S&P Global
Market Intelligence

Legal & General Group Plc LSE:LGEN
FY 2017 Earnings Call Transcripts

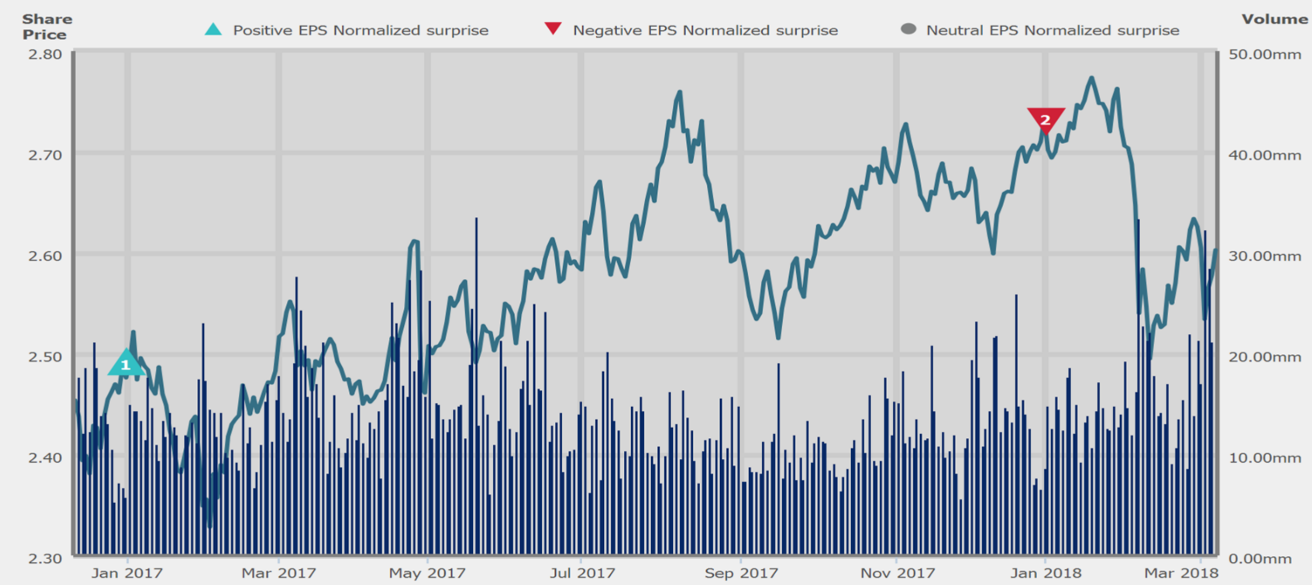
Wednesday, March 07, 2018 9:30 AM GMT

S&P Global Market Intelligence Estimates

	-FY 2017-			-FY 2018-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS
EPS Normalized	0.25	0.23	▼(8.00 %)	0.25
Revenue (mm)	8328.15	6051.00	▼(27.34 %)	8994.40

Currency: GBP
Consensus as of Mar-07-2018 7:56 AM GMT

Stock Price [GBP] vs. Volume [mm] with earnings surprise annotations



- EPS NORMALIZED -

	CONSENSUS	ACTUAL	SURPRISE
FY 2016	0.21	0.22	▲1 4.76 %
FY 2017	0.25	0.23	▼2 (8.00 %)

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Call Participants

EXECUTIVES

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Chief Executive Officer of Legal & General Insurance Division

Chris J. Knight
Chief Executive Officer of Legal & General Retirement - Retail

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CEO of Legal & General Capital and Director

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Director of Fund Management

Nigel David Wilson
Group CEO & Director

Simon Gadd
Group Chief Risk Officer

Stuart Jeffrey Davies
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Presentation

Nigel David Wilson
Group CEO & Director

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

2017 financial highlights were formidable. Operating profit up by 32% to GBP 2.06 billion. PBT also up by 32% to GBP 2.09 billion. EPS up 50% to 31.87p and ROE of 25.6%.

Our results do include the mortality reserve release at GBP 332 million for the full year. That is GBP 274 million posttax. This led to an additional GBP 250 million of dividends from our LGAS entity to group, increasing remittances.

There was a one-off boost to EPS from the reduction to the U.S. corporate tax rate which was positive for our U.S. Insurance business. Legal & General is strongly cash generative, with net release from our continuing operations also up 9% to GBP 1.4 billion. And we are structured to enable cash to flow easily up to group without trap cash [of] capital in subsidiaries. Remittances were at GBP 1.6 billion, up from GBP 1.1 billion for 2016.

We're therefore confident in recommending a 7% increase in the full year dividend to 15.35p amid a terrific year. I would, of course, like to thank all of my colleagues and thanks particularly to Steve Ellis who's sitting in the second row here and the team in our lifetime mortgage business. In less than 2 years, they've created a market-leading business with a 30% -- plus market share. And it is based on Solihull, proving you can grow new entrepreneurial businesses in financial services outside of London, a model we've also replicated in Barnsley.

This slide captures medium-term trends in our financial performance, showing consistent delivery of strong financial metrics. Our goal is to make our medium-term trends our long-term trends. Operating profit has grown [back to] 12%, net release by 9% and return on equity has grown from 14.9% to 25.6%.

Net release retained after payment of the dividend has averaged over GBP 500 million over the last 3 years. You should also note that book value per share has also grown by 7% and grew 13% last year, so in 2017, 7% DPS growth coupled with 13% increase in book value per share was over 20%.

Although we have reported a 32p of earnings per share, if you take off the effects of the 2017 mortality release and the one-off change in the U.S. tax rates, we delivered a 23.1p of EPS and 9% growth on last year, which is in line of our stated long-term EPS ambition.

We've been busy for several years at Legal & General shaping our company for the future, enabling us to focus on our core businesses, which can drive real earnings growth for shareholders and which are economically and socially useful in our chosen markets.

This has included decluttering or disposing of subscale legacy of nonstrategic businesses. Our disposables include our old-fashioned businesses in the Netherlands, France, Germany, Egypt, Gulf, Bahrain, Ireland and our less successful acquisitions, Suffolk Life and Cofunds. Some of this is also being strategic with the most important [latest stat] being the sale of our Mature Savings business announced in December for GBP 650 million.

We also secured an ongoing long-term investment management agreement for LGIM and with Swiss Re, we have a great partner for our long-standing customers.

We have significantly reshaped the group over the past few years to a simple, focused, modern business model. This reshaping has allowed us to redefine our strategy. It is unchanged overall, straightforward and consistent. But we've clarified and simplified what we do. The strategy is effective in 3 broad business areas: Investing and Annuities, Investment Management and Insurance.

Our strategic purpose is unchanged: To improve the lives of our customers, to build a better society and in doing so create value for our shareholders. By aligning these interests, we create the inclusive capitalism of our annual report.

Our divisional structure is retained, and I'm fortunate to have an outstanding leadership team, Laura, Chris, Cheryl, Mark, Kerrigan, Jackie and Bernie, who are all here today sitting in the front row. And we are delighted to have added Jeff Davies, Paul Miller and Emma Hardaker-Jones to our leadership team, as well as welcoming John Godfrey back from his sabbatical, advising the Prime Minister.

Our strong collaboration across teams and the synergies between the divisions mean that we can collectively perform better than the sum of our parts. I will talk in more depth about the strategy later this morning once Jeff has taken you through the numbers.

But the resulting 3 core business is focused on our core strengths, modern products, technology innovation and a footprint which is global for LGIM but to date, largely U.K. and U.S. for the rest of the group.

Moreover, we deliver sustainable profitable growth and our strategy continues to be driven by 6 long-term growth drivers: aging demographics, globalizing asset markets, creating real assets, welfare reform, technological innovation and creating today's capital. All play a part in creating market conditions from which we can benefit. And they are more relevant today than ever. And in 2017, we demonstrated how we were able to use them for customers, for shareholders and for society.

Strategy in the abstract can be elegant but execution is paramount. We are applied thinkers. This busy slide illustrates progress in areas where we are positioned to benefit from the growth drivers to become leaders in our chosen markets.

Highlights include: LGIM approaching GBP 1 trillion of AUM, group-wide direct investments increasing 44% to GBP 14.4 billion and we became the first company to achieve GBP 1 billion of lifetime mortgage advances in a year. As well as a GBP 463 billion solutions business with a 40% -- plus market share and as Mark will tell you, tremendous global growth opportunities.

I'm also pleased to say that Bernie Hickman and Steve Griffiths did a great job in 2017 of turning around our underperforming group protection business, now profitable in H2 and beyond.

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

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

Stuart Jeffrey Davies
Group CFO & Director

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

As Nigel has already said, it's been an outstanding year as the headline level, with operating profit from the continuing operations up 35%. This includes the recent changes we have made to our reserving for longevity but has been adjusted for the sale of our Mature Savings business. As we flagged at the half year, we reviewed our longevity improvements assumptions, and we moved to an adjusted version of the next actuarial table, CMI '15.

This made the total release in the year GBP 332 million. Even without this prudent release, we grew operating profit from continuing operations by an impressive 12% as a result of our excellent execution and clear focused strategy.

Our key divisions performed strongly in 2017, contributing to the 9% increase in net release from continuing operations. In line with half year, on top of the net release, there is now in total of GBP 250 million additional dividend from the LGAS subsidiary in respect to the mortality release. When added together, this means the group generated GBP 1.7 billion total release, up 21% in 2016.

On internal dividends, the cash remitted to group in respect to 2017's results was up 46% from last year at GBP 1.6 billion. We [regrew] our return on equity to 25.6%. Finally, at a high-level summary of our capital position, the group Solvency II net surplus generation was GBP 1.2 billion, up from GBP 1.1 billion last year, leading to a coverage ratio of 189%.

This net surplus generation will continue to grow over time. As an additional point, our coverage ratio as of 5th of March was an estimated 196%. Our dividend policy based on operating metrics remains unchanged.

The board took into account the strong 2017 results, together with the medium-term underlying business prospects and has therefore announced a full year dividend of 15.35p, which is 7 -- up 7% from the previous year.

Turning to the operating profits from our divisions, we saw good growth in many areas. Our institutional LGR business, which deals with the corporate pension scheme, grew 39% on a reported basis and after excluding the mortality release, it was a strong 10%.

This was as a result of the larger opening position, together with a 7% growth in new business sales. Our retail LGR business grew 116% and a great 26% after excluding the mortality release.

New distribution arrangements as the preferred provider of Annuities to Aegon and other DC platforms helped drive this. LGIM grew an impressive 9% on the back of record external inflows and strong asset performance, while maintaining discipline in its market-leading cost income ratio.

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

LGI contributed GBP 303 million, which was flat year-on-year with growth in its U.S. division offset by the previously reported adverse claims experienced in group protection and lower long-term lapses on older business in retail protection.

And finally, GI contributed GBP 37 million, down GBP 15 million from 2016, predominantly due to the impact of increased costs from escape of water in line with industry experience as we reported at half year.

We're happy to say, we've not seen a repeat of this in the second half. In terms of divisional performance, I'll start with LGR. We've already covered the 13% operating profit growth, even without the mortality releases. LGR's net release was up 16% to GBP 688 million, benefiting from a new business surplus increase of 13%. This was as a result of securing attractive spreads in direct investment whilst maintaining our discipline when pricing new business. We've also warehoused more DI than last year which we can now apply to new business in 2018.

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

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

On the back of further analysis of our own mortality experience and the trends we have been seeing, we've also decided to move to an adjusted version of the next actuarial model, CMI '15, for our longevity improvement assumptions.

These adjustments are made to reflect how our annuitants differ from the broader population and apply some smoothing. As you can hopefully see from this illustrative graph, our model still anticipates the same long-term improvement assumptions. Moving to CMI '15 simply assumes that you'll experience slightly lower improvements in getting there.

You could see this is a minimal change in our total life expectancy assumption, illustrating the prudence of this release. Going forward, we will continue to scrutinize the likelihood of a sustained slowdown in mortality improvement of population data and that on our own book emerges and consider whether to make further changes to our best estimate assumptions. If we do choose to make assumption changes, it will be in stages and over several years.

In the coming year, we will consider the appropriateness of moving to CMI '16. As an indication, simply moving mechanically to this table would have a similar sort of economic impact as a total release this year.

This table breaks down the new business sales in LGR. We wrote GBP 3.4 billion of U.K. bulk annuities in 2017, as demand remains strong with GBP 1.4 billion of this transferring from LGIM clients, giving further evidence of the unique breadth of pension derisking solutions we can offer clients.

Additionally, we wrote a further 15 deals in the U.S., bringing the total business written there to over $1.6 billion. Demand from U.K. pension plans remains substantial and the pipeline of transactions we are in active discussions with has risen to GBP 17 billion.

The U.S.-defined benefit pensions market has similar potential, with the market growing year-on-year. We will continue with a measured approach as we look to expand. Our LGR Retail business had a particularly strong year with new Individual Annuity business up 78% due to the new distribution agreement and demand continuing to return to this market.

Also in LGR Retail, our lifetime mortgage business wrote loans of just over GBP 1 billion. The market has a potential to grow rapidly with GBP 1.5 trillion of U.K. housing equity owned by the over 55s. We expect up to GBP 4 billion to be transacted in 2018, up from GBP 3.1 billion last year. And with our 33% market share and great distribution network, we are well placed to benefit from this growth.

The asset portfolio backing our annuity liabilities has expanded its range and diversity in 2017 and remains defensive in nature. 20% of the portfolio is in sovereign-like assets and over 2/3 of it is A-rated or better.

In addition, we continue to have a GBP 2.7 billion credit default reserve held against it. We now have 17% of the portfolio in direct investments with stable income, often collateralized or secured on great counterparties. Overall, this is still less than we hold in sovereign, which is an opportunity to create further value.

LGIM had a year of strong growth with record external net flows of GBP 43.5 billion, which is 5% of opening AUM and GBP 33 billion of this from international clients.

Operating profit grew 9% to GBP 400 million, and we maintained a steady cost income ratio of 50% due to the scalable nature of our business model offset by continued investments in our growth strategy and increased regulatory costs.

Positive flows across virtually all of our channels, regions and investment areas demonstrates the breadth of LGIM's business model. We continue to grow our U.K. DB business and remain the largest manager of assets in this market and the market-leading provider of LDI solutions.

We are also the largest manager of DC assets in the U.K. with good growth in the past year and the market leader in workplace master trust. Our U.K. retail business is also growing rapidly with record net inflows of GBP 3 billion and ranking third in net flows for the second consecutive year.

As I mentioned, nearly 3/4 of outflows last year came from international clients, with our international AUM at GBP 228 billion. Our U.S. business contributes significantly to this with assets of $189 billion across an expanding range of strategies of 350 clients.

Our thought leadership in the U.S. DB market has [been to] increasingly implement LDI strategies and consistent strong performance in our range of active fixed income funds and now complemented by a more recently established index team and DC proposition.

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

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

LGC continues to grow assets and profits, as it diversifies the asset classes it invests in. Operating profit was up 6% and PBT at GBP 363 million, with strong performances from both the direct investment and traded portfolios.

In the direct portfolio, a combination of asset disposals and sales of funds generated GBP 369 million of proceeds, exceeding the target of GBP 250 million for 2017. And importantly, our disposals during the year met our return expectations of at least 10% to 12% IRR.

These sales proceeds were recycled as we invested or committed almost GBP 700 million into new investments, as well as into our existing portfolio, including new investments in Later Living as well as expanding our Build to Rent fund with LGIM.

Our operating business investments also delivered strong results with 10% in NPR expanding rapidly and CALA delivering revenue of GBP 776 million, more than 3x the amount we'd achieved the year we acquired our share.

In our housing portfolio, we will continue the expansion of our Build to Sell and Build to Rent offerings, and we have measured plans to develop businesses in the Later Living and affordable housing sector.

We intend to grow the urban regeneration portfolio through further investments into existing projects and the regeneration of cities where we do not yet have a presence.

For LGI, operating profits for the division as a whole was flat year-on-year. Within that result, U.S. protection grew 5% with good premium growth of 8% and favorable mortality experience.

In U.K. Protection, our profits of GBP 209 million were impacted by the previously reported adverse claims experienced in group protection as well as some lower long term [that was] experienced on all the business in retail protection.

The range of actions taken by group protection, including pricing at scheme renewals, has returned the business to profitability in the second half and we anticipate it will continue on this trajectory in the coming year.

The margin across U.K. Protection remained robust in a competitive environment. Given 2017, our U.S. business launched a direct-to-consumer sales channel and work is ongoing to digitally transform the business.

This will continue in 2018, with the launch of an application that provides an instant underwriting decision for more customers and digital collection of medical information to increase efficiency.

As usual, LGI America has already paid its 2018 dividend. This year, it was $105 million, up from $100 million paid last year.

In GI, gross premiums increased 13% to GBP 369 million whilst maintaining our pricing discipline in a competitive market. 38% of our premium now comes from our direct channel.

As [the slide shows here], our operating profit was affected predominantly by the impact of increased costs from escape of water claims in Q1. We took action to address this and saw improved claims experience in the second half, as can be seen by the 92% combined ratio.

GI is now on 7 distribution agreements in the last 2 years with major U.K. financial institutions, several of which will commence in the first half of 2018, and we have diversified our proposition with our acquisition of pet insurance provider, Buddies. These factors combine to give good prospects for growth in 2018.

On savings, the team did a great job in delivering the 2017 results amid a few distractions. As you are all aware, we announced the sale of our Mature Savings business to Swiss Re in December for GBP 650 million, achieving a sale price of 1x Solvency II to our own funds. The profits of over GBP 400 million will be recognized when the Part 7 completes, which is targeted for mid-2019.

Moving to our capital position. The group Solvency II surplus increased GBP 1.2 billion since the last year-end to GBP 6.9 billion. Our Solvency II coverage ratio, calculating our shareholder basis, increased to 189%, up from 171% last year. As I mentioned earlier, our coverage ratio as of 5th of March was estimated at 196%, reflecting increases in interest rates since the year-end.

Our economic capital showed similar growth over the last year, as expected. We have expanded our usual Solvency II surplus bridge to explain the GBP 1.2 billion total movement over the year.

As we guided, our operational surplus generation has increased to GBP 1.3 billion. The impact of the amortization of the opening transitional was broadly offset by the corresponding release in risk margin. The impacts of writing new business in the year was a very capital efficient strain of less than GBP 100 million.

Operating variances of GBP 0.4 billion, including the impacts of the change in our mortality assumptions, experience variances, changes to model calibration and management actions.

These actions include changes to asset mix, matching adjustment optimization and hedging strategy. We also chose to strengthen our interest and inflation calibration which offset some of the benefits in the second half.

Our market movement for the year were a net 0, with equity market rises offset by credit spread narrowing and small interest, inflation and FX changes.

And similarly on Solvency II, our usual slide gives you our estimate of the present value of Solvency II surplus emergence from the key elements of the new business we wrote.

As we have already noted, our margins continue to be resilient whilst maintaining pricing discipline. For a small strain of less than GBP 100 million, we have created GBP 564 million of value.

So to conclude for me, even without the mortality releases or one-off U.S. tax benefits, our business produced excellent growth with an operating profit increase of 12% and an EPS growth of 9%. This is in line with our previous EPS guidance and an indication of our ongoing ambition.

On longevity, we maintained our prudent and staged approach to the trends we are seeing, and will investigate to move to CMI '16 in light of our 2017 experience.

All our businesses have great growth opportunities and are backed by a strong balance sheet and cash position whilst delivering excellent ROE.

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

Nigel David Wilson
Group CEO & Director

Thank you, Jeff. Clearly, this has been another great year of delivery. I'm both very pleased for my colleagues. I'm very proud and privileged to be the CEO of Legal & General.

Record annuity assets, record assets under management and record insurance premiums. But what is really exciting, as Jeff mentioned, is looking forward, how our reshaped business and focused businesses can address and build on so many global trends which are moving in our favor.

Our strategy begins with our 6 long-term growth drivers which are highly relevant and drive continued growth here at Legal & General. To take on a few. The aging demographics, combined with tension and welfare reform is still leading to the significant DB to DC shift, which continues to gather pace.

We now manage GBP 68 billion of DC assets, the largest manager in U.K. We're highly focused on the whole DB journey from LGIM -- LDI products to buy-ins and buyouts at LGR and providing the direct investment to deliver the returns expected by our policyholders and our shareholders.

We're also actively growing in DC, both in the U.K. and so far in the U.S. Technological innovation drives so much today, but we at in Legal & General are more than keeping pace.

Investing today's capital to provide a threefold benefit: solving customers' problems, building a better society and delivering strong returns for Legal & General shareholders.

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

And in Investment Management, we continue to build out our world-class international businesses. And we are addressing the U.K. Savings gap by growing our retail investments and Workplace Savings businesses.

Finally, within insurance, we're seeking to harness technology to become a fully digital and data-enabled insurer, while addressing a clear customer need for financial protection. The numbers Jeff took you through show we are very capable capitalists, but what we do also meets real customer and real societal needs.

Let me take you through each business area briefly. First, LGR, we're investing in Annuities. LGR Institutional is our largest business, and we continue to be really excited by its growth prospects. Our franchise, particularly including LGIM, gives us a differentiated ability to source attractive business.

Our financial and brand strength allows us to remain disciplined in our pricing. Laura has picked up the reins and has promised me another great year in 2018.

In LGR, Chris has terrific plans to further broaden our individual annuity franchise within this important area, delivering complete retirement solutions. Then on the investing side of the business, we have a unique capacity to source attractive and high-performing direct investments by LGIM, by LGC and by lifetime mortgages.

LGC has 2 principal goals: first, it uses our strengths, including our existing businesses, network, brand and talent to invest our shareholder capital to maximize returns; secondly, it supports our other businesses by creating or unlocking debt-like instruments -- investments with great counterparties for LGR and by creating opportunities for LGIM and its clients.

Recent examples include the urban regeneration project in Cardiff and ceding LGIM's build-to-rent fund. LGC invests in 4 principal areas: revenue generation, housing, SME finance and clean energy.

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

LGIM is a business we have built for the future. Once rooted in U.K. DB pensions, LGIM's strategy today is focused on 3 things: broadening our investment capability, growing globally and expanding our U.K. DC and retail businesses to address the U.K. savings gap.

We've expanded into the whitespace, huge multibillion-pound markets, such as global high-yield, multi-assets, real assets, factor-based investing. We have no legacy problems on the upside. And we're taking a global lead on ESG, more of our inclusive capitalism. Sacha Sadan and his team are leading the markets across the world.

We plan to host a Capital Markets Day in June, focused on LGIM. So you can look forward to hearing more from Mark and his outstanding management team.

Our insurance business goal is to be a fully digital and data-enabled insurer. Firstly, we're looking to use technology to improve operational effectiveness, reduce costs and improve customer outcomes, with extensive use of robotics, AI and big data.

Secondly, we are digitizing and diversifying our distribution. For instance, SmartQuote for GI where we offer executable quotes after only 5 questions by using big data. And as Jeff mentioned, we are already winning partnership business because of it. Thirdly, insurance is where we innovate and explore alongside digital pioneers in fintech and insurtech.

As Jeff said, GI delivered 13% growth in premiums in 2017 and indeed, Cheryl and her talented team are planning to make me even happier by achieving even more growth in 2018 and beyond.

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

The refocusing of our business puts growth in the U.S. [to the fore]. We have 3 excellent growing businesses with great management teams. LGIM has delivered strong growth in client numbers, including some of the largest U.S. DB and DC funds. LGR, with a strong pipeline in a market where only 4% of the $3.7 trillion of DB liabilities have transacted so far. LGI's U.S. term insurance business is well positioned for the many opportunities we see for increased digital deployment and more D2C activity.

Now a few case studies for future [growth]. In 2017, we launched LGIM's Future World Fund to address the demand for better risk-adjusted returns alongside greater ESG impacts. With over $6 billion in the fund to date, we have a $100 billion ambition. And our build-to-rent fund is currently a GBP 1 billion business, ceded by LGC but it has also attracted investors from LGIM's global institutional clients.

It is truly amazing that to date, we haven't created an institutional asset class in-housing in the U.K. We will change that. We see it as a GBP 10 billion opportunity, which taps into the demand we are seeing right across the U.K. for high-quality institutionally owned rental accommodations, a classic case of fixing a market failure and using our commercial strength to help tackle a societal problem.

It's not just the millennials who face a housing shortage, but older people too. Legal & General is once again providing a solution to later life living.

Digital or insurtech has become a watchword across our industry. It is also crucial to use data to improve the customer experience, which is what we do in GI through SmartQuote and SmartClaims. Five years ago, filling a digital slide was demanding. Today, we have multiple projects evolving at real pace and with real energy. We started a few years ago with 4 robots, known as the remotes. Now we have more than 50 with many more being developed to massively increase efficiency in our operations, primarily in LGI.

Our partnership with Slice Labs, like our work in parallel lending with SalaryFinance, addresses contemporary customer needs.

So another great year, but we remain ambitious. We achieved 17% EPS growth in 2016 and 9% in 2017. So well placed and on track for our financial ambition to achieve 10% EPS growth from 2015 onwards.

I feel like our business is in great shape. We are at a real inflection point. We have clear strategic goals we are delivering on. We have a great set of businesses, unencumbered by the legacy of the past, a globally trusted brand and a great team focused on our exciting growth opportunities.
With that, let me open it up to Q&A.

Question and Answer

Nigel David Wilson
Group CEO & Director

Gosh. Oliver? Can we limit everybody to 3 questions at the most.

Oliver George Nigel Steel
Deutsche Bank AG, Research Division

Oliver Steel, Deutsche Bank. Three questions. First of all, on cash, GBP 3.4 billion is what you're saying you've got at the moment. I don't think that includes anything yet from the Savings sale. So perhaps, you can talk about what it could be pro forma? But then I don't think what we've ever really sort of clarified is how much of that cash is actually excess and perhaps even also link it in with the solvency ratio now at 196%, how much of that is excess? Second question is, what are you going to do with it? You've proved that a lot of your business is capital-light, even the annuities business is not facing that much strain and the sort of businesses you're in don't sort of sound as if they've got a lot of major acquisition opportunity [if I omit the collar], so what are you going to do with it? And then third question is, perhaps for Jeff, so you're saying the longevity release in 2018 will be the same as 2017. But you're...

Stuart Jeffrey Davies
Group CFO & Director

[Is that] what I said.

Oliver George Nigel Steel
Deutsche Bank AG, Research Division

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

Nigel David Wilson
Group CEO & Director

I'll get the first 2 and let Jeff left lots of breadcrumbs for people to follow there and it's interesting to watch people's faces as they were trying to figure out exactly what he was saying. But he believed in rehearsals was totally clear and fully [understandable]. But he was getting points of correction from Mark Zinkula, so it's on actuary and issues, which is the first time, so all that training that he's had to go through for several years are beginning to show a benefit. On the cash point, indeed, you're right. The GBP 650 million of cash that we received from the sale of Mature Savings isn't included in the GBP 3.4 billion. We received that on the 2nd of January, and as Jeff mentioned, that will result in over GBP 400 million of profit being credited to the P&L in 2019. There was some other cash we received, which was as part of the transfer and that's one of the footnotes, which Jeff might highlight, which where that goes to. On the whole issue of capital and what we're going to do with it, that's why I've got a great outstanding management team who're going to inundate me with brilliant ideas in the next few years. But you're right at the moment that we've created a very capital-light model, which is generating about GBP 0.5 billion of extra cash per year that we're not actually using as a business. Hence, the cash balance keeps going up and up and up and with the disposals, it goes up even further. But because we got a 20-odd-percent return on equity, we have business models where we can deploy the capital truly efficiently. We have a huge amount of whitespace to expand into, and I alluded to a few of those areas. The rollout of Future World as a global brand is a key priority and one that Mark and I are massively enthused about on a personal level. We have a series of bolt-on acquisitions that we're thinking of making. Mark's been thinking of making one in America for a few years, and he's still thinking of it in 2018. I hope this year, he actually gets on and does one of them because we need a greater direct investment capability in the United States. We've still got further opportunities in Cheryl's business and in Chris's business. So we're not short of opportunities to deploy the capital, but we'll be very patient. We'll be very patient and very measured is the word that Jeff used. And yes, the Solvency II ratio is pretty close to 200%, but we like having a particularly strong balance sheet, and we've never had targets for our Solvency II ratio. Now Jeff, can you ask -- answer that third tricky question?

Stuart Jeffrey Davies
Group CFO & Director

Yes. It was all clear from the presentation, as Nigel says. Yes, so the longevity, we will look at CMI '16. We were waiting for our 2017 data to be fully developed. And as you note, we've even adjusted version of those tables. It was adjusted CMI '15. So what I talked about in the presentation was if you just mechanically plugged in CMI '16, you get an answer very similar to the total release that we had this year. But of course, we're not in a position today to say, we will just mechanically plug it in because we smooth out data to make sure there aren't blips in it. We look at our own portfolio. We look at our socioeconomic group against the underlying data. So that's the reason for the caveats around it. It's not as simple as saying we'll just move to that table. There's a lot of work to be done for that and understanding what's driving it and continuing to invest in understanding what's driving those. And then looking forward, yes, we still talk about the several years. Only last week, there was CMI '17 released and that showed the same sort of similar numbers. Again, you're talking small numbers, but you saw the 0.2 change in life expectancy. But that would, again, translates into the same sorts of releases if you continue to see it. So we need to see what comes out of our data, and we will continue to keep addressing it. But we see the trends, and we believe there is a medium- to long-term slowdown in mortality improvement in the short term.

Nigel David Wilson
Group CEO & Director

2 actually points there. So both of our senior audit partners smiling that you've made the correct answer to the question on that, which will keep them both happy. I think the other point is I noticed 1 or 2 of the notes that came out this morning said the mortality release is one-off. I mean -- I think Jeff's trying to say that it's not one-off, it's for multiple years. And we're moving forward in a very measured way in terms of recognizing what's happening to longevity for the business. Andy thought he was getting there -- the mic there. That's what you get for being the broker, okay?

Gordon Aitken
RBC Capital Markets, LLC, Research Division

Gordon Aitken from RBC. And first on mortality, so you have moved to an adjusted version of the tables and [color] your books different. Just wondering, how it is different? And what actually has been your -- the experience mortality -- experience of your new annuities versus the population? Your book would definitely be wealthier than the population. And you talked a bit about this. And I'm just wondering if you're holding -- because there's a bit of debate in the industry, actually it's about how that wealthier segment is moving. So I'm wonder if you're holding some prudence back here. And as far as the second question is on retail annuities. In the open market, you talked a bit about that as a proportion of the total annuity market. It was broadly 45% a year ago, and I'm wondering what it is now and how fast you think the open market will grow?

Nigel David Wilson
Group CEO & Director

Yes. I'm going to let Chris answer the second question, and Jeff's going to have yet another go at answering the first question. Then, we'll give mic to you, Andy.

Stuart Jeffrey Davies
Group CFO & Director

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

Chris J. Knight
Chief Executive Officer of Legal & General Retirement - Retail

Yes, thanks. Yes, we see the open market continuing to grow. The whole market grew modestly sort of in 2017 up again over the last 2 years, and we've seen 100,000 people coming to retirement every year going forward. With more DC money, rather than [DP] encumbered, we see that potential to grow. So it's up for us to make that market. I think the introduction of PS 17 12 is also going to have an impact. That happened last week. So we'll have to see what that does. But that essentially means that when anybody gets an annuity quote going forward, they will be presented with the best price in the market as well as -- the price -- immediate price as well. So that may well -- that -- we see that as being net positive for us over the long run.

Nigel David Wilson
Group CEO & Director

Yes, one of the interest and intended consequences of George Osborne's pension freedom, so you're going to see a lot more inversion in pension solutions being offered by providers like ours -- like ourselves. And it was in fact creative destruction at work and one industry reduced in size massively and a lots of other new industries are emerging around it and they are pretty much trying to be market leaders in all those other areas. And so far, DC has been a huge success lifetime mortgage and later living are [all new], also doing incredibly well. Andy?

Andrew Sinclair
BofA Merrill Lynch, Research Division

This is Andy Sinclair from BofA Merrill Lynch. Three questions for me, please. Firstly, on LGIM. Just wanted to if you could give us about -- thoughts on the pipeline of business coming into 2018 and also what you can think of for the longer term cost/income ratio for that business? Secondly, staying on LGIM, your recent ETF investment Canvas, just wondered do you feel that gives you everything that you need to compete in the ETF space? And how material can ETFs be for LGIM? And thirdly, on the dividend, you've pointed towards EPS growth of 10%, guided towards dividend growth of 7%. How do you feel about the divergence of these and can they increase in coverage over time?

Nigel David Wilson
Group CEO & Director

Mark, you've got 2 questions to answer. I think this is the first time you've had 2 questions back-to-back.

Mark Zinkula
CEO of Legal & General Investment Management and Director

All right. And thank you. So in regards to the pipeline, I think we are expecting to see a continuation of what we have over the past 2 to 3 years, which is continued positive net inflows pretty much across the board. You saw this past year, we've seen an increase in flows in every region, increase in flows in DC and retail, down slightly in DB, but again still positive in that we still expect to have continued single-digit profit growth for the foreseeable future in the DB market and well the other markets, obviously, where the growth potential is higher. We do have one, which we announced last year, but we do have one significant outflow the first part of this year, which is the ACCESS local authority pension pool which is [a good example of] outflows. So that's -- again, there will still be a lot of lumpiness in the DB part of the business, but again the underlying trends are still very favorable for a business model very broadly. In regards to the Canvas acquisition, so I think, yes, the timing is certainly right for us as we're expanding our retail business. As I pointed out earlier, we're doing very well. In the U.K., retail market now we're now expanding into Europe and ETFs are becoming increasingly popular in Europe for a variety of reasons, which I'll go into if you're interested in more detail. And we think we have the right partner. It's a great leadership team and actually, since we announced the acquisition in November, assets are already up

25% from the announcement date, and we'll continue to launch funds that would be expected, core funds, [thematic] funds, and ESG-related funds that would be expected from our brand.

Nigel David Wilson
Group CEO & Director

Jeff, do you want to...

Stuart Jeffrey Davies
Group CFO & Director

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

Nigel David Wilson
Group CEO & Director

Okay. Laura, do you want to?

Ravi Tanna
Goldman Sachs Group Inc., Research Division

It's Ravi Tanna from Goldman Sachs. And 3 questions, please. The first one was just going back to the cash that was asked about earlier, the GBP 3.4 billion. I was wondering if you could give us any sense of how much of that's encumbered versus what's freely available? And also if you could perhaps give us a sense of where that sat, whether it's in LGF or elsewhere in the group? The second one was just on the annuity business. Obviously, very strong new business surplus, and you've referenced the contribution from direct investments and lifetime mortgages. There's a speech from the DRI last week referencing their scrutiny around use of matching adjustments, internally rated assets, and you've, obviously, talked about the scope to take that further. I was just wondering how -- if you could tell us a bit more about your risk appetite in that context, please. And then the third one was on LGC. Obviously, with the decision to set out of investments and crystallize cash, there's a trade-off with profits to a certain extent. I know some is being reinvested and recycled, but could you give us a sense of that trade off going forward, please?

Nigel David Wilson
Group CEO & Director

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

Simon Gadd
Group Chief Risk Officer

So Simon, we presented before about all of our direct investments. We -- the primary aim is to make sure that they are a good match to our liabilities and make sure that all the risks underneath them are properly assessed. The matching adjustment process, which was referred to in the question, and I happened to get approval from the PRA to any asset that goes into that portfolio really ups the game in terms of making sure that there is really rigorous assessment of the risks, that the cash flows are as fixed as possible so that they are a good match for liabilities. And lifetime mortgages, we have to put into a structure to do that. But again, that's been rigorously assessed with the PRA, and I believe there's a continuing dialogue about that. We are very comfortable with the way we are currently reserving for and capitalizing against the risks for that product. There's only -- there's a limit to how much ultimately we can have in direct investments back in annuities, but we're a long way away from that at the moment because of the liquid nature of those liabilities. So I think it's about 17% of the portfolio currently. We've got plenty more scope to increase that without encumbering any liquidity issues.

Kerrigan William Procter
CEO of Legal & General Capital and Director

Great. Yes, just on the reinvestment and recycling of capital within LGC. We have a range of assets within LGC on the direct investment side. We have yielding assets, development assets, operational assets and then some -- a start-up area. And of course, some of those assets come to the end of their useful life with LGC and it makes sense to sell them [owned] things like part of our office developments in Cardiff urban regeneration. We sold those [owned] parts of Bracknell, moved on. And of course, we got really exciting reinvestment opportunity. So if things like some of the land we bought for our communities business where we're building out 3,000 houses and the exciting opportunity -- the really exciting opportunity in later living where we put GBP 100 million in, in 2017. So the net investment was positive. We expect to [give you] some guidance on the future. But we expect to put more of that into some of those really exciting opportunities in later living, for example. Some of the existing urban regeneration plans could be developed [there], and we're working with further cities, really exciting plans on clean energy where we've only just started. And we've got about GBP 100 million in, in a range of fintech, proptech and healthtech companies that's incredibly exciting we can curate and develop further. So it's going to be net positive, obviously, in a whole range of really exciting areas.

Nigel David Wilson
Group CEO & Director

I think we took a very measured approach here as well, is that we wanted to do a proof-of-concept because we know what a cynical group of people we have in the room here -- with us today. So build it and sell it is part of it. And it was great to see in Cardiff that the -- there were 2 European investment firms who bought the assets and a Canadian firm who bought it in Bracknell. So it wasn't -- I'd love to say that was in the plan, but it wasn't in the plan. That actually these would have wide international institutional appeal, which is something we found to be unexpected, but actually beneficial to us as a company. Colm, just start.

Colm Kelly
UBS Investment Bank, Research Division

Colm Kelly, UBS. Firstly, is on the margins. As mentioned earlier, the annuity margins and the new business margins are improving materially through the direct investment strategy. I supposed why -- how do you see the trajectory in terms of margin expansion going forward? Is there more to go there? I know Kerrigan previously mentioned there was a bit of a ceiling in terms of how much lifetime mortgages could be used within the asset portfolio given the matching, the need to maintain matching. So maybe just some color on that. And also just why the, may be the Solvency II in your business margin has come down a little bit since the half year. Secondly, on LGIM, again, performing very well, on flows, on earnings, also the cash remittances are up, I think, for the first time since 2014, with a payout of 76%. So just thinking about how that progression and the payout from here, given it had come down a little bit prior to this year. Are we going to see continued growth in that cash remittance number? Or should we expect a little bit more held back for may be reinvestment or acquisitions in the -- [as the management says, has] alluded to earlier? And then finally on the subsidiary cash remittance, you provided enhanced disclosure on that, so thank you for that. I'm assuming the sale of [closed] funds and the proceeds have not been remitted from entities, and so may be is that flagged for reinvestment? And then finally, there's the other subsidiary remittances of GBP 120 million. So I was just wondering if you can provide a little bit more detail on where -- what is driving that? I think last year, the sale of Suffolk Life contributed to that number. I'm just looking at some of the subsidiaries underpinning it. I don't know if -- I don't think [they] have paid dividends [that largely] in the past prior [rather than GRE]. So just maybe a color on where exactly it's driven from it and can we expect continued growth in that number going forward?

Nigel David Wilson

Group CEO & Director

Okay. On the -- I'll just give -- while Jeff's thinking of a couple of the answers here, I'll give a bit of waffle to give Jeff some time. The -- on how we think about the portfolio. The thing we are trying to flag is we have over 20% in sovereigns and moving from sovereigns to [new] area to direct investments is -- or lifetime mortgages is a phenomenal trade for us and hugely value creating. We haven't really started on that. So there's a lot of backward optimization that if you want to talk to Laura and Chris about it afterwards very specifically on the actions we have taken and the size of the prize in that given area. But I don't know whether you want to add anything to that or take that very complicated last question or whether you want to take one off-line as to what the remittances are going to be, the mix of remittance.

Stuart Jeffrey Davies
Group CFO & Director

Yes, I was going to say GBP 120 million remittance is probably the best way to [indiscernible] later on in that. But some of that is [tidying up]. Some of them is smaller entities, just paying [a pence], small amounts. I mean, obviously, the vast majority of remittance comes from LGIM, [L gas], et cetera. And that's where we're seeing good progress, good precedent around release of the longevity release and then the dividend payment on top of the underlying and then just trying to get more disclosure on the GBP 1.6 billion paid up and what are we moving to group and where is that sitting. So that was the main thing around that.

Colm Kelly
UBS Investment Bank, Research Division

[indiscernible]

Stuart Jeffrey Davies
Group CFO & Director

Yes, that's small numbers. Start of '17, we would have doubled that. [There's] normal course of dividends as it was paid through. And we were pretty clear in the dividend strategy around what we pay through LGAS, et cetera. And just on -- adding on the annuity and new business margin, et cetera, I mean, it was sort of following up from the previous question as well. I mean, as Simon said we are 17%, 4% lifetime mortgages of the total book. As an in force portfolio and overall, we believe there's plenty of headroom in that and that we could easily have 30 or the 40 [as an answer to that]. There's headroom there, which is a number of years of adding to that book. And as lifetime mortgage grows, we grow in new business, we grow the total book. We can allocate this DI that we [would have added to the] in force [or through] new business. We'll be disciplined in that. And because we have that optionality with in force, we can maintain the pricing discipline. So we're very focused on the right new business, added value, the right returns on economic capital and know we can apply to the in force if we need to.

Colm Kelly
UBS Investment Bank, Research Division

[indiscernible]

Nigel David Wilson
Group CEO & Director

Yes. I mean, I think [in particular] last year, some of you pay a huge amount of attention to this. Whereas, in fact, we [usually round it] to the nearest GBP 50 million in some of the internal stuff. And then you could [model it at] at 76% or 72% or 78%. We rarely do that. But we tried to demonstrate this year that there's a huge amount of remittances. And rest assured, there'll be a huge amount of remittances again this year because we hadn't realized the sensitivity of some of the elements to exactly making sure that we don't have trapped cash or trapped capital in the divisions. So we recognize we didn't succeed last year in convincing all of you. So [it's a creed], in particular. [Kevin], give me a touch of my color to remind me that, actually, this is part of the equity narrative. I will come back to you.

David Bracewell

Redburn (Europe) Limited, Research Division

It's David Bracewell, Redburn. Two questions. One on the workplace savings. There's going to be an increase to contribution rates this year also and after. I'm just wondering how that will [you know] affect your business -- I don't know what your average contribution level is for your current workplace [flows]. So I'd just be interested to hear how that might impact the flows there. And the second question is on the risk margin for the annuity business. There's a good chance the PRA is going to maybe change the rules there, allow you to have some flexibility. Just wondering if they do relax the rules there, what you might do in terms of strategy. Would you reduce the reinsurance that you purchase? Or actually, you found that the reinsurance is so cheap you might keep that going forward?

Nigel David Wilson
Group CEO & Director

They're both very good questions. There are all sorts of odd reasons which you're going [afterwards]. But, Mike, why don't you explain why [indiscernible] are doing such a fantastic job in the DC space?

Michael Barrie
Director of Fund Management

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

Nigel David Wilson
Group CEO & Director

Actually, I love the answer to the next one, it depends. Yes, but it does depend. If there's a movement, it will come down to what is the cost of reinsurance versus how much of the risk margin is being reduced and the cost of capital trade-off. We've always said that it entirely depends how much any risk margin reduction would be, and we will then review. The reinsurance remains very good value for both parties. And we have a good supply. We have the 14, 15 on the panel that we can get reinsurance from. So we'll maintain to look at that, the operating model, obviously, with a focus as well on new business strain and managing that on a [substitute] basis. I'm sure we would continue to be capital efficient.

Greig N. Paterson
Keefe, Bruyette & Woods Limited, Research Division

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

Nigel David Wilson
Group CEO & Director

Okay. I'll do a little bit on the first one, just by way of background. I think people also forget the individual annuity business we don't reinsure at all. The U.S. annuity business we don't reinsure at all. All the back book transactions we don't reinsure at all. It's only the U.K. PRT business. And so it's hard to do linear mathematics around those lots of changes in the mix. And it's really -- answering the preceding question, it's the ratio that we have in the U.K. PRT business which may well change going forward depending on what percentage [is on those]. And if you want to be really technical about this, Tim Stedman -- [gave] an incomprehensible answer to Jeff and I last night, which was, depends. And you can do the depends sensitivity with Tim afterwards. But [you're on].

Stuart Jeffrey Davies
Group CFO & Director

Yes, sure. I mean, in terms of first half to second half and percentage, I mean, it's very similar. The model hadn't -- didn't change. It's 80%, 85% range shown on the U.K. PRT. We look at each case on an individual basis, depends how much deferred and in-payment is in a transaction and what the pricing is, especially on deferred reinsurance where it's available. Both -- some of that drives that, but there isn't any conscious decision that we've made between first half, second half on that. In terms of [certainty], we don't -- we haven't been explicit on how much we're allocating to new business versus in-force. I mean, some of the useful metrics is we carried over more DI than we had the previous year, and so we could have allocated a lot more if we want to make them look better, and we effectively warehoused some of that. I think the other thing which has improved the most and significantly is obviously greater [matter] lifetime mortgages. If you're writing deferred and you have lifetime mortgages, that is a reasonable pickup on yield compared to any other assets we'd be sourcing at the very long tail, big impact, long-duration, high-yield pickup, so that has an impact on that. Tax rates...

Greig N. Paterson
Keefe, Bruyette & Woods Limited, Research Division

What's the increase [indiscernible]?

Stuart Jeffrey Davies
Group CFO & Director

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

Nigel David Wilson
Group CEO & Director

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

Laura Doyle
Former Head of Investor Relations

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

Nigel David Wilson
Group CEO & Director

Yes, we don't think anybody else has this LGIM, LGC, LGR capability. And because we created huge amounts of optionality over the last 4 or 5 years in all these towns and cities across Britain, we will reap the benefits of that in future years. And Chris and the team are innovating hugely in the lifetime mortgage market, which is going to increase the flow of that business coming. Or -- and as Simon mentioned, we're well below our risk appetite at the moment. Jon? And we'll come back to this side.

Jonathan Michael Hocking
Morgan Stanley, Research Division

Jon Hocking, Morgan Stanley. I've got 3 questions on LGIM, please. Going back to the ETF points. Clearly, conventional wisdom is unless you're top 5 player in ETFs, you don't really make any money. It's a very crowded space. But I guess on the flip side, you guys are running at sort of 4, 5 bps expenses. So I was wondering whether we should think about ETFs differently for you given your expense base, is the first question. And the second was some of factor-based investing. Is this sort of a [follow-on] offer? And what capabilities do you have there? What capabilities do you have the need -- do you need to build rather? And then finally, you've got some 3 strategies which are pretty low-cost use of funds. You've got this classic index business, a passive business. You're going to have -- you have the ETF platform, and you're going to have [comp]. Is there a sort of issue here [of some crowding] and [sort of to get it to market offer]. You've been so well known in that sort of index space. You had to actually sort of pitch to institutional retail clients, and you've got some 3 things which should essentially do something very similar.

Nigel David Wilson
Group CEO & Director

Yes. Well, Mark is thinking of answering the first 2. I think the key thing, we have such huge whitespace to go into. Mark and I have been on a few trips to America, to the Middle East and to the Far East. And what struck us is how well the residents would all talk to customers around there, and these values and behaviors of the firm are really highly regarded. And the colleagues have gone then and made it easy for us. As I said, when we went down, but the reception we've got is being absolutely outstanding. And now it's putting people on the ground. And as you said, we have much more equity narrative or narrative around the products and solutions that we have. And people -- we're getting demand pull in Australia. Somewhere haven't even visited, but we're winning mandates, Korea, Taiwan, Japan, for all areas where we're just beginning to put the infrastructure in. And so we've had demand pull ahead of the infrastructure. Mark, do you want to answer the 3 questions?

Mark Zinkula
CEO of Legal & General Investment Management and Director

Yes, absolutely. No, the related questions are very good questions. Conceptually, thematically, what's happening is the index market, the passive market is still evolving. And it's from a product vehicle perspective as well as product design perspective. And so we still have a lot of demand in the core index space, but the market is evolving towards factor-based investing. So investing in different kinds of indices that the client needs, which we define as factor-based and some people call it smart beta, more thematically in the ESG space. You talked about the future wealth fund and so forth. And there's a blurring of the line of what's technically index or passive and what's a bit more than that. But this is the direction of travel, and we want to be, we are, I think, right now but it's early days, a market leader in developing products that are going to meet evolving investor demand. And it's part of this value proposition is just the strength of our corporate governance team, just the importance that's being placed, especially for an institutional investor [that's in it] over time [plus] the millennial crowd and wealth managers and so forth, that we are proper stewards in doing our part as one of the largest asset managers to hold companies accountable for a variety of ESG topics and some are higher priority than others for various clients. In regards to the ETF space, understand the conventional wisdom. I mean, keep in mind this is still very, very early days in the ETF market here. Vanguard was a late entrant in the U.S. back when the ETF market was evolving there. And we have a very strong index brand, a very strong passive brand. Yes, we have the scale, but we also have the brand. We're known to be in the space. ETFs are primarily a vehicle for index strategies, broadly speaking. So we do believe that we can enter the market, not starting as a top 5 provider, but grow rapidly over the next several years. And again, it is up to the strength of our scale and operating model and our brand, and it's still -- it's very early days in this market outside of U.S., frankly, and the rest of the world. I think I covered all the questions.

Nigel David Wilson
Group CEO & Director

Okay. We'll go here, then go and see Andrew.

Barrie James Cornes

Panmure Gordon (UK) Limited, Research Division

It's Barrie Cornes, Panmure Gordon. I've got a couple of questions. First of all, in terms of the lifetime mortgage market, I wonder if you could just give us a view in terms of the outlook and also maybe comments on any potential regulatory concerns, [over the passage of] [indiscernible] early. And the second question I had was in respect to the credit default reserve, which I presume has got no drawdown during the year. I just wonder whether or not there's any chance of reserve release of that [there].

Nigel David Wilson
Group CEO & Director

I addressed that question 5 years ago, Barrie. Why don't I just give you the same answer that we had 5 years ago. We almost never had to draw down on the default reserve. And [apparently I've been] studying it very carefully for the year-end. [It's been] switching on since -- we've had PricewaterhouseCoopers, I think, from the 175 years as our auditor. I think the original auditor was, in fact, Price all those years ago. But it's something that -- we're constantly active enough to see whether it's -- we have [access] approval [stuff on the] credit reform reserve. And Chris, do you want to talk about lifetime mortgages? And you should have -- we have Steve here today. And so if anybody's got a lot of detailed questions, then Steve will be around afterwards so he can answer them.

Chris J. Knight
Chief Executive Officer of Legal & General Retirement - Retail

We're very positive about the lifetime mortgage market going forward. GBP 1.5 trillion of equity owned by the people in retirement. So -- but I think it's ripe for innovation. We actually really try our best to go way beyond the sort of regulatory compliance minimum to make sure the customer is getting really good value for money. For example, by making all our products flexible so people only borrow what they need to borrow when they set one up and then they can come back to us for future borrowings. We've not seen -- and I think probably because of our approach to compliance and distribution that we're not seeing a lot of early redemptions. That's not a big -- not even been a small issue really for us. Those of you who read the Sun, yesterday, you would have seen they helped us announce our property [preferred] lifetime mortgage. You see some people living in houses that are tiny, unsuitable for them, and we can help them fix the house up and make it livable rents, rent it all out and so forth. So whether it's -- so for separated, divorce being an issue, people living without children. It's a huge -- children, without children, there are 1 million people over 60 living, aging without children. Why on earth would you not want to take a lifetime mortgage out of it? What are you waiting for, kind of thing. So I think there's tons of things that you can do to [those] mortgage there.

Nigel David Wilson
Group CEO & Director

[indiscernible] legacy 25% conversion rate, you target probably [indiscernible] come in.

Chris J. Knight
Chief Executive Officer of Legal & General Retirement - Retail

As you can see, we're quite passionate about that.

Nigel David Wilson
Group CEO & Director

Yes. There's a [simple test] -- Chris, I'll just -- when you all read the Sun yesterday, which I thought was a...

Chris J. Knight
Chief Executive Officer of Legal & General Retirement - Retail

Which I thought they didn't all read the Sun yesterday.

Nigel David Wilson
Group CEO & Director

So hopefully, you can have a copy of this.

Unknown Analyst

First one is a numbers question on the figure you show on slide -- the mortality basis slide, where you show the CMI '15 impact of 65 and 23.5. I'm just trying to remember what CMI unadjusted was. I think it was 22.8. And I was just wondering the margin versus what the population stuff is because, basically, the point is I'm trying to work out, a, what I'm looking at here, the 23.5, is this your base table bulk annuity rolled up with all your assumptions? And it sounds like you put an extra smoothing factor on top of the base CMI stuff because you talked about smoothing. So if you used a different smoothing, it just went to the CMI, which you can do. Or are you using the base CMI tables on top of your own population? And the second question is a more strategic one. So the 10% EPS growth sort of ambition thing, it's a bit hard for businesses largely kind of annuities. So maybe you could help us out as to how you're going to grow the earnings by 10% [per annum].

Nigel David Wilson
Group CEO & Director

That was also a question we were asked 5 years ago. I think then, since then we've gone at slightly faster than 10%. Bernie, maybe you want to take the first question here.

Bernard Leigh Hickman
Chief Executive Officer of Legal & General Insurance Division

The first is fairly straightforward. There was a big [letters that were] illustrative and very much what it is. [And I would say] investments on an IFRS basis. That is 1H that we chose to just show how we're changing the underlying. But yes, as we said earlier, we do apply smoothing [to it] -- we apply smoothing to our own data, we apply smoothing to how we bring the CMI tables in. And so they're all adjusted. And that's just as an indication of what the movement has been on an IFRS type basis, so estimate basis what's the -- it's the quantum change that's important, the 0.1 or the 0.2 rather than the absolute number.

Nigel David Wilson
Group CEO & Director

I think on the EPS thing, we have a multitude of businesses now in the portfolio. At a personal level, I think they're all capable of growing at circa 10% per annum LGM, LGR -- 2 LGR businesses, LGC and GI. I think Bernie's got the most difficult task with the current portfolio to get 10% growth in the retail protection businesses. I think given the great work that Steven, the team did in 2017 in group protection, I'd be disappointed if we didn't get 10% growth in the group protection business. So when we come here next year, Steve will be standing proudly and telling you we didn't hit the [track] in 2018. Andrew?

Andrew John Crean
Autonomous Research LLP

It's Andrew Crean, Autonomous. Could I ask 3 questions? On the protection side, could you just give us the numbers for what [the case] on retail protection was and whether you have got over the persistency problem now? Secondly, on [actually mortgages], is there a finite amount of appetite you've got for this? It's the one product which has got a cliff guaranty in it. It's very Continental European rather than U.K. TRA, I think in June, came out with some quite scary statistics, what would happen if housing fell 25%, 30%. And then thirdly, what's the nature of the annuity pricing competition? You've got the normal BPA market, and then you've got this enormous life back book coming in. What is the pricing comparison between the 2? And is this the tail wagging the dog or the dog wagging the tail?

Nigel David Wilson
Group CEO & Director

Yes. On -- we'll answer in reverse order. I think the -- both the customer business in the U.K., where we mentioned the GBP 17 billion, which is the highest, we usually have GBP 10 billion in the hopper. We've got GBP 17 billion in the hopper. It depends how much we convert in that. But there's an increase in demand and supply in the U.K. at the moment. Certainly, that's going to work its way through the marketplace. And the point that I think Jeff and I were trying to get across was we have a lot of pricing discipline around that. So we're not going to chase any particular individual transaction because we have an ever increasing breadth of opportunities that we've been presented in the market. But we certainly have enough risk appetite, capital and direct investments to support a pretty high level of growth in 2018 from the size of the back books that we've got. And I don't know whether Chris or Simon want to take the equity lease issue. Maybe Simon?

Simon Gadd
Group Chief Risk Officer

Following up on that, the answer I gave earlier. So in total, the DI, we have an appetite threshold for. But lifetime mortgages, I want to use Jeff's answer about depends again, because it depends on the mix of that business, so it very much depends on how much your average loan-to-value is on that portfolio. We are very careful not to be aggressive on loan-to-value. We're trying to keep that down to as low as possible so that we've got the bandwidth to offset volatility in house prices. So as long as we keep that down, we'll have more capacity. Also, I think there was mention about a new product that we're launching in that space where effectively, the borrower pays the interest, carries [upon the] interest where their -- effectively, you're are a lot more...

Nigel David Wilson
Group CEO & Director

[And we all know -- that was a rehearsal].

Simon Gadd
Group Chief Risk Officer

You're a lot more protective [inside the quarter] than we are in [a time when] there's a roll-up of interest. So yes, it would depend on the mix of business as to how much we can -- but we are very on top of being very prudent about our assumptions about future house price inflation.

Nigel David Wilson
Group CEO & Director

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

Bernard Leigh Hickman
Chief Executive Officer of Legal & General Insurance Division

Yes. So on Page 32, we set out [indiscernible] and valuation assumptions. It says here, we haven't got a problem in persistency. We've actually got customers really happy with us. And we've got lower lapses, that's just in later durations, and on our level term business and the whole of life business. But the premiums stay level. The claims and quite a bit of our insurance premiums go up, and so it's just a mechanical fact. If we get people happy to stay with us, we actually make slightly less money, and so it's just a kind of minor impact. Just to give you a quantification on that. So [we're talking, you know,] like a level term -- long-term persistency rates, you were seeing that rate at 3.3% going to 3.1%. So it's quite a tiny change in lapses. And yes, we hope customers carry on wanting to give us premiums and remaining in force, and we'll be doing what we can to keep them happy. So yes, that's what's going on broadly with the lapses and the figures are in the pack.

Nigel David Wilson
Group CEO & Director

The price of success. Last 2 questions. We'll try and finish by 11, okay?

Unknown Analyst

Just 2 questions, please. If we see rates increase, presumably good follow [up on] bulk annuity demand, does it have any impact on the ability to source direct investments? Does it make that harder? And does that become an issue for you guys as bulk annuity demand presumably increases? And then secondly, as you're looking to replicate your U.K. model in the U.S., specifically in the PRT space, you've seen, I think, 60% growth there this year. The markets outgrew, I think, 70%. Which areas -- how do your models differ right now? And specifically, if you could talk a little bit about infrastructure of direct investment sourcing differences and any plans that you have there going forward.

Nigel David Wilson
Group CEO & Director

I'll let Laura pick up the second question there. On the first question, just in general, on DI, you're right in the sense that it will be terrific for us to see interest rates go up [indiscernible] even stronger than [it is] yesterday. But we don't see any sensitivity around that. I think there is just a huge demand for new assets across the U.K. and really across the U.S. and Europe. And we need to recognize how crappy their infrastructure is. [I'm not going to give ourselves an efficient] rating, [which has] now gone from C- to D+. So they're in a push, a push there. But also, in the U.K., the expression reviews is a sort of coalition of doers. There's lots of discussion that [leavers and stayers], but outside of London, it's all about who wants to do things. And we're finding pretty much across the country getting PRS schemes or housing schemes through a lot of regeneration projects, roads, et cetera, relatively straightforward. Probably the best environment we've had for 30 years. It's still a C+, but it's moving towards a B in terms of how much better it's getting here in the U.K. And Laura, do you want to...

Laura Doyle
Former Head of Investor Relations

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

Nigel David Wilson
Group CEO & Director

One of the key messages is this capability. And if you think Kerrigan's move from LGIM to LGR to LGC, Laura's move from LGR to LGC back to LGR, Chris has pretty much worked in every division right now, but Mark Zink, he just seems to sit at LGIM all of the time. Last question?

Angel Parasotam Kansagra
HSBC, Research Division

Angel Kansagra from HSBC. Three questions, please. The first one is, you have given the split of cash remitted to the group from subsidiaries, which is welcome disclosure. Would you ever think of giving the split of operating capital generation by divisions? So -- because it's quite strong to see that the operating capital generation cash remittance comfortably cover the dividend, but to just see what the divisions are contributing, that would be useful. The second is on net capital strain. How much net capital strain have you seen from the U.K. PRT, in particular, if you give the split from that? And the third one is, I know you can't or you won't actually comment on political outcome, but if a labor government comes in, we are talking about nationalizing some of the industries. Have you thought of taking any action on your credit portfolio, in particular, utilities?

Nigel David Wilson
Group CEO & Director

I'll answer the third question, which is one of my specialist topics, but I'll let those really difficult first 2 question pass to my colleague, Jeff Davies.

Stuart Jeffrey Davies
Group CFO & Director

I'll do the third. You're talking the operating cash generation, you mean, on a [72] basis.

Angel Parasotam Kansagra
HSBC, Research Division

The capital [indiscernible].

Stuart Jeffrey Davies
Group CFO & Director

Yes. The issue with that is, of course, you've got to allocate the capital, so I think it would get a little bit messy. So it would be part of the issue of allocating it both between legal entities and divisions. You start to make so many assumptions that we probably wouldn't get it pass the auditor. So I think that's the issue. We will be as transparent as we can around this. So having said that, we haven't been explicit on the strain. But we do -- we say that's less than 4% for the PRT business, which is predominantly U.K. And so that gives you an indication. So that gives you the negative within rights of [the] other business like LGI, which creates positives and offsets and brings you back to the less than GBP 100 million number that we quoted, the total across the group.

Nigel David Wilson
Group CEO & Director

On -- in the whole political situation right now, I've never met Corbyn, and I don't know him well. So it's difficult having an informed judgment on exactly what's going to happen. What we have seen is this is our experience with the local authorities across the U.K. And regardless of whether they're labor conservative, but it's [back in] Bristol, Birmingham, Bracknell, Cardiff, Leeds, Manchester, Newcastle, there's just a whole array of political people. And the labor mayors or the local politicians have been equally, equally enthusiastic about being involved with us. In respect of utilities, quite a lot of utilities are actually in America because the BBB rated American utilities. Yes, we have some exposure in the [indiscernible], but it's a more senior level. And if you want the exact numbers for that, then I'm sure Laura can provide those to you afterwards. We've looked at the portfolio, and we think we've got more portfolio adjustments that we need to make as a group in respect to the ongoing political climate. We're very happy with the diversified nature. I mean, the switch-out of sovereign into [something], that's kind of the biggest change in the stock, the various floor changes that Chris talk about, Laura talked about and Jeff talked about earlier, which we'll see over the next few years.

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