Morgan Stanley Conference 2015

Slide 1 Cover plus dividends

Good Afternoon,

I'm not going to treat you to a re-working of Legal & General's results presentation today... but one of the outcomes of a having a clear strategy and a relatively straightforward business model is that we have been able to deliver consistent dividend progression over the last five years... from 3.84p to 11.25p... a 24% annual growth rate.

That progression is based on growth of the stock of our business... which delivers operational cash and net cash which delivers dividend progression for shareholders.

That was the theme of our results presentation this earlier this month, and it is consistent.... in 2008, Net cash was £320m... In 2014 it was over £1.1bn.

But today I want to look forward rather than back... so this feels like the right moment to remind you of the usual disclaimer on forward-looking statements...

Slide 2 Forward-looking Statements

... and some of my statements today will be very forward-looking.

Slide 3 QE/Financial Indigestion

There are a number of very clear factors currently at work across the world – today I want to look at some of these... how they affect our industry, and our response to them at Legal & General.

First, the broader economic picture.... A great many people in the developed, Western world are still living in recession. This is obvious in countries where growth is flat or negative... but even in the United States and the UK there is a persistent personal recession in many areas... family finances are flat-lining or moving backwards... real wages have fallen behind and while there is higher employment than anyone expected a few years ago, there is disappointingly lower productivity, and hence lower prosperity... 25% of all UK jobs need the educational skills of an 11 year-old.

Last week, the UK Chancellor announced that families were now experiencing real income levels last seen in 2009... it took a long time to get back to the pre-recession start-line. This explains the disillusionment with governments, mainstream politicians, both in the UK and even more so in the Euro-zone.

QE was probably a life-saver for the global economy five years ago... but the effect was to drive up asset prices rather than creating real economic value – it helped those who live on investments, not on wages. .. QE was designed by the rich, for the rich.

It was notable, just recently in the very first week of Eurozone QE, that the first obvious effect was not to help unemployed Spanish or Greek youth – but to push the DAX to an all-time high. It leaves us hooked on cheap, digital money – monetary methadone. And it facilitates overconsumption by governments as they can in effect issue perpetual zero-coupon debt... and it leaves us wondering what will happen post QE.

If that is a negative, then we have a positive counterpoint with technology. We have had 500 years of print, a decade of digital, and financial services is behind other sectors and just getting started.

Public policy is changing fast, with huge potential effects on our sector. There is barely a risk on the register that is not man-made by politicians or other policymakers. But we should not be too unfair on them... Policy challenges include coping with a changing demographic - an ageing population with care needs that can't typically be funded, either by themselves or by the state – and a need to channel investment into infrastructure to drive growth.

There has never been so much money in the world, chasing such low yields, and missing so many investment opportunities.

Regulators likewise face huge challenges: their activities to a large extent determine whether money can be put to work in the real economy or locked up in a kind of financial deep-freeze where it remains cryogenically preserved in case of another crisis.

Meanwhile the banks are seen not as investors, but as a rich source of income from fines and taxes... with the net result that they retrench from the economy as a whole, and from long-term finance in particular. I understand absolutely the need for public and taxpayer protection and for transparency – but equally we need a much better climate of constructive collaboration. I would hate it if the levels of bank tax through levies and fines forced banks not just to retrench, but to re-domicile.

So these are some of the issues shaping our business – and which we define as macro-trends. I like to think we were early identifiers of these... but they are now becoming recognised more widely.

Slide 4 Helicopter Money

First, QE.... the position I outlined is now widely shared – by left and right, central bankers, academics, politicians and market operators.

It begs the question, "what next?" we know tapering is an option for central banks in recovering economies like the US. But digital money – and 97% of the world's money is now digital – is like toothpaste: it can't be put back in the tube. Likewise, QT – Quantitative Tightening – feels unlikely for the Fed.

The more present risk is the temptation to go more radical in the Eurozone... the quotes show you the head of steam behind "helicopter money"... but while QE did facilitate helicopter travel for the few, dropping money from the helicopters does not help the many – or not for long. It is simply too random, too short-term to deliver anything except a brief consumer boom.

The right thing is slow money... long term investment in infrastructure, in R&D and in vocational education to unlock the supply side and create long-lasting prosperity through productivity gains.

Slide5 Real wages, productivity

Productivity is the puzzle we desperately need to solve, at least in developed economies where it has fallen back over many years... and because productivity is in part a function of labour market size, the telling statistic from McKinsey is that without productivity accelerators, shrinking labour markets over the next fifty years will drive a sharp decline in growth.

Moreover, wage growth has fallen behind productivity over the long-term – as Bob Reich's US work shows – so we have a compounding effect. Fewer workers, at constant productivity levels, generate less growth. Real wages are disconnected from productivity and barely connected to real growth rates. All this is tough for family incomes... tough for tax receipts... and tough for government deficits. Even though we have high youth unemployment, as Ros Altmann has recognised we also we need everyone to work longer.

There are a number of productivity accelerators, but investment in physical and digital infrastructure is key. This includes digital education– and also includes hard economic and softer social infrastructure like hospitals and schools, as well as housing. Long-term institutions like Legal & General can play a key role through slow money.

Slide 6 Direct Investments

These are some examples of direct investments we have made in the UK – £5.7bn so far... and we have the ambition and capacity to invest £15bn in physical assets across infrastructure, regeneration and housing. We led with student accommodation... and private rental is going to be the next major asset class we create in this way. It's desperately needed for the broader economy, and it makes financial sense for us by using the illiquidity premium generated by the long term asset to raise risk-weighted returns.

Slide 7 Media City

Here is one of our recent direct investments: Media City in Salford, Manchester... fast becoming one of the UK's much needed economic hubs and the home of the BBC.... Salford is one of the towns we are also regenerating as a part of our English Cities Fund.... and like many UK towns, a place that was not overbuilt but under-demolished and in massive need of renovation and regeneration to achieve its potential. We know this type of investment has a scale impact... a multiplier effect of 3 to 1.

You can see also how LGC, our business division responsible for direct investments, increased its contribution last year…this is economically and socially useful investment working at its best.

Slide 8 Digital Delivery, Revolutionary Growth

Digital is driving the second industrial revolution. Here, incidentally, is what the first industrial revolution did for economic growth... for those who are interested, I'd also recommend the recent work by Andy Haldane at the Bank of England, an innovative regulator, who extrapolates economic growth – or rather lack of – even further back into the Stone Age.

George Stigler observed as early as 1961 that information economics, much more than the economics of physical objects, are the economics of scale – a massive multiplier operates due to network effects and the cheapness of the raw data once it has been created or packaged for the first time. This is a second industrial revolution. Like the first industrial revolution, that replaced cottage industries with mass-production, it will increase volumes, and shrink existing profit pools while generating new ones. It favours the large players or the very niche – the middle gets hollowed-out.

Slide 9 Industrialisation of manufacturing

The second industrial revolution will have profound effects for financial services, both in manufacturing and distribution.

As Jon Hocking's excellent research shows, our industry lags behind in digital experience.

Legal & General's protection business, which has a 25% market share in the UK is already 80% Straight Through Processing, with unit costs that enable us to compete very effectively on price while still generating solid margins...

Workplace pensions are similarly highly automated and becoming cost-effective as scale builds... and our SME proposition in workplace is entirely digital. Index is again a highly digital business built on delivering customer value.

We have more to do to continue to upgrade our digital customer interface – it is a work-in-progress to continually adapt to change – but we are developing mobile insurance in Asia and Africa. We fully expect to see more automation in the life sector. We expect the motor sector to make ever more use of telematics... the digital driverless car is cruising around Californian highways.

Slide 10 Retirement Freedom and Choice

Turning now to public policy...

A year ago at this conference we were digesting the Chancellor's changes to the at-retirement market... the end of compulsory annuitisation.

Legal & General predicted a 50% fall in individual annuity sales in 2014, and a further 50% in 2015... those forecasts look broadly correct. We also highlighted that, for us, it was not particularly material, as we were already well along the path of transitioning to the corporate de-risking, bulk annuity market. Indeed, as you will know, last year we wrote a record £8.5bn of annuity business, with Legal & General Retirement generating £343m of net cash and £428m of operating profit, a 38% increase year on year.

For our retail customers, we are ready for the changes which come into effect this April – we will have cash-out products... fixed term retirement products...

and we have acquired NewLife –to accelerate our new lifetime mortgages business.

These are important steps: as the UK's leading pensions campaigner Ros Altmann has often highlighted... retirement will become a gradual process, not a one-off event... people will work longer, and more flexibly. My generation will live longer in retirement, and will increasingly need to fund care costs.

Slide 11 Personal Balance Sheet

One of the largest items in the typical retiree's personal balance sheet is their house. The present value of the state pension is around £200,000... and the typical value of the house would be similar – more in the South of England. That is at least five times more than the typical value of a DC pension pot... so we expect that increasing numbers of people will turn to housing equity to augment retirement income. In total the over 60s in the UK have an estimated £1.3 trillion of housing equity. We are expecting Legal & General to be moving towards an annual run rate of £500m of lifetime mortgages by the time we exit 2015.

This year's budget announcement was the creation of a secondary market for existing individual annuities. It's a move we support – and we provided input to the policy. We believe we can make it work, and that it represents a new business opportunity as long as consumer protection is not ignored.

The government's consultation process has only just started, but work by Oliver Wyman suggests there are £250bn of annuities that could potentially be sold. So if only 2% change hands through the sort of auction process we are suggesting, then that is a £5bn market, starting from 2016. Volumes will naturally depend on prices for the consumer... and these, in turn, will depend in part on the prevailing interest rates when the annuity was originally bought... but I do think that 2% is a conservative estimate.

Slide 12 Profit Pool

Our estimate of the overall effect of the reforms to the individual retirement market – is that the greater flexibility will encourage more DC saving together with the ageing population will increase the available market size. ..and new profit pools will emerge.

This analysis excludes the potential positives of lifetime mortgages and secondary annuity trades... which is precisely why these new business opportunities will be important.

Slide 13 DC Savings

Defined Contribution saving is expected to grow – some commentators expect it to be £3 trillion by 2030, with overall DC assets becoming much larger than current DB pension assets as savers accumulate at contribution levels which are set to rise to 8% and will have to rise beyond that.

Slide 14 Growth Potential UK DC

Again digital will be hugely important: cheaper processing means lower unit costs and charges: 50 bps is our proposed charge cap, in reality fees and charges will be between 25 and 50bps – compared with the 100-125bps paid in Australia where the DC workplace pension approach was pioneered.

Digital will also play a role in customer service and communication both in accumulation and decumulation, with constant, real-time interaction via mobile devices.... and because digital favours scale players, we will see consolidation. I expect our market share to grow faster than the overall market in DC.

Slide 15 De-risking journey

Whilst the growth in DC is the longer term growth opportunity, global defined benefit schemes are turning to de-risking strategies. We recently published a report which showed two-thirds of the UK's largest private pension schemes are looking at some form of pension risk transfer solution … and nearly half said they were looking to implement that solution in the next five years.

Almost 70% had already implemented a liability driven investment or LDI strategy and nearly half were aiming for a buy-in or full buy-out.

This should not be a surprise as these are largely legacy issues for current management teams who would love to get the lumpy volatile liabilities off their balance sheets and be able to talk to their investors about current trading rather than pension deficit repair programmes. To date only £80 billion of pension scheme liability has been insured... compared to £1.8 trillion of total liabilities. There is a long way still to go.

Slide 16 Unaffordable Welfare

Welfare reform is another policy area with huge potential impact on financial services. Governments which run deficits in Europe – and I include the UK – can't afford to go on as they have been.

In the UK, if the Conservatives are re-elected, they have committed to a £12bn annual cut in welfare spend. So far, we have not seen any detail on how this might be achieved... but in truth, any government will have to reduce this expenditure, which currently runs at £164bn in total, or £81bn for working-age benefits.

So we are at the point when Sir William Beveridge's great creation – the 1945 Welfare State – is due for an update. This is not perhaps as politically difficult as you might expect... the polling data for younger people suggests that there is appetite for a return to a more genuinely contributory principle... something more like the original insurance plan of the Beveridge Report... which has morphed over the years to becoming much more complex, much less hypothecated, and much more part of general taxation.

Slide 17 Four steps to Beveridge 2

You will not be surprised to see we have plans for Beveridge 2.0... which we have discussed with government and opposition.

At this stage, this is of course just one suggestion... but what it illustrates is that very substantial savings can be made for government by introducing a fairer, less regressive system of tax relief for pension saving, while at the same time better benefits can be provided for lower taxpayer premiums or contributions. There is a win, win, win solution here.

One of the key's to this is using the pensions auto-enrolment mechanism – the digital "plumbing" that firms like Legal & General have put in place – to deliver it. This takes us back to the point about the digital revolution... and the capacity to deliver at very low cost. We capped our workplace pension charges at 50bps... under a Beveridge 2.0 model like this, a premium of 50bps of salary will deliver more generous sickness benefits to the majority of employees than can currently be done under National Insurance, where the contribution rate for anyone earning over £8000 annually is currently 12% of salary.

Despite the changing attitudes of Generation Y, I don't underestimate the political challenge for any government of delivering a scheme like this... ultimately political consensus has to be built around long-term change – as it was for pensions reform when Lord Turner's influential analysis was accepted by all parties and implemented over the life of more than one government.

We do need a Welfare Commission – much as we had with Adair Turner's Pensions Commission.

Slide 18 Regulation

Regulation.

We know that regulators face a difficult dilemma – from a global level, to an EU level, to a national level, their statutory remit is to protect consumers and taxpayers by reducing individual and systemic risk. Any responsible financial services player knows and supports this. But they do this at the same time as policymakers are trying to promote growth, and frequently they are obliged to have regard to broader economic policy.

And because of the plethora of regulators, the connections between primary legislation, secondary legislation and regulation on the ground... and the connections between international and local regulators... sometimes it looks confusing. Regulators have extensive powers, and though it may not always feel like it, they have limited resources. The tendency since 2009 has been to over-compensate for the industry's errors of the past, to over-simplify because they have been let down by models and occasionally, to play to the court of public opinion rather than to analyse the facts.

Being a referee or a policeman is not easy. Having a clear and consistent regulatory regime can be a competitive advantage... but it is a fine line and there is a material risk that layer-upon-layer of capital requirements, levies, fines and other restrictions including the risk of regulators becoming, *de facto* shadow directors of companies, will force parts of the industry to retrench, indeed to relocate if the alternative is to become uncompetitive.

The answer is better and more constructive collaboration – a tripartite arrangement between the industry, its regulators and the politicians who answer to the taxpayer.

Slide 19 Clear and focused strategy

Now, back to Legal & General.

I have talked a lot today about trends. The five macro-drivers of growth form our strategic roadmap... and our business activities are built out from there.

Here you see some of the results from 2014 – management actions facilitated by the trends, which, if executed well, deliver operational and financial results. I won't go through them as they are self-explanatory... they all start with understanding what is going on in the wider world... but execution is paramount.

We are fortunate in two things – first we are a company that believes in socialising data and analysis. A relatively flat structure means we can debate and critique our understanding of the world and refine our responses accordingly. Colleagues love my regular Saturday and Sunday morning e-mail debates!

And second that we have the management bench strength to deliver our business plans.   Legal & General has a team with real strength and depth... my colleagues have stepped up and we have recruited well from banks and competitors who share our view of “economically and socially useful products”.

Slide 20 Financial highlights for 2014

Our financial highlights for 2014 show strong growth with LGR assets up 28% to £44billion and LGIM assets up 16% to £709 billion. Retail Protection Premiums exceeded £1 billion for the first time. Operational cash and net cash grew 6% and 10% respectively and our RoE rose to 17%.

We are beginning to develop a track record in EPS growth: 10% for the last three years. We achieved an EPS of 16.7 pence in 2014.

Legal & General have several market leading businesses and they are scale businesses. We can provide great prices to our customers and consistently reduce our unit costs as we drive growth.

The strength of performance enabled us to recommend a full year dividend of 11.25p, up 21% versus last year. And at this level the dividend is 1.65 times covered by net cash in line with previous guidance.

2014 was a strong year but we are not complacent. There is still more work to do and challenges lie ahead.

Slide 21 Dividend Worm

We thought our dividend guidance has been very clear, but as the slide shows... we obviously didn't communicate it well enough.

We will be putting our Solvency 2 internal model in for review by the PRA in the next few months – we will know the outcome later this year, and at that point we will of course refresh our guidance on dividend policy.

George Osborne's Treasury team has done a superb job in negotiating a commercial outcome for Solvency 2 that works for the UK life sector, particularly in respect of the Matching Adjustment.

This can for the basis of a collaborative model involving government, regulators and the industry... indeed the Treasury's success to date is one reason why Legal & General is now making a direct investment contribution to growth in the UK... and why we will raise that investment to £15bn, almost 1% of GDP. This will help deliver the Northern Powerhouse... and growth for the UK as a whole.

Slide 22 More to do in 2015

These are the goals we have set for Legal & General for 2015... You can see the guidance being given for Operational cash for five business segments... which amounts to an 8% uplift versus 2014. Because Operational cash is largely determined by the stock of business, these are meaningful guidance numbers... we are giving them because we have a very high level of confidence in achieving them... and we know this almost from the beginning of the year.

The targets we have set for management action are ambitious but achievable... we will begin the internationalisation of the retirement business, start on lifetime mortgage sales, expand private rental as a direct investment asset class and continue LGIM's international business. We intend to drive up profitability in the platform space, and reduce unit costs across most of our retail businesses through greater digital efficiency.

We will reduce Operating costs from £1.25bn to £1.17bn, a 6.4% nominal cost reduction – the restructuring costs for this £80m reduction will be just £40m – a 50% ratio – so positive for the bottom line.

This is not a one-off exercise. We see cost reduction as business as usual, which is why we take restructuring charges above operating profit in our accounts. Our CFO Mark Gregory takes this hair-shirted view precisely because the focus is not just about a headline number, but about the actual P&L impact.

Slide 23 Sustained Growth

And on a five year view, we will be equally goal-focused. We are on the second floor of the tower block, going up. We are ambitious, but we are also realists and risk-managers. So by 2019, we aim to double the size of LGIM's US assets in LGIMA... grow premiums in the UK at twice the rate of GDP growth... create an international retirement business and invest over £15bn directly in UK real assets, including by creating new asset classes in private rental housing and regeneration.

I remain optimistic about Legal & General's prospects in 2015 and beyond... though I do recognise we still have much work to do. I look forward to keeping you, the market, updated about our progress and of course our dividend policy... and I look forward to being able to offer our customers great value and service on April 7th as the new pension flexibilities arrive, and beyond.

Thank you very much for your attention.