Transcript

Legal & General Annual Results

Wednesday, 10 March 2021

Nigel Wilson Good morning, everyone, and thank you for joining Jeff and I on this call, and I hope you all enjoyed the video. We feel as though we delivered what we said we would deliver in 2020. Our operating profit is flat, our dividend is flat, and our balance sheet is in a stronger position than when we went into the pandemic.

We're very excited about the prospects for future growth. We feel as though the agenda in the UK and, indeed, in the US and, as you'll have seen, we're announcing Kerrigan is moving to Asia. So, the prospects for future growth are increasing for the group.

We remain totally committed to our dividend policy, which we articulated last year, and we're feeling very confident about our capability to deliver an exciting future here, at Legal & General. The first question is from Andy Sinclair. Andy.

Andrew Sinclair Thanks. Morning, Nigel and Jeff. Three from me, as usual, if that's okay. Firstly, it was just on new business margin. Annuities really strong. I just wondered if you could give a bit more colour on that and how we should be thinking about margins for 2021.

Secondly, was on LGIM flows. Very nice in a tough year but just really wondered if you could give us some colour on the pipeline. How has 2021 started so far in your different regions, different geographies?

Thirdly, it was just actually on the Solvency II review post-Brexit. We've probably heard quite a lot during this results seasons that risk margin change is nice but probably not a gamechanger but the expansion of the matching adjustment could be quite helpful.

I just really wondered, firstly, if you agree, and secondly, if could tell us, practically speaking, what does that really mean. Would you be looking at investing in different assets that you aren't able to at the moment or is it just different treatment for similar assets? Just some colour there would be really helpful. Thanks.

Nigel Wilson Okay, Andy. Jeff is going to take the first one, I'll do the second one and we'll do a double act on the third one.

Jeff Davies Hi, Andy. Our new business margin, as you say, looks strong. A couple of things going in there. One we can take credit for, which is very much good asset sourcing from the team, traded well when the spreads were wider around credit, obviously just pricing well, and we play across the whole market from the smallest deals to the largest and we can really focus where we think there's margin. So, we benefitted from that asset sourcing and that pricing, and doing everything well, the reinsurance, etc.

Then, it was just longer duration, as well, and there was quite a lot of business in there that was significantly longer duration in 2019. We talked about that at the half year. That's just a business mix thing. But, generally, margins are up across the business.

Will that repeated? Well, obviously, duration will be what it will be but we certainly we believe we have competitive advantages in sourcing assets and that stands us in good stead to both write the volume and achieve good margins. I'm sure we'll cover that further in other questions.

Nigel Wilson On LGIM, we had £20 billion of net inflows last year. I think that was a very solid year and in stark contrast to lots of our competitors. How are we thinking about the world at the moment? America had net outflows last year, which is very unusual for America and that was for technical reasons rather than market reasons. America has got off to a good start this year, good inflows already. We're increasing the product offering in the United States.

Michelle's strategy is very much about modernising, diversifying and internationalising. Another good example of that is in Europe, where we're increasing our presence across Europe, we're expanding our sales forces across Europe, we're seeing very strong demand for our ETFs across Europe and, in general, we're nudging towards moving into higher priced, higher margin products.

We've been in Asia for a long time, ten years. We've got what I will say is a strong foothold. We haven't made as much progress there as, personally, I would have liked over the last ten years, and moving Kerrigan across to Asia is certainly a signal of our intent in Asia, not just within LGIM but right across the board.

Here, in the UK, DC pension flows are continuing to be very positive. We had a fantastic year in 2020 and we've got off to a great start in 2021, as you heard. This is a very high growth market and we're market leaders in that with £113 billion of AUM. We hope, in the next few years, to increase that to about £300 billion of AUM as the market grows from £400 billion to £1.0 trillion, here, in the UK.

In terms of Solvency II, our industry has had a really good pandemic in many ways. You saw our cash collected at 99.9% and our strategy, which we very much led on, of investing in different types of direct investment assets, we're very pleased that the regulator has been very positive on affordable housing and build-to-rent housing.

There's a general theme that the Treasury, the regulator and ourselves are all aligned, that our industry, and I think that's all in our industry. I think if you ask Phoenix. Aviva and M&G, you'd get a very similar response right now. There's an enormous demand in the UK for the capital that we have and there's a great array of investment opportunities.

Climate change is a huge opportunity for our industry, indeed, for the whole economy. We, in our industry, can play a much bigger role and we intend that Legal & General play the biggest role in that specific development.

So, what has really pleased me is the fact that the regulator, the central government, the local governments and, indeed, the Treasury, are all very supportive of levelling-up, Build Back Better, the ten-point climate plan and the role that our industry can play in helping deliver economic growth in the future. That is all I was going say on a macro level but I don't know if Jeff wants to make one or two other comments.

Jeff Davies Yes. It is just I think there are misconceptions that, somehow, the insurance industry wants to increase risk with this flexibility around matching adjustment, etc, whereas actually it is being able to play in a bigger universe of assets, and Nigel set out all the climate-related ones that are a key focus for us.

By that, what I means is there some which have standard contract features which just make them ineligible and the most obvious being things like pre-payment risk. The big debate was do cash flows have to be completely fixed or can they be highly predictable? And, just moving away from that completely fixed allows some flexibility to make sensible assumptions, add lots of assets together to get diversification, and allows to compete with other funders on a larger pool of assets, and not move down in the risk spectrum and take on more risk associated with it.

Nigel Wilson Thank you. Next question is from Andrew Baker, or questions. We're expecting two or three from everyone, actually.

Andrew Baker Great. Thanks, guys. Good morning. I will stick with tradition and go with three, as well. The first is on LGC. We saw about £60 million negative from COVID in the first half due to the stopping in the housing operations. That was about £40 million negative, then, in the second half. Can you just help explain what the driver of the second half impact was there?

Then, on LGI, the £110 million provisioning in 2021. Are you able to give a little colour around what you are assuming in terms of US excess deaths and any timing between first half and second half if possible?

Then, finally, are you able to provide an update on potential longevity charges in the US RBC framework and any impact you might see on the US PRT market as whole if these two come in? Thank you.

Nigel Wilson I'll answer the first one and Jeff will answer the second and third one. On the first one, of the £100 million, CALA accounted for £84 million. The rest of it, part of that was in affordable housing which was all to do with construction delays in the housing industry and that was more by accident than by design.

I don't think the government really meant for the housing industry to get closed down quite so much. And, as we've seen in the latter half of 2020 and, certainly, in the first two months of 2021, the demand for housing has been very strong and forward orders in the housing business are at an all-time high, at over 50% right now. Jeff.

Jeff Davies Just on the LGI point, £110 million. As you rightly point out, the vast majority of that is in respect of potential claims in the US. We just thought that was prudent given the range of potential outcomes in the US.

They're starting to make better vaccine progress, etc. We work directly off the industry and population projections, so that sort of figure would take you out to, originally it was April, but it actually looks like that figure would take you out, now, to round about June time, which is when they would see this trailing off to an underlying core number of deaths in the base scenarios, the IHME projections around that.

It may well have headroom. Of course, there's prudence in that we're not allowing anything for any potential offset in deaths in the annuity portfolio in UK and US. So, we're comfortable that's prudent but we think it's a sensible thing to do with that level of variation that's possible in the US from here to, say, the summer.

Then, just on the longevity. I understand it's moving forward as an industry body. I believe the biggest holder of longevity risk, PRUFIN, is heading that up in terms of the individuals for the committee. There's a reasonable distance to go around that. We're in the discussions.

In the same way when Solvency II came in, in the UK, companies adapt, they'll deal with it. Whether reinsurance is a solution, whether it's fully retrospective or only on new business going forward, we'll see, but the industry will deal with that as and when it happens. We priced off economic capital ourselves, which obviously includes allowance for all these risks and so we would expect to just simply flow through, see what happens and adapt to the market.

Nigel Wilson Thank you. Next question, Jon Hocking.

Jonathan Hocking Morning, everybody. I've got three as well, please. Firstly, on the capital strain in UK PRT. I think, Jeff, in your presentation you said it was around 4%. Given the margin was very strong last year, should we expect that to get a little bit tougher in 2021, all things being equal?

The second question in LGIM, just on the flows. I appreciate you said it was a tricky year last year and the US looked exceptional but you've settled down into what seems like a lower level of net flows than historically. I think, going back a few years, you used to run pretty sustainably at 4-5% net new money per year. Is that a level that you could expect to get back to or is there a new strategy here of more going for margins over volume? That's the second question.

Then, the final question, just on the budget. With the higher tax rate coming in from 2023, to what extent does that change your capital generation plans in the back end of the strategic plan you put our last year? Thanks.

Nigel Wilson Jeff, do you want to take the first one, I'll take the second and you can do the third?

Jeff Davies Yes, no problem. It was actually better than the 4%. It was certainly sitting between 3% and 4%. It was probably one of the lower strains. The team performed extremely well on that and we're obviously very conscious of capital usage, given the level of uncertainty through last year.

They did benefit, as I said, on the margins from very good asset sourcing, good use of reinsurance. They're a very smart team to whatever the type of liabilities that are coming to us to optimise that metric.

We've historically delivered in and around that level. Whether it's 3.5% or 4.5%, we anticipate being able to maintain that sort of level in and around that 4% level that we've done for many years. It remains to be seen how this year plays out and levels of competition. It's too early to have too many pricing points in that, and there's plenty of pipeline, so we'll see how that plays out.

Nigel Wilson Just amplifying what I said earlier about LGIM net flows, there is certainly, under Michelle's leadership, a slight change in the strategy. There's less emphasis on index and volume and more emphasis on ESG, multi-asset, real assets, high yield, emerging market debt, ETFs.

As a consequence of that, we may see lower absolute net flows but we're hoping for higher organic growth and higher margins from this modification of our strategy over a greater international footprint. We'd like to see more growth in America, Europe and, indeed, in Asia. Jeff.

Jeff Davies Just on the tax rate. Obviously, that's the headline in the tax rate. There's obviously other areas that may well be positive for us. Overall, we'd see a number of the tax incentives are extremely positive for encouraging investment but we wait to see what the details are as they come out later in the month. Those could offset some of the rate impact of that. All things being equal, obviously, the rate on its own would take something off the range of potential capital cash generation down the track but there may well be offsetting in what we'd expect to do.

Given the range we have, the £8.0-9.0 billion and the materiality of the tax change, we're obviously going to stay with those ranges and we'd look to still deliver in line with those ambitions.

Nigel Wilson Thank you. Andrew.

Andrew Crean Good morning, it's Andrew Crean. Three questions. Firstly, Nigel, you said you'd got off to a good and positive start to 2021 and you've give a couple of examples. Could you just elaborate a bit more, perhaps in terms of the PRT volumes?

Secondly, UK Workplace remains, I think, marginally, in loss. Could you just give us a sense as to when that very large business is actually going to ramp up and make a proper profit?

Then, thirdly, coming back to the risk margin, I note that a reform of the risk margin could add five points to your solvency. It would also massively reduce the volatility which has, I think, been the major problem that you've had over the last five years. Does that make you think, at all, about target levels of coverage and whether you could, post risk margin change, actually be running with two higher solvency margins? I know that's a slightly different question than you usually get.

Nigel Wilson Jeff will answer the slightly different question that we usually don't get and I'll answer the somewhat easier first two questions. A good positive start means that, right across the board, every part of the group has a very positive start to 2020.

We've seen strong growth in retail protection in the UK, for example. Group protections have been very, very strong. The annuity business, good flows. As we mentioned earlier, LGIM has had good flows into the business. PRT business team, incredibly busy. There's a lot of quoting on deals going on at the moment.

The absolute volume of deals in the UK may, at the end of the year, end of 2021, depend on whether there are really big deals. We saw the market as £28-30 billion last year. We had the largest market share of that.

We're expecting the market to be similar this year, but it partially depends on whether some of our big clients are going to do the multibillion pound deals in 2021 or will they get broken up and done in bits over the next few years. But, we're feeling very good about the start that we've made and, as I mentioned earlier, the housing market has been on fire in the first two months.

On Workplace, that may be a little of a misunderstanding, I think, and poor communication on our part. Workplace is separated into two parts. One of it is the platform which is the number that is the loss-making, which is an £80-90 million type of business that the DC platform business sits on which has always been owned by LGAS, so in the insurance business, but for a number of years was managed by LGIM.

LGIM absolutely makes profits off the manufacturing part of the business, manufacturing the assets, and so the £113 million, or even more now that we've got today, is actually very profitable for us as a business activity. The platform, itself, isn't.

We've transferred that, in a sense, back into LGAS. It's always sat in LGAS from an ownership point of view. It now comes under Andrew Kail, who joined us, and is part of the pensions strategy that we've got there. So, you'll see some more innovations within LGRR around the workplace savings platform.

Our ambition is very much to make that a profitable part of our business on a go-forward basis. It sits in Cardiff. The team are looking at how do we automate more? How do we make it a bigger and more successful part of the group and, hopefully, in the future, use it part of our international expansion, because there's hardly a country in the world doesn't want to have wider auto enrolment, a bigger DC business and more efficient platforms? Jeff, do you want to take the third question?

Jeff Davies Yes. Just on the risk margin. Yes, you're right, Andrew, that we provide the sensitivity. I think that's on a 66%, two-thirds reduction in risk margin. Obviously, it will very much depend where the final regulation ends up and, when all of that regulation lands, we will reassess one in 20, one in 50, one in 200, what's the sensitivity of our capital and reassess all of our internal tolerances that we work to.

So, that will be a process that we go through. Whether there's a scenario in there where it sufficiently changes a sensitivity to raise credit, etc, that we think we can run with less capital remains to be seen. We push on the outcome at this stage and worry about that at a later stage.

Andrew Crean Thanks.

Nigel Wilson Colm.

Colm Kelly Hi. Thanks a lot, Nigel and Jeff, for taking the questions. Two main questions from me. The first one is just on the annuity portfolio becoming self-financing at £100 billion of assets under management. I suppose that £87 billion at the end of this year and with another year of expected new business, you will be close to that number in terms of assets under management, where it becomes self-managing. Where does that timeline fit relative to the three to five years that you had indicated before? So, maybe, if you can discuss that.

Secondly, just on management changes. Obviously, quite a lot of changes announced today across the divisions, including both CEOs for the annuity businesses and Andrew Kail coming in. Obviously, one was required due to Simon retiring but perhaps the others a bit less expected. So, maybe just the rationale for making so many divisional management changes this year, particularly in the context of it being the continued uncertain trading environment that we're operating in.

Jeff Davies The self-finance, as we said, within the range of £90-110 billion. There's some dependency there on the type of business we're writing, levels of strain, as Jon referred to earlier, but we're getting close to that range now. We'd said it was at that range, which put us two-three years away, potentially, from being there.

So, you're right, it's £80-87 billion with a good year's new business. You get some runoff, of course, of the back book of the order of £3.0-4.0 billion as it gets bigger, so we make progress towards that. That might be an area we'll be looking to disclose. We haven't really decided what would be helpful and what we can show on that but it's clearly something where it would be useful to try and show some progression towards, but it's whether we can produce something meaningful around that. That is something we'll look at.

Nigel Wilson On management changes, we actually have a relatively stable operating environment and reasonably predictable demand for our products, so we're feeling pretty good about that. On the specifics, Simon Gadd has been due to retire for a while and we have known about that for a while.

Chris Knight, it was always part of his career development that he wanted to become the CRO, and the transition has been in progress for several months already. Andrew Kail joined us several months but officially just started last week. Kerrigan was made Chairman of China quite a long time ago and has been working with me and others on our strategy for Asia.

Laura used to run a large part of LGC, so moving her back to LGC, she'll just run the whole of it now and have responsibility for that. Kerrigan is not going to take up his position until later in the year and Laura is not going to move across until later in the year. We're just flagging these externally. We flagged them internally a while ago, that these moves are going to happen.

It's very exciting to have Andrew join us. It's fantastic that Kerrigan has put his hand up and is going to move to Asia because I think it's difficult to do that job, fly in and fly out. It's very exciting for Laura that she's going to move across to LGC. So, we feel as though, overall, we've got great continuity. We've continued to strengthen the capabilities of the company and we've given some new challenges to some of our best and most successful people. Next is Gordon.

Gordon Aitken Thanks. Morning, Nigel. Morning, Jeff. Three questions, please. First on the mortality release of £177 million. Can you split that out between the base table effect and the future projects, as you've done in previous years?

Staying with the mortality, the second question, you've said you've conservatively adopted the CMI '18 tables. Now, CMI '18 was a six-month reduction in life expectancy of which three months was a smoothing factor. If you could maybe just say how many months did you effectively reduce life expectancy by in your release to date and maybe comment on the smoothing factor and what it currently is, and whether it not it changed.

Just, third, back to this point about the post-Brexit Solvency II reform. In terms of changes in the risk margin, I know you've talked about sensitivity of a 66% reduction, but do you share the views that the ABI put forward, their proposal, and if the risk margin was to be reduced would you, then, stick with your previous guidance of actually retaining more longevity risk? Thank you.

Nigel Wilson I think, Jeff, if you do one and two and we'll do a double act, again, on three.

Jeff Davies The £177 million is all trend assumption. There was no material base table changes. We did our normal BAU where we just reassessed everything against experience. Obviously, there's a lot of distortions in 2020 data so it's really the move to CMI '18 is that £177 million, so it's all trend assumption there.

As you say, we say we've been prudent, conservatively adopted that, so therefore we're at lower of your six months. You are talking one or two months of change that would drive that sort of level for a book of our size. We just think that you can see the CMI ’19, that’s fine, we can allow for that. We definitely didn’t want to overshoot what that was telling you, by any means and, at the same time, there is a lot of noise in 2020.

Normally, with a book of our size, we’ll have had an early indication of how experience is playing out and what it looks like a couple of years ahead of the table we’re adopting but, clearly, we didn’t have that this time. There are a whole range of new dynamics going on. We don’t know whether there is going to be underlying COVID deaths, what will happen to flu.

Will there be different attitudes to health? Will people look at the impacts of obesity, etc? When that’s done, will there be more funding of health services? We want to spend a lot more time looking at that, understanding what the impacts have been before we would move forward with any further release around it. So, we’ll keep monitoring it is the answer around that.

Nigel Wilson On the post-Brexit Solvency II, I don’t think any of us are thinking that this is going to a capital windfall for us, as an industry. Knowing Sam and the rest of the team at the regulator, what they give us with one hand, they’ll take with another around that.

I think, on in the risk margin, at what level will we retain greater longevity risk? At 66%, it’s in that pivotal area. We actually asked for even more than that in the submission that we made to the Treasury on this. We do think there really needs to be a fundamental change in that and I think everybody in this industry accepts that. I think that’s the big change.

I think what the industry is looking for and the ABI, and we’re not members of the ABI, but what we’re all looking for is more flexibility on matching adjustment. I think there’s a genuine desire to play a bigger role and get much more asset flexibility. As Jeff rightly pointed out, this isn’t a chance for additional risk for us, it’s actually a chance for greater diversification and more relevance as an industry and that we’re allowed to invest in assets.

We own 25% of Pod Point, which will be the UK’s largest electric vehicle charging. That type of asset, at some point will be, we think, appropriate to put into pension funds, anything that’s got a future stable cash flow. We own onshore wind. It’s an asset class that we’ve been interested in and invested in for a long period of time. We’d like to see structures emerge and an opportunity to invest and put that in the annuity portfolio, as well.

Solar is another that we want to put in there. Carbon capture is yet another one that we want to include. As we mentioned earlier, various types of housing, build-to-rent housing, affordable housing, are all things that we want to do. Ironically, we’ve already got housing for homeless people, which is very much part of our S included in the annuity business.

Our regulator has definitely accepted this. We’ve moved on a long way in the last ten years. We used to have to trot across on a deal-by-deal basis and get a null objection on transaction-by-transaction basis. I think the Bank of England, Andrew, and Sam and his team at the PRA, are all realising that we can play an important role in future policy as an industry and they shouldn’t just be looking at the banks to help out.

It’s very much our ability to have patient capital and lot of different forms of capital and the sheer size that we are. We have £1.3 trillion of assets under management and that’s going to get bigger. As Colm has highlighted, we’re very close to getting £100 billion in annuities. You start investing £10-20 billion of that in different types of assets and in new assets, £20 billion is 1% growth for the UK economy. As an industry, we can easily achieve that. Next question, Oliver.

Oliver Steel Good morning. Three questions from me. First is the impact of higher interest rates. You've talked about the impact on the solvency and, to be fair, you've also talked quite a lot about flows today, but I wonder if you can just give us a broader sense of, for instance, the impact on AUM, whether there's a change of mix because of higher interest rates, in terms of LGIM flows. Any benefits coming through on the PRT or individual annuity front, LGC and capital generation, more widely?

Second question, maybe my forecast was just a bit out, but the expenses with LGIM were actually a bit less than I'd expected. Is that something you recognise and can you just remind us of the expense progression that you expect in LGIM? Then, the third question is on Kerrigan moving to Asia. Can you just take us through what the loose target might be for that business?

Nigel Wilson Those are interesting questions, Oliver. I think, on interest rates, we've highlighted the major changes in interest rates. I think everything else is second order. Theoretically, we should see PRT volumes increasing but there's never been much of a correlation between volumes and interest rates in the past. In terms of LGIM flows, as you went through that list, I went through the list earlier, there's minor second order impacts on all of those flows but everything is second order.

On expenses at LGIM, yes, we did see some progress in 2020 and we are very aware that LGIM's expenses have gone up 10% per annum for quite a long period of time and that's higher than we would like, and that that team are working incredibly hard to make the business more efficient.

On Kerrigan to Asia, we've been looking at opportunities over a number of years. We shied away from the insurance opportunity that a lot of other people had. We have various relationships out there that we've had for a number of years that we'd like to scale up now, particularly on the LGR side, on some asset sides for LGR, on the LGIM side, where we've been leading with some index funds and some fixed income funds into China and the rest of Asia. We want to particularly increase our share of ESG funds in China, Japan and the rest of Asia.

We recognise that there's huge changes going on in the pension industry and the wealth industry in China and on the pension industry, in particular, we think we have a big role to play. We're pretty sure that they'll eventually move to an auto-enrolled pension system out there. DC is going to play an important role and the richness of our asset base, our experience here, is we, again, think market-leading.

People are really interested in what we have to say about ES&G because we've invested directly in all of those asset class. So, a lot of our peers in China and the rest of Asia are very interested in what we've invested in. Modular housing is something that doesn't trip off the tongue for an insurance company or an investment company in China, but there's a huge amount of interest in particularly that part of our business.

As you may have seen today, we announced in Bristol that we are building modular houses which are affordable, EPC A-rated. They're being manufactured in the North, just outside of Leeds. So, in terms of levelling-up, Build Back

Better, having a social conscience, modernisation, building affordable, creating assets potentially for LGR, this sort of investment ticks all the boxes and you'll be seeing more of that from us on a go-forward basis. Steve.

Steven Haywood Good morning. Thanks very much. Three questions from me, as well. Just following on from your last comment about Asia. Have you considered or are you considering inorganic growth there, as well, via potential bolt-on M&As or joint ventures with partners?

Secondly, you talk about, in your results, the £228 million COVID impact in 2020. Now, it would be interesting to see how much of that you think will reverse in 2021. Obviously, the £110 million provision should not come through again in 2021, assuming your assumptions and the vaccine rollout is going in line with that. So, it would be interesting to see what other aspects of this £228 million could potentially reverse in the 2021 results.

Then, finally from me, on third-party capital in LGC. Now, it's very interesting because it's obviously quite opaque for us to see what third-party capital is coming in here. Can you give us an idea of the pipeline of third-party capital? Can you talk about any particular names or types of institutions that are looking to invest with you, as well. Thank you.

Nigel Wilson The first one. Jeff, do you want to take the second and I'll do the third? It's very unlikely that we'll do acquisitions in Asia. It is very likely we'll do joint ventures in Asia. I think we've had discussions with a number of people over the years on joint ventures. We've got a couple of people now we're working with who we think are much more likely joint venture candidates for us, but you won't be seeing a multibillion pound acquisition for us Asia in 2021 or in 2022.

Jeff Davies Notably, in the form of partnerships, as well, not traditional legal JVs. There's many ways that you can work with people in partnership to grow in the region. Just on the second one, yes, you're right. We would look at those. We've, hopefully, provided for the claims we'd expect to see from COVID in '21. There is obviously a huge range of uncertainty around that and how it could play out.

CALA is having a fantastic time at the moment, with strong tailwinds coming into the business, so we would expect that to experience a very strong '21, again, all things being equal, lots of uncertainty around that. And, we wouldn't expect to see the group cost element being repeated either. So, we're positive to see turnaround in those and we should expect to see a nice increase around that.

Obviously, other businesses need to perform, as well. Some of them had exceptionally strong results in 2020 in that environment with good, strong new business margins. So, everyone needs to continue performing but we're going into the year confident with a level of uncertainty that you all know about.

Nigel Wilson On third-party equity or capital coming into the businesses, if you look at slide 13 and 14 in the pack that we sent out, Pemberton, clearly, we set up a number of years ago. We've put the actual data on slide 14 showing the AUM growing from £0.5 billion to almost £10 billion in five years. We'd expect that trend to continue. We see absolutely further support and for the funds coming in from third parties, they have over 100 LPs already in Pemberton.

Later Living is another area that we think we'll see third equity flowing into that. Build-to-rent, we've already got third-party equity in terms of a partnership with PGGM. LGIM has already set up a fund which has a number of insurance companies and pension funds who are co-investors in that. NTR has already started on the third-party capital coming into the business. Pod Point is another one where we think will accelerate its growth through third-party financing coming in there.

I don't think for the next few years much will come into Oxford. We'll be very much doing that on our own. Bruntwood SciTech, we're still establishing the business. We've got a number of exciting opportunities and Jeff and I are doing a road trip together very shortly to look at one of those opportunities.

The data centre business, we'll probably bring third parties into those. And, fund of funds and ADVs, we'll certainly bring third-party funding into those. The exact amount of that we'll tell you as we make various release. Some of those will happen as early as the first half of 2021. Thank you. Next question.

Ashik Musaddi Good morning, Jeff. Just a couple of questions I have, maybe three. First of all, how do we think about debt leverage? Now, if I look at your peers like M&G, Phoenix, Aviva, everyone is targeting debt leverage as a percentage of Solvency II own funds of about 30%, whereas you are at about 34%.

If I look at the maturity profile of your debt, I think there is only one bond of £300 million coming to maturity this year, and for the next four of five years there is nothing. So, how do we think about that, given that your peers are targeting less than 30% and you're at 34%? Would you use the capital, because of rising interest rates, to reduce leverage on an actual-rated basis or are you absolutely fine with this?

The second thing is, if I think about illiquid assets, that is now about £30 billion direct investments in total out of £120 billion of total assets you have. How would you classify your risk appetite? It's about 24-25% at the moment. Peers are saying they can go up to as much as 40%. Would you say, more or less, that's what your plan is, as well?

Thirdly, in terms of assumption changes, if I look at the assumption changes year after year after year, for the last three, four, five years, maybe, it's about 20% of your group earnings. How do you think about that going forward? Would it be a consistent feature of your IFRS operating profit or would you say that because longevity releases could now reduce, as we have seen this year, in 2020, this would be a much less prominent featuring going forward? Thank you.

Nigel Wilson Those questions are all for Jeff, actually.

Jeff Davies The debt leverage, we've talked about before. We focus on the rating agency leverage ratios. Moody's Adjusted has usually been the number that's been relevant for us. We've said we've at the top end of where we'd expect to be at the current time but, as you say, there is a debt coming in July. We'll look at that and what we want to do with that. Obviously, any redemption of that would reduce the leverage.

We have a strong conviction that we will grow our balance sheet so, in many ways, as our business grows those leverage ratios will naturally fall for us and that's what has happened consistently for us over of the last four, five, six years. Whenever we go raise the debt, we grow the balance sheet. Book value, again, grew 5% this year. The balance sheet continues to grow and so our leverage ratio is reducing that way. We drive the growth, that's how we invest, and we continue to do that.

On the illiquids, yes, you pointed out it's less than 30% at the moment, so plenty of headroom in that. We've talked about a 40-50% range and the important point within that is we don't consider all of these assets illiquid by any means. So, yes, there is a ballpark figure. Is it 40%? Is it 50%?

But, we do a lot more analysis underlying that to work out what do we think is truly illiquid versus what we think is liquid, and it's the liquidity of the total asset portfolio that we look at in determining where we would set that range, but we have plenty of headroom in being able to achieve that to get those sorts of levels.

Just on the assumption changes, actually the longevity release was up this year to last. It was £177 million versus £155 million. We obviously focus on the numbers excluding longevity releases for that very reason because it distorts some of the figures. It's within there. Obviously, it helps but it's not the way we run the business, what we've shown in our ambitions.

We have regular reviews. We have BAU reviews or mortality across all of our business, of persistency. We run through those. There are always areas of modelling that need updating, whether it's discussions with auditors, whether it's just prudence that's built up and, as a line of business grows or an assumption grows, it becomes more material and the more ad hoc version you put in at the start needs to be made more accurate and invariably we've been conservative in those. So, we just carry on with that process and that leads to changes along the way of BAU.

Nigel Wilson The £300 million is at a 10% coupon, so we save £30 million of interest, as well, so boost earnings on an annual basis, on a go-forward basis if we actually do pay it back in July. Next question is from Ming Zhu.

Ming Zhu Hi. Good morning. Just two questions from me, please. First is your US pension risk transfer, the growth has been excellent. Could you just give a little bit more colour in terms of the competition and the sort of competitive edge you have there? What have you done or what more actions are there to do in terms of going forward to capture the opportunities in that market?

My second question is your credit default reserves, the £3.5 billion still unutilised and given what happened last year and there's no default, the assumption you've got behind to calculate that credit default reserve is that too conservative? Just two questions, please. Thank you.

Nigel Wilson Jeff will answer the second question but I do agree it's too conservative, but I'm not going to win that argument, necessarily. On the US PRT, yes, we had a fantastic year, last year. We've taken a very measured approach to the United States, recognising that some of the UK firms have not succeeded in America, and so we're determined to be very successful.

Just as an illustration of our success, in the good old days, when we were busy building up the team there, we had very few people who really wanted to come and work for us. We had to work incredibly hard to get people to join us. We advertised for a job a couple of weeks ago, we had 300 applicants, 300 highly competent applicants because people love the fact that we're supporters of inclusive capitalism, of ESG, and so our brand is resonating incredibly well with customers in the United States.

I'd say there are more competitors in the United States, so the competitive intensity is greater in the United States. We're constantly adding to our DI capabilities in America. They're not as good as we want them to be. In two or three years' time, we'll have a much stronger DI offering in the United States, a DI capability in the United States, and that's part of the strengthening that we've been doing with the team in the last few years.

So, we're very well-known now. We get access to most of the deals. We're competitive on deals. There isn't anybody we think has a tremendous competitive advantage over us. It's not quite like the UK where we absolutely have competitive advantages over everyone, we think, in the UK, and that's one of the reasons we've had tremendous long-term success. But we're working very hard to fill the minor gaps that exist between our competitive position and say, PRUFIN in the United States and, certainly, the brand resonates incredibly well. Jeff, do you want to take the second question?

Jeff Davies Yes. There isn't a lot to say. We haven't fundamentally changed our methodology for years on that. We take a pretty fixed amount which is of the order of a 40 bps or so amount that we put in there. There, then, is an additional loading on top of that. We benchmark it around the industry and we think it is conservative.

And, as you say, the fact that we didn't use it and we haven't used it, there's still uncertainty in how the economy plays out. There are elements of it that we, then, are trying to run off over time. But, of course, as the portfolio grows and actually with interest rates falling as well, the total amount in the reserve goes up as you've seen.

There's a small element around the edges that we're trying to run off. That is slowed by the business growing. We think it's conservative. It's useful to have there. Investors like having it and we've talked about we would use it in the event of defaults, etc. I don't think there's a lot more we can say on that one.

Nigel Wilson I'd just like to say thank you to our team again. Year after year after year, we've had zero defaults and the cash collection on the investments has been truly outstanding and industry-leading. We've got a great team who work together in a very collaborative way and I'd just like to take this opportunity to thank you for them all. We've got two more questions to come. The first is from Larissa and the second from Dom.

Larissa Van Deventer Thank you and good morning. Two questions. The first one, you had a strong year on bulk annuities in the US. Can you give us a sense of how margins in the US compare versus those in the UK and how you see those evolving in time? The second question, also on bulk annuities, your new business strain has been low at 3% to 4% for some time, as you mentioned earlier. How sensitive is that to inflation and what happens if inflation reverts back to the two-odd percent or higher that we have seen historically?

Jeff Davies The key determinant for us in pricing the business in the US is a return on economic capital. We think that reflects all the risks. We target the same sort of returns as we do on the Solvency II capital in the UK. Clearly, we think there's upside in both, obviously, economies of scale and how much we can spread expenses in that business as it grows and, as Nigel talked about, in the DI capability and asset sourcing, which is nowhere here obviously as efficient as it is in the UK.

Both those would give us upside in those margins, but they are broadly comparable in a capital allocation return on capital sense, but not all metrics are equal for other reasons. So, we're comfortable with that. We're pleased to grow it. It's a competitive market at times. And, then we don't allocate capital, we then allocate it to UK deals. Similarly, we were a player in the Canadian market. So we can look at these and decide where we put capital to make sure that we're getting the right returns on our capital as we put it to work.

On new business strain, yes, that continues to be efficient. It isn't entirely sensitive. We don't take inflation risk explicitly on any of those as it does, obviously, do something to the duration. You have the inflation element, so you get typically longer business in UK versus US, but we're not active takers of the inflation risk on that. As Nigel would say, we don't think it's a rewarded risk. We look to hedge and offset, in a similar way, to interest rates. And, so it doesn't have a big impact on it. It's much more driven by the strain at the moment around what we do with reinsurance, for example.

Larissa Van Deventer Thank you very much.

Nigel Wilson Dom.

Dominic O'Mahony Hello. Hi, folks. Hope you can hear me. Three questions from me, if that's all right. Just coming back to Asia. Nigel, it was interesting to hear your comments earlier about having in the past shied away from insurance risk there. Clearly, LGIM has a real opportunity there. You mentioned the asset side of the LGR book. Would you consider other more risk-based growth in Asia? It may sound like a bit of a wildcard but the Japanese defined benefit pension sector, you might think that's ripe for an emerging PRT market. Is that something you could be interested in?

Second one, on the maths really. LGR, the release from operations, just as a percentage of the opening balances, on my maths, that's declined from being in sort of the mid-90s in terms of basis points on the opening balance, where it's been for a few years, to something in the mid-80s. Is that essentially some sort of COVID effect in 2020? Would you expect it to get back to something like the mid-90s going forwards?

Then, thirdly, just on UK PRT, I understand that there have been some emerging structures that some of your competitors are using that involve sort of full pass-through of risk, including asset risk, through to insurers in North America. Is this a new structure in creating more competition in the UK market? Is there any sign that actually things are intensifying? Thank you.

Nigel Wilson I'll take the first one and Jeff can take the second and third questions. On Asia, the answer to that is, yes, we do like to take informed and rewarded risks. That's a big thematic about what we are as a firm. And, we felt entering some of the Asian markets before, we were taking unrewarded risks, if you like with counterparties who maybe didn't always have the capabilities that we'd want to work with.

We definitely have much more capability now than when we first looked 8 or 10 years ago at the Asian opportunities, both in the product offerings and the strengths of our specific businesses and, really, our digital capabilities.

I think we haven't talked about it very much on this call but if you were to ask Jeff and I what really excites us about what we've achieved during the pandemic, our digital capabilities have soared and, as a consequence of that, we think we have more opportunities for international expansion, including in Asia. Jeff, do you want to take the other two questions?

Jeff Davies Yes, sure. I don't think there's anything in particular going on within that release of operations as an element, as a quirk. There is clearly an element that's COVID. I think you're looking at the total annuity profitability within that would be slightly reduced volumes from LTM, then less profitability coming through which drags it down a fraction, which is obviously COVID-related and, also, some of the costs of setting up the advice business around the LTM. They're small figures, which really is why you get that little dip. So, we're not seeing anything dramatic. We're not expecting changes within that away from the norm, I would say.

The asset reinsurance, it's something we've talked about a lot. We've done trial versions of that, if you like. We've not done it at enormous scale, but we clearly have many counterparties that would be interested in doing it with us. It's a way that we would fund larger volumes in a year if we thought that made sense.\

There is capital that is keen to be put to work in the UK PRT market. We're as well-placed as anyone to source the front end of that and to access some of that capital. We continue to talk to exactly the same parties. We have some ready to go on the blocks, as and when they're needed and, equally, we do some proof of concepts to make sure that we can do everything that's required, from reporting to the legal documentation, etc.

So, I think it's helpful for the market. We all know there's still a huge, huge potential market in the UK and a relatively limited capital pool that can write that business. And so we're always looking at efficient ways and ways to access that and I think that's helpful.

Nigel Wilson Again, I'd just like to say a big thank you for all of you who are on the call. There are over 200 people on this call, so that shows a very high level of interest, and they're all weren't relatives of Jeff and myself.

We're very happy with 2020, as I said at the beginning, operating profit flat, dividend flat and the balance sheet stronger. Jeff made an important point about rewarded and informed risk, which is what we're about. Yet again, we had no defaults. We had 99.9% of our cash flow from DI was paid.

As you just heard Jeff say, we had £110 million of COVID costs that we took in 2020, which relate to 2021, that are hopefully not repeatable, and Jeff keeps telling me those are prudent, and CALA was £84 million. Together, those two account for £200 million of it and I think that loss will be reversed in 2021. And, whilst we didn't mention it here, the LGI investment variance, if rates stay where they are right now, that will be better than reversed in 2021.

Public policy is moving our way. Our capabilities have increased. We've strengthened our management team. We've got a very focused strategy which has delivered continuously for us over the last ten years, and we look forward to the future with confidence and, certainly, we've got off to a very good start in 2021.

I hope very much that we'll see all of you in person at some point. We'll welcome you all to our office, here in Coleman Street. If not, I'm sure, there's one or two local drinking establishments that would more than welcome us at some point in 2021, given the poor customers that they had in 2021. And, we're hoping that we and many of us can support the City as the City returns to business and tries to re-establish its position or continue to establish its position as a world-leading centre. So, thank you. Have a great 2021.