The Financial Crisis – Ten Years On

Slide 1: Title

Ten years is a long time. in global terms we've had it so good, but for many it doesn't feel like it.

Slide 2: 'Famous Five' replace the big banks…

Demographically, boomers born between 1945 and 1955, at their professional prime around the crisis, have mostly retired. Millennials born between 1985 and 1995 who were mainly still at school during the crisis have entered the labour market, bringing new working practices, expectations and behavioural shifts.

Housing has become more expensive for millennials than for their parents, meanwhile grandparents, the prime economic beneficiaries of the last decade, have seen a modest increase in life expectancy but a significant increase in care needs.

Technology has advanced exponentially. We are all tech companies – but the pure tech sector, particularly the "famous five" have seen exponential growth in customers, and value, and have replaced the banks as a dominant force in business and the economy. They are the new global Titans. The tech shake-out in 2000 was a Schumpeterian "creative destruction" – not so in banking, where only the destruction occurred.

Ten years ago, much of today's AI and robotics was still science fiction. Companies were still in "transmit" or sell mode versus their customers. The next ten years will be equally interesting too as big tech is coming under the same scrutiny as big banks have. Not issues of liquidity or credit, but of privacy, security and use of data.

Slide 3: FTSE Original Constituents

Of the FTSE100's original 1984 components only 28 remain. In the last ten years, the departures comprise a long list, including household names. Many left the stage because they failed to read and respond to these trends or to their customers.

Slide 4: UK used to have the biggest banks in the world

The UK entered the crisis with some of the biggest banks in the world, and while the US banks have recovered well, the UK banks have lagged. Market capitalisations are broadly the same or lower, and still significantly below book value. Insurers both in the UK and US by contrast have prospered – two or three-fold increases in market capitalisation and significant premiums to book.

Slide 5: Different Causes, Different Effects

In macroeconomics, experimental concepts like ultra-low or negative rates and QE have become mainstream – perhaps the new normal as we have become addicted to the "monetary methadone"? The side effects have included asset price bubbles and a rise in inequality between those living on stagnating real incomes and those with growing asset wealth – one of the causes of greater political uncertainty and polarisation.

Some old certainties have unravelled – relationships between cause and effect have become disconnected, we have low inflation and full employment. Technology is hollowing out the middle class and the Gig economy hurts tax receipts.

But some other things are constant – we have low investment, low productivity growth, and static real wages. We are not tackling our ageing population and we still worry too much about the last crisis, not seizing our real opportunities.

Slide 6: Strategic Overview

I like to think in Legal & General's case we correctly identified the major post-crash trends of ageing demographics, globalisation of asset markets, the need to create assets to boost yields, welfare reform, technological innovation and the demand for long-term capital.

By staying relevant, and responsible, our business has managed to maintain its resilience.

Slide 7: Focused high performing business

We are, however, doers as well as thinkers: and here are some of the results we have delivered based on those identified trends. I won't go through the list, but it illustrates ten chosen sectors where we are market leaders coupled with, delivering strong operating profits from divisions.

We are still at an early stage of what can be done – these trends are not going away and importantly they are global trends, as applicable in the US as in the UK, and increasingly in Asia.

Slide 8: Economic Agents poor at predicting risk events

The financial industry as a whole – and I include regulators and economic policy makers at the Fed and the BoE as well as firms – did not see this coming in 2008. Hence the Queen's famous question: "why did nobody predict this?"

A quick search of central bank governors' quotes at the time is interesting, well "up there" with those from record label execs who declined to sign the Beatles or publishers who turned down Harry Potter.

Bank governors were not the only people to fail to spot the crisis or to calibrate the consequences incorrectly. The predictive power of the usual economic agents was simply found wanting… including commentators, analysts, investors and indeed L&G.

There is, I believe, a "recency bias" which assigns too much importance to negative short-term events, a focus on current noise rather than genuine longer-term signals and on anecdotal rather than empirical data, and a herd instinct or "confirmation bias" which makes it safer to be among the collectively wrong than to be uniquely right.

Our industry – and indeed the entire ecosystem of economists, policymakers and regulators too often overlook the issues which really matter as the urgent is prioritised above the important: China joining the WTO, the creation of the iPhone in hindsight mattered more than the bankruptcies of Enron or the Icelandic banks. In the UK, we should ask what will make more difference to Birmingham in the next twenty years: city devolution or Brexit?

Slide 9: how we have evolved into a high growth company

Meanwhile at a company level, the last decade has seen us repositioning Legal & General as a high growth company, with a greater focus on asset management driving a threefold increase in AuM, and an even greater increase in the annuity asset book where LGR adds value by combining investment and longevity expertise.

We have less subscale or peripheral legacy business in the UK and internationally, are positioning ourselves for technological change, and instead of the old share buyback programme have driven improvements to our underlying businesses to deliver a similar threefold increase in operating profit from divisions.

Slide 10: Our Financial Ambition

It is by focusing on great delivery, against the background of the mega trends that we can deliver not just resilience, but progression. Both in cash, which was our priority post 2008, but also by delivering sustained historic EPS and RoE growth, and by rolling that forward at a similar rate of earnings growth for the next period through to 2020.

We are off to a good start with 41% increase in the first half of 2017.

Slide 11: Over-reliance on banks

Some things have not changed enough since the financial crisis.

Over-reliance on banks has much to do with this. While banks were bailed-out or taken into state ownership, and the reckless levels of leverage of 2008 reduced, we have failed collectively to reduce our reliance by making it easier for the real pools of money – often very long-term money - held by institutions to be deployed into the real economy, and despite efforts around, for example Private Placements we have failed to create a well-functioning capital market to operate alongside banks as it does in the US. Instead, too much long-term money has been channelled into low or negative yielding, but liquid assets.

This does not deliver good outcomes – neither for underlying investors, nor for the broader economy. It is part of a post-crisis “safety-first” or “risk-off” approach which avoids tackling some fundamental economic problems.

Continuing over-reliance on banks moreover holds up the pace of change as the policy of "extend and pretend" supports low productivity firms and industries when in reality more Schumpeterian "creative destruction" is required.

Slide 12: Direct Investments

Legal & General has stepped up by making direct investments – a £15bn programme with £12bn already invested - infrastructure, housing, clean energy, urban regeneration. The results are socially and economically positive, and these are increasingly demonstrating commercial value as a way to match liabilities and capture illiquidity premium in a low-return world. I am delighted that others are following suit… even if it does mean more competition.

Slide 13: Re-equitising society

There is no better example of post-crisis unfinished business post-crisis than this. Very simply, debt finances the past, equity finances the future.

The growing prevalence of debt over equity makes us miss opportunities. The UK is great at start-ups, very poor at scale-ups. This is despite the great efforts made by, in particular, the London Stock Exchange through its ELITE programme, the Business Growth Fund and investors like Neil Woodford and Pete Davies, and it is something we need to see addressed through Damon Buffini's patient Capital review.

But it also applies to larger companies. The post-crisis phenomenon of large cash reserves, debt issuance and share buybacks, frankly, rewards the present at the expense of the future. The Stock markets should be a channel for investing money, not a sort of scaled-up ATM for extracting cash. Short-termism in the financial sector was heavily criticised at the time of the crisis. What has happened however is that while financial institutions have had to rein-in risk in the last decade, "financialisation" and short-termism has continued to spread across the corporate sector.

L&G's approach here includes our investment through ADV to grow regional tech companies in the UK and our work with Universities on spin-outs. However, something much bigger is needed – not just us but also through other parts of the financial sector.

Slide 14: Appropriate Regulation

We all, I believe, understand and perhaps even empathise with the need for regulators to step up after the crisis. But it is important that, ten years on, they respond not just to the proximate causes and the bad behaviours that led to that 2008 event, but also to the longer-term consequences of the policy response. In short, they need to support investment to improve productivity and hence to boost real wage growth. They are not merely the police force of the financial sector – they can enable and support the good as well as bearing down on the bad.

Slide 15: Distributed knowledge is driving the age of the customer

The biggest change since the 2008 crisis is the relentless march of technology. This is how we see it at Legal & General. This is a clear and dramatic shift in power from the producer or seller to the consumer. Poor customer service, opaque pricing and fees, and heavily-intermediated commission-driven sales practices are the past. Customer satisfaction, interaction and dialogue directly with customers to deliver frictionless customer journeys is the future – and that can only be done in combination with best value if we deploy technology in the right way.

The death of affordable, mass-market financial advice in the last ten years is a huge negative: ever-optimistic, I believe it can be re-born, but the advisor may be all or partly digital.

The advance of fintech, indeed potentially also of medtech and edtech and broader digital is not a direct response to the crisis, but it has changed the environment in which we operate – and it may turn out to be just as far-reaching as the crisis, if not more so.

Again it has, by the way, a connotation for Brexit. If we go back a bit further, 25 years, to 1992, the hottest political topic was Britain's membership of the Exchange Rate Mechanism. It made and broke political careers as we crashed out. The internet browser was invented in the same year, but was little-noticed. I suspect the browser made more difference to most peoples' lives, and our businesses, than Deutschmark pegging.

The Brexit debate today is bigger than ERM, but there are clear parallels. If the Brexit downsides are a period of uncertainty, and perhaps a 0.5% slowing of growth as trade agreements are negotiated with high friction cost adjustment then there is a huge opportunity to compensate by investing more to improve productivity and growth – and to self-determine success - which in the long-term could be very positive.

Slide 16: Values and Behaviours

Following the crisis, a healthy injection of humility and a re-building of values to align better with those of our customers was needed. This applies to our industry, but also to those who set the rules and make the frameworks where we operate.

We saw how much regard was given to the views of "experts" in the course of the Brexit debate – they were treated with scepticism at best. The crisis extinguished the last traces of the culture of deference.

Values, corporate culture, and behaviours by contrast, have become more important. This emphasis on behaviours is important for recruiting the best talent among that group of Millennials who have come of age since 2008. It is also something regulators have come to recognise: a firm's culture is as important as letter-by-letter compliance with a huge rule-book which inevitably offers loopholes and permits unintended consequences.

We need to respond positively to this, both in our own firms, for example at Legal and General we define good behaviours as "straightforward, collaborative and purposeful" and by fostering greater diversity – we have a 50-50 by 2020 programme to grow the share and responsibility of women – and in the firms where we invest, which means greater engagement in governance issues, broadly-defined, and an ever-increasing focus on serving customers.

Slide 17: Our six growth drivers frame customer and macro-solutions

The lessons of almost every financial crisis – certainly of the five major ones in the US between 1792 and 1929 – is that they lead to better institutions and market practices: central banking, deposit guarantees, even stock exchanges, were all born following a crisis, not in the heady times just before the crisis struck.

2008 catalysed new and exciting thinking in macroeconomics, risk management and I hope is beginning to drive real behavioural changes. But ten years on we are far from having all the right solutions: the obvious way to start working on these is to look at the current trends that I listed at the beginning and which form the strategic backdrop to our business at Legal & General: ageing demographics, globalisation of asset markets, the need to create assets to boost yields, welfare reform, technological innovation and the demand for long-term capital.

You cannot tame a trend, but you can “lean in” to it, work with it, and commercialise it, and that is what we try to do in our business.

Slide 18: Share Price

Here is the end-result. The 173% TSR growth is good to have, but there is another point to the slide. The various dips on the upward trajectory were due to issues like pensions freedom and its impact on individual annuities, regulators’ thematic reviews, and of course Brexit. The point is that these were all deemed to be huge events at the time – but they had no effect on underlying mega-trends like demographics or technology. They were examples of the recency bias that I mentioned earlier. Some of these events were serious and required management action – for example building a lifetime mortgage business.

But even Brexit, where we saw a 25% share price movement overnight after the referendum – is not, in the longer run “Brexistential” compared with population ageing, technology or the need for real assets.

I’m now very happy to take any questions.

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