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Speaker: Wadham Downing, Interim CFO (Chair)
John Pollock, Chief Executive for Protection and Annuities
Mark Gregory, Chief Executive for Savings
Mark Zinkula, Chief Executive for LGIM
Kate Vennell, Head of Investor Relations

Call Duration: 00:43:38

Operator:

Good morning and welcome to the Q3 IMS conference call. Throughout today's call all participants will be in listen-only mode and afterwards there shall be a question and answer session. I'd just like to remind you this conference call is being recorded.

Today I'm pleased to present Kate Vennell, Head of Investor Relations. Please begin your meeting.

Kate Vennell:

Good morning, everyone, and thank you for joining Legal & General's Q3 update call. **Wadham Downing, Interim CFO**, will chair the call this morning and is joined by several of our colleagues. In the room we have **John Pollock, Chief Executive for Protection and Annuities**, and **Mark Gregory, Chief Executive for Savings**. Also joining us from the **US is Mark Zinkula, Chief Executive for LGIM**. They will be delighted to answer any questions you have, but first Wadham will give a short summary of the results.

Wadham Downing:

Good morning and thank you, everyone, for making time to join this call. As you'll see from this morning's press release, we have delivered record third quarter sales: up 28% in Q3 and up 6% year-to-date. Of particular mention in the quarter, UK protection is up 30% and US protection up 33%; individual annuities up 10% with £350 million of premiums received in the quarter. In our savings business, auto enrolment is now underway and, together with the transfers of existing schemes, has led to net inflows in workplace pensions of £429 million. Mark Gregory will tell you more about this during the call.

LGIM is making visible progress in expanding into new markets - America, Europe and Asia - with flows from international clients of £5.6 billion so far this year, £3.3 billion in Q3 alone.

On financials, our cash performance is strong: total operational cash at £702 million. Within that our business units delivered growing operational cash; up £25 million, from £661 million to £686 million. Net cash at the business unit level was up £44 million, from £556 million to £600 million. Total net cash for the group is both substantial and diversified, up £15 million to £616 million, and we remain on track to deliver the cash targets we reiterated at the half-year.

We continue to strength our capital position. You will have seen our announcement, in September, of a further tranche of US capital restructuring, improving LGA's capital position by \$200 million and our IGD surplus by £88 million. Also worth mentioning: no defaults in our LGPL annuity portfolio.

On outlook, we remain positive. The businesses are trading strongly. We are excited about playing a bigger part in UK infrastructure investment, with £900 million invested in projects to date. We are confident our businesses can continue to grow, to provide more value for both our customers and shareholders. I'll now open the call to questions.

Blair Stewart, Bank of America Merrill Lynch

Thank you very much and good morning to everyone. Can I ask three quick questions? Firstly, just an update on the pipeline on the annuity business, please, as usual. Secondly, the impact of the changes you're making on the asset side of the balance sheet: perhaps you can talk about the impact that's having on your expected investment return. And, thirdly, I noticed a statement from Nigel talking about accelerating earnings growth. I would imagine that that would need to have some sort of assets on the management growth as well. That's not a particularly strong feature of these results. There are a lot of inflows, but also some outflows as well. So I just wonder if you could comment about what would need to be in place now to see an acceleration of earnings growth at the company. Thank you.

Wadham Downing:

Okay. First question, John, and maybe a bit around assets, as well, in terms of infrastructure.

John Pollock:

Hi, Blair. The pipeline for annuities is much as it was. It's a relatively quiet market but, as you know, very lumpy and we have seen some larger scheme quotes emerging in the market. Very often that's price testing. So, pipeline of committed sales is always impossible to predict. So it's not a brilliant description. The market seems to be reasonably active but I think it's more about price testing than real commitment. But we are fairly optimistic. Demand is still strong and we're fairly optimistic over the foreseeable future.

Wadham Downing: Do you want to say anything about assets and infrastructure?

John Pollock:

Yes. There has been a lot of work on the asset side of the balance sheet. We haven't been out there hunting yield. We've been very cautious in the management of the business, as you indicate. De-risking gives us certainty of returns. We're blessed with having the LGIM capability and competency. So we have been de-risking but without much impact on yield. As a consequence, I don't expect there to be much impact on our investment return.

Wadham Downing:

On the shareholder side of assets, Blair, we highlighted at the half-year sort of a tactical position in cash. Since the half-year we have reduced cash levels a little bit; diversified our exposure away from sort of concentrated developed markets, reflecting our views in opportunities in more global markets. And then on the earnings growth, yes, we've been talking around stocks of our businesses, not only assets under management but premiums, and you'll see the premium growth coming through the press release and I think you will see us talking more around EPS measures and earnings going forward. You know, we're keen to show the impact on our financials of the growth we're seeing coming through in our businesses.

Blair Stewart, Bank of America Merrill Lynch:

And would it be fair to say, would you agree with that statement, that in order to see an acceleration in profits growth you would need to see a pick-up in assets under management growth or do you think there's more you can do on the margins?

Wadham Downing:

Mark Z might want to comment around the mix of businesses coming in but, yes, it will be growth of stock across our businesses, whether that's assets under management, premiums or assets under administration.

Mark Zinkula:

This is Mark Zinkula calling in from the US. I would echo those comments. I think you have to look at certainly net inflows which are up considerably year over year. We want to continue to increase those over time but as well the mix of business. So, as we win more fixed income and LDI mandates, those are higher-margin mandates and ultimately will contribute to earnings growth as well.

Blair Stewart, Bank of America Merrill Lynch: Okay. Thank you very much.

Jon Hocking, Morgan Stanley:

Good morning, everybody. I've just got three questions. First on capital, you haven't given an update on capital in the statement, unless I missed it; if you could just give us some comments on where you sit versus the first half.

Secondly, I noticed in the statement there's a comment that you want the Solvency II rules to incentivise you for investing in infrastructure and long-term assets. There's a comment there about making long-term equity investments. I just wonder whether you could give me an update on where you think Solvency II is going to land. Is there any chance for long term equity investment to be an advantaged asset class.

Then, finally, just going back to Blair's question about earnings growth, given the capital intensity of your business surely it makes more sense to target ROE rather than EPS? I think the sector doesn't have a

particularly happy track record of companies focusing on EPS growth rather than book-value growth. I wonder if you could comment on that. Thank you.

Wadham Downing:

Okay, certainly. On capital: as you know, we don't issue IGD numbers in Q1/Q3. We do provide you with sensitivities in our year-end accounts. So if you take your half-year £3.8 billion, you can sort of work out where we have tracked from there and then don't forget our press release in September which highlighted an IGD benefit of £88 million sterling.

Jon Hocking, Morgan Stanley:

So there's no departure from the sensitivity application in the first half? If we do that we're not going to come up with a wildly incorrect answer?

Wadham Downing: I don't think you'll come out with anything wildly different.

Jon Hocking, Morgan Stanley: Okay. Thank you.

Wadham Downing:

On Solvency II, yes, we did make a big thing around infrastructure. We're very keen to demonstrate our social purpose in terms of infrastructure and we demonstrated that with £900 million in investments so far. You know, we do require the Solvency II rules to support us in not only that but also playing a wider part and we've highlighted equities as well as something that we could see a purpose for.

On the third one, ROE as well as EPS I think you'll see coming forward. We already have ROE within our KPIs. I think EPS you'll see coming through as well. So I think it will be a combination of all those.

Jon Hocking, Morgan Stanley: Okay. Excellent, thank you.

Andy Hughes, Exane BNP Paribas:

Hi, guys; three questions if I could. The first one is on the extension and the infrastructure investments. Now, could you possibly break out the positive impact of investing in the infrastructure projects and the loss that you're making on selling the bank sub-debt? The problem here is that obviously a big chunk of your annuity profits and cash flow are going from reinvestment on the annuity portfolio and as you extend the spread duration those reinvestment profits disappear. Effectively you could record pretty much whatever EPS you like by moving into longer-duration spread assets through infrastructure, but obviously that's not necessarily sustainable. So it would be good to know what's going on that side. The other point, I guess, is following on from Blair's question about assets management growth. It seems that you're basically growing less in the IFA space in terms of asset inflows and more in the EBC lower-charge space. So could you give us an idea of the fee income on the back book versus fee income on business you've written during the first nine months?

And the third point was, I guess, related to that, coming back to my favourite topic of what is described as a supermarket sweep where you're kind of mopping up a lot of these defined contribution pension schemes post auto enrolments. Aren't you going to incur a lot of sterling reserve costs which is not reflected in IFRS and not reflected in operating cash as a result of writing lots of small-ticket pension items, which is a real IGD cost but not necessarily an IFRS cost? And isn't your IFRS and operating cash therefore going to overstate the real cash as you write these pension schemes? Thanks.

Wadham Downing:

Okay, sure. The first one should go to John, then to Mark.

John Pollock:

Yes. It is pretty straightforward, Andy. We don't really have too much reinvestment risk because we duration-match at outset. So we'll take long-duration assets and any interest rate swaps to get to duration-matching. So we're not really taking a huge amount of reinvestment risk. That said, what we think is quite important, and just amplifying what Wadham said, is that this sector can aid with recovery towards growth in the UK if we are capable of participating in infrastructure and the Government has been making some positive noises about investment banks and infrastructure banks which we think we may well be able to invest in.

We already invest in things like student accommodation, which is part of the long-term infrastructure landscape of the UK. So we think these are very suitable assets for annuity play, as well as playing a part in the social usefulness of our organisation. So I don't think some of your comments about profits coming from reinvestment risk and whatever are entirely accurate.

Andy Hughes, Exane BNP Paribas:

So when you write an annuity contract to invest in a BB bond that goes on for sort of seven years and you earn a high yield for seven years following that you have to assume risk-free, when you get to the end of the seven years and you reinvest that at a higher rate than risk-free, that doesn't generate a profit for you?

John Pollock:

Well, first off, we don't go too far down the yield search in BB, Andy, I'll tell you. We've had pretty clear asset disclosures and you know we don't do that. If we were doing that we would have an awful lot of money in Greek bonds, which clearly we don't. So your hypothesis from the start is slightly flawed there.

Andy Hughes, Exane BNP Paribas: No, I'm talking about spread duration.

John Pollock:

I understand what you're saying. The principle of what you're saying would be accurate if we behaved in that way, but we don't. As I said at the beginning, we tend to duration-match assets and not have large uncovered mismatch risk. So whilst I understand the logic of what you're saying, it's not how we behave in the asset portfolio management.

Andy Hughes, Exane BNP Paribas:

So you're saying there's no profit from extending the spread duration on the infrastructure projects?

John Pollock:

I'm not saying there's no profit. I'm saying that the amplification that you're giving it is not quite how the overall portfolio management is working.

Wadham Downing: Let's move on to Mark.

Mark Gregory:

Okay, yes. Just to pick up on your point around I guess a shift from IFAs to EBCs during the course of this period, clearly there are a couple of things going on there, Andy. First and foremost, ahead of RDR a lot of IFAs are clearly having to adjust their operating models. So in no sense are L&G turning their back on the IFA marketplace and, indeed, we expect that to come back again as it used to be post-RDR. Having said that, clearly in the short-term that has coincided with a strong push in the corporate pensions space. We've kind of seen the EBC volumes go up at the same time as retail IFA volumes have come down.

In terms of your question around what that means in terms of income, I think the way to think about is that they are just very different shapes of business. Particularly for an IFA, you typically get transactional type business: a bond here, a pension there, etc, which might look higher gross margin but we think about the business on a much more net margin basis. So, again, we've invested in our corporate pension space to make sure we can handle volume very efficiently and, again, we see that as being bigger volumes of business but coming through with efficient scalable systems, meaning that is feeding through to the bottom line. Just a very different shape of business, I think, between retail IFA business and EBC business generally.

And on to your subsequent question around the impact of sterling reserves on small pots and indeed the flow-through into IFS profits. You're quite right to say that they don't feature in IFRS operating profit definitions but we do include sterling reserves in our definition of net cash where it goes through the strain numbers. So there'd be no hiding of the implications of writing small-pot business. Again, I make the same point I made on the previous comments. We've invested very heavily to make sure that this business comes on very efficiently. So the level of variables/attributable costs that we expect to allocate to that business won't actually be that high. We've made the investment and this business is coming on very, very slickly.

Andy Hughes, Exane BNP Paribas:

Should we expect a strain then in net cash when auto enrolment starts and this business comes on? I mean, even if it's got, I don't know, an £8 per year sort of allowance, you're not going to be getting anywhere near an amount of £8 of fees for quite some time for some of these people on auto enrolment. So are you going to have a cash impact then if you're reflecting positive sterling reserves in --

Mark Gregory: I'm expecting a non-material impact from sterling reserves.

Andy Hughes, Exane BNP Paribas: Thank you.

Oliver Steel, Deutsche Bank:

Good morning, everyone. Two broad questions, the first is on the protection side. At the Interims, I thought you said that the surge in public sector protection buying had been a bit exceptional, but it's clearly continued in the third quarter and I'm just wondering what exactly is happening there; how big that market could be and where you're positioned in that.

Then, secondly, on protection ... I'm sorry, this is developing into three questions. Secondly on protection is the growth rate in your stock of premiums in UK protection has gone from, I think, 2% last year to 6% so far this year on a 20% year-to-date growth in new business and I'm just wondering if you can sort of help us with the translation from new business growth into the stock of premium growth if, let's say, we're look forward over the next 12 months.

The third question I've got is on LGIM. You've grown very strongly overseas but I don't think I've seen a quarterly breakdown of the net inflows from overseas. So I wonder if you could just give us that.

Wadham Downing: The third one will go to Mark Z, but start off with John.

John Pollock:

Yes. I'm sorry, Oliver, if I implied that there is either a surge or that it was sort of one-off in nature. If I didn't say this, what I meant to say was that we had started work really off the back of the very strong public sector connections that we have with LGIM in being able to facilitate some product support for them as they're looking for cost savings. So we've been able to deploy a product into the councils that has gone particularly well. I don't think that it is particularly one-off in nature. It basically insulates them from the costs of ill health/early retirement and, as a consequence, it looks a little bit like us to our GIP product. So we think that's just a sector that has been opened up by our engagement and I don't really see any particular reason for that market to go away any time soon. So I'm reasonably optimistic about our continued success in that space.

Just turning to stock versus new business, new business you could think about as determining the rate of growth of stock because we've always got claims and lapses going off the back book. So the amount of new business that we're putting on determines, if you like, the rate of growth of the overall portfolio.

So the strong rate of new business growth which we have seen has helped drive up the rate of growth in the stock.

Wadham Downing: The third question: Mark, do you want to answer the LGIM question?

Mark Zinkula:

Sure. I don't have the numbers committed to memory, but we had strong net inflows in the third quarter from overseas. I believe it was £3.3 billion for the quarter. Overall net inflows were slightly up over the quarter. Again going from memory, I think it was £0.6 billion as I recall. So the bulk of the net new business was in the first half of the year. We had a quiet August. It's not unusual for the third quarter to be somewhat quiet, given it's the overlap with the summer months. But we've had a good strong finish to the quarter. It's continued into the fourth quarter.

Oliver Steel, Deutsche Bank: Thank you.

Ashik Musaddi, JP Morgan:

Okay, hi, thanks for that. Three questions. If I heard it correctly, you mentioned that the LGIM inflows from International is £3.3 billion and the overall inflows is £0.6 billion in this quarter, i.e. there's a big outflow of £2.7 billion in the UK. Now, can you give some more colour on what that is and what kind of margin was that?

The second question is can you give us some colour on the labour turnover in this auto enrolment that you have taken, like Sainsbury, ASDA, M&S, etc, and how does that compare with your normal group pension portfolio?

The third one is can you give us some colour on the margins on annuities and protection? Is there any of contraction in margins you have seen in the third quarter or is it normal or is it going up? Thank you.

Wadham Downing: Okay, we'll start with Mark Z, then Mark G and then John.

Mark Zinkula:

If I've interpreted your question correctly, it was in regards to strong international growth but net outflows on the UK book and we've been pretty open about this and discussed it. Last year is the first year we saw net outflows in our passive book. The UK DB market is a very mature market. We have a large market share and we're trying to protect our position there and successfully doing that, particularly most of the outflows are going to be in our passive book. But correspondingly we still have persistency rates that are north of 90%, which are outstanding levels, and so we're keeping a lot of clients on the books and, as they're transitioning out of equities and de-risking into fixed and LDI strategies, we're doing a good job of transitioning a lot of those clients. So even though we could see net outflows on the UK DB book, if there are slight net outflows on passive mandates and ultimately growth in fixed income and LDI mandates, we can still see profit expansion even though it's a very mature market and soon to be declining market, very gradually declining market.

Mark Gregory:

Okay, I'll pick up your question about labour turnover and auto enrolment schemes. The key point here, Ashik, is the fact that we underwrite every scheme individually. So there's no kind of "take it" price out there. If a scheme has different characteristics, such as perhaps higher labour turnover, we will price that accordingly. So that's absolutely part of our underwriting process.

John Pollock:

And, yes, just on P&A margins, I am very happy with our margins; very happy indeed. There's been no particular margin pressure in any of our lines of business during this quarter. So I'm very comfortable.

Ashik Musaddi, JP Morgan: Thanks a lot.

Greig Paterson, Keefe Bruyette & Woods:

Just three quick questions, am I understanding this correctly: you've now decided you're going to de-emphasise the cash flow metric that you've been trying to get investors to focus on for the last two years and moving back to an embedded-value EPS-type arrangement? I mean, that's the message we're getting. Anyway, just talk around that.

The second point is just workplace pensions. If you just look at the consensus and what the actual number was, I think there was a misunderstanding around how you book the surge in workplace pensions you have won. The stuff you've announced today, to what extent is that going to transition in the fourth quarter or the first quarter next year when we have to sort of up our numbers from that process? In other words, what have you announced to date and not booked yet?

The third question is just sort of quarter-to-date, I wonder if you could talk about the individual annuity side; whether you had seen any material impacts of people positioning around gender pricing in individual annuities?

Wadham Downing:

Okay. I'll take the first and then pass it on to Mark and John. No, we haven't moved into that direction, I have to say, Greig. What we're just underlining is that we just want to translate the strong operating performance into strong earnings growth and we will be promoting up some of the other metrics. We're still very focused on cash and our cash targets.

Greig Paterson, Keefe Bruyette & Woods:

Just in particular, because you said that EPS are going into KPIs now, there's a strong correlation between IFRS and your statutory cash flow. So I can only understand that as meaning that the EV EPS are now going to come into the KPIs. Is that a correct understanding?

Wadham Downing:

That's not quite what I said either. We have ROE. I think at the half-year you'll have noticed that we promoted EPS and ROE into our sort of headline financials and I'd expect us to be doing the same in our end-of-year statements.

Greig Paterson, Keefe Bruyette & Woods:

But what accounting regime are you going to focus on for the EPS? That's what I'm trying to ascertain.

Wadham Downing: So this is IFRS EPS.

Greig Paterson, Keefe Bruyette & Woods: All right. So there's no re-emphasis of EV?

Wadham Downing: No, there won't be, I'm afraid.

Greig Paterson, Keefe Bruyette & Woods: All right. No problem.

Wadham Downing: Okay.

Mark Gregory:

Just to help you with your forecasting, Greig, just to perhaps be clear. Perhaps we'll go through it step by step. What we saw in Q3 are the sort of names we put in the press release today. So we saw the pension scheme transfer for Mark & Spencer during that quarter as well, their existing pension savers coming across to L&G. So that was in the numbers. Likewise, the conversion of the Sainsbury pension scheme was in the Q3 numbers. In Q4 we would expect to see the bulk of the other pension schemes transfer across to L&G during the Q4 period and we will see the first of the big auto enrollee schemes. So Sainsbury will auto enrol during Q4 and then in Q1 next year we'll see the vast majority of the new auto enrollees will come on to the books. So there is a phasing going on here.

Greig Paterson, Keefe Bruyette & Woods:

I wonder if you can just give a magnitude. I mean for the fourth quarter the bulk of the rest of the schemes coming in, is that on a par with the third quarter M&S and Sainsbury, below or above?

Mark Gregory: I'd prefer not to guide, if you don't mind, Greig.

Greig Paterson, Keefe Bruyette & Woods: I'm just trying to ... are they similar?

Mark Gregory: I know what you're trying to do. I'd prefer not to guide.

Wadham Downing: Okay, John, did you want to come in?

John Pollock:

Yes, nice try, Greig. Gender pricing impact: I mean the rules are all pretty clear and I think most of the major players in the market have indicated when they're going to move and what we're actually seeing in terms of how the transition on 21 December will take place is people making sure that they're slightly extending their price guarantee period to allow for the cash to move from the seeding scheme into the annuity, just to make sure that people aren't disadvantaged around the period of time.

But in terms of any kind of pre-activity, what you've got to remember - and I do think I probably say this pretty well every time - the vast majority of people don't have huge majority of choice over when they retire or when they draw their income. Our pot size is still around £30,000, which indicates the scale of the people that are annuitizing and the demographic that are annuitizing. So we're not really seeing much impact yet from gender price and that doesn't surprise me. That said, it is possible that some of the market growth at the margins is being driven by those people who have a capability to choose in bringing forward their drawdown of their annuity, but it is definitely at the margins, Greig.

Greig Paterson, Keefe Bruyette & Woods:

Sure. Sorry, I just have another quick question. I see you've gained market share in UK House and that's in the light of others gaining market share in UK House. I'm wondering what sort of reduction in the pure combined ratio we need to factor in for the full year. I mean is it going to be large or little and how much rate have you given up to achieve that surge in market share?

John Pollock:

Oh, Greig, dear oh dear. That's just not how we behave and you know that. So that's a very cheeky question. What we have done is we have deployed some capability and grown particularly in direct. So we've opened up our capability and growth the business but we just are always selective on price. We're not desperately trying to grow the top line unless it contributes very much to bottom-line growth. So our growth is not some kind of desperate whatever. It is opening up new channels. We've signed some new distribution arrangements within the broker channel and the business is growing very nicely, but it is not sacrificing core just to get top-line growth.

Greig Paterson, Keefe Bruyette & Woods:

I was just worrying because my premium halved when I moved to you guys and I just wanted it acknowledged that it was because I'm a better risk, as you obviously see that's the case.

John Pollock:

You clearly are, Greig. You clearly are. You're not in a flood zone. Even if you were, actually, you're tall enough to be able to wade through the water.

Greig Paterson, Keefe Bruyette & Woods: Exactly. Excellent. Thank you very much.

Wadham Downing: Thank you.

Gordon Aitkin, RBC Capital Markets:

Good morning. A couple of questions, please. The first one is a follow-up on asset management with the successful diversification outside the UK but outflows in the UK. Your traditional strength has always been in the UK managing indexed equities for the UK DB pension schemes. Now, these pension schemes are closed to new entrants and in some cases future accrual. I just wonder are you seeing the benchmarks of these DB pension funds gradually shifting towards bonds as they mature. That's the first question.

And the secondly on bulks, I mean there's a real lack of supply in the bulk market now. Who are you up against when a scheme is being brokered?

Wadham Downing: Okay. So the first one Mark Z and then John.

Mark Zinkula:

Yes, there's definitely a trend. I would say it's not so much of a benchmark change towards bonds as it is towards ... I guess I'd describe it as funded status volatility. So there's clearly been a shift in the UK and it's now happening in the US. Our US business model has really built the focus on this phenomenon where there's a fundamental shift in the way that most plans are thinking about managing the asset risk and it's less of a weighted average mix of market benchmarks and a traditional - whatever it would be - 60/40 or 50/50 split equities to bonds and now rather it's more of a liability-based benchmark and different plans are at different tolerance levels, regarding how much status volatility that they can sustain around that specific benchmark. That's going to be different for each plan because, again, the characteristics are going to be different. And then over time clearly they're going to be going out of equities and increasingly into fixed income and all the LDI strategies and, ultimately, if they can afford it, into annuity strategies. And so we've transitioned our business model, from a client-service perspective all the way through to the product offerings that we have in both the UK and US, to accommodate the needs of clients as they go down this de-risking path.

John Pollock:

Yes, hi, Gordon. Just in terms of BPA, actually still the usual suspects appear on quotes. I mean it's not really for me to comment on our competitor strategies, but certainly we're still seeing many of the normal players. PIC, MetLife, Goldmans are all still there. We do still see Pru and Aviva from time to time and it does depend a lot on the scheme. But mostly I would say the competition is still the usual suspects.

Gordon Aitkin, RBC Capital Markets: Thank you.

Andy Hughes, Exane BNP Paribas:

Hi, guys. I realised I wasn't cheeky enough in the previous questions, so I'll have another go. There's just two basic simple questions. The first one was a very simply numbers question. On page 10 when you show the tied agent number, that doesn't include the mortgage club or is that the mortgage club, because I just couldn't really understand why the tied agent number is falling. So given that protection sales is very strong, I thought the mortgage club was growing strongly. So maybe you can tell me where the mortgage club is shown in that disclosure and how that's doing.

The second question was about LDI. I mean have you had conversations with UK-based clients with CPI-related liabilities regarding the impact of what LDI solutions they may have put in place and the implications of the changes to RPI, because it seems that quite a lot of people who've got CPI-related liabilities and chose to implement LDI may have a negative shock from the changes to the way in which RPI is calculated. So could you comment on that, please?

Wadham Downing: Kate, do you want to answer the first one and then Mark Z on LDI.

Kate Vennell: Well, John perhaps --

John Pollock:

I'll take the mortgage club. What's happening here is changing mix within the club. The club is actually writing ever-higher numbers of mortgages and that's because we have some DA non-tied members in the mortgage club. So we're increasing our share and those people typically would operate a panel of suppliers. We had two changes in the network that resulted in slightly lower protection sales where there was some restructuring of some members from fully-tied to DA and one fairly large supplier decamped from us and moved elsewhere. So there have been slightly lower protection numbers. That said, that's been offset by the concentration in panel use amongst the DAs. So this is still a very sound inflow of business for IP. Most of the growth in IP that we have seen has been coming from IFA and our bank assurance sector. So it's just a little bit of mix going on there, Andy. So it's very strong mortgage distribution and then a couple of member changes that have resulted in slightly weaker protection. That said, there have been slightly higher sales of investment products through that channel but that's another story.

Andy Hughes, Exane BNP Paribas:

Okay. So the DAs are in there as well or are they in a different line?

John Pollock:

Well, the DAs would be reported through IFA because they are typically IFAs, even though they're tied to the club for mortgages. So they're managed through the network line. The numbers move between the two lines, depending on how the mix is happening.

Andy Hughes, Exane BNP Paribas: Okay, thanks.

Wadham Downing: Mark is going to answer the LDI question.

Mark Zinkula:

Yes, sure. I guess I'll take a broader perspective here. There are a lot of changes underway in the market right now. You highlighted one. There's movement toward central clearing and so forth. So we have to make sure we continue to develop the range of options to accommodate different plans' needs as market conditions change or these dynamics evolve and we're clearly engaged with clients on all these issues. It's not going to, we don't think, diminish the demand for LDI solutions but it certainly could result in slightly solutions or different ways to hedge interest rate and inflation risk, equity risk and so forth, depending on the underlying asset composition that a plan has. And so we're just continuing to evolve our mix of strategies and solutions as market conditions change.

Andy Hughes, Exane BNP Paribas:

Are there people out there who are sitting on a surprise loss from their LDI strategy that you've had to contact and what was their reaction?

John Pollock: Getting cheekier now, Andy.

Andy Hughes, Exane BNP Paribas:

No, I'm just interested. Because if the purpose of LDI is to hedge your liabilities, and obviously a lot of people have CPI-related liabilities and obviously the inflation hedge is clearly RPI and RPI could be falling, I'm just trying to work out whether there's a mis-selling liability coming from LDI in the UK and I've just got no way of working out whether that's a realistic thing or not.

Mark Zinkula:

We don't provide advice, first of all. So I don't think, in terms of a mis-selling scandal or insinuation, that that would be the case here. As conditions change we're just simply working with the plans to help them hedge their risks in the best way that's in accordance with their risk tolerance levels.

Wadham Downing:

Okay, we've probably got time for one more question. Any more questions on the queue?

Alan Devlin, Barclays:

Thank you very much and good morning, everyone. Just two questions on LGIM. First of all, you mentioned in your press release that you recently received regulatory approval to market passive funds or index funds in the US. That's obviously a huge market but also massively competitive for people

Vanguard and BlackRock having trillions of dollars of assets. So how are you going to tackle that market and do you have the scale to be successful there?

And then just a second question to follow up on LGIM UK. Are you trying to say that the gross outflows from the mature UK is fairly consistent because the mature DB plans are running off but the gross inflows on sales are more seasonal and they tend to be quiet in the August period so the kind of outflows you've seen in this quarter we shouldn't necessarily be too concerned about?

Mark Zinkula:

In regards to the first question - and you're right, it has been a massively competitive market in the US - we do think that there are ... Well, circumstances have changed since we began to build our presence in the US about five years and I guess I'd highlight the main ones. Certainly post-Lehman there's been increased focus on manager concentration risk and we've been getting a lot of reverse inquiries and there appears to be more demand for another large index manager in the US market potentially.

Secondly, companies are increasingly managing their pension liabilities on a more holistic basis globally. Global companies are. So we have an opportunity to leverage off our UK client base. We have several UK clients that have affiliates in the US. Typically it's a parent subsidiary relationship, one direction or the other.

Third, we now have a presence in the US where we have a very successful platform focusing on fixed income and LDI. So the incremental cost of building out the proposition is less and we have a strong reputation already with consultants and so forth, so this is the natural next step in the evolution of our business model in the US. And, finally, I would say that there is, for certain plans an opportunity to provide passive management services as part of de-risking strategies that plans are contemplating.

In regards to your second question, unfortunately I do think, given the size of our book and the fact that we have several large clients, there's going to be some lumpiness in flows both directions, both in terms of outflows and inflows. I think from a quarter-to-quarter basis there will be some lumpiness. We expect persistency rates, on balance, to still stay very high. They've been around 90% for several years and we do anticipate that we'll be able to retain a lot of clients as they go out of passive and into LDI and fixed income strategies, as I mentioned before, but there will be some lumpiness both directions on a quarter-to-quarter basis.

Alan Devlin, Barclays: Okay. Thanks very much.

Wadham Downing:

Okay, thank you very much. We'll close the call there. Thanks, everyone, for your questions and for dialling in this morning and we look forward to speaking to you later, at year-end. Thank you.

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