

WHAT FUTURE FOR THE ENDOWMENT LIFE ASSURANCE POLICIES?

Since the late 90's, leading insurance companies in Mauritius have introduced life assurances linked with their investment portfolios. This has caused the sales of the traditional life assurance plans like the endowment policies to fall drastically. However, is it not premature to talk of their extinction since the recent continuous disappointing performance of the investment policies have brought them back to *life*.

For the last two years figures have shown an increase in the sales of life assurances linked with investment. Almost 60% of the policies sold by insurance companies were investment scheme which ranged from life assurances, educational plan and personal pension plan. The craze for those plans was due to the fact that it was new, flexible and carried a sensational rate of return. However, with the difficult economic situation prevailing, causing a fall on investment returns, the underperformance of investment policies has brought even the most hazardous investors back to earth. The rates of return declared during past years on the investment policies are far less than what was quoted at the time of purchase. The experts are terming the situation as a temporary downslide that would be halted upon market recovery. But for how long will they keep saying this?

To understand the difference between an endowment policy and an investment policy, it is important to know how these policies operate. The most common type of endowment policies are 'the ordinary endowment with profits' and the 'money back policy with profits'. These are the most basic forms of endowment, with level premiums throughout and a payout of the sum assured plus the accrued bonuses on maturity, or earlier death. The main difference between the two is that the policy provide for the payments of the sum assured in installments every 5 years to policyholders on the money back policy whereas the full sum assured is payable at maturity under the ordinary endowment option. If the policy runs to maturity, bonuses will be higher than if it becomes a death claim because they will have been added for a longer period. The rate of bonus declared is based on the actuarial valuation which is usually carried out every 3 years. Actuaries adjust levels of bonus to take account of fluctuating profit returns. However, in determining bonuses, the profit proceeds are kept during good economic period in order to compensate during times of weaker profit margin. This process is known as

“smoothing” and it provides policyholders with a constant and regular bonus increase on their policy. The bonuses once declared cannot be reduced or removed. Usually, the policyholders can cancel the policy for a cash surrender value after payment of two full years’ premiums and the amount refundable will be around 60% of premiums paid. However, surrendering an endowment early is often not the best advice.

On the other hand we have the newly launched investment policy which is a life assurance coupled with an investment plan. This type of investment plan which is being sold by insurance companies on the island is a market-linked one. This means that the value of the investment is directly linked to the performance of the fund. The money are usually invested in the insurance company’s investment portfolio which consists of government stocks, bonds, debentures, equities, units on stock market and property investments. This is similar to a unit-trust investment where the rate of return is not stable.

The mechanism of an investment plan is that an account is set up for each client. The cost of life cover plus administration charges are deducted from the premium paid and the balance is invested. At the end of each company year an interest rate is declared based on the investment performance of the fund. This rate is then used to determine the amount of interest to be credited to the account of policyholders. Some of the projected rates of growth assumed in the past have been as high as 16% per annum. The incentive of investment policy is that by giving investors smoother returns, clients would escape the day to day movements of the stock market. During past years, a return of 12% to 14% was achievable but as markets have fallen steadily during the few years, even the big insurance companies cannot afford to keep declaring returns that are not being met by their underlying fund. The actual declared rates of returns are around 7% to 9% and it is easy to discover why investment policies are no more the trend for investors without mentioning that these policies carry phenomenal charges such as 60% to 90% initial first year charge at the end of each month on premiums paid. A management fee of 5% to 10% of monthly premium is charged for subsequent years and finally an asset management fee of 1% to 3% of the account balance per annum is deducted at the end of each financial year. In case you wish to surrender your policy during the first 5 years a surrender charges is applied on your account balance. The above charges vary from different offices but are approximate figures of what are being applied on the market.

However, if you have already purchased an investment plan it does not mean your policy is in peril but the rate of return which has been declared recently shows that at the end of the term of your policy you

might get a lump sum which is far less than what was anticipated. For instance, if a 30-years old investor is paying Rs 1000.- monthly on a investment policy, he may reach a breakeven situation, i.e. the total amount paid equals the accumulated value of his funds, after 9 years if we consider the actual return rate of 9%. Hoping that the market recovers over time, the long term forecast for investment rate should be better. However, this is going to be a slow process as most experts are forecasting a single digit growth on the world market for the coming years. Even if in the short term the situation will be brighter, the insurers will be very cautious before raising their rates significantly until their wounds of past years are fully closed.

However, even though the timing is not appropriate, the investment policies are still charming future prospects. The reasons behind this craze are:

- The figures on the quotes available on the market are based on projected figures and not on the actual rate.
- The death cover are higher
- A friend recommended it
- Tax relief
- The possibility of making partial withdrawal
- Higher commission paid to sales agent

As a sales agent, the last point is difficult for me as to say and will surely meet a lot of disapproval but we all know that it is true. Thankfully, these days should be behind us as most sales agent are nowadays more customer oriented.

If you find yourself in any of the above scenarios, you just have to ask your insurance company a revised projected account balance based on the actual return rate. If you noticed any underperformances discuss the matter with your sales agent to determine the best course of action for you. You will have the option of keep it going, making an extra monthly contribution to compensate for the shortfall, surrender it or even cancel it to purchase a more appropriate plan.

In summary, we find that our traditional endowments with profits policy have still a bright future ahead despite the challenge of the investment policies. Of course a certain degree of risk is crucial for growth but at what price are future prospects willing to gamble in an investment scheme. The performance of the investment plan nowadays is somehow much like the England Football Team Liverpool with an impressive

history but with much difficulty to win the championship in recent years and the fans are hoping each year will be their year of glory. In order to protect future investors, the ideal thing should be the introduction of another type of investment plan with a guaranteed portfolio where the rate of return at maturity on the lump-sum capital investment is guaranteed at a fixed rate of let us say 8%. The insurance company is obliged to meet the guaranteed rate. If the fund delivers less than 8%, the company will make up for the difference. If the fund does better, only 8% will be paid. Also, future investors should be given the possibility of switching from either plan i.e, the market-linked portfolios and the guaranteed portfolios if they wish depending on how the market is performing thus preventing them from burying their head in the sand in case of poor economic situation.

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