With-Profit Endowments 2016

During 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. Alongside this 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.

SL Investment Management Limited (SL) has been a major participant in the endowment purchasing market for over 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 may perform in the future.

The performance of the leading UK equity indices was particularly volatile during 2015. A strong start to the year was contrasted by falls in the second half of the year leading to closing positions similar to levels at the beginning of the year. Property indices had another strong year, achieving double digit returns; however, the main gilt indices showed only low levels of growth over the same period. Nevertheless, the assets and investments in the With-Profit funds are actively managed and the published 2015 annual returns for all of the With-Profit funds were positive, although each has shown a significant fall from the returns achieved during 2014.

Table A: Return on With-Profits funds over the calendar years 2014 & 2015

Life Company	2014 Annual Return	2015 Annual Return
Clerical Medical	7.1%	2.3%
Commercial Union	8.0%	6.0%
Friends Provident	7.2%	2.3%
General Accident	8.0%	6.0%
Legal & General	9.6%	3.1%
Norwich Union	9.0%	5.3%
Prudential	8.3%	3.6%
Royal Life	10.6%	n/a
Scottish Amicable	7.8%	2.6%
Standard Life	6.5%	2.9%
Scottish Widows	8.0%	3.0%
Average	**8.3%**	**3.7%**
FTSE All Share Index (total return)	1.2%	1.0%
FTSE 100 index (total return)	0.7%	-1.3%
ABI UK - mixed 20%-60% Shares - Life	3.9%	0.9%
IPD UK All Property Monthly (total return)	19.3%	13.1%
Morningstar 90 days notice	0.6%	0.6%

Note: The figure for Royal Life had not been released at the time the report.

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

Table A (above) shows the reported gross annual returns achieved on the assets underlying the With-Profit funds of the larger Life Companies (as specified by SL). 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. Commercial Union and General Accident (which share the same underlying With-Profits Fund) top the 2015 calendar year returns having achieved 6.0%. SL's analysis shows that for these funds the investment managers have maintained higher proportions in property and equities than competitors in recent years. The weakest performers were Friends Provident and Clerical Medical, returning 2.3%, whose asset allocation and investment strategies have performed comparatively poorer.

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 breakdown of reported Equity, Property and Fixed Interest assets for each of the funds. The levels of reported EBR for 2015 are generally similar to 2014 levels although there have been significant changes in the asset mixes for Royal Life (increase) and Scottish Widows (decrease). Royal Life now has the highest holding of Equities and Property, at 73% albeit these figures are recorded at the end of 2014. Commercial Union and General Accident lead the end 2015 figures at just over 70%. Friends Provident has the lowest reported holding, at just below 44%.

Table B: Asset Mix as at end of 2015

Life Company	Equities	Property	Fixed Interest / Cash/ Other
Clerical Medical	37.0%	13.8%	49.2%
Commercial Union	52.0%	18.2%	29.8%
Friends Provident	35.1%	8.8%	56.1%
General Accident	52.0%	18.2%	29.8%
Legal & General	47.0%	15.0%	38.0%
Norwich Union	50.8%	19.1%	30.1%
Prudential	48.6%	16.1%	35.3%
Royal Life*	62.0%	11.0%	27.0%
Scottish Amicable	47.7%	9.2%	43.1%
Standard Life	29.0%	20.9%	50.1%
Scottish Widows**	44.0%	13.0%	43.0%
Average	**45.9%**	**14.8%**	**39.2%**

* Royal Life figures as at end 2014.

** Scottish Widows figures as at the end of November 2015.

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 2016, for a male aged 30 (next birthday) and a monthly premium of £50. The largest payout is from Scottish Amicable, with a payout of £29,549, yielding an annualised return of approximately 5.0% per annum. Legal & General produces the lowest return over the 25 year term of £25,170 with an annualised yield of 3.9% per annum.

Table C: Maturity Payouts

Life Company	March-16 (£)	Return
Clerical Medical	27,125	4.4%
Commercial Union	25,355	3.9%
Friends Provident	29,040	4.9%
General Accident	25,825	4.1%
Legal & General	25,170	3.9%
Norwich Union	26,069	4.1%
Prudential	28,958	4.9%
Royal Life	25,542	4.0%
Scottish Amicable*	29,549	5.0%
Standard Life	26,128	4.2%
Scottish Widows	27,490	4.5%
Average	**26,932**	**4.8%**

Average Saving Account
Payout = 19,624
Return = 2.1%

* Scottish Amicable released figure is for unitised with-profits.

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 positive asset performance figures for 2015, 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-15 (£)	March-16 (£)	Change (£)	Change
Clerical Medical	29,222	27,125	(2,097)	(7.2%)
Commercial Union	27,333	25,355	(1,978)	(7.2%)
Friends Provident	29,682	29,040	(642)	(2.2%)
General Accident	26,778	25,825	(953)	(3.6%)
Legal & General	28,539	25,170	(3,369)	(11.8%)
Norwich Union	24,626	26,069	1,443	5.9%
Prudential	31,296	28,958	(2,338)	(7.5%)
Royal Life	30,930	25,542	(5,388)	(17.4%)
Scottish Amicable	30,475	29,549	(926)	(3.0%)
Standard Life	26,891	26,128	(763)	(2.8%)
Scottish Widows	26,612	27,490	878	3.3%
Average	**28,399**	**26,932**	**(1,467)**	**(5.2%)**

With only two exceptions, the majority of Life Companies in this group have shown a reduction in the maturity payout amount. The two Life Companies that have increased are Norwich Union and Scottish Widows (for 2nd year in a row) with Norwich Union showing the largest increase of £1,443 (5.9% up on 2015). However, as in 2015, this particular Life Company actually pays out one of the lowest amounts from this group. The most significant reduction in maturity payout is by Royal Life which has reduced the payout from £30,930 to £25,542, a reduction of £5,388 (17.4% down on 2015).

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 but will also reflect the returns that have been achieved during the lifetime of the policy. 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 regulatory returns and SL will be producing its annual analysis as and when they are published later in the year.