

## **With-profits life insurers are bigger and stronger**

### **A survey of 20 leading with-profits life insurers (5<sup>th</sup> annual survey)**

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Large with-profits funds are still growing, and looking stronger than a year ago, with assets now totalling £380 billion, up from £347 billion.

Chris O'Brien commented: "The 'realistic balance sheets' that life insurers issue as part of their returns to the Financial Services Authority (FSA) help remove some of the mysteries about with-profits funds. This is our 5<sup>th</sup> annual survey, covering the 20 top with-profits life insurers."

Companies have been helped by good investment returns in 2005. Highlights are:

- In total, insurers' assets are 6.88% more than their liabilities (on this 'realistic' valuation), a surplus of £24.5 billion. The surplus a year ago was £20.7 billion.
- Prudential had a £10.7 billion increase in its assets; with £89.3 billion assets in total, it remains the largest with-profits life insurer.
- Standard Life, planning to demutualise, shows realistic assets exceeding realistic liabilities by £4.1 billion, 24% up from £3.3 billion a year ago.
- In total, companies are setting aside £24.4 billion for options and guarantees (included in their liabilities), up from £23.2 billion a year ago.

The FSA also requires companies to carry out "stress tests", to check they can cope with specified adverse scenarios. These require a further £8.5 billion (2004: £9.7 billion) of capital, and all firms meet this requirement. Indeed, if we look at the companies' insurance business as a whole, then their capital is £33.4 billion (2004: £26.6 billion) more than regulatory requirements.

Chris O'Brien added:

"Companies use different assumptions in the new basis, and the new regime does not always reflect companies' individual situations suitably. Care is therefore needed in making comparisons between companies.

Where companies have a large surplus of realistic assets, policyholders do not necessarily receive more as a result, though some of those surplus assets might be distributed in the future, e.g. by a demutualisation or other arrangement. A relatively low ratio of surplus assets is not necessarily a sign of weakness. However, a company with a large surplus of available assets may have extra flexibility, e.g. as regards new business growth or its ability to invest in equities.

The actuarial profession has (for 2005) issued guidance such that closed funds ordinarily include what would have been an excess of assets over liabilities as a planned enhancement to the with-profit benefit reserve (WPBR), reflecting such surplus being added to bonuses at some stage. Since those planned enhancements then appear as a liability, the surplus becomes zero.

Four closed firms that show a zero surplus have material amounts included in their planned enhancements to WPBR which, if regarded as surplus, would result in surplus assets ratios as follows:

- Scottish Equitable 7.06%; Equitable Life 6.59%;
- Pearl Assurance 3.04%; Phoenix Life & Pensions 1.84%.
- \*some insurers have "support arrangement assets"; these have been added to the realistic value of assets in calculating the ratio;
- In 2005, following new guidance, closed funds may show zero surplus on the basis that surplus assets will be distributed through bonus;
- ~ 2005 figs include Provident Mutual with-profits business following transfer of fund

Note that, in a proprietary life insurer, a share of such enhancements would in fact be payable to shareholders.

9 insurers show a positive cost (to them) of "smoothing"; for 9, their smoothing is an asset to them (for 2 it is neutral).

Further research we plan will extend this work to smaller insurers; analyse firms' payouts; and examine firms' mortality assumptions on pensions."

The tables below set out the figures, and the following commentary is provided:

Large and medium-sized life insurers that have with-profits business have, from end-2004, been required to include, in their annual FSA Returns, a "realistic balance sheet". This is intended to reflect the assets and liabilities in a more appropriate way than previously, where artificialities obscured the true financial position. Broadly, the new approach is based on market values.

In particular, the calculation of liabilities should now reflect the way the business is being run, and include terminal bonus that has accrued to date. Options and guarantees should also be valued consistent with prices on financial markets.

Companies also have to continue to report on the previous basis (with some changes) and, if necessary, keep more capital than required under the realistic reporting regime.

Companies are required to carry out "stress tests", which helps determine the "risk capital margin", i.e. the capital needed to cover specified adverse scenarios. In some cases the capital is provided from the surplus realistic assets. In others it is provided from other sources, e.g. post-demutualisation or other support arrangements, shareholders' funds, or the present value of future profits on policies written outside the fund. These other sources may indeed provide substantial backing for the with-profits business.

The stress tests are not necessarily suitable for all companies' circumstances. The FSA requires life insurers to carry out "Individual Capital Assessments" (ICAs), containing financial projections related to their own business plans. The ICA results are reported to FSA but are not included in the FSA Returns.

Table 1 sets out:

- the realistic value of assets of the with-profits fund: this can include the present value of future profits on non-profit contracts written in the fund;

- support arrangement assets, as agreed with FSA (some companies have other arrangements to support the business but shown in other parts of the form);
- the assets available to the fund, being the sum of the realistic value of assets and support arrangement assets;
- the realistic value of liabilities: in making the calculation, companies can take credit for future management actions (e.g. changes they can make to their investment strategy, bonuses and charges to policyholders in adverse scenarios, provided that is consistent with their principles and practices of financial management): however, companies have done so to differing extents, and this reduces comparability of the figures;
- the surplus assets and ratios, as shown; and
- the overall excess of available capital resources to cover long-term insurance business capital resources requirements (CRR): this relates to the company rather than the with-profits fund, and also reflects a number of the old rules; furthermore, it may under-state the capital available within the company in certain circumstances, and does not allow for further capital that may be available elsewhere in the company's group.

Table 2 sets out:

- the component parts of the realistic value of liabilities:
  - the with-profit benefit reserve (WPBR): broadly the asset share or an equivalent calculation;
  - in addition: the provision for options and guarantees; other policy liabilities; minus charges; financing costs; and realistic current liabilities of the fund; each expressed as a % of the WPBR;
- the risk capital margin: this reflects the additional assets needed to cover specified "stress tests". In making the calculation, companies can take credit for management actions, and have done so to differing extents;
  - Examples of the types of change in the stress tests are: equity values falling by 20%; interest rates increasing by 0.72 percentage points; an increase in spreads for corporate bonds, debts and reinsurance; and persistency rates changing by 32.5%;
  - In closed funds where the liabilities include surplus to be distributed, the RCM can also be zero as, in the adverse scenario, no further assets are needed; instead, there is less surplus to distribute; and
- the risk capital margin is shown as a % of the realistic value of liabilities.

Table 2A

This sets out, for 2005, items in a number of rows of the realistic balance sheet.

LIFE INSURANCE COMPANY FINANCES								
Figures in £m								
<b>End-2005</b>								
<i>Table 1</i>	[1]	[2]	[3]	[4]	[5]	[6]	[7]	[8]
						-----Surplus assets ratio-----		Excess of
	Realistic	Support	Assets	Realistic	Surplus assets	-----using-----		available
	value of	arrangement	available	value of	using	Realistic	Available	capital
	assets	assets	to fund	liabilities	available	value of	assets	resources
Figures in £m	of fund			of fund	assets	assets		to cover
			[1]+[2]	see note n1	[3]-[4]	{[1]-[4]}/[4]	{[3]-[4]}/[4]	CRR
	form 19 line 26	form 19 line 27	form 19 line 29	form 19 line 59				form 2 line 42
AXA Sun Life plc	10,639.412	750.055	11,389.467	8,871.970	2,517.497	19.92%	28.38%	1,850.095
CGNU Life Assurance	15,156.799	0.000	15,156.799	13,074.968	2,081.831	15.92%	15.92%	1,652.315
Clerical Medical Inv Grp	18,526.255	0.000	18,526.255	17,460.719	1,065.536	6.10%	6.10%	2,064.275
Co-operative Ins Soc (n2)	21,983.906	0.000	21,983.906	21,169.439	814.467	3.85%	3.85%	937.457
Commercial Union L.A.	14,687.545	0.000	14,687.545	12,744.352	1,943.193	15.25%	15.25%	1,284.118
Equitable Life	10,133.081	0.000	10,133.081	10,133.081	0.000	0.00%	0.00%	167.083
Friends Prov L & P	14,844.756	0.000	14,844.756	14,608.948	235.808	1.61%	1.61%	1,577.060
Legal & General	21,170.900	0.000	21,170.900	20,328.811	842.089	4.14%	4.14%	4,403.594
National Provident Life	6,299.668	0.000	6,299.668	6,291.789	7.879	0.13%	0.13%	132.859
Norwich Union L & P (n3)	29,389.120	0.000	29,389.120	28,107.820	1,281.300	4.56%	4.56%	1,120.486
Pearl Assurance	10,450.837	0.000	10,450.837	10,450.837	0.000	0.00%	0.00%	588.214
Phoenix Life & Pensions	7,054.568	0.000	7,054.568	7,054.568	0.000	0.00%	0.00%	99.193
Phoenix & London Asce	5,831.671	0.000	5,831.671	5,831.671	0.000	0.00%	0.00%	240.641
Prudential Assurance	89,309.043	0.000	89,309.043	81,330.348	7,978.695	9.81%	9.81%	5,993.608
Royal London Mutual	15,604.564	0.000	15,604.564	14,188.506	1,416.058	9.98%	9.98%	1,512.238
Scottish Equitable	9,786.011	0.000	9,786.011	9,786.011	0.000	0.00%	0.00%	640.683
Scottish Mutual Ass	7,698.302	0.000	7,698.302	7,660.004	38.298	0.50%	0.50%	986.707
Scottish Widows plc	19,049.385	1,367.778	20,417.163	19,284.632	1,132.531	-1.22%	5.87%	3,016.677
Standard Life Ass	45,318.555	0.000	45,318.555	41,231.356	4,087.199	9.91%	9.91%	4,172.409
Sun Life Assurance	7,334.454	0.000	7,334.454	6,185.729	1,148.725	18.57%	18.57%	927.743
Total	380,268.832	2,117.833	382,386.665	355,795.559	26,591.106	6.88%	7.47%	33,367.455
<i>Table 2</i>	With profits	Provision for	Other	Minus	Financing	Realistic	Risk	RCM % of
	benefit	options and	policy	charges	costs	current	capital	realistic
	reserve	guarantees	liabilities			liabilities	margin	value of
	(WPBR)					of fund	of fund	liabilities
	form 19 line 31	form 19 line 41+43	see note n4	form 19 line 35+36	form 19 line 45	form 19 line 51	form 19 line 65	see note n5
		% WPBR	% WPBR	% WPBR	% WPBR	% WPBR		
AXA Sun Life plc	7,405.943	7.92%	6.49%	0.00%	0.00%	5.39%	550.133	6.20%
CGNU Life Assurance	11,074.601	4.48%	3.44%	0.00%	0.00%	10.15%	460.538	3.52%
Clerical Medical Inv Grp	15,859.814	7.73%	2.72%	-3.75%	0.00%	3.40%	771.248	4.42%
Co-operative Ins Soc	14,818.471	12.71%	5.47%	-5.61%	0.00%	30.28%	77.010	0.36%
Commercial Union L.A.	10,957.680	6.60%	3.07%	0.00%	0.00%	6.64%	685.738	5.38%
Equitable Life	8,181.385	10.47%	13.30%	-4.23%	0.13%	4.18%	0.000	0.00%
Friends Prov L & P	12,515.126	9.77%	3.06%	-3.33%	0.22%	7.01%	276.271	1.89%

Legal & General	17,925.473	3.83%	5.30%	-0.17%	0.00%	4.45%	327.057	1.61%
National Provident Life	4,628.460	23.03%	1.60%	-7.13%	14.42%	4.01%	71.831	1.14%
Norwich Union L & P	23,740.997	12.86%	5.84%	-4.31%	0.00%	4.00%	868.572	3.09%
Pearl Assurance	8,247.780	7.91%	16.53%	-0.93%	0.00%	3.21%	0.000	0.00%
Phoenix Life & Pensions	6,132.447	5.65%	4.59%	-0.76%	-0.01%	5.57%	0.000	0.00%
Phoenix & London Assce	4,534.941	28.08%	2.81%	-8.07%	0.00%	5.78%	230.028	3.94%
Prudential Assurance	73,798.817	3.06%	4.12%	-2.09%	0.00%	5.12%	2,439.654	3.00%
Royal London Mutual	11,263.185	10.86%	7.75%	-1.17%	0.00%	8.54%	229.535	1.62%
Scottish Equitable	8,316.752	13.70%	7.74%	-4.42%	0.00%	0.64%	0.000	0.00%
Scottish Mutual Ass	6,781.434	10.84%	2.13%	0.00%	0.00%	-0.02%	0.000	0.00%
Scottish Widows plc	16,703.865	11.76%	7.64%	-7.22%	0.00%	3.27%	312.557	1.62%
Standard Life Ass	37,887.822	6.15%	0.87%	-7.73%	0.00%	9.53%	735.299	1.78%
Sun Life Assurance	5,319.549	12.24%	-1.72%	0.00%	-2.60%	8.36%	504.366	8.15%
Total	306,094.542	7.96%	4.68%	-3.34%	0.19%	6.76%	8,539.837	2.40%
<i>Table 2A</i> (see note n6)	Line 32	Line 33	Line 34	Line 35	Line 36	Line 41	Line 42	Line 43
AXA Sun Life plc	0.000	0.000	393.820	0.000	0.000	324.460	0.000	261.958
CGNU Life Assurance	0.000	0.000	19.306	0.000	0.000	473.809	229.297	21.850
Clerical Medical Inv Grp	0.000	0.000	104.928	594.379	0.000	876.460	0.000	349.426
Co-operative Ins Soc	591.366	0.000	86.216	714.260	116.982	1160.736	0.000	722.598
Commercial Union L.A.	0.000	0.000	0.000	0.000	0.000	502.804	219.371	220.292
Equitable Life	0.000	0.000	667.835	299.705	46.226	846.941	0.000	10.000
Friends Prov L & P	0.000	0.000	0.000	278.556	138.783	427.204	0.000	795.602
Legal & General	0.000	0.000	32.531	9.409	21.026	441.966	0.000	244.226
National Provident Life	0.000	0.000	0.000	30.194	299.623	1054.916	3.463	10.906
Norwich Union L & P	0.000	0.000	0.000	1010.072	13.107	1821.179	693.217	1231.243
Pearl Assurance	151.545	0.000	355.637	47.519	29.330	314.291	96.895	337.889
Phoenix Life & Pensions	0.000	11.017	129.522	46.647	0.000	85.870	0.000	260.325
Phoenix & London Assce	0.000	56.553	2.245	366.154	0.000	420.560	0.000	852.732
Prudential Assurance	0.000	0.000	1263.121	1476.379	66.857	1585.692	0.000	670.821
Royal London Mutual	0.000	0.000	466.855	0.000	132.129	667.957	0.000	554.750
Scottish Equitable	0.000	0.000	690.731	367.477	0.000	736.085	0.000	403.026
Scottish Mutual Ass	0.000	0.000	141.901	0.000	0.000	594.454	0.000	140.877
Scottish Widows plc	0.000	0.000	208.004	179.107	1027.331	588.586	0.000	1376.023
Standard Life Ass	0.000	0.000	0.000	1489.283	1438.272	2072.546	555.883	258.728
Sun Life Assurance	0.000	0.000	34.681	0.000	0.000	457.046	0.000	193.819
Total	742.911	67.570	4597.333	6909.141	3329.666	15453.562	1798.126	8917.091
<b>End-2004</b>								
<i>Table 1</i>	[1]	[2]	[3]	[4]	[5]	[6]	[7]	[8]
					Surplus assets	-----Surplus assets ratio-----		Excess of available
	Realistic value of assets	Support arrangement assets	Assets available to fund	Realistic value of liabilities of fund	using available assets	-----using-----	Realistic value of assets	capital resources to cover
Figures in £m	of fund	assets	to fund	of fund	assets	assets	assets	to cover

			[1]-[2]	see note n1	[3]-[4]	{[1]-[4]}/[4]	{[3]-[4]}/[4]	CRR
	form 19 line 26	form 19 line 27	form 19 line 29	form 19 line 59				form 2 line 42
AXA Sun Life plc	10,227.289	518.115	10,745.404	8,940.394	1,805.010	14.39%	20.19%	1,374.247
CGNU Life Assurance	12,253.868	0.000	12,253.868	10,542.729	1,711.139	16.23%	16.23%	1,425.790
Clerical Medical Inv Grp	18,269.618	0.000	18,269.618	17,714.369	555.249	3.13%	3.13%	1,515.969
Co-operative Ins Soc (n2)	16,312.110	0.000	16,312.110	15,572.312	739.798	4.75%	4.75%	687.433
Commercial Union L.A.	13,482.983	0.000	13,482.983	11,866.080	1,616.903	13.63%	13.63%	1,223.600
Equitable Life	10,722.516	0.000	10,722.516	10,191.893	530.623	5.21%	5.21%	104.347
Friends Prov L & P	14,370.245	0.000	14,370.245	14,238.787	131.458	0.92%	0.92%	1,086.311
Legal & General	19,539.858	0.000	19,539.858	18,676.107	863.751	4.62%	4.62%	4,009.726
National Provident Life	6,338.415	0.000	6,338.415	6,334.732	3.683	0.06%	0.06%	71.035
Norwich Union L & P	26,252.304	0.000	26,252.304	25,044.963	1,207.341	4.82%	4.82%	1,137.687
Pearl Assurance	10,357.630	0.000	10,357.630	10,031.471	326.159	3.25%	3.25%	481.546
Phoenix Life & Pensions	7,140.249	0.000	7,140.249	7,009.311	130.938	1.87%	1.87%	152.431
Phoenix & London Assce	5,680.498	0.000	5,680.498	5,680.498	0.000	0.00%	0.00%	6.433
Prudential Assurance	78,594.466	0.000	78,594.466	72,553.770	6,040.696	8.33%	8.33%	4,665.018
Royal London Mutual	13,929.062	0.000	13,929.062	12,866.617	1,062.445	8.26%	8.26%	739.754
Scottish Equitable	9,551.529	0.000	9,551.529	8,854.297	697.232	7.87%	7.87%	844.723
Scottish Mutual Ass	8,571.640	0.000	8,571.640	8,496.382	75.258	0.89%	0.89%	931.861
Scottish Widows plc	17,823.980	1,265.472	19,089.452	18,117.821	971.631	-1.62%	5.36%	2,592.944
Standard Life Ass	40,482.915	0.000	40,482.915	37,195.220	3,287.695	8.84%	8.84%	2,954.680
Sun Life Assurance	7,058.219	0.000	7,058.219	6,362.410	695.809	10.94%	10.94%	621.742
Total	346,959.394	1,783.587	348,742.981	326,290.163	22,452.818	6.33%	6.88%	26,627.277
						20,669.231	22,452.818	
<i>Table 2</i>	With profits	Provision for	Other	Minus	Financing	Realistic	Risk	RCM % of
	benefit	options and	policy	charges	costs	current	capital	realistic
	reserve	guarantees	liabilities			liabilities	margin	value of
						of fund	of fund	liabilities
	form 19 line 31	form 19 line 41+43	see note n4	form 19 line 35+36	form 19 line 45	form 19 line 51	form 19 line 65	see note n5
		% WPBR	% WPBR	% WPBR	% WPBR	% WPBR		
AXA Sun Life plc	7,102.507	10.26%	11.61%	0.00%	0.00%	4.01%	402.560	4.50%
CGNU Life Assurance	8,969.027	4.72%	5.39%	-0.39%	0.00%	7.82%	333.126	3.16%
Clerical Medical Inv Grp	16,034.048	9.08%	1.47%	-5.68%	0.34%	5.26%	575.077	3.25%
Co-operative Ins Soc	13,623.288	10.51%	5.87%	-5.62%	0.00%	3.55%	238.467	1.53%
Commercial Union L.A.	10,386.083	6.70%	3.53%	-0.32%	0.00%	4.35%	426.870	3.60%
Equitable Life	8,681.972	8.24%	6.94%	-4.56%	0.18%	6.59%	330.142	3.24%
Friends Prov L & P	12,134.659	10.46%	2.88%	-3.11%	0.00%	7.11%	278.606	1.96%
Legal & General	16,478.563	4.89%	4.79%	-0.06%	0.00%	3.72%	643.487	3.45%
National Provident Life	4,759.209	22.26%	1.40%	-7.58%	12.98%	4.05%	84.828	1.34%
Norwich Union L & P	21,845.608	11.85%	5.59%	-5.11%	0.00%	2.32%	1,018.391	4.07%
Pearl Assurance	8,240.477	8.97%	10.53%	-0.73%	0.00%	2.96%	373.645	3.72%
Phoenix Life & Pensions	6,423.939	4.39%	2.80%	-1.58%	-0.02%	3.52%	62.558	0.89%
Phoenix & London Assce	4,548.348	24.40%	1.83%	-7.66%	0.00%	6.33%	310.094	5.46%
Prudential Assurance	66,757.403	3.38%	3.64%	-2.23%	0.00%	3.89%	1,798.334	2.48%
Royal London Mutual	10,635.565	10.55%	7.88%	-1.44%	0.00%	3.99%	276.566	2.15%
Scottish Equitable	8,196.904	15.06%	-0.51%	-6.89%	0.00%	0.37%	486.992	5.50%

Scottish Mutual Ass	7,704.320	9.43%	0.02%	0.00%	0.00%	0.83%	403.821	4.75%
Scottish Widows plc	16,076.497	10.69%	7.39%	-6.83%	0.00%	1.44%	403.859	2.23%
Standard Life Ass	33,994.055	6.39%	1.32%	-7.42%	0.00%	9.12%	928.582	2.50%
Sun Life Assurance	5,342.177	11.86%	3.35%	0.00%	-2.35%	6.24%	332.574	5.23%
<b>Total</b>	<b>287,934.649</b>	<b>8.05%</b>	<b>4.14%</b>	<b>-3.59%</b>	<b>0.19%</b>	<b>4.53%</b>	<b>9,708.579</b>	<b>2.98%</b>
Notes								
All figures are from companies' annual returns to FSA								
n1 With profits benefit reserve plus the % additions and deductions shown in Table 2								
n2 Figures relate to year-end 31 December, except Co-operative Ins Soc (8 January 2005, 14 January 2006)								
n3 Norwich Union L&P figures for 2005 include former Provident Mutual with-profits business following a scheme of transfer								
n4 Form 19, lines 32 - 33 + 34 + 42 + 44 + 46 + 47								
n5 Risk capital margin as % of realistic liabilities = form 19: line 65/line 59								
n6 Lines on form 19 as follows:								
line 32: past miscellaneous surplus allocated to WPBR								
line 33: past miscellaneous deficit attributed to WPBR								
line 34: planned enhancements to WPBR								
line 35: planned deductions for the cost of guarantees, options and smoothing from WPBR								
line 36: planned deductions for other costs deemed chargeable to WPBR								
line 41: future costs of contractual guarantees (other than financial options)								
line 42: future costs of non-contractual commitments								
line 43: future cost of financial options								
line 44: future costs of smoothing (possibly negative)								
line 45: financing costs								
line 46: any other liabilities related to regulatory duty to treat customers fairly								
line 47: other long-term liabilities								
line 51: realistic current liabilities of fund								







