Legal & General Half Year Results August 2020
Nigel Wilson
Good Morning, welcome to our first-ever virtual results presentation... delivering value through Inclusive Capitalism.

Let me say at the outset that I hope you, and your families, have come through COVID and lockdown healthy.

This has been a difficult time for many people and many businesses - with more economic and social dislocation to come.

I am incredibly proud of the way Legal & General has risen to the operational and market challenges.

We have continued to do good business, to serve our customers and look after our people.

We have paid around £1 billion in gross insurance claims and we didn't miss a beat paying annuities and pensions... paying out in bad times as well as good is simply what we are here to do.

We have paid all of our people 100% of their salaries.

We took no government funding...
... on the contrary, we supported communities and laid the groundwork to be a key part of the investment-led reconstruction that our economy so badly needs.

This includes planning approval for Sky Studios Elstree, the UK's new state of the art film and TV studio, as well as £150 million commitment to Sheffield city centre regeneration project.

Our purpose and strategy are aligned.
L&G is both socially and economically useful.
Today is about the economic part of that, but first…

…the usual disclaimers apply to forward-looking statements.

In the first half of this year, L&G demonstrated that our balance sheet is robust, our operational earnings are resilient and our strategy with its six growth drivers highly relevant, both to weather the storm of a health pandemic and to help Build Back Better.

While in lockdown, we secured several planning permissions to take forward housebuilding, affordable, later life living, build to rent and urban regeneration.

While more than 90 colleagues worked together to innovate a commercial project to counter the next crisis... Climate Change.

The first two R's of Robustness and Resilience are shown in these financial highlights.

Operating profits from divisions were £1.1 billion, down by only 2% versus H1 2019 even as UK GDP shrank by 24%.

Three out of our five divisions - LGRI, LGRR and LGIM delivered increased operating earnings.

The balance sheet showed itself once again to be robust... once again, No defaults.

The S2 coverage ratio at the 30th June was 173%, slightly up against the prior year's 171% and Solvency 2 operational surplus generation was £0.8 billion.

This H1 performance has enabled us to announce an interim dividend of 4.93p.

Setting the interim dividend at this level, flat to the interim dividend for H1 2019, is prudent, consistent with treating all stakeholders responsibly as well as playing our part in the wider pensions landscape.

Jeff will take us through results division by division.

What you see here is the specific impact of COVID on our business.

Two divisions, LGC and LGI each saw reduced operating profits... an impact of £60 million from site closures for LGC and £80 million from higher claims... and future provisions from LGI.

In addition, £21 million of extra expenses were incurred group-wide, including a massive acceleration of plans to enable IT to adapt very fast to home-based working.

Stripping out these COVID specifics, underlying operating profit rose by 7%.

The outlook at an operational level for the second half of the year is resilient and robust.

Our ambition is for a similar performance in H2 compared to H1.

LGRI suffered minimal impact from COVID and has a significant PRT pipeline of £18 billion.

£675 million was completed in July and a further £2.7 billion is in exclusive negotiations.

Volumes in LGRR are already coming back... our ambition is for 2020 individual annuity volumes to be similar to last year's... £970 million.

LGIM performed well and is expected to continue on that consistent path.

LGI grew GWP during COVID and likewise is expected to continue growing.

LGC sites are all open and building again - performance in H2 depends on a sustained recovery of the housing market.

Looking forward, we see a total of over £525m of offsetting positive items from the disposal of Mature Savings and potential mortality releases.

Turning to dividend coverage…

Here you can see the sustained strength of dividend coverage under both IFRS and Solvency 2.

Over the past 5 years including 2020 consensus, we have built £3.6 billion of cumulative IFRS surplus above the dividend and £2.5 billion of Solvency 2 surplus.

Our aim over the longer term is to maintain our progressive dividend policy.

This reflects the underlying strength and growth of our business, the clarity of our strategy and structure with its lack of trapped capital and cash, and of course our rigorous focus on execution.

Having kept the 2020 Interim dividend flat to give ourselves flexibility against an uncertain economic backdrop, we will update you through a capital markets day in November, when we should have greater clarity.

Having successfully come through H1 with profits resilient, the balance sheet robust and our products more relevant than perhaps they've ever been...
... our outlook for the second half of the year is positive and realistic.

I'd now like to hand over to Jeff to take us through the numbers in more detail.

Jeff Davies
Thank you Nigel and let me add my own best wishes to you and your families at this time.

In my presentation I'm going to cover...

… the financials for the first half of the year on both a group and divisional basis
… the management of our traded credit and direct investment portfolio
… and lastly, our capital position and surplus generation.

The first half of the year has been challenging for global markets, and Legal & General was not immune to this.

However, our focused, diversified, and resilient business model has seen limited real economic impact, and has continued to deliver value to our shareholders.

Operating profit from continuing divisions was £1.1 billion, with growth in three of our five businesses…

... LGRI, LGRR, and LGIM delivered solid new business flows, while also benefitting from continued profits from their respective portfolios.

In the first half of 2020 Group investment spend was £72 million.

As previously indicated, we are continuing to make measured investments into our business in order to improve efficiency, drive growth and meet evolving regulatory demands.

Over the near term this primarily relates to augmenting cyber security, upgrading the IT infrastructure and preparation for IFRS 17.

We expect this to reduce as these projects complete and move to BAU.

Additionally the Group incurred approximately £21 million of exceptional COVID-related costs, reflecting, for example, the deployment of hardware to facilitate remote working for our people and adapting our work places.

Including these costs, group operating profit was down 6% to £946 million.

The negative investment variance of £661 million in the first half was largely due to the formulaic impact of discounting reserves at lower rates in LGI, as we have seen in previous periods… and unrealised market impacts within LGC's traded equity portfolio, where we are long-term investors and can absorb the volatility.

Finally, the Group's Solvency II coverage ratio at the end of June was [173]%... and currently is broadly unchanged.

I will cover our capital position in more detail later.

Turning to our divisions…

LGR delivered strong operating profit growth in the first half, up 10% to £721 million.

This performance was driven by the on-going delivery of prudential margin releases from our growing back book, new business surplus generated from a steady flow of UK PRT, the evident heavier mortality experience, and positive variances arising from routine updates to our modelling assumptions.

Our Institutional business grew operating profit by 12% to £585 million.

In UK PRT we maintained pricing discipline, achieving a Solvency II new business margin of 10.6% reflecting longer duration transactions in the period compared to prior year, and capital strain of just 4%.

Our Retail business delivered operating profit of £136 million, up 4%.

Individual annuity and lifetime mortgage volumes were down year on year as they were temporarily impacted by the lockdown measures.

To counter this, we accelerated technology innovation across our retail product offerings, and have recently seen a recovery.

Compared to May, annuity sales in June were up 27%, and lifetime mortgage applications more than doubled.

We are considering very carefully the current and longer-term impacts of COVID-19, both direct and indirect, on the mortality of our annuitants.

Alongside this, we continue to analyse the impact of incorporating the next actuarial table, CMI 18, in our year end reserving... ... in isolation, this would imply a release of around £200m.

LGRI had a good first half, writing £3.4 billion in global PRT across 29 transactions, at attractive margins.

The uptick in deal count illustrates the continued demand for PRT, and smaller transactions allowed us to manage credit sourcing in volatile times.

In the UK we wrote £3.2 billion on a wide range of deals including a ninth buy-in with ICI… another example of where we are able to leverage one of many long standing client relationships.

In the first half, 76% of UK PRT deals were with LGIM clients, demonstrating the resilience provided by our unique position in the market.

We are continuing to make progress in the US PRT market, with premiums up 11% compared to the prior year.

During lockdown, we undertook the first international transaction, securing benefits for IHS Markit's UK and US pension plans at the same time.

The PRT market remains very active.

2020 is anticipated to be the second largest on record, with £20 to £25 billion of UK PRT expected to transact.

Our intention remains to write £40 to £50 billion of new UK PRT over the next five years.

As always, we will be disciplined in our pricing and deployment of capital, weighing the interests of all our stakeholders when making new business decisions.

Our LGR bond portfolio, which is a source of long-term, captive AUM for LGIM, has now grown to £76.4 billion.

The portfolio is defensively positioned and has not been materially impacted by COVID.

We have kept lower-rated, cyclical exposures to a minimum, including those directly impacted by COVID, for instance airlines, hotels and leisure, which together constitute less than 1% of our portfolio.

We have been proactive in our risk management and continually review our BBB exposures, which remain well diversified.

Over the last year, where appropriate, we have taken the opportunity to improve credit quality at attractive pricing levels and did so actively in H1.

As a result we have outperformed the downgrade experience of the market, with just 0.6% of our traded credit assets downgraded to sub-investment grade compared to around 1.5% for the total market.

As further protection, we continue to hold a substantial credit default reserve of £3.5 billion, and experienced no defaults across the portfolio in the first half.

We have maintained high credit quality with 2/3rds of our bond portfolio rated A or better and 18% in sovereign-like assets.

Going forwards, we recognise the economic impact of COVID-19 is still developing and we will continue to monitor and safeguard our portfolio.

LGR has a diversified and high quality direct investment portfolio with stable income from high quality counterparties, often additionally collateralised or secured, making it resilient to market stresses.

The £23.6 billion DI portfolio experienced no defaults in the first half, and 99% of scheduled cash flows were paid.

Additionally, all assets are independently internally rated and, as with the traded credit portfolio, downgrades to sub-investment grade have been minimal.

During H1, 1.4% of our UK DI downgraded to sub-investment grade.

These downgrades relate to assets under construction where we have experienced temporary delays.

Upon completion, we expect these to be upgraded to investment grade.

As we show here in the chart on the left, the primary exposure in LGR’s DI portfolio is counterparty risk to high quality institutions such as HMRC.

This constitutes 70% of the portfolio - as shown by the light grey circle.

Our ability to self-manufacture attractive, long-term assets to back annuities, such as build-to-rent or affordable housing or through Lifetime mortgages, is a differentiating feature of LGR’s business and remains a key competitive advantage.

Moving on to LGIM... operating profit was up 2% year on year to £196 million, reflecting increased revenues partly offset by continued investment in the business as part of LGIM’s growth strategy.

Higher revenues were driven primarily by LGIM's resilient AUM.

As indicated at our full year results, £29 million of annual LGIM-related project expenditure, previously reflected in Group, has been allocated to the LGIM results from 2020.

This, and LGIM's continued investment in data, analytics and our investment platforms, has led to a cost income ratio of 58%.

Total AUM reached £1.2 trillion, with international assets accounting for 31%, at £385 billion.

We remain a market leader in UK DC, where we now have 3.7 million workplace members and AUM of £97 billion.

Despite significant market volatility, total Retail AUM stands at £39 billion and we are top 3 in gross UK sales in H1.

Our diversified asset base has been resilient during a period of significant market volatility, with AUM up 4% from the end of 2019.

We maintained positive external net flows of £6.2 billion, with good growth in UK DC... driven by 41 new scheme wins in the half... and ongoing demand from our UK DB clients for LDI solutions.

Following its strong performance in 2019, Asia continued to show good growth potential with positive net flows of £5.2 billion.

However, this was offset by outflows in the US where we saw some DB pension clients rebalance their portfolios away from fixed income towards other asset classes based on pre-set asset allocation thresholds.

Despite this short term volatility, we remain confident in our international growth strategy over the medium term.

We continue to be a global leader on ESG, with more than £170 billion in responsible investment strategies.

In LGC, operating profit decreased 29% to £123 million primarily due to a pause in traditional housebuilding activities during the UK lockdown.

CALA was the most operationally impacted of our build to sell businesses.

Since June we have seen an improvement in the housing market.

If conditions remain similar to today, we estimate a 30% reduction in sales across the year, with the majority of the impact already reflected in the first half result.

Profit before tax was down due to the unrealised losses in the traded equity portfolio and some less significant valuation reductions, primarily our two DI retail assets that we have previously highlighted.

Our diversified Direct Investment portfolio now stands at £3 billion, up 15% on the prior year.

In the first half we continued to deploy cash to support the growth of our businesses, in particular making good progress in our affordable housing and Later Living activities.

Over the next three to five years we continue to expect to build our diversified direct investment AUM up to approximately £5 billion, with a target blended portfolio return of 8% to 10%.

Now moving onto our protection division, LGI.

Operating profit was £88 million, due to higher COVID-related claims and provisions.

The overall impact was partly insulated by the high proportion of reinsurance used in UK Retail Protection.

Profit before tax was down largely due to the formulaic impact on reserves of falling interest rates, as seen in previous periods.

Despite market competition and the temporary disruption from COVID, total gross premiums were up 5%.

The business continues to grow at good levels of profitability with Solvency 2 new business value up 19% to £138 million, driven by business mix and cost savings.

We anticipate continued premium growth across our UK and US businesses as technological innovation makes our products more accessible to customers and supports further product and pricing enhancements.

Moving onto our capital position.

Despite recent market volatility our balance sheet remains well capitalised with the Group's Solvency II surplus at £7.3 billion, and a coverage ratio of 173% at the end of June.

The quality of our capital remains strong… 74% of our Own funds is tier 1, and we remain confident in the resilience and capacity of our balance sheet to withstand further shocks.

We have bridged the Solvency II surplus to help explain the movement since the year end.

Operational surplus generation from the growing backbook was £0.8 billion.

As in previous years, we paid by far the larger of the two dividend payments of the year in the first half... £0.8 billion versus £0.3 billion.

The main impact on Solvency surplus in the half relates to market movements of £0.9 billion.

There is a positive £0.3 billion mostly from inflation and FX related movements offset by;

… £0.6 billion relating to interest rates, reflecting the non-economic impact of lower interest rates on the valuation of our balance sheet…

… £0.2 billion relating to lower equity market returns...

… And £0.4 billion reflecting the impact of spreads, with the positive impact of spread widening more than offset by the effect of dispersion.

We use the term dispersion when spreads on lower rated assets widen more than those with higher ratings.

This increases our modelled cost of trading those assets after projecting downgrades in a range of scenarios.

Under Solvency II, the main impact comes from sub-investment grade assets widening and so our full disclosure includes a new sensitivity to help those of you that model our balance sheet.

We wrote new business very efficiently, with total new business strain of just £100 million.

During the first half, debt markets for investment grade issuers were especially attractive and we took the opportunity to successfully raise £0.5 billion of sub-debt and £0.5bn of restricted Tier 1 debt...
... this gives us additional buffers and optionality, should there be further material market shocks.

We will, of course, remain disciplined in the deployment of our surplus capital to ensure we meet or exceed our target returns, and remain within our risk tolerances as market uncertainty continues.

So to conclude, it's been a challenging period for our customers, for our people, and for society at large.

Where we have been able to, we have continued to execute our long term strategy effectively, with three out of our five businesses delivering growth.

Our rigorous approach to risk management has ensured the balance sheet is strong, well-capitalised and continues to generate surplus… and our credit portfolio is positioned defensively.

In the second half we will remain extremely vigilant and will continue to monitor and manage the impact of COVID-19 across our businesses.

We firmly believe that our synergistic business model is well placed to execute on opportunities in the second half, with all our businesses competitively positioned in growing and profitable markets.

We intend to be a leader in the post-pandemic economic recovery... supporting our society, shareholders and customers.

As Nigel said, we are resilient, robust and highly relevant... and our ambition is for a similar performance in H2.

Thank you.