UK Life Office PRA Returns Analysis

Reporting Period 2014

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1. Executive Summary

- In preparation for Solvency II and following the recent years of higher than normal uncertainty in the financial markets, UK Life Insurance companies are now generally in a much stronger solvency position than previous years.
- Fixed interest securities are now more proportionally held in investment grade stock, while the equity backing ratios remains significant enough to provide optimistic prospects of growth.
- The SL ranking system now more accurately rewards companies who hold large amounts of free assets. In addition, a greater emphasis has been placed on those companies who hold large amounts of equity investments, as these life offices should be in a position to experience greater growth.

2. What are the PRA Returns?

Each year all UK insurance companies must publish a set of prescribed returns. The content and rules behind these returns are controlled by the Prudential Regulation Authority (PRA, see next section). These aim to:

- demonstrate the company's compliance with the PRA's regulations
- disclose the company's level of solvency and
- display what the company "looks like" - for example, the fund's size, the company's exposure to different markets, product specifics and the basis on which the company is valued.

The PRA Returns are published in the second quarter of each year, and SL Investment Management (SL) undertakes a comprehensive review of the PRA Returns for over 30 of the top Life Offices (based upon those offices that SL deem to be most prevalent in the TEP market).

This ensures that SL continues to keep abreast of significant developments regarding with-profit funds, enabling us to assess whether there are material factors that may impact on clients' existing portfolios of TEPs and\or their current buying programmes.

3. FSA into PRA and FCA

From spring 2013 onwards the regulation of the with-profit funds is no longer carried out by the FSA, but instead by two new organisations. These organisations are called the Prudential Regulation Authority (PRA) and the Financial Conduct Authority (FCA), each of which have separate roles for financial regulation in the UK.

The PRA was created as a part of the Bank of England by the Financial Services Act (2012) and is responsible for the prudential regulation and supervision of around 1,700 banks, building societies, credit unions, insurers and major investment firms. This includes assessing the quantity and quality of capital that a firm holds in order to meet its future liabilities, ensuring that the firm's liquidity is sufficient as well as assessing the robustness of the internal systems.

The FCA's role is to regulate conduct in the retail and wholesale markets by overseeing any trading that takes place between parties in the these markets. The FCA is able to provide greater focus on these areas than was possible with the FSA, through earlier intervention to prevent problems from developing.

4. SL's Headline Figures

SL summarises several measures from the PRA Returns - for comparison between Life Offices in which the SL advised TEP funds are heavily invested.

Free Asset Ratio (FAR)

The FAR (also known as excess working capital) is a measure of solvency on a realistic basis. It represents the realistic excess working capital (if any) available to the with-profit fund, above and beyond sums committed to be distributed to policyholders expressed as a proportion of its realistic liabilities.

A positive FAR shows that a company is holding a degree of working capital within the with-profit fund that either it does not currently intend to distribute to policyholders, or for which no strategy has yet been determined for distribution. This may indicate a potential for possible windfall payments in the future.

A zero FAR shows that the company holds sufficient capital to meet its liabilities, sufficient capital to meet its resilience tests and intends to distribute all capital in the with-profit fund to policyholders.

A negative FAR illustrates that the company intends to distribute all capital in the with-profit fund to policyholders and that adverse scenarios will be met by working capital from elsewhere (perhaps directly from the non-profit policies in the corporate body, from the non-profit fund or by way of support from a parent company).

With-Profit Benefit Reserve (WPBR)

The WPBR may be either a retrospective valuation of asset share or a prospective valuation of future bonuses; most Offices use the asset share approach to value the WPBR. In the analysis below, the WPBR is shown as a proportion of the realistic assets.

A lower percentage implies that there is a greater value of assets in excess of the WPBR to cover other future liabilities and protect against adverse experience.

Future Policy Related Liabilities (FPRL)

The FPRL covers the realistic liabilities expected by a Life Office, in addition to their WPBR. This will include items such as the cost of guarantees and smoothing[1], planned allocations from the inherited estate and obligations to treat customers fairly[2]. In Fig.1, we have reported the FPRL as a proportion of the realistic liabilities.

A high FPRL may imply that the WPBR may not be sufficient to cover contractual or non-contractual guarantees and therefore additional capital needs to be held to cover the future liabilities.

A closed Life Office may choose to distribute the inherited estate to the with-profit policyholders. If this is the case then the FPRL will include the value of any proposed transfer, this increases the liabilities and therefore restricts the free assets of the Life Office.

Proportion of Fixed & Variable Interest Securities Held in Investment Grade Assets

This figure gives an indication as to the level of security of a Life Office's fixed and variable interest investments.

A high proportion means that, of the fixed and variable interest assets held, a large number are issued from a company/government with a credit rating of at least BBB (according to Standard & Poor's).

Equity Backing Ratio (EBR)

The EBR is the proportion of assets held in equity and property and demonstrates the Life Office's attitude to risk. A high EBR implies that the Life Office is adopting a slightly riskier strategy when investing - for which they should be compensated with potentially higher returns over the long term.

WP Return

This is the reported investment return of the with-profit fund for the relevant calendar year.

Standard & Poor's (S&P) Credit Rating

S&P is an independent credit rating agency. A credit rating is designed to summarise how financially stable a Life Office is. However in some instances the rated entity is the financial group as a whole and so it is not directly applicable to the financial stability of the with-profit fund.

Surrender Value/Discounted Guarantees Less the Present Value of Total Future Premiums (SV/Disc Gtees-TFP)

This ratio is the sum of the SVs, across all of SL's advised funds, divided by the sum of the guarantees (sum assured plus bonuses attributed to date) less future premiums, discounted at 5%.

[1] Smoothing is the process of retaining surplus profits in the good years of investment, in order to enhance the payouts to investors in the bad years.
[2] Treating customers fairly may include for example, honouring the payment of guarantees and ensuring surrender values represent a fair policy value.

Only policies with a SV quoted after the 1st January 2014 (and prior to end February 2015) have been included in the analysis.

A lower SV/Disc Gtees-TFP implies a policy's surrender value has a higher backing from elements that have been guaranteed by the Life Office and, as such, can offer a higher potential return.

A higher SV/Disc Gtees-TFP implies that the surrender value of a policy is comprised of a higher proportion of non-guranteed elements that may be subject to significant variability.

Surrender Value/Estimated Asset Share (SV/EAS)

This report does not disclose SV/EAS ratios. If you would like to discuss these types of attribute further please contact us.

This ratio is the sum of the SVs, across all of SL's advised funds, divided by SL's measure of EAS. Only policies with a SV quoted after the 31st March 2014 have been included in the analysis.

In general, a lower SV/EAS is deemed attractive – the policy may be purchased at a good discount to EAS.

It should however be noted that the ratios provided are based upon a relatively small sample of policy enquiries and will include a wide range of maturity dates and policy terms. The closer that a policy is to maturity the higher the expected SV/EAS and, therefore, this statistic may not show the greater discounts available for longer dated policies.

It is therefore recommended that no decisions be made on inferences drawn from this statistic alone.

SL Rating

SL has used the information described in this communication, to construct its own Life Office rating. Points were awarded to each Life Office for its ranked position in six of the measures given above. The Life Offices are ranked by the measure with a consequent score being assigned (Higher ranking equates to a higher score, i.e. 1st equals highest score). An average of these scores was taken across each Life Office, weighted by those measures SL deems to be most important/informative regarding future potential growth. A ranking of these weighted average produces the final SL Rating, where the lower ratings represent the Offices for which we would envisage greater future potential growth.

The process described above is performed on over 30 of the Life Office that are considered to be the most prevalent in the TEP market and the table below shows the top 20. Teachers Assurance top the list for the 2014 reporting year, as a result of a very strong showing across all of the categories that feed into the rating, in particular it's FAR and EBR. National Farmers and Royal London also rank highly, largely due to their high EBR and increased amount of free assets. This ensures that they are in a position to take full advantage of any future growth in the equity market as well as being in a strong financial position with the possibility of distributing the surplus to the policyholders.

Life Office	FAR [1]	WPBR [2]	FPRL [3]	% of FI & VI Securities Held at Investment Grade [4]	EBR [5]	2014 Return [6]	S&P Rating [7]	SV/(Disc Gtees-TFP) [8]	SL Rating [9]
Teachers Assurance Company	63.4%	50.5%	12.2%	99.8%	56.8%	7.2%	n/a	111.3%	1
National Farmers Union Mutual Insurance Society	23.8%	60.7%	20.1%	95.0%	54.0%	9.9%	n/a	151.6%	2
Royal London Mutual Insurance Society	42.7%	53.1%	8.2%	90.5%	44.4%	10.7%	A	111.7%	3
General Accident Life Assurance	11.1%	71.6%	4.4%	82.8%	45.2%	8.1%	A+	110.3%	4
Commercial Union Life Assurance Company	11.1%	71.6%	4.4%	82.8%	45.2%	8.1%	A+	120.5%	5
Scottish Widows Fund & Life Assurance Society	0.8%	67.5%	20.0%	93.6%	50.4%	7.0%	A	131.9%	6
Legal & General Assurance Society	2.8%	82.9%	8.5%	85.9%	42.4%	9.8%	AA-	129.5%	7
Wesleyan Assurance Society	21.7%	75.0%	2.9%	93.1%	65.4%	6.3%	n/a	142.0%	8
Prudential Assurance Company	8.6%	80.5%	5.2%	69.8%	41.0%	8.3%	AA	134.3%	9
Friends Provident Life Office	0.2%	72.1%	17.7%	99.4%	30.9%	7.3%	A	129.6%	10
Guardian Assurance Company	0.0%	68.4%	27.4%	97.3%	45.6%	5.5%	n/a	183.6%	11
Norwich Union Life Insurance Society	8.2%	65.5%	16.6%	78.1%	35.0%	9.1%	A+	120.5%	12
Clerical Medical & General Life Assurance Society	0.0%	73.5%	21.0%	89.9%	39.2%	7.1%	A	125.4%	13
National Mutual Life Association of Australasia	0.0%	39.5%	50.3%	100.0%	38.2%	7.3%	A	159.0%	14
Royal Liver Friendly Society	0.0%	69.0%	26.3%	95.6%	32.5%	12.3%	A	107.9%	15
Standard Life Assurance Company	0.0%	68.7%	11.4%	96.1%	34.9%	8.6%	A+	121.4%	16
United Friendly Life Assurance	0.0%	89.4%	9.6%	93.6%	35.8%	16.6%	A	138.0%	17
Liverpool Victoria Friendly Society	7.7%	61.3%	16.0%	89.5%	34.6%	11.9%	BBB+	145.2%	18
Britannic Assurance	0.0%	89.0%	10.3%	92.7%	37.1%	9.7%	n/a	139.9%	19
Scottish Equitable Life Assurance Society	0.0%	62.2%	29.0%	97.7%	27.5%	5.8%	A+	128.5%	20

1 Source: 2014 FSA returns Form 19
2 Source: 2014 FSA returns Form 19
3 Source: 2014 FSA returns Form 19
4 Source: 2014 FSA returns Form 49
5 Source: 2014 FSA returns Form 48
6 Source: 2014 FSA returns Form 48
7 Source: S&P website (as at 31/08/2015)
8 Source: SL Database
9 Source: SL Based Rating System
It should be noted SV/EAS figures are allowed for in the ratings but not shown in the table due to the proprietary nature of the calculations

Fig.1

5. Appendix A

Below is the table from the most recently released report from 2013, based on the 2012 financial reporting year.

Life Office	EWC [1]	WPBR [2]	FPRL [3]	% of FI securities held at investment grade [4]	EBR [5]	2012 Return [6]	S&P rating [7]	SV/(Disc Gtees-TFP) [8]	SL rating [9]
Royal London Mutual Insurance Society	38.8%	58.1%	8.3%	82.1%	50.8%	8.7%	A	136.2%	1
Wesleyan Assurance Society	29.2%	65.4%	7.3%	81.4%	66.8%	10.8%	n/a	142.4%	2
Prudential Assurance Company	7.7%	82.3%	5.3%	76.2%	32.9%	10.4%	AA	142.8%	3
Teachers Assurance Company	40.2%	57.4%	12.4%	Unavailable	66.5%	8.3%	n/a	133.5%	4
National Mutual Life Association of Australasia	0.0%	44.8%	48.3%	98.8%	38.2%	8.7%	A-	168.6%	5
Scottish Widows Fund & Life Assurance Society	0.5%	72.9%	16.4%	79.7%	49.5%	8.4%	A	140.0%	6
National Farmers Union Mutual Insurance Society	24.6%	60.6%	19.3%	81.8%	49.6%	7.9%	n/a	182.6%	7
Liverpool Victoria Friendly Society	5.2%	64.9%	20.5%	91.8%	39.7%	6.2%	BBB+	126.7%	8
Medical Sickness Annuity & Life Assurance Society	0.0%	71.6%	28.4%	81.4%	66.8%	10.8%	n/a	311.9%	9
Guardian Assurance Company	0.0%	70.8%	27.2%	96.3%	42.1%	10.6%	n/a	188.4%	10
Friends Provident Life Office	0.1%	76.0%	15.3%	94.5%	31.3%	8.7%	A-	139.0%	11
Sun Life Assurance Society	0.0%	65.5%	28.3%	91.8%	32.6%	8.1%	A-	125.8%	12
Swiss Pioneer Life (formerly Pioneer Mutual)	0.0%	76.5%	16.0%	94.8%	32.7%	8.9%	n/a	162.1%	13
General Accident Life Assurance	1.9%	78.1%	8.5%	62.8%	45.5%	7.2%	A+	146.6%	14
Clerical Medical & General Life Assurance Society	0.0%	74.2%	21.9%	87.2%	44.9%	5.9%	A	132.2%	15
Legal & General Assurance Society	4.3%	80.6%	9.5%	86.4%	40.8%	10.7%	AA-	145.0%	16
Royal Liver Friendly Society	0.0%	69.9%	24.2%	96.7%	26.7%	9.4%	A	117.1%	17
Equity & Law Life Assurance Society	0.0%	61.5%	33.3%	93.4%	48.9%	10.3%	A-		18
Commercial Union Life Assurance Company	1.9%	78.1%	8.5%	62.8%	45.5%	7.2%	A+	161.3%	19
Scottish Amicable Life Assurance Society	0.0%	84.3%	10.3%	76.3%	38.4%	9.7%	AA	141.5%	20

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2 Source: 2012 FSA returns Form 19
3 Source: 2012 FSA returns Form 19
4 Source: 2012 FSA returns Form 49
5 Source: 2012 FSA returns Form 48
6 Source: 2012 FSA returns Form 48
7 Source: S&P website (as at 30/11/2013)
8 Source: SL enquiries since 01/05/2013 to 30/11/2013
9 Source: SL based rating system
It should be noted SV/EAS figures are allowed for in the ratings but not shown in the table due to the proprietary nature of the calculations

Fig.1

Disclaimer

This report and its content are intended solely for professional advisors or institutional investors. It must not be used or relied upon by private or retail investors.

The information in this document has been compiled from the reports to the PRA issued by the stated life assurance companies in 2015 in respect of the 2014 Financial Year. Its intended purpose is to summarise some of the key facts and figures from those reports pertinent to the with-profits endowments issued by those companies. Where the process of compiling this document has involved subjective judgement or approximation we have followed an approach that we consider suitable for this purpose. While we hope you will find the information helpful, it is provided on the basis that we do not give any representation or warranty that the information is complete and accurate, that it has been correctly extracted or that it is suitable to be used for purposes other than that for which it was originally intended. Nothing in this document should be considered to constitute financial or other professional advice or recommendations.

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