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COVER STORY

## The Rs 17,77,66,56,00,000

The SEBI-IRDA tussle will change ULIPs for ever. What it means for millions of investors

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### The Battle Of Ulips

- **14 December 2009** Sebi sends a show cause notice to HDFC Standard Life asking why Ulips launched by them should not be registered with Sebi
- **15 January 2009** Sebi sends the show cause notice to 13 more insurance companies
- **9 April 2010** Sebi issues an order banning 14 life insurance companies from raising new or additional funds from existing Ulips until they get their registration from Sebi
- **10 April 2010** Irda issues a notice with the words 'notwithstanding the Sebi's circular'; life insurers do business as usual
- **12 April 2010** Finance minister intervenes, maintains status quo and asks the two regulators to seek legal mandate from an appropriate court
- **13 April 2010** Sebi puts its Order in abeyance but puts ban on the launch of new Ulips by the insurance companies as mentioned in Order
- **15 April 2010** Sebi reportedly moves Supreme Court and High Court Mumbai, Delhi, Hyderabad
- **16 April 2010** MoF reportedly bans launch of new Ulips by all insurers

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**W**ho will regulate unit-linked insurance plans (Ulips)? Securities and Exchange Board of

India (Sebi) or Insurance Regulatory and Development Authority (IRDA), or both, or the two supervised by a super-regulatory body? This question would not have bothered many some months back. In the last 7-8 years in which Ulips have grown rapidly, they have been regulated by the insurance regulator IRDA. However, the exclusive regulatory guardianship suddenly came to occupy centrestage on 9 April when Sebi issued an order barring 14 life insurers from launching new Ulips without registering them with it, arguing that since the investment component of Ulips involves investments in the securities market, it requires a mandatory registration with it. In the ensuing week, marked by an intense tussle between the two watchdogs, the dispute over regulatory jurisdiction seems to be far from over and is now headed for courts on the advice of the finance ministry, the interceder in the dispute (see The Battle of Ulips and Bones of Contention). The Ulip issue is no small question given the amount of public money involved: assets under management (AUM) are approximately Rs 1.77 lakh crore. Even the life insurers could be hit. Ulips constitute 80-90 per cent of their sales and have been growing at about 25 per cent annually over the last four years. To a great extent this justifies the Rs 16,281 crore these companies have invested in the life insurance business. Then, there are around 2.5 million agents who make their living out of the business.

Despite the high stakes involved, the regulatory spat in no way impacts the fortunes of Ulip

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Despite the high stakes involved, the regulatory spat in no way impacts the fortunes of Ulip investments. Regulations are in place that secure your rights as an investor and make it incumbent for life insurers to discharge their liabilities to you in terms of providing the benefits of the plan provisions. However, in all probability, the current episode will unleash forces of change forcing regulators and the government to bring in new regulations that will change the very character of Ulips. Before we spell out the changes we see on the horizon, a brief background is necessary.

## Bones Of Contention

### What IRDA Says

1. Ulips have a mandatory insurance cover that is a vital and an inseparable part of each such product.
2. Unlike mutual funds, Ulips are linked with the policyholder's life.
3. 'Unit Linked Life Insurance Business' is defined in Irda (Investment) Regulations, 2000.

### What SEBI Says

1. Ulips are different from traditional insurance products, and they are a combination of insurance and investment.
2. The attributes of the investment component of Ulips are akin to the characteristics of mutual funds.
3. Investment component of Ulips carries equity market risks. So, Ulips need to be registered with and regulated by Sebi.

Life Insurers' Stand	Sebi's Contentions
<b>A</b> Ulip is a life insurance product not covered under the definition of "securities" under the Securities Contracts (Regulation) Act, 1956.	Units of mutual funds are "securities" as defined under Section 2 (h) of the Securities Contracts (Regulations) Act, 1956. Merely because they are named as units of Ulips, they cannot be ousted from the ambit of definition of "securities".
<b>B</b> The predominant feature of a Ulip is insurance cover, which is dependent on human life. The mere existence of an additional investment feature cannot convert a Ulip into a mutual fund.	If in a combination product there is an investment component, in any proportion, exposing investors to the risks of equity market, it can be issued only after obtaining registration from Sebi.
<b>C</b> Section 11AA (3) of the Sebi Act excludes contracts of insurance under the Insurance Act, 1938, from the purview of collective investment schemes.	ULIPs launched/offered by the said companies are not purely in the category of "contracts of insurance" but have components of investment products.
<b>D</b> The product was launched after following appropriate procedures and obtaining a unique identification number from IRDA, which is the regulator in case of life insurance products. Thus, there was no need to obtain a certificate of registration from Sebi.	Approval/registration from one regulatory authority does not exempt the company from complying with other applicable laws and being administered by other relevant regulators.
<b>E</b> Unlike a mutual fund, a Ulip is not established in the form of a trust. The fund is held by the insurance company itself as required under the Insurance Act. Additional features such as fund management and fund management charges are alone not sufficient to convert a life insurance product into a mutual fund.	Section 12 (1B) of the Sebi Act says "no person" can sponsor or cause to be sponsored a collective investment scheme including a mutual fund unless he has been registered with Sebi under the Sebi Act. An entity which is not established in the form of a trust cannot launch or offer an investment product in the nature of mutual fund without being registered with Sebi.

The current episode has served as an excuse for many Ulip-hating experts and vested interests to come to the fore giving the product some seriously bad press. At the same time, one needs to understand that Sebi has only sought the registration and regulation of Ulips. It hasn't banned the product as some think. "Ulips aren't as bad as they are made out to be," says Manish Jain, a Gurgaon-based financial planner. He is right. During the initial spurt of launches, they appeared to be a much more transparent alternative in terms of disclosure and flexibility to investors, giving them a significant growth upside over the long term through exposure to equity markets (as compared to less flexible and low-return conventional life insurance products such as endowment and money-back plans). As they are market-linked, the investor, of course, will have to deal with the risk of market swings.

Conventions might say that you shouldn't ideally be mixing insurance and investment, and that too in a combo, as the convenience comes at a cost, often a steep one. But not everyone is in an ideal situation. You might lack investment discipline which a regular contribution product with a lock-in would offer, or have much easier access to Ulips than other products or not mind the cost of convenience and so on. The problem lies in the deviation from the Ulip Guidelines (laid down by IRDA in December 2005) that has happened over time (see Rules vs. Reality). Complicated product architecture, absence of universally accepted performance benchmarks that facilitate evaluation, inadequate insurance element, ill-trained sales personnel, Ulips' rapid

progress is a case study of deviation from the ideals it was supposed to follow.

But perhaps the most outrageous aspect has been the high distribution commissions to ill-trained, and many a time, ill-intentioned sales staff, be it agents, institutional distributors or banks. These costs make a serious dent on the final return from the investment. Equally bad was the rampant misselling that is still associated with Ulips. To be fair, IRDA tried to stem the rot by capping the reduction in yield to 3 percentage points for Ulips with tenure up to 10 years and 2.25 percentage points for Ulips with a term of more than 10 years. There were also moves such as protecting policyholders abandoned by agents. But all this is too little when you compare it with the changes Sebi brought in for mutual funds, especially the abolition of entry loads.

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### Rules Vs. Reality

Despite clear-cut Ulip guidelines by Irda in December 2005, insurers are not complying fully with most of the rules

#### Objectives

- Provision of fair insurance coverage in the interest of policyholders
- Disclosures should facilitate an informed decision by policyholders
- Preserving the longterm nature of insurance products to meet policyholders' savings needs

#### Slip-Ups

- Coverage mostly at five times the premium
- Disclosures are not standardised and often without benchmarks
- Most Ulips sold as 3-5 year products
- Surrender charges made nil after 5 yrs by IRDA gives a shorter-term flavour

Some other areas where compliance has been dismal:

#### Irda's guidelines that every Ulip should comply with:

- No technical jargon
- Remain simple for the sake of understanding
- Transparency in all aspects of terms and conditions

#### Irda's guidelines for market conduct:

- Separate training to insurance agents before selling Ulips
- Documentation to support informed decision-making by the buyer while purchasing Ulips

#### Irda's guidelines for disclosures:

- Performance of various funds over 1-5 years, and since inception, and a comparison with the benchmark index
- Unit statement should be issued on every policy anniversary and also on each transaction

#### Advertisements should reveal that:

- The premiums and funds are subject to certain charges related to the fund or to the premium paid
- The contingency on which the guarantee, if any, is payable and the exact quantum of such guarantee

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While Ulip providers argue that it is a combination of insurance and investment, the truth is that advertisements harp on it only as an investment. In fact, many Ulip providers and their sales personnel successfully aped some of the worst practices of mutual funds and plumbed new depths of regressive business practices detrimental to customer interests. Much like new fund offers (in MFs), insurers kept launching new Ulips as a charade to raise money. Self-serving advertisements misled investors following the letter but violated the spirit of the code, accompanied by the expensive mollycoddling of successful agents. No one protested till Sebi clamped down on the rot in MFs. Despite IRDA's moves last year, Ulip providers could still do what they were doing while the MFs couldn't. As a result, they raised more money than MFs. Perhaps that's why the insurance industry smells a rat in the latest regulatory fracas. S.B. Mathur, secretary general, Life Insurance Council, feels "There seems to be a hidden agenda, especially looking at the urgency of it." While this may or may not be true, Sebi's 9 April move looks aimed at forcing a uniform set of rules for both MFs and Ulips.

#### How Ulips Will Change

Whoever be the regulator, you can now be sure that a lot of action will follow to check the rot that has crept into the system (see Future of Ulips). Despite all the glib talk of customer satisfaction from financial services companies, the truth is that the customer's investment is a mere statistic in the quest for higher AUM. We have plenty of role models from abroad on the

kind of body which should regulate, but the key would be figuring out what works best for Indian customers. Says Sanket Kawatkar, head, life insurance consulting, India at New-York based consulting company Towers Watson: "Overseas, unit-linked business is considered life insurance business." Investor interest needs to be the pivot of future Ulip regulation. In times to come, expect lower distribution costs that will bump up your returns, genuine product launches, restrained ads, frequent disclosures, establishment of universal benchmarks and, above all, better compliance.

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## Future Of Ulips

Whoever be the regulator, Ulips are set to change after the current imbroglio. Here's a peek into their future.

- More Ulips will give both the sum assured and fund value
  - Low or zero upfront charges
  - Low, staggered or zero commissions
  - Separate agent certification to sell
  - Fewer charges across products
  - No guarantee of any nature
  - Even benefit illustrations showing indicative returns will not be allowed
  - Better performance disclosures against benchmarks
  - Surrender charges likely to go up to the 10th year, which will make Ulips truly long-term products
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## What You Should Do

**Existing investors.** Continue with your Ulips (see Your Ulip Strategy). Go for the highest equity exposure in the initial years, switching to low or no equity exposure just before the tenure's end. Says Anil Rego, a Bengaluru-based financial planner: "There is no reason to worry. Whoever be the regulator, investor interest will be protected."

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## Your Ulip Strategy

### Existing Ulip Investors

- Be assured. The dispute is over regulatory jurisdiction only. It has not changed the character of Ulips; insurers are mandated by law to meet obligations to you. Don't worry.
- Keep paying premiums. Gains from Ulips, especially investments in equity options, pay off only when you are invested in them for at least 10 years. Premium disruption will impact growth of your corpus, especially for targets such as kids' future and pension.
- Banish thoughts of exit. A premature exit will seriously hurt you due to the high punitive charges associated. For exits before five years, you will have to pay back the tax breaks that you enjoyed.

### New Ulips

- **Examine if you need Ulips.** You need to check whether Ulips meet your needs and whether you need them in the first place. Compare with other alternatives. You can get a cost-effective life cover from term plans. Make investments in mutual funds too and invest for kids' future and retirement without necessarily investing in children's and pension Ulips even though the latter may have many in-built benefits.
  - **Understand that convenience comes at a cost...** If you seek the convenience of a combination of life cover and market-linked investments, and are willing to pay high distributor charges for it, and charges for premium allocation, policy administration and fund management, consider Ulips. To ensure tax-free maturity from Ulips, it's better to keep a life cover of at least 20 times your premium, keeping the proposals of the Direct Taxes Code in mind.
  - **...and risk.** No matter what any one says, your invested money in Ulips bears the risk of market fluctuations, besides risks such as interest rate fluctuations and repayment default in debt security investments by Ulip fund managers. Any guarantees come at still higher costs that dent returns or result in a compromise on the growth upside that equity exposure gives.
  - **Buy only pre-April 9, 2010 Ulips.** There were plenty of Ulips in the market before the Sebi order came in. Ulips launched after 9 April, if any at all, will be in disputed regulatory territory. Steer clear of them. What your Ulip strategy should be in the backdrop of the ongoing Sebi-Irda tussle
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**New buyers.** Stay away from Ulips that might be launched after 9 April. They would be in disputed territory. There are enough existing plans to choose from. If you like actively managing your money, a combo of term plan and mutual funds will work best. But if you don't like self-service, and don't mind a combo at a cost as is true with Ulips, link it to a long-term goal like your child's future or retirement. Choose Ulips that give both sum assured and fund value as death benefit (Type II Ulips). Ensure that you have a life cover of at least 20 times the annual premium; the impending Direct Taxes Code Bill might favour it.

annual premium. the impending Direct Taxes Code Bill might favour it.

To sum up, the Sebi-IRDA tussle only has glad tidings for you. There aren't many times in your life when you are in a situation when you flip the coin and win, no matter which side is up.

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EXTREMELY INFORMATIVE...THANKS TO OLM TEAM....NOW I REALLY KNOW WHAT TO DO WITH MY EXISTING ULIP INVESTMENTS..THANKS A LOT GUYS.

INDRA GHOSH  
KOL, INDIA

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