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June 2012

Navigating macro hazards and moral hazards.

EVERY DAY MATTERS

Legal & General

Forward looking statements.

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Summary.

1. **Our market leading franchises in Risk, Savings and Investment Management businesses to date have been resilient, even as UK real GDP growth is close to zero and housing market problems persist.**
2. **Our business model execution is improving the certainty of cash flow and therefore increasing the certainty of dividends despite the Euro crisis.**
3. **Attractive features of our business going forward are:**
    i. Decline in state spending will increase the UK "pensions gap"
    ii. Pension derisking across the corporate world will allow us to pool risk and use our economics of scale
    iii. Decline of bank lending is creating new business opportunities
    iv. Creation of "homogenous" global asset markets is allowing LGIM to expand rapidly within Corporates and Sovereign wealth funds
    v. Regulatory change including RDR, Auto enrolment is providing future growth opportunities
4. **We face an increasing number of regulatory, political and economic risks.**

Both eastern and western Europe have tried to replicate success of USA.

“United States of Europe, must be a political reality or it cannot be an economic one” Arthur Salter (1931).

1. **1917 – 1989: USSR/Communist bloc – failed due to “obvious” political and economic factors.**
2. **1950 – 2012: European Union and European Monetary Union (1992). Fixed FX rates, mispriced credit growth, huge differences in labour competitiveness, capital mispriced.**

“Facts that challenge such basic assumptions and thereby threaten people’s livelihoods and self esteem are simply not absorbed. The mind does not recognise them” Daniel Kahneman (2011). (Cognitive Illusion)

Background: Macro hazards and moral hazards.

1. **In 1989 Berlin Wall came down – massive restructuring of Eastern European bloc required to resolve political and economic problems.**

2. **In 2000 we had the "Equity Technology Bubble" bursting, which left a "flat world" and an excellent digital infrastructure; "Creative destruction;" new businesses e.g Apple, Google, Facebook with massive cash and capital surpluses.**

3. **In 2007/08 the "Global Property Debt Bubble" burst which coupled with bank leverage, fiscal deficits, FX rigidity, embedded derivatives and trade imbalances has created three major problems. Creative Destruction?**

Despite above global nominal GDP growth could be 5 – 6% in 2012 and 2013.

Huge global structural imbalances caused by three financial problems.

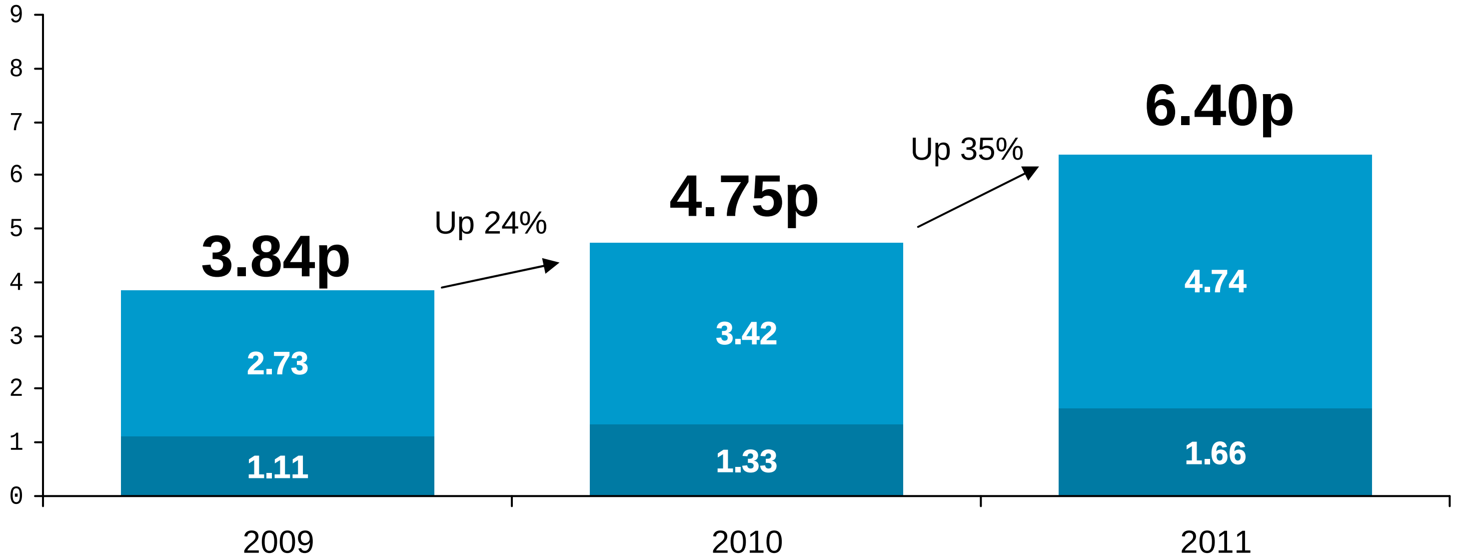
PROBLEM	SITUATION
FISCAL	Size and rate of change of Government expenditure. UK deficit in 2011/12 £125bn (8% of GDP) in addition to unknown off balance sheet liabilities. Austerity not working.
BANKS	Inadequate margins for Risk “trying to pick up pennies in front of express trains”, cross border lending mispriced due in part to embedded derivatives. Banks recapitalisation challenging.
LABOUR COMPETITIVENESS	FX rates wrong, relative labour market rates wrong, massive trade inbalances e.g. Spain/Germany: US/China

Solutions require resolving all three problems

Involving cash rich corporate sector (the supply side)

2011 Full year dividend up 35%:

Sustainable, diversified and growing cashflow coupled with unwind of dividend cover should result in superior dividend growth.



Op cash (£m)	**726**	**840**	**940**
Net cash (£m)	**699**	**760**	**846**
Dividends (£m)	**225**	**279**	**376**

L&G: Strategic clarity. Relatively simple businesses and simple balance sheet. No complex products. No burning platforms

Transparent Business Model

Linkage between 2011 operational cash, profits, earnings and dividends.

All in £m	Operational cash generation	New business strain	Net cash generation	Experience variances	Changes in valuation assumptions	Non-cash items	Investment gains and losses, international and other	IFRS profit/ (loss) after tax	Tax expense/ (credit)	IFRS profit/ (loss) before tax
Risk	482	(31)	451	22	24	(86)	-	411	150	561
Savings	174	(63)	111	(12)	(5)	6	(6)	94	34	128
Investment mgt	189	-	189	-	-	-	-	189	45	234
International	51	-	51	-	-	-	39	90	47	137
GC&F	44	-	44	-	-	-	-	44	8	52
Investment projects	-	-	-	-	-	-	(41)	(41)	(15)	(56)
Operating profit	**940**	**(94)**	**846**	**10**	**19**	**(80)**	**(8)**	**787**	**269**	**1,056**
Variances*	-	-	-	-	-	-	(55)	(55)	(42)	(97)
Other	-	-	-	-	-	-	(9)	(9)	6	(3)
Total	**940**	**(94)**	**846**	**10**	**19**	**(80)**	**(72)**	**723**	**233**	**956**
Per share	**16.13**		**14.52**					**12.46**		
Dividend per share	**6.40**		**6.40**					**6.40**		

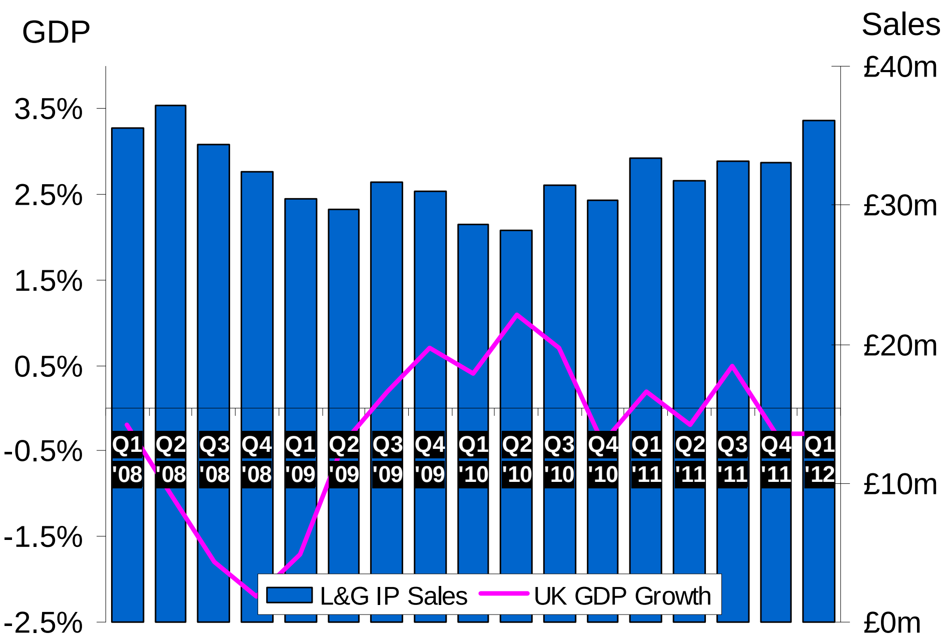
*Note: Investment Variance; £(2)m Asset related, £(95)m Other (mark to market interest rate swaps)

Dividends from subsidiaries increased 47% to £701m.

Dividends supporting cash generation	**2011**			2010		
	Net cash £m	**Dividend £m**	**Dividend % of cash**	Net cash £m	Dividend £m	Dividend % of cash
Risk	451	500	89	429	300	60
Savings	111			68		
Investment management	189	150	79	162	132	81
International	51	51	100	44	44	100
Sub total	**802**	**701**	**87**	**703**	**476**	**68**
Group capital and Financing	44			57		
Total	**846**	**701**	**83**	**760**	**476**	**63**

- Divisions deliver profits and generate cash
- Transfer majority of cash to L&G parent
- L&G pays dividend to shareholders and strengthens capital position
- L&G attempts to avoid balance sheet “shocks”

Protection – Resilient performance against no GDP growth and housing market recession.

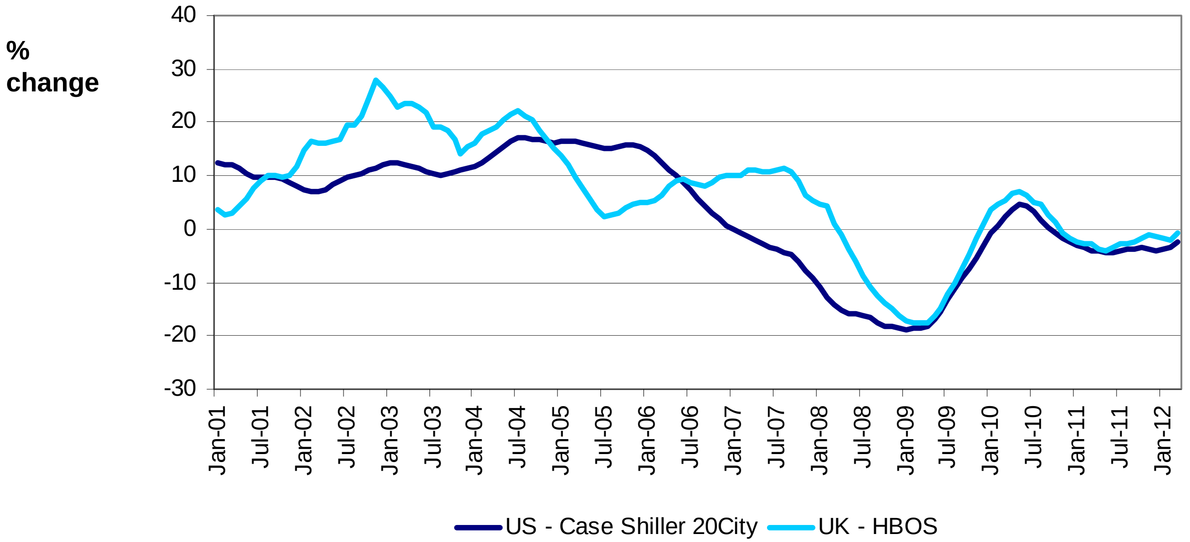


Annuities and Institutional Fund management similar trends

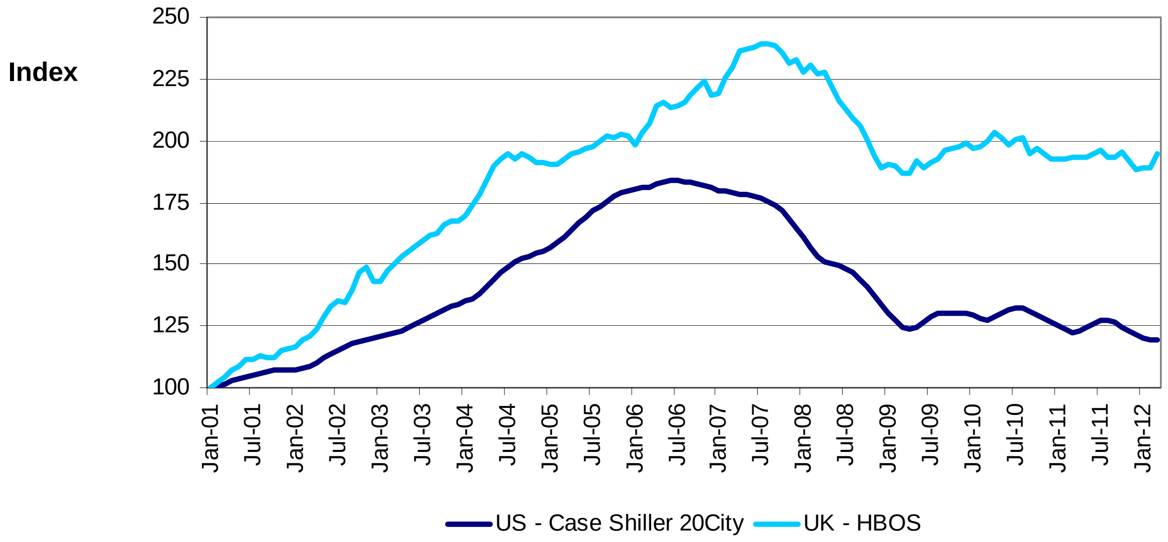
- **L&G IP Market share 19%**
- **L&G GP Market share 15%**
- **Secure distribution through Barclays, Nationwide and L&G Network, and leading IFA position**
- **Expect shift of welfare provision from public to private**
- **Scale efficiency supported by automation of underwriting (75% protection decisions at point of sale)**

- ABI data 2012

The divergence of house prices between UK and USA.



US and UK house price movements look similar and have been seen as highly correlated



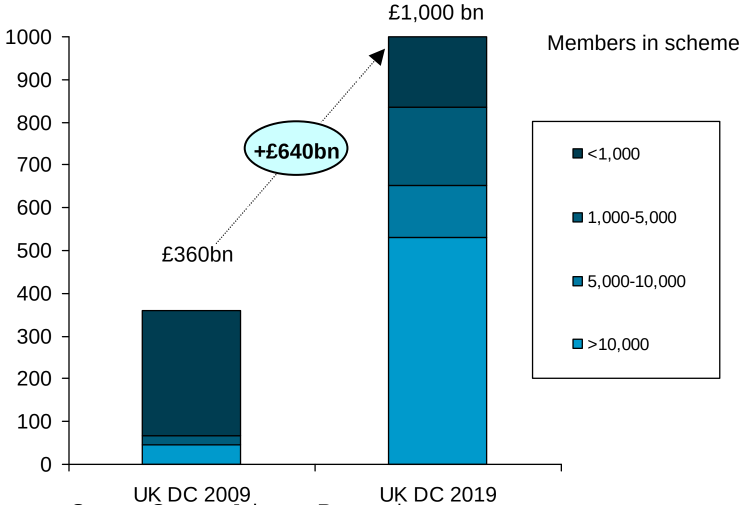
But, huge difference in relative prices. UK housing and banking dependent on low interest rate environment to retain value. But more restricted supply in UK.

The “London skew”

L&G response to Workplace Savings & RDR – internal Investment in digital

Well-positioned for UK Savings growth.

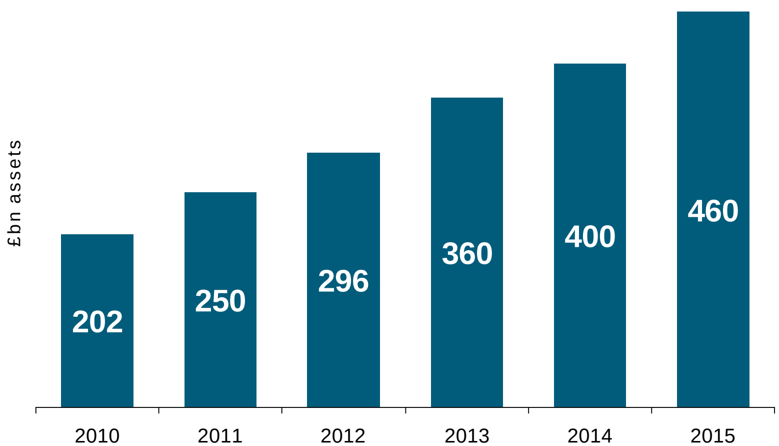
Forecast growth in UK DC Assets



Source: Spence Johnson Research

- Assets in UK DC schemes forecast to reach £1 trillion by 2019
- L&G already has 415,000 potential auto-enrolment members
- Market-leading provider for auto enrolment solutions
- Operational leverage through scale and automation

UK retail investment platforms

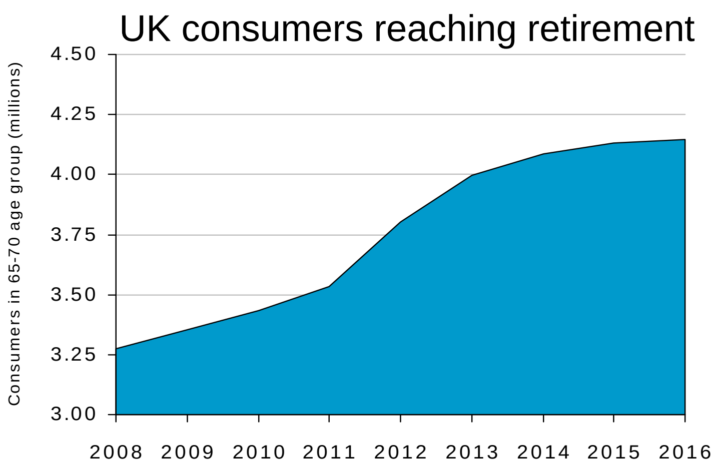


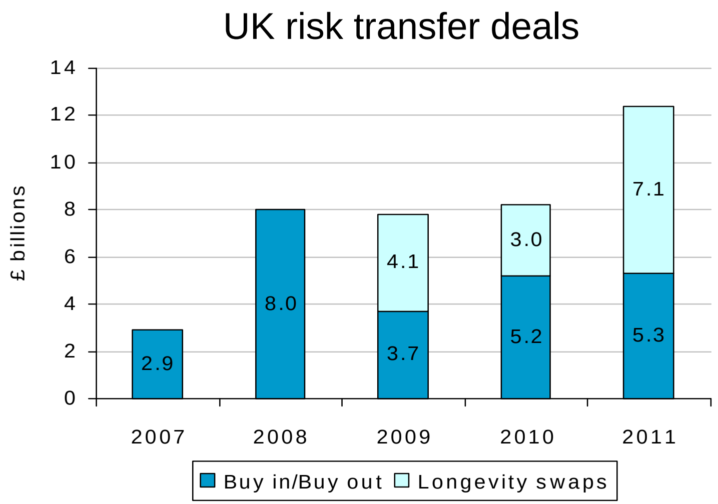
Source: Platforum report; IBA; IMA; Deloitte analysis

- Baby boomers born between 1945 and 1960 own 80% of the UK's wealth: £6.7 trillion (Source:ONS)
- As they reach retirement from 2010 to 2025, assets will be consolidated
- RDR also set to accelerate growth in investment platforms
- L&G well positioned to build fee income as investment assets grow rapidly

L&G P&L response to the Pension gap

Annuities: a high growth market.





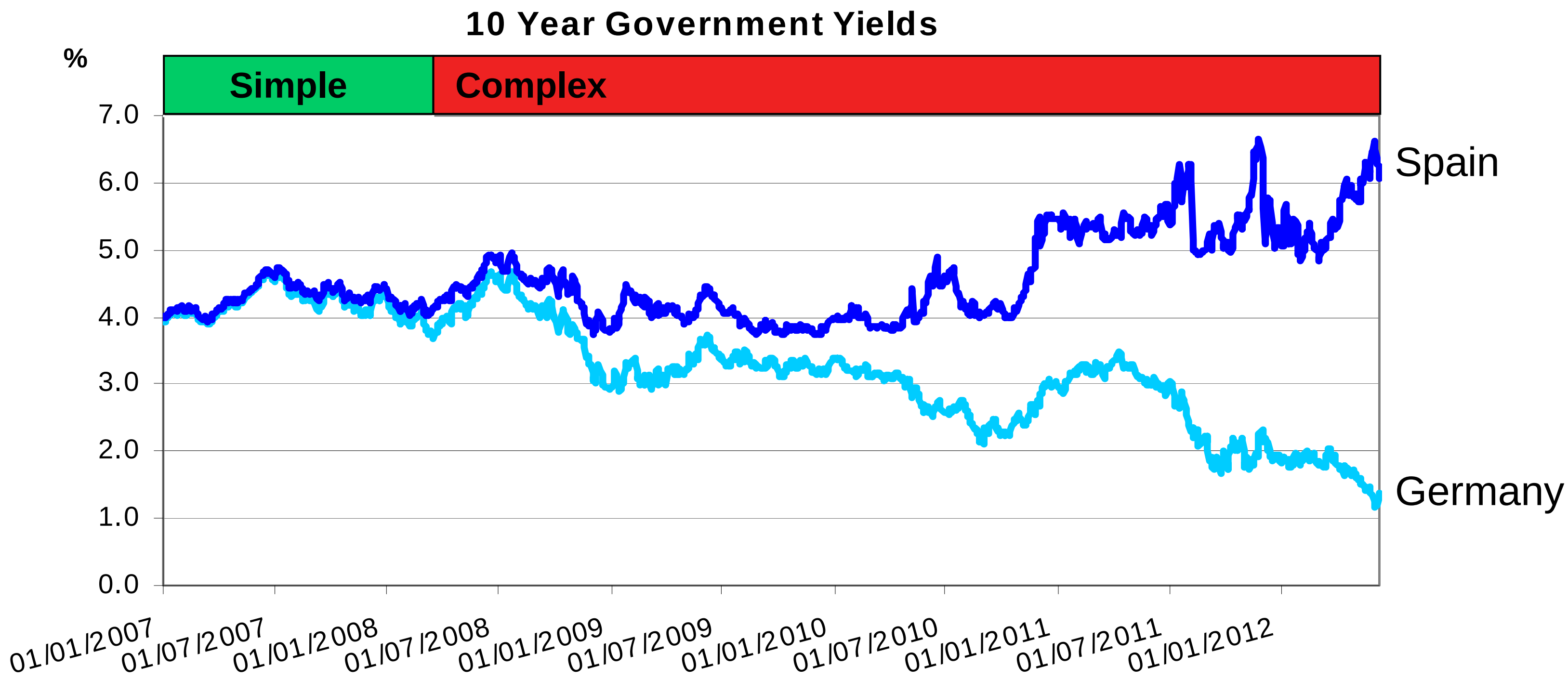
- Baby boom generation reaching retirement
- Maturing DC pot sizes increasing (up to £31K) (1)
- Record UK market sales in Q1 12 (£3.1bn). (1). Market size predicted to reach £15bn in next five years (2)
- Increasing numbers of consumers using open market option (1)
- £12.4bn of UK de-risking deals in 2012 (3)
- FTSE 350 pension deficits up to £92bn (4)
- Market potential enormous (£1,000bn plus)
- L&G offers full de-risking service (buy-ins, buy-outs, longevity, LDI)
- Unparalleled experience in longevity management

Sources: (1) ABI, (2) Mintel, (3) Hymans Robertson, (4) Towers Watson

Comprehensive global derisking capability.

	Defined Benefit Assets	Strategic Asset Allocation	Asset Derisking	Longevity Derisking	Bulk Purchase Annuities
				L&G Annuities	L&G Annuities
	LGIM Expertise	LGIM Expertise	LGIM Expertise	LGIM Expertise	LGIM Expertise
	Index Funds Commodities Diversified Funds Cash Property	Solutions Team Derisking Mandates	Active Fixed	Liability Driven Investments Longevity Insurance	Buy-in Buy-out (Underpinned by Asset derisking & LDI solutions)
AUM (£bn)	224		72	58	28
				1	

Where simple financial relationships were assumed, off balance sheet embedded derivatives lie.



Current interest rate curve ± **Risk 1**: Devaluation Revaluation ± **Risk 2**: Downgrade Default Recovery % ± **Risk 3**: Policy Intervention ± **Risk 4**: Liquidity

First Stage

Lesson from the UK to Europe is that banking recapitalisation is complex and has mixed success – US more responsive.

Date	Action	Capital Injection	Outcome
Sep 07	Northern Rock run, guarantee and nationalisation	Unknown (£26bn funding by Jan 08)	Debatable – good bank bought for £0.75bn, unknown losses in bad bank and BoE gave in to moral hazard
Apr 08	RBS rights issue	£12bn	Failure – still required state support
Apr 08	HBOS rights issue	£4bn	Failure – only 8% participation
May 08	Bradford and Bingley rights issue	£0.4bn	Failure – deposit business sold to Santander for £0.6bn, rest nationalised
Jun 08	Barclays rights issue	£4.5bn initially plus £7bn of capital instruments	Success – although required overseas investments
Jul 08	Alliance and Leicester taken over	Unknown, Santander paid £1.3bn	Success
Sep 08	Lloyds/HBOS merger	Unknown, but HBOS made £10.8bn loss in 2008	Failure – still required state support
Sep 08	Building Society mergers	Unknown	Success – thanks to Nationwide strength
Oct 08	RBS nationalisation	£25.5bn for 67% stake	Failure – current market cap c.£25bn
Oct 08	Lloyds/HBOS nationalisation	£17bn for 40% stake	Failure – current market cap c.£20bn

Are we moving to creative destruction in UK Banking?

Large Corporates to play increasing role in retail financial services: Tesco, Sainsbury's, M&S.

Insurance and Fund management to play increasing role e.g. Workplace Savings including L&G.

Banks traditional lending role being passed to others e.g. UK commercial property & infrastructure.

Private equity playing a larger role in numerous markets.

Corporate derisking being undertaken by Insurance/Fund Managers

L&G response to:
Eurozone crisis – Minimising risk.

Composition of Bond Portfolio

FY2011 £m	Bond Holdings	%
UK	11,758	36.5
USA	10,548	32.7
North Europe	4,192	13.0
Peripherals	1,158	3.6
Other Europe	1,324	4.1
Rest of World	2,249	7.0
CDO	998	3.1
Total	**32,228**	

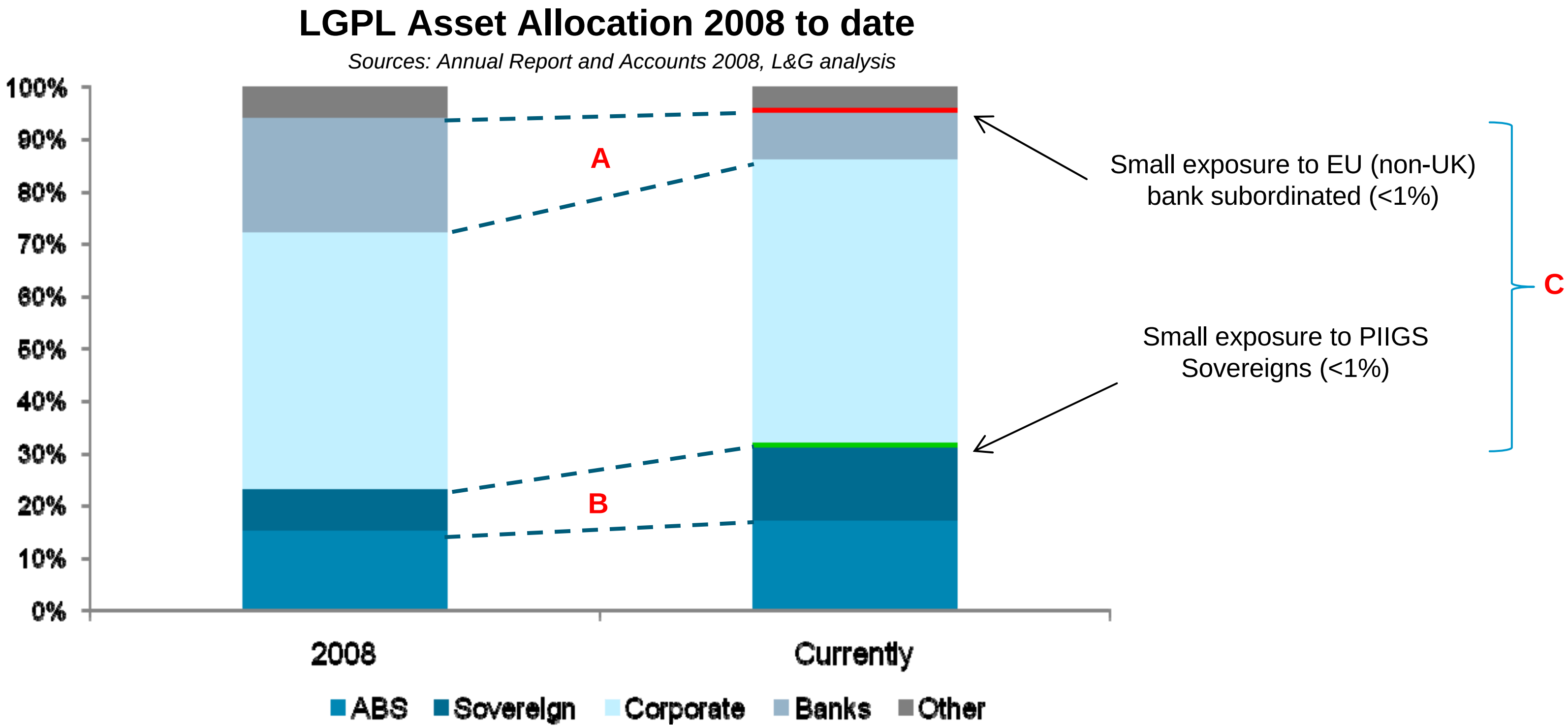
Peripheral Exposure

FY2011	Sovereigns	Other
Greece	-	-
Portugal	3	42
Ireland	4	221
Spain	29	207
Italy	281	371
Total	**317**	**841**
Total Portfolio	**6,188**	**26,040**

1. Portfolio globally diversified, 3,000 instruments
   - Majority of UK and European corporates are global players
2. Minimal direct exposure to peripheral Governments.
3. Low need for liquidity.
   - Annuity Premiums cannot be returned
   - Ongoing new investment increases ability to diversify portfolio.
4. Low correlation of spreads to defaults.
   - 2008 experience, actual defaults low relative to spreads (£1.5bn default reserve)
5. Board governance of risk & contingency plans
   - Weekly review of MI against scenarios
   - Potential operational actions identified

Increasing certainty of cash and avoiding shocks.

Investment actions to date



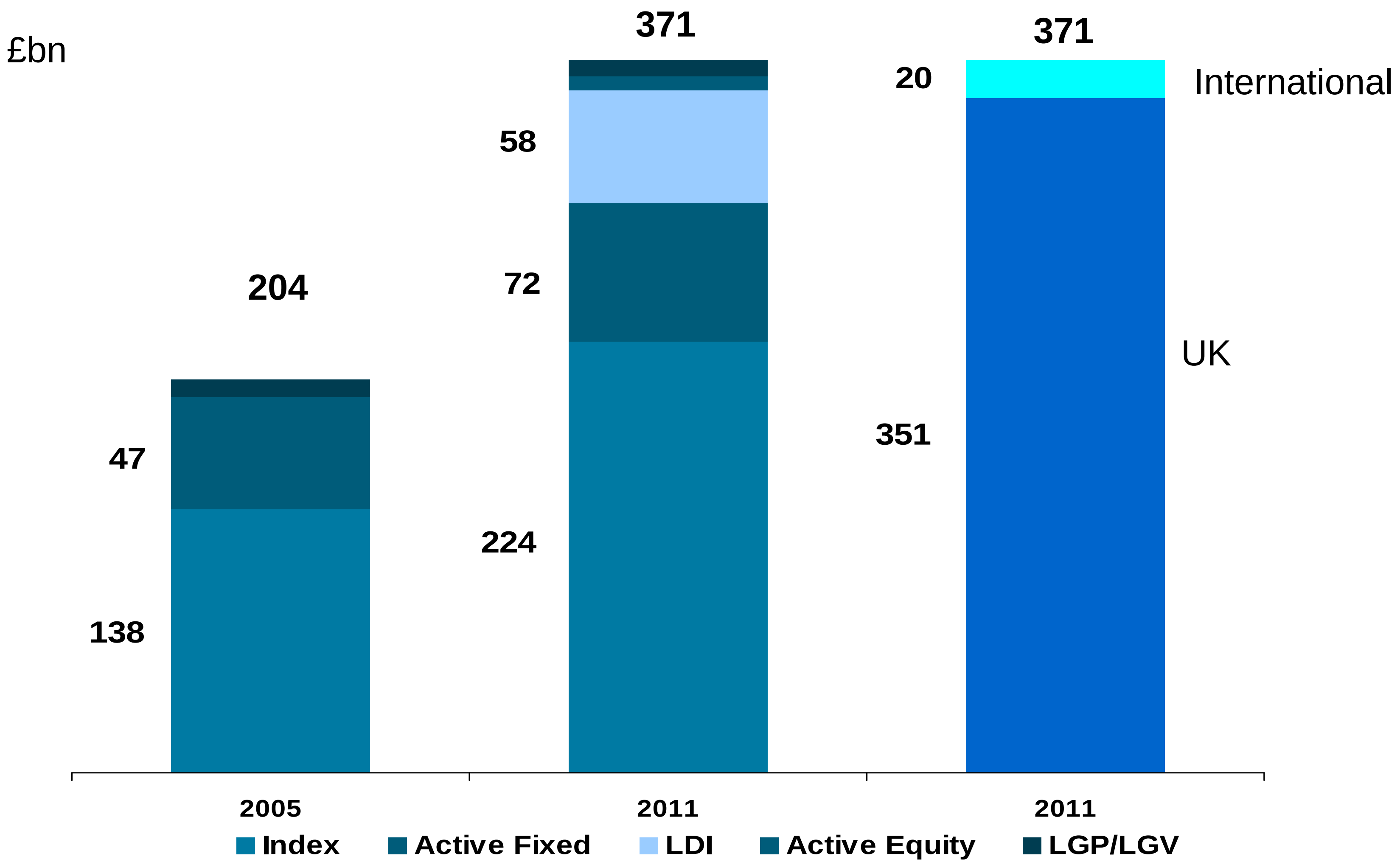
- Increased diversity of the portfolio (> 3000 instruments, >500 issuers, many sectors and geographies)
- Increased asset duration at spreads in excess of reinvestment assumptions
- Reduced Banks exposure from 22% to 9% and reduced proportion in sub debt, despite attractive yields (**A**)
- Increased Sovereign exposure from 7% to 14%, mainly via increased Gilt exposure (**B**)
- Minimised exposure to PIIGS Sovereigns and EU (non-UK) subordinated banks (**C**)

Economic decisions, constrained by regulatory impact

£1.8bn growth in Shareholder assets in the last 2 years invested in low risk assets

Shareholder Assets £m	
2010 Opening shareholder assets	**4,167**
Opening group capital and financing assets (incl. LGAS and LGPL shareholder assets)	*3,656*
Opening shareholder assets in other subsidiaries	*1,688*
2011 Opening shareholder assets	**5,344**
Group operational cash generation	940
New business strain	(94)
Net cash generation	**846**
External dividend payments in the year	(298)
Other	40
Closing group capital and financing assets (incl. LGAS and LGPL shareholder assets)	*4,344*
Closing shareholder assets in other subsidiaries	*1,588*
2011 Closing shareholder assets	**5,932**

Substantial global growth opportunities exist – scaleable platforms.



In conclusion.

High levels of macro challenge and uncertainty, however, L&G delivers:

- **Resilient business franchises in diverse markets**
- **Balance between Risk, Savings and Asset Management activities**
- **Operational business aligns to macro-trends: longevity, public-private risk sharing, corporate and pension de-risking, withdrawal of banks, regulatory change.**
- **Strong and Substantial Cash Generation supports good dividend flow.**
- **High Quality of Cash; diversified and high portion can be remitted up to group.**
- **Strategic response to emerging regulatory opportunities.**
- **High level of IGD Solvency surplus and large level of default reserve.**
- **Effective risk management of bond portfolio; reduced exposure to Eurozone difficulties.**
- **Capability to extend model to new territories and emerging consumer needs**