With-Profit Endowments 2013

During the first quarter of each year, most of the UK Life Insurance companies will publish results on the performance of their with-profit funds during the previous calendar year. They will also announce the changes that they are making to annual bonus rates, terminal bonus rates and payouts for with-profit policies. Individual policyholder statements will be sent out detailing the bonus additions and guarantees that are to be applied to policies. 2013 is likely to be a busy year for Life Insurance companies as the number of endowment policies that mature this year is likely to be higher than in previous years.

SL Investment Management Ltd has been a primary participant in the endowment market for over 20 years and is constantly monitoring the performance of the larger UK life companies, comparing the changes in bonus rates from year to year to ascertain how policies might fair in the future. Following a stock market rally in the latter half of the year, expectations were high for a positive change to maturity payouts. The results for the larger issuing life companies were mixed. Whilst the annual investment returns announced show the funds performing well, this has not translated through into payouts which have mostly reduced from the levels achieved last year.

Table A: Return on With-Profits funds over the year 2012

Life Company	Annual Return
Clerical Medical	n/a
Commercial Union	7.3%
Friends Provident	8.5%
General Accident	7.3%
Legal & General	10.6%
Norwich Union	8.1%
Prudential	10.5%
Royal Life	n/a
Scottish Amicable	n/a
Standard Life	7.9%
Scottish Widows	9.0%
Average	**8.7%**
FTSE All Share Index (total return)	12.3%
FTSE 100 index (total return)	10.0%
ABI UK - mixed 20%-60% Shares	8.4%
IPD UK All Property Monthly (total return)	2.4%
Morningstar 90 days notice	0.6%
Source: Life Company data and press releases	

Without exception, the published 2012 annual returns for each of the With-Profit funds were positive but some fell someway short of the returns achieved by the indices of underlying assets. Table A shows the annual returns achieved on the assets in the with-profit funds of the larger Life Companies together with comparable performance figures for other investments and indices. The With-Profit annual return figures are before the deduction of tax and expenses.

With the equity markets performing well over the course of the year, Legal & General and Prudential topped the one year returns, at 10.6% and 10.5% respectively, which have obviously been boosted by the investment strategies employed by these two providers. The weakest performers were Standard Life and General Accident, both returning below 8.0%, whose asset allocation and investment strategies have fallen below the competition.

The asset mix of a With-Profit fund is a key driver to the ultimate performance achieved. As With-Profit funds mature they will tend to adopt a strategy of holding a greater proportion of fixed interest assets. This will be to both support capital preservation and to ensure that the funds comply sufficiently with solvency regulation.

The profile of the liabilities of the funds and the requirements for the funds to comply with stringent regulation can restrict the investment freedom and limit the strategies that can be adopted going forward. The equity backing ratio (EBR) is typically the ratio of the equity and property assets to the total assets in the fund. Table B shows the broad breakdown of Equity, Property and Fixed Interest assets within each of the funds. There is a distinct variation in the EBR of the funds, with Commercial Union and General Accident having the highest holding of Equities and Property, at over 64%, and Scottish Amicable the lowest holding, at under 42%.

Table B: Asset Mixes

	Equities	Property	Fixed Interest / Cash / Other
Clerical Medical	39.9%	12.3%	47.8%
Commercial Union	43.9%	20.5%	35.6%
Friends Provident	36.5%	9.9%	53.6%
General Accident	43.9%	20.5%	35.6%
Legal & General	42.0%	13.0%	45.0%
Norwich Union	38.1%	20.3%	41.6%
Prudential Assurance	34.3%	12.8%	52.9%
Royal Life	39.0%	6.0%	55.0%
Scottish Amicable	30.4%	11.4%	58.2%
Standard Life Assurance	32.3%	12.9%	54.8%
Scottish Widows	39.0%	14.0%	47.0%
Average	**38.1%**	**14.0%**	**47.9%**
Source: Life Company data and press releases			

The payout amounts for maturing endowment policies fair well against conservative investments into bank savings accounts. Table C shows the actual maturity payouts for 25 year term policies maturing at 1st March 2013, for a male aged 30 next birthday and a monthly premium of £50. Prudential and Scottish Amicable sit atop of this list, with payouts of £32,528 and £32,931 yielding annualised returns of 5.7% and 5.8% per annum. Norwich Union produces the lowest return over the 25 year term of £24,600 an annualised yield of 3.7% per annum.

Table C: Maturity payouts for a male aged 30 next birthday at outset

Life Company	March-13	IRR
Clerical Medical	30,915	5.3%
Commercial Union	27,359	4.5%
Friends Provident	30,271	5.2%
General Accident	29,765	5.1%
Legal & General	30,789	5.3%
Norwich Union	24,600	3.7%
Prudential Assurance	32,528	5.7%
Royal Life	30,943	5.4%
Scottish Amicable	32,931	5.8%
Standard Life Assurance	27,791	4.6%
Scottish Widows	25,432	4.0%
Average	**29,393**	**5.0%**
Source: Life Company data and press releases		
Average Savings Account	21,724	2.8%

Over the last 10 years, the payouts on maturing policies have been reduced almost consistently year on year. Despite the good performance figures for 2012, the latest bonus rate announcements have, in the main, led to a further reduction in payouts for 25 year term policies when compared to the equivalent period last year. Table D shows the maturity payout for a policy maturity this year and the comparable figure from 12 months ago.

Table D: changes in payout from year to year

Life Company	March-12	March-13	Change
Clerical Medical	32,960	30,915	-2,045
Commercial Union	29,120	27,359	-1,761
Friends Provident	31,530	30,271	-1,259
General Accident	31,950	29,765	-2,185
Legal & General	33,601	30,789	-2,812
Norwich Union	23,466	24,600	1,134
Prudential Assurance	33,679	32,528	-1,151
Royal Life	31,648	30,943	-705
Scottish Amicable	35,523	32,931	-2,592
Standard Life Assurance	28,439	27,791	-648
Scottish Widows	27,935	25,432	-2,503
Average	**30,896**	**29,393**	**-1,502**

Source: Life Company data and press releases

All, with a single exception, have shown a reduction in the payout amount. The exception is Norwich Union which shows an increase in maturity payout of 4.8% or £1,134 to £24,600. However, the Norwich Union payout is still the lowest payout amount in this group. The largest reduction in payout amount has been from Legal & General which has reduced the payout from £33,601 to £30,789, a reduction of £2,812 or 8.4%.

The fact that payouts have mostly reduced, even though asset returns have been positive for the last year, will in part be due to the smoothing processes that each Life Company has employed. It may be that this is a strategy to increase smoothing reserves and strengthen balance sheets which could be interpreted as a positive for the groups of policyholders whose policies mature in the future. More detail and information will become available when the Life Companies complete their Financial Conduct Authority returns and SL will be producing its annual analysis as and when they are supplied later in the year.

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