The Actuarial Profession
making financial sense of the future

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BUILDING A DIVERSIFIED FINANCIAL SERVICES BUSINESS THAT CREATES SHAREHOLDER VALUE IN A FAT TAIL WORLD.

L&G'S FINANCIAL STRATEGY.

Sustainable, predictable and growing cashflow which will result in superior dividend growth.

- Successful measurement and management of risks in delivering cashflows:
  - Market risk in the asset side
  - Actuarial risk on the liability side

"Increasing" cashflow *certainty* is slowly being reflected in the share price performance.

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WHAT IS DIVERSITY?

"Diversity" can drive share performance in many ways:

- What can be measured and managed: dividend, geographic, product, insurance, investment, M&A
- Which are recognised and rewarded by investors and "agencies" in delivering cashflow and capital certainty?
- What are the risks that diversity brings?
- Are the risks recognised?

Key question: What type of diversity assists in successful execution of the strategy?

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BACKGROUND.

In the last 10 years it has been difficult for companies to deliver shareholder value

- FTSE is broadly in the same position as it was 10 years ago, however
  - UK house prices are about double what they were 10 years ago
  - BAT , BG and SSE are three of the best performing shares
- Numerous high profile company's have share prices less than they were 10 years ago – unclear that "diversification" has driven value creation
- Understanding what types of diversification and what types of focus create shareholder value is critical – possible misguided views on these subjects from "agencies"

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FAT TAIL DISTRIBUTION AND LITTLE CORRELATION: SHARE PRICE PERFORMANCE OVER 10 YEARS

Company	Share Price 11/05/2001	13/05/2011	% Change
BP	610	442	-28
Shell	2026	2150	6
Barclays	555	274	-51
HSBC	776	648	-17
RBS	471	43	-91
Lloyds Banking Group	375	55	-85
GSK	1937	1349	-30
AstraZeneca	3284	3194	-3
Vodafone	232	168	-17
Scottish & Southern Energy	610	1335	119
National Grid	563	620	26
BG	267	1322	396
Rio Tinto	1132	4093	262
Xstrata	292	1358	364
BAT	556	2704	387
Prudential	806	735	-9
Aviva	953	436	-54
L&G	149	116	-22

* Listed on LSE on 19/03/2002

Source: Bloomberg, BoAML

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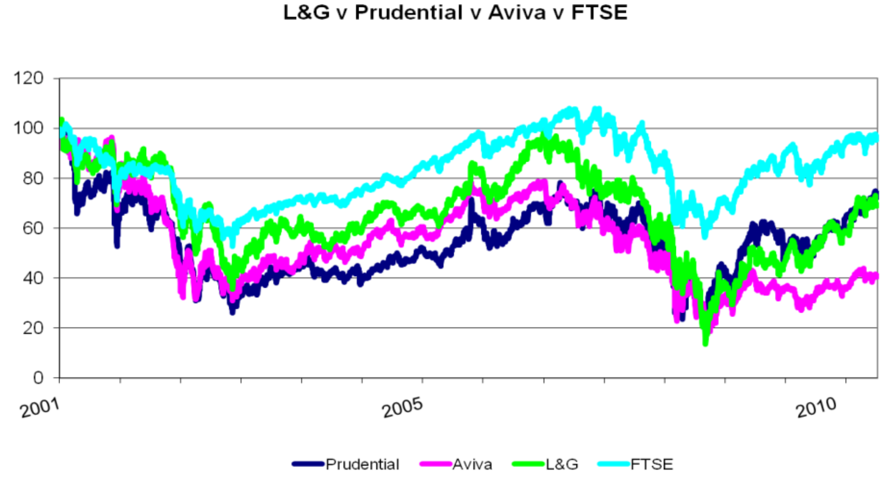
IMPACT OF GEOGRAPHICAL AND M&A DRIVEN DIVERSIFICATION?



Source: Bloomberg

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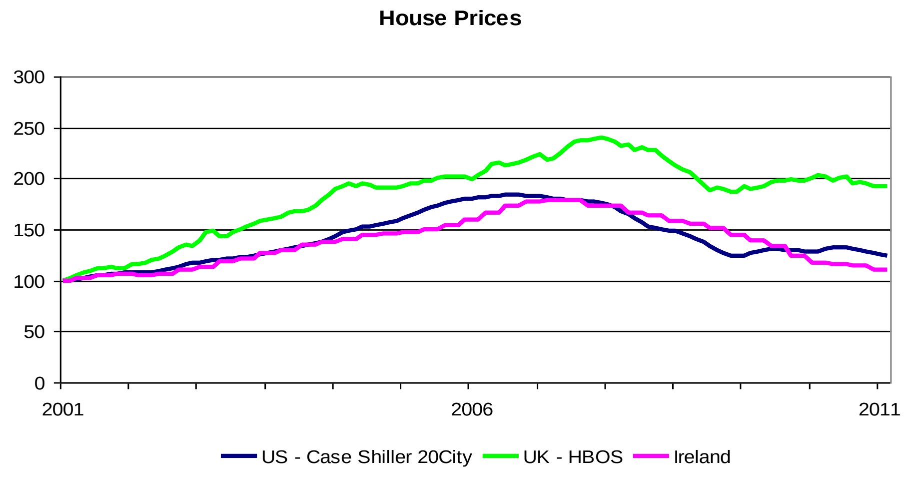
UK HOUSE PRICES 2X FTSE RETURN



Source: Bloomberg

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L&G SNAPSHOT.

Legal and General consists of 5 businesses that have " relevant diversification", a high degree of focus and an ability to measure and manage diversified risks

- **LGIM** – Highly efficient asset manager with £350b of AUM
- **Housing and Protection** – Scale UK insurance business; mortality risk
- **Annuities** – Scale UK spread business; longevity risk, credit risk
- **Saving** – Scale UK spread business, lapse risk, cost risk, asset risk
- **International** – Scale in US insurance, subscale elsewhere

Synergies exist between businesses, including diversification of the risks that we understand well

MARKET LEADING BUSINESSES.

RISK BUSINESS

2010: IFRS Profits: £560m
Cash: £429m

ANNUITIES

2010: Operational Cash: £229m
Net Cash: £289m

High scale spread business. Expertise in mortality, asset/liability mgmt. Strong growth prospects

Funds Under Management	£25bn	#1
Individual Annuity APE	75% of FUM	#1
Average Size	£26,000	
No of Bulk Annuity deals	115	#1
Average Size	£7.8m	
Earned interest margin	117bps	
New business Margin	11.9%	
Expected market growth	10-15%	

HOUSING & PROTECTION

2010: Operational Cash: £210m
Net Cash: £140m

High scale insurance business. Leading distribution franchise. Risk heavily reinsured

In force premiums	£1.4bn	+6%
Protection premiums	£1.2bn	+6%
New Business APE	£175m	-3%
Market share	16%	#1
New business margin	6.4%	
GI premiums	£281m	+3%
General insurance COR	106%	
Expected market growth	5% pa	

INVESTMENT MANAGEMENT

2010: IFRS Profits: £206m
Cash: £162m

Low cost asset manager, leading position in the UK with strong international growth potential

Funds Under Management	£354bn	#2
External Clients	75% of FUM	#1
FTSE100 Clients	50 out of 100	#1
Gross New Business	£33.1bn	+5%
Int'l new business	£6bn	+165%
Fee to Fund ratio	10.7bps	+9%
Cost to Fund ratio	5.5bps	+6%

SAVINGS

2010: IFRS Profits: £115m
Cash: £68m

Transformation continuing. Sales up 43%, headcount down 20%. Attractive market prospects

Funds Under Management	£64bn	+16%
New Business APE	£1,253m	+38%
Net asset flows	£3.1bn	+82%
Unit Trusts AUM	£23.3bn	#4
Cofunds Assets	£30bn	#3
Workplace Savings	£7.2bn	#3
Expected market growth	5-10%pa	

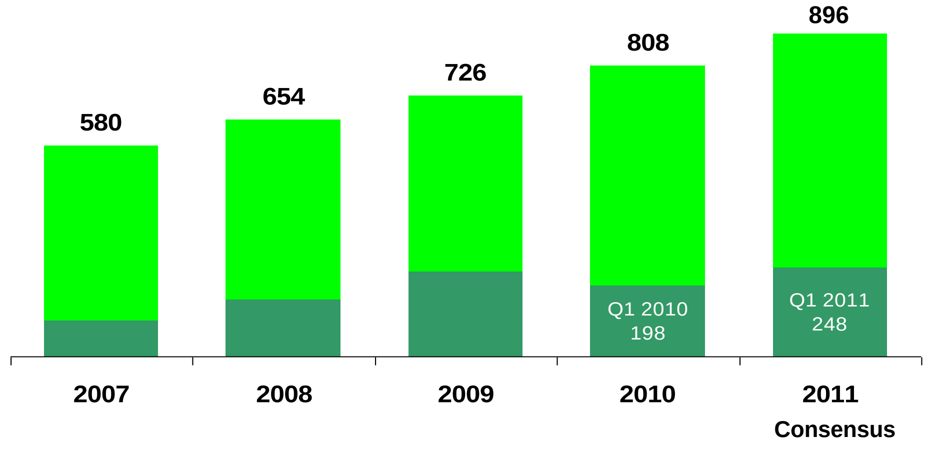
INTERNATIONAL

2010: IFRS Profits: £102m Cash: £44m

Aim to be coherent, dividend paying and delivering acceptable returns

US	$778m premiums, $175m operating profit, $53m cash	Europe	€709m premiums, €37m profits, €12m cash	Emerging Markets	£53m APE in India

NET OPERATIONAL CASH*(£m)
Growing 12% per annum



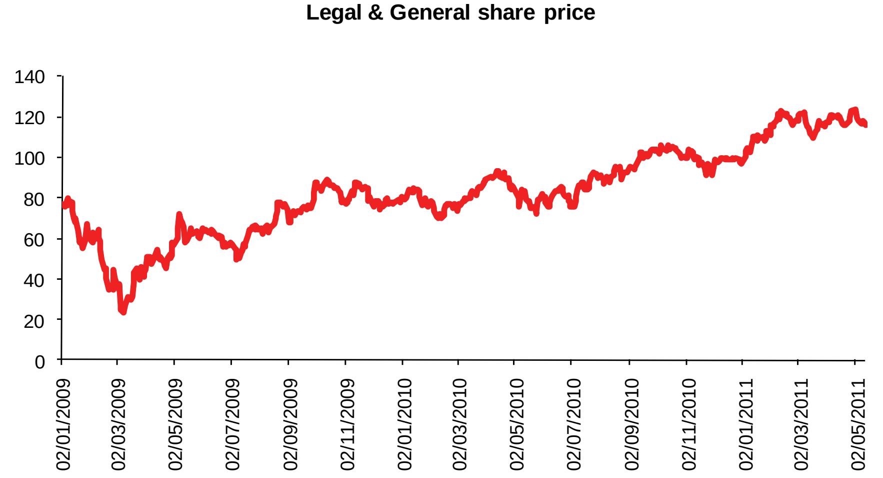
*After deducting after tax interest cost

MARKET ASSESSMENT.

Despite a consistent growth in operational cash of around 12% per annum, L&G has experienced a volatile share price.

- Net operational cash has grown from £580m in 2007 to £808m in 2010 (+40%).
- Market consensus is £896m in 2011 and Q1 results are “supportive”.
- Despite “highly predictable” cashflow, share price volatility has been high.
- CDS and share price have been highly correlated.

VOLATILE SHARE PRICE.



DIVIDEND HISTORY.

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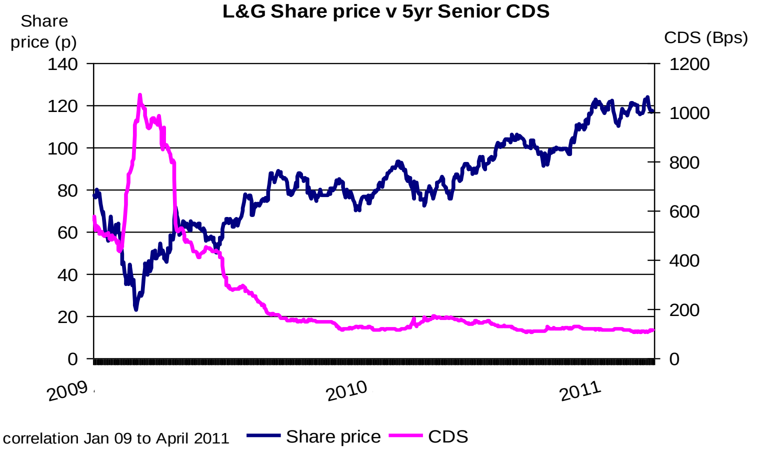
NEGATIVE CORRELATION OF CDS & SHARE PRICE.



Source: Bloomberg

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SHARE PRICE DRIVERS.

Lack of diversification of cash flow and "incorrect" prediction of high correlation between CDS, equity prices and defaults probably major causes of share price volatility and share price decrease

- Annuities contributed 52% of net cash in 2009
- Major concern was that future cash would be substantially reduced through credit default experience
- This proved not to be the case despite "high assumed correlation" between CDS, equity prices and expected defaults
- We now have a £1.5b credit default reserve against our annuity credit portfolio around £22b – approx 64bp per annum

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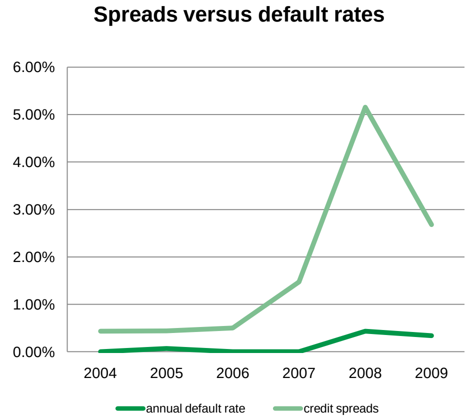
INHERENT CREDIT RISK LOW.

- "Agency" pressure to increase provisioning led to over-reserving generally.
- Volatility of insurers surplus increased perception of investment risk.
- The benefits of L&G's diversified credit portfolio (>500 credits) was not focussed on during the crisis.
- L&G's default experience has been insignificant versus provisioning levels.

→ Market indicators can be more volatile than inherent risks, leading to negative perceptions .



Data :
1) Spreads : ML 5-10 years GBP corporate sector options adjusted spreads
2) Default rate : Moody's annual default rate for investment grade bonds

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ANNUITES CONTRIBUTED £364m (52%) OF £699m NET CASH IN 2009

	2009 FY Actual £m	2011 Operational Cash Consensus £m
Operational cash	235	236
New business strain	129	
Annuities - net cash	364	
Operational cash	219	219
New business strain	(79)	
Housing and Protection - net cash	140	
Operational cash	106	158
New business strain	(77)	
Savings - net cash	29	
Investment management	125	176
International	8	53
Group capital and financing	33	36
Net cash	**699**	
Net operational cash	**726**	**878**

*3 leading analysts (current consensus at 13 May 2011)

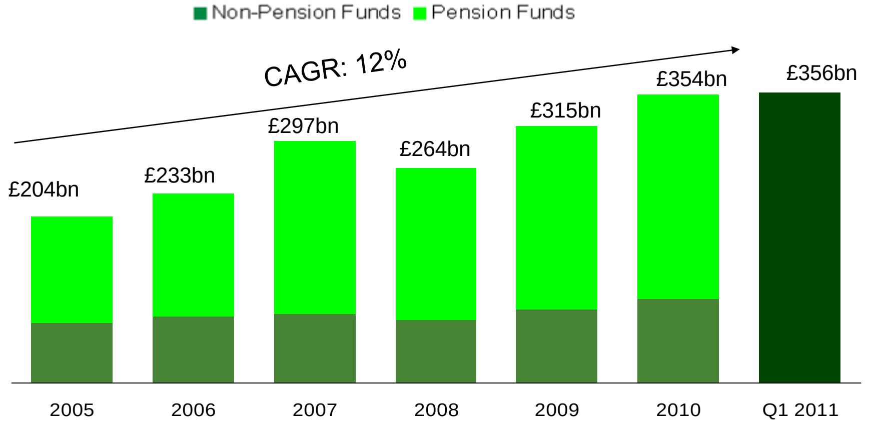
**Group Capital and financing is Investment return minus after tax cost of debt

OUR RESPONSE.

We have accelerated the growth of our operational and net cash for our other businesses - diversifying our sources of cash flow and our risk

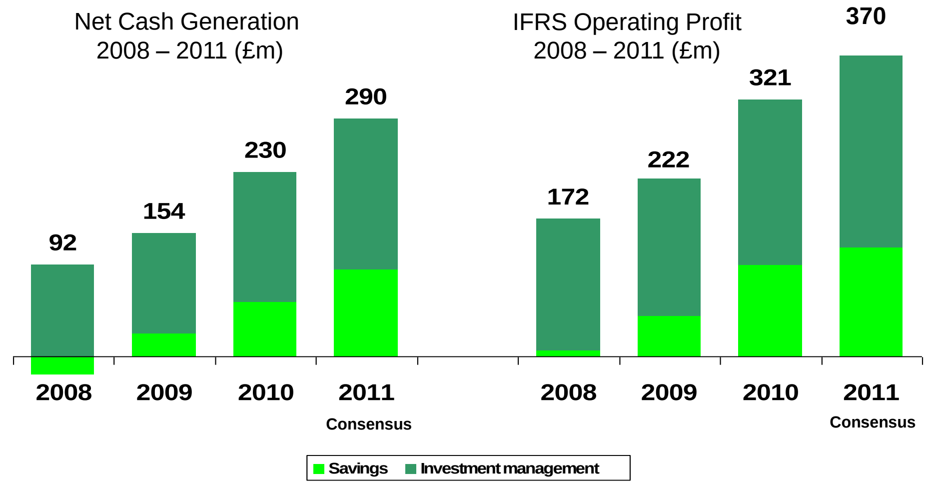
- LGIM has become a bigger part of what we do
- Savings has been turned around into a profitable growth business
- International has become cash generative and we are returning substantial excess capital to Group

BUSINESS GROWTH: LGIM AUM AND PROFIT 2005-2010.



Profit £96m → £206m
FTSE 5,600 → 5,900

SAVINGS AND LGIM: MASSIVE INCREASE IN PROFITS AND CASHFLOW.

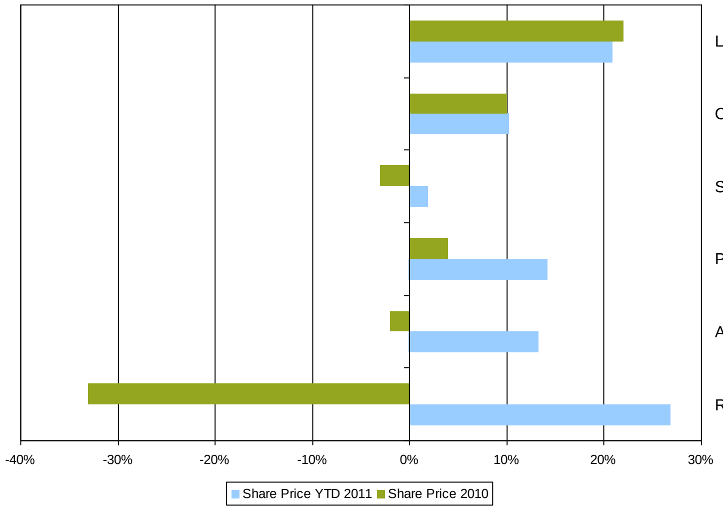


MARKET RESPONSE.

The success of this diversification and focus has resulted in a story of absolute and relative share price performance.

- L&G performed well in a sector that was a relatively poor performer in 2010
- L&G is performing well in a sector that is performing relatively well in 2011
- Unclear as to why sector relative performance in 2011 is much higher than 2010

SHARE PRICE GROWTH 2010 AND YTD 2011:



	FTSE Rank YTD	FTSE Rank 2010
Legal & General	5th	44th
Old Mutual	27th	59th
Standard Life	46th	77th
Pru	13th	71st
Aviva	18th	80th
Resolution	2nd	100th

SOME PERCEPTIONS CHALLENGING.

There are three issues that we continue to focus on:

- International diversification.
- Demystification of insurance valuation methodology.
- The discounted value of the sector.

RATING AGENCY COMMENTARY.

Moody's (Dec 2010) (May 2011)	I. **Credit challenge** - limited geographical diversification due to focus on UK life market II. **What could change rating up** - Substantial improvement in geographical diversification of revenues and profit III. **Downgrade** - negative view on UK life market and L&G's reliance on this market
Standard & Poors	1) Weakness • Limited geographic diversification outside the UK • UK concentration is viewed as a weakness 2) Overseas • Provide some revenue diversity

INTERNATIONAL DIVERSITY.

International diversification to date has been variable → limited evidence of success:

- Limited industry empirical data to support geographic and M&A diversification
  - Acquisitions have not created shareholder value either geographic or via "related activities"
  - Entrance into new emerging markets (China, India, Turkey) is "expensive" at 3x embedded value and do we understand risks?
  - "Difficult" to create economies of scale in manufacturing and distribution in new markets?
- L&G has operations in US, France , Netherlands, Germany, Egypt, Gulf & India, but impact has been "variable".

DEMYSTIFICATION OF INSURANCE VALUATION METRICS.

- Insurance by "quality" of valuation metrics driven actuarial modelling and assumptions.
- Realised cashflow depends on accuracy of these "estimates".
- Insurance risk can be highly diversified and therefore add substantial shareholder value
  - Industry diversified versus undiversified ICA's in range 30% - 50%.
  - Do we have full range of relevant life and insurance risks in UK?
  - Is our cost of capital competitive?

HIGH DEGREE OF CONFIDENCE OVER 2011 CASH.

	FY 2010 Operational cash generation (£m)	FY 2010 New business strain (£m)	FY 2010 Net cash generation (£m)	FY 2011 Operational cash generation (£m)	FY 2011 New business strain (£m)	FY 2011 Net cash generation (£m)
Annuities	229	60	289	c. 220		
Protection	216	(70)	146	c. 230		
Insured Savings	77	(70)	7	c. 100		
In-force cash generation	522		442	c. 550		
With-profits	46		46	c. 50		
Savings Investments and other savings	15		15			
GI and other risk	(6)		(6)			
LGIM	162		162			
International dividends	44		44	c. 50		
Group capital and financing – Post tax investment income	118		118			
Group capital and financing – Post tax interest expense	(93)		(93)			
Total	808	(80)	728			
Variances and other			(10)			
International (excl. dividends)			33			
Tax gross up			251			
Operating profit			1,002			

UK UVIF*: £8.0bn

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Why does market discount VIF so much?
MARKET VALUE AND EEV.

	FY 10 Analyst Pack Reference:	EEV 2010 £m	EEV 2010 pp share	"Analysts" / Market value £m	"Analysts" / Market value pp share	Op Cash 2010	Op Cash 2011
IFRS							
LGIM	*5.18*	324	6	2,640	45	162	
Savings Investments	*5.18*	142	2	300	5	21	
GI	*5.18*	120	2	250	4	(6)	
		586	**10**	**3,190**	**54**		
PVIF							
UK[1]	*5.17*	4,220	72			562	
International[2]	*5.17*	1,090	19			44	
Total PVIF[3,4]		**5,310**	**91**	**1,846**	**31**	606	
EEV SNW							
UK[5]	*5.16*	3,035	52	3,035	52		
International	*5.16*	748	13	748	13		
		3,783	**65**	**3,783**	**65**	25	
Other[6]	*5.18*	**(1,540)**	**(26)**	**(1,540)**	**(26)**		
Cost of capital[7]	*5.17*	**(409)**	**(7)**	**(409)**	**(7)**		
						808	
Strain						(80)	
Total		**7,730**	**132**	**6,870**	**117**	**728**	

1 - UK VIF is discounted at 7.3% at FY10 and 8.0% at FY09.
2 - US VIF is discounted at 6.6% at FY10 and 7.4% at FY09. Europe VIF is discounted at 6.5% at FY10 and 7.1% at FY09.
3 - Market value of PVIF reflects c3.1x 2011 UK expected release (Note: this excludes any release from the International business).
4 - Market value of PVIF is 35% of published PVIF and assumes a discount rate of c25% - 35% of future cashflows.
5 - Primarily £3.2bn (FY09: £2.3bn) of Society shareholder capital (Analyst Pack note 4.01).
6 - Mainly Group Capital and Financing non-covered business of £(1,580)m (Note: this includes the Group's debt), Other risk (£3m) and International emerging markets (£37m) equity.
7 - Cost of capital represents the cost of having to hold solvency capital for the life of the in-force policies

Key:
PVIF - Present value of in-force (VIF excluding cost of capital)
VIF - Value of in-force (includes cost of capital)
SNW - Shareholder net worth
AuM - Assets under Management
GWP - Gross written premiums
GC&F - Group capital and financing

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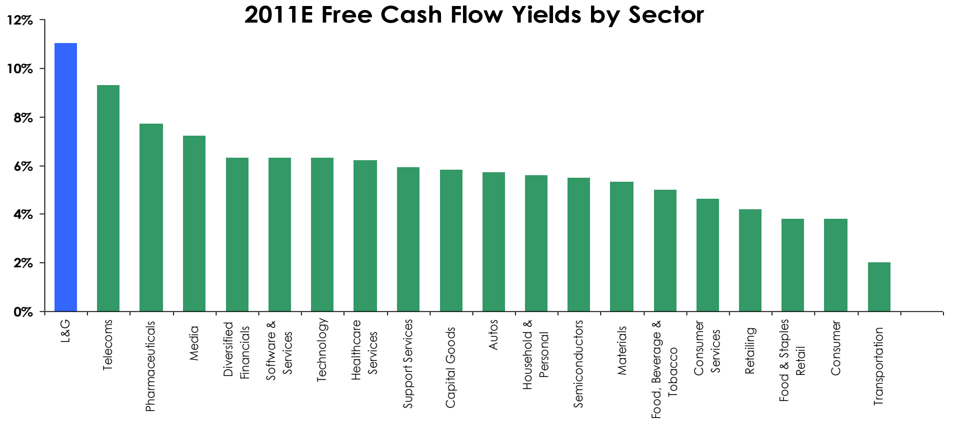
Why is the risk of our cash flow so high?
VALUATION: Free Cash Flow Yields.



Source: Global BofAML estimates, 27/4/11. LGEN Share Price 117.0p (as at 12 May 2011)

Agencies have challenge in how to price and value fat tail risks

Source of risk	Agency issues
Dividends	Perceived risk from substantial reduction
Cashflow (PVIF)	Perceived insurance risk is higher than actuarial estimates (lapse, mortality, longevity etc)
	Perceived market risk reflects correlated fat tail risk of asset “blow outs” (credit, sovereign, equity, CDO)
Cost of capital	Agency costs of shareholder assets greater than £409m
	Risk of investing assets below assured return
Regulation	Fat tail shock plus “excess capital” invested in low yielding assets

WIDE RANGE OF MARKET EXPECTATIONS.

	2012 Net Cash (£m)	2012 DPS (p)	2012 Dividend Cover (x)	Dividend CAGR (%)
Nomura	**929**	**7.20**	**2.2**	**23**
HSBC	**919**	**6.28**	**2.5**	**15**
JP Morgan	**868**	**6.29**	**2.4**	**15**
Citi	**835**	**5.49**	**2.6**	**8**
Credit Suisse	**819**	**6.01**	**2.3**	**12**
Deutsche	**813**	**6.30**	**2.2**	**15**
Berenberg	**810**	**6.28**	**2.2**	**15**
Jefferies	**785**	**6.28**	**2.1**	**15**
KBW	**782**	**6.00**	**2.2**	**12**
Morgan Stanley	**783**	**6.28**	**2.1**	**15**
BoAML	**736**	**5.75**	**2.2**	**10**
Consensus	813	6.15	2.3	13
Range	736 - 929	5.49 – 7.20	2.1 – 2.6	8 - 23

DIVERSITY CAN ASSIST IN DELIVERING L&G'S STRATEGY.

Benefits of diversity exist.

However, many risks of diversity exist:

- Diversity can increase marginal costs and challenge management focus.
- Barriers to entry to new markets can be high and information gap large.
- The detailed risks/benefits of diversity must be understood.

Rating agencies, Analysts and consultants responses to diversity in the insurance sector are generally penal versus other sectors and not uniformly applied.

Source of diversity And risk reduction	Issues	Value of strategy
Product	**+ profit characteristics can complimentary/synergy + recycling of business possible**	**Good**
Geography	**+ different economic backdrops -information gaps/limited management bandwidth -Regulatory change**	**Mixed**
Insurance	**+ strong negative correlations available - underwriting performance must be strong to avoid cost**	**Good**
Investment	**+ idiosyncratic risk can be diversified - global synchronisation may limit benefits in the tail**	**Good**
M&A	**- synergy benefits unclear - entry costs**	**Unproven**

EMERGING CONCLUSIONS.

- Successful diversification of our cash flow has been partially rewarded by improving share price
- "Agents" give too much emphasis to geographic diversification and too little to insurance diversification
- Our industry has failed to implement and communicate shareholder value creation versus other sectors