With-Profit Endowments 2015

In the first quarter of each year, most 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 ultimately the levels of payout for maturing With-Profit policies. Individual policyholder statements will be sent out detailing the bonus additions and guarantees that are to be applied to their policies. 2015 is expected to be a busy year for Life Insurance companies as the number of Endowment policies that mature this year is likely to be of a similar level to that in previous years.

SL Investment Management Limited (SL) has been a major participant in the endowment purchasing market for 25 years and is constantly monitoring the performance of the larger UK Life Insurance Companies, comparing the relative performance of With-Profit funds and changes in bonus rates from year to year to ascertain how policies might fare in the future. In general, equity performance during 2014 was not particularly impressive, certainly when compared with the previous year. However, the performance of the With-Profit funds has been driven by solid performance in the fixed interest assets and impressive performance in the property sector. Indeed the property index suggests a significant uplift on the already impressive double digit returns of 2013. Without exception, the published 2014 annual returns for each of the With-Profit funds were positive, although the majority showed a slight reduction on the solid performance achieved in 2013.

Table A: Return on With-Profits funds over the calendar years 2013 & 2014

Life Company	2013 Annual Return	2014 Annual Return
Clerical Medical	9.9%	n/a
Commercial Union	9.1%	8.0%
Friends Provident	7.5%	7.2%
General Accident	9.1%	8.0%
Legal & General	9.1%	9.6%
Norwich Union	9.8%	9.0%
Prudential	10.3%	8.3%
Royal Life	9.1%	10.6%
Scottish Amicable	9.1%	7.8%
Standard Life	9.6%	6.5%
Scottish Widows	9.0%	8.0%
Average	**9.2%**	**8.3%**
FTSE All Share Index (total return)	20.8%	1.2%
FTSE 100 index (total return)	18.7%	0.7%
ABI UK - mixed 20%-60% Shares - Life	7.8%	3.9%
IPD UK All Property Monthly (total return)	10.9%	19.3%
Morningstar 90 days notice	0.4%	0.6%

Note: The figure for Clerical Medical had not been released at the time the report.

Table source: Life Company data, reports and press releases.

Table A (above) shows the gross annual returns achieved on the assets underlying the With-Profit funds of the larger Life Companies (as per SL experience). The figures for the previous two complete calendar years are shown together with comparable performance figures for other investments and indices. The figures in the table represent gross annual return figures, i.e. before the deduction of tax and expenses. Royal Life topped the 2014 calendar year returns at 10.6%, which is likely down to the asset allocation and investment strategies employed by this provider. The weakest performer was Standard Life, returning 6.5%, whose asset allocation and investment strategies have performed poorly compared to that of their competitors.

The asset mix of a With-Profit fund is a key driver to the overall performance achieved. As With-Profit funds mature they will tend to adopt a strategy of holding a greater proportion of fixed interest assets (i.e. government and corporate bonds). This will be to both support capital preservation and to ensure that the funds comply sufficiently with stringent solvency regulation. The liability profile of the funds and the requirements to comply with such stringent regulation can restrict the investment freedom and limit the strategies that can be adopted going forward.

The equity backing ratio (EBR) is typically defined as the ratio of the equity and property assets to the total assets in the fund. Table B below shows the broad breakdown of Equity, Property and Fixed Interest assets within each of the funds. In 2014 and for the majority there has been a preservation of the increased EBR from the previous year, with Commercial Union and General Accident having the highest holding of Equities and Property, at just above 70%. Royal Life has the lowest reported holding, at around 27%.

Table B: Asset Mix as at end of 2014

Life Company	Equities	Property	Fixed Interest / Cash/ Other
Clerical Medical*	44.9%	13.8%	41.3%
Commercial Union	52.9%	18.0%	29.1%
Friends Provident	34.6%	10.9%	54.5%
General Accident	52.9%	18.0%	29.1%
Legal & General	43.0%	13.0%	44.0%
Norwich Union	51.2%	19.4%	29.4%
Prudential	44.7%	16.0%	39.3%
Royal Life*	22.2%	4.4%	73.4%
Scottish Amicable	44.7%	9.2%	46.1%
Standard Life	32.8%	18.6%	48.6%
Scottish Widows	46.0%	14.0%	40.0%
Average	**42.7%**	**14.1%**	**43.2%**

* Clerical Medical and Royal Life figures as at end 2013.

Table source: Life Company data, reports and press releases.

The payout amounts for maturing endowment policies are significantly higher than that of a conservative investment into a bank savings account over an equivalent term. Table C below shows the actual maturity payouts for 25 year term policies maturing at 1st March 2015, for a male aged 30 (next birthday) and a monthly premium of £50. Prudential sit atop of this list, with a payout of £31,296, yielding an annualised return of approximately 5.4% per annum. Norwich Union produces the lowest return over the 25 year term of £24,626 with an annualised yield of 3.7% per annum.

Table C: Maturity Payouts

Life Company	March-15 (£)	Return
Clerical Medical	29,222	5.0%
Commercial Union	27,333	4.5%
Friends Provident	29,682	5.1%
General Accident	26,778	4.3%
Legal & General	28,539	4.8%
Norwich Union	24,626	3.7%
Prudential	31,296	5.4%
Royal Life	30,930	5.3%
Scottish Amicable	30,475	5.2%
Standard Life	26,891	4.4%
Scottish Widows	26,612	4.3%
Average	**28,399**	**4.8%**

Average Saving Account
Payout = 20,231
Return = 2.3%

Table source: Life Company data, reports and press releases.

Over the last 10 years, the payouts on maturing policies have reduced almost consistently year on year. Despite the good asset performance figures for 2014, 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: Maturity Payouts Calendar Year-on-Year Change

Life Company	March-14 (£)	March-15 (£)	Change (£)	Change
Clerical Medical	30,048	29,222	(826)	(2.7%)
Commercial Union	28,788	27,333	(1,455)	(5.1%)
Friends Provident	29,586	29,682	96	0.3%
General Accident	28,869	26,778	(2,091)	(7.2%)
Legal & General	29,278	28,539	(739)	(2.5%)
Norwich Union	25,988	24,626	(1,362)	(5.2%)
Prudential	31,438	31,296	(142)	(0.5%)
Royal Life	30,398	30,930	532	1.8%
Scottish Amicable	31,793	30,475	(1,318)	(4.1%)
Standard Life	27,304	26,891	(413)	(1.5%)
Scottish Widows	25,842	26,612	770	3.0%
Average	**29,030**	**28,399**	**(632)**	**(2.2%)**

With a few exceptions, the majority of Life Companies have shown a reduction in the maturity payout amount. The three increases come from Friends Provident, Royal Life and Scottish Widows with Scottish Widows showing the largest boost of £770 (3.0% up on 2014). However, as for 2014, this particular Life Company actually pays out one of the lowest amounts from this group. The most significant reduction in maturity payout is attributed to General Accident which has reduced the payout from £28,869 to £26,778, a reduction of £2,091 (7.2% down on 2014).

The fact that maturity payouts have, on the whole, 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. However, it is not possible to comment on this with any conviction or certainty at this time. More detail and information will become available when the Life Companies complete their PRA returns and SL will be producing its annual analysis as and when they are published later in the year.

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