Money Simplified

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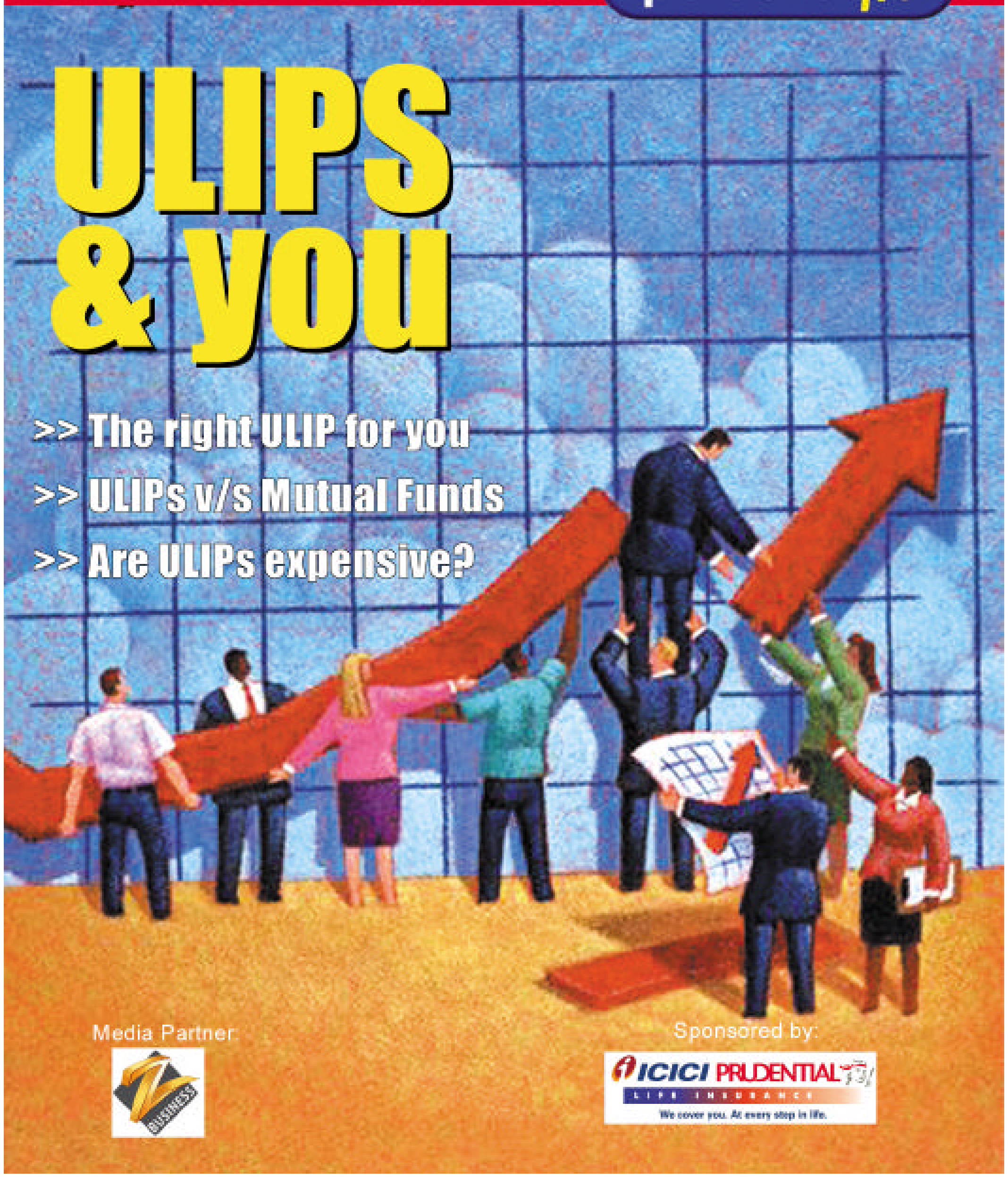
ULIPS & you

>> The right ULIP for you

>> ULIPs v/s Mutual Funds

>> Are ULIPs expensive?



PREFACE

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ULIPs & You

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Unit Linked Insurance Plans (ULIPs) are probably the most aggressively marketed savings-based financial product in the market today. They are also probably one of the most mis-sold. In interactions with our clients, both resident and non resident, we have come across numerous instances of mis-selling. In some instances the client did not know what a ULIP actually was even though he had committed a substantial amount of money to the product! Indeed, even the media has been reporting instances of how insurance agents have been 'pushing' ULIP products.

But there is a lot more to ULIPs than the bad press it has received in recent times. In this issue of the Money Simplified, we unravel the ULIP and suggest how best to benefit from it. We highlight the risks associated with ULIPs and also how you can go about identifying the right ULIP product for your needs.

A big challenge to putting together a guide on ULIPs is the limited amount of information that is available. Be it with respect to the expense ratios or the stocks in which these funds have invested. Or even the commissions that are paid to insurance agents. The Personal*fn* Research Team undertook several official and informal interviews with individuals from the industry, ranging from Product Heads to agents, to plug this gap. Even though these interactions were very helpful, what surprised us is that there is ambiguity amongst the insurers with respect to certain guidelines like portfolio disclosures or the tax treatment for top-ups and withdrawal amounts. We hope the IRDA, the insurance regulator, will take note and remove any ambiguity that may otherwise exist in the guidelines.

At the end, we are sure that this guide to ULIP, probably a first in the country, will empower you to take the right 'ULIP decision'.

All the best!

Team Personal*fn*

23rd September, 2005

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What ULIPs are all about?

For the generation of insurance seekers who thrived on insurance policies with assured returns issued by a single public sector enterprise, unit-linked insurance policies (ULIPs) are a revelation.

Traditionally, insurance products have been associated with attractive returns coupled with tax benefits. The returns were often so compelling that insurance products competed with investment products for a place in the investor's portfolio. Insurance policies then were symbolic of the times when high interest rates and the absence of a rational risk-return trade-off were the norms.

The softening of interest rates introduced a degree of much-needed rationality to endowment plans; attractive returns at low risk became a thing of the past. This also coincided with an upturn in equity markets and the emergence of a new breed of market-linked insurance products like ULIPs. While in conventional insurance products the insurance component takes precedence over the savings component, the opposite holds true for ULIPs. More importantly ULIPs (powered by the presence of a large number of variants) offer investors the opportunity to select a product which matches their risk profile; for example an individual with a high risk appetite can shun traditional endowment plans (which invest about 85% of their funds in the debt instruments) in favour of a ULIP which invests largely in equities.

In traditional insurance products, the sum assured is the cornerstone; in ULIPs, premium payments is the key component. ULIPs are remarkably similar to mutual funds in terms of structure and functioning; premium payments made are converted into units and a net asset value (NAV) is declared. Investors have the choice of enhancing their insurance cover, modifying premium payments and even opting for a distinct asset allocation than the one they originally opted for. Also if an eventuality were to occur, in case of traditional products, the sum assured is paid along with accumulated bonuses; conversely in ULIPs, the insured is paid either the sum assured or investment corpus whichever is higher.

While few would dispute the value-add that ULIPs can provide to one's insurance portfolio and financial planning; the same is not without its flipside. For the uninitiated, understanding the functioning of ULIPs can be quite a handful! The presence of what seems to be relatively higher expenses, rigidly defined insurance and investment components and the impact of markets on the corpus clearly make ULIPs a complex proposition. Traditionally, the insurance seeker's role was a passive one restricted to making premium payments; ULIPs require greater participation from both the insured and the insurance advisor.

As is the case with most evolved investment avenues, making informed decisions is the key if investors in ULIPs wish to truly gain from their investments. The various aspects of ULIPs dealt with in this publication will certainly further the ULIP investor's cause.

ULIPs Vs Traditional insurance plans

It wasn't too long back, when the good old endowment plan was the preferred way to insure oneself against an eventuality and to set aside some savings to meet one's financial objectives. Then insurance was thrown open to the private sector. The result was the launch of a wide variety of insurance plans, including the ULIPs.

Two factors were responsible for the advent of ULIPs on the domestic insurance horizon. First was the arrival of private insurance companies. ULIPs were one of the most significant innovations introduced by private insurers. The other factor that saw investors take to ULIPs was the decline of assured return endowment plans. Of course, the regulator – IRDA (Insurance Regulatory and Development Authority) was instrumental in signaling the end of assured return plans. Today, there is just one insurance plan from LIC (Life Insurance Corporation) – Komal Jeevan – that assures return to the policyholder.

While these were the two factors most instrumental in marking the arrival of ULIPs, another factor that has helped their cause is a booming stock market. While this now appears as one of the primary reasons for their popularity, we believe ULIPs have some fundamental positives like enhanced flexibility and merging of investment and insurance in a single entity that have really endeared them to individuals.

Given that ULIPs are relatively new and remain an enigma for a large section of insurance-seekers in this note we compare them to the traditional endowment plans to give you a perspective.

Sum assured

Perhaps the most fundamental difference between ULIPs and traditional endowment plans is in the concept of premium and sum assured. When you want to take a traditional endowment plan, the question your agent will ask you is – how much insurance cover do you need? Or in other words, what is the sum assured you are looking for? The premium is calculated based on the number you give your agent.

With a ULIP it works in reverse. When you opt for a ULIP, you will have to answer the question – how much premium can you pay? Depending on the premium amount you state, you are offered a sum assured as a multiple of the premium. For instance, if you are comfortable paying Rs 10,000 annual premium on your ULIP, the insurance company will offer you a sum assured of say 5 to 20 times the premium amount. In our illustration your sum assured could vary from Rs 50,000 to Rs 200,000. Within this range, you have to decide how much insurance cover you need. Of course the multiple to calculate the sum assured varies across life insurance companies. In the case of LIC's ULIP, the sum assured–premium relationship works the traditional way. So you need to state how much sum assured you are looking for and your premium is calculated as 1/10th the sum assured. If you have opted for a sum assured of Rs 100,000, your annual premium will be Rs 10,000.

Investments

Traditionally, endowment plans have invested in government securities, corporate bonds and the money market. They have shirked from investing in the stock markets, although there is a provision for the same. However, for some time now, endowment plans have discarded their traditional outlook on investing and allocate about 10%-15% of monies to stocks. This percentage varies across life insurance companies.

ULIPs have no such constraints on investments. They invest across the board in stocks, government securities, corporate bonds and money market instruments. Of course, within a ULIP there are options wherein there are caps on each instrument (stocks, bonds).

Expenses

ULIPs are considered to be very expensive when compared to traditional endowment plans. This notion is rooted more in perception than reality. Let us take agent commissions to understand this better. Sale of a traditional endowment plan fetches a commission of about 30% (of premium) in the first year and 60% (of premium) over the first five years. Then there is ongoing commission in the region of 5%. Sale of a ULIP fetches a relatively lower commission ranging from as low as 5% to 30% of premium (depending on the insurance company) in the first 1-3 years. After the initial years, it stabilises at 1-3%. Unlike endowment plans, there are no IRDA regulations on ULIP commissions.

Mortality expenses for ULIPs and traditional endowment plans remain the same as also the administration charges.

One area where ULIPs prove to be more expensive than traditional endowment is in fund management. Since ULIPs have an equity component that needs to be managed actively, they incur fund management charges. These charges fluctuate in the 0.80%-1.50% (of premium) range. We could not get a fix

How ULIPs fare against the competition

	ULIPs	Traditional endowment plans
Sum assured	As a multiple of the premium	Known upfront, premium is based on it
Investments	Allocation to equities, bonds, gsecs, money market depending on the option	Larger allocation to bonds, gsecs, money market, smaller equity allocation
Expenses	Lower agent commissions, higher fund management charges	Higher agent commissions
Flexibility	High	Low
Transparency	High	Low
Liquidity	High	Low
Tax benefits	Available	Available

on the fund management charges of traditional endowment plans despite having spoken to several insurance companies.

Flexibility

As we mentioned at the very beginning of this article, one aspect that gives ULIPs an edge over traditional endowment is flexibility. ULIPs offer a host of options to the individual based on his risk profile. There are insurance companies that offer as many as five options within a ULIP with the equity component varying from zero to a maximum of 100%. You can select an option that best fits your objectives and risk-taking capacity. Having selected an option, you still have the flexibility to switch to another option. Most insurance companies allow a number of free 'switches' in a year.

One aspect that gives ULIPs an edge over traditional endowment is flexibility.

Another innovative feature with ULIPs is the 'top-up' facility. A top-up is a one-time additional investment in the ULIP over and above the annual premium. This feature works well when you have a surplus that you are looking to invest in a market-linked avenue, rather than keep in a savings account or a fixed deposit.

ULIPs also have a facility that allows you to skip premiums after regular payment in the initial years. For instance, if you have paid your premiums religiously over the first three years, you can skip the fourth year's premium. The insurance company will make the necessary adjustments from your investment surplus to ensure the policy does not lapse. We however recommend that you do not skip your premium payments. Remember, ultimately its your investment surplus that is being eroded with every skipped premium.

With traditional endowment, there are no investment options. You select the only option you have and must remain with it till maturity. There is also no concept of a top-up facility. Your premium amount cannot be enhanced on a one-time basis and skipped premiums will result in your policy lapsing.

Transparency

ULIPs are also more transparent than traditional endowment plans. Since they are market-linked, there is a price per unit. This is the net asset value (NAV) that is declared on a daily basis. A simple calculation can tell you the value of your ULIP investments. Over time you know exactly how your ULIP has performed.

Most ULIPs also disclose their portfolios regularly. This gives you an idea of how your money is being managed. It also tells you whether or not your mutual fund and/or stock investments coincide with your ULIP investments. If they are, then you have the opportunity to do a rethink on your investment strategy across the board so as to ensure you are well-diversified across investment avenues at all times.

With traditional endowment, there is no concept of a NAV. However, insurers do send you an annual statement of bonus declared during the year, which gives you an idea of how your insurance plan is performing. Traditional endowment also does not have the practice of disclosing portfolios. But given that there are provisions that ensure a large chunk of the endowment portfolio is in high quality (AAA/sovereign rating) debt paper, disclosure of portfolios is likely to evoke little investor interest.

Liquidity

Another flexibility that ULIPs offer the individual is liquidity. Since ULIP investments are NAV-based it is possible to withdraw a portion of your investments before maturity. Of course, there is an initial lock-in period (3 years) after which the withdrawal is possible.

Traditional endowment has no provision for pre-mature withdrawal. You can surrender your policy, but you won't get everything you have earned on your policy in terms of premiums paid and bonuses earned. If you are clear that you will need money at regular intervals then it is recommended that you opt for money-back endowment.

Tax benefits

Taxation is one area where there is common ground between ULIPs and traditional endowment. Premiums in ULIPs as well as traditional endowment plans are eligible for tax benefits under Section 80C subject to a maximum limit of Rs 100,000. On the same lines, monies received on maturity on ULIPs and traditional endowment are tax-free under Section 10.

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We are a part of Quantum Information Services Ltd., which is one of India's most experienced research houses (set up in 1990). Quantum also offers equity research via its online initiative, www.equitymaster.com

Our offerings

- Personal*fn* helps individuals plan their investments so that they can meet their financial commitments (like retirement, marriage and child's education)
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Our publication

- Personal*fn* also publishes the Money Simplified, a free-to-download bi-monthly guide to help you plan your finances better.

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ULIPs vs. Mutual Funds

ULIPs as an investment avenue are closest to mutual funds in terms of their structure and functioning. As is the case with mutual funds, investors in ULIPs are allotted units by the insurance company and a net asset value (NAV) is declared for the same on a daily basis. Similarly ULIP investors have the option of investing across various schemes similar to the ones found in the mutual funds domain i.e. diversified equity funds, balanced funds and debt funds to name a few. Generally speaking, ULIPs can be termed as mutual fund schemes with an insurance component.

However it should not be construed that barring the insurance element there is nothing differentiating mutual funds from ULIPs. Despite the seemingly comparable structures there are various factors wherein the two differ. In this article we evaluate the two avenues on certain common parameters and find out how they measure up.

1. Mode of investment/ investment amounts

Mutual fund investors have the option of either making lump sum investments or investing using the systematic investment plan (SIP) route which entail commitments over longer time horizons. The minimum investment amounts are laid out by the fund house.

ULIP investors also have the choice of investing in a lump sum (single premium) or using the conventional route i.e. making premium payments on an annual, half-yearly, quarterly or monthly basis. In ULIPs, determining the premium paid is often the starting point for the investment activity. This is in stark contrast to conventional insurance plans where the sum assured is the starting point and premiums to be paid are determined thereafter.

ULIP investors also have the flexibility to alter the premium amounts during the tenure. For example an individual with access to surplus funds can enhance the contribution thereby ensuring that his surplus funds are gainfully invested; conversely an individual faced with a liquidity crunch has the option of paying a lower amount (the difference being adjusted in the accumulated value of his ULIP). The freedom to modify premium payments at one's convenience clearly gives ULIP investors an edge over their mutual fund counterparts.

2. Expenses

With mutual funds, expenses charged for various activities like fund management, sales and marketing, administration among others, are subject to limits as prescribed by the Securities and Exchange Board of India (SEBI). For example equity-oriented funds can charge a maximum of 2.5% per annum on a recurring basis for all expenses; any expense above the prescribed limit is borne by the fund house and not the investors. Similarly funds also charge their investors entry and exit loads (in most cases, either is applicable). Entry loads are charged at the timing of making an investment while the exit load is charged at the time of sale.

Insurance companies have a free hand in levying expenses on their ULIP products with no upper limits being prescribed by the regulator i.e. the Insurance Regulatory and Development Authority (IRDA). This explains the complex and at times 'unwieldy' expense structures on ULIP offerings. The only restraint placed is that insurers are required to notify the regulator of all the expenses that will be charged on their ULIP offerings. Expenses can have far-reaching consequences on investors since higher expenses translate into lower amounts being invested and a smaller corpus being accumulated. ULIP-related expenses have been dealt with in detail in the article "Understanding ULIP expenses".

3. Portfolio disclosure

Mutual fund houses are required to statutorily declare their portfolios on a quarterly basis, albeit most fund houses do so on a monthly basis. Investors get the opportunity to see where their monies are being invested and how they have been managed by studying the portfolio.

There is lack of consensus on whether ULIPs are required to disclose their portfolios. In our interactions with leading insurers we came across divergent views. While one view was that disclosing portfolios on a quarterly basis is mandatory, the other view was that there is no legal obligation to do so and insurers are required to disclose portfolios only on demand.

The ULIPs vs. Mutual Funds face-off

	ULIPs	Mutual Funds
Investment amounts	Determined by the investor and can be modified as well	Minimum investment amounts are determined by the fund house
Expenses	No upper limits, expenses determined by the insurance company	Upper limits for expenses chargeable to investors have been set by the regulator
Portfolio disclosure	Not mandatory*	Quarterly disclosures are mandatory
Modifying asset allocation	Generally permitted for free be or at a nominal cost	Entry/exit loads have to borne by the investor
Tax benefits	Section 80C benefits are available on all ULIP investments	Section 80C benefits are available only on investments in tax-saving funds

* There is lack of consensus on whether ULIPs are required to disclose their portfolios. While some insurers claim that disclosing portfolios on a quarterly basis is mandatory, others state that there is no legal obligation to do so.

Some insurance companies do declare their portfolios on a monthly/ quarterly basis. However the lack of transparency in ULIP investments could be a cause for concern considering that the amount invested in insurance policies is essentially meant to provide for contingencies and for long-term needs like retirement; regular portfolio disclosures on the other hand can enable investors to make timely investment decisions.

4. Flexibility in altering the asset allocation

As stated earlier, offerings in mutual funds and ULIPs are largely comparable. For example plans that invest their entire corpus in equities (diversified equity funds), a 60:40 allotment in equity and debt instruments (balanced funds) and those investing only in debt instruments (debt funds) can be found in both ULIPs and mutual funds.

If a mutual fund investor in a diversified equity fund wishes to shift his corpus into a debt from the same fund house, he could have to bear an exit load and/ or entry load. On the other hand most insurance companies permit their ULIP inventors to shift investments across various plans/asset classes either at a nominal or no cost (usually, a couple of switches are allowed free of charge every year and a cost has to be borne for additional switches). Effectively the ULIP investor is given the option to invest across asset classes as per his convenience in a cost-effective manner.

This can prove to be very useful for investors, for example in a bull market when the ULIP investor's equity component has appreciated, he can book profits by simply transfe rring the requisite amount to a debt-oriented plan.

5. Tax benefits

ULIP investments qualify for deductions under Section 80C of the Income Tax Act. This holds good, irrespective of the nature of the plan chosen by the investor. On the other hand in the mutual funds domain, only investments in tax-saving funds (also referred to as equity-linked savings schemes) are eligible for Section 80C benefits.

Maturity proceeds from ULIPs are tax free. In case of equity-oriented funds (for example diversified equity funds, balanced funds), if the investments are held for a period over 12 months, the gains are tax free; conversely investments sold within a 12-month period attract short-term capital gains tax @ 10%.

Similarly, debt-oriented funds attract a long-term capital gains tax @ 10%, while a short-term capital gain is taxed at the investor's marginal tax rate.

Despite the seemingly similar structures evidently both mutual funds and ULIPs have their unique set of advantages to offer. As always, it is vital for investors to be aware of the nuances in both offerings and make informed decisions.

ULIPs and You

Ever since unit-linked insurance plans (ULIPs) made their debut, they have become a subject of much discussion and debate. On the one hand, they were a trifle too complicated for individuals not yet exposed to the stock markets; on the other hand, they were much-maligned because of the 'unusually high' costs. As ULIPs made their presence felt, insurers were more open to discussing the costs and how they evened out over the long term. This and the flexibility that ULIPs offer became important points that made individuals consider adding them to their portfolios. Today, more individuals are open to using the ULIP-way to create wealth over the long term. Over here, we have outlined exactly how ULIPs can help you fulfill that responsibility.

ULIPs can help you save for child's education/marriage, planning for retirement and other investment-related objectives.

If you are between 25-35 years of age

You are young, probably married and even have kids. If you are the sole breadwinner in the family, then you have quite a few responsibilities to fulfill right from planning for your child's education/ marriage to planning for your own retirement to providing for the family in your absence. The last responsibility is the most critical and ironically it is the easiest and cheapest one of the lot to fulfill. At Personalfn, we have always been votaries of term insurance – the cheapest way to get a life cover for yourself. Term insurance is also insurance in its 'purest' form, in other words there is no savings element in it, which ensures your premiums are very low. There is no better product to provide for your family in case of an eventuality and all individuals must consider taking a term plan.

Term insurance of course takes a huge burden off your chest as also your wallet. But it still leaves you with a problem. If term insurance is only going to take care of the 'risk' element, who is going to take care of the 'savings' part. This is where ULIPs come in. Of course, that is not to say that ULIPs do not have an insurance element, they do, but it is limited largely to the earlier years and after a point they don the investment mantle.

So how can ULIPs help you save for child's education/marriage, planning for retirement and other investment-related objectives? ULIPs can do all this and more because they come with a lot of variety. Consider this; except for term insurance (because it does not make sense), just about every life insurance product has a ULIP option. So you have endowment ULIP, child plan ULIPs and pension ULIPs. As a matter of fact, there are some life insurance companies that only have ULIP products; they don't have traditional endowment, pension and child plans at all!

What that tells you is that if you are willing to take on some risk, a ULIP can help you meet a lot of your financial objectives. If you are looking to set aside some money for your child's education, the 5%-6% return on an endowment plan may not even take care of inflation, let alone provide for a medical or MBA degree. The return you earn on a child plan should not just counter inflation, it should be enough to cover the cost of education. And the way cost of education is spiralling, your insurance plan must work very hard. Given their equity component, ULIPs are ideally placed to fulfill this role.

As we mentioned before, ULIPs are flexible; there are various options within a ULIP with the equity component varying right from 0% to 100%. This ensures that you are able to select an option that best suits your risk profile. Let us understand how ULIPs can be tailor-made to serve your financial planning needs.

You are in the 25-35 years age bracket. Your most pressing financial objectives are providing for your child's future and your own retirement. ULIPs can help you achieve both. Although you can take a single endowment ULIP to achieve both objectives, we think it is more prudent to make a demarcation between the needs and take separate ULIPs dedicated to each objective. Opt for a ULIP child plan to provide for your child's higher education, marriage and seed capital for business to name a few needs. One way to handle this multi-faceted objective is to take a ULIP money-back plan. This way you get monies at regular intervals to address multiple needs.

The other important plan that individuals must consider taking earlier on their lives is a pension plan. Building a corpus to face the rigours of retirement should be given the priority it deserves. Again, a long-term investment objective like retirement planning could do with an equity 'push'. Here is where a ULIP pension plan can add value to your retirement portfolio. Likewise a ULIP endowment plan can help you meet investment objectives like buying property or setting up a business for instance.

If you are between 35-45 years of age

By the time you reach the 35-45 age bracket, some of your existing ULIPs are probably nearing maturity. For instance, if you had taken a ULIP child plan earlier on, it is likely to mature in this age bracket to coincide with the need (higher education/marriage) you had in mind at the time of taking the ULIP.

However, if you married late or did not begin planning your finances at an early stage in your life, now is the time. If you haven't insured yourself as yet, go for a term insurance plan. The advantage of taking a term plan at a slightly advanced age is that you have a better idea of how your lifestyle is likely to pan out going forward. In terms of costs, term plans remain your cheapest option no matter when you take one.

You can opt for some of the ULIPs for individuals in the 25-35 years age bracket depending on your needs. Remember, unlike endowment, which gets really

expensive at an advanced age, ULIPs because of the way they are structured, do not turn out that expensive.

If you are over 45 years of age

In this age bracket, it is likely that you are insured. However, you still need to review your insurance cover taking into consideration the changes in your lifestyle, income, needs and financial commitments. Beef up your insurance cover through a term plan.

By this time, your ULIP pension plan will have matured. You can then opt for an annuity, immediate or deferred, depending on your requirements.

Points to note

Since ULIPs offer a lot of flexibility, you need to keep some points in mind to optimise the benefits.

1. Notice we have recommended ULIP child plans/pension plans and even term insurance for most individuals. When you opt for these plans it is important that you take your insurance consultant into confidence. He is the one who is going to help you with the numbers, so you need to tell him exactly what you are looking for in an insurance plan.

2. Remember there is an insurance cover associated with ULIPs. Since it is also likely that you have other insurance plans like term and/or endowment, it is important you have a clear idea of exactly how much your insurance cover is worth after considering all your insurance plans. This number will prove helpful when you review your insurance cover at regular intervals.

3. Likewise, ULIPs also have an investment element. You are likely to have investments in mutual funds, stocks, bonds and fixed deposits as well. You need to add up the market value of all these investments while calculating your investment worth. This number will prove useful when you wish to beef up your investments in a particular asset.

4. ULIPs derive their 'power to perform' from equities. When you have a lot of aggressive ULIPs in your portfolio it means that you are overweight on equities. Add to this your investments in stocks and equity funds, and your exposure to equities increases even further. To temper your equity exposure, it is generally advisable to opt for conservative/balanced ULIPs (maximum 50% equity exposure).

5. Even if you are a high-risk investor, you must gradually shift your assets to a conservative ULIP option as your age advances. Financial prudence dictates that risk reduces as age increases; this needs to reflect in all your investments including ULIPs.

6. Like with all investments, it is prudent to diversify your ULIP investments. This is necessary due to several reasons with financial prudence being the most important reason. Varying flexibility levels in ULIPs across insurance companies is another factor that should make you opt for a ULIP from more than one insurance company. Varying level of expenses in ULIPs is another reason to opt for ULIPs across insurance companies to keep expenses on the lower side.

Understanding ULIP expenses

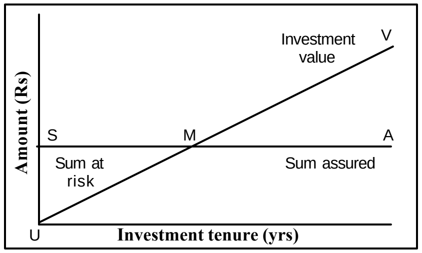
Unit linked insurance plans (ULIPs) have become a rage today. Many individuals have taken ULIPs to meet their financial planning needs. But it is important for individuals to evaluate the costs attached to ULIPs before zeroing in on a plan. We take a look at these costs and evaluate how they affect ULIP returns.

Classification of expenses
Broadly speaking, ULIP expenses are classified into three major categories:

Mortality charges
Mortality expenses are charged by the life insurance company to cover the risk of an eventuality to the individual. The individual has to pay mortality charges for the entire sum assured to begin with. But as the value of his investments goes up, the mortality expenses fall. This is because since the individual's investments (i.e. premium) have attained a certain value, the insurance company will have to bear the risk of an eventuality only to the extent of the difference between the sum assured and the investment value (also known as sum-at-risk). Therefore, the mortality expenses are charged only on the difference.

It is also due to this very reason that the mortality charges keep fluctuating as the investment value keeps changing. Also, once the investment value crosses the sum assured, the mortality expenses fall to zero. A graph will help in understanding things better.

As the graph shows, the tenure is depicted on the X-axis and investment value is depicted on Y-axis. The line SA denotes the 'sum assured' while the UV curve denotes the 'unit value'.



The sum assured remains fixed for the entire tenure. This means that if the unit value happens to be lower than the sum assured, the sum assured will be payable to the individual in case of an eventuality. But once the unit value crosses the sum assured, the nominees will receive the unit value and not the sum assured. This is the reason why mortality costs keep fluctuating as the unit value rises and falls. The sum-at-risk, and therefore in effect the mortality charges, keep going down with an increase in the unit value and vice-versa.

Administration, sales/marketing charges
All life insurance companies incur certain expenses on a regular basis. Agent commissions, sales and marketing expenses and overhead costs incurred to run the business on a day-to-day basis are examples of such expenses. These may be incurred daily, monthly or annually. The same are recovered from the premium paid by individuals. For some companies, a certain percentage of the premium paid goes towards these charges while for others, it may be a percentage of the premium as mentioned plus a fixed amount like say, Rs 60, which

is levied on a monthly basis. Companies normally adjust these charges by knocking off units from the individual's policy.

Individuals should note that ULIP expenses tend to be higher in the initial years. One reason for this is the commissions paid to the insurance agents on ULIP sales, which tend to be higher in the first few years. While the figures may vary across life insurance companies, it is broadly in the region of 7% - 20% for most companies. Some companies are even known to pay as much as 25-30 % upfront on a few of their ULIP products.

Fund management charges
These charges are levied by the insurance company to cover the expenses incurred by them on managing ULIP monies. Such charges are akin to fund management charges incurred by mutual funds and they vary across different investment options like diversified equity funds, balanced funds, debt funds and so on. The charges are generally higher for managing equity-oriented ULIP options and they are lower for managing debt and money market ULIP options.

For example, a certain company charges 1.50% of the corpus to manage an equity fund and 0.60% to manage a money market fund. However, another insurance company levies a flat charge of 0.80% irrespective of the ULIP option. However it is worth mentioning that the net ULIP expenses are not capped by the Insurance Regulatory and Development Authority (IRDA) and can differ significantly across companies.

Individuals should note that fund management charges play an important role in determining the ULIP returns over a period of time. This is because the charges are levied on the ULIP corpus, which keeps fluctuating over the tenure. This is unlike the yearly administration and sales and marketing charges that are levied on the premium which remains constant throughout the tenure. Therefore, the lower the fund management charges, the better will be the ULIP returns and vice-versa.

Apart from the above-mentioned broad categories of expenses, there are some other charges, which individuals need to consider. Such charges are however, optional charges in the sense that they will be incurred only if individuals decide to exercise certain options available to them.

ULIP fund-switch charges
Such charges are borne by individuals when they decide to switch their money from one type of fund to another. If individuals want to switch their monies from say 100% equities to a balanced/debt fund, then some insurance companies charge a fee for the same. While they may allow a certain number of free switches every year, a charge of say, Rs 100 will be recovered from the individual for any switch over and above the free switches. Such charges will differ across companies.

Top-up charges
Top-up amount, which is the amount paid over and above the premium amount for the year, is allowed by most companies. A certain percentage is deducted from the top-up amount to recover the expenses incurred on managing the same. The deduction is

usually lower as compared to charges levied on the normal premium amount. These charges are usually recovered by knocking off the required number of units from the policyholder's account.

Cancellation/Surrender charges
If an individual wishes to surrender his ULIP policy, some companies levy a charge on his corpus known as surrender charges. Usually, such charges are levied in case individuals wish to exit the policy before say, 3 years from the date of buying the ULIP.

Having understood the various types of expenses that ULIPs incur, an illustration will help in comprehending just how ULIP expenses affect returns. Let us take three insurance companies, A Ltd, B Ltd and C Ltd offering ULIPs. The sum assured is Rs. 200,000 and the tenure is 10 years while the premium is Rs 20,000 p.a. While the expenses are calculated as a percentage of the annual premium, the assumed rate of return is 10% CAGR. Some figures in the illustrations below are rounded off for ease of calculations.

As can be seen from the Table 1, 27% of the first two years' premium in case of Company A goes towards expenses. The expenses drop to 3% third year onwards. The fund management charges are assumed to be 1% p.a. and the maturity amount in case of Company A works out to approximately Rs 297,850.

Table 1: ULIP details of Company A

Annual premium (Rs)	Expenses in 1-2 years (%)	Expenses 3rd year onwards (%)	Annual fund management charges (%)	Maturity value (Rs)
20,000	27.00	3.00	1.00	297,850

Figures used in the examples are for illustrative purpose only.
Returns shown in the illustrations are compounded annualised.

As the Table 2 shows, 15% of the first year's premium goes towards expenses in case of Company B. The expenses fall to 5% of the yearly premium second year onwards. The fund management charges assumed are 1.75%. Maturity value in case of Company B works out to approximately Rs 289,710.

Table 2: ULIP details of Company B

Annual premium (Rs)	First year expenses (%)	Expenses 2nd year onwards (%)	Annual fund management charges (%)	Maturity value (Rs)
20,000	15.00	5.00	1.75	289,710

Figures used in the examples are for illustrative purpose only.
Returns shown in the illustrations are compounded annualised.

In case of Company C (Table 3), the first-year expenses are 24%. They fall to 8.50% from the second year upto the fifth year. Sixth year onwards, they become 6%. The fund management charges assumed in this case are 1.50% p.a. The maturity

value in Company C's case works out to approximately Rs 288,345.

Table 3: ULIP details of Company C

Annual premium (Rs)	First year expenses (%)	Expenses from 2nd-5th year (%)	Expenses 6th year onwards (%)	Annual fund management charges (%)	Maturity value (Rs)
20,000	24.00	8.50	6.00	1.50	288,345

Figures used in the examples are for illustrative purpose only.
Returns shown in the illustrations are compounded annualised.

As can be observed in the above illustrations, the net expenses as well as the way in which they are spread over the tenure differs over a 10-Yr period. The maturity values would therefore, differ. Expenses in case of Company A are the highest in the first two years. but they fall significantly after that. Also, the fund management charges are the lowest for Company A.

Expenses are the lowest and relatively well spread over the entire tenure for Company B; but the fund management charges are the highest for them at 1.75%. For Company C, the (net) annual recurring expenses are the highest as well as spread unevenly over the tenure. Therefore, over a 10-Yr period, Company A manages to give the best returns.

ULIP expenses also have a tendency to even out over the long term. This is due to the fact that although they are on the higher side over the short term, they fall significantly and therefore, spread out evenly in the long run. Let us take an example to better understand the same.

As can be seen from the Table 4, Company ABC Ltd charges 27% as expenses in the initial two years. The expenses fall to 3% third year onwards. A look at the percentage returns over a 10-Yr, 20-Yr and a 30-Yr period will help put things in perspective.

Table 4: Long-term impact of costs on returns

Tenure (Yrs)	Yearly premium (Rs)	Initial 2-Yrs	Remaining tenure (Yrs)	Fund management charges (%)	Maturity value (Rs)	Effective rate of return (%)
10	10,000	27	3	1.00	148,923	7.10
20	10,000	27	3	1.00	509,056	8.25
30	10,000	27	3	1.00	1,353,834	8.52

Figures used in the examples are for illustrative purpose only.
Returns shown in the illustrations are compounded annualised.

Expenses

Over the initial 10-Yr period, the returns work out to approximately 7.10% of the yearly premiums (compounded annualised). However, if one takes a look at the returns over a 20-Yr period, they increase to approximately 8.25% of the annual premiums. And if viewed from a 30-Yr horizon, the returns go up to as much as 8.52%!

The reason why ULIP expenses tend to even out over the long term is because although they are high in the initial years, they fall considerably over a period of time. And since the expenses are levied on the yearly premiums by most insurance companies, the impact on the returns generated by the earlier corpus remains unaffected. This makes the returns over say, a 20-Yr term or a 30-Yr term look attractive.

Of course, the returns will differ with a change in the sum assured, the percentage of expenses levied, how well spread the expenses are over the entire tenure, the fund management charges and so on. Individuals therefore, need to bear in mind that ULIPs are not only about the market-linked returns that they offer; there's more to ULIPs than just that. Bear in mind that ULIP expenses is a multi-faceted creature; it has the potential to make a considerable difference to the returns. If evaluated with a discerning mind, ULIPs can add significant value to the individual's portfolio.

Comparing ULIPs

Comparing ULIPs across companies

Unit linked insurance plans (ULIPs) have gained in popularity in the recent past. A primary reason for this phenomenon has been the alluring returns over their plain vanilla counterparts. However, many individuals are not too sure when it comes to comparing ULIPs across life insurance companies. We have presented individuals with some basic parameters to evaluate ULIPs and have compared ULIPs (endowment) across four life insurance companies.

1) As can be seen from the table, the individual can begin by look at the different ULIP investment fund options available to him. The more options a ULIP from a particular company offers, the better it is for him. This facilitates movement between various investment options whenever he wishes to do so, depending on how and when he takes a call on the markets.

2) It is also important for the individual to understand the exact portion of

How ULIP endowment plans fare

	LIC (Bima Plus)	ICICI-Prudential (Lifetime II)	HDFC Standard Life	SBI Life (Horizon)
Product type	Market linked plan	Market linked plan	Market linked plan	Market linked plan
ULIP fund options	Risk fund, Balanced fund, Secured fund	Maximiser II (Growth), Balancer II (Balanced), Protector II (Income), Preserver	Growth fund, Balanced fund, Defensive fund, Secure fund, Liquid fund	Dynamic fund, Growth fund
Allocation to equities	Min 50% in risk fund; min 30% in balanced fund; min 10% in secured fund	Upto 100% in maximiser-II; upto 40% in balancer-II; nil in Protector II & Preserver	100% in growth fund; 30-60% in balanced fund; 15-30% in defensive managed fund; nil in secure managed & liquid fund	0-100% in Dynamic fund; 0-75% in growth fund (allocation depends on age)
Minimum premium (Rs)	10% of sum assured (Min. sum assured: Rs 50,000)	18,000	10,000	12,000
Min/Max Age at entry (Yrs)	12Yrs-55Yrs	Min: 0 or 18. Max: 35 or 60 (depends on level of sum assured)	18-60 (subject to plan type)	14-60

The information in the table is sourced from company websites and from our interactions with the companies. For further details, individuals are advised to contact the insurance company.

	LIC (Bima Plus)	ICICI-Prudential (Lifetime II)	HDFC Standard Life	SBI Life (Horizon)
How is Sum assured calculated*	10 times annual premium	Level I sum assured: Annual contribution **X** a multiple. Level II sum assured: sum assured can be increased subject to certain conditions	5-20 times the regular premium amount	10 times the annual premium. Maximum limit: Rs 10 Lacs
Riders available*	Yes	Yes	Yes	No
Initial years' expenses	N.A.#	12%-19% in first yr (depends upon the annual premium amount). 4% from 2nd-5th yr. 2% from 6th-10th yr.	10%-27% in initial 2-Yrs (depends upon the annual premium amount)	15% in 1st yr. 10% in 2nd and 3rd yr.
Fund management charges	1% p.a.	Maximiser II- 1.5%; balancer-1.0%; protector II & preserver-0.75%	0.80%	Equity fund-1.5%; bond fund-1.0%; money mkt fund-0.25%
Expenses after initial years (%)	N.A.#	1	1	5
Fixed monthly expenses (Rs)	N.A.#	60	15	70
Partial withdrawals allowed*	Yes	Yes	Yes	Yes
Charges on top-ups (%)	1.5	1	2.5% for initial two yrs. 1% thereafter.	1
Switch charges	2 switches allowed during policy's life. Charges: 2% of the unit value at time of switch	4 free switches in a year. Rs 100 per switch thereafter	5 free switches in a year. Company may charge upto 2% of switched amt for additional switches	--

* Conditions apply. # Not available.

Fixed monthly expenses for some companies are subject to inflation-based indexation and may change in future.

Companies reserve the right to change their policies anytime in the future.

premium money that can be allocated to equities. This would help discerning individuals who understand their risk profile to choose a particular company's ULIP based on their risk appetite.

3) Knowing the minimum premium helps in understanding whether an individual will be comfortable paying the annual premium on a regular basis. For example, an individual might have won a lottery or received a bonus from his organization, which might tempt him to opt for a ULIP with a higher premium. However, he has to understand that insurance is a long-term contract and that he has to be able to sustain the premium payments every year.

4) The way in which the sum assured is calculated also helps individuals in planning their finances better. Most insurance companies give the option to structure the sum assured and premium to the individual. The individual can structure the same in such a way that his objectives on the returns front as well as his risk profile are taken care of. He may if he so wishes, have a higher investment content to sum assured ratio if he is a risk taker and vice-versa.

5) Expenses are one of the most important criteria while evaluating ULIPs. Expenses take a toll on the returns. They share an inverse relationship with returns. Hence, it becomes imperative to evaluate expenses minutely on various parameters like how well spread they are over the tenure, how high they are in the initial years and so on.

6) ULIPs can be tailor-made to suit individual tastes and preferences. Therefore, certain parameters like whether top-ups are allowed or not, what proportion of the top-up amount is invested, how often can individuals switch between the different types of funds and what are the charges associated with the same play an important role in determining the utility of a particular ULIP for an individual. If for example, the individual is an informed individual and he feels that he can take calls on the markets frequently, then he would ideally like to buy a ULIP, which does not charge money on switching or charges a very low amount. This will help the individual in enhancing his returns.

As can be seen from the above points therefore, it becomes important for individuals to comprehend ULIPs to begin with and also appreciate how to go about evaluating them. For if ULIPs are well understood, individuals, in a bid in insure themselves, will also stand to benefit greatly from investing in them from a long-term perspective.

Mis-selling: ULIPs' greatest bane

The role played by insurance advisors or agents (as they have been conventionally referred to) has been put under the scanner in recent times. The biggest contributor for this has been the mis-selling in the ULIPs segment. Conventionally an insurance advisor's role was limited to helping his client select the right insurance policy, picking up the premium payments and arranging for receipt of the maturity proceeds. However ULIPs require a far greater degree of expertise and participation from the advisor. Sadly, experience suggests that advisors have been found wanting on both counts and more often than not, ULIPs have been sold for the wrong reasons. In this article we discuss some of the wrong premises for selling ULIPs.

ULIPs require a greater degree of expertise and participation on the part of the the advisor.

1. Ignoring the insured's risk appetite

Insurance advisors are known to be quite trigger-happy while suggesting ULIPs to insurance seekers and in the process have shown disregard for the latter's risk profile and need. Often the advisor's income becomes the key point in recommending a product rather than the client's need. For example an individual with a low risk appetite whose insurance needs can be covered by a term plan might be sold an ULIP which invests its entire corpus in equities. Similarly an individual whose investment portfolio comprises of equities and equity-oriented mutual funds could do with a conventional product like a term plan or an endowment plan; the same would ensure that his investment and insurance portfolios are diversified across asset classes.

2. Not revealing the expenses

The expense structure for ULIPs tends to be a very complex one and varies across insurers, different offerings i.e. equity plans, debt plans and others. Usually the expenses tend to be higher in the initial years (20%-60% of premium) and taper down during the subsequent period. Higher expenses translate into a lower amount being invested which in turn means a smaller corpus is created during the first few years. Insurance advisors often fail to reveal these facts to ULIP investors resulting in the latter not being aware of his true financial standing.

3. Positioning ULIPs as a short-term avenue

Insurance advisors are known to entice investors by positioning ULIPs as investment avenues for the short-term. This practice is especially prevalent for selling equity plans when attractive returns are promised over short-term horizons. Advisors flaunt the surrender

value clause to convince investors of their investment's liquidity. However investors are almost never informed of facts like liquidating the ULIP investment during the initial years (generally the first 3 years) entails receiving the surrender value at a discount i.e. investors are penalised for prematurely liquidating ULIP.

4. Encouraging non-payment of premiums

The flexibility in premium payments is often used by advisors as a ploy to sell ULIPs. Unlike conventional insurance products wherein non-payments of premiums could result in the policy becoming lapsed; ULIPs continue to be in existence so long as size of the corpus doesn't fall below a stipulated minimum amount. However the insurance company deducts mortality charges and other mandatory expenses from the investor's existing corpus. Hence a default in paying premiums results in a loss for the investor albeit it seems like the former is an inconsequential event. Again insurance advisors rarely bother to inform their clients about the flipside of not paying premiums.

Listed above were some of the 'techniques' deployed by advisors for peddling ULIPs; however this list is far from exhaustive. So how should investors counter this problem? The solution perhaps lies in the law of 'caveat emptor' (let the buyer beware). Investors need to equip themselves with better information and be aware of the investment they are undertaking. Instead of relying only on the advisor, investors can scan through the insurance company's sales literature, financial websites and newspapers to become well-versed with the investment avenue.

Rest assured, if your investment advisor only paints a rosy picture with all factors pointing in favour of an ULIP investment, he has probably failed to present the true picture!

How ULIPs manage their monies

Unit linked insurance plans (ULIPs) have become much sought after by individuals who want to buy life insurance. Not only do they offer an insurance cover but also have potential to generate attractive returns as compared to plain-vanilla plans. The method in which ULIPs manage their money differs from that for a traditional endowment plan. Here, we have outlined just how unit linked plans manage their money.

ULIPs are different from traditional plans in the sense that they invest the premium money in market-linked instruments; primarily in stocks, bonds, government securities (gsecs) and money market instruments. ULIPs also differ significantly from traditional plans in that they offer several options to individuals based on the equity component varying from zero to a maximum of 100%. Therefore, individuals are free to structure their ULIP portfolio. They have the choice to invest their premium money in stocks, bonds, gsecs or a combination of the above to suit their requirements. Let us take a look at just what these options are and how they differ from each other.

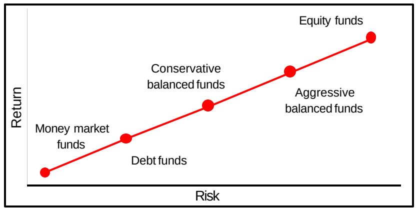
ULIP options

Broadly speaking, most life insurance companies offer individuals 4 options to choose from; Aggressive/Growth funds, Balanced funds, Debt funds and Money market funds. They differ primarily in the nature of their investments as well as their risk profiles. A graph will help in understanding the same better.

Aggressive/Growth fund

Such types of funds invest a major portion of the premiums in the equity markets. They are therefore, considered to be high on the risk parameter. The investment mandate, though largely the same, may differ slightly across various life insurance companies. For example, while most companies have a mandate of being able to invest upto 100% of the aggressive/growth fund corpus in stocks, a few cannot exceed say, 80% of their investments in equities.

The above mandate has the potential to make a difference to the returns generated by the ULIP portfolio. For example, if stock markets look attractive from a long-term perspective, an individual can take advantage of the same by investing in the aggressive/



growth fund option so long as his risk profile coincides with the higher risk levels associated with such an investment.

Balanced fund

A balanced fund invests the premium money in a portfolio, which consists of both equities as well as debt instruments. The balance is struck by

investing upto 60% of the portfolio in equities and the balance 40% in debt instruments like gsecs and bonds. Some companies though may strike a balance by having say, a 45:55 (debt:equity) asset allocation. Balanced funds are considered to be medium-risk investments.

Investments in balanced funds are ideal for individuals who are apprehensive of taking the 100% equity route but would still like to add a dash of equity to their portfolio to spruce up returns. Balanced funds also add value to individual portfolios when the stock markets are running high and individuals would like to temper their risks by going down on equities.

Capital guarantee products

A few insurance companies also offer ULIPs with a capital guarantee. This product assures to give back to the individual the premiums, which he has paid over the policy's tenure in case his fund value is less than the premiums paid. (Capital guarantee, for most insurance companies, is applicable usually on the premium, which is net of expenses and invested, and the applicable bonus, if any). Such ULIPs are primarily balanced funds in nature with a difference; they invest upto 30% of their portfolio in stocks and the remaining 70% in debt instruments. The safety of the 'capital guarantee' stems from the fact that 70% of the premium money is invested in relatively safe debt instruments which moderates the risks of investing in stocks.

Debt fund

These types of funds invest the premium money in debt instruments like gsecs, bonds and AAA rated securities. Such funds are considered to be safe in nature when compared to their riskier equity/ balanced counterparts. The returns though, tend to be lower and steadier than the equity/balanced fund.

Debt funds act as a good avenue for individuals to park their corpus in case they feel that the stock markets are overheated and could be headed for a correction. They also add value for individuals who feel that they have attained their 'targeted' returns and would now like to book profits by shifting a part/whole of their corpus into debt instruments. Besides, if one considers the tax benefits which life insurance offers to individuals, then debt investments offer a good opportunity when compared to avenues such as bank fixed deposits.

Money market fund/Liquid fund

Such a fund invests the premium money it receives in short term liquid instruments like bank deposits and the money markets. By short term, we mean instruments, which have a maturity of one year or less. This fund is considered to be very safe on the risk parameter and stable on the returns front. Individuals can use such funds to park their money for the short term

Hybrid category

Besides the major categories of fund options explained above, some companies offer additional options to individuals by structuring ULIP options which invest across various categories in different ratios. For example, a certain insurance company may have a fund, which invests upto 70%-85% in gsecs and bonds while the remaining 15%-30% goes into equities. Another company may have a fund, which invests across equities, debt and the money markets. Some insurance companies have also segregated their debt portfolio into money market funds, gilt funds, bond funds and floating rate funds. While so much variety may appear confusing to a lot of individuals, discerning investors have the opportunity to invest in a ULIP option based on their requirement and risk profile.

While much variety may appear confusing, discerning investors have the opportunity to invest in a ULIP depending on their risk profile.

Fund management of ULIPs

The ULIPs' fund management differs across various life insurance companies. Some companies outsource their ULIP fund management to third parties while some have in-house fund managers to do the same. For example, a certain insurance company takes advise from its mutual fund arm on how to manage its ULIP portfolio while another insurance company has an independent fund management team to look after its ULIP monies.

Investment mandate for ULIPs

ULIPs have a mandate to invest in equities, gsecs, bonds and money market instruments. Apart from this broad mandate, there are no specific rules or guidelines laid down by the insurance regulatory and development authority (IRDA) as to how ULIPs can go about investing their money in the markets.

For example, growth/aggressive ULIPs can invest in any stock. The stock can be from any sector or from the large-cap, mid-cap or small-cap segment. The decision on where to invest rests entirely on the fund management team that manages ULIP funds. We believe having investment guidelines in some form helps in curbing the risky nature of such instruments. Having said that, life insurance companies understand the nature of ULIPs; being an insurance product first and then an investment avenue.

Evaluation parameters for ULIPs

Given below are some parameters on which ULIP portfolios can be evaluated. Also given are our comments on the ULIP portfolios (for their aggressive growth funds which invest approximately 90% of the premium in stocks) of Company A Ltd, (portfolio as on July 2005), Company B Ltd (portfolio as on June 2005) and Company C Ltd (portfolio as on July 2005). All portfolios have been taken from company websites.

Top 10 holdings

We maintain that the top 10 stock holdings in any portfolio should not exceed 40% of total net assets to maintain the diversified nature of the fund. This helps in reducing volatility from market swings. All three companies under consideration have an allocation of over 40% in the top 10 stocks. While C Ltd (45.8%) appears to be relatively better off than the others, B Ltd, in spite of being well diversified across stocks, holds 50.7% in its top 10 stocks. A Ltd has a concentrated portfolio with 56.0% in its top 10 stocks.

Sectoral allocation

In terms of sectoral allocation, all three companies have invested across various sectors. A Ltd has a preference for the 'industrial capital goods' sector (21.4%), while its allocation to the top 4 sectors (57.6%) appears to be on the higher side. B Ltd and C Ltd are well diversified across several sectors.

Equity allocation

On this front, Company A Ltd appears to the most aggressive of the lot. Though all the companies studied here have a mandate, which allows them to invest upto 100% in equities, A Ltd has invested 98.96% of its net assets in equities with the rest invested in the debt/money markets. Company B Ltd (91.3% in equities) and Company C Ltd (91.0% in equities) appear to be relatively less concentrated.

Consistency in holdings

Insurance has always been considered to be a long-term contract and the same rationale is applicable to ULIPs as well. Since the fund manager can invest with a long-term gestation period, the same should reflect in his investments. The ULIP portfolio's equity component should ideally display a reasonable degree of consistency in terms of stock picks and sectoral allocations. The ULIP fund manager's hand is not forced by redemption pressures or by the need to clock strong growths over shorter time frames, which a fund manager handling a mutual fund might be exposed to. Investors would do well to track their ULIP portfolio on a regular basis; this in turn will help them better understand their fund manager's investment style of functioning.

Having understood the various ULIP options and also how to evaluate ULIPs, it becomes imperative for individuals to invest in an option after evaluating the risks associated with it. After all, life insurance has always been considered sacrosanct; individuals look at insurance more as a safety net for their future and then as an investment avenue. It makes sense for individuals to recognise and assess the options available so as to ensure a safe and secure future for themselves and their families.

Frequently asked questions

What is the commission paid to life insurance agents on ULIPs; upfront as well as ongoing?
The commission structure differs across various life insurance companies. However, broadly speaking, first year commissions are in the 7%-20% range while ongoing commissions are in the 1%-5% range.

How much do individuals actually receive on maturity at the end of the tenure in ULIPs? Do companies factor expenses into the maturity in 'benefit illustrations'?
The maturity amount as shown in the benefit illustrations of companies is what individuals receive at the end of the policy tenure. However, some companies may not factor in the fund management charges into the maturity amount. Individuals need to ask their insurance advisor/agent about the same.

Are expenses clearly displayed on insurance companies' websites/sales literature?
The expenses are clearly displayed on most company websites as well as sales literature.

Are tax benefits available on ULIPs?
Tax benefits under Section 80C and Section 10 (10D) are available for ULIPs. These are the same as those for regular life insurance plans.

Are top-up amounts (premium and maturity amounts) eligible for tax benefits under Section 80C and Section 10 (10D)? Are partial/full withdrawals taxable?
We have failed to come out with a unanimous view on this topic despite interactions with various life insurance companies.

Is it mandatory for insurance companies to disclose their ULIP portfolios at regular time intervals?
Again, there is lack of consensus on whether ULIPs are required to disclose their portfolios. While some insurers claim that disclosing portfolios on a quarterly basis is mandatory, others state that there is no legal obligation to do so. On our part, we have seen certain insurance companies disclose their portfolios on a monthly/quarterly basis.

Has IRDA placed any caps/upper limits on the expenses that can be charge on ULIPs?
No, IRDA has not placed any restrictions on the expenses that can be charged by insurance companies on their ULIP offerings.

Are there any investment norms imposed by IRDA on ULIPs?
Our interactions with insurers indicate that ULIPs have a relatively free hand in making investments. IRDA has not imposed any norms.

5 steps for selecting the right ULIP

For a product which is capable of adding significant value to investors' portfolios, ULIPs have far too many critics. We at Personalfn have interacted with a number of investors who were very disillusioned with their ULIPs investments; often the disappointment stemmed from poor and inappropriate selection. We present a 5-step investment strategy that will guide investors in the selection process and enable them to choose the right ULIP.

1. Understand the concept of ULIPs
Do as much homework as possible before investing in an ULIP. This way you will be fully aware of what you are getting into and make an informed decision. More importantly it will ensure that you are not faced with any unpleasant surprises at a later stage. Our experience suggests that investors on most occasions fail to realise what they are getting into and unscrupulous agents should get a lot of 'credit' for the same. Gather information on ULIPs, the various options available and understand their working. Read ULIP-related information available on financial websites, newspapers and sales literature circulated by insurance companies.

2. Focus on your need and risk profile
Identify a plan that is best suited for you (in terms of allocation of money between equity and debt instruments). Your risk appetite should be the deciding criterion in choosing the plan. As a result if you have a high risk appetite, then an aggressive investment option with a higher equity component is likely to be more suited. Similarly your existing investment portfolio and the equity-debt allocation therein also need to be given due importance before selecting a plan. Opting for a plan that is lop-sided in favour of equities, only with the objective of clocking attractive returns can and does spell disaster in most cases.

3. Compare ULIP products from various insurance companies
Compare products offered by various insurance companies on parameters like expenses, premium payments and performance among others. For example, information on premium payments will help you get a better picture of the minimum outlay since ULIPs work on premium payments as opposed to sum assured in the case of conventional insurance products. Compare the ULIPs' performance i.e. find out how the debt, equity and balanced schemes are performing; also study the portfolios of various plans. Expenses are a significant factor in ULIPs, hence an assessment on this parameter is warranted as well.

Enquire about the top-up facility offered by ULIPs i.e. additional lump sum investments which can be made to enhance the policy's savings portion. This option enables policy holders to increase the premium amounts, thereby providing an opportunity to gainfully invest any surplus funds available.

Find out about the number of times you can make free switches from one investment plan to another. Some insurance companies offer multiple free switches every year.

4. Go for an experienced insurance advisor

Select an advisor who is not only conversant with the functioning of debt and equity markets, but also independent and unbiased. Ask for references of clients he has serviced earlier and cross-check his service standards. When your agent recommends a ULIP from a given company, put forth some product-related questions to test him and also ask him why the products from other insurers should not be considered.

Insurance advice at all times must be unbiased and independent; also your agent must be willing to inform you about the pros and cons of buying a particular plan. His job should not be restricted to doing paper work like filling forms and delivering receipts; instead he should keep track of your plan and offer you advice on a regular basis.

5. Does your ULIP offer a minimum guarantee?

In a market-linked product, protecting the investment's downside can be a huge advantage. Find out if the ULIP you are considering offers a minimum guarantee and what costs have to be borne for the same.

NOTES

FEEDBACK

1. Which are your preferred avenues for investment?
   - ☐ IPOs/Primary markets
   - ☐ Secondary markets
   - ☐ Mutual Funds
   - ☐ Debt Instruments (if yes, please specify)
   - ☐ Real estate
   - ☐ Bullion

2. What is the value of your investment in mutual funds?
   - ☐ Less than Rs 1 lac
   - ☐ Between Rs 1 - 5 lacs
   - ☐ Between Rs 5 - 10 lacs
   - ☐ More than Rs 10 lacs

3. Do you use a computer ?
   - ☐ Yes
   - ☐ No

4. Do you have access to the Internet ?
   - ☐ Yes
   - ☐ No

5. Who do you consult before making an investment ?
   - ☐ Friend
   - ☐ Broker
   - ☐ Financial magazines (if yes, please name some)

   a.____________ b. ____________ c. ____________

   - ☐ Dailies

   a.____________ b. ____________ c.____________

   - ☐ Internet

6. Which are your favourite financial websites?

   a.____________ b. ____________ c.____________

7. Have you visited www.personal*fn*.com?
   - ☐ Yes
   - ☐ No

8. If yes, which sections of the website do you visit the most?

   a.____________ b. ____________ c.____________

9. What else would you like to see on www.personal*fn*.com?

   ____

10. Would you like to apply for a personal finance product on the Internet?
    - ☐ Yes
    - ☐ No

11. How does the Money Simplified compare with other books of similar nature?

    ____

    ____

12. Please give your suggestions for improving the Money Simplified?

    ____

    ____

13. Would you like to receive Personal*fn*'s newsletter by e-mail?
    - ☐ Yes
    - ☐ No

14. If you are in Mumbai, Pune, Bangalore, Chennai or Hyderabad, would you like to be contacted by Personal*fn* for any of these products - (if yes, click relevant option)
    - ☐ Mutual funds, fixed deposits, bonds, tax-saving schemes
    - ☐ Life Insurance
    - ☐ Home loans

Name :
Address :

Occupation :
Telephone :
Fax :
E-Mail :

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