Merrill Lynch Conference
1st October 2009
"Competing in the New Normal"

Good morning everyone. I'd like to spend the next twenty minutes or so giving you our perspective on Legal & General's strategy and prospects.

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First the usual forward looking statements disclaimer which I am sure you are all familiar with.

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For those of you who don't know us, Legal & General is a UK based risk, savings and investment management group. We manage assets of over £300bn; have over 6.5million UK customers with around 9% market share of total UK life and pension new business. We also have a range of businesses in both developed and emerging international markets.

We have built a portfolio of businesses, most of which are strong players in their own specific market. Collectively, they make up an inter-dependent group with multiple layers of synergy. We differ I believe from most large UK Life companies in that we have an important investment management arm with substantial external funds under management, a greater focus on traditional life assurance risks rather than saving, and a strong tied distribution network, including partnerships with several of the UK's largest retail banks. We also generate a lot of cash.

And our business outlook is exciting. We are well placed to benefit from recovery in the UK and global economy. We have a clear strategy delivering strong cash generation and profit growth, through simple, low cost products, an efficient manufacturing capability, and proven distribution strength.

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As a company we manage high scale operations in large markets. We build strong client and distribution franchises. In Savings we are investment management led manufacturer and assembler of modern, flexible and capital light products. In Risk we insure risks we are able to understand and target an appropriate return on the capital we deploy. In Investment management we deliver low cost, high quality service in scalable, lower risk core funds. Internationally, we are building a portfolio of businesses aimed at generating enhanced growth prospects For the Group.

We have a strong set of businesses, many of which are leaders in their markets. And the Group benefits from multiple levels of synergies. In all businesses we target cash generation, efficiency in capital utilisation and delivering high risk adjusted returns. Our cash generation profile in 2009 underpins the prospect of substantial growth in the dividend.

And all of our businesses have a very clear sense of the value they add to people's lives and the purpose they serve. We take pride in those businesses that successfully and responsibly align the interests of shareholders and customers whilst meeting a wider social and economic need. We're also very clear on our wider role as a responsible steward of other people's capital through our extensive corporate governance activity in LGIM.

The execution of our strategy is on schedule but there is more to do. We are improving our approach to capital allocation to drive even greater accountability and focus on return on capital. We are committed to greater clarity and quality of reporting to shareholders, and we are optimistic in finding solutions, be it political, technical or structural to the challenges on Solvency II.

Our business has proved resilient to the economic downturn and is very well placed to benefit from economic recovery. I'd like to go on to talk in a little more detail about the components of the Group.

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Over the years we have built organically a high scale, high quality investment management franchise with an unparalleled reputation for service amongst its large client base. It is by some distance the largest fund manager to UK pension funds with over £180bn of pension funds under management. We look after money for 3,000 pension funds in all including 52 FTSE 100 companies. And you can travel from the South of England to the Shetland Islands without leaving some of the 41 local authorities from whom LGIM has an investment management mandate. And LGIM is still growing, at the end of August it had over £300bn of funds under management with over 70% of these funds managed for external clients. LGIM has delivered an impressive 16% compound growth in funds under management over the last 16 years – from £31bn in 1994 to £300bn today.

This stellar growth in funds in LGIM is evidence that our strategy is working. We are complementing our index tracking proposition with other core investment products aimed at our leading UK corporate pension fund franchise. Particularly encouraging is the progress being made by our core fixed income and LDI area where we have now established a strong presence. And, as LGIM's pension fund clients continue to de-risk their liabilities they are natural clients for the buy-out solutions offered elsewhere in the Group – over 50% of BPA schemes we sold in the first half were to LGIM clients. We are also seeing strong interest from non UK clients, particularly in our index funds.

LGIM is already highly profitable. It has a cost income ratio of around 50%, well below other fund managers who don't benefit from the massive scale economise LGIM enjoys. As market values rise, fee revenue will increase. Therefore LGIM is a business well placed to profit from economic and market recovery and I expect continued strong new business flows for the rest of the year and into 2010.

Finally, for those of you who still look at EEV, it is worth noting that LGIM is held on the Group's balance sheet at its net asset value of £370m only - and therefore its full value is not recognised in a simple EEV per share calculation.

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Our risk businesses comprise individual and group protection, annuities and general insurance.

Over recent years we have created the leading protection franchise in the UK. We have in excess of 15% new business market share in new individual protection and over 20% in group protection. Gross premiums have grown strongly over the last five years – a compound growth rate of 14%, as can be seen on the slide. Our scale and ability to process high volumes of business is allowing us to drive down unit costs and makes us the partner of choice for major distributors. In the medium term we believe that £1bn of premiums per annum will be the minimum scale required to be competitive in the protection market. We already have scale comfortably in excess of that level.

The maturity of the protection business also means that it is generating cash – over £90m in the first six months of the year. Excellence in underwriting and technology has improved returns whilst also enhancing customer and distributor experience.

In the first half of 2009, the mortgage market remained weak with transactions over 50% lower than in the first half of 2008. This had a material impact on individual life protection sales, a large proportion of which are mortgage related. Our own sales were down 18% compared with the first half of 2008. Despite this, our flexible model allowed us actually to improve EEV margins to 7%, a figure we believe to be amongst the highest in the sector. There are now positive signs of recovery in the housing market and this has improved the outlook for individual protection.

Underlying Group Protection premiums were up 6% in the first half despite market volumes coming under pressure from the impact of a weak economy on our corporate clients. We lead the market in Group life assurance and are continuing to invest in developing our Group Protection operating platform generally. We see it as an increasingly important component of our overall protection business going forward. Profits and cash flow remain strong, driven a combined operating ratio averaging in the low 90%s over the last five years.

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In annuities we have a large book of diversified annuity liabilities built up over many years and comprising a good mix of individual and bulk pension buy out business. These annuities are backed by a diversified portfolio of corporate bonds, almost all of which are investment grade. Gross interest margins remain attractive, as can be seen on this slide, compared with other hold-to-maturity borrowing and lending businesses and, unlike them, we are not exposed to liquidity risks.

In the first half there was, I believe, some misplaced concern about default risks in credit portfolios backing UK annuity books. We are conservatively invested and very conservatively reserved. At the end of June we held a present value of £15.7bn of non profit annuity liabilities on a best estimate basis backed by £18.9bn of investments backing reserves for this business on the balance sheet – over 120% coverage of best estimate liabilities. This is an important point. Unlike insurers in the rest of Europe which only recognise impairments as they arise, UK annuity writers are required to hold reserves against the possibility of adverse experience, predominantly the risk of future credit defaults but also reinvestment risk etc. Actual credit losses in 2009 to date have been negligible.

The outlook for annuities is very strong. Growing volumes of maturing DC pensions will fuel growth in individual annuities. Recovering markets will make it easier for trustees to make the transition to buyout. We remain selective in the sort of annuity business we write. Despite this selective approach, potential demand is still materially outstripping our risk appetite for this business. To exploit fully the enormous growth opportunity in this market I feel it will be necessary for us to attract financial partners who will provide risk capital to sit alongside our acknowledged expertise in pricing and administration. In order to do so, the capital uncertainties associated with the introduction of the Solvency 2 regime will need to be overcome.

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In March this year we announced an acceleration of our savings strategy. This has been to move out of traditional markets favoured by some established competitors which are characterised by high capital intensity, pitiful returns and geologically long cash pay back periods.  For instance we effectively exited the commission paying group pensions market several years ago.  We favour a modern, transparent, capital light savings model.  Execution of our plan is progressing extremely well.  At our half year results we announced that new business strain in non profit savings had been reduced from £161m for the whole of 2008 to only £44m in the first half of 2009.  New business strain as a percentage of premiums has fallen to less than 2.5% from more than 3.5% in 2007 and overall savings EV margins are up to 0.3% despite the effects of lower volumes of insurance wrapped savings products and a higher risk discount rate.

This turnaround has been achieved through aggressive action on product mix, commission and costs. Of the three, mix has been the main driver of the improving financials.  As you can see from the slide, total sales of savings products in the first half of each of the last three years have been similar. But the mix has been transformed. Sales of old fashioned high strain non profit pension and bond products (shown in the red shades on the slide) have declined substantially as a percentage of total sales and been replaced by Sipps, unit trusts and new style with profit products. We expect this trend to continue and for the impact of the actions we have taken on costs and commission, which take longer to feed through, to contribute to better economics for this business going forward.

And the prospects for savings are good.  Economic recovery, coupled with further rollback of state support, will stimulate private saving.  We are experiencing strong demand for our revamped range of pension and unit trust products, and, in the workplace, our market leading group SIPP proposition continues to attract a lot of interest from employers.

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To remind you, our international portfolio comprises our businesses in the US, France and Netherlands alongside our stakes in the emerging markets of Egypt, India and the Gulf States.  IFRS profit performance for our international businesses in the first half of 2009 was 35% better than in the equivalent period the previous year.

Our international portfolio is an area of focus for us.  We are sharpening our strategy to focus on improving returns and accelerating growth.

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So, we have a strong set of businesses, many of which are leaders in their markets. Our biggest market shares are in the segments we consider to be most attractive – for example asset management, protection, and annuities. We already have the scale we need in the markets we favour. And the Group enjoys multiple levels of synergies

I've tried to illustrate this synergy on this slide.  First, many of our businesses benefit from new business opportunities which would not be available to them in the absence of the other businesses in the Group.  For example, LGIM regularly introduced clients to the BPA business.  Individual annuities are sold to over 80% of maturing Legal & General pension customers.  Group Protection and Defined Contribution Group Pensions clients are regularly introduced from other parts of the Group. Bank assurance ties require multiple product capability.  We estimate the value of this new business synergy to be around 30% of Group new business APE and 40% of new business value added in H1 2009.

Second we benefit from significant financial synergy within the group. This includes capital diversification and cost benefit as well as the tax benefits arising from being in both the life protection and savings markets. We estimate the value of financial synergies is well into three figure millions of pounds per annum.

Finally there is the less tangible synergy. All of our businesses operate under a single brand, with shared values and shared infrastructure. Whilst all of this is hard to quantify it is, nonetheless, an important source of added value achieved through our broad mix of businesses operating under the same umbrella, if you will forgive the pun.

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Nigel Wilson, our new CFO, has joined us from outside the sector with a mandate to improve the clarity and quality of reporting to shareholders. Nigel is here today, and will join me to answer any questions. We've already started on that journey with our adoption of and focus on cash generation as a key performance metric and a key target for management. Operational cash generation, defined as in force release less new business strain for the life businesses and post tax IFRS profit for the non life businesses, in 2008 was £320m. We set out a target to deliver at least £450m of operational cash in 2009.

At the half year, cash generation was £301m, well on track to achieve our target of £450m and exceed our impressive historic growth of 36% per annum. This transformation in cash generation has been achieved through a number of management actions.

We are prudent on costs. In 2008, we reduced headcount by 10% and committed to a further 10% in 2009. At the end of June we had removed a further 7% of headcount, well on track to exceed our 10% target.

We target high quality new business. A combination of actions including reducing commission terms, altering product mix, repricing and introducing new product charges enabled us to reduce new business strain to just £31m in the first half of 2009, down from £334m in the whole of 2008.

Our cash generation profile in 2009 means the dividend is easily covered by cash and gives prospects for substantial dividend growth.

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As well as making progress on cash flow, we have a robust balance sheet. IGD surplus at the end of June was £1.9bn representing 192% capital coverage, up from 169% at the end of 2008. At the end of August, we estimate IGD surplus had further improved to £2.4bn. We are improving internal capital allocation methodologies which will further focus management on delivering returns on capital employed.

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So in summary, if the new normal includes recognition that capital will be scarcer and more expensive in the future than it was in the past, then Legal & General is already competing in the new normal. We've built a portfolio of businesses, most of which possess the characteristics we like; high scale, strong customer and distribution franchises, a robust cash generation profile, capital efficiency and contribution to the synergy model of the Group. We are building a culture of ambition alongside prudent risk management and a low cost attitude. We have taken and will continue to take the tough decisions on management, portfolio composition, and capital. We go into 2010 with significant and accelerating momentum.

We see strong prospects for economic recovery continuing in the UK and we are well placed to benefit.

We're committed to a programme of improved investor clarity and communication to help understanding of the business and unlock latent value.

Thank you for listening. Are there any questions?