Legal & General

Q1 Interim Management Statement 2015

Wednesday, 6th May 2015

Mark Gregory, Group Chief Financial Officer

Good morning everyone and thanks for joining our Q1 call. With me in the room today are Mark Zinkula, CEO of LGIM; Duncan Finch, MD of Insurance; Jackie Noakes, MD of Mature Savings; and Mike Berry, MD of Digital Savings. And on the line we have Kerrigan Procter, MD of L&G Retirement and Paul Stanworth, MD of L&G Capital.

The top line numbers are that operational cash is up 11% year-on-year at £330m. Net cash is up 8% at £326m. LGIM's total assets are up to 17% compared to Q1 2014 at £737bn. Annuity assets are up 19% at £45.6bn. Savings AUA up 11% at £113bn. And UK Protection premiums are up 5% at £372m.

Our strategy remains to drive grow in our business, based on five global macro long-term trends, namely: ageing populations; welfare reform; globalisation of asset markets; digital lifestyles; and retrenching banks. All of these trends have played a part in today's numbers.

Turning to our businesses, and starting with L&G Retirement. Our stock of annuity assets has increased to £45.6bn, with sales in the first quarter of over three quarters of a £ billion, including £655m of bulk annuity transactions. Individual annuities remain a key part of our retirement proposition, and sales totalled £99m in Q1.

Pensions freedom started on 6th April 2015, and we're offering our customers various propositions in response to these new freedoms. This includes lifetime mortgages where we've completed the acquisition of New Life Home Finance, and are now active in the market.

Moving to LGIM, which now has total assets of £737bn. External AUM net flows in the first quarter were a healthy £4.3bn, driven by continued demand for LGIM's pension de-risking capabilities and further expansion of its international operations in the US and Asia.

Total international assets were £126.4bn. Workplace pensions, which is now part of LGIM, grew assets under administration to £13bn, up 43% year-on-year.

Our Insurance business had a solid first quarter, with UK Retail Protection gross written premiums up 6% and UK Group Protection up 3%.

Legal & General Savings, which now comprises digital and mature savings, increased its assets under administration by 11% to £113bn. Digital savings had net inflows of just under £1bn in the first quarter, and our Cofunds platform now has £76bn of assets.

L&G Capital remains focused on increasing the risk adjusted returns on shareholder funds; a further £400m of new direct investments were completed in the quarter. The Group's total direct investments are now £6.3bn, up 62% year-on-year.

The price changes introduced last year by Legal & General America resulted in sales of $31m compared to $38m in Q1 2014. Gross premiums however increased 5% to $283m.

Turning to outlook, we've positioned our businesses to grow as the long-term macro trends play out over time. We made a good start to 2015, and the business has momentum both in the UK and increasingly so internationally.

In terms of regulatory capital we've updated you on where we are with the Solvency II process. Discussions with the PRA are ongoing. This is an iterative process, and we will provide updates as clarity emerges. Final clarity is not expected until late in Q4 this year.

In summary, our stock of business is up, cash generation is up, our businesses have momentum and growth opportunities and finally we remain confident in delivering the 2015 operational cash guidance we gave at the time of the 2014 prelims.

I now open the call to questions.

Q&A session

Question 1

Andy Sinclair, Bank of America Merrill Lynch

Three questions. Firstly, can you see us the level of regular premiums flow that you're now seeing coming into workplace pensions on a quarterly basis if you excluded any transfers in of existing assets? Just to get an idea of the underlying flow per quarter.

Secondly, you've mentioned that large workplace pension schemes are being re-broked I just wondered if you could give us an idea of what the reasons are for these schemes leaving their existing providers, and what L&G is doing that others didn't.

Thirdly, just on Solvency II; I just wondered if you could confirm for us the application for transitionals doesn't affect your dividend policy and moving to 1.5 times cover by net cash generation by the end of the year.

Mark Gregory

I'll pick those up quickly, and let Mark add a bit of colour that he wants to add on the workplace.

In terms of the flows, year-on-year we had £0.5bn of inflows in the first quarter this year, so similar to where we were last year. A slight difference in terms of the make-up, Andy. I think last year we had more pension transfers come with the scheme whereas this year I think we're seeing more of the regular premiums coming through quarter in, quarter out. In some ways the compound effect of the flywheel of regular contributions beginning to have an impact in workplace. So in absolute terms the cash flow looks similar, but actually the make-up is slightly changing we're now seeing the benefit of having more members on our auto-enrolment platform, obviously with pay rises etc. that impact coming through. So similar I'd say, slightly different colour than what we had this time last year.

In terms of the general re-broking in the workplace market, I don't think at this stage many schemes are actually being formally re-broked. We are seeing some interest potentially from broker firms themselves in terms of whether to revisit some of their earlier decisions. Certainly some of the companies have perhaps used a final salary type solution to actually comply with the auto-enrolment rules when it first came in. I think some employers are now looking at whether that was the right answer, and therefore whether a more DC focused solution might be right. Certainly we are seeing quite a lot of activity in that space. But certainly the general interest in workplace remains very, very high.

In terms of the impact of transitionals, and does it have any impact on the dividend policy: we said today that we will be applying for a transitional provision as a part of our Solvency II application. We won't know whether that's needed or the size of that until the end of this year because it's based on the end of the 2015 balance sheet. To be absolutely clear, the transitional rules are very clear-cut, so any transitional relief will come straight off the technical provisions. That boosts own funds. That's a key component of the Solvency II balance sheet, so it will have no impact on the dividend policy. Our dividend policy remains as we stated at year end two months ago.

Question 2

Andrew Crean, Autonomous Research

Can I follow up on that question on transitionals? If you apply transitionals for one subsidiary would you then be blocked from getting dividends up from that subsidiary to Group, in the case where presumably you're trying to build capital in a subsidiary rather than reduce it through dividends?

Mark Gregory

To be absolutely clear on that point, I'll probably reiterate the answer I just gave to Andy on the previous question: transitionals are clear-cut in the way they work. They are absolutely clear, they come off debt provisions i.e. they reduce your debt provisions therefore they increase own funds. And the Solvency II balance sheet surplus will be cut on the overall state of the overall balance sheet. It's not about component parts it's the total balance sheet. So we're not foreseeing any issues with any blockage of in-flows up the Group.

Andrew Crean

So no fungibility issues from your annuity company in terms of income dividends?

Mark Gregory

Correct.

Question 3

Greig Paterson, KBW

Just three quick questions. One is in terms of new business release bulks, what sort of outlook, stable, up, down for the rest of the year? I just want to understand the trend in that sort of margin.

I noticed on the individual annuities you had a jump in the first quarter versus the fourth quarter last year, which is unusual in the run up to the A day. I was wondering why that was, did you launch a new product or was there some kind of phenomena going on there?

And then the third question: in terms of cost cutting the £80m, I wonder if you could, now that you're further into the programme, give us an idea of how much of that £80m will fall through to the bottom line? And of that, how much is actually coming through within the target to achieve breakeven on the workplace savings business?

Mark Gregory

Thanks, Greig. Kerrigan if you're still on the line can you ask the question on bulk trend and individual annuities, what happened in the first quarter? And I'll come back and say a few words on the cost-cutting programme.

Kerrigan Procter, MD (Legal & General Retirement)

In terms of new business release and the trend in margin really we're not seeing any change in that trend. We continue to find what we consider are attractive assets, attractively priced assets to allow us to support that. We obviously didn't disclose separately the new business margin, but the ongoing trend in new business.

Greig Paterson

So it's roughly unchanged?

Kerrigan Procter

Yes, roughly unchanged at the moment. Of course we always come back to our point that we have an internal return on capital hurdle metric, and we've applied that consistently throughout. So you'd probably expect something similar in terms of trend.

Greig Paterson

And then individual annuities, why have they jumped quarter on quarter?

Kerrigan Procter

No new products in Q1. They came in Q2 with freedom of choice on April 6th; so no new products in Q1. We just found ourselves a little bit more competitive while retaining our price discipline. So slightly up from where we were in Q4. But I think the Q4, Q1 run rate is broadly what we were expecting.

Greig Paterson

You don't have cap drawdown in there, do you?

Kerrigan Procter

No, we don't. That's just individual annuities.

Mark Gregory

And on the cost cutting point, Greig, as you say, we did highlight that we were targeting £80m of absolute cost savings this year. Obviously we did that at the same time where we expect to spend roughly £40m of restructuring costs to achieve it. So before we get too excited about any bottom line impact we will have to expense the restructuring costs at the same time.

Broadly, again we haven't given too much away, when we announced it at year-end some of this is just to reflect the fact some of our books are more mature in nature and therefore will have a declining revenue profile. Therefore some of this is just good housekeeping to make sure our cost profile reflects some of our revenue profile for some of our more mature books.

As a rough rule of thumb I would expect probably about half or just over half of that net benefit to drop through to the bottom line. Again, that's not a precise number at this stage, but just to give you some steer about what impact you might see from that.

And in terms of the impact you asked specifically about workplace savings, every part of the organisation is playing its part. I would say we've designed workplace to be a highly automated process in the first place. We have a highly automated onboarding process there. So I think in terms of the net-net, probably workplace won't be one of the major beneficiaries from the explicit cost save programme.

Question 4

Farhad Changazi, Nomura

Sorry, I might have missed the answer to Greig's question on bulk annuities. Are we expecting bulk annuity premiums in full-year 2015 to be up on full-year 2014?

Just two other questions; one on LGIM. It looks like the index fund is doing better in Q1. I know we had a big one last year with Tesco but could you give some guidance and outlook how we should be thinking about outflows from the index fund this time round? Should we take Tesco out from last year and then model up increasing outflows from 2014?

And the final question is on LGC: could you just remind us again of your ambition for total assets in LGC, and any colour on how much of that will be direct investments? Thanks.

Mark Gregory

Kerrigan, if you pick up the clarification point on the bulks outlook, Mark Zinkula can pick up on index. And Paul pick up the comment on our asset profile within LGC?

Kerrigan Procter

Really my answer to Greig was more around the new business recent margin. In terms of premiums I would say 2014 £5.9bn of bulk premiums was really an outstanding record year. So I'd view that as a tough hurdle to beat, shall we say.

I think £650m in Q1 was a good result in bulks in Q1. Plenty of pipeline out there, we talked about £10bn pipeline in the markets and I think that pretty much remains out there.

So there's plenty of demand from the clients and we'll just be selective about which deals make sense for us in terms of our internal hurdle metrics. So positive but it's a lumpy business and we'll be selective.

Mark Zinkula, LGIM Chief Executive Officer

In regards to our index business, we are seeing more inflows for the first part of the year outside of the UK DB channels, so consistent growth in other channels locally and won our first couple of index mandates in the US, and we'll talk more about this at half-year, there will be more activity over the first half of the year. And then we won a couple of mandates recently in Asia, which are not funded yet, so we're having good progress, much better progress in growing our index assets in other channels.

In regards to the outflows, last year we did have an unusual number of large one-off events, so in terms of what to model, I think you have to look at this, outflows of passive equities from UK DB plans as they de-risk, and fortunately we've seen that more than offset by growth in our Solutions business. That trend will continue, but again, it will be somewhat uneven year-to-year and certainly quarter-to-quarter. We are doing a much better job though in retaining assets that are switching out of passive equities into other products, de-risking products, which shows up in our market and other line item, movement line item, so we are doing a better job of expanding our range of LDI solutions and our fixed income offerings, as well as into property as well, we're seeing a lot of switches, a higher level of switches, into those other products, which not just retains assets but in most cases also enhances our revenues.

Paul Stanworth, MD Legal & General Capital

So LGC is looking after a portfolio of around £5bn. The returns on that overall portfolio were around 4.5%. And out of the portfolio, around 1.5bn of that was equities and we've been acquiring direct investments, effectively over time, to replace equity at around £0.50bn a year. What it allows us to do is contribute to operating businesses and projects which can help the access to assets for the annuity funds and also provide co-investment opportunities for LGIM's funds as well. So the ambition, which was your question, is to replace, effectively, the traded assets we have in equities with real assets for superior returns that give us better access to assets for the annuity fund and bring in more clients for LGIM. And overall, there will be an enhanced return from those other business units as a consequence of the assets that we purchase. Our focus is on, which Nigel reiterated I think in the last results, our main focus is housing and urban regeneration, and also we are looking at where there are opportunities in energy space and alternative finance.

<u>Question 5</u>

Ravi Tanna, Goldman Sachs

Hi, good morning and thank you. Just one question please on the impact of the pension freedoms on defined benefit pension schemes. A number of your peers, and also some of the actuarial consulting firms, were referring to an uptick in the number of increase from customers in DB schemes who are looking to transfer into DC schemes so that they can ultimately cash in their pension pots. So I was just wondering what your experience has been of this. Have you also seen an uptick and do you expect it to be a material impact at all on your business? Thank you.

Kerrigan Procter, MG of LGR

It's certainly been a well discussed topic that deferred pensions could be approached to switch their pensions to DC and then cash them in when they get to 55. I think it's been more discussion rather than action, and even though enquiries have gone in probably for people checking their pension amounts, I haven't seen a lot of actual action in terms of transfers. I think it's more challenging to actually go ahead and do it because you need to get an IFA's advice, show the trustees that you've got IFA advice, and then find a DC provider who will accept the cash. So it's a fairly involved process, so no impact on our business as yet. I can't really see that being a substantial impact on the business going forward. And, in fact, I think if DB schemes tackle that by reducing their deficit by transferring cash for deferred, it would actually free up the market to do even more bulk transfers for pensioners. So probably overall it might be a positive if it does pick up, but no pick up I've seen yet.

Question 6

Anasuya Iyer, Jefferies

Hi, thanks for taking my question. I just want to come back to the US outlook question. When I think about your business in the UK, I think of it across the pension de risking spectrum, so I think about index LDI plus bulk together. Should I think the same way in the US, or should I think of it separately there with you focusing on the index mandates instead of the entire spectrum?

And my other question was with US expansion, is there any Solvency II issue there? I know a lot of European players talk a lot about Solvency II equivalence for their US businesses, and is there something there that I should think about for you as well? Thanks.

Mark Gregory

Okay, Zink, perhaps you could comment on the more general LDI index stuff?

Mark Zinkula

Yes, from a market perspective, you should certainly think about thematically the US is going through the same transition in its pension landscape as the UK. Their DB plans are de-risking and there's a shift from DB to DC. This is playing out in the details a bit differently in each country; and ironically the DB market in the UK is ahead of the US in de-risking, but the US is way ahead of the UK in the growth of the DC market, but it's the same general trends that are happening.

From an LGIM perspective, or an L&G perspective, since our history is in the UK market, we established a sizeable and market-leading position in the UK DB market, which we were then protecting and have been growing actually as that market's gone from a growth phase to the maturity phase, and ultimately into annuitization, so we had a buy-out/buy-in longevity risk offloading phase which then obviously flows into Kerrigan's business.

In the US, since we entered the market already in this maturity phase, we're establishing our business as a market leading LDI business, so we built our business starting with our LDI business rather than index business for those reasons, but we're now adding the index business to it. And then obviously Kerrigan can talk about his plans for expanding into the annuity space, but clearly we see that as a growth market in the US as pension plans continue to mature and those that can afford it and desire to do so will ultimately pursue some kind of longevity risk offloading strategy.

Mark Gregory

And on your second question about any impact of Solvency II on our US expansion, I think it's fair to say that a lot of our expansion currently is coming through LGIM as non-insurance business that is not impacted by Solvency II in any way. Just more generally, almost certainly most of our risk capital and solvency will be deployed in the UK and therefore it would need quite a material change to our model than actually it would do in the US to make much of a difference to our Solvency II balance sheet. So I'm not saying it's completely immaterial but I'm simply saying it's unlikely to be a big driver of our ambitions in the US.

Question 7

Abid Hussain, Societe Generale

Hi, morning all, three questions from me if I may. The first one on bulk annuities. On the surface, it appears you're focusing on smaller cases, or certainly in Q1. Can you just talk about the competitive landscape at the small end, the mid-end and the large end in terms of bulk annuity transactions?

The second question is on Cofunds. Cofunds net flows were about half of what they were this time last year and can you just talk about what's driving that slowdown as we had expected a ramp-up in flows by now?

And then finally, my last question is on Solvency II. You mention in the press release this morning the use of transitional arrangements. Can you just talk about what product that might relate to? I'm assuming it's probably annuities. And can you also just talk about what restrictions, if any, the regulator might apply should you go down the transitional route? Thanks.

Mark Gregory

Kerrigan if you pick up the bulk question, Mike if you could pick up the co-funds flows point and I'll come back on the Solvency II impact.

Kerrigan Procter

On bulks, I think what you can say about the bulk market, it's anything but it's not homogenous. So even if you look at £650mn, that's 15 contracts, but they weren't all equal size, there are two larger ones in that, let's say, and probably the medium size in terms of your description of the market, and then a few smaller deals.

I guess just in terms of competitive nature, the large deals are just very lumpy and we think we have a USP in that space and it's probably only ourselves who do the larger ones, or maybe there are a couple of other firms who get involved. Small certainly felt the impact of the change of freedom and choice in pensions and increased competition there, so we did less in that market in the last year, and probably less overall in Q1, but that's starting to come back, that's starting to become slightly more attractive now. So I think the initial reactions have worn through and pricing is starting to look a bit more even across the competition there. And medium is probably somewhere between small and large, slightly fewer competitors in the medium space; so again, the medium space is probably where the majority of the £650mn came from in Q1, so definitely some attractive deals for us.

Mike Berry, MD of Digital Savings

Perhaps now if I turn to Cofunds. You are quite correct, the inflows into co-funds were a little lower in the first quarter of 2015 than the first quarter of 2014. You need to see the co-funds business as being two things: there are institutional flows and there are retail flows. The institutional flows tend to be a little bit more erratic, depending upon the deals with particular customers. The first quarter of last year we had particularly strong flows into our institutional business, so the reduction in net flows over the year represents a reduction in institutional inflow.

Mark Gregory

And your question on what transitional impact it might have on particular products, just taking a step back, transitionalswork on a total balance sheet basis, so you simply compare your total technical provisions under Solvency II compared to where you were the same thing under Solvency I. They're calculated on a different basis, and if your Solvency II technical provisions are higher than on Solvency I then you get transitional relief for the difference. So it's a total balance sheet impact rather than any particular products themselves being affected by it, and therefore, as I said earlier to the previous questions from Andy and Andrew, we're not foreseeing any restrictions on the back of that and the way the balance sheet will work in a Solvency II regime.

<u>Question 8</u>

Gordon Atkin, RBC

Morning, thanks. I've got three questions on bulk annuities please. First in the UK, There are several schemes have bought buy-ins from you on a slice of their liabilities, that's been an increasing trend, I just wondered what proportion of these do you expect to be pretty much repeat buyers, and just give a sense of the size of this repeat business and also the probability. That's the first question.

The second one is on the US, it's a follow up from a previous question so when I asked about how you're pushing on here and I understand your way in was to sell LDI mandates to big pension funds there, so I just wondered how many of let's just say the top hundred pension funds in the US or whatever number you want to give me are you managing LDI mandates for currently.

And the third question on the Dutch market, you talked about some intent here, and I'm assuming that you'd only look at post retirement liabilities, and I just wonder, is this quite a small opportunity or a small potential market at the moment, given that lots of the schemes in Holland are still open? Thanks.

Mark Gregory

Okay thanks, Gordon. I think, Mark if you want to just chip in on the LDI point in the US but Kerrigan, if you could just perhaps answer those three?

Kerrigan Procter

Yes, fantastic. Mark, I will hand over to you for the comments on the number of LDI mandates in the US for the top one hundred. But just in terms of UK buy-ins I think it's a very, very good point, it's definitely part of our business model, our bulk annuities new business team is split into two parts, strategic and core, and strategic is really about setting up relationships with the top two hundred pension schemes, very much with the idea that in an ideal situation there'd be a large initial transaction and then further slices of new business and so it's developing as far more of a relationship management business, so I would put it as quite a high probability that we'll get repeat business from that kind of strategic relationship with the largest clients.

In terms of the US, clearly an interesting market for us. Mark, did you want to say something about that?

Mark Zinkula

Yes, I'll be really brief because my answer is I don't know off the top of my head. In terms of your question, the number of top one hundred pension funds that are clients, I don't know that exact number, it would be a substantial number though for the top, whatever, top five or top ten pension funds are clients. And just given the inherent nature of our business model as you can imagine a significant percentage of our assets would be with the largest plans in the country because they're going to be the first to implement these kind of strategies and obviously do them in size. So for both of those reasons a substantial percentage of our assets are with the hundred largest plans in the country and that portion will continue to grow over time as they continue to implement the other de-risking strategies as they hit their various targets, I just don't know the exact number off the top of my head, but we can get back to you with that.

Kerrigan Procter

Yes, just finally on the Dutch market, I mean we are interested in entering as a reinsurer probably as much as a direct writer there, there's definitely some opportunities for us that we're following up, we have our longevity pricing basis and investment strategy all set so that we're comfortable with that and there are deals to be done but you're right to say that it feels like a smaller market than the UK and the US certainly. But we'd expect to see some action there, there's certainly some deals in the markets pipeline and things that we're interested in.

Gordon Aitken

So just on that last point you'd be reinsuring the major Dutch insurance companies who are writing this business?

Kerrigan Procter

Well, probably that's the first option, to provide capacities to the market in that way, although there are some ways in which you could enter as a reinsurer directly with pension schemes, but that's probably a bit further down the line.

<u>Question 9</u>

Jon Hocking, Morgan Stanley

Morning everybody, I've got three questions please, two on Solvency II and one on bulks. On the Solvency II point around the transitionals, I think what you're saying seems to be different than the message that we had from the Pru at full year, it may be sort of a nuance, but they seem to be talking about taking the transitionals on a discrete basis for the annuity fund rather than applying it across their entire UK business. I wonder if you would comment on that.

And secondly, I just wonder whether you or the industry have any idea yet about how you're going to communicate when you had some final idea about where the Solvency II numbers sat and whether you were going to talk about when you had model approval, is it going to be a '15 even or a '16 event?

And then just finally on bulks, just on the pipeline I just wonder whether you're seeing any impact on the pipeline for the sort of funding pressure we've seen on DB schemes in the course of the sort of recent reporting season from the corporates in the UK? Thank you.

Mark Gregory

Okay, I'll pick up the first two then Jon. Just on the transitionals point, of course I'm not entirely sure what Nick said at the Pru prelims, I'm sure he was technically right in what he said, but the way that it works, just on aentity balance sheet basis, so it will be done at an entity level and it will be at a Group level based on the actual, as I said earlier, the difference between the technical provisions under Solvency I and Solvency II, so that is the way the directive is set out, it's very clear cut and that's the way it's going to operate in practice.

Jon Hocking

Just a point, some of your competitors have talked about a sort of partial internal model basis and effectively choosing entity by entity whether they use an internal model or a standard formula so I'm surprised you say you're going to apply it to the entire business.

Mark Gregory

We can do it on a regulated entity basis, so we have various regulated entities within L&G Group and it will also apply at Group level, but within that we will have certain entities which will be done on standard formula which are less important from our perspective and some on our internal model basis, so I think we're saying the same thing.

Jon Hocking

Okay, so you're not saying you're going to use the transitionals for the entire Group balance sheet, it's just going to be the transitionals for discreet entities where it makes sense? So you're saying exactly the same as the Pru?

Mark Gregory

If then it aggregates up to Group level, yes we're saying the same thing.

Jon Hocking

Okay fine, thank you.

Mark Gregory

In terms of communication I guess we're all in the same camp here, we're all obviously in fairly fluid ongoing negotiations and discussions with the regulator. I would envisage, Jon, we'll only get clarity very late in this year and I wouldn't be surprised if the PRA don't try and coordinate it to make sure we all get feedback at pretty much the same time, I think it would make sense to do that to an extent. But I think in terms of your expectations I think it could well be very, very late 2015 and indeed it could easily be slipping into 2016 before we have the absolute clarity the market would like to have at this point. And, Kerrigan, on bulks?

Kerrigan Procter

Yes, just the impact on funding pressures, I mean in terms of if we want to talk about the market pipeline out there, I mentioned the ten million pound figure as the kind of people who are looking to "transact", just to be clear they might not all transact this year. But I think most of those have probably gone down the de-risking route or LDI route in some ways, so actually the continuing fall or lower for longer interest rates hasn't had so much of an impact on them. So no impact that side.

Clearly those further away from de-risking or just embarking on the de-risking route, they'll be the ones probably most impacted by what you've seen in reports and accounts on the size of pension deficits; and therefore may have a longer journey to go before they're ready to proceed to actual pension risk transfer. They'll be looking actively at pension risk management so they'll be definitely courted by our LGIM business.

<u>Question 10</u>

Alan Devlin, Barclays

Hi guys, thanks. Just a couple of questions from me. First of all your new business strain was quite low in the quarter, even without the benefit of any large books, I wonder if you'd tell us what's driving that and if that's sustainable if you don't have any major books throughout the year.

And just secondly on your retail protection business, I know you've got a large share of the market there, the premiums were up and sales were down, I wonder if you could give us some colour about what's going on in that market and what the outlook is? Thanks.

Mark Gregory

Okay, thanks Alan. I'll pick up the first one on new business strainand Duncan, you can comment on the dynamics in the retail protection market right now. Clearly Q1 and Q3, Alan, we don't give the exact breakdown by component part of op cash strain and net cash, to give you a little bit of colour though, I mean some of the benefits we get simply come from greater scale, full stop; so some of the unit costs etc, some of our overheads etc, the bigger the books are in total so some of those unit cost benefits come through to new business as strain or surplus as well.

So in some ways it's just the fact that as an organisation gets bigger so we spread our fixed costs more generally and therefore the impact on each component, such as new business strain does reduce. So a bit of that is going on in the dynamic as well, clearly we'll show a bit more colour at the half year when we actually give the detailed breakdown, but clearly we are very active in managing the amount of capital and strain we incur when writing new business, that's been true for a quite a while now at L&G. Duncan, just on the retail protection one?

Duncan Finch, MD of Insurance

Yes, just on retail protection, so the first quarter yes, we're satisfied with the performance that we had in the first quarter in retail protection. Quarter one '15 did reflect slightly lower volumes of retail protection business compared to the same quarter in 2014, that was a very strong quarter, but underneath that the underlying business that we have in retail protection continues to perform very strongly.

New business obviously is only part of the story, as Mark said earlier on, overall GWP for retail protection is up 6% year-on-year. In terms of full year outlook I'd just direct you to the outlook statement that we've got that talks about where we will be on the full year in terms of new business volumes and margin.

Question 11

Ashik Mussadi, JP Morgan

Hi, good morning everyone. I have a couple of questions: first of all sorry if you've already answered this, but can you tell us what sort of transitional arrangements are you using, is it mainly on the discount rate, is it mainly on the asset risk charges, so some sort of colour on that.

Secondly, I guess you have a big deferred annuity book as well in your annuities, I think it's around £4bn or £5bn, so whereas I heard that there is no matching adjustment will be applicable on this particular book as of now. So any thoughts on that, what are you doing with that book, are there any issues in respect of capital on that particular book, how you'll be using that under Solvency II.

And thirdly, I mean just to cross check, the lower volumes in bulk annuities, has it anything to do with Solvency II, i.e. are you pulling back on bulk annuities at the moment because of uncertainty on Solvency II or now is it just a timing thing rather than anything else? Thank you.

Mark Gregory

Okay thanks Ashik, I'll probably pick up on all those myself, again I feel a bit like a cracked record on the transitional point; I keep coming back to it, transitionals are calculated based on total technical provisions, for the entity if you compare Solvency II with Solvency I, that is the way the rules work. So I think people are looking for shadows which don't exist, it's very clear cut, it's defined in the directive, we will make an application, we won't actually know when we need them or what size we're going to need them, it'll be based on the 31.12.15 balance sheet, so that's the way the rules are going to work in practice.

In terms of your point around matching adjustment applicability to deferred annuities, I'm afraid you're just wrong on that, the MA rules are the MA rules and whether it's deferred or an annuity in payment doesn't matter, it's still eligible for matching adjustment treatment.

And the final one about whether we're pulling back on volumes in respect of having one eye on Solvency II, I think Kerrigan's already picked up the point earlier on, the dynamics of the market are that the bulk market remains pretty lumpy, £655m was a good first quarter for bulks. Clearly we recognise that Solvency II is coming down the track and we're happy writing new business and recognising the likely landscape with the capital regime post this year, so certainly no impact on Solvency II in terms of the amount of business we're writing in the bulk space.

Ashik Mussadi

Yes, thanks a lot for your clarity, but just coming back on your bulk deferred annuity point, I thought that matching adjustment is only applicable to businesses where you have fixed cash inflows and fixed cash outflows, i.e. there's no optionality. But if you think about deferred annuity book, my sense is that there is a huge amount of optionality because of the recent pension freedom. Okay, so would matching adjustment still apply on that? Sorry, but I got a bit confused on that, so any colour on that would be really good, thank you.

Mark Gregory

I'll stick to my answer I gave earlier, Ashik, we still full expect the matching adjustment to apply to both deferred and the pensions in payment on our annuity book.

Concluding Comments: Mark Gregory

Okay, I think that's probably the last of the calls, so I thank you all for your interest this morning and we'll see you again shortly.