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.

Financial Markets and With-Profit Performance

The performance of the leading UK equity indices was noticeably mixed during 2016. A weak and volatile first half to the year was contrasted by a very strong recovery (following the Brexit referendum) in the second half of the year leading to closing positions reaching new all-time highs. Property indices had a relatively poor year, achieving low, single digit returns; however, the main UK gilt indices showed slight improvement over the same period (albeit with sizeable volatility during the year). Nevertheless, the assets and investments in the With-Profit funds are actively managed and the published 2016 annual returns for all of the With-Profit funds were positive, with each showing a significant increase from the returns achieved during 2015.

Table A: Return on With-Profits funds over the calendar years 2015 & 2016

Life Company	2015 Annual Return	2016 Annual Return
Clerical Medical	2.3%	8.5%
Commercial Union	6.0%	12.1%
Friends Provident	2.3%	11.9%
General Accident	6.0%	12.1%
Legal & General	3.1%	15.3%
Norwich Union	5.3%	11.4%
Prudential	3.6%	14.5%
Royal Life	1.2%	-
Scottish Amicable	2.6%	14.9%
Standard Life	2.9%	8.2%
Scottish Widows	3.0%	9.0%
Average	**3.5%**	**11.8%**
FTSE All Share Index (total return)	1.0%	16.8%
FTSE 100 index (total return)	-1.3%	19.1%
ABI UK - mixed 20%-60% Shares - Life	0.9%	10.4%
IPD UK All Property Monthly (total return)	13.1%	2.8%
Morningstar 90 days notice	0.6%	0.5%

Note: The figure for Royal Life is not available at the time of compilation of this 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 determined 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. Legal & General top the 2016 calendar year returns having achieved 15.3%, with Scottish Amicable not far behind at 14.9%. SL's analysis shows that for these funds the investment managers have maintained higher proportions in property and equities than competitors in recent years, although perhaps less so over 2016. The weakest performers were Standard Life with posted returns of 8.2%, whose asset allocation and investment strategies have performed comparatively poorer.

Asset Allocation

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 the reported Equity, Property and Fixed Interest assets for each of the funds. The levels of reported EBR for 2016 are, on average, slightly lower compared to 2015 levels although there are clear differences in the amount of change, ranging from an 8% decrease (Legal & General) to a 6% increase (Clerical Medical). Royal Life remains the highest holding of Equities and Property at 68% albeit these figures are recorded at the end of 2015. Norwich Union leads the end 2016 figures at just over 65%. Friends Provident has the lowest reported holding, at just below 43%.

Table B: Asset Mix as at end of 2016

Life Company	Equities	Property	Fixed Interest / Cash/ Other
Clerical Medical	41.9%	15.2%	42.9%
Commercial Union	47.0%	17.4%	35.6%
Friends Provident*	35.4%	7.4%	57.2%
General Accident	47.0%	17.4%	35.6%
Legal & General	43.0%	11.0%	46.0%
Norwich Union	46.0%	19.2%	34.8%
Prudential	47.4%	15.2%	37.4%
Royal Life**	57.0%	11.0%	32.0%
Scottish Amicable	50.0%	10.2%	39.8%
Standard Life	32.5%	18.6%	48.9%
Scottish Widows	48.0%	14.0%	38.0%
Average	**45.0%**	**14.2%**	**40.8%**

* Friends Provident figures as at end June 2016.

** Royal Life figures as at the end of 2015.

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

Maturity Payouts

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 2017, for a male aged 30 (next birthday) and a monthly premium of £50. The largest payout is from Royal Life, with a payout of £30,612, yielding an annualised return of approximately 5.3% per annum. Standard Life produces the lowest return over the 25 year term of £24,929 with an annualised yield of 3.8% per annum.

Table C: Maturity Payouts

Life Company	March-17 (£)	Return
Clerical Medical	25,004	3.8%
Commercial Union	27,046	4.4%
Friends Provident	29,235	5.0%
General Accident	27,670	4.6%
Legal & General	26,408	4.2%
Norwich Union	27,450	4.5%
Prudential	29,268	5.0%
Royal Life	30,612	5.3%
Scottish Amicable*	29,865	5.1%
Standard Life	24,929	3.8%
Scottish Widows	25,071	3.9%
Average	**27,505**	**4.5%**

Average Saving Account
Payout = 17,211
Return = 1.1%

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

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

The payouts on maturing endowment policies have reduced significantly over the last decade. For example, comparable payouts for the Life Companies above have dropped (on average) just over 10% in the last 5 years (i.e. from March 2012 figures), with some movements in excess of 20%. Positive asset performance figures for 2016 has resulted in bonus rate changes that have, in the main, led to an increase 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-16 (£)	March-17 (£)	Change (£)	Change
Clerical Medical	27,125	25,004	(2,121)	(7.8%)
Commercial Union	25,355	27,046	1,691	6.7%
Friends Provident	29,040	29,235	195	0.7%
General Accident	25,825	27,670	1,845	7.1%
Legal & General	25,170	26,408	1,238	4.9%
Norwich Union	26,069	27,450	1,381	5.3%
Prudential	28,958	29,268	310	1.1%
Royal Life	30,403	30,612	209	0.7%
Scottish Amicable	29,549	29,865	316	1.1%
Standard Life	26,128	24,929	(1,199)	(4.6%)
Scottish Widows	27,490	25,071	(2,419)	(8.8%)
Average	**27,374**	**27,505**	**131**	**0.5%**

With only three exceptions, the Life Companies in this group have shown an increase in the maturity payout amount. The three Life Companies that have decreased are Clerical Medical, Standard Life (both for the second year in a row) and Scottish Widows, with Scottish Widows showing the largest decrease of £2,419 (8.8% down on 2016). The most significant increase in maturity payout is by General Accident which has increased the payout from £25,825 to £27,670 giving an increase of £1,845 (7.1% up on 2016).

The fact that the maturity payouts have, on the whole, increased will in part be down to the significant increase in the asset returns achieved during 2016, although this will be tempered by the smoothing processes employed by the Life Companies and returns achieved over the lifetime of the policies. Increased payouts could be a sign of reduced reserving requirements as the With-Profit fund sizes reduce (as a consequence of fewer in force policies), 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.

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