Q2 2018 Earnings Call

Company Participants

- Bernie Hickman, CEO-Legal & General Insurance
- Cheryl Agius, Chief Executive Officer-General Insurance
- Chris Knight, Chief Executive Officer, Legal & General Retirement, Retail
- Kerrigan Procter, Chief Executive Officer-Legal & General Capital and Executive Director
- Mark Joseph Zinkula, Director, CEO-Legal & General Investment Management
- Nigel D. Wilson, Group Chief Executive Officer & Executive Director
- Stuart Jeffrey Davies, Group Chief Financial Officer & Director

Other Participants

- Abid Hussain, Analyst
- Alan Devlin, Analyst
- Andrew Baker, Analyst
- Andrew J. Crean, Analyst
- Andrew Sinclair, Analyst
- Ashik Musaddi, Analyst
- Barrie Cornes, Analyst
- Colm Kelly, Analyst
- Dominic O'Mahony, Analyst
- Gordon Aitken, Analyst
- Jon M. Hocking, Analyst
- Oliver Steel, Analyst

MANAGEMENT DISCUSSION SECTION

Nigel D. Wilson {BIO 1535703 <GO>}

I'm not going to use my glasses today at first. Good morning and welcome to 2018 Half-Year Results Presentation. This morning I'll take you through the highlights, Jeff will take you through the financial results and divisional performance in more detail, and then I will return to discuss some of the broader strategic themes and our outlook.

Today, I'd like to start by thanking my colleagues, our management team and all of our employees for their hard work and collaboration in delivering these results. Across all of our divisions, we have a stronger management team than I have ever seen at any time since joining Legal & General. All of my colleagues are performing at a higher level. Our industrial scale-up has succeeded, and we're now building a technologically scaled-up business.

The usual disclaimers apply. This was another six months of strong performance from Legal & General. Investments we have made set us up for a very busy H2; are in line with our financial and growth ambitions for 2016 to 2020.

On the slide here, we've excluded last year's £126 million mortality release from the comparisons as we had no equivalent for H1 2018. The next mortality release in H2 is expected to be higher than last year's total of £332 million.

Operating profit from divisions of £1.059 billion was up 7% versus half year 2017. Solvency II operational surplus generation of £700 million was 11% up on the prior year. Earnings per share at £0.13 were lower than the prior due to the decrease in investment variance of £142 million from £175 million to £33 million. And our interim dividend of £0.046 is also 7% up versus last year, consistent with our policy.

Stepping back, we see operating profit from divisions, which was £1.1 billion in 2011 growing at 10% per annum since 2011. EPS over the same period is growing again at 10% per annum. This strong growth trajectory is without including the effects of last year's mortality release. And looking at dividend per share, I've included data in the slide back to 2007. You see the same steady progression in growth at 10%. It is worth noting, operating profits were £658 million back in 2007. Now after a decade of growth, they're over £2 billion.

Looking at the double digit compound growth in operating profit from divisions, from dividends per share and earnings per share with a longer term is instructive. During this period, we have had numerous and plenty of exogenous challenges including Solvency II, pensions freedom, (03:02) reviews, the Brexit referendum, interest rates falling. In each case having a clear strategy and focus on the ability to implement management actions has enabled Legal & General to deliver a steady drumbeat of rising operating profits, earnings per share and rising dividends.

The interim dividend rate for H1 2018 at £0.046 is up by 7% from £0.043 last year is set in accordance with our formula. So, no change to our approach of measured progression, which provides a high level of predictability for our investors. Jeff will cover the balance sheet in more detail. But in summary, we see here the consistent effect of growing operational service generation. We've written significant volumes of new business (03:52) the last few years, while the SCR has in fact reduced from £8.3 billion to £7.4 billion. And through small and negative new business trend delivered consistent net surface generation.

The SII coverage ratio continues to strengthen, and at the end of June was 193% compared to the 186% a year ago. The longevity release we expect to make in H2 will provide additional capital for Legal & General.

This nutshell of operating profit by business division shows the positive momentum from H1 2017 to H1 2018 across every business division, except General Insurance. Never have we had so many opportunities to grow. Never have we had such a strong management team to deliver that growth. We now need to execute. And H2 has got off to an excellent start with more to follow in the rest of the year and beyond.

Our businesses and their profits are aligned to structural growth drivers in the broader economy. Over the next 20 years, the UK population age 65 to 84 is estimated to grow by almost 40%. This aging demographic in the UK underpins a PRT market, which is busier than ever, with an active court levels at over £20 billion in a market where pricing factors are moving in favor of deal execution. We have over £7 billion expected to complete in H2 2018. We expect a record year in 2018.

We also expect strong double digit growth in retail retirement products to continue in H2 and beyond. In housing, CALA and our other housing businesses are just reaching scale in a market, which is still well short of the target 300,000 homes per year. In Investment Management, we are leading the shift towards DC. We're strong in global LDI and fixed income, and we expect to see further U.S. and international growth in H2 and beyond.

In the insurance businesses, markets and weather conditions have been difficult, but our management actions are turning around previous areas of underperformance moving customer acquisition increasingly to direct and employing digital to improve products, pricing and service. Our confident outlook suggests that we will again outperform in H2 and beyond enabling us to achieve our targeted EPS performance out to 2020. I'm very positive about H2 and the years to come.

Now, I'd like to hand over to Jeff.

Stuart Jeffrey Davies {BIO 20023574 <GO>}

Thank you, Nigel. Good morning, everyone. I'm not going to use Nigel's glasses either. Right. This morning I'm going to cover the financials for the first half of the year, where we are investing, the performance of each of our divisions and finally the group's capital position.

As Nigel said earlier, we've been consistent in our delivery and the first half has been no exception. Our operating profit from divisions is up 7% with growth in five of our six businesses, which demonstrates the quality of our divisions and the relevance of our focused long-term strategy. This growth rate excludes the first half 2017 mortality release of £126 million. This is consistent with how we presented the full-year results.

All comparisons I make to half-year metrics will be excluded in this mortality release, unless otherwise stated. We are using some of these mortality releases and strong profits to invest in high-growth opportunities within our chosen markets. As previously flagged, we're making measured investments across our group to drive cost efficiencies, gain access to growth areas, enhance customer experience and to comply with evolving regulatory framework. In the first half of 2018, on top of the investment within divisions, this resulted in a £13 million increase in group investment spend, meaning operating profit was up 5%.

PBT was down, largely as a result of lower investment variance compared to the first half of last year due to adverse equity market performance and lower long-term interest rates impacting LGR reserves. Net release from continuing operations was down slightly to £658 million, primarily due to lower new business surplus from LGR. Our return on equity remains above 20% illustrating the efficiency of our balance sheet.

Now, we'll turn to operating profit from divisions. In the first half, LGR's Institutional business, which deals with corporate pension schemes, grew 8%. This was as a result of larger opening position and continued stable unwind of prudent margins.

Our Retail LGR business grew 11%. LGIM grew 5% and maintained the leading cost income ratio of 51%, whilst continuing to invest. This was despite challenging markets.

LGC was up 21% following a strong performance from our £2 billion direct investment portfolio, which included an additional contribution from CALA Homes following the full acquisition in March. LGI contributed £154 million, up 5% from the prior year following the turnaround of group protection, which returned to profitability and continued good performance in our UK retail protection business. This was partly offset by adverse mortality experienced in the U.S., where the market was impacted by an exceptionally bad flu season.

General Insurance was down due to the adverse weather experience, in particular the freezing Q1. This was consistent with the wider market. Our diverse type business model means that we can manage temporary fluctuations across the group and still deliver attractive returns to our investors.

And a quick update on the disposals we've recently announced, Mature Savings expected to complete in 2019 following the Part VII transfer. In the first half, we recognized £56 million operating profit from this business comprising the unwind of the expected underlying profits and a one-off release of £33 million provision, which is no longer required following the transaction. In June, we announced an agreement to sell our stake in IndiaFirst, resulting in pre-tax profit of around £45 million on completion. This is expected by the year-end.

I'll talk in more detail about each of our division shortly. But first, I'd like to cover our investment in the business, which we've referenced at our full-year results. We are well-placed to invest in future growth with our robust balance sheet, cash position, ongoing mortality releases and strong ROE. The investments we are making achieve four objectives; improve operational efficiencies through technology investments, access growing market through bolt-on M&A, enhance the customer experience, and meet evolving regulatory standards.

In technology, we are investing across the group. For example, in LGIM, we are focusing on DC pensions and personal investing. In LGR, we are partway through a multi-year technology project modernizing our platforms in preparation for significant PRT activity expected in coming years. In GI, SmartQuote has revolutionized the quoted process and SmartClaim help streamline the claims process for customers.

We are investing more in robotics across the group both in customer-facing operations and finance functions. Examples of M&A investment are Canvas, Buddies and Salary Finance. Our regulatory spend has increased to reflect changes such as IFRS 17, GDPR and MiFID II. We continue to deliver these as efficiently as possible.

We've collaborated across divisions to ensure a seamless offering for our customers on platforms like legalandgeneral.com and My Account, and of course, focusing on the latest advances in cyber security to keep our data secure. Our investments in the business will help us deliver our long-term growth objectives.

Returning to the divisions and LGR, in the first half, operating profit was up 9% to £480 million following a strong performance from the back book and positive operating (12:28), partly driven by the acceleration of fully processing PRT scheme data.

As I mentioned at our year end results, we're currently investigating the appropriateness of moving to CMI 2016. Our latest estimate of this is a reserve release at the higher end of the £300 million to £400 million range under IFRS and Solvency II, as we adjust our best estimate assumptions. We will continue our analysis and expect to make any changes for year-end following completion of this work.

Looking at new business in more detail, we wrote nearly 1.1 billion of annuity premium in the first half, including the innovative transaction and the BAA Pension Scheme. In LGRI, U.S. pension risk transfer business more than doubled premiums in the first half, and we expect this positive momentum to continue into the second half of the year as this is when we have historically seen more activity in the U.S.

Since we started in the market three years ago, we have written almost $2 billion of annuity premiums. In the UK, the bulk annuity market has been attracting headlines recently for a record pipeline. We are currently pricing more than $20 billion of live transactions as Nigel said. We have retained a significant portion of the 2017 warehouse direct investments and added to this to support higher second-half volumes that we mentioned earlier.

Moving on to retail business. Individual annuity sales was slightly down at £337 million, as last year benefited from increased H1 sales during a catch-up period at the start of the Aegon distribution agreement. We continue to see demand returning to the individual annuity market. And in the second quarter, we saw a 16% increase in premiums compared to the same period last year.

We are the leader in lifetime mortgages with a 28% market share, having written £521 million in loans in the first half up 23%. We remain positive about the potential in the second half of the year. Although, we are market leaders, we are recent entrants, so lifetime mortgages only represent 5% of our £56 billion annuity portfolio.

There's been a lot of talk in the market following the PRA's recent consultation on the use of lifetime mortgages to back annuity liabilities. We will, of course, be working with our industry peers to respond to the consultation, but our view is that we have a robust capital treatment for lifetime mortgages and a relatively small exposure. So, we believe any change from this new consultation will not be material to our capital position. In short, the second half holds a lot of promise for LGR with a strong new business pipeline and positive momentum.

Within our annuity asset portfolio, we continue to maintain a high credit quality with approximately two-thirds rated A or better, 19% of which is in sovereign-like investments. We have continued to increase our allocation to direct investments, and these now make up 19% of our asset portfolio.

On this slide, we've provided a list of some of our largest direct investments. As you can see, we focus on securing long-term rental income from high-quality tenants with our largest exposure been over £1 billion to the UK government, primarily through HMRC.

Now let's move to LGIM who were the focus of our Capital Markets Event in June. LGIM has shown consistent growth with operating profit up 5% to £203 million, driven by higher AUM at the start of the year and increased revenues from flows. This was partially offset by the impact from adverse markets on management fee growth and continued investment in the business. We've maintained a stable cost income ratio of around 50% due to the scalable nature of our business model and fund performance continues to be strong.

External net flows were £14.6 billion, with good performance across regions, channels, and product lines. This excludes £2.4 billion of AUM, which moved to LGIM as part of the Canvas acquisition. In the first half, we saw positive flows from our DC, retail and international businesses, which helped offset the structural shift from our UK DB index business as our clients continue to derisk.

We talked about this trend in June and as an example, we flagged one large outflow of £6 billion from a local authority scheme .UK DC had a great performance and we maintained our market leadership, while building the largest and fastest growing Mastertrust.

In retail, our rapid growth has continued into the first half of the year and AUM up 17% to more than £25 billion. International AUM increased by 16% and this now makes up nearly a quarter of our assets.

At our Capital Markets Event, we talked about LGIM's three strategic themes. Firstly, we have continued to broaden our investment capabilities building on our core strengths. This includes expanding into Europe with ETFs, offering real assets, which are in high demand by pension schemes and packaging our responsible investing capabilities into our Future World funds.

Secondly, we are addressing the savings gap. Much of our growth in this area is in retail and in DC, where we now have over 2.8 million customers. Thirdly, we are expanding internationally as we export our core strengths. We have had success in our carefully-chosen markets within the U.S., Europe and Asia, and we see a strong pipeline to the second half of the year. As we have previously stated, LGIM's operating profit growth target is 8% to 10% over the medium term.

Moving on, LGC continues to grow profit, as we diversify and expand the assets we invest in. Operating profit was up 21% to £172 million following a strong performance from the direct investment portfolio, and also benefiting from the additional contribution from CALA Homes. It should be remembered that due to the seasonal nature of housing, CALA experiences higher profitability in the first half of the year.

PBT was £82 million, down from £194 million in the prior year with lower equity returns, resulting in negative investment variance in the traded portfolio. Direct Investments achieved a net portfolio return of 9.1%. The portfolio is now over £2 billion. And in the first half of the year, LGC invested or committed over £700 million into new opportunities, as well as into existing asset classes. This included the launch of Affordable Housing and further investments in to Build to Rent fund with LGIM Real Assets.

Through the creation of Real Assets, urban regeneration and clean energy investments, we are rebuilding UK cities, generating stable returns for shareholders, MA-eligible assets for LGR, and attractive assets for LGIM clients. We will continue to expand into cities where we do not yet have a presence. The traded and treasury assets portfolio was £6.1 billion and includes cash holdings of £4.1 billion, up from £3.4 billion at the year end. This is mostly due to the receipt of proceeds from Swiss Re for Mature Savings.

Our protection division, LGI, had an improved performance in the first half of the year. Operating profit increased 5%. However, there are a couple of moving parts to highlight here. In the UK, our leading Retail Protection business reported good profit growth with some one-off model enhancements offsetting adverse lapse experience and lower product margins in a competitive market.

As previously guided, Group Protection returned to profitability, following management actions taken to address adverse claims experience. Total UK protection premiums increased 3% and our direct distribution channel again performed strongly, accounted for 21% of retail new business APE.

In the U.S., operating profit was down $48 million to $24 million, largely due to the higher-than-expected claims in the first half, compared to favorable mortality experience in the prior year. This adverse experience was due to elevated cases of flu in line with the market – wider market.

Assuming constant FX rates, U.S. premiums grew 3% and the business remained the second largest provider of U.S. term life assurance through the broker channel.

GI made an operating loss of £6 million in the first half, primarily as a result of the adverse weather experience in line with the market with the Q1 freeze. Excluding the freeze impacts, operating profit would have been up £7 million to £22 million, and a combined operating ratio of 92%, highlighting underlying progress in the business.

Gross premiums increased 12% to £193 million, whilst maintaining our pricing discipline in a competitive market. The division is also becoming increasingly diversified with our pet insurance business gathering momentum. Overall, 37% of our premium now comes from our direct channel, demonstrating the returns in our investments in technology. GI has had eight distribution agreements with major UK financial institutions go live since the start of 2016, including two new partnerships in the first half of this year. We remain in active discussions with potential new distribution partners who value our SmartQuote and award-winning SmartClaim propositions. These factors combined to give good prospects of growth in the second half and beyond.

Moving onto our capital position, the group Solvency II surplus stands at £6.9 billion. Our Solvency II coverage ratio increased to 193%, up from 189% at yearend. Due to the increased understanding of, and focus on Solvency II, we no longer intend to publish our economic capital coverage ratio. We retain ECE for internal management purposes and for those of you that are interested, the coverage ratio at the end of June continues to be around 60% higher than the Solvency II ratio shown here.

We have bridged the Solvency II surplus to help explain the movements since the year-end. Operational surplus generation was £0.7 billion, up 11% from the prior year. This already covers the larger of the two dividends paid each year. New business strain in the first half was around £100 million. As per last year, the majority of this figure was in respect of our U.S. term sales, which we reinsure and finance in the second half, significantly reducing the eventual strain from this business. Operating variances during this period included a number of minor movements which net to zero. And finally on Solvency II, our usual slide gives you our estimate of the present value of Solvency II surplus emergence from the key elements of new business we wrote.

As we have consistently noted, our margins are resilient. We continue to maintain pricing discipline. In LGR, the new business margin was slightly higher than usual at 10.3%. As you know, we wrote fewer deals in the first half, therefore this is not a true representation of our expected full-year margins. In LGI, the new business margin was 7.1%, reflecting product mix changes and the impact of competitive pressures in the Retail Protection market.

So to conclude, our business produced a solid performance in the first half with operating profit from divisions up 7%. The group continues to achieve an ROE of over 20% and our healthy solvency and cash positions provide further optionality to continue growing in what we believe will be an exciting second half of the year with many opportunities.

I'll now hand back to Nigel to go into more detail on a number of high-growth areas across the group.

Nigel D. Wilson {BIO 1535703 <GO>}

Thank you, Jeff. You'll now be familiar with the way we described our three core businesses: Investing in annuities, investment management and insurance, and the divisional structure that sits beneath it. For the next few slides, I'll talk about the implementation of strategy in those three areas. The strategic thinking outlined here should be familiar to all of you. Our alignment to these six structural drivers of growth is (25:18) worth repeating because the growth drivers continue to work for us.

One, ageing demographics underpin pension risk transfer. We are confident of executing a further £7 billion in H2 this year. As pension deficit shrink, so demand grows, as more schemes reach the point where buy in or buy out becomes economically priced for them. The aging demographic also drives lifetime mortgages; where the market was about £1.6 billion in 2015 when we started, it is now about £4 billion and is expected to be £6 billion by 2020.

Two, globalization of asset markets; where LGM's international AUM has grown by 22% compound since 2014 and where we will expand from our low base into Asia and extend our reach in Europe, including through ETFs.

Three, in real assets, the LGC direct investment portfolio grew 49% in H1 2018. Housing and infrastructure are key political challenges for the UK, ones where legal and general can make a good economic return.

Four, welfare reform; where for example, the move to auto enrollment has contributed to a 21% increase in LGM's workplace customers, part of a 15% increase in DC, where AUM is now a market-leading £72 billion.

Five, technologies improving customer service and customer value; I will return to this later. We are scaling our businesses successfully using technology, as Jeff mentioned, but we have significant further opportunities to improve.

Six, on the need for today's capital evidence itself in our 200 VC investments and the growth of our Pemberton funds to almost €3 billion.

This is a new slide which helps illustrate the way we think about long-term growth for Legal & General. There are three broad categories in the business: Startups, scale ups and grownups. In summary, our grownup businesses, as Jeff discussed, are performing incredibly well.

These grownups are our largest businesses, the 100% owned, typically with leading or at least substantial market share. They're innovative and entrepreneurial and successfully compete in attractive growing markets. But we also look at build versus sale options, hence the disposal of Mature Savings for £650 million, at a profit of more than £400 million, which would be booked in 2019.

Scale ups are strategically aligned growth businesses, where we can be either 100% owners or holders of a significant minority stake. These businesses have the potential to become grownups and as they grow, so we can increase our ownership as part of financing their growth. CALA is a great example of this. It has moved up to the grown ups space with L&G, now as Jeff mentioned, 100% owners, in effect, replacing Mature Savings. Other businesses where we own minority stakes can likewise be funded to grow: Pemberton in SME lending; NTR in clean, green and cheap energy; ADV, our venture capital partnership with the British Business Bank; Salary Finance and Smartr365. If despite growth, the strategic fit is not right, a minority stake can be sold at a profit, for example, IndiaFirst.

Looking now at the 100% owned scale ups which are delivering fast growth to Legal & General; these include build-to-rents, LGIM America, LGR America, European ETFs, DC and Retail and Future Cities. Here, you have a set of high performers with strong growth prospects. For example, our total build-to-rent pipeline is now 3,000 homes across nine schemes nationwide, more than double our pipeline a year ago. Our U.S. businesses, LGRA and LGIMA are similarly well-paced for growth. LGIMA for example delivered net inflows of £8.3 billion in the U.S. in the first half of this year.

Our startups are either 100% owned or companies in which we have a minority stake. The 100% owned startups are developed within the business units; for example, our surveying and insurance businesses. The minority-owned startups which are in areas connected with our core businesses, which we believe have outstanding potential for growth. As that growth materializes, we increase our stake to help support its growth. We have some terrific start ups and scale ups in Bernie's business, including Salary Finance and Smartr365, as well as Care Sourcer in Chris' LGR Retail business.

To get more granular about this, here, we illustrate the L&G housing ecosystem, driven both by the need for new real assets and the deployment of technology. This encompasses house-building across all forms of tenure: For sale, for rent, later living and affordable. It utilizes the leading market shares we have to L&G Mortgage Club and our leading surveying business as well as our Lifetime Mortgage business. House moves are also the natural point for GI and indeed protection transactions, again, with a significant data or digital component.

We have three other exciting ecosystems which we'll discuss at a later date; workplace, retirements and real assets. They drive real synergies and collaboration across Legal & General.

Our growth pyramid had CALA moving from scale up to grown up. L&G's investment has facilitated a tripling of revenue in five years, a 2.5% increase in housing units delivered and a 5 times increase in EBIT. Operating margins have indeed improved, but they're still only 13% compared to a 21% industry average. The pipeline is strong with 3,000 units per annum of credible medium-term targets.

LGIMA is likewise in transition from scale up to grown up. Initiated with $6 billion of internal assets back in 2007, since 2013, it has successfully attracted U.S. and domestic and international funds and now has over $180 billion under management. Its product range is extending; from early significant successes in active fixed income and LDI, we're now building out to index and starting in multi-asset and real assets and LGIMA is now positioned to be one of the drivers of our 8% to 10% growth in LGIM.

LGIM Asia is in the start up bracket. Yes, we've won mandates in Asia, but we're just beginning to scratch the surface in a market that is becoming one of the three pillars of global asset management. We're adding resources and are investing for growth into numerous Asian markets.

Like LGIMA, LGRA is a 100% subsidiary in the scale up category. From a standing start in 2015, it has written nearly $2 billion for 28 clients, including $300 million in H1, up from $141 million in H1 2017. The background is a U.S. PRT market estimated at $20 billion to $25 billion this year, driven by a supportive policy environment and a favorable mortality and rate environment. We are enabling this business to grow by utilizing group-wide infrastructure and real asset capabilities in the United States, as well as leveraging our strengths, including longevity, investment management and admin expertise.

Salary Finance was a start up at which we first invested in, in 2017; now, clearly a scale up, where we now have a 40% shareholding. It has half a million employees on its platform already, and we expect it to reach a million by the end of this year. Because it is a truly digital scale up business, we can scale up quickly. Salary Finance is intending to launch more widely in the U.S. in H2. More innovation for L&G will follow in all of these areas.

All financial services businesses, in fact, probably all businesses, full stop, now have to be technology businesses. You've seen some of our digital start up and scale up investments in our earlier pyramid of growth, but the use of technology is increasing everywhere, and appears across our grown up businesses too. This includes the cloud, robotics, AI, big data, blockchain and platforms. The key to this, for us anyway, is focus and delivery, rather than just unveiling technical solutions, which are in search of a problem to solve. So, we measure carefully, for example, the costs and benefits of unattended and attended robotics.

Disruption for us is a responsibility and a privilege; this applies even when we are disrupting ourselves. So, the use of big data, for example, in surveying or GI, is not just about pricing. It is also about our customers' journey. For example, being able to solve and secure home cover on any device, 24/7, by just answering five questions or fewer. Operate an (35:07) model of this sort requires plenty of entry points for companies and businesses as they grow, but it also requires focus on exit, when it's right to exit. In recent years, we have consistently sharpened our focus through a series of disposals, closures and simplifications.

We see these moves through two connected lenses: strategic fit and shareholder value. The slide illustrates our exit from businesses which were subscale, underperforming in profit or growth terms or in geographies or segments which did not align to our strategy or a skill set. Since we've started, it has delivered £1.3 billion of cash to invest in higher growth businesses.

Turning now to the LGC £8.1 billion asset portfolio, the composition of the portfolio with over £4 billion of cash clearly indicates that there are many optimized opportunities ahead for Kerrigan and the team. We've made very significant progress growing direct investments which more than doubled since 2015. They now stand at over £2 billion and generated £104 million of operating profit in H1. The direct investments naturally support our PRT business. This is LGC's role as an asset sourcer. The traded-in treasury assets portfolio however now stands at £6.1 billion, with operating profit of £68 million. We have to deliver more profits from these assets.

The standout item here, which Jeff and I both commented on, is the component of cash which is well over £4 billion. Reinvesting cash into more productive assets, while maintaining a group ROE of over 20% is a clear winning strategy for Legal & General. Given our success to date and the opportunities presented to us, we will be accelerating LGC's evolution in H2 and beyond.

I will finish on our financial ambition and strategic goals. Our goal is to replicate the 10% compound annual growth in EPS, which we delivered for 2011 to 2015 for the period 2016 to 2020. Halfway through, we're on track to deliver on our goal. Our outlook for H2 is confident about moving forward in a material way on each of the strategic goals listed here. We do expect to close a further £7 billion in PRT transactions. We expect workplace AUM to grow further and faster. We expect LGIMA to deliver further growth. We will get off the ground in LGIM Asia and to expand in housing and urban regeneration across more cities in Britain. We will deliver inclusive capitalism fulfilling an economically and socially useful role and we will do that by utilizing all the talents of all of our people and all the strengths of our positive supportive culture.

Now I'll open up to questions.

Q&A

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

Can you just mention your name so that people – even I know who you are, for the camera.

Q - Andrew Sinclair {BIO 17749036 <GO>}

Thanks. It's Andy Sinclair from BofA Merrill Lynch; three from me, as usual, please. Firstly, on the pipeline, £7 billion of bulk pipeline the UK, could you just give some color on the global opportunities as well? Do you expect a better H2 than H1 globally as well for pension risk transfer? Secondly, sorry, still staying on pension risk transfer, has pricing or competition changed after the consultation paper on lifetime mortgages. And third, moving across to the insurance business Group Protection ADE (00:38:58), growth ticked up a little bit in the first half of the year. Just wondering if you could comment on pricing trends outlook here after a few wobbles in the insurance business?

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

Sure, I'll answer 1, Jeff can answer 2 and Bernie can answer 3. The £7 billion in the pipeline, those are exclusive deals that we expect to close, in fact, expect to close either one later this week or early next week. And so the £20 billion that used to be called pipeline is now called actively quoting because of the more explicit definition from our CRO, Mr. Simon Gaad, on that particular thing.

The pipeline is also very strong in America, but the metrics are not as well developed in America. But, certainly, the second half is always stronger than the first half. But I think, as Jeff talked about, and I certainly talked about, we'll just maintain our financial discipline in America but the – there's certainly a bigger pipeline in H2 in both the UK and the United States. And, in fact, there's a couple of other countries, Holland and Ireland, also featuring in the pipeline for H2.

And, indeed, into 2019, the pipeline is also looking very strong in H1 of 2019 as well. I can see my colleagues at the back nodding their head because they won't be getting much time off over Christmas. Jeff?

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

Yes, sure. The pricing competition around LTM, certainly we've been reflecting a possible outcome of that consultation within our pricing, and the trustees, the schemes have been accepting of that, can understand the logic, given we've been winning. We, therefore, assume our competition must be doing the same around that. And so, it just – it flows through. We can provide the explanation. We can provide the impact on pricing and it's been accepted.

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

Bernie?

A - Bernie Hickman {BIO 19334629 <GO>}

Yes. So, on Group Protection, we've been making a number of changes, particularly in making our pricing more sophisticated, and also addressing customer service and it's really good to see that that's coming through in new businesses sales as well. Part of our pricing is putting premiums up and sometimes retain schemes and that will come through into APE as well. So, yes, some really encouraging trends in terms of margins and other activity in the market that's always evolving. We remain, yeah, more sophisticated and disciplined in our pricing and we'll be looking to get profitable new business wherever we can.

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

Thanks, Bernie. I'd like to thank Steve Gritters (00:41:29) and all the team at Group Protection who've just done an outstanding job for this. I know that Steve's not here today because he's working hard.

Q - Alan Devlin {BIO 5936254 <GO>}

Thanks. Alan Devlin from Barclays. Two questions. First of all in L&G capital, just picking up on your last point you made, obviously, the cash is growing faster than the (00:41:48) in the direct investments. Realistically, how quickly and how much can you put into direct investments? Can it be a big delta to earnings as we saw in the first half?

And then just secondly on the Lifetime Mortgages, just a follow-up from Andy's question; obviously not a big impact on your back-book because it's a small part of AUM, but what is the impact on the new business margins, because you're writing a lot of it going forward? And also, are you changing your LTM pricing, as well as your unit pricing to affect any changes? And how do you think that the PRA can justify their assumptions...

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

You've got four questions. (42:28) PRA often come to these meetings they hide somewhere in the back. I'm just looking around to see whether they're here or not. I think the – I'll ask Kerrigan to talk to talk about LGC. I'll just echo some of the points that – and I'll just go through the Lifetime Mortgage.

It's a very attractive market and the PRA are trying to stop in a certain sense, very high loan-to-value, high rate products for people and they've developed a system which does that, I think, in my view.

We don't always get treated the same way as banks, so hence, we've got a £2.6 billion credit for preserve (00:43:01), which is way high than any banks would have on an asset portfolio because we fulfill a different role in banking. We are structural (00:43:08) providers of long-term capital into the industry. So, we tend to have more owners than other banks, (00:43:15) we would have more ownership and lifetime mortgages are in that area.

As Jeff mentioned, it's not a problem for us within the Lifetime Mortgage business and it's certainly not a problem in the – as a consequence in the PRT business. We've got lots of upside, yet in terms of the amount of assets we've only got £2 billion of the £56 billion in Lifetime Mortgages. I don't think in any way it was just designed to catch L&G out. I think it was – in a sense, it was more encouragement to L&G in the Lifetime Mortgage market.

On LGC, Kerrigan, why are you not investing more money when you got all this money sitting idly around?

A - Kerrigan Procter {BIO 15093363 <GO>}

Well, I think in Nigel's press book (00:43:54), he talks about changing Britain and the real enduring need for private capital in the residential housing across Britain and the economic investment in our great cities outside of London. Certainly there's an incredible demand for it and we think a great social and economic purpose if you're putting money to work there.

Residential housing, we're live on just about 90 sites across the UK, attractive opportunities for buying land (00:44:20) lot more that we can do there in sectors such as affordable housing, later living, and indeed, of course, build to sell, where there's an incredible demand for all those and a supportive market broadly across all those markets and more we can do there certainly.

And in the future of our UK cities, again, that £500 million invested in that £2 billion portfolio, there's a lot of demand as we see regional de-evolution of people wanting to work with us to apply private capital to their opportunities and that's commercial environments, residential environments or mobility, connectivity, sustainability, all the future of our cities.

So we certainly see huge opportunities for growth. My colleagues on the stage tell me frequently to invest it wisely. So we will be very careful about the way in which we build out that portfolio, but certainly a huge number of opportunities and you should expect to see that £2 billion investment grow at a pretty reasonable pace with that backdrop.

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

Yeah. Again, I'd like to thank Kerrigan for moving from LGR to LGC and that was because he saw the huge opportunities that we have in LGC to grow the business. And along with John Godfrey and Pete Gladwell, who used to do a lot of work with me, Kerrigan, John Cummins, who joined us from RBS, who's made a huge contribution already and his team. We got much more resources going into this than we had before.

Very highly talented people who are being welcomed in Edinburgh and Glasgow and Newcastle, Bristol, Bath, et cetera, et cetera, Cambridge, Oxford, there's lots of REIT (45:50) activity going on and lots of towns and cities are leaning into Brexit, which is a positive thing on devolution, regional devolution and empowerment of these people is really another big positive for us as a firm.

Q - Gordon Aitken {BIO 3846728 <GO>}

Gordon Aitken from RBC. Three questions, please. First on Solvency. You're running at 193%, it's obviously a lot higher than when you started under Solvency II, just wondering if you can comment on what are the drivers there; is it board-driven, regulator-driven, shareholder-driven, or was it just a short-term issue?

And second on equity release, I know you said you already have a robust capital treatment for Lifetime Mortgages; does that mean that you are using a deferment rate which is within what the PRA is talking about, to the north of 1%?

And just finally, UK bulk's actually got (00:46:46) you feel you got some fantastic opportunities and mostly alternative opportunity here. So bulks, you said the strain is less than 4% at the moment, so let's just say it's 3%; now you can't run a bulk at 100% solvency, so let's say 140%, so the strain after building up the capital requirement, I know that's not how you define strain, but the actual image you hit on an £18 billion book could be £1.3 billion.

Now, there is an £18 billion book out there; the big advantage that would have over DB schemes is of course DB schemes don't come with any capital. This already comes with its capital in the market scene that's priced less than £1 billion, compared to the £1.3 billion for a DB scheme. Why isn't that more profitable to you than the DB schemes that you're taking on?

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

There's a man who's got more ambition than I have. I can't believe this is happening. I feel ashamed of my lack of ambition for this particular division. Jeff, do you want to answer one and three? And Chris, can you answer two? If you can remember what one and three were.

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

(00:47:51) Yes, go on.

A - Chris Knight {BIO 18966542 <GO>}

Yeah. I think there's a number of changes to – sorry, trying to find the question there, to the PRA's new sort of proposed basis for Lifetime Mortgages. So, it's been hard to perhaps point out that we came from a sort of (00:48:07) kind of approach to more of the marketing assistant. I guess we are pretty confident in what we see there, the 1% deferment rate which is what very much sort of (00:48:17) be really quite modest impact for us, both on existing business and also for the new business, really only on a section of the higher loan-to-value products more likely to have an impact, I would think, on – people offering perhaps slightly lower loan-to-values for similar interest rates in the future?

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

Okay, Jeff.

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

Yeah, sure. The 193%, I'd categorize it more as a natural evolution, to be honest. It's not that it's targeting anything in particular or we're aiming at that. There's been some rise in interest rates though they're still reasonably low. You know, that drives some of it. Obviously, a lot more sophistication in managing the metric, and the likes of Tim and those in the LGR team in particular optimizing matching adjustment on an ongoing basis, optimizing that asset portfolio, that helps to drive it, refinements in the model on an ongoing basis, which have moved that higher.

So we have surplus generation also which we haven't been spending, which we seeing in other parts of the balance sheet. So there's a general evolution of it and we keep it under review. We don't think it's too high yet so I think it gives us great optionality to write things like £7 billion plus of PRT deals. Whether it gives us optionality to drive £18 billion is another question.

I mean, I think the question is more of the attraction – relative attraction. We're always interested in large transactions around annuities. However, when we can write £7-billion-plus of PRT, (00:49:54) maintain our pricing discipline, we believe using a lot of the advantages we have, whether that's relationships, the asset side of the balance sheet, whether it's more bespoke transactions, then we believe that also drives a lot of efficiency for us. So it would have to be reasonably compelling and we'd look at other things apart from just the capital strain associated with that.

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

Okay. Thank you.

Q - Colm Kelly {BIO 19140684 <GO>}

Thank you. Colm Kelly, UBS. Two questions, one on the cash generation, or is there really sub operations as it's called? I supposed that used to be the core cash metric to communicate the sustainability of the dividend strategy looking at the growth rate of that. Since 2017, each half year, it's 0%, 2%, minus 8%, now (00:50:42) impacting their – the back-book cash generation has been flat. What has changed or why should I not be looking at that metric as continuing to be key for the dividend's sustainability? That's the first question.

The second question, apologies if I didn't pick up the answer earlier to the new business margin impact from the equity release consultation, if you could just comment on that? I know you have the numbers draw on it, but it's not material for the solvency. But for the new business margin. In fact, that would be useful. Thank you.

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

Zero for the second one. I think the – Jeff, do you want to take the?

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

Yeah. I was going to say zero to the second, but we're flowing it through the pricing as I said. So, we anticipate that going through. It's still a really attractive asset from a funding perspective for the annuity portfolio. So, we would see that flowing through.

In terms of release from operations, as you say, there's a lot of moving parts that's been going on there, mix of business, the mature savings dropping out, and so, that then drives changes in what you see on the release from operations, and even things like FX flow through on LGI. And so, there are always movements on that metric.

I mean, we look at release from operations, we look at net release from operations, obviously, we anticipate that being significantly higher when you add in a large amount of PRT business in the second half and we see good growth in these metrics on an ongoing basis. We also look at Solvency II surplus generation. That's why we gave the exact number in growth for the operational surplus generation, 11% clearly bigger than 7%. We then have a new business strain and we can manage that. We can offset the gain's longevity releases, et cetera, so we look at that number as well, and obviously the normal (00:52:21) metric. so, we look at a range of these.

I mean, I've already said to a few other people, I'm thinking we'll do a bit more cash-type disclosure at the year end because the figure is big, what is – and relating that to what are we paying out from entities. But it never quite landed at the half year. It's much cleaner to do it at the full year, so we'll look at a number of these metrics in kind of a bit more cash-type disclosure.

Q - Colm Kelly {BIO 19140684 <GO>}

Okay.

Q - Oliver Steel {BIO 6068696 <GO>}

Oliver Steel, Deutsche Bank. So, fist question is on...

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

How many questions you got all in all?

Q - Oliver Steel {BIO 6068696 <GO>}

Three.

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

Three. Okay. Feel better.

Q - Oliver Steel {BIO 6068696 <GO>}

So, first question on the direct investments you're warehousing within LGR, can you remind us how much you built that up by last year, how much you've added to that this year and I suppose, basically what I'm looking for is some helpful indicator towards the sort of new business margin. You might expect on that £7 billion-plus of (00:53:17) you've got in the second half.

Second question is, the STR came down I think £300 million. You've talked in a couple of questions ago, about sort of management actions you've taken. Is that what drove it and how much more have you got to do on that front. And then finally, with reference to slide 29 that's the – that's the sort of interlinking on the whole of the housing activities that you've got. How much cross-selling are you actually doing between those areas (00:53:48) CALA Homes to new mortgages, new protection policies how much existing mortgages are moving into equity release mortgages? Anything you can give us on that, please?

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

Yeah. I'll do one and three, Jeff, if you'll do two on this. The direct investments, we obviously warehouse direct investments the following year and those typically cover a large proportion of what we want to complete during the following year. So we have that in hand.

We knew we had a huge pipeline of customer business which, in a certain sense, was one of the reasons we didn't press all the way hard on the very large back-book transaction earlier in the year. We've been quite to see £3 billion of it a la Aegon (00:54:33) but we have so much customer business that we want to focus on the customer business and refer to deal team. They just did a great job of doing that.

The sorts of assets that we're getting, similar to last year, and the margin itself on the deal will be much more related to the duration of the liabilities that we've taken on rather than the policy of the assets that we have in the portfolio. And Jeff mentioned the movement between what gets shared between us and the customers is similar going forward. So we won't see material differences from the margins that we expected on the back book.

In terms of slide 29, the synergies exist not in (00:55:20) a few more mortgages for our business. If you take Build to Rent, Build to Rent is generally something to create synergies between all three divisions where LGIM a big - are trying to build and will indeed, I think, succeed in building the first institutionally-funded asset flats (00:55:40) around housing. LGC, obviously, building - providing the equity capital to kick-start that - all those schemes going in partnership with PGGM who are great partners for us, and have lots of expertise in this area.

And once we structure those portfolios, LGR will take a cash-flow-based, matching adjustment approach to getting assets which fit the portfolio. I could go through all of the others and at some point, we'll arrange a presentation where we'll go through all the ecosystems of how things have joined up together, but that's probably the best example of how we - how we're currently working together. And investing in new real assets which we can structure in such a way that they benefit LGC, LGIM and LGR, an (00:56:30) regeneration, we talked about Cardiff and Leeds and Manchester before. There's more of that going to happen because we have much more capability to do that which was really what Kerrigan was saying and the answer to - answer the earlier question, Jeff.

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

Yeah. On the SCR, I mean, there's no single big driver of that. There will be an element of rates. There will be an element of slight changes in diversification and what we would cover our bite-in (00:56:57) scenario as we call it. There'll be elements of small pieces along the line where we're optimizing model changes on an ongoing basis, et cetera. As you saw in the up-variance, there was a whole load of things that's just sort of cancelling out, but in terms of how many of those do we have to go, I mean, there's a long way to go of evolution. We're constantly optimizing. So what does it do for capital? What do we do that we - do we use an internal reinsurance? Do we change the structures that we have for external risk transfer et cetera? So there's a long way to go and always add a benefit on that in understanding how it all diversifies in the model and what optimizes it, what makes it a business et cetera?

We have a long way to go around that and there will still be material areas where we believe we can improve the model and simply bring the SCR down, and PRA will have a (00:57:46) few when they think it goes up.

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

So (00:57:52) too and then A and B. Just on home, the combined ratio of 92%, if my memory serves me correct, we used to be running around 94%, 95%. That's 92% (00:58:05) Now, you've done a whole bunch of new deals. I assume you would have to bid up for the deals. I would've expected the combined ratio to have gone up given all the other (00:58:13) rates in the markets et cetera.

So is - I mean, why has - why have you got such a favorable (00:58:18) with the combined ratio? And are there any other sort of bulk - distribution deal costs that aren't included in the combined ratio that say, below the line in your start-up spend or something like that? That's question one.

Second one is, just with (00:58:34) to between its March results and its disclosures, Solvency II to convert it with equity release portfolio from - to change the internal ratings from AA to A. I was wondering what - if you've had conversations with PRA around your sort of circa £13 billion direct investments and the ratings on that and if there's any risk from that?

And the third question is, I'm surprised by the material savings operating profit in the first half. I was wondering is there going to be any further contribution in the second half from that element.

Cheryl takes the first question. Kerrigan, I'll do little introduction then you can take the second question, Jeff takes the third question. So, Cheryl, do you want to just answer the first question?

A - Cheryl Agius {BIO 20013065 <GO>}

Thank you. Our client ratio has continued to improve excluding weather because we have been much more strong in our pricing discipline and our risk selection and we've also been rebalancing - balancing our portfolio. So we reduced our exposure to broker business and increased it to the direct. And going back to the point about acquisition of the new deals, they're being reflected in the combined ratio too.

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

Okay. Thank you. Just in terms of the - in the old days, we used to go and get every deal that we did in direct investments have a non-objection from the regulator.

We've moved on since then because we gained the trust of the regulators. So we certainly had no discussion on the raising of the lifetime mortgage book, but Kerrigan is there anything else you want to add?

A - Kerrigan Procter {BIO 15093363 <GO>}

Well, I guess just reflecting on the slide that we showed earlier. So, on the top 10 LGR direct investments there could be the LGC ones also is a very robust internal ratings process that's been agreed and discussed with the PRA extensively. We have an independent team based in LGIM filled with experts, group credit risk officers (01:00:31). So it's a very substantial process across a very diverse set of assets. So, we're very comfortable with those – internal rating process and no reason to expect any wholesale shift in what we're doing there.

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

I think our internal – (01:00:48) committee give their team a particularly hard time. They seem to enjoy giving Mark, Kerrigan and those who are here, particularly difficult time.

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

And the material savings is relatively straightforward. It's just an accounting thing. We're not allowed to realize all of the profit from the transaction until the Part VII. Therefore, we sort of amortize that, if you like. It comes out whilst we're still on a reinsurance state rather than a Part VII. So, we expect the underlying £20 million to £25 million each half year until we get to that Part VII as it just unwinds.

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

Okay. Andrew? Then we'll come back.

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

Hi. It's Andrew Crean with Autonomous. Can I ask three questions? Firstly, could you give a slightly more numerical answer to the – what the impact of 1% impairment (01:01:40) rate is? And also, the growth rate in the direct investments from £2 billion. What sort of growth rate per annum are you looking at?

Secondly, your ambition to grow earnings to 2020 by 10%. The dividends are growing at 7%. Should we expect A to come up to B or B to come down to A?

And thirdly, could you talk a little bit about the, I suppose, toxic culture in LGIM? Particularly, that would be a concern to me if it involves the area, which is doing internal ratings.

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

Indeed, it would if that were true. I'll take the culture things first, if I may. And then, Jeff, if you take the second question. Kerrigan, I think you've got to come back and give a better answer on the growth of DI.

I'm very proud of everything that Mark and the team have achieved over a number of years in LGIM. And any time we have any whistleblowing across the group, we – in a sense that culture is about actively encouraging whistleblowing for people to come forward in a very anonymized way if there are issues that they want to raise. It's part of our openness as a firm.

We have a policy which allow, which says every non-executive can go to any management, meeting, anywhere in the world at any time. Our regulators, including (01:03:07) sitting on a whole day in the life of L&G and so they see how we work, starting with the 7:00 o'clock management meetings (01:03:17) finishing up in the call centers most of the evening listening to calls. So, we want to be totally transparent about all of this.

It's unfortunate these things have gotten in the media, relating to incidents that happened in 2017, but they have - but reassured, we're totally convinced and know that we have a positive supportive culture here, we have an independent review from Latham & Watkins, which assessed our culture and it came out as positive, supportive and respectful. Any firm at any time, will have a number of whistleblowers, and we're no different from anybody else around that. And we've actively encouraged (01:03:56) to come forward. And there's an independent review of whistleblowers carried out by our internal audit function once a year, and every year that I've been here, that's turned out to be a good report, and supportive report, the things that we're trying to do as a firm. I don't know Mark whether you want to add anything to what I've just said?

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

Yeah. I think, I guess I would just encourage everyone to look at this topic as comprehensively as possible and focus on facts. Things can be alleged at any time and how the press chooses to portray it, we can't control, but we have an outstanding culture in LGIM. It's something that we take pride and we know it drives absolutely everything in our business, every aspect of our business. It's what we're primarily known for, I think with our brand in the marketplace. And situations like this are actually really unifying for the employees.

I spent much of the last couple of weeks, most of the last couple of weeks talking with employees and clients. And it's just been extremely supportive, understanding situation, not to say we don't have situations that come up, not to say that there is always going to be issues in a large organization like Nigel mentioned, and we'll continue to address them within the controlled framework that we have. And in this situation, I think we - it acted the way it was intended to do independent investigation, and I'm trying to bring closure to the activities that were alleged.

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

Thank you, Mark. Jeff, you want to discuss the lifetime mortgage and...

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

And the dividend.

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

And the dividend.

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

I mean, yeah, the last time - we're not going to give any more on the numbers. You can't just look at it at the deferment. You have to look at how do you structure it in the SPV (01:05:45), how does it flow through MA to get the total capital implications. So, we -

we're perfectly happy it's not material to group capital and as others it will be worse off than us on that number. So, we don't need to sort of cover that further, we don't think.

The 10% versus 7%, well, we made a pretty clear statement about sustainable medium term, 7%. We've only done it once. But probably it would make sense to have a record if it's sustainable medium term of doing that. There's no magic number about the 10% versus the 7%. And I've said a number of times we look at the whole range of metrics. We don't just look at (01:06:27). And we use some of that headroom for investment. We look at what else we can do with it, and we look at Solvency II. We look at our capital position. We look at our cash position. We look at earnings and other basis, how much are we generating. So, there isn't a magic between the two on those.

A - Kerrigan Procter {BIO 15093363 <GO>}

I'm going to give you slightly better figures in it. Just in terms of H1 gross new investment for direct investment in the portfolio was just over £700 million. Obviously, CALA was over £300 million of that, net new investment round about the £500 million level or just over the £500 million level. As Nigel said, we certainly got the team, the quality, the capability, the bandwidth, and the opportunities to keep exploring opportunities at that rate. So, that would be the rate of opportunity discovery precisely, which ones will do and where it will be a little bit lumpy.

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

Okay. Just work our way around.

Q - Andrew Baker {BIO 20402705 <GO>}

Hi. Andrew Baker, Citi. Just two questions please. So first one, on growing the bulk market you're seeing some competitors do some larger longevity transactions, you got £7 billion second half pipeline. Are you seeing longevity reinsurance capacity concerns either this year or just your longer term outlook on the capacity there?

And then secondly, you're obviously further down looking at IFRS 17. Are you in a position to give an updated view on what you see high level potential impacts on that. Thank you.

Okay. On the longevity we've seen no capacity issues whatsoever. And so we're very happy with our relationship we have. In certain sense, in the protection market, we see no capacity issues at all for the last 25 years. And so we've been doing a one-time business for a long time. And on the other side, we're absolutely fine.

Jeff, do you want to take the second question?

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

Yeah. I mean IFRS 17 we did lots of work. We're comfortable. And as we've said before actually has limited impact in terms of back book versus new business profits, et cetera because of the way it works. But it's a reasonable distance. Often, all the latest debate is, is there 11 or 14 issues that need to be changed.

So, version of IFRS 17 and when it's coming in is probably the question. So, our focus remains implementing efficiently not burn in money trying to bring something in, until that we get enough clarity, but being far enough advanced and improving our technology so that we can implement it. But we're not nervous about the accounting implications that this takes and we wait for more clarity to talk about it when we get that.

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

I think we have four more questions here. And so, if there's any more than the four more questions here, you can put the hands up because I think we've got four more questions here to answer, four multiple questions.

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

Morning. Jon Hocking from Morgan Stanley. Got three questions, please. First on annuities. Can you talk a little bit about how you're pricing for longevity? You actually are already taking semi-2016 into price maneuvers since we're actually moving ahead of two semi-2016s, first question.

Secondly, could you give us update, please, on what's happening on L&G Homes? Is that up and running? Are you still sort of test manufacturing or you're actually full-launched there?

And then, finally, lifetime mortgages, you've obviously built fantastic origination capacity there very quickly. Is there an outcome from the payroll review that makes it less attractive for backing the annuities? And is there actually a role for the balance sheet even if it isn't at all actually that interesting any more from the annuity perspective?

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

Yeah. Well, I'll answer the third one, which is no. I think Jeff made that point earlier on – to the lifetime mortgage. The remaining (01:10:00) attractive for us anyway in terms of the back (01:10:06) the competitors around that. If Kerrigan answers two and you answer one, Jeff, if that's okay. Kerrigan on two?

A - Kerrigan Procter {BIO 15093363 <GO>}

Correct. Just on (01:10:14). I'm sure we all know the strategic reasons for being there. Anybody in residential house-building is probably Real Asset's portfolio and needs an answer to this significant skill shortage we already see on building sites around the country. That's getting worse. You might be thinking Brexit. But aging demographic in the workforce on site is a very significant feature there. So, you need an onset to address that skill shortage as we go from 20,000 to 300,000 houses.

And taking that construction off-site and putting it in the factory and doing 80% of the build there makes a lot of sense from a strategic rationale. We are already producing light houses that people will live in with the first set of houses, first of all house now on our (01:10:57).

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

Yeah. On longevity in pricing, obviously for PRT business in the UK, we reinsure a vast majority. But the more important question is what are the reinsurers doing? We continue to see very aggressive terms. We think they're already being forced because of the competition reasons to factor in a lot of this, in the slowdown in longevity improvement into their pricing, so that naturally flows through in that. Obviously for the individual retail annuities, we're very careful in anticipating where we think the basis will be and Chris (01:11:35) wants to be more aggressive. He still knows (01:11:40) he's only going to be reporting it from what we've actually implemented by the year-end. So, we have to balance that at any point in time.

Q - Andrew Baker {BIO 20402705 <GO>}

Okay. Any order.

Q - Dominic O'Mahony

Thank you. Dominic O'Mahony, Exane BNP Paribas. Three questions for me all on PRT. The first is – so 2018 is going to be great year in terms of audience for the market. You're excited about H1 2019, and I think we all understand those are the structural drivers. What I'm trying to get my head around is whether – the sort of the recent dramatic improvement in funding positions is creating a surge in 2018, early 2019, which will then settle down and then revert to sort of a long-term growth, whether you actually you see this as sort of a step change?

The second question on pricing, it sounds like H2 is going to be dominated by very large ticket items, does that affect the pricing dynamic and the capital strength dynamic, or actually would you expect it to be similar to last year? And then, finally, in terms of pricing and capital strain on non-UK business, are there any different dynamics there that we should be aware of? Thank you.

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

Yeah. The markets are so big. And as more deals get done and our capacity to do more deals and bigger deals has increased by definition our clients have – some of them have £5 billion, £10 billion, £15 billion, £20 billion that they want to do, we've done bits of that so far. So, it's definitely repeat business with existing clients. We do have £400 billion of LDI business that we've done in previous years, so the hopper is enormous, and we've created a similar hopper as you know in the United States.

When you coming into the yearend, that's why we had all that DI that we have a very busy year. To be fair, it's a bit busier than we thought, but it's still within the parameters of being the direction (01:13:32). I think people are thinking that the market could go from £20 billion to £40 billion in any given year, and there's still a few back books to do, so there's lot of shortage of demand from clients.

There's a similar picture in the United States. There's a very (01:13:49) hopper of things that need doing. We can't be absolutely certain, but certainly 2019, first half which we have reasonable visibility on already is also very busy for the DI team? Do you want to add some color on the pricing and capital, Jeff?

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

Yeah. It isn't just large ticket. We have a number of deals that we're in the discussions on in there. The dynamics change all the time on the pricing. It will be sometimes people will say a big deal is really attractive, they really want to do it and they're less interested in smaller deals and the smaller deals look more attractive to us. So, it does move around quite often, which is a tricky one to explain to the board actually.

You tell them one strategy and then there's another. And then in terms of the non-UK, the dynamics are pretty similar, we ourselves are very conscious of using economic capital in our pricing for that. So, in terms of return hurdles on an economic capital, they are very similar. We're newer to the market. So, we're therefore a bit more wary on what we report to make sure that we are – we've just been slightly more conservative on that. But in terms of return, targets and economic profit (01:15:06).

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

I think one of the other lucky things we've got. We've got the likes of Simon Gadd and Tim Steadman who have been around forever, and having been up and down the cycles (01:15:15) we've got long term knowledge of the way the markets (01:15:17). So, rest assured, their heart beats never get above 65 when we're discussing any of this stuff.

And so, we're very measured in our approach and never get overexcited about the stuff, but I get a bit excited about at times and Jeff starting to get excited. Of course, Kerrigan has been being with us a long time and worked on the LDI business for a long time as well. So, there's a great team, there's a very experienced team that are dealing with all of these issues. Two questions to go.

Q - Abid Hussain {BIO 20229932 <GO>}

Hi. It's Abid Hussain from Credit Suisse. Just two questions if I can. Firstly, coming back to PRT, why do you think the PRT deals have been skewed towards H2 this year? Is there something peculiar going on during H1.

And then what proportion of deals in exclusivity do you typically close, is it 100%? And then, second question on direct assets, how will the yields on your liquid assets tracking relative to triggered assets. Have you seen any compressional or are they stable related to last year?

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

Yeah. I think – the answer is all the things are positive. And so we've got a great origination capability and NDI (01:16:34) assets, so I'm very, very happy with all of that. And so, anything else you want to add Jeff?

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

Yeah. I don't think there's anything magical about H1 versus H2 deals, take a while to land. There's a lot of discussion that needs to go on. So, I don't think there's anything there. As Nigel said, we're already in conversations about things in Q1 2019, that could easily then move to Q2 2019, et cetera. So, I don't think there's anything magical there. Yeah, percentage exclusivity, we're confident that's...

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

We had 10 deals last year, which at beginning of H2, we're exclusive and the team delivered all 10. So, they were 10 for (01:17:15) 10 last year and that's – I'm sure that's the kiss of death. And I can see them all – they're all glaring at me and will give me a hard time tonight when this is all finished. But so far, so good. And (01:17:28) touch it, but we usually have a very high conversion rate. Clearly, there's some macro exogenous things happen, which are outside our control or the clients control then things tend to fall away. But they rarely fall away perpetually, they come back maybe 12, 18 months or two years, two years later.

Q - Barrie Cornes {BIO 2389115 <GO>}

Morning. It's Barrie Cornes, Panmure Gordon. I've got three questions, if I may. First of all, back to lifetime mortgages. I think you talked about the market at £6 billion by 2020. I just wondered if that's the slowdown, I thought maybe (01:18:01) have given a sort of bigger figure. I wonder if that's related to the consultation paper. So your outlook on lifetime mortgages, please.

Second question, LGIM, when you held Capital Markets Day, was about to launch a retail savings campaign, it seems they're relatively quiet. I wonder if you could comment on that, please. And thirdly on the GI side, you talked about weather in Q1, but just wondered if the (01:18:28) claims from previous years (01:18:30) dried up?

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

I'll let Cheryl answer the third one. Mark, do you want to answer the second one. One the first one, Steve Ellis is my sort of guy – my sort of guy. You've got all the compliance people who just give you a hard time about future projections or you always have to be very cautious to proven design.

But I think the market could be a lot bigger going forward. And certainly the FCA have been encouraging that, the treasury encouraging that, it's very good for the economy. I think there's only 2,000 agents out of the 7,000 agents, which are trying to sell the product or actually selling the product so far. And if just Chris and the team could just get out and do a bit more of this thing, then clearly we would have an even bigger and more successful business going forward. Cheryl, will go next and then Mark.

A - Cheryl Agius {BIO 20013065 <GO>}

Just on escape of (01:19:24) water, so it's an industry-wide issue. It's parallel just like (01:19:28). Last year we had higher number of claims than we anticipated. We are pricing now at the right levels and choosing the right risks.

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

Okay. Mark?

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

Yeah. We didn't intend to have a big bang approach launching our newer direct investment business, but we did launch it with a new ad campaign, Own Your World, which you saw somebody introducing around town and you've seen it earlier in the presentation slides.

So positioning our brand in the marketplace, adjusting pricing on some of the existing funds, launching some new funds, especially some of the more thematic Future World funds in that range, improving the customer experience, tracking metrics more effectively. We're seeing some really positive trends and (01:20:14) and I were just talking about this this morning. And there'll be another series of ads and so forth in September. So, a series of steps that will continue to occur over the next year and on an ongoing basis. So, we're very much looking at this in that context, not just a big bang one-time launch.

Q - Barrie Cornes {BIO 2389115 <GO>}

Okay. Thank you.

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

Saving the best for last.

Q - Ashik Musaddi {BIO 15847584 <GO>}

Hi. Ashik Musaddi from JPMorgan. Just couple of question. Jeff, you mentioned about warehousing assets for the expected volumes. Can we just get some thought on how does the mechanic for the profit booking work? So, are the warehousing assets in LGR currently earning profits in LGR, which will move to the new business, or how does the mechanics for the profit booking work for warehousing assets for future business? So that would be good.

The second one is – I mean LGIM assets you still see very strong positive flows, £12 billion, £14 billion in the first half. Having said that, you have lost around £30 billion of assets in index funds, which is one of your core business, whereas we always hear as an analyst that it is a massive shift from an active to passive. So, what is the dynamic not working here in UK, or is it that some of your index fund is moving towards a structured solutions or something? Any thoughts on that?

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

Okay. Mark you're going to take the second question. Jeff, do you want to...

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

Yeah. The asset one is relatively straightforward, we basically haven't allocated it to back the annuity portfolio. Therefore, the warehouse is simply set in the balance sheet. The market value in the annuity business when we allocate that to bucket it flows through the IFRS either in business surplus where we put it or (01:21:59) come through an investment there. So, we haven't allocated that yet. We're not taking account of those yield up less compared to the underlying portfolio.

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

Because we designate business that we know we're probably going to get, we don't have to book the profit. So, we don't – that's why we carry the positive, but (01:22:15). So we physically know which deals were highly likely, so we align into those deals pre the year end, and it's always been our policy to do that. Mark?

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

Yeah. With regard to the index flows, so looking back on where this business started, it was predominantly in UK DB Equities. And obviously that's instructional runoff as those plans are derisking. And so that's what's driving – it has been driving for a while the other sustained net outflows in our index funds, not every year, but frankly most years since I've been in the job. But meanwhile, those clients are going into a broadening range of all the solutions. Our percentage market share has gone up from low-20s to around 30%. So, you can think of that as a shift out of equities into a broadening range of LGI solution strategies ultimately into some kind of buyout situation if they can afford it and want to do that.

Then meanwhile, we are growing our index business and all their channels. So, we're seeing positive net flows in other channels, in other regions, the core building blocks for our multi-asset products, which are multi-asset solutions, but they're building blocks for those products. But we do have to accelerate the growth in these other markets and channels to offset this, what will be continued structural outflows in the UK DB equity space.

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

Okay. Thank you very much. I'd just like to echo one of the point, Mark, that we have a multi-asset team which has just done a tremendous job with the – (01:23:49) and the rest of the team have just done a great job. They have a huge opportunity because there's tons of whitespace to expand into in a market (01:23:57) of leading the diversification of the portfolio just being in DB index. We wouldn't be enjoying being £1 trillion AUM company right now. So, great credit to all of the team within L&G.

I'd just like to say thank you to all my colleagues yet again for their great efforts in H1. (01:24:17) able to turn up for this particular presentation, they're hard at work at their desks. I'll be winding down (01:24:26) in about 15 minutes time just checking up on everybody, and thank all of you for your questions and your interest today. And we do remain confident about H2, and we'll see you all again in March. Thank you.