Q4 2010 Earnings Call

Company Participants

- John Whorwood, Group Treasurer
- Justin Brown, Annuities
- Matt Hotson, IR and Strategy Director
- Paul Stanwick
- Simon Burke, Group Tax Director
- Tim Stedman, Actuarial Function Holder
- Unidentified Speaker, Company Representative
- Wadham Downing, Finance Director

Other Participants

- Andy Hughes, Analyst
- Blair Stewart, Merrill Lynch
- Greig Paterson, Analyst
- Oliver Steel, Analyst

Presentation

Operator

Hello and welcome to today's Legal & General preliminary results 2010 technical conference call. During this call all participants will be in listen-only mode. After the presentation there will be an opportunity for questions.

I will now hand you over to your first speaker, Matt Hotson, Director of Investor Relations. Matt, over to you.

Matt Hotson {BIO 15471425 <GO>}

Thank you. Good afternoon, everybody. Good to see a number of you on the line. We thought this morning's results were reasonably straightforward. And I guess, the calls that we got this morning didn't throw a huge amount of difficult problems that we have taken into this afternoon's session. Although we have had one or two queries that we are going to walk through first.

The same format as we have done before. We will sort of do a listen-only Q&A session where I will read the question, and some of the technical experts who I've got in the room with me here will answer. Then we will open up the call to any other questions that people have got after that.

So with no further ado, we will kick off. The first two or three questions are regarding some of the actuarial reserving and modeling, which Tim Stedman is going to answer. First of all, on BPA data loading. What is it and how is the GBP59 million positive effect from BPA data loading, how should we think about that going forward?

Tim Stedman {BIO 19448392 <GO>}

So what is it? I think most of you are fairly familiar, but when we write a BPA contact it does take us a period of time before we can finalize the scheme data with the trustees, and finally load that data onto our admin systems.

We don't take any material risk against that data, but until we've got certainty over it, we hold some prudence within the reserves for just the uncertainty around the data. Once the scheme is loaded we can release that prudence.

So toward the end of 2008 and early 2009 we wrote a fairly significant number of schemes which we couldn't load onto the admin systems in the short term. Those schemes during 2010 went through the loading and verification process. And so we were able to release the prudence in the reserves and that is what you can see coming through today.

Matt Hotson {BIO 15471425 <GO>}

Okay, next question is on inflation modeling benefit. Where there are some numbers in the accounts specifically what have we changed in order to produce that benefit. Tim again.

Tim Stedman {BIO 19448392 <GO>}

This was something that came through at the half-year. As we said then, we prefer[ph] a rolling program of reviewing our models. In the first half of 2010 we looked at the inflation modeling around deferred annuities, and there were two elements where we were able to improve the modeling.

First of that relates to the inflation of benefits just in the year prior to retirement, where actually -- the benefits stop inflating sort of six to nine months before the contract vests, but the models were assuming that the benefits continued to inflate. So we basically improved the modeling around that, which released some liability.

And the second thing that we did was improve the modeling around our cap and collar benefits. These are ones where increases are capped at a certain rate of increase, and if inflation goes above that then the cap kicks in. And in some of those we found in some instances we are adding a bit too much inflation, sort of exceeding the cap. So we were prudent -- and again, we have improved the modeling there. And the net effect of both of those added up to GBP84 million.

Matt Hotson {BIO 15471425 <GO>}

Then the final one in this area is the GBP43 million reserve release in protection.

Tim Stedman {BIO 19448392 <GO>}

The vast bulk of this relates to a release of margin, again, at the half-year around improving our modeling of waiver of premium. Then towards the end of year when we reviewed the basis for the sort of standard sort of annual review there were a few other small items plus and minus.

Matt Hotson {BIO 15471425 <GO>}

Okay, moving on to a question, which I think got raised briefly this morning, but a bit of follow-up questions on it in terms of the interplay between the increase in the Euro CP paper and the reduction in the Triple X reserves, which John Whorwood, Group Treasurer, is going to respond to.

John Whorwood {BIO 15470378 <GO>}

The question related to actually the full effect last year of the Triple X -- the first securitization in terms of the Triple X Group of the Potomac Dutch Auction securities. And we financed that while producing commercial paper. So we spent a total of $360 million on buying back notes, and that represented the $440 million par value of the total $550 million securitization. And that was financed by using CP. So the principal reason for the increase in our CP at the year-end relates to that.

At the same time you will have seen that the nonrecourse Triple X debt on the balance sheet relates to the Fairmac[ph] issue, also reduced by the (inaudible) we actually purchased.

There was a gain on the buyback circa[ph] 80 million, and that was reflected in the international investment payers[ph] which reported a figure of 28 million of the 35 million reported in 2010 that was vested[ph] in 2009 as well.

So we did talk about in the call earlier this year about the US capital restructuring that we are able to replace the Potomac Triple-X financing with an internal Triple-X reinsurance solution. And that allowed us to repay the Potomac notes.

Matt Hotson {BIO 15471425 <GO>}

Okay. Thanks, John. A couple of questions on the assets backing the annuity portfolio. One on the increase in sovereigns, or relative increase in sovereigns. Was that a Solvency II preplanning issue which Paul Stanwick[ph] is going to pick up.

Paul Stanwick

Thanks, Matt. The answer to that question is that we actually did the trade because we felt it was an economically sensible trade to do, not because of a Solvency II requirement. The basis of the trade was the disconnection in the markets between the level of swaps, the level of gilts, and the level of credit between short-dated and long-dated assets. We felt that long dated gilts reflected a better return over swaps than the short-dated credit that we had.

We executed the transaction, and the reason it came out neutral on earnings is just the way that the risk premium is reflected back in through the results.

Matt Hotson {BIO 15471425 <GO>}

Okay, moving on to the disclosures on PIIGS Bank Tier 1 debt, and we have had a follow-up question on how that -- does that include the exposures within the CDO, which Justin Brown is going to pick up.

Justin Brown {BIO 19943344 <GO>}

First of all on the PIIGS' and the Group's coordinated bank exposures it is for debt securities only, i.e., we do not look to the reference entities in the CDOs.

We think this is a reasonable approach is the subordination in the CDO structures. I mean, that losses on the reference entities are diluted from a shareholder perspective, and hence are not a natural fit for the debt securities table.

For the CDOs, the (inaudible) CDOs reflect the underlying risks in the reference entities. On this basis it is fair to conclude that the proportion of subordinated holdings in the CDOs is not material. Therefore, the majority of the CDO portfolio will have no exposure to Tier 1.

Matt Hotson {BIO 15471425 <GO>}

Okay, moving on to cash flow and our cash flow disclosure, I think this is a question from Oliver at Deutsche about the difference between the disclosure we gave last year and the disclosure we gave this year in terms of the 2011 and 2012 VIF utilization profiles and just trying to explain the difference. Wadham Downing is going to attempt an explanation to that.

Wadham Downing {BIO 17627522 <GO>}

Thanks, Matt. The difference between the numbers is almost entirely due to the change in the profile of the models, one-off short-term capital releases, which are not included in the operational cash generation numbers.

These items are expected to manifest in experience and/or investment variances and augment the IGD surplus. They primarily relate to the model benefit that brought forward tax losses in LGAS and over time should reduce to zero. The expected operational cash flows remain broadly in line with what was disclosed in the half-year 2010 and the full-year 2009 numbers.

Matt Hotson {BIO 15471425 <GO>}

Okey. Another quick one for Wadham, which was a follow-on from Andy Hughes' question at Exane this morning on how much of the EV is annuity rated. Nigel said 2 billion. We thought we would just check that.

Wadham Downing {BIO 17627522 <GO>}

Yes. The disclosure you gave is for GBP4.2 billion and use of[ph] this element before cost of capital is, in fact, GBP2 billion. After cost of capital the numbers are GBP3.9 billion and GBP1.7 billion, respectively.

Matt Hotson {BIO 15471425 <GO>}

Okay, on to tax. A couple questions on tax for Simon Burke. So does having the use of losses have an impact on the EEV effective tax rate? And what ratio would be applied to the EV results in 2011?

Simon Burke {BIO 19146780 <GO>}

Thanks, Matt. There is no impact on the tax rate and EV profit from the losses in 2010. That is very similar to the first[ph] impact. In terms of modeling the EV results, I would use the statutory tax rate going forward.

Matt Hotson {BIO 15471425 <GO>}

The second one on tax -- on deferred taxes. This is one from Raghu at Citi. Reconciliation of the GBP300 million fall in the deferred tax asset on the asset side with the changes in the P&L, which were GBP125 million in Risk, and GBP39 million in Savings, and how does that all stack up again? Simon Burke.

Simon Burke {BIO 19146780 <GO>}

So those numbers refer to the movement in deferred tax in operating profit, the GBP125 million and the GBP39 million, whereas the GBP300 million or GBP301 million, actually, movement on the IFRS balance sheet is the total. So the difference between what has gone through operating profit and the total balance sheet movement is investment variance.

Matt Hotson {BIO 15471425 <GO>}

Okay. Thank you. So moving back now to the final -- prepared question we've got was on the change to the new CMIB tables. What was it, and have we adjusted other margins on that basis? That is one back to Tim Stedman.

Tim Stedman {BIO 19448392 <GO>}

Yes, so the GBP59 million charge includes the cost of both updating the tables, together with changes to the base used to reflect 2010 experience. I think I would remind you that we took about a GBP90 million positive for experience last year. And we don't really think that the GBP59 million charge is massively material in the context of a book of GBP25 billion.

Generally, we are happy -- or we were happy with the level of prudence in our annuitant mortality basis. So the changes in the base tables and the parametization of the CMI model have given a broadly neutral cost. But we think that the new tables have got a much better shape.

Matt Hotson {BIO 15471425 <GO>}

Okay, that's the end of the sort of pre-sent in questions we have. We've got a couple of other ones that I got from Raghu, which we need a little bit of time to think about on contingent loans and impact of annuitant rates on one or two things, which we will come back to separately.

But we will now open the call up to questions if anybody else has got anything else they want us to give a view on. Back over to you, Hugh.

Questions And Answers

Operator

(Operator Instructions) Oliver Steel, Deutsche Bank.

Q - Oliver Steel {BIO 6068696 <GO>}

A very simple question, which is, do you have a figure for total assets under management or assets under administration? I've got the GBP353 billion that you described for LGIM. You've got another GBP11 billion of retail and other. Does that include all of the annuity business, all of the Savings business for which you give separate inflows disclosure?

A - Matt Hotson {BIO 15471425 <GO>}

I can probably answer that, which is rare on a technical call, so I'll make the most of it. The GBP354 billion in LGIM is the assets that LGIM manages. That includes all of LGIM's client money, which is in total, I think from memory, is the pack of about GBP260 billion. That is 75% of that number.

It also includes all of the annuity assets. It includes the vast majority of the Savings assets, although there are some Savings contracts where they have been sold with an open market option, so there are some funds that go to other asset managers. And it includes all of the shareholder funds as well.

If you reconcile all those numbers together you should get to something around the GBP354 billion. So I think the total number is the quoted number four LGIM.

Q - Oliver Steel {BIO 6068696 <GO>}

Okay. Thanks.

Operator

Blair Stewart, Banc of America; Merrill Lynch.

Q - Blair Stewart {BIO 4191309 <GO>}

Just one question. Just on the movement in non-cash items for Risk. It is mainly the deferred tax movement, it went from (221) negative to (125) negative. What is the best guidance you can give on how that number is going to move over the next couple of years. Thanks.

A - Matt Hotson {BIO 15471425 <GO>}

Okay, I will pass that one over to Simon Burke, Head of Group Tax.

A - Simon Burke {BIO 19146780 <GO>}

Well are you asking about the impact on operational cash generation or just literally on (inaudible)?

Q - Blair Stewart {BIO 4191309 <GO>}

No. The operational cash generation, I think you have been clear about the GBP60 million benefit that will drop away in 2013, if I'm not wrong. It is just really on that line item, is that just going to gradually go down to zero or how should we model that?

A - Simon Burke {BIO 19146780 <GO>}

I would have thought it would run at about that level for a couple more years.

A - Unidentified Speaker

I would say the core part of it will probably run down probably by 2013, (inaudible).

A - Matt Hotson {BIO 15471425 <GO>}

So the deferred tax asset is really made up of a short-term element and a long-term element. The short-term relates to the losses on the LGPL set-up and taking of the increased default rates. They will run off until about 2013. The longer-term element is a whole lot of other things, which runs on into 2020, from memory. I think we did answer that question about this time last year.

So I guess there is a reasonable amount of short-term of element in that -- in the Risk part, which will fall off in 2013, and then it will be reasonably flat for a few years to come.

Q - Blair Stewart {BIO 4191309 <GO>}

Okay, so it stays at around current levels for a couple of years than maybe drops down a step, and then stays at a lower level after that. Is that -- would that be a fair approach, probably correct?

A - Unidentified Speaker

Yes.

Q - Blair Stewart {BIO 4191309 <GO>}

Super, thanks.

Operator

Greig Paterson, KBW.

Q - Greig Paterson

Just two questions. One is the annuity margin was reasonably flat year-on-year, but you put through a mortality strengthening. So I was wondering just what the other items were that there must have been a big positive there?

The other point is, just so I can get a feel for what the change in the mortality was, I wonder if you could say, if it was a standard 65-year-old male what is the expectation of life now in the reserves and what was it before then on the EV as well?

A - Matt Hotson {BIO 15471425 <GO>}

I've got a few people just scrambling through packs, just to try and find the answers. I think the 65-year-old male numbers are in the pack, which somebody -- Tim is --.

A - Tim Stedman {BIO 19448392 <GO>}

Page 91, I think.

A - Matt Hotson {BIO 15471425 <GO>}

Page 91 of the pack. But Tim can just give you the quick headlines.

A - Tim Stedman {BIO 19448392 <GO>}

Best estimate 24 years, last year 24.5. And on the reserving basis this year 25.6, and last year 25.7. (multiple speakers).

Q - Greig Paterson

Sorry, say that again. So on the EV there was a significant change. There was not much change on the statutory (inaudible) side.

A - Tim Stedman {BIO 19448392 <GO>}

Yes, broadly. If you call half a year significant.

Q - Greig Paterson

Then so why did the annuity margin not go down?

A - Tim Stedman {BIO 19448392 <GO>}

I think the margin is made up of a number of things. Obviously, it is business mix, the price you charge in the market. To some extent, I think we knew some of these changes were going to be coming, so they got reflected in prices during the course of the year.

A - Unidentified Speaker

The GBP59 million is spread across the whole book, so, therefore the impact on new business is relatively trivial. And I believe we have been probably pricing recent new business closer to the CMIB tables, and therefore the impact is diluted even more.

Q - Greig Paterson

So you pulled back your pricing (type) thing?

A - Unidentified Speaker

Yes, so the pricing effect of the new mortality tables was already in there before the charge at the year-end.

Q - Greig Paterson

Should that not have hurt volumes quite materially or did everyone follow you type thing?

A - Unidentified Speaker

Well it clearly hasn't hurt margins.

Q - Greig Paterson

Volumes, volumes. I'm just trying to understand.

A - Unidentified Speaker

I think the militarily change in isolation would have a pretty small impact on the price.

Q - Greig Paterson

All right. Thank you.

Operator

Before we go into onto Andy Hughes from Exane BNP Paribas, (Operator Instructions) And Andy, over to you.

Q - Andy Hughes {BIO 15036395 <GO>}

(inaudible) talking about shares; that was quite funny. Just a couple of questions. Just a clarification on the EV number. So I take the GBP1.7 million net of tax, presumably I need to add GBP1 billion required capital. So the annuity EV and total is GBP2.7 billion. Is that correct -- out of 6.2 or 6.3?

A - Unidentified Speaker

We had a figure of GBP300 million for capital.

Q - Andy Hughes {BIO 15036395 <GO>}

Just taking 4% of GBP25 billion of reserves, is that --?

A - Unidentified Speaker

It is cost of capital, not total capital.

Q - Andy Hughes {BIO 15036395 <GO>}

But I need to add -- the GBP1.7 billion is the VIF, net of cost of capital, and I would need to add it on the required capital to get to the EV for the annuity portfolio, which presumably is (multiple speakers).

A - Unidentified Speaker

We will clarify that for you (multiple speakers).

The numbers that Wadham quoted are the VIF, the annuity element of the VIF. If you want a number back on the total EV, we can come back with a (inaudible) number. Your methodology sound sensible. Let's just take it that way and just come back to you.

Q - Andy Hughes {BIO 15036395 <GO>}

The other question is following on from Greg's question, I guess, on the change in longevity tables. You have obviously reduced prudence and the best estimate assumptions and also in the reserving assumptions at older ages, (now) age 65.

I'm assuming that it is a net thing, so your GBP58 million is a big strengthening at younger ages for the deferred annuities and the kind of relaxation at older ages. Could you break down the GBP58 million and break down what is going on?

Because, obviously, it is a bit surprising that your numbers you show on page 91 actually shows things being released. Because, obviously, you'd expect these numbers to go up over time as mortality improvements come in. And you've gone from 24.5 for best estimate 65 down to 24, and from 25.7 to 25.6 on the reserving, which sort of suggests you have released reserves, rather than added to reserves for these lines of business. Thank you.

A - Unidentified Speaker

As we said, the new tables changed the shape, and in our view to a better shape. We give that 65-year-old number to try and help people out, but clearly it is not particularly indicative of the whole range of annuitant mortality that we are assessing.

Your theories sound sensible, but we're probably not going to give a huge amount of data in terms of breakdown in numbers below the GBP59 million.

Q - Andy Hughes {BIO 15036395 <GO>}

Do you know what has happened at younger ages? Has there been a more significant shift in the younger age. I mean, so if you're thinking about 40-year-old effectively, I mean, has that life expectancy gone up a lot on both the EV and the reserving?

I guess the problem is, I don't -- I can probably guess what has happened to reserving, but I don't know what has happened to the best estimate assumptions. Have they moved to a minimum rate of 2% as well?

A - Unidentified Speaker

I haven't got any numbers for other ages in front of me, sorry. I think generally what we saw when we moved from the MC table to the new CMI table was that MC seems to be particularly penal for verily very old ages, sort of 80 and above. So that has resulted in a shift to different ages. But Matt is right, we picked a point age. There other ages and the effects are different across the age range.

A - Matt Hotson {BIO 15471425 <GO>}

Well we will have to talk some more about it, Andy, if you're still concerned.

Q - Andy Hughes {BIO 15036395 <GO>}

No. It is just a bit odd, basically, because the data you have given gives the opposite effect to the one you have actually put in terms of changing the tables.

A - Matt Hotson {BIO 15471425 <GO>}

It is just a function of the shape of the disclosure. It is a fair point. We can think about a better disclosure statement, which gives us more sense of the shape.

Q - Andy Hughes {BIO 15036395 <GO>}

Thank you.

A - Matt Hotson {BIO 15471425 <GO>}

Okay, I don't think we've got any more questions prepared. Hopefully that has been useful. We will continue to do these calls for as long as you guys say there is demand for them. But if there are any more questions that occur to people, you know where we are. And I am sure you will give me a call. Thanks very much.

Operator

This now concludes today's call. Thank you, all very much for attending. You may now disconnect your lines.