S1 2019 Earnings Call

Company Participants

- Bernie Hickman, Chief Executive Officer, Legal & General Insurance
- Chris Knight, Chief Executive Officer, Legal & General Retail Retirement
- Jeff Davies, Chief Financial Officer
- Kerrigan Procter, Chief Executive Officer, Legal & General Capital
- Laura Mason, Chief Executive Officer, Legal & General Retirement, Institutional
- Nigel Wilson, Group Chief Executive
- Simon Gadd, Group Chief Risk Officer

Other Participants

- Abid Hussain, Analyst
- Alan Devlin, Analyst
- Andrew Baker, Analyst
- Andrew Crean, Analyst
- Andy Sinclair, Analyst
- Colm Kelly, Analyst
- Dominic O'Mahony, Analyst
- Fahad Changazi, Analyst
- Gordon Aitken, Analyst
- Greg Patterson, Analyst
- Johnny Vo, Analyst
- Jonathan Hocking, Analyst
- Julian Wellesley, Analyst
- Oliver Steel, Analyst

Presentation

Nigel Wilson {BIO 1535703 <GO>}

Good morning and welcome to our 2019 H1 Presentation. Firstly, a couple of bits of housekeeping. Here are the usual forward-looking statements. Please switch off mobile phones. And if there is a fire alarm, the home team will shepherd you downstairs.

The jet engine on the screen reflects one of our three standout deals of the first half of 2019, the largest ever UK PRT deal, over GBP4.6 billion for Rolls Royce. The other two records were the partnership with Oxford University, which we announced a few weeks ago, which will deliver up to GBP4 billion of investment over the next decade. We expect a significant amount of these assets will support our PRT business. So Oxford University post graduate engineers may well be living and working in facilities, which fund the pensions of their Rolls Royce predecessors. This is an example of inclusive capitalism in practice. The third record for LGIM was the award of a $50 billion mandate from GPIF in Japan, adding to record international inflows.

These deals reflect skills and capacity across the L&G Group, real asset expertise in LGIM and LGC, appetite for long-dated real assets in LGR, new expertise in science-based real estate through our Bruntwood SciTech JV, and the desire to execute transactions, which we demonstrate repeatedly that we are economically successful, socially useful and increasingly international. I'm delighted the business is performing so well and at scale. Scale, technology and trust are three of the most important assets a financial business can have and we have all three. These strengths plus depth of management track record and strong presence in markets with opportunities mean that all five businesses should contribute to our future growth.

The sale of Mature Savings and GI enables us to focus on businesses where we have a leading market share and into adjacencies, where we see outstanding growth potential. That success is reflected in our financial metrics. 12 years ago, in 2007, full-year operating profit from divisions was just over GBP650 million. It took us 175 years to make our first GBP1 billion profit. In the last six months, we made GBP1.2 billion, up 12%. EPS of GBP0.1474 is also up 13%. Operational surplus generation at GBP800 million is up by 17% and ROE is again at the 20% level. Book value of GBP8.7 billion is GBP1 billion ahead of this time last year and up by 13%. And as expected, our dividend is GBP0.0493, that's 30% of the 2018 full-year dividend payment.

This is not outstanding, or in any sense, a flash in the pan. It is part of a consistent long-term growth story over a decade. Since 2011, we've delivered 11% compound growth in operating profit, 10% growth in EPS, 14% growth in DPS, and 7% growth in book value per share. The credit for this is due to our strategic clarity, excellence in delivery and a strong and collaborative management team who are with us here today. So I'd like to thank Jeff, Bernie, Laura, Chris, Kerrigan, as well as Cheryl and Claire who are overseeing the sales of GI and Mature Savings and welcome Michelle Scrimgeour to the team as the new CEO of LGIM.

That team manages a focused set of five growing and profitable businesses and delivers the synergies that make them significantly more than the sum of the individual parts. L&G is a clear global leader in Pension Risk Transfer and LGRI had a fantastic H1 with operating profit up 45% to GBP524 million. We have a 30% market share in the UK, but only 3% of the similarly-sized US market. So there is plenty of headroom. And since the end of June, we've executed further US business, breaking away from the under $100 million deals and into the mid-sized scheme bracket.

LGIM is by some margin the largest UK investment manager with GBP1.1 trillion of AUM, but we only have 1.7% of the global market, again, headroom for growth. LGC is a unique business, delivering 12% compound growth in operating profit. As well as being a successful business in its own right, it is the funnel for assets for LGRI and LGIM, key to our success. The Insurance business has around a quarter of the UK life market and is growing premiums. It is a key driver of our digital effort, delivering growth through customer-centric technology, which also brings down operating costs.

LGRR, the Retail Retirement business had a fantastic half year, delivering 47% growth in individual annuity sales. Rumors of that markets demise due to Pensions Freedom were, as Mark Twain said when he read his own obituary [ph], greatly exaggerated. We have transformed the UK Lifetime Mortgage market. The market has grown from GBP1 billion to GBP4 billion and our share is close to 30%. The competitors are now following, so we have to continue to evolve and innovate our own product suite.

Looking across the five businesses, flows [ph] for those businesses are strong annual compound growth rates, ranging from 9% for Insurance, up to 45% for Individual Annuities over the last three years. And in terms of H1 2019 versus H1 2018, all five divisions have grown sales.

Our strong track record within the five businesses is underpinned by a mutually reinforcing business model. This provides us with unique synergies in asset manufacturing and management. Our model also benefits from these capital synergies and diversification provided by LGI.

Our Retirement business is helped to provide LGC with capital, which it uses to create and structure real assets to back liabilities in the Retirement division and to drive shareholder returns. LGC also provides assets for third-party clients via LGIM, our Investment Management business. LGIM in turn acts as an important lead generator for our PRT business through its relationships with DB pension trustees and its focus on LDI. LGIM is also an important source of third-party co-investment for LGC and, of course, provides asset management services for both of these businesses. Each of our businesses, therefore, make important contributions, too, and benefit significantly from one another. This is a mutually beneficial and unique combination and the key source of our long-term competitive advantage.

For Legal and General, this has been a strong first half and we're also starting H2 strongly with the pipeline of opportunities across all five divisions.

I will come back to outlook later, I'll now hand over to Jeff, to take you through the H1 financial performance in more detail.

Jeff Davies {BIO 20023574 <GO>}

Okay. Thank you, Nigel. Good morning, everyone. This morning I'm going to cover the financials for the first half of the year on both the Group and divisional basis, the management of our credit asset portfolio, and lastly, our capital position, together with a bit more detail on how we think about the impact of growing PRT volumes over the medium-term. Kerrigan will cover LGC's results separately in his presentation.

In the first half, the Group delivered another strong set of results. Operating profit from divisions was up 12%, benefited from an exceptional performance in UK PRT and increasing market share in UK Individual Annuities. As we previously flagged in our 2018 results, we're continuing to make measured investments into our business in order to improve efficiencies, gain access to growth areas, enhance customer experience and comply with the evolving regulatory framework. In the first half of 2019, this resulted in a GBP20 million increase in Group investment spend.

Operating profit increased by 11% to just over GBP1 billion. PBT was up 12%, as a result of higher investment variance due to post of equity market performance, and an accounting gain arising on the valuation of assets in the Group's defined benefit pension scheme. This was partially offset by lower long-term interest rates impacting LGI reserves, as we've seen in other periods. As Nigel, mentioned earlier the synergies between our businesses drive profits and fuel future grow. This is demonstrated by the Group delivering a return on equity of 20.2%.

Given a number of known factors, including lower rates, our Solvency II coverage ratio reduced to 171%. Operational surplus generation was GBP0.8 billion, up 17%. And we expect a similar level of OSG in the second half. I'll cover our capital position in more detail later.

But turning to operating profit from our divisions, LDR has continued the momentum from the second half of last year, growing operating profit by 36% to GBP655 million. This was driven by the ongoing delivery of prudential margin releases from the back book and the new business surplus emerging from our record global PRT volumes of GBP6.7 billion. Both of our Retirement businesses performed strongly. With the volume increase, our Institutional business grew operating profit by 45% to GBP524 million, whilst our Retail business grew operating profit by 10% to GBP131 million. We continue to exhibit discipline in our pricing approach and originated significant direct investments to support our new business, with DI AUM growing by GBP4.9 billion in half one -- H1 2018.

The UK Annuity business we transacted in the first half was written at attractive margins in line with prior periods. As we mentioned at the 2018 year-end results, we're currently investigating the appropriateness of moving to CMI 17. Based on our analysis so far, the trend of slower mortality improvement is continuing and we currently estimate the impact of a change to our assumptions could result in a release of the order of GBP200 million. We'll finalize our analysis in the second half and expect to make any changes at year-end, following the completion of this work.

Moving on to Retail Retirement, our Individual Annuity business is a leading provider in the UK market. Sales increased 47% to GBP497 million, benefiting from wider market penetration and improved pricing sophistication. Lifetime Mortgage advances were GBP489 million, down slightly from last year as we maintain pricing discipline in a competitive market. In the second half, we plan to launch our retirement interest-only mortgages to address the growing number of individuals reaching retirement with interest-only mortgages, adding to our existing solution for this segment of the market.

Our LGR asset portfolio, which is managed by LGIM, has now grown to GBP72 billion, whilst maintaining high credit quality and good diversification by sector. 16% of the portfolio is in sovereign-like assets and the proportion of direct investments is 20%. Since the 2008 financial crisis, we've reduced our holdings in banks and insurers in order to reduce our financial correlation risk and to improve our sector diversification. LGIM manage the portfolio to avoid downgrades and defaults and has been extremely successful at this, realizing less than GBP25 million of default losses in traded credit since 2007, whilst maintaining overall portfolio of credit quality. As further protection, we continue to hold a substantial credit default reserve, which has grown to GBP3.2 billion.

We've covered our DI portfolio in some detail in previous presentations, so on this slide, we focus on UK-listed corporate credit. This comprises just 23% of LGR's bond portfolio with many of these holdings being multinational companies such as GSK, Vodafone and Unilever with significant overseas earnings. In total, the credit quality of our UK investments is similar to that of LGR's aggregate asset portfolio with over 70% of UK assets A rated or higher. Our portfolio is also geographically diversified. Whilst the vast majority of our liabilities are denominated in sterling, we hedge our currency exposure to deliver matching sterling asset cash flows.

In LGIM, operating profit was up 1% to GBP205 million, reflecting increased revenues from flows and positive markets. As previously guided, this was offset by continued investment in the business, specifically on the automation of our processes, system developments and customer experience enhancements. Reflecting this investment, the cost-income ratio of 53% has increased marginally from last year.

Total AUM is now over GBP1.1 trillion with international assets accounting for almost 30% of GBP343 billion. External net flows were GBP60 billion, representing 5.9% of opening AUM. Of this international net flows were an impressive GBP45 billion and included the GBP37 billion passive mandate with the Japan Government Pension Investment Fund, leveraging our strong ESG approach and providing LGIM's Asian business for the platform for future grow. UK DC had another good performance with AUM now exceeding GBP86 billion. This includes over GBP7 billion in our Master Trust, one of the largest and fastest-growing in the UK.

Moving onto our Protection Division, LGI. Operating profit was down GBP20 million to GBP134 million, largely due to the prior year benefiting from model refinements. In the UK, both our Retail and Group Protection businesses continue to generate good profits, with UK margins improving in the first half. In the US, operating profit was up GBP23 million to GBP41 million, primarily due to a reserve release following improvements to the new IFRS methodology, and lower adverse mortality compared to the prior period.

Total new business annual premiums were up 9% to GBP178 million and gross written premiums were up 7% to GBP1.4 billion. The business continues to grow at good levels of profitability. And looking forward, we expect the full-year LGI operating result to be in a similar range to 2018.

Moving on to our capital position. The Group's Solvency II surplus stands at GBP5.9 billion, and our coverage ratio was 171% at the end of June. The quality of our capital remains strong, 78% of our own funds is Core Tier 1, and we remain confident in the resilience and capacity of our balance sheet to withstand significant shocks. We have bridged the Solvency II surplus to help explain the movement since the year-end.

Operational surplus generation from the back book was GBP0.8 billion, up 17% on the prior year. There were a number of well understood movements during the period, including the one-off redemption of GBP400 million of sub-debt previously flagged at the year-end, the larger of the two dividend payments for the year, and the non-economic impact of lower interest rates on the valuation of our balance sheet, which was partially offset by positive equity markets, and the discretionary deployment of GBP0.3 billion of capital to fund significant UK PRT volumes, which remains low strain at circa 4%. In the second half, we anticipate a similar level of OSG, a modest contribution from the disposal of the GI business and the potential mortality release. This will comfortably cover the smaller second half dividend to be paid, whilst also providing additional capital to support further new business, with the final ratio subject, of course, to market movements.

This slide shows our capital requirements before diversification. Given our focus on annuities, our primary risk exposures are to longevity and credit. In the context of recent rate moves, we note that our economic exposure to interest rates as low, just 1% of our SCR is held against rates. And finally, as we grow our direct investments, it's worth emphasizing again that in many cases, our primary exposure is to the counterparty and not to the underlying property. Property constitutes just 8% of our year-end SCR.

L&G is well positioned to benefit from the ongoing structural growth opportunity in PRT. Whilst new PRT business require solvency capital to be put against that on day one, this capital commitment pays back quickly and generates an attractive and long-term flow of operating surplus for the business. To help illustrate this, we've modeled the cumulative Solvency II surplus generation for a notional GBP10 billion of annual UK PRT sales. This is based on the mix of PRT business we've written over the last three years.

For L&G, UK PRT new business has a capital strain of around 4% on day one and generates approximately GBP100 million per annum in OSG over the next few years, resulting in a typical payback period of around five years. Over the life of this business, we expect to generate significantly more than GBP1 billion of surplus. Clearly, the level of new business strain will vary depending on the makeup of impairment and deferred annuities. We manage the mix of business carefully to achieve the desired balance between strain and profitability.

As we have shown, PRT is one of the contributors to OSG growth. We have been growing dividends at 7% per annum since 2017. Since that time, OSG has grown on average at 11% per annum, and we'd hope to continue at around the 10% level over the medium-term. This provides plenty of capacity to write desired levels of new business. OSG net of dividends paid has grown at 19% per annum, given increased coverage on this particular metric. Given the level of market opportunity in PRT and a significant surplus generation we've shown, as well as the strength of our balance sheet, we are happy periodically to deploy more capital in the period than we generate. For example, this may be the case in the second half. We will, of course, remain disciplined in the deployment of our surplus capital to ensure we meet or exceed our return target.

So to conclude, our businesses produced a good financial performance in the first half with double-digit growth of key metrics. LGR performed strongly in a buoyant UK PRT market, and this business remains highly attractive to us. As we (Technical Difficulty) this business, the Group's OSG, earn-ins and cash continue to increase at double-digit, giving us optionality to invest in new business. We continue to achieve a return on equity of around 20% and the synergies between our businesses are a unique source of competitive advantage.

LGC is a key part of those synergies, and I'll hand over now to Kerrigan to go into more detail on the first half performance of his business and the exciting developments we've been announcing there.

Kerrigan Procter {BIO 15093363 <GO>}

Thank you, Jeff. Starting with the H1 financials. LGC divisional operating profit was GBP173 million slightly up compared to H1 2018's GBP172 million. Within that, direct investment operating profit was GBP99 million just down on the previous GBP104 million and reflecting a UK market for housing that was more challenging at the start of 2019 from the first half of 2018. Earnings overall up more significantly at GBP278 million compared to GB{82 million, given the relative performance of the roughly GBP2 billion invested in an internationally diversified portfolio of equity of multi-asset. Our direct investment portfolio has grown from GBP2 billion a year ago to over GBP2.6 billion at 30th of June.

Legal & General Capital flow invested GBP7.8 billion of assets, of which GBP2.6 billion is direct investment in three growing business lines, namely L&G Homes, Future Cities and SME Finance. We expect to double the investment over to GBP5 billion in these three business lines over the next three to five years. Our investments cover residential and commercial real estate, infrastructure, private credit and venture capital. Our planning assumptions for our real assets of a double-digit returns in development with high-single-digit returns for developed and operational assets, giving a target blended return on the direct investment portfolio of 8% to 10% overall.

I planned to spend the next few minutes on how we are investing both in a way that is consistent with L&G structural growth drivers, including creating real assets, today's capital and aging demographics, and in a way that supports asset creation for LGR's annuity portfolio, for LGIM clients. L&G's three-legged asset strategy of asset funding through Pension Risk Transfer and Individual Annuities. Asset management through LGIM and asset creation through LGC has been in place for several years now. Three examples of LGC creating real asset to back annuities are to facilitate the launch of new LGIM funds are Affordable Homes, Private Sector Build to Rent and the Oxford University partnership announced in June.

The Legal & General Affordable Homes business was created in 2018. Since then, the business has been seeking to acquire build and manage new affordable homes across England, working in collaboration with housing associations and local authorities. Contracts have been exchanged with four affordable schemes and the first scheme in Croydon completed at the start of July, many more schemes are in the pipeline. L&G Affordable Homes will be near breakeven in its first year of operation and we expect it to be profitable in 2020. Furthermore, the affordable rents on these homes pay CPI-linked rental income, creating a portfolio of assets that can be structured the CPI-linked asset. We will start using these assets to back PRT business late this year or early next year.

LGIM's Build to Rent fund, which holds a portfolio of urban apartment buildings for private sector rents is a product in demand from pension schemes, given the stable cash flows that can be achieved from multi-occupancy rental accommodation. It has 13 schemes across the UK, delivering around 4,500 homes for elective renters. In time, the BTR fund will be large enough or mature enough to be able to fund the development of a pipeline of new apartment buildings. But to get the fund started, the combination of Legal & General's capital and PGGM's capital is being used to fund the initial development pipeline with new sites in H1 in Glasgow and Wandsworth.

The third example is one of the future asset creation. In June, L&G announced the 50/50 partnership with Oxford University to develop projects in and around Oxford covering affordable homes, key work homes, student accommodation, commercial property and the creation of science and innovation districts with modern work space and research facilities. Through this partnership, we expect to be able to create up to GBP4 billion of assets over the next 10 years, much of which were back annuities or form part of LGIM managed funds.

Moving on to Homes, where our strategy has three dimensions, through which our L&G Homes customers can buy a home, rent a home or enjoy later life in their own home. Firstly, on homes to buy, which is all on the CALA's mature operations and governance. CALA sold just under 1,100 homes in H1 2019 compared to just over 1,200 in the first half of 2018. Secondly, on homes to rent covering Affordable Homes and Private Sector rental. L&G's platform for developing and operating homes to rent delivers good returns for shareholders, diversifies our exposure to the housing market, stimulates the economy through construction and development and creates assets to pay pensions.

Thirdly, on homes for Later Living, which is where L&G's long-term themes on the need for real assets and the aging demographic meet. I believe that this is a significant investment opportunity presented by the longevity economy that goes beyond the traditional view of opportunities to sell pills and cruises [ph]. The Later Living business was profitable in 2018 and we expect the combined business to deliver similar profits this year. Later Living is also an interesting asset class for L&G, it delivers returns from property development and sales, but also delivers recurring income through management fees and rental income, which can in time restructured to pay pension.

My presentation in March included a look north when I talked about our Future Cities investment in Manchester, Leads and Newcastle, and I've just talked about Oxford in England's Economic Heartland. But we also go West with further investment in Cardiff and Bath committed since the start of the year. Last week, we announced the later stage of investment in Cardiff Central Square in partnership with the Welsh Government and Rightacres Property. This development will provide a transport interchange, build to rent apartments for our BTR fund and office space with a long lease, the back pension. Earlier in 2019, we announced the redevelopment of Bath Quays North, 5.5 acre riverside site and in May, we announced the first urban later living community would be in Bath.

The futureproof the regional economies, local stakeholders in cities need to support education, jobs, homes and communities. But Future Cities also need to be connected and clean, which is why we have been investing in renewables infrastructure and digital infrastructure. In renewables infrastructure, LGC has invested around GBP130 million in 19 onshore wind and solar assets across Europe with our partner, NTR, including further deployment of funds in H1. Put together with the over GBP850 million of UK offshore wind infrastructure debt managed by LGIM Real Assets for LGR, Legal & General is becoming a meaningful UK investor in renewables. We see electric vehicle infrastructure becoming an extension of this strategy, which is why we took a 13% stake in Pod Point, a UK provider of electric vehicle charging points in Fairbairn [ph].

Digital infrastructure, this is the integration of digital technologies with physical infrastructure to deliver connected and resilient asset to form the backbone of Future Cities. It is one of the fastest-growing segments of infrastructure. We made our first investment in this sector in January, with a circa GBP60 million investment in the Kao Data Centre, a new data centre near Harlow, targeting the Cambridge to London corridor.

Our third LGC business line is SME Finance, covering private credit and venture capital. Within SME Finance, we have seen good progress with our investment in the private credit manager Pemberton, in which L&G is a 40% shareholder. Pemberton has raised over EUR2.5 billion of funds over the last 12 months, and as of half year, at AUM of approximately EUR5.5 billion. Of LGC circa GBP400 million of assets in the SME Finance portfolio, approximately GBP300 million, a cornerstone investment in Pemberton's private credit funds. These have performed well.

The SME Finance venture capital investment approach is via a fund-to-fund strategy with over GBP100 million committed across nine managers and good initial returns, Our next step is to introduce an investment vehicle to allow LGIM's defined contribution investors access to the fund-of-funds approach. So BC into DC.

In summary, the assets Legal & General Capital manage need to support liquidity, capital coverage and deliver good long-term return for shareholders. However, given the long-term nature of the capital, Legal & General strategy is to do more with these assets and use them as a catalyst to create of the assets for the Group. We are delivering on our plans to do this in Homes, Future Cities and SME Finance in a way that is good for customers, shareholders and more broadly, the UK economy.

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

Nigel Wilson {BIO 1535703 <GO>}

Okay. Thank you, Jeff, and thank you, Kerrigan. To deliver a decade of consistent double-digit growth, we have aligned our strategy with six global macro trends, which are structural rather than cyclical. We've also read the benefits of leaning in. We deliberately have a combination of businesses focused on two types of markets, we have big markets, where we have a relatively small market share, where we can outpace market growth. For example, in global asset management, US PRT and UK housing. And also, growth markets, where we already have a big market share and where we can grow by retaining market leadership. This includes DC pensions, lifetime mortgages, UK PRT and insurance. We've exited declining markets like Mature Savings and those where we will always be sub-scale like GI.

To pick some examples from the data, in PRT, we have a 30% market share in the UK and expect the market to exceed GBP30 billion annually over the next few years. It used to be a GBP3 billion annual market. So this is a 10 times increase in terms of flow and a step change in terms of accumulation of stock. In the US, we expect a similar market performance, but we start from a 3% market share.

In global asset markets, our market share has grown from 1.2% in 2007 to 1.7% today. We expect this market to grow and our share to keep growing faster. Our share of global revenues should grow faster still as we improve our product mix. We've executed well in the US and in entering Asia. 10 years ago, we're a UK DB index house. Today, the growth we are delivering is in international, in DC, in solutions and multi-asset products, backed with a leading ESG focus.

In real assets, the combination of LGC, LGRR and LGIM gives us significant -- gives us a significant advantage. In UK housing, we have a macro terms, a government target of 300,000 homes per year, a huge shortfall, and market share for L&G of 2%. And in the house building sector, a unique balance sheet and a trusted brand to deliver at scale.

In UK DC, we have GBP86 billion of assets and a 19% market share. ISA [ph] will more than double over the next five years, and we can grow our current 1% market share. Our ecosystem to forge [ph] and our scale will enable us to improve returns for pension services, including innovative ideas like BC into DC. This is a live and exciting piece of government policy.

Another driver is technology, which is most obviously visible in retail-facing products. Adoption improves the cost base and the user experience. We can see this in pensions, in mortgages, in surveying and in protection. It also makes it possible to operate economically with a low cost of entry in adjacent markets, which are currently broken. There are several examples of this, including Salary Finance to disintermediate payday lending, Caresourcer also to connect social care users and care providers and Pemberton to lend to SMEs. Our business model is tried and tested in the UK and is increasingly being transferred to international markets.

Looking at DB pensions, we see across six markets, with total market size of almost GBP10 trillion, and we operate in 85% of the global DB market. As those market develops, we can build out our model with its unique combination of asset management, pension risk transfer expertise, retirement solutions and capital investment. We've already achieved market entry in PRT in The Netherlands, Canada and Ireland. And in the United States, we're moving up through the size brackets of PRT, and we are already a top three international asset manager in Japan.

China is rapidly liberalizing its markets to permit establishment of a 100% foreign ownership subsidiaries, and indeed, after supportive discussions, we are progressing our application for a wholly-owned foreign subsidiary in 2020.

Here, you see the doubling of both international PRT premiums under LGIM's international AUM since 2016. We expect this growth trajectory to continue. Our partnership with Brookfield has enabled us to do our first Canadian PRT deal this year. We can genuinely claim to be the only global PRT player. We've also written in excess of GBP1 billion of PRT business in July alone and have a pipeline of GBP20 billion plus. Our strategic ambition should be in no doubt. Historically, we've delivered 10% EPS growth from 2011 to 2015, and we are on track to replicate this for 2015 to 2020.

By backing the global growth drivers, being focused and delivering well, we've managed fluctuations from regulatory change and mitigated risks from market volatility. In the second half of the year, strategic clarity and excellent delivering, top line and bottom line across all our divisions will be our priority as we work through a period where there will be a lot of external political noise from Brexit and global trade issues. We are well prepared.

Beyond that, we will accelerate our global ambition based on the tried and tested model, which is now -- which we now have in the UK and which is now delivering for us also in the United States. I have every confidence that the management team here can deliver that goal. We can scale up success. We can be financially and socially useful, and we are a leader already in financial solutions and a globally trusted brand.

Now, we're happy to take questions. So we start in the floor. If you can say your name, then people will...

Questions And Answers

Q - Alan Devlin {BIO 5936254 <GO>}

Okay. Thanks. It's Alan Devlin from Barclays. A couple of questions. First of all, on the PRT volumes. I think you've already written GBP8 billion year-to-date, including the staff this half. What is your kind of capacity to continue writing more volume this year? Is it the -- and what is the constraint to that? Is it the Solvency Capital? Is at the access to direct investments? And continue to writing more volume above the kind of GBP10 billion level you've quoted before?

And then secondly on L&G Capital, obviously, still continue significant growth in the direct investments but the earnings haven't come through, relatively flat. I think you talked about the J-curve in your press release. When do you expect the earnings to come through from these investments? And given your target of writing GBP5 billion of direct investments, you had a 10% return. Should we expecting that business to earn GBP400 million plus in the next three to five years, which obviously be a material uplift in earnings, not just for LGC but also for the Group? Thanks.

A - Nigel Wilson {BIO 1535703 <GO>}

Great questions, Alan. I'm now going to delegate the answering of those questions to my line [ph] of colleagues on my right. But you're right in a sense in both of them that we've said that we'll -- we are expecting to write about GBP50 billion over five years and there's nothing that we can see that's going to blow us off track from doing that. And indeed LGC has to drive up the returns as you suggested. But I'll let Jeff do the first and Kerrigan do the second.

A - Jeff Davies {BIO 20023574 <GO>}

Yeah. Well, Nigel has covered it in sort of the medium-term. We're definitely open for business in the second half. We showed that we have considerable surplus generation on an ongoing basis. So, we will look at what's available in the market. We balance of value versus capital usage, profitability puts us in a strong position and we flex the structures as well for the scale of those deals to make sure that we can write the ones that are most attractive. No constraints on the asset origination. You saw a significant number we brought in over the last 12 months. We continue to generate the direct investments we need from that, and are now actually been very successful around the credit side of things as well in writing, too. But we're making all the metrics stack up with the assets that we're sourcing and don't see constraints on that. So looking at -- we tend to look slightly longer than six months and if I look in 12 months to 18 months, there's plenty of pipeline there, we can pick the ones we want and we're happy to write that.

A - Kerrigan Procter {BIO 15093363 <GO>}

Great. Thanks, Alan. Just on the other points. In terms of the GBP5 billion, we wrote about GBP500 million or investment GBP500 million of new investment over the last year in total, which gets us from the 2.5 years to 5 years. Obviously, it depends on -- investing is about not only what wins, it depends on precisely when we get that into the market, but we feel confident with that pace we can get to the GBP5 billion. And there are enough attractive opportunities around both the development of new real assets and then the operational real assets to get that blended return. So, I'm feeling good about the the quantum of investment opportunities and the potential returns that we talked about in that portfolio. So, yes, to answer that.

In terms of when some of those investments come through, some of these investments are literally investments in land that we're building things on. When you first buy the land that's cash out, but then it takes a while to develop and the profit comes in when you actually move on or stabilize those assets. So there's a bit of a time lag between getting real assets in the ground, sometimes literally in the ground and then turning around, which could be -- for Homes business pretty much straight away, Later Living about a year later and then some of the other businesses, it might take a couple of years to see that return come through.

A - Nigel Wilson {BIO 1535703 <GO>}

Yeah. Just wanted -- just working along the line and then, if you can just pass the microphone...

Q - Oliver Steel {BIO 6068696 <GO>}

Oliver Steel, Deutsche Bank. Two questions. The first is that, assets at LGC actually fell in the first six months, and I know there was a strong mix change, but the overall assets fell. So why did that happen?

And then secondly, Jeff, I mean, you talk about -- I should ask this simple. In the first half, the market moves on solvency, but quite a lot less bad than expected. Can you explain why that's happened and what the market move in the second half to date has been?

A - Nigel Wilson {BIO 1535703 <GO>}

Kerrigan, do you want to go with the first one?

A - Kerrigan Procter {BIO 15093363 <GO>}

Yeah. I mean, it's a reasonably simple answer, in that, three real parts of the portfolio, there's direct investment, which you saw growing GBP2.2 billion to GBP2.6 billion over the last year. The equity portfolio roughly GBP2 billion, equities and multi-asset which has moved with markets, effectively we didn't moving around and then the cash element. The cash element includes our treasury balance and it's that treasury balance that's moved in and out, debt gets repaid or dividends get paid. So it's the treasury balance and cash that's really moving around there.

A - Jeff Davies {BIO 20023574 <GO>}

Yeah. You are right on the market movement, it wasn't so evident on the slide, I think it was minus 0.2 was the number. Obviously, there is offsetting items within that, as we said. So you saw -- you were all pretty close on consensus. So, therefore, it was all in line with our sensitivity. The rates was down significantly in that 0.2, as you all know, and then that was offset by uplift from equities but also sterling weakening is a benefit to us, with all our surplus capital in the States is suddenly worth a lot more in our calculation. We get pluses and minuses for shapes of inflation changes. So there is a lot goes in there. Spreads, the different things over the first half, it's never quite a simple as a sensitivity relative differences between BBB, BBs and As, et cetera. But the big, big movements were rates down and equities up a bit, so therefore, they largely offset within that.

Yeah. Second half, there has been movement -- I mean, it's a month. And there have been quite a bit of movement in the last few days as we noted. But generally the rates moved in line with the sensitivities as you'd expect, but there's offsetting items on that. Again, FX has obviously gone in our favor, the surplus generation is now significant, we're adding 2% to the solvency ratio every month just from surplus generation. So that's significant as we move forward. So, yeah, there would have been movement in line with the sensitivities on rates but with some offsetting items on that. We also did get significant amount of money, a check for GBP5 billion, not quite, but it's load of assets landed right at the end of June. We've optimized those a bit as well in the start of July and that's almost GBP100 million back on the operating variance that you saw. So there is always bits moving around within the balance sheet. Yeah.

Q - Dominic O'Mahony

Thank you very much. Sorry. Hi, Dom O'Mahony, Exane BNP Paribas. Thank you. Three questions, if that's all right. You made reference to some of the potential macro tail risk on the horizon. I wonder if you could just refresh us on your capital management's policy around that. If I number correctly, in the past, you talked about 140% threshold, so sort of thinking about whether the things need to be done. And indeed hedging the best estimate rather than involved in the full solvency balance sheet. Any update or color on that would be helpful? And in particular, is there anything changed in terms of your -- the way you run the business as you sort of approach that number? Or if you at 150%, do you continue to write bulk annuities in the same manner as you would today?

Second question, just on the LGC, it looks like quite considerable growth in direct investments to come. Is there a capital strain from that? How does that impact the insurance balance sheet on a solvency basis?

And then thirdly, just on bulk annuities, clearly, very strong volumes. If I look at what you said, you talked about a GBP30 billion market and actually sort of roughly GBP30 billion a year for about five years. The pipeline number, I don't think has changed since full year. If I was being jealous [ph], I might say that's flat or a sort of an outlook that's flat. But the market share that is already very high. But also, you see this is a growth opportunity, I think. Could you help me square that circle? Thank you.

A - Nigel Wilson {BIO 1535703 <GO>}

Only somebody in this industry would say that was flat. I think you got to go and work in retail, or a sector [ph] for a period of time. Laura, why don't you explain why there's lots more market opportunities than even the GBP20 billion number that we're putting on right now? And then Jeff can answer those rather technical questions.

On the threshold of 140%, as we explained ever since we did that, that wasn't really a threshold. It's sort of more a sort of initial thinking around something that's long since been putting the (inaudible).

A - Laura Mason {BIO 20420360 <GO>}

Yeah. So, Dom, I think we're always sense that in terms of the number that we can actually say we're quoting on. I'm not exactly sure how we define it. So, I think it's the numbers of why we've actually put a quote out. In terms of the actual pipeline, I think Nigel's estimate of GBP30 billion over the next five years is a relatively conservative one. It is a business that doesn't have a sort of smooth trajectory, I know conservative. And so, I don't think it gets flat. I think there's just -- so we did think about this, we said GBP27 billion in March, we said GBP20 billion now, and that is just how we sort of calculated the number of deals that will be amount that we're actually quoting on, but certainly we're seeing the actual number of visible deals in the UK sort of coming in almost on a daily basis. So very confident they will grow.

A - Nigel Wilson {BIO 1535703 <GO>}

Yeah. With -- obviously, going up the deal [ph] is in the United States as well. And we did a $200 million plus deal. It was only that has been below $100 million and we've got more access to direct investments and more future access to direct investments and all those things come together. We've opened up the Canadian market, the Netherlands market and the Irish markets. And so, actually there is an enormous pipeline of stuff coming at us. But as Jeff will tell you, he is pretty miserable at the capital committees, and he is rubbing his hands together. We will just do the deals that we think are in the long-term interest of our shareholders.

I'm deeply hurt about being called conservative.

A - Jeff Davies {BIO 20023574 <GO>}

Yeah. I mean, in terms of managing the balance sheet, as Nigel said, we don't like to set a range, I mean, the ratios. If one of the things we look at is the quantum of surplus, et cetera, gets distorted as we see it now from rates moving from one bucket to another as Tim likes to say, and have a bit of Own Funds to SCR moves the ratio, but I still have the same pans the day after to pay the claim. We do look at that, obviously, as it would reduce, but at the levels we're at we're very comfortable. Simon constantly stresses it for various scenarios, and we look at that on an ongoing basis, but we still hedge in the same way. It's not quite a bit, we hedged sort of IFRS, cash flows for an IFRS -- both therefore for the Annuity business, they move around, get closer or further away from the Solvency II but at different points in time, but that's generally how we look at that. So there isn't -- there's nothing we've done fundamentally to shift at the moment. And we'll always look at is as anything opportunistic, but there's nothing at the moment.

And in terms of the DI, I mean, I can answer it. I mean, it's -- I mean, part of the strategy we talked about is selling down some of the traded equity over time. General rule, therefore, it will be reasonably like-for-like. If we were to move cash even into DI, some of which we did, as you can see over the first sort of six months, it again generally diversifies away extremely well, and you saw those numbers are very big credit, very big longevity. So, you put in a bit of direct investments against that, which is very different risk profile and they diversify a way. So he overall capital impact is lower, it's very efficient on a risk adjusted return basis.

Q - Julian Wellesley {BIO 16738430 <GO>}

Julian Wellesley from Loomis, Sayles. Couple of questions. First, is on LGIM, just wondering about the cost progression outlook there, and if there'll be any change, not in strategy, but maybe in emphasis with a change in leadership there. And just as a second question, you mentioned pricing discipline in Lifetime Mortgage. How do you see the current pricing environment?

A - Nigel Wilson {BIO 1535703 <GO>}

Yeah. Chris, you go on with the second question. I'll just take the first. Michelle isn't here today, we have an LGIM America Board meeting, and we decided that it was actually better for her to go over there, meet all of our colleagues there, then you lost basically, good choice as well. And so, she is definitely coming at the year end and we'll go into some of her own initial strategic thinking around it, but she is inheriting a pretty fantastic business in many ways.

But we got lots of optionality for growth and that's one of the things that we are really spending time out because there's areas that we're in already that is adjacencies to those areas where we can expand into. And we found the international expansion relatively straightforward so far. We've done America incredibly successfully. We've got a major -- we've got our license in Japan in six weeks, which is somewhat a record. And I've never seen the Chinese so friendly towards us. I can't think why. And the two visits I've had so far this year. So you're unlikely to see a radical change in strategy. But there's a whole bunch of people that we've hired to expand into areas that we're not really in already and our options for growth have expanded massively in the last couple of years. So we'd hope to see it an acceleration in revenue rather than a deceleration in revenue on a go-forward basis.

Chris? You can put your book down, if you want.

A - Chris Knight {BIO 18966542 <GO>}

Yeah. I think Lifetime Mortgage market sort of growth, it seems to have paused a bit in the first half of this year, but I don't think it's a long-term factor that the dynamics driving that in the long run, and GBP1.5 trillion of equity owned by the over 60s still very much there, but a bit of Brexit uncertainty creeping in on that.

From a cost perspective, the rates you can get for a Lifetime Mortgage very low LTV, now it down sort of 3.3%, which I think is pretty reasonable deal for people. We had a 29% market share in Q2 and we don't for the (inaudible) or chase what's just going to soft market at the moment. So sort of short-term pause, long-term very strong growth dynamics still.

A - Nigel Wilson {BIO 1535703 <GO>}

And then just work along the line if it suit you.

Q - Jonathan Hocking

Hi, good morning. It's Jon Hocking, Morgan Stanley. I've got three questions, please. Firstly, coming back to the solvency. I'm guessing it is sort of in the 160s on a mark-to-market basis. And as you said, you're going to rebuild solvency in the second half. Sort of what comfort can you give us that if we had a combination of stresses from a hard Brexit? Just looking your sensitivities, if you take a scenario where your property markets are down, equity markets are down, rates are down, which I guess, would be the outcome of a hard Brexit in October. It could be a very large drawdown in the solvency ratio on a -- at least on a mark-to-market basis. How is the Board got comfortable with that risk going into the second half? It's the first question.

Second question, just looking at the workplace business, the number of members has gone up a lot. You talked a little bit about that why that's happening. I would have thought a lot of schemes sort of settled ahead of auto-enrollment. Are you winning new schemes? You're actually population existing scheme and more matters.

And then just on the LGIM business, you've been guiding for a while the cost income ratios tipping up a little bit. Is the 53% for the first half, is that something we should annualize for the full year? Thank you.

A - Nigel Wilson {BIO 1535703 <GO>}

Good. Jeff, you want to take solvency, I'll take the two LGIM questions.

A - Jeff Davies {BIO 20023574 <GO>}

Yeah, sure. Yeah. I mean, as I said earlier, the rates will have moved it down starting at 170%, that's going to take you into the 160%. So we'll have gone down a few percentage points. We'll have already generated surplus for a month to offset that FX, you can pick any day you like for equities or spreads. And so, where isn't those move around. But core central is that, it's just gone down a bit, gone up a bit for some other stuff. And so, that we're comfortable where that is.

On the bigger picture question, interesting and we can all guess what will happen to the economic environment at that point in time, and we purposely don't when we presented to the Board because you can imagine the debate you would have. And so, we present some economic scenarios and don't attribute them to any particular happening. And the Board are very comfortable. We've looked at all of those, whether it's rights down, up what's happening to equities, what's happening to sterling, invariably some of them will pick the worst of most of those as well. And clearly, we are comfortable to be standing here talking about rights in volumes, but we will manage that on an ongoing basis. They all stay in the vast majority of scenario stay well within our risk appetite and we're comfortable with those.

I mean, one interesting point people talk about rates down, of course, you may well going to steepening end of the yield curve, which then will have a different impact again. So there are always offsetting in all the piece. So we model a wide, wide range of scenarios and very comfortable with the plan [ph].

A - Nigel Wilson {BIO 1535703 <GO>}

On workplace, is Emma here? I know she isn't. So there is the -- we're winning a lot of new schemes and continuing to win schemes. And, in fact, the biggest scheme we've ever won in terms of assets, we won has (inaudible). And so, we're feeling very confident about the future flows and it is right on a chessboard as we get more schemes and people contribute more if you just got a natural growth around that. And so, our ambition is, by no means, achieve the GBP3.4 million in the UK, we're looking from a giant number over time. And also for the US, we're still in a very early days in the US, but we've won some great clients already in the United States. Again, we've won a very big client in H2 already, so the team is feeling happy about the flows that we're getting in the US, which is not even pointed out here. It was a little bit later than we expected in the first half of this year, but it picked up already in the second half of the year.

In terms of cost-to-income ratio, in part that's Michelle was to decide how did she want to add to the cost base relative to the revenue base. We certainly feel as though we have lots of opportunities for growing revenue quicker. In some ways we have to moderate the rate of growth of -- of course, part of that is going to come through when we have an eventually a slowdown in the IT spend hardly related to regulation and cyber and various other areas, but also because we've been modernizing the business, as we've gone into these -- in these new areas. We don't really have a target for cost-to-income ratio. It's a number that's just risen at around the level it's out there at the moment. But we do have a sort of ambition to grow the bottom line a little bit more than we've done in the first half of this year and indeed in the latter part of last year.

Q - Andrew Baker {BIO 20402705 <GO>}

Hi, Andrew Baker, Citi. Three questions, please. First your bulk annuity pipeline in UK and US is strong, we've seen rates come back, potentially widening funding gaps for unhedged plans. Is there -- do you see low rates impacting the demand for bulks moving forward?

Secondly, in your release this morning, you mentioned you bolstered your structuring expertise in the PRT space in order to develop capital-light solutions. Is there anything new that you're doing there? And if you could just give a little bit on that, that would be great?

And then third, you mentioned on the longevity releases target of GBP200 million, or I shouldn't say target, a guidance of greater than GBP200 million. This is less than maybe a number that you given last year for 2019 estimate. Is this take into account lower depth in 2019 that you're seeing or is there something else sort of why you're looking at that or that number has come down a little bit? Thank you.

A - Nigel Wilson {BIO 1535703 <GO>}

Yeah. On the -- I'll let Laura to give -- maybe give a little bit extra on this. But the lower rates, we always had low rates for a long period of time. And if I said to you three or four years ago, by the way, the market is going to be GBP30 billion and rates are going to be 0.5%. You'd have all said, well, it's just ludicrous when it's at GBP3 billion. So, the correlation between rates and demand is just not there in part because so many of them are hedged and so many of them are already hedged with us because we've got a 42% share of the LDI market. In terms of innovation, that we'd go into -- Laura, maybe you can talk a little bit about that and then Jeff can answer the question on mortality.

A - Laura Mason {BIO 20420360 <GO>}

Some of the new structures that we are looking at these include different reinsurance structures with external couterparties, as well as our own internal counterparty, LGRe. And certainly, some of the assets that we're working on with Kerrigan's business where we're able to find structures that work well from a capital perspective are also helping. So, really a sort of combination of reinsurance and asset structure.

A - Jeff Davies {BIO 20023574 <GO>}

Yeah. And on the longevity, I mean, we've been steering that we would be cautious and then potentially maybe spread these out a bit more, we've done more and more analysis on it. We do want to make sure we understand the cause of depth. We want to make sure understand the impacts of socioeconomic class. We are still only looking to 2017, we know in theory, there is a quite a bit to come in 2018. So we think there's prudence within that. 2019 experience is lighter than it's been in the last couple of years, but it's still neutral, I would say, I think that's in line with our peers are saying. That's not weighing heavily on our decision on what we do on the future improvements, don't forget this is what we feed in for improvements blend in over 10 years, 15 years. So this is much more -- we will look at our data as it's coming through, but it's much more fundamental analysis of what is driving your long-term assumption, and therefore, how you blend into that long-term assumption. But, I mean, yes, one of the fact, but that's not impacting. It's a bigger picture of what's driving that. What's the causes of depth. What's the differences by socioeconomic group, which are not that material for us, but we just always want to understand it and relatively a bit cautious, and that's really small.

Q - Fahad Changazi {BIO 15216120 <GO>}

Hi, good morning. It's Fahad Changazi from Mediobanca. Could I -- a couple of questions. Could I just chase up on the Solvency II? Because Jeff you sort of mentioned that it's down by a bit, because of the market. When I mark-to-market it, I think I was getting up to 10% of market boost and that's not including FX, that's wrong, fair enough. If you can just clarify that?

The other thing is on the H2 bridge for the Solvency II, there is GBP0.7 billion of OSG H2, H1 it was GBP0.8 billion, you have GBP200 million of mortality leases coming. So does that imply you're writing more bulks or is that covering more bulks in H2 versus H1 or is there something else going on there, given that you got mortality releases?

And the final thing is on new business margin in annuity, this has gone up in H1. Could you perhaps talk about pricing? Because there's so much demand, is pricing benefiting or is it just going back to historic levels and it was a blip we had before into the new business margin?

A - Nigel Wilson {BIO 1535703 <GO>}

Yeah. The sample size is always so small when you're doing a few large deals, but I think in general, there are well-informed buyers and well-informed sellers. And so, you should expect just minor movements in margins.

Jeff and Laura, do you want to answer those two questions?

A - Jeff Davies {BIO 20023574 <GO>}

Yeah. Sure. Yeah. Clearly, it's not 10%. And so, it is a few percentage points down if you apply the, as I said, the interest rate sensitivity and then will come back and that's sort of where you're looking at. There's nothing that moves more than the sensitivity. Or you can pick a day, I mean, what was it Monday, when equities were down and then that's back again. But no it's no way near that. Whatever you would have a 161% or something in that case. No, that's not the case.

The bridge, I think that the longevity is separate. So that's not within that. The GBP800 million, GBP700 million is just rounding, one was a little bit over GBP750 million, one is a bit below GBP750 million. So we're saying GBP1.5 billion roughly. But it wasn't quite comfortable putting it as another GBP800 million because we felt that may round too higher number and plays out but we thought that was the safer side to put it and the longevity is on top of that. So none of those numbers include anything for PRT new business.

A - Laura Mason {BIO 20420360 <GO>}

And I agree with what Nigel said, in terms of the...

A - Nigel Wilson {BIO 1535703 <GO>}

(inaudible) self now.

A - Laura Mason {BIO 20420360 <GO>}

I mean, the growing pipeline has been well flagged. So I think we -- and a number of our competitors have been well prepared for this pipeline. So we do expect overall margins to be fairly consistent. And we will maintain our pricing discipline.

A - Nigel Wilson {BIO 1535703 <GO>}

Greg?

Q - Greg Patterson {BIO 21641359 <GO>}

Hello. Greg...

A - Nigel Wilson {BIO 1535703 <GO>}

You don't need a microphone.

Q - Greg Patterson {BIO 21641359 <GO>}

Greg Patterson, KBW. Three questions. One is, I wonder if you can just talk about -- I know we haven't had a lot of downgrades but is there any early signs of that? Because obviously that's a here still Solvency. I wonder if you just talk about the downgrade environment, what we're seeing now?

Second point is on the Retail LGI, I mean, obviously there is a wave of FinTech in that area and that's obviously putting pressure on margins. I wonder if you can just talk about the trajectory of margins there and also just about the Group margin trend, because obviously that's can be lumpy and that's interesting.

And the third question is, I know there's sort of weak, not one-to-one correlation, but in terms of your capitalization on the rating agencies and your AA- financial strength rating. At what point -- if the Solvency II ratio fell with the rating agency start would be a sort of start being worried about it? There must be some level. I mean, if it's 100%, you're going to get downgraded. I just don't understand where now and a 100% is an issue?

A - Nigel Wilson {BIO 1535703 <GO>}

Jeff, you want to take first and third and then Bernie, you come in with the second one after Jeff's done with the first and the third one, which is broadly the same question.

A - Jeff Davies {BIO 20023574 <GO>}

Yeah. I mean, downgrades in our credit portfolio, there's nothing particular we've got on the horizon at all, even Simon is agreeing with me. Tesco was upgraded, wasn't it? Which was good. So, yeah, but the sort of sectors wherein we share the diversification we're not saying that, you're not seeing I don't know, utilities, for example, being downgraded. So, no, there is nothing we've seeing on the horizon on that. We have obviously for the half year been through a thorough process as well on the internal ratings on our own direct investment portfolio, and again we're not seeing that, there are few pluses and minuses of external valuations on that stuff, but nothing on data we're holding. So nothing on the downgrades.

Yeah. On the rating side of things, well, as you know, I mean, S&P in particular have their own model, that's completely separate, driven off the Solvency II balance sheet with a bit of this and those numbers don't change fundamentally for what happened into your Solvency II ratio. There will be different impacts of market movements on a ratings model. Ultimately, at some point a long way down there would be a question about market performance and can you sell the business, and clearly, that's nowhere near where any of these companies are. So, it's nothing that has come up and we've just recently been through all our conversation with the rating agencies, all very positive and you see in the press releases, that was very much continuation of the same position, they recognize our strength in the businesses that we're in, market-leading position, but also they do recognize the diversification that's come through from the international expansion, which you're seeing is a positive by the rating agencies.

A - Nigel Wilson {BIO 1535703 <GO>}

Bernie?

A - Bernie Hickman {BIO 19334629 <GO>}

Yeah. So on -- so UK margins is actually slightly improved first half to first half and that's because we are actively looking to optimize pricing, optimize our product mix, optimize everything to improve margin. At the same time, we realize dividends are paid in pounds, not percentages. And so, we're looking to optimize that pound outcome as well. So, technology referenced, yeah, that's a really important point. But the key point is, we've been leading that technology innovation and that's been driving our unit costs down, which we will put back into pricing, if that's what we need to do to optimize the outcome or if we cannot optimize and increase margins, we will do. So, yeah, we're, I'd say, at the leading edge of the curve on technology and intend to remain there and continuing to invest in our technology platforms and partnering with technology players, FinTechs as well to make sure the cutting edge of technology. And so, yeah, going forwards -- we are delivering good margins and we'd be confident we can carry on with all our competitive advantages to deliver good margins going forward.

A - Nigel Wilson {BIO 1535703 <GO>}

Don't say anything about the America.

A - Jeff Davies {BIO 20023574 <GO>}

I'll come on the Group. Yeah.

A - Bernie Hickman {BIO 19334629 <GO>}

Yeah. So, yeah, America, we're doing a similar technology investment patent there and hope to get unit cost savings, part of which will go back into price, part of which would help to improve margins. There the margins have come down slightly, both markets are competitive markets and the margin will fluctuate over time. Obviously, we're always doing everything we can to improve margins. Group protection has gone up slightly, that just varies a little bit depending on product mix as well.

A - Jeff Davies {BIO 20023574 <GO>}

Yeah. Technology is inherently deflationary as we found in lots of different industries and financial services is going to be the same, that's why you're just going to see price competition, you can see that in the asset management industry, it's very pronounced right now. Our central case is not for real price increases over the next years but technology to drive down prices, but we have to use technology to get our cost base down. We've been very good at doing that so far, when we certainly believe that we are as competitive as everybody else in any of the areas that we compete in, but we're not standing still, there's a huge amount of efforts. And all the guys are nodding because we're in the preliminary budget say, just for next year is that, we have to use technology both to give better value to customers, but to also drive down our costs and you have to perform and transform and then unless we perform and transform, we will lose market share, and that's not at all what we want to do.

Q - Colm Kelly {BIO 19140684 <GO>}

Colm Kelly, UBS. Just a question on the solvency ratio of the insurance entity. So the operational surplus generation of GBP1.5 billion is important, and thank you for the guidance, I suppose as important from a dividend perspective is getting that out of the entities and the insurance entity clearly is a vast majority of that. Given the capital optimization program that you have, the insurance entity solvency starting point is much lower than -- at the Group level, I think it was in the mid-150%s at the start of the year. It is subject to similar market impacts us to the Group ratio. A little bit different to the Group ratio, there is a large cash remittance typically coming out in the second half. So, I think the question for me will be, one, are you able to update even broadly on where the insurance entity solvency ratio is at the half or even currently?

Secondly, at what level would that solvency ratio of that entity you need to get to before you would be in any way concerned around constraints over cash remittances from that entity to the Group?

And just thirdly, you mentioned the risk appetite that you have. Can you maybe -- you articulate a bit more -- in a bit more detail about the risk appetite is for that entity? Because clearly it will be in the risk appetite statements et cetera.

Last question, is just on Canadian bulk annuities or PRT. Positive entry into that market this year to large markets. Do you think the experience and expertise that has been built up in the US will help you scale that business up more quickly than the US did or should we expect a similar trajectory of growth in Canada as we have for the US? Thanks.

A - Nigel Wilson {BIO 1535703 <GO>}

I'll take the easy one, which is the last one. Just -- we're going to have a measured approach to all of our international -- too many bridge businesses have taken a sort of slightly (inaudible) approach to international expansion with the acquisitions and everything else. We've got such tremendous momentum in all of our businesses. We can be very measured. We didn't do a Chinese joint venture in insurance like lots of with the firms. We haven't got any legacy issues when we expand into these markets because we've got legacy assets, or legacy businesses from the past. So we'll just see a measured approach.

Jeff, do you want to answer all the questions on LGAS and Simon is going to give his views on the risk appetite and how we think about it and how we measure ourselves against it.

A - Jeff Davies {BIO 20023574 <GO>}

Yeah. LGAS, you're right, it was on 53, year-end there's going to be a SCR that's published. And so, we gave that number, but significantly less exposed to the movements than we've seen that the Group because we obviously don't have the debt repayment and the dividend payment, which will be the other big item. It doesn't come out and in fact, we have much smaller remittances from the entities in the first half, I would say, that's in the second half. So, the impact we've seen at Group is much, much less on the individual insurance entity on LGAS.

We -- again, we model all the scenarios. We don't have concerns over dividend requirements in the second half. Don't forget the things that are positive, the surplus sits in there, the surplus generation from the annuity back book, longevity releases will flow-through for that business. So, we're comfortable, I think we got three of the Board members here, actually, we're comfortable as a Board on the dividend remittances from LGAS, and we again have modeled it as part of the Group modeling, we model individual subsidiaries and where are they against the risk appetite.

To you, Simon.

A - Simon Gadd {BIO 17956222 <GO>}

Just a follow-up on that, and so we don't have a hard line for LGAS in the same way as we don't have a hard line for Group. We very much look at this by through the scenario and stress testing lens, looking -- playing out different scenarios, what does that do to the coverage ratio. I think the only thing I would differentiate between LGAS and the Group is, there are different management actions available to manage a downside in LGAS, clearly, there is more from the Group but there is also the ability to move business around the Group to make it as most efficient deployment of that capital as possible, and we have a reinsurance mix that are in LGRe that helps us do that.

So, yeah, no hard and fast rules but, yeah, as Jeff said, it's about making sure that we're on top of all the stresses, understanding how they behave. Big dependence on Laura's business in terms of making sure that the credit portfolio is property diversified, we're really on top of the areas where there is potential vulnerability to those stresses like Brexit and we've done a lot over the last year or so to prepare ourselves for that. So we've had plenty of warning. So, yeah, that's the broad picture.

Q - Colm Kelly {BIO 19140684 <GO>}

Just to follow up on that. if I can. I mean, in the risk appetite statement, regularly now look for a limit such that post those stresses, your solvency won't go below a certain number or is that just simply a 100% minimum requirement?

A - Simon Gadd {BIO 17956222 <GO>}

From a regulatory perspective, it's 100%. Yes. So anything above that is the management's discretion.

Q - Colm Kelly {BIO 19140684 <GO>}

Okay. And is the Board requirement aligned with that?

A - Simon Gadd {BIO 17956222 <GO>}

So, the Board has its own view as to what it wants to be able to do and how -- what stresses it was about to be resilient too, and that's how -- that's what I just answered previously.

Q - Colm Kelly {BIO 19140684 <GO>}

Okay. Thank you.

A - Nigel Wilson {BIO 1535703 <GO>}

Okay. Johnny and then Andrew.

Q - Johnny Vo {BIO 5509843 <GO>}

Okay. It's Johnny Vo from Goldman Sachs. Just a couple of questions. I guess, I was kind of surprised by the MA spread that you recorded for the half year at 121%, which is quite resilient from 138% and I think you're one of the higher end in terms of MA spreads that I can see and broadly in line with where most players were at the year-end when spreads were very wide. So, what -- or how is that spread developed over the last few years? Can you just give us some data points on that?

In terms of MA spread for new business, is that different to the overall book? Are you applying more liquid assets to new business as an asset mix, rather than your existing book?

And finally, in terms of -- just following on from the question from Colm, I mean, is there a risk that some of the treasury assets to sit in L&G finance get used to support the LGAS solvency position in a down scenario, given that you're looking for stress? Thank you.

A - Nigel Wilson {BIO 1535703 <GO>}

Jeff, do you to take the first and the third one and Laura take the second one?

A - Jeff Davies {BIO 20023574 <GO>}

Sure. I think they will get wrapped up in one. So, I mean, there's one big MA portfolio, we put the assets in there. So there's no different. So, Laura, can talk about pricing assumption, if you like. Yeah, I mean, we're not -- everything I looked at, I looked at all the year-end SCRs sort of interesting character I am and we didn't -- I didn't say anything particularly out of line. We obviously had some different mix of the business. We have LTM, which is very beneficial. We secured a lot of these HMRC assets that we've talked about in the past. But we've done very well on trading, US credit for example, over the last six, 12 months but there is nothing we would say is unusual in that. There's nothing we've done differently in the MA. It has moved around broadly in line with -- there's slight change in our mix in the asset portfolio, we have been increasing the amount of DO, which we know is an uplift, it's moved with that. If anything, it probably be a bit flatter because that has a proportion in the last six months hadn't changed dramatically because we've been writing a lot, even though we sourced over GBP4 billion. So there's nothing in particular there. We'd be happy to go through in more detail LGAS and stuff. But there's nothing I am aware of there.

And then in terms of treasury assets, I mean, there's long, long list of management actions we'd take at some point. I mean, we are not foreseeing go into the treasury and saying, let's put a load of cash into LGAS today by any mean. So there are the long list of management actions we could do.

A - Laura Mason {BIO 20420360 <GO>}

And in terms of the relative proportion of direct investments versus traded in new business, we have used a higher proportion of direct investments in new business than has been in the back book. I think over the last half -- last year, we increased our direct investments in the overall book from about GBP17 million to GBP20 million, that's actually remained fairly constant over this half year, because we continue to make sure that we invest, where we see the best value. And I think as Jeff said earlier on, we saw some better relative value in the traded markets in terms of how we executed the big deals we did this half year.

A - Nigel Wilson {BIO 1535703 <GO>}

Three more -- four more questions. And then we'll just...

Q - Andrew Crean {BIO 16513202 <GO>}

Hi, good morning. It's Andrew Crean, Autonomous. Can I ask three questions? The first one is a follow-up on the longevity question. Moving down your forecast from GBP300 million to GBP200 million is substantial. I just want to know, is that stylistic or whether it is a response to data, i.e., I'm just saying that you want to spread this over a longer period of time but you don't actually think that the quantum of releases in the future has changed at all? Or is it a more material issue?

Secondly, Slide 20, which was the profit signature on your BPA. Could you give us the IRRs around that and say in terms of the capital invested, is that actually 100% on the sale or something higher?

And then stripping out LGR and looking your other continuing businesses, they have over time not managed to grow at the same rate or even, particularly at the sort of 10% target rate. Do you expect that to change over the next few years, particularly I think you're backing away from the LGIM 8% to 10% growth forecast. Because if they don't and they don't grow in line with the dividend, then the dependency of the dividend on annuities increases and that -- it doesn't turn please the market?

A - Nigel Wilson {BIO 1535703 <GO>}

Yeah. In terms of the third question, I'll answer that, while Jeff, just thinking of the answer to the first two question. If you look at the rate of growth of operating profits on Slide six, you'll see LGC is at 12% over the last three years. And if you do the reverse math switch from the numbers that Kerrigan was talking about, we definitely want to be looking for a higher rate of growth. So the principle that you're alluding to is the same. We haven't in any way backed away from LGIM. It's just we've got a brand new CEO and the one message he gave me is please don't even give me any hospital passes, answering tricky questions from Andrew Crean in particular. But the Retirement Solutions business has actually been the star performer and in terms of its percentage growth on an annual basis.

And as you rightly point out, we've done fantastically well out of PRT and we can see the pipeline. So of the five businesses, three are performing at around the level that you were targeting talking about. LGIM, we'll wait for Michelle to come back to us in March. And Insurance business is getting higher top line than people expected. We haven't yet translated that into higher bottom line and that's because we are in the midst of this sort of second wave of technology transformation that Bernie talked about and we've got to get America growing a bit faster than we have in the past to get its profitability up the level.

So, when I mentioned earlier that not all businesses are firing on all cylinders, despite there's sort of 10% growth in all key metrics over a long period of time. I think still think we have a lot to do to get to an optimal performance across all our divisions and all the divisions and not yet performing, as well as they truly could perform. Jeff?

A - Jeff Davies {BIO 20023574 <GO>}

Yeah. On the longevity, no, I mean, it isn't that there is anything structural. I mean, I don't think we'd ever said it was GBP300 million. We said, mechanically if you drop 2017 and you'll get GBP300 million and some of you have done that and mechanically you drop 2018 and you got a bigger number. But we've said we will be cautious. We just want to understand it. There isn't obvious data, there is some movement for socioeconomic class that we want to understand more, make sense to potentially wholesome back whether that means they're all then eventually comes out three out instead of now or it comes out in five years, in some ways, it doesn't really matter. And it's better to understand what's there. And at the moment, being one year behind is working extremely well for us on that front because we get to see what is developing in 2019. We know where we've got significant changes in 2018 that we -- that can come through as well. So it works in our favor. So there isn't anything. We would be flagging it if we thought there was something we're seeing in the data. But that isn't the case. It's just we want to understand a little bit better, make some allowances for some of these, while we probably do even more work again before we release next year to go in.

On the other one, well, I'm obviously not going to give the IRR. You can't get the rule with us, that's why we showed them a big because you all would. The simple answer on the -- obviously you guys know the Australian number is at a 100% and you can do whatever math you want to do around that and what level you believe we should or shouldn't be allowing for in the focus on Australian on IRR. I mean, we talk about targeting a sort of a double-digit return on that stuff. But it goes back to one of Nigel slides that it's all about the synergies. It isn't really about how much do we make on an individual PRT business not allowing for LGC returns LGIM fees and the fact that we leverage up and add in other assets to it. So when you put all that in you can have a range of six different metrics but hit different targets, but you have to factor in the profits we're making across the Group, which is why you get to a 20% ROE.

A - Nigel Wilson {BIO 1535703 <GO>}

I don't mind which microphone you get.

Q - Abid Hussain {BIO 20229932 <GO>}

Morning. It's Abid Hussain from Credit Suisse. Just two questions from me. Firstly, just going back to the longevity reserve releases. Can you give us an indication of what they might be once you move to CMI 2018 tables, please?

And then the second question is on liquidity. Can you just explain briefly the drivers behind the lower liquid resources? I think they dropped down to GBP3.1 billion at the half year versus GBP4.4 billion at the full year. And a link to this, what is the Group surplus liquidity running at the moment? I think the full year number was GBP1.5 billion. Thanks.

A - Nigel Wilson {BIO 1535703 <GO>}

Yeah. Jeff I think they're both for you.

A - Jeff Davies {BIO 20023574 <GO>}

Yeah. So, well, I said the CMI 2018. I mean, if you literally just drop it in, it's the much bigger number, you can get the GBP400 million, but we don't just literally drop it then. So we will -- it will depend what we see in the data, what more analysis we do and how much we think it needs to be held back for all we do further work. So it come in answer from GBP0 million to GBP400 million in that case. We may well choose to spread it out for the same reasons and apply some caution.

But on liquidity, yeah, I mean, the main movement is the time and we talked earlier a little bit around -- in terms of treasury liquidity, in terms of dividend out versus dividend up from subsidiaries, et cetera. On the bigger picture, really what's happening is, we put quite a bit into direct investments. So you see the GBP500 million, GBP600 million that's gone into direct investment plus we pass them out in the external dividend and coupon. So there isn't really anything that's happened in there. The rest are small amounts here or there, that's moved around whether that's a bit of money spent on projects, bit of money that's been taken back on deposit, not on deposits in entities, but there is nothing major that's moved apart from that.

Q - Gordon Aitken {BIO 3846728 <GO>}

Yeah. Thanks. Gordon Aitken from RBC. Just a couple of questions. One, on the annuity stream, we've just come from the presentation where management said the strain on bulks addressed in this half as half versus last 2018 H1. You're still talking about 4% new business strain. Just so if you can square those two statements?

A - Nigel Wilson {BIO 1535703 <GO>}

What was the first one?

Q - Gordon Aitken {BIO 3846728 <GO>}

Well, Phoenix saying the strain on bulks they've written this half is half of what it was.

A - Nigel Wilson {BIO 1535703 <GO>}

What was it last -- well, the two numbers?

Q - Gordon Aitken {BIO 3846728 <GO>}

Well, they didn't give percentage out in terms of...

A - Nigel Wilson {BIO 1535703 <GO>}

To be the masters, it's very hard to do then.

Q - Gordon Aitken {BIO 3846728 <GO>}

I mean, the point is that, I'd be -- I mean, you're talking about GBP60 billion demand in the bulk market at the moment, I'd be surprised if you're not getting better pricing than you were a year ago.

Second question is, just on competition, can you give us a sense of competition in direct investments? I mean, University of Oxford, they are obviously looking for a partner. Was there anyone else you could do that aside from you? And I'd like to say in Glasgow new rental site, I mean, the City Council, did they put out for tender, how many companies pitched?

A - Nigel Wilson {BIO 1535703 <GO>}

I mean, there is always competition, but it's never the same competitor anywhere, and we've been at this for about 10 years now in the direct investment space. And so, most of them are long-term relationships. I'd say, the recent Cardiff deal, there wasn't any competition for that because it's sites that we own now and we've got lots of optionality around those sites and that happens right across the UK. For new things, there will of course be competition. And indeed, maybe Kerrigan, can talk a little bit about the competition in Oxford or Bath or somewhere.

A - Kerrigan Procter {BIO 15093363 <GO>}

Yeah. I mean, just a few points on that. I read a whole list of the sorts of things that Oxford University are looking forward in Oxford. And yes, there were people who could do part of that. So affordable housing or student accommodation or key worker housing, old sites, the innovation districts, but we're able to bring all of that together and all the types of capital it might be required, so whether that's equity or debt, it could be LGIM managed funds or it could be LGR. So there is a -- over the years, we've built a pretty unique set of skills. So, yes, there are people competing right against the end in the Oxford University partnership for example, but it's quite a range of skills that we bring there. So we feel we're in the pretty good place to win the bits of direct investment business if we want to.

A - Nigel Wilson {BIO 1535703 <GO>}

Yeah. We haven't lost very many of these pitches over the last years. And we are incredibly well positioned for a huge pipeline of these future deals that we haven't yet announced. I think just on the news, it's very hard to talk about what Phoenix will do, but we're very happy with the numbers that we've got and 4% is a pretty good number to use in all their models on a go-forward basis.

Andy, last question to you.

Q - Andy Sinclair {BIO 17749036 <GO>}

Thanks. It's Andy Sinclair from BoA Merrill. Just two from me to just tidy up at the end. Firstly, possibly for Bernie just on UK protection. We've touched on maybe a couple of elements there already, but the release from operations and IFRS operating profits have been on a bit of a downward trend for a few years now, despite as you said, premiums climbing quite a bit over that period. When do you think that starts to turn around for maybe that tech investment start to pay off? So that's one.

Secondly, it was just on the GBP2 billion pipeline in the US for PRT. How much of that US pipeline would you typically expect to convert and how many deals within that given that it's starting to be some bigger ones you're looking at? Thanks.

A - Nigel Wilson {BIO 1535703 <GO>}

Yeah. Bernie and Laura, would you want to just answer those?

A - Bernie Hickman {BIO 19334629 <GO>}

Yes. There's always a few moving parts in the release from operations, UK was up a little bit half year to half year, which was -- it was good, but there is moving parts within there, there is a tax effect that's been ongoing for many years now. I think that drops away next year. So are more hopeful that we can have kind of sustained period of growth next year. But there are other factors, the FinTech is starting to come through as well. So that's been a positive. We've been changing some of the reinsurance between UK and the US, that had a small negative on the UK, obviously, offset in the US. So, they're all kind of single-digit moving around positions really. So the underlying position remains the same as we get -- growth in premiums that should be -- that will be flowing through into release of prudence margins and that should be the long-term kind of position that would get into, but we've noise around that.

A - Nigel Wilson {BIO 1535703 <GO>}

So Laura is going to give a conservative view about the American prospect.

A - Laura Mason {BIO 20420360 <GO>}

On the US, I think we are really pleased with the organic growth we've seen over the last couple of years and in particular moving from the smaller size of the market to slightly bigger and have executed a number of bigger deals this year, and have a number of solutions to execute -- to accelerate that organic growth over the next few years.

I mean, in terms of how much we can give, that's a very difficult question to answer because just as we do in the UK, we maintain our pricing discipline. So we do put in prices that we would be happy to win that.

A - Nigel Wilson {BIO 1535703 <GO>}

Yeah. As we move up the scale, the probability of us winning large deals probably decreases. We've done very well in there, GBP100 million, as we go into bigger classes maybe the profitability -- because we knew into those classes will be less. So it isn't a easy mathematical question to answer, but we can -- I'll cover -- we can cover it a little bit more detail after we finish.

Thank you, everyone, for doing the two shows today. And hopefully, we'll just be a one show but the -- at the year-end. Thank you for all of your questions and thank you also -- you've been supporting us for your continued support and even Colm said well done and shook my hand at the start. We've got it on -- we've got it -- John managed to get a little video clip that we're going to put on our side this afternoon, it's just the first for everything on learning. But look forward to seeing you all at the year-end, and then, of course, we'll be joined by Michelle as well. So thank you.