

UNIT LINKED INSURANCE POLICY Vs MUTUAL FUND

Unit Linked Insurance Policies (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.

How ULIPs can make you RICH!

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 entails 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 policy's 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

In mutual fund investments, expenses charged for various activities like fund management, sales and marketing, administration among others are subject to pre-determined upper limits as prescribed by the Securities and Exchange Board of India. For example equity-oriented funds can charge their investors a maximum of 2.5% per annum on a recurring basis for all their 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. 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. During our interactions with leading insurers we came across divergent views on this issue. While one school of thought believes that disclosing portfolios on a quarterly basis is mandatory, the other believes that there is no legal obligation to do so and that insurers are required to disclose their portfolios only on demand. 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.

ULIPs vs Mutual Funds

- **Investment amounts**

ULIP: Determined by the investor and can be modified as well

MUTUAL FUND: Minimum investment amounts are determined by the fund house

- **Expenses**

ULIP: No upper limits, expenses determined by the insurance company

MUTUAL FUND: Upper limits for expenses chargeable to investors have been set by the regulator

- **Portfolio disclosure**

ULIP:Not mandatory*

MUTUAL FUND:Quarterly disclosures are mandatory

- **Modifying asset allocation**

ULIP:Generally permitted for free or at a nominal cost

MUTUAL FUND:Entry/exit loads have to be borne by the investor

- **Tax benefits**

ULIP:Section 80C benefits are available on all ULIP investments

MUTUAL FUND: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.

4. Flexibility in altering the asset allocation

As was stated earlier, offerings in both the mutual funds segment and ULIPs segment 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 investors 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 transferring 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.