

COVER STORY

Is The New ULIP Really Better?

New rules are chipping away at costs and differences. And that may be good

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Changing Rules

The game has changed for Ulips. We take a look at what the various changes in the rules mean for you

The Old Rule Lock-in period of three years;

The New Rule Lock-in period of five years. Limited premium payment (LPP) term extended to five years;

The Impact: This will make investors stay in the policy longer.

The Old Rule Policies were front-loaded, resulting in high policy charges during the initial years;

The New Rule Even distribution of charges during the lock-in period;

The Impact: Commission for agents has fallen

. Aggressive selling may come down.

The Old Rule Minimum cover of five times the premium was allowed;

The New Rule All policies should now have a minimum cover of at least 10 times the premium for people below 45 years. For 45 years and above, it should be at least seven times;

The Impact: Life insurance policies will be bought more as a protection than as investment.

The Old Rule No guarantees on pension plans were offered;

The New Rule Minimum guarantee of 4.5 per cent per annum is now offered with all pension plans. Partial withdrawals are not allowed;

The impact: There will be limited exposure in equities now. It is suitable for conservative investors who are looking for some minimum guarantee with their pension plans.

The Old Rule Heavy surrender charges, as high as 90 per cent of the annual premium or the fund value;

The New Rule Discontinuance charges have been capped, both as a percentage of the fund value and premium and also in absolute terms, not exceeding ₹6,000

. Moreover, there are no surrender charges from the sixth year;

The Impact: Early exit between 5-10 years is less costly now.

The Old Rule* Cost was capped at 3 per cent of total charges for plans of 10 years or less, and 2.25 per cent for those of longer duration;

The New Rule Cost is now capped from the fifth year onwards;

The Impact: Exit after the fifth year is standardised across all plans.

“Firms will invest more in better equipped intermediaries. Customers can look forward to far better product and service experience”

“Two types of insurers will emerge—small but focused players on long-term protection and large players focused on investment aspects”

Unit-linked insurance plans (ULIPs), as a product category, is higher up the complication scale than, say, a fixed deposit or even a stock or a mutual fund. The reason is it is an investment and a protection product kneaded into one

. To complicate matters further are guarantees, additional payouts, differential loading of costs, exit loads and other features. So, it is near impossible for the average investor to figure how his money will flow through the plumbing and how much will come out of the other end.

Over the years, the Insurance Regulatory and Development Authority (IRDA) has tried to set rules that make ULIPs comparatively simpler and, therefore, easier for the buyer to understand. Product disparity and complication had reached such ridiculous levels that about three years ago, IRDA banned the so-called actuarial products. Next, to stop tall claims on what investors could earn, it allowed insurers to give illustrations of returns only at 6 per cent and 10 per cent per annum. Then, last year, it capped the percentage of premium that could be charged as costs over the full term of a ULIP. So, in a way, ULIPs have been getting standardised. Says Uco Vegter, chief marketing and strategy officer, ING Life Insurance Company: "Now, the difference in product design has come down drastically. As a result, there is far more transparency in ULIPs for customers. Moreover, commissions have come down by 50 per cent for agents."

"NAV guaranteed products are for those who aren't happy to invest their entire amount in the stock market and want to play safe"

Now, effective 1 September 2010, a new set of rules tries to straighten out the kinks in the plumbing further (see Changing Rules). They also bring the focus on protection and the long-term characteristic back as many of the ULIPs were being sold as short-term investment products thinly veiled as insurance (and, therefore, eligible for tax breaks). Do these rules succeed in making the ULIP a better product? In general, yes. Costs, including agents' commissions, are down. Moreover, the structure of the costs have become standardised and, therefore, products more comparable. Exits are cheaper now, although the lock-in period is longer. But how exactly do these changes manifest themselves and what are the features that you should opt for now? To figure that out, we looked at randomly picked examples of ULIPs of different genres—type I, type II, pension plans, children's plans and highest NAV guaranteed plans. These are among the 40-odd ULIPs that were either launched or relaunched after 1 September to comply with the new rules. This is what we found.

Category: Type I ULIPs

Example: *Aviva Life Insurance's Freedom Life Advantage*

As in the past, Type I plans continue to provide the higher of the sum assured or the fund value as death benefit. Same is true in the case of this plan. As with other ULIPs, in this kind of plan too, people will now need to stay invested for at least five years due to a longer lock-in. A higher sum assured tagged on with ULIPs now means that in the event of premature death, and if the death benefit is higher than the fund value, the survivors will gain much more than in the past. In this Aviva policy, if you stay invested for 10 years, you get a loyalty bonus of 3 per cent. Thereafter, it is paid at the end of every three years, depending on the premium amount.

Our Buying Advice: With costs capped, your selection of a Type I policy is simpler now. Keep an eye out for adequate life coverage amount as well as the fund performance over different time periods, say, one, two and three years, while buying. Since the changes in norms haven't changed the long-term nature of ULIPs, we maintain our advice that you invest in growth version with high exposure in equities, followed by gradual derisking by switching to low-risk variants in the last three years of the plan's term.

5 Common Features In New ULIPs

As the new rules come into effect, all ULIPs will have certain common features:

- **Mortality rates:** These are outside the IRDA cost cap & have been hiked by many companies
- **Limited Premium Payment:** Several policies have started offering the limited premium payment option for 5 years
- **Minimum Premium:** Now raised. For some policies, it's as high as ₹50,000 now. Earlier, the average was lower
- **Further guarantees on NAV-based products:** Apart from the highest NAV, more guarantees now on offer
- **Loans against ULIPS:** Earlier, it was allowed only for traditional plans

Category: Type II ULIPs

Examples: *ICICI Prudential Life Insurance's Life Time Premier and Kotak Life Insurance's Wealth Insurance*

Outlook Money's favoured version of ULIPs continue to provide both sum assured and the fund value as death benefit. With the increase in the mandatory life coverage amount, this double benefit ULIP category becomes even more attractive since it does a better bundling of life cover and investment.

ICICI Prudential Life Insurance's Life Time Premier, an example of type II ULIPs, offers you a trigger-portfolio strategy that helps you cash in on equity gains whenever the NAV (of a multi-cap growth fund) goes up by 15 per cent. So, when the market moves up by 15 per cent, it transfers the gains to the safe fund; when the market goes down, it buys more equity to maintain the ratio of 75:25 in equity and debt. The other option offered to you is to invest through the fixed-portfolio strategy, where you can choose your own asset allocation from any of the eight funds according to your risk appetite. Apart from pure debt and equity funds, it also offers dynamic P/E and return guarantee funds. While the P/E fund picks stocks on the basis of the price-earnings ratios of the stock on the Nifty 50, the guarantee fund has the mandate to invest 100 per cent in debt, money market instruments and cash. After completion of 10 years, the policy also offers a loyalty addition of 2 per cent of your fund value after every five years.

Kotak Life Insurance's Wealth Insurance. Even though it is a Type II ULIP, this plan, in addition to the sum assured and the fund value on death, also provides a lump sum benefit including all outstanding premiums. But where the life-assured and the policyholder are two different persons and the policyholder dies before the tenure of the policy gets over, the policy continues till maturity and the life-assured is entitled to maturity proceeds.

Our Buying Advice: We continue to give top billing for Type II ULIPs. As with Type I ULIPs, now with cost caps, your focus needs to be on getting the largest possible life cover in a unit-linked plan that has exhibited fund-performance beating its own and other benchmarks. Like Type I ULIPs, in Type II ULIPs too, we will advise you, as before, to invest in the growth version with high exposure in equities followed by gradual derisking by switching to low-risk variants in the last three years of the plan's term.

Category: NAV Guaranteed Plans

Examples: *HDFC Standard Life Insurance's Crest and SBI Life Insurance's Smart Performer*

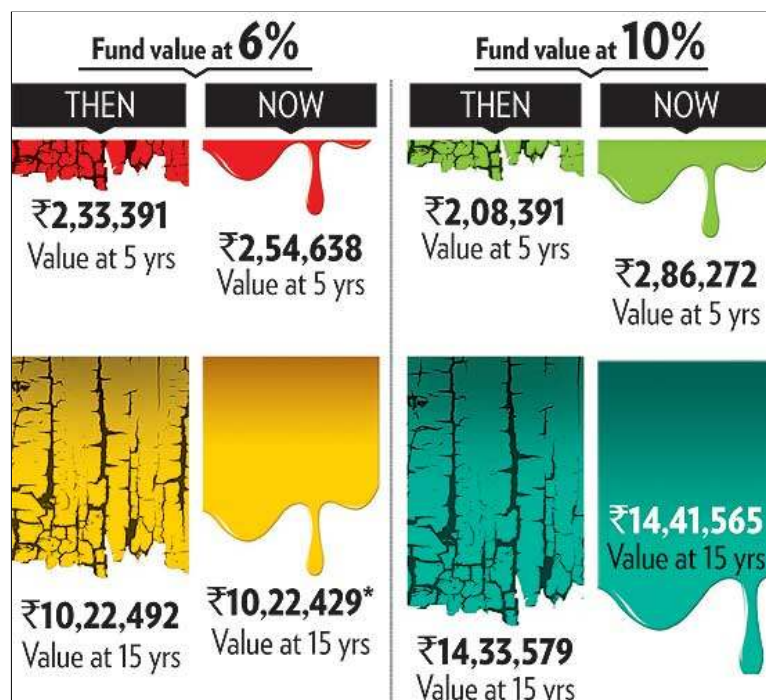
As with highest NAV guaranteed plans before, such plans continue to give the highest NAV recorded during a specific term of the policy. Some of the new offerings have also started guaranteeing the minimum NAV on maturity and few others offer a certain fixed return over and above the highest NAV recorded.

HDFC SL Crest. It has combined a plain vanilla unit-linked plan and an NAV-based guaranteed product in a single policy through two investment options: Highest NAV guarantee fund and free asset allocation fund. The highest NAV guarantee fund offers a minimum guaranteed NAV (net asset value) of ₹15 at maturity or the highest NAV during the first seven years of the policy, whichever is higher. On the other hand, the free asset allocation option offers a plain-vanilla policy with an alternative to invest in five funds with investments in equity ranging from 0-100 per cent.

SBI Life Insurance's Smart Performer. This product offers an increment of 5 per cent to the highest NAV achieved during the first seven years under the daily protect fund. The Daily Protect Fund (dpf) has the mandate to invest in equities ranging from 0-100 per cent. The investment in the DPF can be done through two fund options: Secure Plan, and Secure and Grow. While Secure Plan invests 100 per cent in the DPF, the Secure and Grow option invests 80 per cent funds in the DPF and the remaining 20 per cent in the index fund. It comes with an rebalancing option of automatic rebalancing—for instance, if your investment in index fund increases by 20 per cent, the gains would be transferred to the daily protect fund. But this rebalancing is a one-way option—from index to daily protect fund, and not vice-versa. This option is available for six years as the highest daily NAVs are recorded for first seven years only. At maturity, the prevailing NAV or the highest guaranteed NAV (along with a 5 per cent guarantee), whichever is higher, is paid.

Our Buying Advice: We repeat our previous warnings to you. Guarantees always come at a cost. NAV guarantee plans' fund managers have to invest more in debt which limits the upside in investing in other options with equity exposures. Such products prevent you from getting the real long-term upside of equity investing, a distinct disadvantage in a long term product like ULIP. These plans are costlier than regular ULIPs as they are outside IRDA's cost cap. This is in addition to the fact that these plans can often be incredibly complicated.

How Much You Really Save



Assumptions: For a 35-year-old male, paying Rs 50,000 annual premium and a cover of Rs 10 lakh. Fund allocation is in 100 per cent equity fund. The new product has an inbuilt accidental death cover; *Insurers have increased the mortality rates. Therefore, maturity value is slightly lower for the period of 15 yrs at 6% rate of return

Category: Children's ULIPS

Example: Max New York Life Insurance Shiksha Plus II

Children's Ulips have an inherent feature of 'waiver of premium' benefit. On death, sum assured is immediately paid to the nominee while the plan continues. Insurers keep putting in premiums into the fund till maturity. There is no change in this critical and standout feature of these plans.

Max New York Life Insurance Shiksha Plus II, like many other child Ulips, links the maturity of the policy with the higher education needs of your child. But if a policyholder does not survive the policy, 100 per cent of the sum assured is immediately paid to the family. Thereafter, all future premiums are paid by the company to keep the policy continuing till maturity. At maturity, the fund value is paid out for higher education purposes of the child. Apart from this, 10 per cent of the sum assured is paid out every year to account for school fees for 10 years from the date of death of the policyholder. The benefit is, however, limited to 100 per cent of the sum assured and the duration is limited to the policy term and the maturity age. Moreover, the policy offers you two investment strategies—you can either opt for dynamic fund allocation or choose from six funds of the policy. Dynamic fund allocation shifts your money from high-risk to low-risk funds as you grow older.

Our Buying Advice: If you don't have investment discipline and don't mind buying a product that provides life cover along with accumulation for your child's future, children's Ulips can be considered. Increased mandatory life cover has only made the proposition more attractive. To take maximum advantage invest in investment option with highest equity exposure to begin with, switching to lower-risk options in the last three years of the term. With cost caps in place, focus on getting the largest possible life cover along with a proven fund management track record even as you link the term with goals of your child.

Category: Pension Ulips

Example: LIC's Pension Plus

The new norms have resulted in dramatic changes in unit linked pension plans (ULPPs). Unlike in the past, where there was no obligation to offer a guaranteed return, now Irda mandates a minimum of 4.5 per cent guaranteed return at maturity to the policyholder. This would limit the equity exposure by insurers in their pension plans. Equity being the best bet over the long term among all asset classes, the investor in new pension Ulips will have limited equity upside. The LIC pension Ulip that we have taken as an example is a pure pension plan with a minimum deferment term of 10 years. If all premiums are paid till maturity, the policy offers a guaranteed interest rate on gross premium, which is paid at the end of each financial year. Currently, the minimum guaranteed rate of 4.5 per cent per annum, including on top-ups, is applicable till 31 March 2011, according to IRDA's mandate. On the date of vesting, the fund value or the guaranteed maturity proceeds, whichever is higher, is compulsorily utilised to buy an annuity, depending on the prevailing rates. The policyholder may also opt to commute up to one-third of the benefits to be paid as a lump sum. There are two funds to choose from—debt and mixed funds. Since it's a pension plan, no partial withdrawals are allowed from the policy.

Our Buying Advice: The scope of getting the kind of returns possible through growth options of Ulips is limited here, thanks to the 4.5 per cent guarantee. Clearly, ULPPs can't be your only retirement investment and can be used to make provision for a baseline retirement income.

How Good Is Your Agent?

How good your experience with Ulips is also depends on how efficient your agent is

Does he ask about your needs?

This is important considering that maturity of the policy should be linked with your long-term goals.

Does he prepare a solution to meet your goals?

Agents with the right approach identify your goals and prepare a solution to make you reach them.

Does he suggest a product to you in the first meeting?

Suggesting a product in the first meeting without doing any need-analysis is not the right approach.

Does he ask you to fill the form yourself?

To cut out surprises, it is recommended that you fill the form yourself. It ensures that you are aware about the policy details.

Does he ask you to replace your existing life insurance policy?

Exiting your existing policy for buying a new one is not a good idea.

Does he know about the industry and the products well?

To ensure that your agent does not make any false promises, it is advisable to read about the product well in advance.

What does he feel about term plans?

Term insurance is the cheapest form of insurance. If your agent discourages you from buying a term policy, it might be due to the low commission he will get from such plans.

Does he take into account inflation and protection requirements before selling a policy?

While saving for your future goals always consider inflation to get the complete solution.

Five Things To Watch Out For

When you deal in a market-linked product, there are certain things that must be kept in mind

- Ideally, you should go for a combination of term plans and mutual funds. Ulips are more suitable for those who do not have the financial discipline to keep protection and saving separate
- Buy Ulips only if you want to invest for at least 10 years. It is better to link your goals with the maturity of the policy
- Don't exit from your existing policy. Long-term yield of the policy still remains the same. Rules have changed to provide you an cost-effective exit if you are a victim of mis-selling
- With charges having been standardised, it is recommended that you look at the features of the various plans. Link them with your future goals
- Equity is the best bet among asset classes in the long term, but it's volatile. So, be invested in equity till about three years from maturity

Dealing with the agent

While most of the regulatory changes have gone in the customer's favour, the picture is not so rosy for the agent. Commission levels for the first year are down to 5 per cent from 15 per cent previously. With lower commissions, while agents who are in it for a quick buck are expected to exit the trade, others will try to work towards retaining their customers over the long term.

However, it would be naïve to assume that these changes will be tantamount to the marginalisation of insurance agents. In fact, his role will only get more important. So, the next logical step would be to discuss the traits you should be looking for in an agent in order to judge his efficiency.

The parameters on which you should decide upon the suitability of an agent remain more or less the same; however, in the light of recent changes, the test has become more rigorous. Next time you buy a Ulip, do not forget to ask these questions: Is it the right product? Will it give you the kind of returns you anticipate? Is it suitable for your long-term needs? Your future relationship with your agent should depend on how well he answers these questions.

First Meeting. Does the agent suggest you a product in the first meeting? Doing so, without running a need analysis, is a flawed approach. If your agent is interested in selling you a policy straightaway, without understanding your needs, his motive is maximising his commission and not selling the right product.

Your Needs Come First. It is important that your agent first asks about your future requirements. He should understand what your needs would be and chart out a plan to help you reach those objectives. He should ask you about your life covers and the number of dependents in order to correctly assess your needs. This is the first step of need-based selling; if he falters here, you might end up buying a wrong policy. Outlook Money recommends that your total cover be at least seven times your annual salary.

Finding A Solution. After understanding your needs, the agent should suggest policies matching your risk profile. He should link the maturity of the policy with your long-term objectives. You should keenly observe if he follows the right process of identifying your goals and accordingly suggesting a solution.

Filling Up The Form. Often policyholders willingly allow agents to fill out their forms. And later, they complain about not being aware of the policy details. In order to avoid any after-sale shock, it is recommended that you fill out the form yourself. It ensures that you are aware of the policy details. Moreover, you should also ask for a copy of the proposal form along with the documents. Moreover, if an agent fills out your form, it could be time-consuming and lead to unnecessary delays in policy issuance. Says Pradeep Thapliyal, senior vice-president and appointed actuary, DLF Pramerica Life, an insurance company: "We encourage our agents to get the medical history records of clients filled in by the clients themselves. This ensures that the clients read the information being sought and are aware of the details they disclose or withhold. Incorrect or incomplete medical records can cause delays in policy issuance and also repudiation at the claims stage."

Retaining Existing Policies. New policies always fetch an agent greater commission. He could, therefore, ask you to exit the existing policy and buy a new one saying it is better. The truth is, exiting your existing policy for buying a new one is not a good idea from the cost perspective. We recommend you to remain vested in your Ulip for at least 10 years to get its long-term benefits.

Knowledge of industry and products. Read up before you meet your agent. This will also let you cross-check whatever he says about the policy. "Customers should ask questions and reasons for investing in a particular product; they should compare it with other products in the market," says Manish Jain, a Gurgaon-based Certified Financial Planner. Most importantly, do not be shy about asking your agent questions. The more questions you ask, the greater clarity you get on the product.

Term Plans And Number Crunching. Term insurance is the cheapest form of insurance. If your agent discourages you from buying a term policy, it could be due to the low commissions associated with such plans. When buying a product, inquire about the premium for a term plan from the same company. Make him do some number-crunching on the returns from different products if you invest the same amount in each. Says Jain: "Usually, people go to buy insurance, but they end up buying a Ulip, which is an investment product. The investor should be sure of what his needs are. He should go for term insurance only if there is a requirement to buy insurance."

The Devil of Inflation. Saving for the future without taking inflation into account is a job half done. If you don't factor inflation into your calculations, you will never be able to get what you planned for. If the agent doesn't take inflation into account while charting out your future goals, avoid him.

If you think the agent has done well on these parameters, a long-term relationship with him would not be a bad idea. Alternatively, you could meet some more agents. However, if you are not satisfied with his approach, you know what to do: get ready for a date with another agent.

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