AKG

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With Profits Market Briefing

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Background

AKG has been analysing and assessing the with profits funds managed by UK life offices for a number years. Each year, our work in this area culminates in the publication of AKG's well known and respected UK Life Office With Profits Reports.

The 20th edition of AKG's UK Life Office With Profits Reports was published in December 2016.

The full table of contents can be downloaded at www.akg.co.uk/downloads and the reports can be purchased at www.akg.co.uk/purchase.

This AKG With Profits Market Briefing illustrates some of the key statistics, developments and trends observed in our 2016 With Profits Reports output and it also taps into the wealth of with profits data accrued by AKG over the past 20 years.

AKG WITH PROFITS FUND COVERAGE

AKG's 2016 reports involved the analysis and assessment of 190 sub-funds within 75 funds within 28 firms from 25 different groups that were active in the UK market at the end of December 2016.

The 2016 edition includes individual reports and comments on those providers whose with profits funds exceed £100m, supplemented by smaller companies and friendly societies operating in the intermediary market.

The analysis provided for each company uses information collated from a number of sources, including meetings with a number of the offices, a questionnaire completed by many of the companies, their latest PRA Returns (normally as at 31 December 2015 and hence presented under the Solvency I regime, rather than the new Solvency II regime applicable from 2016 onwards), their PPFMs, CFPPFMs, reports to policyholders, websites and any other available material.

Key Points

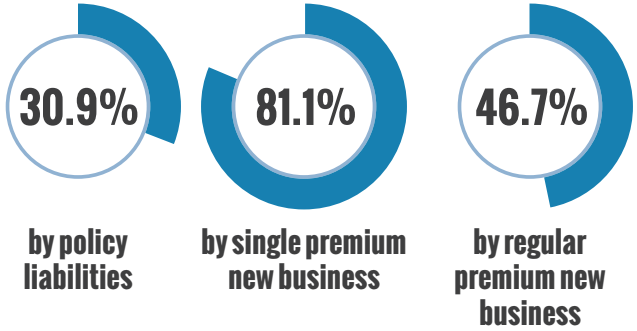
Despite all the tales of doom and gloom, the amount of with profits business in-force remains substantial. Total with profits assets at the end of 2015 stood at over £306 billion.

The top five companies in terms of total with profits liabilities in 2015 were: Prudential Assurance Company Ltd; Aviva Life & Pensions UK Ltd; Standard Life Assurance Ltd; The Royal London Mutual Insurance Society Ltd; Scottish Widows Ltd.

The top five companies in terms of new single premium business in 2015 were: Prudential Assurance Company Ltd; Liverpool Victoria Friendly Society Ltd; National Farmers Union Mutual Insurance Society Ltd; Wesleyan Assurance Society; The Royal London Mutual Insurance Society Ltd.

There was a 33% increase in With Profits new business APE for the market as a whole in 2015.

Prudential Assurance Company Ltd is a dominant market leader. Its With Profits market share is:



With profits funds have continued de-risking, in particular with several transferring blocks of annuities out of the funds. Recent examples of this include de-risking exercises from Phoenix Life Ltd, The Equitable Life Assurance Society, Zurich Assurance Ltd and Scottish Equitable plc.

Under new PRA rules which took effect from 1 January 2016 in conjunction with Solvency II, some subtly different definitions of with profits business were introduced, compared with the previous regulatory position (see page 6 of this briefing for full details).

Two long-standing in force blocks of business were classified as with profits for the first time in 2016, after previously being treated as non-profit:

Friends Life and Pensions Ltd's Secure Growth Fund	Royal London Unit-Linked With Profits business

How Significant is the With Profits Market Nowadays?

CURRENT SIZE OF THE MARKET

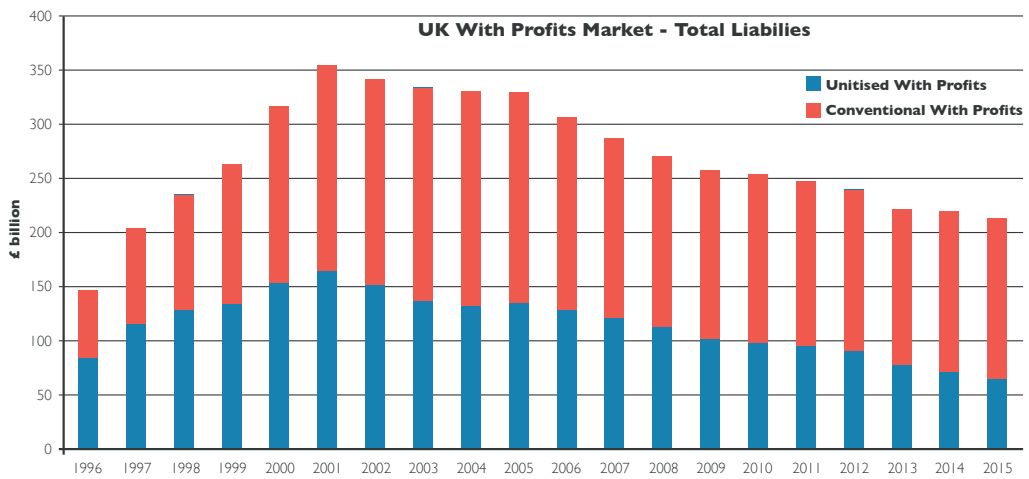
The amount of with profits business in-force remains substantial.

Total with profits assets at the end of 2015 (the most recent date at which comprehensive figures are available) stood at over £306 billion, and total with profits policy liabilities stood at nearly £213 billion.

Whichever way you look at it, these are not inconsiderable sums.

20 YEARS OF THE WITH PROFITS MARKET – WITH PROFITS LIABILITIES

From its peak in 2001 (£387 billion with profits policy liabilities), the size of the UK With Profits market has been steadily reducing year by year, but the corresponding total at the end of 2015 still stood at nearly £213 billion.



Source: PRA Returns Form 50 (Mathematical Reserves) + Form 58 (Bonuses declared)

TOP 5 COMPANIES - WITH PROFITS LIABILITIES

Rank	Company	2015	Market Share
1	Prudential Assurance Company Ltd	£65.7 bn	30.9%
2	Aviva Life & Pensions Ltd	£26.2 bn	12.3%
3	Standard Life Assurance Ltd	£25.5 bn	12.0%
4	The Royal London Mutual Insurance Society Ltd	£17.1 bn	8.0%
5	Scottish Widows Ltd	£12.8 bn	6.0%
Market Total - Liabilities		**£212.8 bn**	

Source: PRA Returns Form 50 (Mathematical Reserves) + Form 58 (Bonuses declared)

Prudential (+5.6%) is more than twice the size of its nearest rival and its market share increased more than 2% as the other leaders declined in size: Aviva (-5.6%), Standard Life (-5.6%), Royal London (-8.2%).

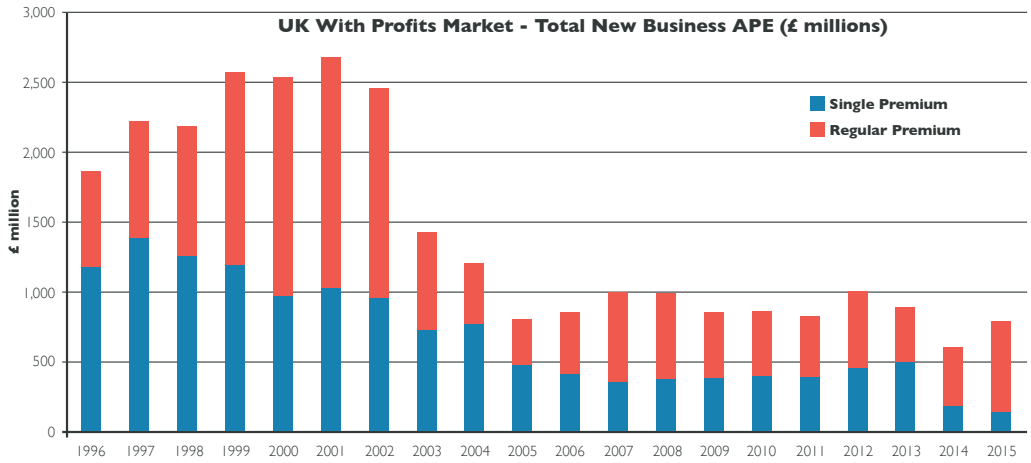
However, Aviva's size stands to grow substantially if the Friends Life (£11.5bn) business is transferred in as anticipated. Across the market, total liabilities fell by 3.3% from 2014's total of £220.1bn.

New Business Volumes

20 YEARS OF THE WITH PROFITS MARKET – NEW BUSINESS

The reduction in new business APE volumes, which also peaked in 2001, has been much more marked, particularly for regular premium business.

There was actually a 33.0% increase in With Profits new business APE for the market as a whole in 2015, which can be ascribed almost entirely to Prudential's £5.2 billion single premium new business, up 62% on the previous year. Thus volumes nearly reverted to 2013 levels following 2014's 32.9% fall.



Source (graph right): PRA Returns Form 47, using the industry standard approach of new regular premiums plus 10% of new single premiums

TOP 5 COMPANIES - SINGLE PREMIUM WITH PROFITS NEW BUSINESS

The top 5 companies accounted for over 95% of the whole single premium market, with each seeing an increase from 2014 to 2015. LV (+147.4%) and NFU (+61.4%) recorded substantial increases.

However, Prudential continues to dominate, with its 61.9% increase having a major impact on the market total, which showed a 56.5% increase from the 2014 level of £4.1bn.

Rank	Company	2015 SP	SP Market Share
1	Prudential Assurance Company Ltd	£5,224.3 m	81.1%
2	Liverpool Victoria Friendly Society Ltd	£382.3 m	5.9%
3	National Farmers Union Mutual Insurance Soc. Ltd	£201.3 m	3.1%
4	Wesleyan Assurance Society	£181.2 m	2.8%
5	The Royal London Mutual Insurance Society Ltd	£155.6 m	2.4%
Market Total - New Single Premiums		**£6,440.6 m**	

Source: PRA Returns Form 47 - only Direct Insurance Business is included.

TOP 5 COMPANIES - REGULAR PREMIUM WITH PROFITS NEW BUSINESS

Only 2 of the top 5 saw increases in regular premium business from 2014 to 2015 - Prudential (+33.1%), again the clear market leader, with a much increased market share, and Police Mutual (+14.3%). Standard Life experienced a 39.0% fall.

The size of the whole regular premium with profits new business market fell over 19%, following 2014's huge fall (nearly 64%) from the 2013 level of £507.8m.

Rank	Company	2015 RP	RP Market Share
1	Prudential Assurance Company Ltd	£69.3 m	46.7%
2	Standard Life Assurance Ltd	£19.0 m	12.8%
3	Wesleyan Assurance Society	£14.7 m	9.9%
4	Police Mutual Assurance Society Ltd	£12.8 m	8.6%
5	Aviva Life & Pensions UK Ltd	£7.2 m	4.8%
Market Total - New Regular Premiums		**£148.5 m**	

Source: PRA Returns Form 47 - only Direct Insurance Business is included

Key Regulatory/Legislative Developments Impacting on With Profits Providers

SOLVENCY II

After many years development 1 January 2016 finally saw the introduction of Solvency II although it will not be until mid-2017 that we see full results presented under this new regulatory regime. Indeed the allowance of 'transitional provisions' mean that it will be some years before results are truly harmonised across Europe, assuming that Brexit does not mean that the UK regulatory regime moves further away from this pan European standard, having already gold-plated the rules in some respects.

Solvency II is about improving protection for policyholders and creating a safer and more resilient sector with capital requirements set to ensure that firms can withstand a forward-looking, one in two hundred year stress. Having the same standards applied consistently across Europe is a fundamental principle of Solvency II, helping to ensure that regulation is not arbitraged and avoiding the risks that this presents to policyholders.

Firms have the option to develop their own internal models to determine their capital requirements, rather than relying on the Standard Formulae within the regulations and the larger firms have been encouraged to follow this route although some have still adopted the standard formulae for parts of their business. In December 2015 the PRA announced that seven groups with With Profits subsidiaries (Aviva, L&G, NFU, Phoenix, Prudential, Scottish Widows and Standard Life) had had full or partial internal models approved and it is to be expected that there has been further development work in 2016 as the new regime bedded in.

Some firms have also published the first high level results under the new regime with Solvency II surplus figures being quoted as at the end of 2015 and half year 2016 as part of their year end and half year presentations.

Not all firms have taken advantage of the transitional provisions, which can allow the full effects of the adverse change in results from the old regime to the Solvency II regime to be brought in gradually over the next 15 years. And several of those who have taken advantage of this provision have already utilised the option to recalculate the level of provisions given the movement in interest rates during the year.

PENSIONS DASHBOARD

In September 2016, the Economic Secretary to the Treasury announced that a prototype will be ready by March 2017. The Pensions Dashboard (intended for launch in 2019) is a platform that will enable customers to see all their pension pots, including state pension details, in one place and thus will help customers to plan for their retirement more effectively. This will be a positive step forward and when combined with other initiatives should support a growth in awareness of, and engagement with, pensions.

At the initial announcement, 11 leading pension companies were said to be committed to building the Pensions Dashboard. Subsequently the ABI, who will be managing the day-to-day running of the pilot project, announced that six more companies were signed up in support of the project. The list of companies involved includes new companies set up in response to auto-enrolment, existing pension providers, large Master Trusts, pension administrators managing DB and DC pension schemes and providers closed to new business. It will be interesting to track the role played by these project stakeholders and to see how other pension providers respond.

Companies across the pensions sector, including those having with profits pension business, will need to continue to create cost efficiencies and better employ digital solutions in 2017. The introduction of the Pensions Dashboard is likely to provide a catalyst for pension consolidation and so companies will also be considering associated business retention strategies.

EXISTING BOOK REVIEW

The FCA has been reviewing closed book business practices in the life insurance sector for a while now and in particular the treatment of customers. On 9 December 2016 the FCA published its final guidance on the subject, *FG16/8 Fair treatment of long standing customers in the life insurance sector.*

This work clearly has ramifications for providers in the with profits sector. The FCA has provided four overarching expected guidance outcomes for providers in order to improve future behaviour in this sector:

- **Outcome 1:** The firm's strategy and governance framework results in the fair treatment of closed-book customers.
- **Outcome 2:** The firm's closed-book customers receive clear and timely communications about policy features at regular intervals and at key points in the product life cycle to enable them to make informed decisions.
- **Outcome 3:** The firm gives adequate consideration to, and takes proper account of, fund performance and policy values in a way that ensures it treats its closed-book customers fairly and proportionately.
- **Outcome 4:** The firm's closed-book customers are able to move from products that are no longer meeting their needs in a fair and reasonable manner.

This won't necessarily have come as a surprise to impacted with profits providers as the FCA's review work has been in train for some time, but it does again fix attention on how closed book customers are being treated.

The FCA will continue to monitor behaviour in this sector and will call-out behaviour which goes against the sentiment of its expected guidance outcomes. Hence, those providers who wish to retain customers and play an active role in the market will have to continue to invest time, resource and money into customer engagement and customer value improvements.

With Profits Defined - The Position Since January 2016

Under new PRA rules which took effect from 1 January 2016 in conjunction with Solvency II, some subtly different definitions of with profits business were introduced, compared with the previous regulatory position:

A with profits policy: "*means a contract of long-term insurance which provides benefits through eligibility to participate in discretionary distributions based on profits arising from the firm's business or from a particular part of the firm's business*".

A with profits fund: "*means the business of the firm, or a particular part of the business of the firm, in the profits of which certain with-profits policies are eligible to participate through discretionary distributions under such policies and the assets of which comprise the items set out in (1) to (6) less the outgoings in (7) and (8) (including the items and outgoings relating to both current and past business):*

(1) ***premiums and other receivables in respect of with-profits policies;***

(2) ***other receipts of the firm's with-profits insurance business, including tax receipts;***

(3) ***amounts which have been provided by the firm to facilitate the carrying on of its with-profits insurance business (other than excluded assets);***

(4) ***all income and capital receipts in respect of the items in (1) to (3);***

(5) ***assets into which the items in (1) to (4) have been converted, including assets representing investment in non-profit insurance business; and***

(6) ***premiums, receivables, other receipts, income and capital receipts from non-profit insurance business falling within (5) or otherwise written for the benefit, in whole or in part, of the firm's with-profits insurance business;***

outgoings:

(7) ***outgoings in respect of the firm's with-profits insurance business permitted in accordance with any relevant provision of the FCA Handbook or any other applicable regulatory requirement and, to the extent that incoming items have been included in (6), non-profit insurance business; and***

(8) ***transfers permitted in accordance with any relevant provision of the FCA Handbook or any other applicable regulatory requirement;***

and, where so required by COBS 20.1A.2R of the FCA Handbook, each distinct part of a firm's with-profits fund identified in accordance with that rule shall constitute a separate with-profits fund."

Overview of Fund/Company Developments

ACQUISITIONS AND MERGERS

The two acquisitions that were conditionally in the pipeline last year were duly completed:

Swiss Re's business unit Admin Re acquired Guardian Financial Services Group, from private equity company Cinven for £1.6 billion on 6 January 2016. Guardian Assurance Ltd was renamed ReAssure Life Ltd on 23 June 2016;

Teachers Provident Society Ltd transferred to Liverpool Victoria on 1 June 2016.

The only further acquisition in the proprietary sector involving (a small amount of) with profits funds was Phoenix Group's acquisition of Abbey Life, which was completed on 30 December 2016.

The steady stream of transfers of engagements from one mutual firm to another, which had been a feature in 2015, dried up before the introduction of Solvency II on 1 January 2016.

COMPANY CONSOLIDATIONS WITHIN GROUPS

There will obviously be different drivers in different firms but doubtless one of the main benefits from transferring funds from several group companies into a single company is to achieve more capital efficiency (through greater diversification) under Solvency II as well as reducing the actual overhead costs of maintaining and reporting for several companies.

Although most groups have now taken this step or have changes in the pipeline we believe this trend will continue to be seen as the industry consolidates further. Conversely the step of actually merging with profits funds has been rare in recent years and this is likely to continue.

The following consolidations involving with profits companies were announced in 2016:

All business of Prudential Retirement Income Ltd (all non profit in nature) transferred to Prudential Assurance Company Ltd on 1 October 2016;

All business of Aviva Annuity UK Ltd (all non profit in nature) was transferred to Aviva Life & Pensions UK Ltd on 1 January 2017;

The business of ReAssure Life Ltd (previously Guardian Assurance Ltd) was transferred to ReAssure Ltd on 31 December 2016.

FUND WIND-UPS

One further with profits fund wind-up was expected in 2016 (Sun Life Assurance Company of Canada (UK) Ltd's SLFC Assurance UK With Profits Fund), following hot on the heels of the company's two fund wind-ups in 2014 and 2015, but it has been delayed until 2017. Policies are due to be converted to a non linked basis and surplus assets will be distributed across these policies.

This is unlikely to be a major trend for some time but AKG expects a trickle of such conversions as funds reach such a small size that it is no longer worth the administrative effort and proportionate cost of maintaining such small funds with the attendant overheads of operating as with profits funds.

This also avoids the risk of very volatile payouts from year to year as surplus capital is shared out over progressively smaller policy numbers and will eventually become quite straightforward as many Court Schemes have included provision for such steps at particular fund sizes (value or policy numbers) and indeed may make it mandatory at a certain level.

BUSINESS NEWLY CLASSIFIED AS WITH PROFITS

There were two notable instances of long-standing in force blocks of business being classified as with profits in 2016, after previously being treated as non profit. These have therefore been included in AKG's UK Life Office With Profits Reports for the first time:

Friends Life and Pensions Ltd's Secure Growth Fund - The Secure Growth Fund was launched in 1971 as a Deposit Administration fund within the then Welfare Insurance Company Limited. Prior to 2016 the fund had not been considered to be a with profits fund but following the changes to insurance regulation the company reconsidered this and decided that from 1 January 2016 the fund would be managed and reported as a with profits fund. The fund had assets of around £565m at the end of 2015.

Royal London Unit-Linked With Profits business - From 1 January 2016, Royal London extended its ProfitShare concept to "*allow its unit-linked pension and drawdown customers to share financially in its success*". New customers buying a unit-linked pension plan and all existing unit-linked customers who set up a unit-linked pension plan since 1 July 2001, including all customers enrolled into a workplace pension, will be eligible to receive a ProfitShare amount. Royal London estimated that 600,000 existing pension customers would immediately benefit and over the next five years 400,000 new pensions customers would be eligible to participate in the ProfitShare arrangements.

DE-RISKING STRATEGIES

Funds have also been de-risking, in particular with several transferring blocks of annuities out of the funds. This avoids the problems of shrinking numbers of with profits policies of progressively shorter terms providing the capital and taking the risk of backing much longer-term annuity policies. It frees up capital, which, as well as benefitting any shareholders, can either be returned to policyholders through enhancements to benefits or used to allow increased equity or 'growth asset' investment in the search for higher returns.

The former has the benefit of allowing the current generation of maturities to benefit from the capital release while the latter, in theory at least, should offer greater benefit to policies with longer to run.

The following risk transfers from with profits companies have taken place recently:

Phoenix Life Ltd reinsured £1.7 bn of pension annuity in-payment liabilities to ReAssure Life Ltd (then named Guardian Assurance Ltd) in July 2014. The annuities were transferred to ReAssure Ltd on 31 December 2016.

The Equitable Life Assurance Society initially reinsured £875m of annuity business to Canada Life Ltd. The annuities then transferred to Canada Life in February 2016.

Zurich Assurance Ltd reinsured three tranches of annuities to Rothesay Life plc (May and December 2015 and August 2016). Subject to approval, the annuities will transfer to Rothesay Life.

Scottish Equitable plc reinsured £6bn of annuities to Rothesay Life plc in April 2016. Subject to approval, the annuities will transfer to Rothesay Life in the first half of 2017.

Scottish Equitable plc reinsured £3bn of annuities to Legal and General Assurance Society Ltd in May 2016. Subject to approval, the annuities will transfer to Legal and General in the first half of 2017.

INCREASED BONUS RATES

These de-risking steps (or at least earlier examples) also no doubt contributed to the position at the end of 2014 where some 40% of with profits funds felt able to increase at least some of their regular bonus rates in order to strike the right balance with the proportion of benefit arising from final bonus.

Increases were much less noticeable at the end of 2015 (and mostly where policies are not eligible for final bonus), with several rate reductions also occurring, possibly as firms were influenced by the PRA requirement (from Supervisory Statement SS14/15) that they '*ensure at all times that [their] strategy for distribution of discretionary benefits…(2) cannot reasonably be expected to have an adverse effect on the safety and soundness of the firm as a whole, or on the benefit security of all policyholders of the firm*'.

Maintaining lower regular bonus rates and allowing fair benefits to be achieved through higher final bonus rates satisfies this requirement while also reducing capital requirements and delaying transfers to shareholders in proprietary (and not 100:0) funds.

However, it does make it harder for policyholders to recognise the value in their policies.

INCREASED OVERSEAS EQUITY INVESTMENT

These de-risking steps also gave some funds the financial freedom to increase their investment in equities or other growth assets during 2014 although equally some funds opted to reduce the proportion invested in growth assets in order to help in that de-risking.

2015 saw fewer surveyed funds materially changing asset mix and there was no clear direction of travel although slightly more increased their equity and property investments than reduced and similarly more switched into overseas equities than out.

About AKG With Profits Fund Analysis and Assessment

PURPOSE AND SCOPE OF AKG'S WITH PROFITS REPORTS

AKG's With Profits Reports are designed to assist advisers with assessment of the relative merits of specific with profits funds. The aim is to provide comprehensive, structured and consistent information, accompanied by AKG's key analytical assessments of with profits financial strength, future performance and transparency.

The reports provide an invaluable resource for intermediaries who are advising clients in the selection of with profits providers for new policies.

Advice for in-force clients should be just as robust as it is for new business. Indeed evaluating existing with profits funds is an important part of an adviser's job and AKG's reports provide a wealth of relevant information and assessments.

Each individual report provides information on the structure and operation of a provider's with profits fund(s). It also highlights the various risks borne by with profits policyholders and concludes with AKG's long established Ratings for:

With Profits Financial Strength	With Profits Future Performance	With Profits Transparency

A number of comparative industry-wide tables are also included, covering a range of key metrics.

REPORTS COMPILATION

Compilation of the reports keeps AKG's research and analyst teams busy for many months, since it involves collection of a huge volume of data, and painstaking analysis of each fund's position before our updated ratings can be determined. The process started in earnest in April, with the gathering of each firm's annual accounts and PRA Returns and an industry-wide market survey that aims to ensure that other pieces of key information that are used in the reports are as accurate and as up to date as possible.

The survey covers topics such as PPFM/CFPPFM changes, With Profits Committee membership and terms of reference, annual reports to with profits policyholders, asset mixes and investment returns. AKG is very grateful to those companies which go to such great lengths to assist us by completing our surveys each year, and by answering any further queries which may arise.

After all relevant financial data, past performance statistics and survey information has been loaded into AKG's databases, a technical analyst drafts the narrative text for each group, company, fund and sub-fund that is covered in the reports. Everything is then subject to technical review by a different analyst and to a market review. AKG's updated ratings are also determined.

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