Q1 2012 Earnings Call

Company Participants

- John Pollock, Group Executive Director, Risk
- Mark Gregory, Managing Director, Savings
- Nigel Wilson, CFO
- Paul Stanworth, Investment Strategy Director

Other Participants

- Andrew Crean, Analyst
- Andy Hughes, Analyst
- Ashik Musaddi, Analyst
- Blair Stewart, Analyst
- Gordon Aitken, Analyst
- Greig Paterson, Analyst
- James Pearce, Analyst
- Jon Hocking, Analyst
- Marcus Barnard, Analyst
- Nick Holmes, Analyst
- Oliver Steele, Analyst
- Raghu Hariharan, Analyst
- Toby Langley, Analyst

Presentation

Operator

Good morning. And welcome to Legal & General Q1 interim management statement analyst call. (Operator Instructions) Today, I'm please to present Mr. Nigel Wilson, CFO; Mr. John Pollock, Executive Director; and Mr. Mark Gregory, Executive Director. Please begin your meeting.

Nigel Wilson {BIO 1535703 <GO>}

Good morning, everyone. And thanks for joining the call. I'm here with several of my colleagues, not just John Pollock and Mark Gregory. But also Wadham Downing, Kate Burnell [ph] and Paul Stanworth. And everyone will be delighted to answer any questions that you may have.

Overall, we've delivered a good set of numbers against a difficult economic backdrop. Operational cash, net cash and sales in aggregate in Q1 were all at a similar level to that of last year, the ups in one area being offset by downs elsewhere. There were no material ups or downs.

We remain on track to deliver the operational cash numbers we gave as guidance at year-end, specifically the in-force cash generation of GBP590 million, which includes annuities, individual protection, group protection, insured savings, with profits of GBP50 million and international of GBP55 million.

As we said at year end. And indeed Tim repeated in his quotes today, we have sustainable and substantial cash. Going forward, this will help support dividend growth.

We have continued to achieve good growth in our higher margin, higher return on capital businesses. Individual protection sales are up 9%, margins remain strong. And gross written premiums are also up.

Our performance in individual annuities improved. Sales were up 18%. LGIM delivered GBP2.6 billion of net inflows. That's up from GBP2 billion last year. And LGIM AUM is now well over GBP380 billion. We also increased an increase in US sales of 25%. And even France was well ahead of last year.

In respect of BPA, there is a good pipeline. And John can talk about that. And we're encouraged by the engagement we're having with customers.

Savings delivered a good performance given the UK economic background and impending regulatory changes. And Mark will answer any questions you've got on that.

We've also continued to re-risk and increase the cash certainty of both the GBP28 million [ph] LGPL portfolio and the GBP5 billion plus shareholder funds. In respect of LGPL, we have for some time been planning for a widespread decrease in bank credit ratings. And we have continued to further reduce our exposure to banks, increasing our exposure to corporates. We also completed our first commercial property loan.

There was once again no defaults in the quarter. And our exposure to problem solving sovereign issues is minimal.

In shareholder funds, we further reduced our equity component, increasing cash and other assets. As we noted at the year end, we have reduced our expected return on our Group capital financing shareholder assets to reflect the more difficult macro environment. The key assumption was cash at LIBOR of 1%. Some analysts, indeed one of two of you, may need to update your models to reflect this 1% assumption and the reduction in equity.

Therefore, whilst we believe we have demonstrated the sustainability of our cash, we're also taking action to improve the certainty of the cash. We're also retaining our very strong balance sheet.

Our operational cash number for Q1 was GBP249 million. This is compared to GBP245 million last year. Increases were consistent with the guidance that we gave.

There are a couple of decreases. And it's worth noting a couple of features of the results. In GI, due to the unfavorable weather, claims are higher as you'd expect. And cash and profits are lower. We do not expect to deliver the same profit or cash in 2012 that we delivered in 2011, as 2011 results were, as we said before, dependent on the very favorable weather. Cash in GP was also around GBP5 million lower than last year.

Strain at GBP39 million was slightly higher than last year's GBP36 million. Net cash at GBP210 million was broadly the same as last year's GBP209 million.

In respect of Solvency II, we've seen more support for stability measures to avoid unintended consequences. Matching premium is the best example of that. However, there's still much detail still to be worked out.

We would be delighted to answer any questions. Thank you.

Questions And Answers

Operator

(Operator Instructions) Jon Hocking, Morgan Stanley.

Q - Jon Hocking {BIO 2163183 <GO>}

I've got two questions, please. On LGIM firstly, could you give us some color on the pipeline for the LDI and the Fixed Income business? And on the international assets, can you comment on how many clients you won in the quarter, new mandates you won in the quarter; what the pipeline looks, if that's a good way of looking at it?

Then secondly, on the Savings business, how much of what we saw in Q1 with the weakness in investment contracts is likely to persist into Q2?

Thank you.

A - Nigel Wilson {BIO 1535703 <GO>}

Yes, I think just in terms of the pipeline, we're pretty happy with the overall pipeline. Indeed, one of the reasons that Mark Zinkula is not on the call with us is he's busy out there selling as we -- and engaged in front office activity as we speak. We've never been specific about the number of client wins. But we're happy with the visibility and the quantity of the pipeline that we have in the business. We're not going to quantify it exactly.

On Savings, Mark?

A - Mark Gregory {BIO 15486337 <GO>}

Yes, Jon, just -- you're quite right to highlight the issue around savings investments. I think we have to reflect here there are some big macro themes at play. We are going through a period of quite low consumer confidence/disposable income to invest in savings products. So I think in many ways, we are seeing some of those macro trends in our savings investments numbers. I think that's one higher level trend.

I think at a slightly lower level, things that we're exposed to, things like our structured products, for example, Jon, we've got quite strong design principles about what sort of products we're prepared to design at any one point in time. And actually, we're very keen to make sure we don't end up passing on very high risk profiles to our customers.

And so in that sense, where we have things low gilt yields and volatility flying around, or whatever, it does make it difficult for us to manufacture products which are necessarily very consumer friendly. So we're quite disciplined in terms of being out there with products at a point in time which we think are right for the customers. So in that sense, we are -- in terms of foreseeing trends, we'd expect our, for example our lower volumes of structured products to continue for the foreseeable future, certainly through Q2, given the -- our sense of the macroeconomic environment and government policy on such things.

So probably you might say we'll probably a slight increase in trend overall. But I wouldn't expect a massive bounce-back to be honest, Jon.

Q - Jon Hocking {BIO 2163183 <GO>}

So it's a weakness because you've pulled product in Q1?

A - Mark Gregory {BIO 15486337 <GO>}

We have actually pulled from product, yes. In fact, we are disciplined. But we're not prepared to keep manufacturing what might look like very good products but with very different downside risk profiles for end customers. So we have pulled products, yes.

Q - Jon Hocking {BIO 2163183 <GO>}

So effectively, your confidence is going to recover in two Q's because you've pulled some product in Q1; that's not going to recur in Q2. And there's an underlying factor, which is obviously not helpful. But it's partly L&G-specific factors that drove the shortfall?

A - Mark Gregory {BIO 15486337 <GO>}

Some and some, Jon. Clearly, the overall macro environment is such that I don't savers are clear whether this is a risk-on/risk-off type market we're in right now. And that has affected our Unit Trust business [ph].

I'll just give you an example on the structured products where we are in part -- I guess we've got quite a big play in that marketplace. And in that sense, we may be slightly more exposed given our disciplined internal processes to that macroeconomic environment and how that helps us design those products.

Q - Jon Hocking {BIO 2163183 <GO>}

Okay. So one last follow-up, then. Is this across all channels? Are you seeing it more in the bank channel or less in the bank channel?

A - Mark Gregory {BIO 15486337 <GO>}

I'd say more in the bank channel.

Q - Jon Hocking {BIO 2163183 <GO>}

Okay. And is there any funding relationship here, or is it just literally --?

A - Mark Gregory {BIO 15486337 <GO>}

Not on our --

Q - Jon Hocking {BIO 2163183 <GO>}

No. I mean the banks' point of view; are they selling other products rather than your products?

A - Mark Gregory {BIO 15486337 <GO>}

Certainly not, certainly not what we've got tied [ph] to this region. They can't do that. So no, it's a mutual agreement between ourselves and our key distributors.

Q - Jon Hocking {BIO 2163183 <GO>}

Okay. Thank you very much.

Operator

Blair Stewart, Bank of America.

Q - Blair Stewart {BIO 4191309 <GO>}

A question along the same lines really, because everything else is pretty straightforward. Just on the Savings net flows, you've seen GBP400 million outflow, despite GBP300 million inflow in the workplace pensions. So the conclusion is that there's quite heavy outflows elsewhere. Could you just talk about that? Is it a lack of gross inflows, or are you actually seeing people pulling money out? That would be very useful.

Then you've also made some comments about the potential impact of the RDR for the remainder of this year. Could you just expand on those a little?

Thanks very much.

A - Mark Gregory {BIO 15486337 <GO>}

Yes. Okay, Blair. It's Mark again. So on the current net flows impact, I think it's a bit -- sorry, you asked about whether it's mainly outflows or mainly inflows. The truth is the inflows are a bit down.

Again, I'd go back to the example of things like structured products where had quite a strong First Quarter last year in that arena. And we've had a much weaker First Quarter, for the reasons I explained when I answered Jon's question before. So I think we are seeing at a top level lower net inflows to some of our products.

On the outflows, again, there are some impacts going on there as well. Again, we are into to some extent a natural maturity profile with some of our older products anyway. So we have seen slightly higher outflows of our onshore non-profit bonds, for example. And some of our with-profits policies.

Again, we are now into -- well, approaching the peak of the endowment sales from 25 years ago. So we've always expected through this period of this year and next year to an extent seeing slightly higher with-profit outflows.

So I think there are some natural maturity type issues going on there. But also some things which are management actions in the First Quarter of this year in terms of things we're prepared to do.

On the second point about the RDR impact, I think we are flagging that we are anticipating something of a market disruption during the course of the balance of this year and probably the first two quarters of next year. Some of this is a little bit anecdotal at this stage, Blair. And I can't hand on heart say we're demonstrably [ph] saying we've seen certain accounts off the road.

But no, there clearly is a big transition for a lot of advisers to go through to get their business models ready for RDR, not least of which is passing high qualification exams during the course of this year.

And again, as we think about the first part of next year, I think a lot of advisers will have to think about how they transform their business models to start talking about an advice charge to their customers rather than it being recompense through commission.

Again, we think that's going to be quite a lot of people, quite a difficult transition for them to make. I'm very confident we'll get there in the end. But we expect there to be something of an impact on advised introduced business as a result of that.

So again, in the long run, we're still very positive on the impact of RDR. But I think we are flagging here an expectation of some market disruption as we get -- as people prepare both before and after the immediate impact of RDR.

Q - Blair Stewart {BIO 4191309 <GO>}

Given the types of IFAs that you're dealing with, you're not paying the commission any more, would you expect yourselves to be slightly less impacted than the market there, given that I guess by definition your partners will be more RDR-ready? Is that a fair assumption?

A - Mark Gregory {BIO 15486337 <GO>}

I think to an extent, Blair. But even then, we've got to still sit down and for the first time, for example, talk about the impact of an advice charge. It's just a very different conversation to one that perhaps advisers will have had in the past. So I don't think anyone's completely exempt from the impact. I might argue we'll be less impacted. But to say we'll be not impacted I think would be overly ambitious for us.

Q - Blair Stewart {BIO 4191309 <GO>}

Okay. That's great. Thanks very much.

A - Mark Gregory {BIO 15486337 <GO>}

Cheers, Blair.

Operator

Greig Paterson, KBW.

Q - Greig Paterson

Three questions. One is I saw that the PIC have got a deal of GBP160 million from Gartmore. I was just wondering if you bid for that and wonder if you can talk about the pricing, how far you were from the person who achieved it.

Second thing is I see there's some strong growth in your GI gross written premiums. Specifically you focused on health there. Others have been pushing hard in that market. So I was wondering what sort of year-on-year rate increases you were achieving in order to produce that top line.

Then as a final question, you made a comment about the phasing-in of start dates on group pensions, that it resulted in a minus GBP5 million reduction in net client cash flows. I was just wondering how that rolls itself forward into the Second Quarter. Does that mean we're going to have GBP5 million higher in the Second Quarter? Just to understand how the mechanics work there.

Thank you.

A - John Pollock {BIO 6037447 <GO>}

Hi, Greig. The group protection, I think -- group pensions, I think you're talking about group protection there, are you, rather than group pensions?

Q - Greig Paterson

Yes. Well you said group protection in your notes. So I assume I'm talking about that.

A - John Pollock {BIO 6037447 <GO>}

Yes. You said group pensions. Just clarifying that.

Q - Greig Paterson

My apologies. Group protection, apologies.

A - John Pollock {BIO 6037447 <GO>}

Let me pick up PIC bid. We don't ever talk about competitive pricing, Greig, as well you know. It's a great question. But I'm not telling you.

Q - Greig Paterson

But did you bid on it? That's all [ph].

A - John Pollock {BIO 6037447 <GO>}

We pretty well offer prices on pretty well everything we're asked for. I don't actually remember the last time that we refused to bid on a case. There are very, very few cases in the market where exclusivity is granted without necessarily a competitive process. And you'll remember our big deal last year was one of those cases.

But we pretty well bid on everything that we're offered to. And we work out our price based on a return on economic capital. And if others bid ahead of us and it doesn't meet our required returns, well, well and good. The market, as you know, is huge. It will, over time, emerge. And we will get our fair share of it. But I don't ever comment on specific competitive deals.

Q - Greig Paterson

All right. So I'll assume that's a yes for the did you bid on it one.

A - John Pollock {BIO 6037447 <GO>}

Well I gave my answer, Greig. As far as GI is concerned, this is not -- our growth has not particularly been driven by rating, it's been driven by distribution growth. We are playing more strongly in the direct space. And one or two additional brokerage deals have been added to our distribution set, all of which have contributed to growth.

So it's not been a rate driven thing. As a general principle, we are seeing some hardening of rates in the housing market, which I think it would be, as you would expect, from the effect of weather over the last two or three years. So there's a slight hardening in the cycle.

Q - Greig Paterson

So what year-on-year rate increases is the market doing, if you don't want to quote yours? Is it low single digits or --?

A - John Pollock {BIO 6037447 <GO>}

Last year would be slightly more compelling numbers than trying to give anything this year. Last year, we saw something in the range of 5% to 10% on average rate hardening. It would be too early this year to give anything that's happened this year. Perhaps we can give you an update on what the market's done maybe Q3 when we've got more sight lines and more data.

And as far as group protection is concerned, there's always timing issues. You'll remember from last year, just the way the business builds up, we have -- we take the reserves when the deal is struck. But the premiums emerge over the year. And that always causes a timing issue and the emergence of cash and strain in the Group Protection business. It's just a particular peculiarity of that business.

I can say that I think some of the welfare reform initiatives that Government have given [ph] seem to be giving a little bit of momentum to corporates to think about their income protection needs and their death in service needs a little more.

We have seen a few more businesses that previously have been self-insured begin to come to market. But as I'm sure everybody is aware, the corporate marketplace does remain fairly subdued.

Q - Greig Paterson

Right. And sorry, I'll sneak in another question. I noticed that you've -- well, I understand you poached some people from the Aviva SME mortgage operation last year and you've launched this year. I was wondering what your targeted percentage of assets backing the annuity liability book you're looking for in terms of the long-term SME mortgage space.

A - John Pollock {BIO 6037447 <GO>}

Well let me just -- we don't ever poach anybody from anywhere, Greig. We --

Q - Greig Paterson

They moved across voluntarily. Sorry; apologies.

A - John Pollock {BIO 6037447 <GO>}

It is true to say that a number of people have joined the LGIM business to help us in that space and we see some advantages in broadening the asset mix there. We don't have specific targets in that space. But you will have seen we've successfully launched that team. And hopefully, there will be more to come in the future.

Q - Greig Paterson

Thank you very much.

Operator

Nick Holmes, Nomura.

Q - Nick Holmes {BIO 3387435 <GO>}

A couple of questions. Firstly, with bulk annuities, are you still seeing positive new business strain? I know it fell last year. And I wondered if this trend was continuing.

Then secondly, changing focus away from the UK, looking at US and Asia. And LGIM's growth opportunities there, I wondered if you could just tell us -- well, elaborate a bit more, tell us about products and clients.

Thank you.

A - Nigel Wilson {BIO 1535703 <GO>}

Yes. I think on the LGIM, it's a little bit early to talk very explicitly about that. We'll give a more detailed review at the half year, when we think we'll have made more demonstrable progress in those areas.

In terms of the BPA market, we're not seeing any different trends from last year really. And that we would expect the strain to be a modest positive number for the year, if we were to make a forecast at this particular time of the year. But it's -- there's no shocks in the marketplace around in either direction.

Q - Nick Holmes {BIO 3387435 <GO>}

Okay. That's pretty clear. And would perhaps John like to make any comments about the pipeline? I think, Nigel, you said he'd give us a bit more detail.

A - Nigel Wilson {BIO 1535703 <GO>}

Not that much detail.

A - John Pollock {BIO 6037447 <GO>}

I always get asked about pipeline. And Greig is a very keen observer of pipeline. And it does depend very heavily on your definition of pipeline.

Perhaps what I could say is I think deficits are up a bit. And that always tends to drive quotation activity lower if funds perceive that they can't afford to de-risk at this stage.

That said, as I always say on this, there are schemes who have been through a de-risking journey historically who find themselves with an asset base that is entirely transactable. And we continue to receive quote enquiries from people who are in a decent position.

So we have a number of live quotes. But as you know. And as I've always said, it is almost impossible to predict whether they will close. And even if we could predict that they would close, it's very difficult to predict exactly when.

So this remains a lumpy business. There's still GBP1 trillion [ph] out there to transact. It will all transact. Your guess is as good as mine as to when. It may take 10 years; it may take 15 years. Who knows?

But there is still good activity. But I think in general terms it's slightly more subdued at the moment than it has been.

Q - Nick Holmes {BIO 3387435 <GO>}

Okay. Great. Thanks very much.

Operator

Andy Hughes, BNP Paribas.

Q - Andy Hughes {BIO 15036395 <GO>}

A couple of questions, if I could. The first one is I guess coming back to the investments. And that slide that was a bit of a surprise. Just looking at the movement between Q1 last year and Q1 this year. And I know you mentioned that structured products you're selling less of. I guess the first part of the question is are structured products for you guys effectively impacted by interest rates? So if interest rates stay at this level, structured products will remain weak. And if you've got any numbers about the sale levels of structured products where we are today versus Q1 last year, that would be very helpful.

The main question was just trying to work out the net flows, because obviously, they've fallen by GBP900 million plus. And these inflows into the Fund have only gone -- the investment single premiums you're receiving have only gone down by GBP400 million. So does that mean there's been a big increase in outflows? And it sounds like it might be from the unit trust products. So can you talk a bit about that. And how different that is to your easy [ph] assumptions?

Thank you.

A - Nigel Wilson {BIO 1535703 <GO>}

Yes, Andy, are you just referring there to the savings flows?

Q - Andy Hughes {BIO 15036395 <GO>}

Yes.

A - Nigel Wilson {BIO 1535703 <GO>}

Yes, not the LGIM flows, which were --?

Q - Andy Hughes {BIO 15036395 <GO>}

No. So the -- yes.

A - Nigel Wilson {BIO 1535703 <GO>}

I'll let Mark answer that.

A - Mark Gregory {BIO 15486337 <GO>}

Yes. Just on your first question then, Andy, about the impact of I guess interest rate environment on structured products, that is an absolutely key determinate of the way these products are manufactured. And generally in terms of products which have a more retail customer demand, typically higher interest rates equate to better shape of payback type structured product vehicles.

So the corollary to that is with low interest rates, that is a -- it's usually more difficult to construct products which are as attractive to the retail market. So you can therefore assume that if gilt rates stay where they are now, then that will remain a tricky environment in which to construct attractive retail propositions in the structured product space.

In terms of flow from one quarter to the next, again, I see nothing as it stands today. We're going to see a significant bounce in structured product volumes in Q2, certainly compared to where we were in Q1 last year. We had a much more conducive environment at that point in time. And we did, therefore, sell a lot more structured products in the First Quarter of last year.

In terms of the broader net flows within investments, again, I guess I'd use structured as an example of what I was talking about. But you are right to say we've had a weaker net flows quarter in our Unit Trust business as well. And again, it's something to do with the retail trends in existence out there. People are, I think, uncertain about where to invest their money. I think we are seeing a period where people are generally I think probably risk off [ph] but just struggling to understand how to construct their portfolios to reflect that.

On top of that, we have one or two of our portfolio distributors. And some of them are multi-management funds, etc., have taken some money away from us, again, very much as part of a portfolio decision. So we have seen some of those slightly lumpier flows in the First Quarter as well.

Just on your very last point, what's the embedded value impact, without being too patronizing, we don't account for our Investments business on an embedded value basis. So it will have zero embedded value impact.

Q - Andy Hughes {BIO 15036395 <GO>}

Okay. So the outflows are for mainly products which aren't investment, because obviously, some of them are and some of them aren't, aren't they? So --

A - Mark Gregory {BIO 15486337 <GO>}

Sorry, I thought you were asking a question specifically about the delta on the -- those on investments.

Q - Andy Hughes {BIO 15036395 <GO>}

The savings.

A - Mark Gregory {BIO 15486337 <GO>}

That is by definition -- in our case, that is all non-insurance business.

Q - Andy Hughes {BIO 15036395 <GO>}

Right, okay. Great. Thanks. Can I ask another question of Solvency II as well? I know you mention in the release that you're happier with some of the progress relating to the counter-cyclical premium, essentially [ph] a buffer. But also, could you perhaps talk a bit about the matching premium, what you're expecting? Because the matching premium, does that seem to be reasonably final in your views now?

And one point on the matching premium was the limitation of the credit spread, the A assets. Are you still thinking that that's going to happen, or do you think that's likely to change as well?

A - Nigel Wilson {BIO 1535703 <GO>}

I think the principle is well established; he detail around it is not well established. I would be very surprised if the A stood the test of time as well. I suspect there are a number of changes which will happen over the next few months. And the direction of travel is certainly in our favor.

Q - Andy Hughes {BIO 15036395 <GO>}

Okay. Thank you.

Operator

Ashik Musaddi, JPMorgan.

Q - Ashik Musaddi {BIO 15847584 <GO>}

Just one question basically on you made a comment that you're investing to further enhance your workplace proposition, basically developing your savings platform. Has there been a change and you have stepped up your investment in developing these propositions, or is it just like in line with what you have been doing for the last -- over the last couple of years or something? If you can give us some guidance on this.

And second, again, on the boarding [ph] thing is how does the pipeline in your group pension look like, because I can see that you have mentioned that the second half this year looks to be more interesting, second half this year; and start of next year looks to be more interesting and we can see a significant pickup in new business. So how do we think about that?

Thank you.

A - Mark Gregory {BIO 15486337 <GO>}

Just on the investment profile, I think it's probably worth saying in L&G terms. And I do stress in L&G terms, we probably are investing certainly more substantial sums in key strategic areas. So you mentioned platforms. Clearly, we're investing in our RDR proposition, as well as our auto enrolment/corporate pensions propositions.

I think in L&G terms, it's fair to say that we are spending more in those areas this year than we have historically. I do stress again, this is L&G talking here. So we are very, very conscious of the value of money. And we don't fritter it away. But for us, we are spending a higher profile I'd say this year than we have done historically.

But again, for a very clear strategic reason, we're still very bullish on the rationale for what we're doing. And we're very comfortable that we'll end up succeeding and getting a good return on the investment we are making.

On the Group pensions pipeline, again, we've given quite a lot of steerage in the notes. Clearly, we are securing a lot of wins which as yet haven't actually appeared on the books. We've given some definitive numbers there; in fact, the number of members who we -- essentially coming across from new schemes that we have acquired.

And it is fair to say at this stage, of the numbers we've given you, both existing pension payers of schemes we've won, or indeed pension new auto enrollees, well, clearly auto enrolment hasn't started yet. So there's no auto enrollees on the books yet. And even for the sum total of all the existing members paying into existing schemes which we've won, not a very large proportion are those are paid. But I think at year end, you asked the question I think I answered then, about 10,000 of the number we have secured last year were on the books by year end. And I think our own -- from memory, we've added about another 5,000 of the numbers we've completed have gone through in the First Quarter of this year. So therefore, by definition, there's still a very big slug of both assets and new life to join our schemes primarily from Q3 this year onwards.

So I am fully expecting a significant spike in the level of completions, not necessarily by quarter. But certainly from a Q3, Q4, Q1. And to a certain extent Q2 next year. Clearly, we are adding to that pipeline with new scheme wins as we go along. It isn't a once and done hiatus. I'm fully expecting us to maintain that level of momentum going forwards as well.

Q - Ashik Musaddi {BIO 15847584 <GO>}

Okay. Can you just give one more follow-up just --? Can you give us some sense of what are your expectations for the opt-in and opt-outs after -- of your existing schemes which you are expecting to basically contribute to new business in the second half?

A - Mark Gregory {BIO 15486337 <GO>}

Yes. It's actually very difficult to answer that overall, because it does very much depend on how benevolent the sponsoring employer has been. And some of the schemes we've won, for example, actually -- people almost can't opt out. They're put into a pension scheme, there's been quite a low contribution from the employer. But there's no requirement for the employee to make a contribution. That's not necessarily the norm. But that's one extreme.

Obviously, another extreme, some employers are taking a slightly more hard-nosed commercial view of the cost of implementing auto enrolment from their perspective. In that sense, no, they are perhaps just meeting the minimum criteria laid down by the regulations.

So in reality, this does massively vary depending on the employer and the mandate. And clearly, our price and underwriting reflects some of those shapes of risks as well.

DWP, when they first set out on the auto enrolment gave some steerage that they thought about one-third of employees would opt out -- sorry, of eligible employees would opt out of auto enrolment. I'm personally slightly more bearish overall than that. I think probably between one-third and one-half will be a more realistic assessment.

Again, I'm partly overlaying there the fact that we are clearly going through a more difficult macroeconomic environment where it's just not easy for people to -- even where the employees put in free money in for them, it's still difficult for them to free up the money they need to meet their side of the bargain.

So I'm slightly more bearish on the level of opt-outs. But again, that's all part of our pricing discipline when we factor that into our economic models.

Q - Ashik Musaddi {BIO 15847584 <GO>}

Thank you.

Operator

Raghu Hariharan, Citi.

Q - Raghu Hariharan {BIO 15133573 <GO>}

I just had three quick ones. The first one was just on the risk sales, obviously strong sales here. I was wondering if you could talk about pricing and how pricing has been working in the annuity market and in the protection market. And what impact that has on margins.

The second one was on LGIM. Clearly, the product mix is richer. You have higher inflows into active and LDI. I was just wondering when will we see the impact of this richer margin product mix into your cash flows. Is it just a timing issue, or is it there in the cash flows and it's offsetting say softness somewhere else?

And the third one was just quickly on savings. Obviously, earlier questions were focusing on the outflows and the inflows. I was just wondering what is the -- what will be the margin impact of the mix you're seeing where you're seeing net inflows into your Group Pensions business and outflows I guess in your Unit Linked Bonds and Individual Pensions business?

Thanks.

A - John Pollock {BIO 6037447 <GO>}

Hi, Raghu. It's John here, Risk Sales. I guess there's not really much of an answer here, other than pricing conditions have remained relatively stable over quite a considerable period, certainly the last quarter and into the Fourth Quarter of the previous year, both for annuities and protection. We've seen rather less activity in pricing in protection since the OFT ruling made price -- competitive pricing less easily accessible.

We did suggest to the OFT at the time that this wouldn't necessarily be a consumer friendly action. However, nonetheless, that's what's happened. As a consequence, our margins we're very comfortable with.

And broadly the same is in annuities. As Nigel said right at the beginning, there's nothing that has changed, or any dramatic moves, or any dramatic drivers in either the annuity bulk market or in the CPA market that is changing anything substantially. So by and large, it's steady as she goes in both those markets.

A - Nigel Wilson {BIO 1535703 <GO>}

In terms of LGIM, we are investing to achieve that growth. We're building an infrastructure in the Middle East, building an infrastructure in America. And have started to build infrastructure in Asia. So you have to recognize to get the growth you've got to spend the money to get there. So the bottom line impact is not dramatic from getting extra volume through.

A - Mark Gregory {BIO 15486337 <GO>}

Just on the savings margin point, it's clear there's quite a lot of moving parts going on within the Savings covered business, new business margin. But overall, my view would be I wouldn't expect the mix in the First Quarter to add any material change to the overall savings margin that we've been achieving recently.

Q - Raghu Hariharan {BIO 15133573 <GO>}

Okay. Thank you.

Operator

James Pearce, UBS.

Q - James Pearce {BIO 16758460 <GO>}

A couple of questions. You've had flat sales with new business straying off a bit. And you talk about that being driven by changes in mix. Could you clarify on that whether you're talking about product mix within the UK, or a shift from the UK to international?

Then secondly, the UK volume that you've seen, how do you think your market share has developed during the period? Do you think your UK volume will be -- will turn out to be typical of the markets?

A - Nigel Wilson {BIO 1535703 <GO>}

Yes. It's very hard on a quarter basis to give specific recommendations of views on market share. I think we were pretty happy with the market share performances we got in 2011. And there's nothing that we've seen in 2012 that says we've trended with any significant variance away from the '11 performances.

In terms of strength, the delta is very small year over year. And it's predominantly a couple of million extra in insured savings as we invest to grow that business, as Mark's talked about on the answer to at least five questions.

Q - James Pearce {BIO 16758460 <GO>}

Okay. Thank you very much.

Operator

Oliver Steele, Deutsche Bank

Q - Oliver Steele

No one seems to have asked about cash flow this morning. Maybe I missed a comment saying that we shouldn't ask questions about it. But if I can ask on that. How much --? You talk about investment de-risking. And I was wondering if you could just give us a few more figures on what -- numerically what changes you've made to your bank exposures, what's happened to your equity portfolio. And what the net cash flow impact will be looking forwards.

A - Nigel Wilson {BIO 1535703 <GO>}

I'll talk about the financial impacts. I'll ask Paul to give a more market contextual background of what we've been doing.

In a sense, for some time -- we used to have about 40% of our shareholder funds in equities. And that's now down to well below 20%. And on a bigger amount. And we've moved a lot of that money into law return higher certainty assets, whether those are short-term gilts or cash. But much lower return assets. And people just need to recognize that when they're modeling that through for the year. In large, that's influenced by our colleagues at LGIM's view.

Paul, do you want to -- ?

A - Paul Stanworth {BIO 15495409 <GO>}

Broadly speaking, you'll have noticed in the past that we have reduced exposure to the bank sector. And we continue to do that at roughly a reduction of about 1.5% of LGPL's funds have been moved out of banks and into gilts. And within shareholder funds, a similar kind of quantum reduction in the equity exposure as well, without any change to the projection of cash flow the year or going forwards.

Q - Oliver Steele

Okay. Well that was the follow-up question that I had on that, which is -- inasmuch as this is LGPL asset mix changes, as you say, you're not changing your projections going forwards. But can you quantify the impact on the shareholders (multiple speakers)?

A - Nigel Wilson {BIO 1535703 <GO>}

The assumptions are in the back of the accounts. Without actually reproducing our model here, it's just that we noticed in a number of models. And I can't remember which specifically, that they -- the amount of investment return built into the group cover [ph] and financing line was just too high given the switches in the mix that we've made in the portfolio and the decrease in the assumed returns.

We're not using the easy assumption of long-term return on cash, we're using our 1% return on any LIBOR related fund. So we're using the 1%.

The first point that Paul made was really the cash flow that we're getting out of the businesses for annuity and everything else is in line with the projections we've made. We just happen to have de-risked the portfolios to achieve those cash flows. We haven't done that in the Group capital numbers. We will decrease the returns.

Q - Oliver Steele

Thank you very much.

Operator

Andrew Crean, Autonomous Research.

Q - Andrew Crean {BIO 16513202 <GO>}

Two questions, firstly on -- going back to the Solvency II issue. I think you have said in the past that you would review your capital position when you had greater certainty over Solvency II and a more stable macro background. In terms of the former, I think you're indicating greater confidence that you'll get matched premiums, albeit that you are also saying that there's a potential for the whole process to be delayed.

In the light of that, I just wanted to ask when you feel you will get enough certainty around Solvency II to be able to push forward with the capital review. I know in the past you've talked about wanting to see the ink dry on the legislative paper before that. Is that still true? That's the first question.

The second question, I was just wondering, Mark, whether you might be able to help me with a bit of math around these 415,000 potential new auto enrolment people. If you're saying 60% of them will contribute, that's about 250 million people. If they have GBP25,000 of salary and they contribute 7%, you're talking about GBP430 million/GPB440 millions of new premium which on, say, 20 basis points of charge, would net you revenue of less than GBP1 million. Is that the correct math, or do we think that they'll be bringing money, existing pension pots with them?

A - Nigel Wilson {BIO 1535703 <GO>}

I'll take the first one on Solvency II. I think it is the -- we're still in the ink-drying mode. Whilst the -- as I said earlier the direction of travel's fine. The level of detail that's going to be required to get consistency across Europe is probably in line with our own expectations. But a lot greater than other people's expectations. And the inference you draw, Andrew, is probably that there's a reasonable chance of the process getting delayed. The probability of that's probably increased in the last couple of months.

Q - Andrew Crean {BIO 16513202 <GO>}

And does that then delay your process for doing a review of your capital position?

A - Nigel Wilson {BIO 1535703 <GO>}

Yes.

A - Mark Gregory {BIO 15486337 <GO>}

Just on the corporate pensions price and an impact on the earnings, Andrew, clearly, I'm not going to comment precisely on exactly where our margins are and just how we're pricing individual mandates. But it is fair to say that our strategic thinking is that auto enrolment in itself is a catalyst for much wider scheme reorganization.

So in that sense, they transfer existing built-up pension pots. And the fact that those employees by definition are already used to saving in a pension scheme has been key to our strategy. And virtually all the biggest schemes we've won have -- have either -- are coming with some fairly significant asset transfers at the same time.

So it will be remiss of you just to think of this as being people building up pension pots from a zero base. Clearly, that is part of the mix. But it's certainly not the sum total. And in fact, we very much see this as being a kind of market disruption point where employers have been forced to think about their pension arrangements for their employees. And we're fighting very hard to make sure that we produce a one size fits all for all their employees' solution, not just for their new auto enrollees. And that's absolutely core to our --

Q - Andrew Crean {BIO 16513202 <GO>}

So it's the existing employees who are more valuable in the near term, isn't it?

A - Mark Gregory {BIO 15486337 <GO>}

Yes. I'd [ph] argue that point. But clearly, we're trying to be inclusive, Andrew. And think about all the employees, not just a few. But it is fair to say that people can -- tend to be worth rather more to us than those starting from --

Q - Andrew Crean {BIO 16513202 <GO>}

Scratch.

A - Mark Gregory {BIO 15486337 <GO>}

Starting from zero. And anyway we'll stress again, we have invested very heavily here to make sure that we are very efficient. But clearly, this is a scale game ultimately. And without commenting on the kind of numbers you've quoted, it's fair to say that the greater the scale and the greater the efficiency, then the more attractive this business becomes.

Q - Andrew Crean {BIO 16513202 <GO>}

Thanks very much.

Operator

Toby Langley, Barclays.

Q - Toby Langley {BIO 15924432 <GO>}

Toby Langley, Barclays Research. I've got three questions. The first is on any benefit that you feel you had in the First Quarter from the kind of dithering from the Treasury around chopping pension tax relief. St. James's Place certainly appears to have done quite well in the First Quarter from that and your numbers year on year are up a pretty decent amount. What, if any of that, has trickled over into the Second Quarter?

And -- sorry, that's a two-part question really. Then what is -- what have trading conditions been like in April?

Nigel and Mark, you've talked about investing. I'm just wondering if there's any chance you can give us a bit more help really in terms of quantifying how much you're investing. And also how long you expect to continue to invest for. I know we're talking about these numbers on an L&G basis. But some of your peers that are also indulging along similar lines do see fit to flash those numbers at the market. It would be interesting if you could maybe provide a bit more color.

Then following up on Andrew's question, just about this point on asset transfer, is there an asset to premium ratio that we should maybe be thinking about in terms of thinking about what's the economic benefit of turning on these auto enrolment agreements?

Thanks.

A - Mark Gregory {BIO 15486337 <GO>}

Right. On the first one, the kind of any benefit from -- this speculation about shaving higher rate -- shaving any higher rate tax relief off pension contributions, it's probably in our (technical difficulty). For us, it's most obvious, Toby, in our high net worth pension proposition, i.e., Suffolk Life, where I think there we did see some benefit.

Now in reality, the one that we cry out for as an organization is a bit of stability in the whole pensions legislative and fiscal policy, because this -- all governments tend to have a habit of just tinkering in the pensions space. And what we really, really would like to see is a period of absolute stability and giving therefore pension savers the certainty that when they get to -- they're saving for a certain outcome. I think that's something which we would all in this industry benefit from.

But that said, there was a slight hiatus in the First Quarter. And I think probably as a result, we saw some benefit from the kind of whispering press around the fact that higher rate tax relief on pensions was going to go. So some (inaudible). I wouldn't say the read-across into quarter 2 is remotely renewable [ph] scheme. I think it's clear we're trading those businesses as hard as we possibly can. But I don't think that's down to any kind of fears over pension tax relief.

Do you want to take the investment one?

A - Nigel Wilson {BIO 1535703 <GO>}

In terms of investment, it's really the same answer I gave to Raghu's question earlier is that LGIM, we're having to spend -- we'll give a better review and sense of that at the half year when there's a bit more certainty about one or two things that are going on in America in terms of approvals that we're hoping to get either this month or next month. And that we're reasonably optimistic about. But there's things that we've just got to get through the regulatory pipeline.

In Savings, that's partly contingent on the schemes that Mark and the team have won. And again, there's one or two of those in the hopper that by the time we get clarification during the next two or three months, we'll be able to just give out a richer dataset in terms of qualification of that.

What was the third question?

Q - Toby Langley {BIO 15924432 <GO>}

Yes, on the asset ratio to -- asset to premium ratio. If I could just come back, Nigel, on that point though. In our heads, should we --? One of your competitors -- this investing number is a three-digit number. So for you, is it a two-digit number; is it a single-digit? How should we be thinking about that in terms of modeling?

A - Nigel Wilson {BIO 1535703 <GO>}

It's a two-digit number. But it's not -- it's not a single-digit number.

Q - Toby Langley {BIO 15924432 <GO>}

A two-digit number for the year or in the quarter?

A - Nigel Wilson {BIO 1535703 <GO>}

We can't spend that quickly, Toby.

Q - Toby Langley {BIO 15924432 <GO>}

You can't spend that quickly. Okay, good. All right. And the assets, your premium ratio?

A - Mark Gregory {BIO 15486337 <GO>}

Yes, sorry, Toby. I switched off there. Can you repeat that question again?

Q - Toby Langley {BIO 15924432 <GO>}

So Andrew was, I think, fishing for some sense as to what people may bring to the platform as a result of being signed up to auto enrolment. And I -- probably maybe posturing the question a different way, is there kind of -- how should we think about that mechanistically?

So if somebody's got a salary of GBP25,000 and they're making 7% contributions, fine, that's your regular premiums. But what typically will that type of individual bring with them? Or what do you hope for them to bring with them in terms of asset flows; i.e., transfer of existing savings?

A - Mark Gregory {BIO 15486337 <GO>}

It's very hard to be absolutely definitive about an average, because clearly, the schemes we're talking about, it depends on the employees within those schemes. Clearly, some of these people are -- some of those schemes we're winning have got much, much higher paid employees, than some of the numbers that you're referring to, Toby.

But all I would say. And it's a slightly defensive answer. But I'd just refer back to what I said earlier. Clearly, it's all part of our underwriting to have a feel for a center [ph] which -- you know, a scheme would come with significant and therefore valuable existing pension transfers. And we reflect that into the way we think about the schemes, particularly ones that we are very keen to win.

So it's a key determinant. But I wouldn't want to be too prescriptive about how it works on average, because virtually every scheme has got different characteristics.

Q - Toby Langley {BIO 15924432 <GO>}

Okay. Thank you.

Operator

Marcus Barnard, Oriel Securities.

Q - Marcus Barnard {BIO 2103471 <GO>}

The first question is you talk about the effect that the economic downturn has had on consumer confidence and disposable income. I just wondered if you're seeing this come through in the persistency numbers. And perhaps that's something you could update us with at the half year, because I'm sure people will be interested in ongoing persistency.

And secondly, on your GI business, I see you've seen some adverse claims there and the cash generated is a bit lower. I'm just wondering are you still confident that the GI business adds value to shareholders over the medium to longer term?

Thanks.

A - Mark Gregory {BIO 15486337 <GO>}

: Just on the persistency one, Marcus, I think I'll take your lead there. All I would say just to reassure, I don't think we're seeing any major shifts in the trend either way in the First Quarter. But I think it's a fair challenge to say we should give you a bit more color on any impact of the overall economy on persistency at the half year.

A - John Pollock {BIO 6037447 <GO>}

And on GI, the short answer is, yes. The comparator to last year, if you remember, we had very hard freeze in December 2010, meaning that January '11 was a relatively benign year. We had a bit of a storm in January and a bit of a freeze in February, which has impacted Q1 results. But despite the wet weather, I'm very confident that GI continues to offer very good shareholder value hell bent on continuing to grow that business.

Q - Marcus Barnard {BIO 2103471 <GO>}

Okay. Thank you.

Operator

Gordon Aitken, RBC.

Q - Gordon Aitken {BIO 3846728 <GO>}

Just one question on corporate pensions. It's interesting your scheme wins in the quarter; you brought in 29,000 existing members. And that was ahead of the market leader who reported 26,000. Now we've talked a bit about how much you're investing and you've made it pretty clear that you're investing. But not nearly as much as they are. The question is, simply, why are you winning more than them?

And if you can just touch on the quality of the schemes won; so we don't have that information. So basis points the members are paying, average premium size and staff turnover.

Thanks.

A - Mark Gregory {BIO 15486337 <GO>}

Okay. I'm only pretty able to talk about our own proposition, Gordon. And what we're spending. And I wouldn't want to comment on what others are spending differently to what we are. But it's fair to say we've been very focused on what we think we're trying to solve in this whole corporate pensions space. And it's a mixture, making sure that our proposition is attractive to both employees and employers.

Clearly, in the auto enrolment space, we have a lot of people who have low levels of financial knowledge and awareness having to make some quite big long-term financial decisions. So again, we've thought very hard to think about how one makes sure that we can assist the employer, both through good communications and having good human -- people available to help where necessary to make those decisions; working very hard on making sure that default funds are perfectly risked, etc.

Again, we recognize that in the corporate pensions space, a lot of employees do put their money into the -- into a default fund. So again, very, very clear there; we've got a responsibility to make sure those default funds are absolutely fit for purpose and have the right kind of risk reward profile. So that's the employee side of our proposition.

On the employer side, we're very much aware here this is a big risk point for various senior managers in big corporate entities; i.e., the rules set down to comply with auto enrolment are absolutely prescriptive. And those members [ph] have got to be auto enrolled around length of service, number of hours per week, their salary bands, both lower limits and upper limits; and the rules absolutely give you no latitude as to where -- you've got to get it right.

So again, we've been very, very strong in developing middle-ware type software to make absolutely sure that providing we can get the data accurately out of payroll systems from these big employers that we'll make absolutely sure that the right people are auto enrolled and those who shouldn't be aren't.

That's been -- it's been very much from an employers' point of view a de-risking proposition we've leveraged to make sure that, again, that they remove the headache and how they comply with the auto enrolment obligations, because they are quite onerous.

I think that's why we're actually proving to be quite popular in the -- in this space.

Q - Gordon Aitken {BIO 3846728 <GO>}

Are you all chasing the same type of business, or do you favor particular parts of this market?

A - Mark Gregory {BIO 15486337 <GO>}

Well in the short-term, it is driven, Gordon, by the staging dates, including the very largest employers in the UK are staging first. And clearly, it goes down a declining scale beyond that. So the schemes which are, I guess, available in the marketplace, by definition, are the largest schemes at this point in time, because they're the ones that have to meet the -- in fact, the very largest have to meet the October 1 this year staging date for their employees.

So I think, by definition, it is the largest schemes in the marketplace at this point in time. And now we're probably moving on to the next stage of larger schemes.

Q - Gordon Aitken {BIO 3846728 <GO>}

Okay. Thank you.

A - Mark Gregory {BIO 15486337 <GO>}

This is the last question coming up by the way guys.

Operator

Andy Hughes, BNP Paribas.

Q - Andy Hughes {BIO 15036395 <GO>}

Just a quick question about the change in asset allocation for the annuities now you're starting to do commercial property loans. Obviously, when you write a commercial property loan, its value that you calculate fair value, which I guess is the same as what you lend. Now does this mean that you don't --?

So if I had an annuity backed by a commercial property loan, then I would have a -- I couldn't possibly have a positive new business strain, because after I've taken into account reserving and discounting, because obviously I'm valuing this thing at whatever

I've loaned. So does this mean that basically your positive new business strain will reduce as you start doing more commercial property lending?

A - Nigel Wilson {BIO 1535703 <GO>}

The short answer to that question is, no. The amount of, obviously, commercial property lending so far is trivial in the context of the overall portfolio. We may or may not decide it's a very important asset class going forward. We're just seeing there's some reasonable opportunities in the marketplace for us as consequences of banks deleveraging.

Q - Andy Hughes {BIO 15036395 <GO>}

But does it actually depress your new business, positive new business trends?

A - Nigel Wilson {BIO 1535703 <GO>}

No.

Q - Andy Hughes {BIO 15036395 <GO>}

It doesn't?

A - Nigel Wilson {BIO 1535703 <GO>}

No.

Q - Andy Hughes {BIO 15036395 <GO>}

So how does that work? Are you fair valuing it above what you lend to the Company, or -- ?

A - Mark Gregory {BIO 15486337 <GO>}

The basis on which we would write a commercial loan would be the same as you'd write a quoted debenture, or any other secured type lending. So the difference between what we're doing is that they're bilateral agreements as opposed to traded agreements, which would be bonds. So there'd be no difference at all.

Q - Andy Hughes {BIO 15036395 <GO>}

So you treat it like corporate debt and you'd apply your own rating criteria and use the yield on the asset versus default assumption?

A - Mark Gregory {BIO 15486337 <GO>}

Yes, because the structure of what we're doing isn't typical of bank loans; it's basically the type of stuff that looks like a bond.

Q - Andy Hughes {BIO 15036395 <GO>}

But that's -- my understanding that's very different to Aviva, who do claim that they fair value the debt on their loan balance sheet and use a risk-free rate to discount the liability backing it.

A - Mark Gregory {BIO 15486337 <GO>}

I can't really comment on what Aviva do.

Q - Andy Hughes {BIO 15036395 <GO>}

Okay. And the other part of the question was I guess on the de-risking on the Bank side. When you risked the portfolio and move stuff into high risk securities, the yield went up and you released cash. Now you've de-risked the portfolio, why would the cash not go down?

A - Mark Gregory {BIO 15486337 <GO>}

Because we're changing the composition of some other parts of the portfolios we just talked about into commercial loans. And so there's -- the combination is that we're moving into what we think are favored markets away from non-favored markets. And as Nigel was saying, we correctly predicted the quite significant downgrade of the banking sector. And we've been working for some years to reduce our exposure to that.

Q - Andy Hughes {BIO 15036395 <GO>}

Okay. So as you're selling the Bank debt, you're buying other things which have quite a high yield as well. And that's sharing [ph] a net neutral effect to the underlying cash flow.

A - Mark Gregory {BIO 15486337 <GO>}

And higher risk adjusted yields.

Q - Andy Hughes {BIO 15036395 <GO>}

High risk adjusted -- yes, sorry. Thank you.

A - Nigel Wilson {BIO 1535703 <GO>}

Okay. Thank you, everyone, for your questions. If there are any other follow-up questions, Kate, Wadham and the rest of the team will be around all of today. Indeed, if you've got further questions for Mark, John or myself, we'll be happy to take them.

Thank you, again for your interest. And look forward to seeing some of you in the next few weeks.

Bye.

A - Mark Gregory {BIO 15486337 <GO>}

Goodbye.

Operator

That now concludes our conference call. Thank you, all for attending.