Say “NO” to ULIPs

Wealth First

Recommendation

- **AVOID ULIPs** – Strongly suggest avoiding regular premium Unit Linked Insurance Plans

- **Product has significant NEGATIVES** – ULIPs have high costs, lack strong performance precedence and in our opinion the product structuring is also faulty

- **Better product option available** – A pure term insurance plus a well-planned direct equity/ equity MF portfolio will help achieve investor objectives plus provide a far superior risk-return profile!

the significant NEGATIVES

- **High cost structure** – ULIPs have high upfront costs which could damage long-term returns. Total upfront costs charged on Rs.1 lac premium per year paid over the policy tenor vis-à-vis MFs is below:

Policy term	15-years	20-years
Upfront costs of ULIPs	88,700	107,200
Entry loads of Equity MFs	**33,750**	**45,000**

  High upfront costs act as a deterrent to exit from under-performing ULIPs

- **Lack adequate track record** – ULIPs being in existence for less than 5-years have a relatively short track record compared to MFs. Also, over last 24m ULIPs have consistently under-performed MF peers

Average absolute returns	12m	24m
Researched ULIP universe	39%	101%
Comparable MF peers	**45%**	**135%**

- **Inflexible product structure** – Insurance and investment objectives are quite different and requirements could vary significantly. Given the above, combining both could harm investor interest

AVOID ULIPs …….

We strongly recommend against combining INVESTMENTS with INSURANCE!! A pure term insurance cover along with investment in direct equity portfolios or Equity MFs, in our opinion, is a far superior alternative!

Analysis 1: Comparison of Cost Structures of ULIP and MF Peers

If an investor takes a pure-term policy and invests into equity through MFs, he will be able to create a benefit structure similar to an ULIP, but with significantly lower costs as the below table depicts:

Scheme Name	Upfront		Annual FMC (%)	Mortality costs	Admin costs (monthly Rs.)
	Year	% Premium			
Birla: Flexi Life Line	1st 2nd & 3rd 4th onwards	65.0 7.5 5.0	1.5	These costs depend on policy holder's age and term of plan.	22 per policy
HDFC: ULIP Endowment	1st & 2nd 3rd onwards	30.0 1.0	0.8		20 per policy
ICICI: Life Time Super	1st 2nd 3rd onwards	18.0 7.5 4.0	2.3		NIL
Kotak: Safe Inv. Plan II	1st 2nd onwards	14.0 3.5	1.5		2% p.a.
Reliance: Market Return	1st 2nd onwards	20.0 5.0	1.8		40 per policy
Term insurance + MF	1st onwards	2.3	0.8 – 2.0*	Same as above	Nil

** FMC of 2.0% is charged for Equity MFs; 0.8% - 1.5% is charged for liquid/ debt funds*

The below table gives total upfront costs charged over the life of a ULIP plan on an annual premium of Rs.1 lac by the various insurance companies along with MF comparables:

Scheme Name	15-year term	20-year term
Birla: Flexi Life Line	140,000	165,000
HDFC: ULIP Endowment	73,000	78,000
ICICI: Life Time Super	77,500	97,500
Kotak: Safe Inv. Plan II	63,000	80,500
Reliance: Market Return	90,000	115,000
Equity Mutual Funds	**33,750**	**45,000**

Note: In-house research

Observations:

- Large upfront costs recovered by ULIPs act as a significant deterrent for an Investor wishing to exit under-performing ULIPs
- Except for Equity ULIP plans, we feel that the other fund (liquid, bond, etc) options provided by insurance companies are not even worth considering given the high initial costs
- Only 20-year plus terms with Equity ULIPs can be justified as far as costs are concerned. The flip-side is that one must entrust money for 20-years without an efficient exit option. This is very risky!!

Analysis 2: Equity ULIP performance vis-à-vis MF peers

While insurance companies have been thumping ULIP scheme performances, we find that performances are below MF peers. Absolute returns table below:

ULIP – Equity Scheme Performances		
Scheme name	**12m**	**24m**
Reliance: Market Return	47%	95%
HDFC: Endowment	49	133
Birla: Flexi Life Line	28	NA
ICICI: Life Time Super	43	106
Kotak: Safe Inv.Plan	30	68
Average	**39**	**101**

Like-to-like MF Peers		
Scheme name	**12m**	**24m**
Reliance Vision	44%	136%
HDFC Equity	50	147
Birla Advantage Fund	37	119
Pru Growth Plan	46	141
Kotak 30	43	133
Average	**45**	**135**

Observations:

- ULIPs have a track-record which is less than 5-years old. Comparable performances of ULIPs are below MF peers

Analysis 3: Other Qualitative Factors

1. **Cost of discipline**: Investors are told that insurance products will result in disciplining their investment actions. However, there is a high cost to this "externally enforced" discipline

2. **Highly illiquid products**: ULIP investments are highly illiquid because of the following reasons:

   - Initial and upfront costs are very high while annual recurring costs are lower
   - Discontinuing an under-performing fund could also impact the insurance benefit, which again results in inflexibility

3. **Choice of funds limited**: The industry is at a nascent stage and as such offers limited choices to investors. The options in MFs is far larger and as such preferred

Analysis 4: Product Analysis

Assuming an investor has Rs.1 lac from which he has taken a Rs.20 lac insurance cover and invested the balance in Equity, either through an ULIP or (MF + term cover) in August 2004, the value as on August 2006 would be as under:

Particulars	Reliance		HDFC		ICICI		Kotak	
	ULIP	Vision	ULIP	Equity	ULIP	Growth	ULIP	30
Outflow	Rs.1,00,000 in 2 installments = Rs.2,00,000							
Current value	2,74,000	3,42,000	2,45,000	3,53,000	2,77,000	3,33,000	2,41,000	3,49,000

Note: All figures given above are based on in-house estimates

Observations:

- ULIPs seem to have been "value destroyers" in terms of the last 2-year track record. If today, an investor wished to exit the Kotak MF and invest in Reliance MF, he can do that easily, but with an ULIP the option would be at a very high cost

Why the research on ULIPs?

- The Life Insurance industry has 15 players including LIC and many more waiting to enter
- The increased competition, has resulted in newer and more complex products accompanied by very aggressive sales pitches, which at times could mislead investors
- Increasing doubts from existing investors on the huge marketing costs of ULIPs and an increasing trend towards more and more investor's taking exposure to ULIPs

Research Objective

- Caveat Emptor (Latin for "Let the buyer beware") - Create suitable awareness of the star insurance product namely "Unit Linked Insurance Plans" (ULIP) to help future decision making by Investors

ULIPs – Product Brief

- Unit-Linked Insurance Plans or ULIPs are a combination of insurance and market linked fund units
- After deduction of charges from premiums paid towards ULIPs, balance amounts are invested into a "fund" as per the policy holder's choice. The choice of funds include:
  - Equity funds (Nearly 100% equity exposure)
  - Balanced funds (60 – 70% Equity exposure; 30 – 40% Fixed income exposure)
  - Bond funds (Nearly 100% fixed income exposure)
  - Liquid funds (Nearly 100% money-market exposure)

  Investors can reallocate money amongst the choice of funds provided by the insurance company as per applicable terms. ULIP funds work along the same principle as mutual funds
- The policy holder's share in the fund is represented by the units he holds. The value of the unit (NAV) is determined by the total value of all the investments made by the fund divided by the number of units
- On maturity of the traditional 'with profit' policies, insurance companies bore investment risk to the extent of sum assured and assured bonuses, while in ULIPs the risks/ returns are market linked
- On death, in case of ULIPs, policy holder gets greater of sum assured or unit value of the fund
- Among life insurance Plans, ULIPs have far greater transparency compared to others and scope to earn market returns, making them popular
- Policy holder's can surrender the policy after lock-in period
- Typically, the insurance cover ranges from 5x to 20x the annual premium paid; Premiums paid are eligible for benefits under section 80C of the IT Act, 1961

Conclusion:

- We find the ULIP product structure to be faulty. Significantly high upfront costs, a difficult exit option are significant barriers to any recommendation to invest in this product
- Past product performance does not provide us sufficient confidence to over look the above negatives and suggest long-term investments in this product at present
- In our opinion, an investor's interest will be best served by taking a term cover and investing excess funds through MFs or directly into debt/ equity as required

WEALTH FIRST
809, Raheja Centre, Nariman Point, Mumbai – 400 021; ☎: (022) 22854532/ 30287272 Fax: (022) 22856369
602, Time Square, C.G.Road, Ellis Bridge, Ahmedabad – 380 006; ☎: (079) 26426001-08 Fax: (079) 26449282
E-mail: wealthfirst@vsnl.net