising the prime minister.

Our strong collaboration across teams and the synergies between the divisions means that we can collectively perform better than the sum of our parts. I will talk in more depth about the strategy later this morning, once Jeff has taken you through the numbers. But the resulting threefold business is focused on our core strengths, modern products, technology innovation, and a footprint which is global for LGEN, but to-date largely UK and U.S. for the rest of the group.

Moreover, we deliver sustainable profitable growth. And our strategy continues to be driven by six long-term growth drivers: aging demographics, globalizing asset markets, creating real assets, welfare reform, technological innovation, and creating today's capital. All play a part in creating market conditions from which we can benefit, and they are more relevant today than ever.

And in 2017, we demonstrated how we were able to use them for customers, for shareholders, and for society. Strategy in the abstract can be elegant, but execution is paramount. We are applied thinkers. This rather busy slide illustrates progress in areas where we are positioned to benefit from the growth drivers to become leaders in our chosen markets.

Highlights include LGIM approaching £1 trillion of AUM. Group-wide direct investments increasing 44% to £14.4 billion and we became the first company to achieve £1 billion of lifetime mortgage advances in a year, as well as the £463 billion solutions business with a 40% plus market share; and as Mark will tell you, tremendous global growth opportunities. I'm also pleased to say the Bernie Hickman and Steve Griffiths did a great job in 2017 of turning around our underperforming group protection business, now profitable in H2 and beyond.

Taken collectively, the simplified strategy and the excellent execution by a strong management team has delivered another terrific set of numbers.

I'll now hand over to our CFO, Jeff Davies, who'll take you through them in more detail. Jeff?

## Stuart Jeffrey Davies {BIO 20023574 <GO>}

Thank you, and good morning, everyone. I'm going to run through the financials for the year, our dividend, and capital position before handing back to Nigel for more on the group strategy and Q&A.

As Nigel has already said, it's been an outstanding year at a headline level, with operating profit from the continuing operations up 35%. This includes the recent changes we've made to our reserving for longevity, but has been adjusted for the sale of our Mature

Savings business. As we flagged at the half year, we reviewed our longevity improvement assumptions and we moved to an adjusted version of the next actuarial table, CMI 2015. This made the total released in the year £332 million. Even without this prudent release, we grew operating profit from continuing operations by an impressive 12% as a result of our excellent execution and clear focused strategy.

Our key divisions performed strongly in 2017, contributing to the 9% increase in net release from continuing operations. In line with half year, on top of the net release, there is now in total a £250 million additional dividend from the LGAS subsidiary in respect to the mortality release. When added together, this means the group generated £1.7 billion total release, up 21% on 2016. On internal dividends, the cash remitted to group in respect of 2017's results was up 46% on last year, at £1.6 billion. We regrew our return on equity to 25.6%.

Finally, as a high-level summary of our capital position, the Group's Solvency II net surplus generation was £1.2 billion, up from £1.1 billion last year, leading to a coverage ratio of 189%. This net surplus generation will continue to grow over time. As an additional point, our coverage ratio as of March 5 was an estimated 196%.

Our dividend policy based on operating metrics remains unchanged. The board took into account the strong 2017 results together with the medium-term underlying business prospects and has therefore announced a full-year dividend of £0.1535, which is up 7% on the previous year.

Turning to the operating profit from our divisions, we saw good growth in many areas. Our Institutional LGR business, which deals with the corporate pension schemes, grew 39% on a reported basis. And after excluding the mortality release, it was a strong 10%. This was as a result of the larger opening position together with a 7% growth in new business sales.

Our Retail LGR business grew 116%, and a great 26% after excluding the mortality release. New distribution arrangements as the preferred provider of annuities to Aegon and other DC platforms help drive this.

LGIM grew an impressive 9% on the back of record external inflows and strong asset performance, while maintaining discipline in its market-leading cost/income ratio.

LGC was up 6%, benefiting from returns from the division's £3.8 billion traded asset portfolio and continued strong performance in the £1.5 billion of direct investments.

LGI contributed £303 million, which was flat year on year with growth in its U.S. division, offset by the previously-reported adverse claims experience in Group Protection and lower long-term lapses on older business in Retail Protection.

And finally, GI contributed £37 million, down £15 million from 2016, predominantly due to the impact of increased costs from escape of water in line with industry experience as we reported at the half year. We're happy to say we've not seen a repeat of this in the second half.

In terms of divisional performance, I'll start with LGR. We've already covered the 13% operating profit growth, even without the mortality releases. LGR's net release was up 16% to £688 million, benefiting from a new business surplus increase of 13%. This was as a result of securing attractive spreads on direct investments whilst maintaining our discipline when pricing new business. We've also warehoused more DI than last year, which we can now apply to new business in 2018.

Our total annuity sales of £4.6 billion with a new business value add of 8.5% was achieved with a regulatory capital strain of less than 4%, which is within our target low to mid-single digit range.

For the mortality release, I want to illustrate how our change in assumptions in respect to future improvements drove the £206 million that you see. As you know, at the half year, we decided to release £126 million of prudence in our reserves in light of the continuing high number of actual deaths we experienced compared to expectations.

On the back of further analysis of our own mortality experience and the trends we have been seeing, we've also decided to move to an adjusted version of the next actuarial model, CMI 2015, for our longevity improvement assumptions. These adjustments are made to reflect how our annuitants differ from the broader population and apply some smoothing. As you can hopefully see from this illustrative graph, our model still anticipates the same long-term improvement assumptions. Moving to CMI 2015 simply seems you will experience slightly lower improvements in getting there.

You could see this is a minimal change in our total life expectancy assumption, illustrating the prudence of this release. Going forward, we will continue to scrutinize the likelihood of a sustained slowdown in mortality improvement as population data and that on our own book emerges and consider whether to make further changes to our best estimates assumptions. If we do choose to make changes, it will be in stages and over several years. In the coming year, we will consider the appropriateness of moving to CMI 2016. As an indication, simply moving mechanically to this table would have a similar sort of economic impact as the total release this year.

This table breaks down the new business flows in LGR. We wrote £3.4 billion of UK bulk annuities in 2017, as demand remained strong, with £1.4 billion of this transferring from LGIM clients, giving further evidence of the unique breadth of pension de-risking solutions we can offer clients. Additionally, we wrote a further 15 deals in the U.S., bringing the total business written there to over $1.6 billion. Client demand from UK pension plans remain substantial and the pipeline of transactions we are in active discussions with has risen to £17 billion. The U.S. defined benefit pensions market has similar potential with the market growing year on year. We will continue with our measured approach as we look to expand.

Our LGR Retail business had a particularly strong year, with new individual annuity business up 78% due to the new distribution agreements and demand continuing to return to this market. Also in LGR Retail, our lifetime mortgage business wrote loans of just over £1 billion. The market has the potential to grow rapidly with £1.5 trillion of UK housing equity owned by the over 55s. We expect up to £4 billion to be transacted in 2018, up from £3.1 billion last year. And with our 33% market share and great distribution network, we are well placed to benefit from this growth.

The asset portfolio back in our annuity liabilities has expanded its range and diversity in 2017 and remains defensive in nature. 20% of the portfolio is in sovereign-like assets and over two-thirds of it is A rated or better. In addition, we continue to have a £2.7 billion credit default reserve held against it. We now have 17% of the portfolio in direct investments with stable income often collateralized or secured on great counterparties. Overall, this is still less than we hold in sovereigns, which is an opportunity to create further value.

LGIM had a year of strong growth with record external net flows of £43.5 billion, which is 5% of open in AUM, and £33 billion of this from international clients. Operating profit grew 9% to £400 million, and we maintained a steady cost/income ratio of 50% due to the scalable nature of our business model, offset by continued investment in our growth strategy and increased regulatory costs.

Positive flows across virtually all of our channels, regions and investment areas demonstrates the breadth of LGIM's business model. We continue to grow our UK DB business and remain the largest manager of assets in this market, and the market-leading provider of LDI solutions. We are also the largest manager of DC assets in the UK, with good growth in the past year, and the market leader in workplace Mastertrusts. Our UK retail business has also grown rapidly with record net inflows of £3 billion and ranking third in net flows for the second consecutive year.

As I mentioned, nearly three-quarters of up flows last year came from international clients with our international AUM at £228 billion. Our U.S. business contributes significantly to this with assets of $189 billion across an expanding range of strategies for 350 clients. Our thought leadership in the U.S. DB market, as plans increasingly implement LDI strategies and consistent strong performance in our range of active fixed income funds, and now complemented by our more recently established index team and DC proposition.

But it is not just the U.S. where we have seen success and see significant market potential. In Europe, we had £12.6 billion of net inflows, and we now have £44 billion in client assets. Our acquisition announced in November of Canvas, the ETF platform, will provide clients with access to one of the fastest-growing segments in asset management, broadening our geographical reach and product range.

In the Gulf, we had £3.6 billion of net inflows and now have £36 billion of assets as we deepen our relationships in this region. We've established a distribution office in Tokyo, trading and fund management capabilities in Hong Kong, and won our first Australian client. As well as broadening our U.K. footprint, our global brand is well recognized, and we have been winning mandates whilst we pursue a focused and disciplined expansion.

LGC continues to grow assets and profits as it diversifies the asset classes it invests in. Operating profit was up 6%. And PBT is £363 million, with strong performances from both the direct investment and traded portfolios. In the direct portfolio, a combination of asset disposals and sales of funds generated £369 million of proceeds, exceeding our target of £250 million for 2017. And importantly, our disposals during the year met our return expectations of at least 10% to 12% IRR. These sales proceeds were recycled as we invested or committed almost £700 million into new investments, as well as into our existing portfolio, including new investments in later living as well as expanding our Build to Rent fund with LGIM.

Our operating business investments also delivered strong results, with Pemberton and NTR expanding rapidly, and CALA delivering revenue of £776 million, more than three times the amount it achieved the year we acquired our share.

In our Housing portfolio, we will continue the expansion of our Build-to-Sell and Build-to-Rent offerings. And we have measured plans to develop businesses in the later living and affordable housing sector. We intend to grow the Urban Regeneration portfolio through further investment into existing projects and the regeneration of cities where we do not yet have a presence.

For LGI, operating profit for the division as a whole was flat year-on-year. Within that result, U.S. protection grew 5% with good premium growth of 8% and favorable mortality experience. In UK protection, our profits of £209 million were impacted by the previously reported adverse claims experience in group protection, as well as some lower long-term lapse experience on all the business in retail protection. The range of actions taken by group protection, including pricing at scheme renewals, has returned the business to profitability in the second half and we anticipate it will continue on this trajectory in the coming year.

The margins across UK protection remain robust in a competitive environment. During 2017, our U.S. business launched a direct-to-consumer sales channel and work is ongoing to digitally transform the business. This will continue in 2018 with the launch of an application that provides an instant underwriting decision for more customers and digital collection of medical information to increase efficiency. As usual, LGI America has already paid its 2018 dividend. This year, it was $105 million, up from $100 million paid last year.

In GI, gross premiums increased 13% to £369 million, whilst maintaining our pricing discipline in a competitive market. 38% of our premium now comes from our direct channel. As flagged at half year, our operating profit was affected predominantly by the impact of increased costs from escape of water claims in Q1. We took action to address this and saw improved claims experience in the second half, as can be seen by the 92% combined ratio.

GI has now won seven distribution agreements in the last two years with major UK financial institutions, several of which will commence in the first half of 2018. And we are diversifying our proposition with our acquisition of pet insurance provider Buddies. These factors combined to give good prospects of growth in 2018.

On Savings, the team did a great job in delivering the 2017 results amid a few distractions. As you're all aware, we announced the sale of our Mature Savings business to Swiss Re in December for £650 million, achieving a sale price of one-time Solvency II own funds. The profit of over £400 million will be recognized when the Part VII completes, which is targeted for mid-2019.

Moving on to our capital position. The group's Solvency II surplus increased £1.2 billion since the last year-end to £6.9 billion. Our Solvency II coverage ratio calculated on a shareholder basis increased to 189%, up from 171% last year. As I mentioned earlier, our coverage ratio as of 5th of March was estimated at 196%, reflecting increases in interest rates since the year-end. Our economic capital showed similar growth over the last year as expected.

We have expanded our usual Solvency II surplus bridge to explain the £1.2 billion total movement over the year. As we guided, our operational surplus generation has increased to £1.3 billion. The impact of the amortization of the opening Transitional was broadly offset by the corresponding release in risk margin.

The impact of writing new business in the year was a very capital-efficient strain of less than £100 million. Operating variances of £0.4 billion, including the impact of the change in our mortality assumptions, experience variances, changes to model calibration and management actions. These actions include changes to asset mix, matching adjustment optimization, and hedging strategies.

We also chose to strengthen our interest and inflation calibration, which offset some of the benefit in the second half. Our market movements for the year were a net zero with equity market rises offset by credit spread narrowing and small interest, inflation and FX changes.

And finally on Solvency II, our usual slide gives you our estimates of the present value of Solvency II surplus emergence from the key elements of the new business we wrote. As we have already noted, our margins continue to be resilient whilst maintaining pricing discipline. For a small strain of less than £100 million, we have created £564 million of value.

So, to conclude for me, even without the mortality releases or one-off U.S. tax benefit, our business produced excellent growth with an operating profit increase of 12% and an EPS growth of 9%. This is in line with our previous EPS guidance and an indication of our ongoing ambition. On longevity, we maintain our prudent and staged approach to the trends we are seeing, and we'll investigate the move to CMI 2016 in light of our 2017 experience. All our businesses have great growth opportunities and are back by strong balance sheet and cash position whilst delivering excellent ROE.

I'll now hand back to Nigel to go into more detail on these growth opportunities.



**Nigel D. Wilson** {BIO 1535703 <GO>}

Thank you, Jeff. Clearly, this has been another great year of delivery. I'm both very pleased for my colleagues, I'm very proud and privileged to be the CEO of Legal & General. Record annuity assets, record assets under management and record insurance premiums. But what is really exciting, as Jeff mentioned, is looking forward, how our reshape business and focus businesses can address and build on so many global trends which are moving in our favor.

Our strategy begins with our six long-term growth drivers, which are highly relevant and drive continued growth here at Legal & General. To pick on a few, the aging demographics combined with pension and welfare reform is still leading to the significant DB to DC shift, which continues to gather pace. We now manage £68 billion of DC assets, the largest manager in the UK. We're highly focused on the whole DB journey, from LGIM's LDI products to buy-ins and buy-outs of LGR, and providing the direct investment to deliver the returns expected by our policyholders and by our shareholders.

We're also actively growing in DC both in the U.K. and so far in the U.S. Technological innovation drives so much today, but we, Legal & General, are more than keeping pace. Investing today's capital could provide a threefold benefit: solving customers' problems, building a better society, and delivering strong returns for Legal & General shareholders.

Inclusive capitalism means finding solutions that work for both Legal & General and for society. Having exited from some businesses, we can really concentrate our attention and energies on those that can make a real difference and deliver our unique model of inclusive capitalism. Within Investing & Annuities, we will continue to drive our global leadership in pension de-risking while investing policyholder and shareholder capital in direct investments to address the societal need in infrastructure and housing.

And then Investment Management, we continue to build out our world-class international businesses. And we are addressing the UK savings gap by growing our retail investments and workplace savings businesses. Finally within Insurance, we're seeking to harness technology to become a fully digital and data-enabled insurer, while addressing a clear customer need for financial protection.

The numbers Jeff took you through show we are very capable capitalists. But what we do also meets real customer and real societal need. Let me take you through each business area briefly. First, LGR within Investing & Annuities. LGR Institutional is our largest business and we continue to be really excited by its growth prospects. Our franchise, particularly including LGIM, gives us a differentiated ability to source attractive business.

Our financial and brand strength allows us to remain disciplined in our pricing. Laura has picked up the reins and has promised me another great year in 2018. In LGR, Chris has terrific plans to further broaden our individual annuity franchise within this important area, delivering complete retirement solutions. Then on the investing side of the business, we have a unique capacity to source attractive and high-performing direct investments via LGIM, via LGC, and via lifetime mortgages.

LGC has two principal goals. First, it uses our strengths including our existing businesses, network, brand and talent to invest our shareholder capital to maximize returns. Secondly, it supports our other businesses by creating or unlocking debt-like investments with great counter-parties for LGR, and by creating opportunities for LGIM and its clients. Recent examples include the Urban Regeneration project in Cardiff and seeding LGIM's Build-to-Rent fund. LGC invests in four principal areas: Urban Regeneration, Housing, SME Finance and Clean Energy.

LGC will take fund investments, outright ownership or equity stakes, but only if they satisfy our return criteria and are consistent with our strategy. This is a unique capability and will continue to evolve and accelerate its evolution under Kerrigan's new leadership. And I'd like to thank Kerrigan for taking on this exciting new challenge.

LGIM is a business we have built for the future. Once rooted in UK DB pensions, LGIM's strategy today is focused on three things: broadening our investment capability, growing globally, and expanding our UK DC and retail businesses to address the UK savings gap. We've expanded into the white space, huge multi-billion pound markets such as global high yields, multi assets, real assets, factor-based investing. We have no legacy problems on the upside. And we're taking a global lead on ESG, more of our inclusive capitalism. Sacha Sadan and his team are leading the markets across the world.

We plan to host the Capital Markets Day in June focused on LGIM. So, you can look forward to hearing more from Mark and his outstanding management team. Our Insurance business goal is to be a fully digital and data-enabled insurer. Firstly, we're looking to use technology to improve operational effectiveness, reduce costs, and improve customer outcomes with extensive use of robotics, AI, and big data.

Secondly, we are digitizing and diversify our distribution, for instance, SmartQuote for GI, where we offer executable quotes after only five questions by using big data. And as Jeff mentioned, we are already winning partnership business of this. Thirdly Insurance is where we innovate and explore alongside digital pioneers in Fintech and Insuretech. As Jeff said, GI delivered 13% growth in premiums in 2017 and indeed Cheryl and her talented team are planning to make me even happier by achieving even more growth in 2018 and beyond.

Although we have strong divisional accountability, collaboration and synergies enable us to deliver more than we ever could as individual businesses. It is a vital part of our firm's culture and a key positive differentiator. There are many, many examples of this providing institutional and corporate clients with consistent solutions across LGIM and LGR using asset source by LGM and LGC, leveraging our workplace customer base to offer products from across the group, and creating a single customer interface for over 10 million customers within MyAccount to provide access to retirement, savings and insurance solutions.

The refocusing of our business puts growth in the U.S. to the fore. We have three excellent growing businesses with great management teams; LGIM has delivered strong growth in client numbers including some of the largest U.S. DB and DC funds; LGR with a strong pipeline and a market, where only 4% of the £3.7 trillion of DB liabilities have transacted so far; LGI's U.S. term insurance business is well-positioned for the many opportunities we see for increased digital deployment and more D2C activity.

Now, a few case studies for future growth. In 2017, we launched LGIM's Future World Fund to address the demand for better risk-adjusted returns alongside greater ESG impacts. With over $6 billion in the fund to-date, we have a $100 billion ambition. And our Build-to-Rent fund is currently a £1 billion business, seeded by LGC, but it has also attracted investors from LGIM's global institutional clients. It is truly amazing that to-date we haven't created an institutional asset class in Housing in the UK. We will change that.

We see it as a £10 billion opportunity, which taps into the demand we are seeing right across the UK for high-quality, institutionally-owned rental accommodation, a classic case of fixing a market failure and using our commercial strength to help tackle a societal problem.

It's not just the millennials who face a housing shortage, but older people, too. Legal & General is once again providing a solution through later life living. Digital or Insuretech has become a watchword across our industry. It is also crucial to use data to improve the customer experience, which is what we do in GI through SmartQuote, SmartClaims. Five years ago, filling a digital side was demanding. Today, we have multiple projects evolving at real pace and with real energy.

We started a few years ago with four robots known as the remotes. Now, we have more than 50 with many more being developed to massively increase efficiency in our operations primarily in LGI. Our partnership with Slice Labs like our work in payroll lending with SalaryFinance addresses contemporary customer needs. So, another great year, but we remain ambitious. We achieved 17% EPS growth in 2016 and 9% in 2017. So, well-placed and on track for our financial ambition to achieve 10% EPS growth from 2015 onwards.

I feel like our business is in great shape. We are at a real inflection point. We have clear strategic goals we are delivering on. We have a great set of businesses unencumbered by the legacy of the past, a globally trusted brand and a great team focused on our exciting growth opportunities.

With that, let me open it up to Q&A.

# Q&A

## A - Nigel D. Wilson {BIO 1535703 <GO>}

Gosh. Oliver. Can we limit everybody to three questions at the most?

## Q - Oliver Steel {BIO 6068696 <GO>}

Oliver Steel, Deutsche Bank. Three questions. First of all, on cash, £3.4 billion is what you're saying you've got at the moment. I don't think that includes anything yet from the

Savings sale. So, perhaps you can talk about what it could be pro-forma. But then, I don't think what you've ever really sort of clarified is how much of that cash is actually excess, and perhaps you can also link it in with the solvency ratio now at 196%. How much of that is excess?

Second question is, what are you going to do with it? You've proved that a lot of your business is capital-light, even the annuities business is not facing that much strain. The sort of businesses you're in don't sort of sound as if they've got a lot of major acquisition opportunity (38:29) made the color. So, what are you going to do with it?

And then the third question is perhaps for Jeff. So, you're saying the longevity release in 2018 will be the same as 2017, and...

## A - Stuart Jeffrey Davies {BIO 20023574 <GO>}

You're right, what I said.

## Q - Oliver Steel {BIO 6068696 <GO>}

Well, you can correct that. You've also said you're going to spread it over several years, so does that imply that 2019 and 2020 are also going to be on the same area?

## A - Nigel D. Wilson {BIO 1535703 <GO>}

I'll get the first two and let - Jeff let lots of breadcrumbs for people to follow there and it's interesting to watch people's faces as they were trying to figure out exactly what he was saying, which he believed in rehearsals was totally clear (39:08). But he was getting points of correction from Mark Zinkula. So, it's right, on actuary and issues which is the first time. So, all that training that he's had to go through for several years beginning to show a benefit.

On the cash point, indeed, you're right, the £650 million of cash that we received from the sale of Mature Savings isn't included in the £3.4 billion we received on the 2nd of January. And as Jeff mentioned, that will result in over £400 million of profit being credited to the P&L in 2019. There was some other cash we received, which was as part of the transfer and that's in one of the footnotes which Jeff might highlight, which where that goes to.

On the whole issue of capital and what we're going to do with it, that's why I've got a great outstanding management team who are going to inundate me with brilliant ideas in the next few years. But you're right at the moment that we've created a very capital-light model, which is generating about £0.5 billion of extra cash per year that we're not actually using as a business, hence, the cash balance keeps going up and up and up and with the disposals goes up even further.

But because we got a 20-odd percent return on equity, we have business models where we can deploy the capital truly efficiently. We have a huge amount of white space to expand into and I alluded to a few of those areas. The rollout of Future World as a global brand is a key priority and one that Mark and I are massively enthused about on a personal level.

We have a series of bolt-on acquisitions that we're thinking of making. Mark's been thinking of making one in America for a few years and he's still thinking of it in 2018. I hope this year he actually gets on and does one of them because we need a great direct investment capability in the United States.

We've still got further opportunities in Cheryl's business and in Chris's business. So, we're not short of opportunities to deploy the capital, but we'll be very patient, we'll be very patient and very measured with the word that Jeff here used. And yes, the Solvency ratio is pretty close to 200%, but we like having a particularly strong balance sheet and we never had targets for our Solvency II ratio. Now Jeff, can you answer that third tricky question?

## A - Stuart Jeffrey Davies {BIO 20023574 <GO>}

Yes. It was all clear from the presentation as Nigel says. Yes, so the longevity, we will look at CMI 2016 way; we're waiting for our 2017 data to be fully developed. And as you note, we use an adjusted version of those tables, it was adjusted CMI 2015. So, what I talked about in the presentation was, if you just mechanically plugged in CMI 2016, you get an answer very similar to the total release that we had this year.

But, of course, we're not in a position today to say we will just mechanically plug it in, because we smooth out data to make sure there aren't blips in there. We look at our own portfolio. We look at our socioeconomic group against the underlying data. So, that's the reason for the caveats around it. It's not as simple as saying we'll just move to that table. There's a lot of work to be done for that, and understanding what's driving it and continuing to invest in understanding what's driving those.

And then, looking forward, yeah, we still talk about it the several years. Only last week, there was a CMI 2017 released and that showed the same sort of similar numbers. Again, you talk in small numbers that you saw the 0.2 change in life expectancy, but that would again translates into the same sorts of releases if you continue to see it. So, we need to see what comes out of our data and we will continue to keep addressing it. But we see the trends and we believe there is a medium- to long-term slowdown in mortality improvement in a short term.

## A - Nigel D. Wilson {BIO 1535703 <GO>}

Two actual points there, so both of our senior audit partners smiling that you gave the correct answer to the question on that. That should keep them both happy. I think the other point is I noticed one or two of the notes that came out this morning said the mortality release is one-off. I mean, I think Jeff's trying to say that it's not one-off, it's for multiple years and we're moving forward in a very measured way in terms of recognizing what's happening to longevity for the business.

Andy thought he was getting (43:40). That's what you get for being the broker.

## Q - Gordon Aitken {BIO 3846728 <GO>}

Thanks. Gordon Aitken from RBC. First on mortality. So, you have moved to the adjusted version of the tables. Clearly, your book's different. Just wondering how it is different and what actually has been your – the experience in mortality, the experience of your annuitants versus the population. Your book will definitely be wealthier than the population.

You talked a bit about this. I'm just wondering if you're holding because there's a bit of debate in institute of actuaries about how that wealthier segment is moving. So, I wonder if you're holding some prudence back here.

And as far as the second question is on retail annuities in the open market. You talked a bit about that as a proportion of the total annuity market. It was broadly 45% a year ago. I'm wondering what it is now, and how fast do you think the open market will grow?

## A - Nigel D. Wilson {BIO 1535703 <GO>}

Yeah. I'm going to let Chris answer the second question then Jeff's going to have, yet another go at answering the first question (44:48) you Andy.

## A - Stuart Jeffrey Davies {BIO 20023574 <GO>}

I mean, you're right in that, we have a slightly higher average socioeconomic group within us and there is more uncertainty about how wealth is impacting future improvement developments. We just released the paper along with the panel that we sponsor around what we've seen in the past, but there is that question of do you get faster improvements if you have more wealth because you can invest in that or if you already had all your improvements and, therefore, you may be slower going forward. And so, that just give us that little bit of extra prudence that we factor in. But in terms of underlying experience, there is nothing substantially different about what we have seen to date than what is coming through in the population data and pensioner data, et cetera.

## A - Nigel D. Wilson {BIO 1535703 <GO>}

Chris?

## A - Chris Knight {BIO 18966542 <GO>}

Yeah, thanks. Yeah, we see the open market continuing to grow. The whole market grew modestly sort of in 2017, up again over the last two years. And with 700,000 people coming to retirement every year going forward and with more DC money rather than DB income and we see that potentially grow, it's up for us to make that market.

I think the implementation of PS17/12 is also going to have an impact. That happened last week, so we'll have to see what that does. But that essentially means that when anybody gets here and usually quote going forward, they will be presented with the best price in the market as well as the price – immediate prices as well. So, we see that as being net positive for us over the long run.

## A - Nigel D. Wilson {BIO 1535703 <GO>}

One of the interesting not intended consequences of (46:25) pension freedom is we're going to see a lot more innovation in pension solutions being offered by providers like ourselves. And it was - in fact created destruction of work and one industry reduced in size massively and lots of other new industries are emerging around it and we're pretty much trying to be market leaders in all those other areas. And so far, DC has been a huge success, lifetime mortgage and later living are also doing incredibly well. Andy?

## A - Andrew Sinclair {BIO 17749036 <GO>}

Thanks. It's Andy Sinclair from BofA Merrill Lynch. Three questions from me please, firstly on LGIM. Just wonder if you'd give us about - thoughts on the pipeline of business coming into 2018 and also, what you kind of think of for the longer term cost-to-income ratio for that business.

Secondly, staying on LGIM, your recent ETF investment, Canvas. Just wonder if do you feel that gives you everything that you need to compete in the ETF space and how material can ETFs be for LGIM. And thirdly on the dividend, you've pointed towards EPS growth of 10% guided towards dividend growth of 7%. How do you feel about the divergence of these and kind of increasing coverage over time? Thanks.

## A - Nigel D. Wilson {BIO 1535703 <GO>}

Mark, you've got two questions to answer. I think this is the first time you've had two questions back to back.

## A - Mark Joseph Zinkula {BIO 16142450 <GO>}

All right, thank you. So, regards to the pipeline, I think we are expecting to see a continuation of what we have over the past two to three years, which is continued positive net inflows pretty much across the board. You saw this past year, we've seen an increase in flows in every region, increase in flows in DC and retail, down slightly in DB, but again, still positive and that we still expect to have continued single-digit profit growth for the foreseeable future in the DB market, while the other markets, obviously, were - the growth potential is higher.

We do have one which we announced last year, but we do have one significant outflow the first part of this year, which is the access local authority pension pool, which would be £6 million of outflows. So that's - again, there will still be a lot of lumpiness in the DB part of the business. But again, the underlying trends are still very favorable for a business model very broadly.

In regards to the Canvas acquisition, so I think, yeah, the timing is certainly right for us as we're expanding our retail business. As we pointed out earlier, we're doing very well in the UK retail market now. We're now expanding into Europe and ETFs are becoming increasingly popular in Europe for a variety of reasons, which I'll go into if you're interested in more detail. And we think we have the right partner. It's a great leadership team. And actually, since we announced the acquisition in November, assets are already up 25% from the announcement date and we'll continue to launch funds that would be expected, core funds and thematic funds and ESG-related funds would be expected from our brand.

## A - Nigel D. Wilson {BIO 1535703 <GO>}

Perfect. Thank you, Mark. Jeff, do you want to?

## A - Stuart Jeffrey Davies {BIO 20023574 <GO>}

Yeah. I mean, the short answer was similar to the earlier one around, we'll continue to invest. It's not a conscious decision to improve coverage ratios or anything else. We think it's a sensible number given where we stand and we continue to review the position – the board will continue to review the position across a range of metrics. So there was nothing magic about either of those. We genuinely believe that's our ambition around growth and we think that's a sensible place to set the dividend at this stage.

## A - Nigel D. Wilson {BIO 1535703 <GO>}

Okay. Laura, do you want to...

## Q - Ravi Tanna {BIO 16926941 <GO>}

Thanks. It's Ravi Tanna from Goldman Sachs. Three questions, please. The first one was just going back to the cash that was asked about earlier, the £3.4 billion. I was wondering if you could give us any sense of how much of that's encumbered versus what's freely available. And also if you could perhaps give us a sense of where that's sat, whether it's in LGF or elsewhere in the Group.

And the second one was just on the annuity business. Obviously, very strong new business surplus and you've referenced the contribution from direct investments and lifetime mortgages. There was a speech from the PRA last week referencing their scrutiny around use of matching adjustments, internally rated assets. And you've obviously talked about the scope to take that further. I was just wondering if you could tell us a bit more about your risk appetite in that context, please.

And then the third one was on LGC. Obviously, with the decision to sell out of investments and crystalize cash, there is a trade-off with profits to a certain extent. I know some is being reinvested and recycled. But could you give us a sense of that trade-off going forward, please?

## A - Nigel D. Wilson {BIO 1535703 <GO>}

Okay, on the cash, the cash at £3.4 billion was the cash that was largely held in LGC as you'll see in the slide. It isn't actually the total cash absolutely across the Group, which we didn't give. And there was £650 million that came in January in one tranche and £170 million in another tranche, so we've very long cash. I don't think we've ever given out the numbers as to what's encumbered and not encumbered given the model. Maybe Simon, do you want to just talk a little bit about risk appetite in general and in the lifetime mortgage markets specifically? And Simon's our CRO. And then Kerrigan, can you answer the LGC question?

## A - Simon Gadd {BIO 17956222 <GO>}

So as same as we presented before about all of our direct investments, the primary aim is to make sure that they are good match to our liabilities, and make sure that all the risks underneath them are properly assessed. The matching adjustment process, which was referred to in the question, and I happen to get approval from the PRA to any asset that goes into that portfolio, really ups the game in terms of making sure there is really rigorous assessment of the risks that the cash flows are as fixed as possible, so they are a good match to liabilities.

And lifetime mortgages, we have to put into a structure to do that. But again, that's being sort of rigorously assessed with the PRA and there'll always a continuing dialogue about that. We are very comfortable with the way we are currently reserving for and capitalizing against the risks for that product. So certainly, there is a limit to how much ultimately we can have indirect investments back in annuities, but we're a long way away from that at the moment because of the liquid nature of those liabilities. So I think it's about 17% of the portfolio. Currently, we've got plenty more scope to increase that without encumbering any illiquidity issues.

## A - Kerrigan Procter {BIO 15093363 <GO>}

Great. Yeah. Just on the reinvestment and recycling of capital within LGC, we have a range of assets within LGC on the direct investment side. We have yielding assets, development assets, operational assets, and then a start-up area. And of course, some of those assets come to the end of their useful life with LGC and it makes sense to sell them on things like part of our office developments in Cardiff urban regeneration, we sold those on, parts of Bracknell, moved on.

And, of course, we got really exciting reinvestment opportunities, so things like some of the land we bought for our communities business, where we're building out 3,000 houses. And the exciting opportunity - the really exciting opportunity in later living, where we've put £100 million in in 2017. So the net investment was posted - we're expected to do some guidance on the future. We expect to put more of that into some of those really exciting opportunities in later living, for example. Some of the existing urban regeneration plans could be developed out and we're working with further cities, really exciting plans on clean energy, where we've only just started and we've got about £100 million in a range of Fintech, proptech, and healthtech companies that's incredibly exciting and we can curate and develop further. So it's going to be net-positive obviously, in a whole range of really exciting areas.

## A - Nigel D. Wilson {BIO 1535703 <GO>}

Yeah, I think we took a very measured approach here as well is that we wanted to do a proof of concept, because we know what a cynical group of people we have in the room with us today. So build it and sell it is part of it. And it was great to see in Cardiff that there were two European investment firms who bought the assets and a Canadian firm who bought it in Bracknell.

So it wasn't – I don't want to say (54:40) that was in the plan, but it wasn't in the plan that actually these would have wide international institutional appeal, which is something we found to be unexpected, but actually beneficial to us as a company. Do you want to just start?

## Q - Colm Kelly {BIO 19140684 <GO>}

Colm Kelly, UBS. Thank you for taking my questions. Firstly is on the margins. As mentioned earlier, the annuity margins and the new business margins are improving materially through the direct investment strategy. As well as what – how do you see that trajectory in terms of margin expansion going forward? Is there more to go there? I know Kerrigan previously mentioned there was a bit of a ceiling in terms of how much lifetime mortgages could be used within the asset portfolio given the need to maintain matching. So maybe just a color on that. And also just why maybe the Solvency II new business margin has come down a little bit since the half year.

Secondly, on LGIM, again, performing very well on flows, on earnings, also the cash remittances are up, I think, for the first time since 2014 with a payout of 76%. So just thinking about how that progression in the payout from here given it had come down a little bit prior to this year, are we going to see continued growth in that cash remittance number or should we expect a little bit more held back for maybe reinvestment or acquisitions in the asset management space as alluded to earlier?

And then, finally, on the subsidiary cash remittances, you provided enhanced disclosure on that. So thank you for that. I'm assuming the sale of co-funds and the proceeds has not been remitted from entities and so maybe is that flagged for reinvestment?

And then, finally, there is the other subsidiary remittances of £120 million. So I was just wondering if you can provide a little bit more detail on what is driving that. I think last year, the sale of Suffolk Life contributed to that number. I'm just looking at some of the subsidiaries underpinning it. I don't think they have paid dividends largely in the past per L&G Re. So just maybe color on where exactly it's driven from and can we expect continued growth in that number going forward? Thank you.

## A - Nigel D. Wilson {BIO 1535703 <GO>}

Okay. While Jeff's thinking of couple of the answers here, I'll give a bit of waffle to (57:05)

On how we think about the portfolio, the thing that we are trying to flag is, we have over 20% in sovereigns and moving from sovereigns area to direct investments or lifetime mortgages is a phenomenal trade for us and hugely value credit (57:24) and we haven't really started on that. So there is a lot of back-book optimization that if you want to talk to Laura and Chris afterwards very specifically on the actions that we set in the size of the price in that given area. But I don't know whether you want to add anything to that or take that very complicated last question or do you want to take one offline as to what the remittances is going to be – the mix of remittance.

## A - Stuart Jeffrey Davies {BIO 20023574 <GO>}

Yeah, I was going to say £120 million remits, it is probably best to just chat with Gavin later on, on that. But some of that is tidying up, some of them are smaller entities just paying small amounts at – I mean, obviously, the vast majority of remittance comes from LGIM, LGAS, et cetera, and that's where we're seeing good progress, good precedent around release of the longevity release and then the dividend pain on top of the underlying and (58:14) trying to get more disclosure of the £1.6 billion paid out from what are we moving to Group and where is that sitting. So that was the main thing around that.

## Q - Colm Kelly {BIO 19140684 <GO>}

(58:23)

## A - Stuart Jeffrey Davies {BIO 20023574 <GO>}

Yeah. That's a – well, that was start of 2017, we would've dealt with that, just as normal course of dividends as it was paid through and it's pretty clear in the dividend strategy around what we paid through LGAS, et cetera. And just adding on the annuity new business margin, et cetera, I mean, it was sort of following up from the previous question as well. I mean, as Simon says, we are 17%, 4% lifetime mortgages of the total book. As an in-force portfolio and overall, we believe there's plenty of headroom in that. We could easily go 30%, whether 40% is the right answer, but certainly, there's headroom there, which is a number of years of add-in to that book.

And lifetime mortgage grows as we grow new business, we grow the total book, we can allocate this DI that we warehouse either to the in-force or to new business. We'll be disciplined in that and because we have that optionality with the in-force, we can maintain the pricing discipline. So, we're very focused on the right new business, added value, the right returns on economic capital and knowing we can apply to the in-force if we need to.

## Q - Colm Kelly {BIO 19140684 <GO>}

Just on the LGIM payout.

## A - Nigel D. Wilson {BIO 1535703 <GO>}

Yeah. I mean, I think – thinking a lot (59:43) last year, some of you pay a huge amount of attention to this. Whereas, in fact, we usually round it to the nearest £50 million and some of the internal stuff. And then, you get (59:53) 76% or 72% or 78%. We rarely do that, but we try to demonstrate this year that there was a huge amount of remittances, and rest assured there will be a huge amount of remittances again this year because we hadn't realized the sensitivity of some of the analysts to exactly making sure that we don't have trap cash or trap capital in the division. So, we recognize we didn't succeed last year in convincing all of you. So, Mr. Crean, in particular, came and gave me a touch of my collar to remind me that actually this is part of the equity narrative. And then we'll come back to you, Greig.

## Q - David Andrew Bracewell {BIO 16394801 <GO>}

Great. Thanks for the question. It's David Bracewell here, Redburn. Two questions, one on the workplace savings, there's going to be an increase to the contribution rates this year, also in the year after. I'm just wondering how that will affect your business. I don't know what your average contribution level is for your current workplace flow, so I'll just be interested to hear how that might impact the flows there.

And the second question is on the risk margin for the annuity business. There's a good chance the PRA going to maybe change the rules, they'll allow you to have some flexibility. Just wondering, if they do relax the rules there, what you might do in terms of strategy. Would you reduce the reinsurance that you purchase or actually if we that the reinsurance is so cheap, you might keep that going forward? Thanks.

## A - Nigel D. Wilson {BIO 1535703 <GO>}

They're both very good questions for all sorts of odd reasons, which we'll go in afterwards. But, Mark, why don't you explain why everyone in the team had done such a fantastic job in the DC space?

## A - Mark Joseph Zinkula {BIO 16142450 <GO>}

Yeah. So, in the workplace business, so contribution rates are scheduled to go up. Many of our clients or our customers are already at an 8% contribution or thereabouts. So, we would expect there to be somewhat of an uptick and we don't expect persistency to go down. The concern is when the contribution rates go up, obviously, that there might be some lapses. So, on balance, net-net, a slight positive for our business overall.

## A - Stuart Jeffrey Davies {BIO 20023574 <GO>}

Being in actuary, I love the answer to the next. It depends. Yeah, but it does depend. If there's a movement, it will come down to what is the cost of reinsurance versus how much is the risk margin being reduced and the cost of capital trade-off. We've always said that. And it entirely depends how much any risk margin reduction would be. And we will then review - the reinsurance remains very good value for both parties. And we have a good supply. We have the 14/15 (01:02:26) on a panel that we can get reinsurance from. So, we've maintained to look at that, the operating model, obviously with the focus as well on new business strain and managing that on a Solvency II basis, ensure we would continue to be capital efficient.

## A - Nigel D. Wilson {BIO 1535703 <GO>}

Okay, Greig?

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

Greig Paterson, KBW. Morning. Three questions on the numbers. I was surprised at the jump in annuity margin, and I'm talking about on your new business release basis. You allocated 80% - sorry, you reinsured 80% of longevity in the first half - on the new business in the first half. What percentage did you reinsure in the second half? I'm trying to understand the change. And second point is in terms of direct investments, what percentage were allocated in the first half to new business - into new business as first and second half? And then, just finally, if you can give us some guidance on where you see the sustainable tax rates going forward at the operating level post the U.S. changes.

## A - Stuart Jeffrey Davies {BIO 20023574 <GO>}

Okay. Yeah.

## A - Nigel D. Wilson {BIO 1535703 <GO>}

Yeah. A little bit on the first one, just by way of background, I think people often forget the individual annuity business we don't reinsure at all. The U.S. annuity business we don't reinsure at all. All the back book transactions we don't reinsure at all. It's only the UK PRT business. And so, it's hard to do linear mathematics when there's lots of changes in the mix.

And it's really – answering the preceding question, it's the ratio that we have in the UK PRT business which may well change going forward depending on what percentage (01:04:14) those. And if you – any of you want to be really technical about this, Tim Steadman was an incomprehensible answer to Jeff and I last night, which was depends. And you can do the depends-sensitivity with Tim afterwards, but do you want to add?

## A - Stuart Jeffrey Davies {BIO 20023574 <GO>}

Yeah. Sure. I mean, in terms of first half to second half and percent, I mean, it – very similar, the model hasn't – didn't change, just 80%, 85% reinsured on the UK PRT. We look at each case on individual basis, depends how much deferred and in payment is in a transaction and what the pricing is, especially on deferred reinsurance where it's available. So, some of that drives it, but there isn't any conscious decision that was made between first half, second half on that.

In terms of percentage of DI, I mean we don't – we haven't been explicit on how much we're allocating to new business versus in-force. I mean, some of the useful metrics is we carried over more DI than we had the previous year. So, we could have allocated a lot more if you wanted to make numbers look better, and we effectively warehouse some of that.

I think the other thing which has improved the margin significantly is obviously greater amount of lifetime mortgages. If you're writing deferreds and you've got lifetime mortgages, that is a reasonable pick-up on yield compared to any other assets we'd be sourcing at the very long tail big impact, long duration, higher-yield pick-up. So, that has an impact on that. Tax rate...



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

Was it increased first half versus second half?

## A - Stuart Jeffrey Davies {BIO 20023574 <GO>}

No. No particular change there. That's right. On tax rate, yeah, the simple answer is it's, at the group level, it's materially neutral on an ongoing basis. It was very much a one-off. So, I mean, there isn't much more to add to that, to be honest, given how big it is compared to the rest of the group.

## A - Nigel D. Wilson {BIO 1535703 <GO>}

Yeah. Laura, do you want to pick up the bits that Jeff missed out on what the – how warehousing works, which I think a lot of people haven't fully covered and the – what the opportunities are in the DI space moving forward?

## A - Laura Mason {BIO 20420360 <GO>}

Yeah, sure. I mean, I think on Jeff's slide, he was very clear about the relative proportion of direct investment and lifetime mortgages in our portfolio growing over the year as the size of our book grew. And the diversity point is a really key point. Through us, divest – direct investments is now almost a flow business. Lifetime mortgages have been highlighted. The other one to highlight is the LGIM's real assets' private placement business both in the UK and U.S., as well as some of the other sources that we're working on with LGIM real assets, and really importantly, the opportunities we're unlocking through LGC. So, we've talked about Cardiff. Newcastle is another one. We did a really successful deal in Leeds, Headingley, on the back of work we've done with LGC in Thorpe Park. I'm looking forward to working with Kerrigan, really, with LGC to unlock further opportunities in the sectors we've chosen.

## A - Nigel D. Wilson {BIO 1535703 <GO>}

Yeah. We don't think anybody else has this sort of LGIM, LGC, LGI capability. And because we created huge amounts of optionality over the last four or five years in all these towns and cities across Britain, we will reap the benefits of that in future years. And Chris and the team are innovating hugely in the lifetime mortgage market, which is going to increase the flows of that business coming. And as Simon mentioned, we're well below our risk appetite at the moment.

Jon? And will come back to this side.

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

Morning. Jon Hocking, Morgan Stanley. I've got three questions on LGIM, please. Come back to the ETF point, one of the conventional wisdom is unless you're a top five player on ETFs, you don't really make any money, and it's a very crowded space. But I guess, on the flip side, you guys are running at sort of 4, 5 bps expenses. So, I just wonder whether we should think about ETFs differently if you – given your expense base. That's the first question. And then, secondly, on the sort of factor-based investing, is this just sort of full-on quant counter offer? And what capabilities do you have there? What capabilities do you have to need – do you need to build rather?

And then, finally, you've got sort of three strategies there which are pretty low-cost fees of funds. You've got the sort of classic index business or passive business. You're going to have the – you have the ETF platform, and you're going to have quant. Is there sort of issue here with sort of crowding in terms of go-to-market offer? You've been so well known in that sort of index space. How do you actually sort of pitch to institutional/retail clients when you've got sort of three things, which should extensively produce something very similar?

## A - Nigel D. Wilson {BIO 1535703 <GO>}

Yeah. Well, Mark is thinking of answering the first three. I think the key thing, we have such huge white space to go into – Mark and I have done a few trips to America, to the Middle East, and to the Far East. And what struck us is, is how well the brand resonates with all sorts of customers around there. And the sort of values and behaviors of the firm that are really highly regarded. And other colleagues have gone then and made it easy for us, as I say, when we went down.

But the reception we've got has been absolutely outstanding. And now, it's putting people on the ground. And as you said, we have much more equity narrative or narrative around the products and solutions that we have, and people, we're getting demand pull. I mean, Australia is somewhere we haven't even visited, but we're winning mandates. Korea, Taiwan, Japan, they're all areas, where we're just beginning to put the infrastructure in. So we've had demand pull ahead of the infrastructure.

Mark, you might want to answer the three questions.

## A - Mark Joseph Zinkula {BIO 16142450 <GO>}

Yeah, absolutely. And the related questions are very good questions. Conceptually, thematically, what's happening is the index market, the passive market is still evolving. And it's from a product vehicle perspective, as well as product design perspective. And so we still have a lot of demand in the core index space, but the market is evolving toward factor-based investing. So investing in different kinds of indices to meet client needs, which we define as factor based or some people call smart beta. More thematically, into the ESG space, you're talking about the future world fund and so forth. And there is a blurring of the lines of what's technically index or passive, and what's a bit more than that. But this is the direction of travel and we want to be we are I think right now, but it's early days a market leader developing products that are going to meet evolving industrial demand.

And as part of this value proposition is just the strength of our corporate governance team, just the importance that's being placed, especially from institutional investors over time by the millennial crowd and wealth managers and so forth that we are proper stewards and doing our part as one of the largest asset managers to hold companies accountable for a variety of ESG topics. And some are more higher priority than others for various clients.

With regards to the ETF space, understand the conventional wisdom. I mean, keep in mind, this is still very, very early days for the ETF market here. Vanguard was a late entrant in the U.S. back when the ETF market was evolving there. And we have a very strong index brand, a very strong passive brand. Yes, we have the scale, but we also have the brand. We're known to be in the space. ETFs are primarily a vehicle for index strategies, broadly speaking.

So we do believe that we can enter the market, not starting as a top five provider, but grow rapidly over the next several years. And again, it is off the strength of our scale, our operating model, and our brand, and it's still – it's very early days in this market, outside of U.S. frankly, and everywhere else in the world. I think I covered all the questions.

## A - Nigel D. Wilson {BIO 1535703 <GO>}

Okay. We're going to go here, then (01:12:01) Andrew. Okay, do you want to move it up? Yeah, Barrie?

## Q - Barrie Cornes {BIO 2389115 <GO>}

Okay. Good morning. It's Barrie Cornes, Panmure Gordon. I've got a couple of questions. First of all in terms of the lifetime mortgage market, I wonder if you could just give us a view in terms of the outlook and also maybe comment on any essential regulatory concerns over policies, which you canceled relatively early.

And the second question I had was in respect to the credit default reserve, which I presume has got no drawdown during the year. I just wonder whether or not there is any chance of a reserve release there? Thank you.

## A - Nigel D. Wilson {BIO 1535703 <GO>}

Addressed that question five years ago, Barrie. And I like to just give you the same answer that we gave five years ago. I mean, we've almost never had a drawdown on the default reserve. I know KPMG was studying it very carefully for their year-end as we're switching auditors. We've had PricewaterhouseCoopers, I think for me, 175 years as our auditor, I think the original auditor was in fact Price, all those years ago, but it's something that – we constantly actively love to see whether we have excessive of prudence built in the credit default reserve.

And, Chris, do you to talk about the lifetime mortgages? And you should – Steve's here today. And so if anybody's got a lot of detailed questions, then Steve will be around afterwards to answer them.

## A - Chris Knight {BIO 18966542 <GO>}

No, we're very positive about the lifetime mortgage market going forward, £1.5 trillion of equity owned by people in retirement. But I think this is right for innovation going forward. We absolutely try our best to go way beyond the sort of regulatory compliance minimums to make sure the customers are getting really good value for money. For example, by making all our products flexible, so people only borrow what they need to borrow when they set one up, and then they come back to us for future borrowing.

We've not seen – and I think probably because of our approach to compliance and distribution oversight, we've not seen a lot of early redemptions at all. It's not a big – not even a small issue, really, for us. Those of you who read The Sun, yesterday you will have seen they helped us announce our property refurb lifetime mortgage, as there is a huge people living in houses that are highly unsuitable for them, and we can help them fix their house up and make it livable and rent it all out, so on and so forth.

So whether it's sort of silver separators, divorce being an issue, people living without children, it's a huge – if you're living without children, 1 million over 60 living – ageing without children, why on earth would you not want to take a lifetime mortgage out of it? What are you waiting for, that kind of thing. So I think there's tons of things that we can do to (01:14:43) the mortgage here. Application form is awaiting.

(01:14:46)

## A - Nigel D. Wilson {BIO 1535703 <GO>}

You wanted to know, like it's a 25% conversion rate today. So when you saw the audience go in.

## A - Chris Knight {BIO 18966542 <GO>}

As you can see, we're quite passionate about growing this market.

## A - Nigel D. Wilson {BIO 1535703 <GO>}

Yeah. There was a sentence there, Chris, I'll just show it. When you all read The Sun yesterday, which I thought is a – they didn't all read The Sun yesterday, (01:15:11) they can have a copy of us.

Thanks so much. First one is a kind of numbers question on the figure you show on slide, the mortality basis slide, where you show the CMI 2015 impact at 65 at 23.5. I'm just trying to remember what CMI unadjusted was. I think it was 22.8. And I was just wondering the margin versus what the population stuff is? Because basically, the point is I'm trying to work out, A, what I'm looking at here, the 23.5, is this your base table bulk annuity rolled up with all your assumptions? And it sounds like you've put an extra smoothing factor on top of the base CMI stuff because you talked about smoothing. So have you used a different smoothing, just went to the CMI which you can do? Or are you using the base CMI tables on top of your own population?

And the second question is more strategic one. So the 10% EPS growth sort of ambition thing, it's a bit hard for businesses largely kind of annuities. So maybe you could help us out as to how you're going to grow the earnings by 10% per annum? Thanks.

That was also a question we were asked five years ago. I think, since then, we've gone at slightly faster than 10% per annum. Maybe you want to take the first question, Jeff?

## A - Stuart Jeffrey Davies {BIO 20023574 <GO>}

I mean, the first, and fairly straightforward, there was big letters I'd say (01:16:35) illustrative, and that's very much what it is. Now, is it the best? Is it IFRS basis? That is one age that we chose to just show how we're changing the underlying. But yes, as we said earlier, we do apply smoothing to. We apply smoothing to our own data. We apply smoothing to how we bring the CMI tables in, so they're all adjusted. And that's just an indication of what the movement has been on a IFRS-type basis, or a best estimate basis.

What's the – it's the quantum change that's important, the 0.1 or the 0.2 rather than the absolute number.

## A - Nigel D. Wilson {BIO 1535703 <GO>}

Yeah, I think on the EPS thing, we have a multitude of businesses now in the portfolio. At a personal level, I think they're all capable of growing at circa 10% per annum, LGIM, LGR – the two LGR businesses, LGC, and GI. I think Bernie's got the most difficult task with the current portfolio to get 10% growth in the Retail Protection businesses. I think given the great work that Steve and the team did in 2017 in Group Protection, I'd be disappointed if we didn't get 10% growth in the Group Protection business. So when we come here next year, Steve will be standing proudly up and telling you we did in fact achieve that in 2018.

Andrew?

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

Good morning. It's Andrew Crean with Autonomous. Can I ask three questions? On the protection side, can you just give us the numbers for what the hedge on Retail Protection was, and whether you have got over the persistency problem now?

Secondly, on equity release mortgages, is there a finite amount of appetite you've got for this. It's the one product which has got a cliff guarantee in it. It's very Continental European rather than UK. The PRA I think in June came out with some quite scary statistics for what would happen if housing fell 25%, 30%.

And then, thirdly, what's the nature of the annuity pricing competition? You've got the normal BPA marking. Then, you've got this enormous life back-book coming in. What is the pricing comparison between the two? And is the tail wagging the dog or the dog wagging the tail?

## A - Nigel D. Wilson {BIO 1535703 <GO>}

Yeah. We'll answer in reverse order. I think both the customer business in the UK where we mentioned the £17 billion which is the highest, we usually have about £10 billion in the hopper, we've got £17 billion in the hopper, depends on how much we convert in that. But there's an increase in demand and supply in the UK at the moment certainly, and that's going to work its way through the marketplace. And the point that I think Jeff and I were trying to get across was we have a lot of pricing discipline around that.

So, we're not going to chase any particular individual transaction because we have a ever-increasing breadth of opportunities that we're being presented in the market. But we certainly have enough risk appetite, capital, and direct investments to support a pretty high level of growth in 2018 from the size of the back books that we've got. And I don't know whether Chris or Simon want to take the equity release issue. Maybe Simon?

## A - Simon Gadd {BIO 17956222 <GO>}

Following up on that, the answer I gave earlier. So, in total, the DI, we have an appetite threshold for. For lifetime mortgages, I'm going to use Jeff's answer about the depends again. It depends on the mix of that business. So, it very much depends on how much your average loan-to-value is on that portfolio. We are very careful not to be aggressive on loan to value, and try and keep that down to as low as possible, so that we've got the bandwidth to accept volatility in house prices. So, as long as we keep that down, then we'll have more capacity. Also, I think there was mention about a new product that we're launching in that space where, effectively, the borrower pays the interest, carries on paying the interest, (01:20:48) a lot more...

## A - Nigel D. Wilson {BIO 1535703 <GO>}

No, we haven't announced that (01:20:49). That was in the rehearsal.

## A - Simon Gadd {BIO 17956222 <GO>}

We're a lot more protective in that type of product than we are in a - one way, there's a roll up of interest. So, yeah, it would depend on the mix of business as to how much we can. But we are very on top of being very prudent about our assumptions about future house price inflation.

## A - Nigel D. Wilson {BIO 1535703 <GO>}

So, we have some very exciting new products coming. And you heard it first today in here. We're trying to figure out how to answer this question yesterday. And Simon, obviously, didn't hear the answer where we went - Bernie's going to answer the other question.

## A - Bernie Hickman {BIO 19334629 <GO>}

Yeah, on page 32, we set out experience variances and valuation assumptions. It's fair to say we haven't got a problem in persistency. We've actually got customers really happy with us and we've got lower lapses, it's just in later durations. And on our level term business and our whole of life business, the premiums stay level. The claims and quite a bit of our reinsurance premiums go up. And so, it's just a mechanical fact if we get people happy to stay with us, we actually make slightly less money. And so, that's just a kind of minor impact.

Just give you a quantification on that, there's sort of talk, like a level term - long-term persistency rates. We've seen lapse rates of 3.3% go into 3.1%. So, it's quite a tiny change in lapses. And we hope customers carry on wanting to give us premiums and remaining in-force. And we'll be doing what we can to keep them happy. So, yeah, that's what's going on broadly with the lapses and the figures are in the pack.

## A - Nigel D. Wilson {BIO 1535703 <GO>}

The price of success. Last two questions, we'll try and finish by 11:00, okay?

(01:22:32) from Citi. Just two questions, please. If we see rates increase, presumably good for bulk annuity demand, does it have any impact on the ability to source direct investments? So, does it make that harder and does that become an issue for you guys as bulk annuity demand presumably increases? And then, secondly, as you're looking to replicate your UK model in the U.S., specifically in the PRT space, you've seen, I think, 60% growth there this year. The market itself grew I think 70%. Which areas - how do your models differ right now? And specifically, if you could talk a little bit about infrastructure - direct investment sourcing differences and any plans that you have there going forward.

Yeah, I'll let...

Thank you.

Laura pick up the second question there. On the first question, just in general and on DI, you're right in a sense that will be terrific for us to if the interest rates go up. Our balance sheet will look even stronger than it does today. But we don't see any sensitivity around that. I think there is just a huge demand for new assets across the UK and across the U.S. and Europe. And both have recognized how crappy their infrastructure is. America gives itself an official rating which is now going from C- to D+. So, they're in a poor state there.

But also, in the UK, and the expression we've used is a sort of coalition of the doers. There's lots of discussion about levers and stairs. But outside of London, it's all about who wants to do things. And we're finding pretty much across the country getting PRS scheme through, housing schemes through, or urban regeneration projects, roads, et cetera, relatively straightforward, probably the best environment we've had for 30 years. It's still a C+, but it's moving towards a B in terms of how much better it's getting here in the UK.

And, Laura, do you want to...

## A - Laura Mason {BIO 20420360 <GO>}

Yeah. I mean, really, just expanding on some of the points I made earlier that we've organically grown great - a great platform for sourcing direct investments, probably quite different to our competitors because of the in-house capability we have through LGIM real assets and LGC. And really worth reiterating that we've - I think we've really only just begun to scratch the surface of the opportunity that we have through LGC. So, we've been very vocal about some of the things we've done in urban regeneration. And if you think about the other sectors that we've chosen to invest in, housing and clean energy, both of those have huge potential for long-term financing and creating investments that will fit our annuity liabilities.

## A - Nigel D. Wilson {BIO 1535703 <GO>}

And one of the key messages is this capability. And if you think Kerrigan's move from LGIM to LGR to LGC. Laura has moved from LGR to LGC back to LGR. Chris has pretty much worked in every division right now. Well, Mark Zinkula just seems to stay at LGIM all of the time.

Last question.

## Q - Angel Kansagra {BIO 19712659 <GO>}

Thank you. Angel Kansagra from HSBC. Three questions, please. The first one is you have given the split of cash remitted to the group from subsidiaries, which is a welcome disclosure. Would you ever think of giving the split of operating capital generation by divisions? So – because it's quite strong to see that the operating capital generation, cash remittance comfortably cover the dividend. But to just see what the divisions are contributing that would be useful.

The second is on net capital strain. How much net capital strain have you seen from the UK PRT in particular, if you give the split from that? And the third one is, I know you can't or you won't actually comment on political outcome, but if a Labour government comes in, they're talking about nationalizing some of the industries. Have you thought of taking any action on your credit portfolio, in particular utilities? Thank you.

## A - Nigel D. Wilson {BIO 1535703 <GO>}

I'll answer the third question, which is one of my specialist topics, but I'll let those really difficult first two questions pass to my colleague, Jeff Davies.

## A - Stuart Jeffrey Davies {BIO 20023574 <GO>}

(01:26:43) first?

## A - Nigel D. Wilson {BIO 1535703 <GO>}

Yes.

## A - Stuart Jeffrey Davies {BIO 20023574 <GO>}

You're talking the operating cash generation, you mean on the 72 (01:26:48) basis?

## Q - Angel Kansagra {BIO 19712659 <GO>}

The capital generation (01:26:51)...

## A - Stuart Jeffrey Davies {BIO 20023574 <GO>}

Yeah. That the issue with that is, of course, you've got to allocate the capital. So, I think it would get a little bit messy. So, that won't be part of the issue of allocating it both between Legal entities and divisions, you start to make so many assumptions that we probably wouldn't get it passed the auditors to be honest. So, I think that's the issue that we will be as transparent as we can around this stuff. Having said that, we haven't been explicit on the strain, but we do – we say that it's less than 4% for PRT business, which is predominantly UK. And so, that gives you an indication. So, that gives you the negative. We then write a lot of other business, like LGI, which creates positives and offsets, and brings you back to the less than £100 million number that we quote as the total across the group.

## A - Nigel D. Wilson {BIO 1535703 <GO>}

Yeah. On – I mean, the political situation, I mean, I've never met Corbyn, and I don't know him well. So, it's difficult to have an informed judgment on exactly what's going to happen. What we have seen is, is our experience with the local authorities across the UK, and regardless of whether they're Labour conservative, whether it's Bath, Bristol, Birmingham, Bracknell, Cardiff, Leeds, Manchester, or Newcastle, they're just a whole array of political people. And the Labour mayors or the Labour politicians and the Conservative have been equally enthusiastic about being involved with those.

In respect of utilities, quite a lot of the utilities are actually in America because – and the BBB rated American utilities. Yes, we have some exposure in the water, but it's at the most senior level. And if you want the exact numbers for that, then I'm sure Laura can provide those to you afterwards. We've looked at the portfolio and we think we've got no portfolio adjustments that we need to make as a group in respect to the ongoing political climate. We're very happy with the diversified niche. I mean, it's the switch out of sovereigns into something that's kind of the biggest change in the stock. The various floor changes that Chris talked about and Laura talked about and Jeff talked about earlier, which we'll see over the next few years.

By way of wrap-up, I'd just like to say thank you for everybody for their interest in following Legal & General. Thanks once again to all my colleagues for great results in 2017. However, it's 2018 now. And my colleagues know well, I waited a whole day, a whole day before sending them out a memo as to what we needed to do for 2018 and beyond. And the enthusiastic response to that memo is, I congratulate them on that. So, thank you. Bye now.