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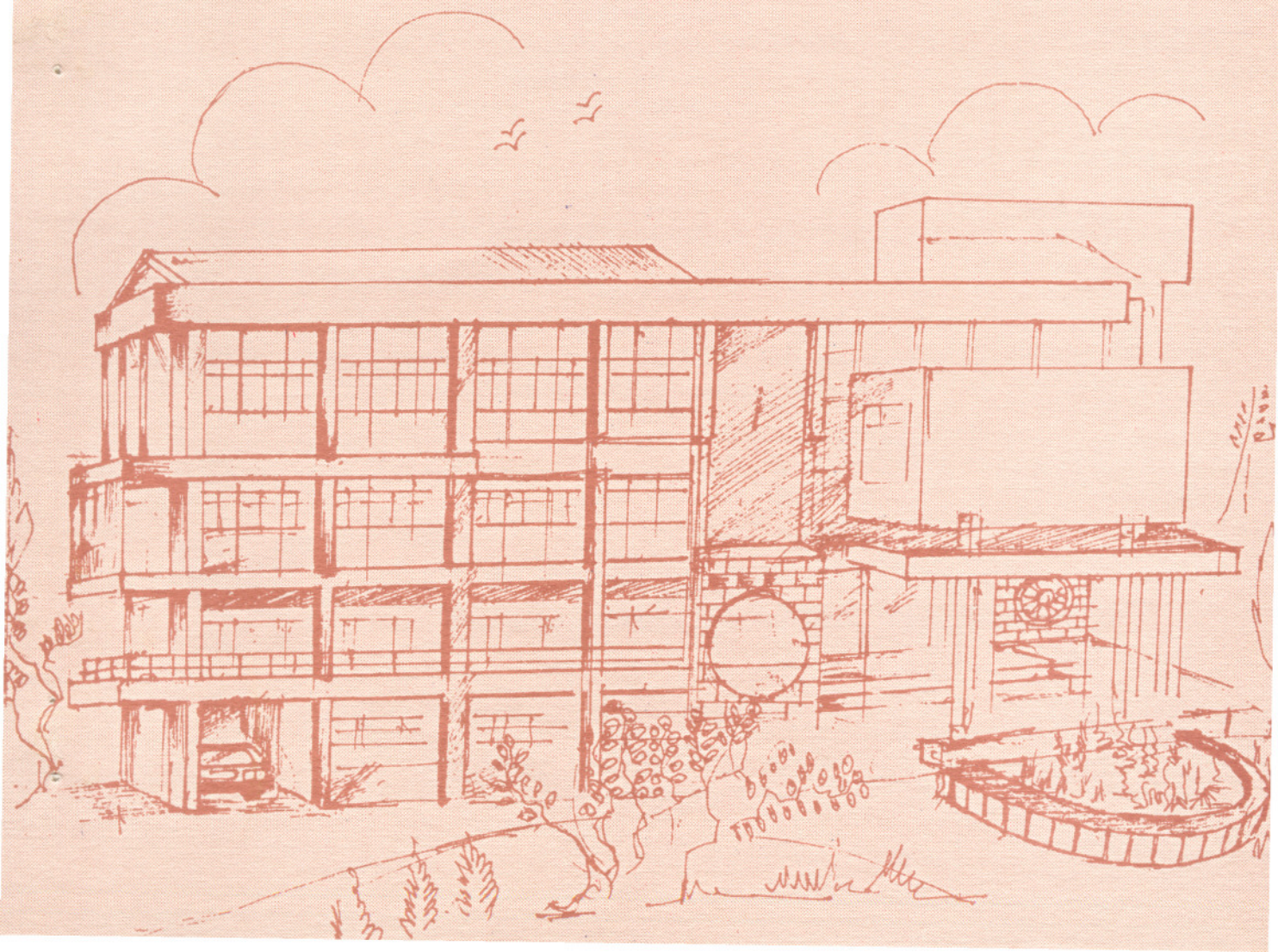
Unit-Linked Insurance Policies in the Indian Market – A Consumer Perspective



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Unit-Linked Insurance Policies in the Indian Market – A Consumer Perspective

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Unit-Linked Insurance Policies in the Indian market- A Consumer Perspective

Abstract

In recent years, Unit-linked insurance products (ULIPs) have become very popular in the Indian markets. ULIP premiums have come to dominate the new premium incomes of private sector insurers and even that of the public sector giant Life Insurance Corporation of India. ULIPs are essentially savings vehicles with a very small component of life insurance. The policyholder retains the flexibility of investing his savings and switching them amongst the various styles of mutual funds operated by the insurance company. Unlike in traditional insurance products - term, whole-life or endowment insurance- the policyholder bears all the investment risks in the hope of higher expected returns on his savings. As such, they compete mainly with plain mutual funds.

Plain mutual funds charge for their services in two forms: entry loads when new units are bought or exit loads when units are encashed; and a percentage of fund value to meet their expenses. In contrast, the charging structure under ULIPs is very complex and opaque. It is not very easy for a policyholder to assess the cumulative impact of these charges on his net fund value. Because of their relatively high initial expenses, ULIPs also levy very high surrender penalties if the policyholders want to withdraw in the initial years.

Therefore, in the interest of transparency, the Insurance Regulatory and Development Authority of India (IRDA) requires insurers to give illustrated fund values and surrender values for their ULIPs. These illustrations have to be given at two different assumed rates of annual returns, currently 6% and 10% of fund value, irrespective of the nature of the unit fund involved.

Using such illustrated values provided by the respective insurers, this paper analyses six different ULIPs to assess whether ULIPs offer a good savings vehicle. We use an alternative of buying a term insurance policy and investing the balance in a plain mutual fund earning the same return as the units under the ULIPs, i.e., 6% and 10%.

In four out of the six ULIPs considered, we find that buying term insurance and investing in a plain mutual fund is a better option in terms of both death benefits and survival/ maturity benefits. In addition, this alternative offers more flexibility to the investors in future contributions. It is also less vulnerable to changes in tax treatment.

Unit-Linked Insurance Policies in the Indian market- A Consumer Perspective

1. Introduction

In this paper we attempt a simple-minded or a rough and ready analysis of the Unit-Linked Insurance Policies (ULIPs) available in the Indian market, from the consumer (investor) perspective. In spite of the tremendous success and popularity of ULIPs in recent years, it is not very clear whether the consumer is getting a better deal.

ULIPs are essentially competitors to investment in mutual funds, although with a small life insurance component thrown in. Because of this life insurance component, the policyholders may enjoy some additional tax benefits on their premium payments and maturity benefits through ULIPs. Against these tax benefits, an investor has to reckon the possibly higher charges levied by ULIPs. The trend in taxation policy is towards treating all savings vehicles on an equal footing. The policyholders are therefore vulnerable to withdrawal of such differential tax benefits in future. This growth in funds flowing into ULIPs has definitely had an adverse impact on funds moving into mutual funds. Which is better for the consumer?

2. The Growing Popularity of ULIPs –Some Indicative Data

Insurance agents are expected to ensure that ULIPs are sold only to people who understand the risks in investing in capital market instruments. Statistics of new business of some of the companies (both public and private) show that there has been a spectacular growth in the volume of ULIPs sold.

The premium income of Life Insurance Corporation (LIC) from new ULIPs has grown 293% in the first quarter of ’05-06 to Rs 886.3 crore from Rs 225.4 crore in the corresponding period last year. LIC’s ULIP premium accounted for 45% of the new business premium from individual policies. This is a major shift from last year, when ULIP products accounted for only 18.5% of the total premium from the sale of individual assurances in the first quarter of 04-05.[2]

[2] http://www1.economictimes.indiatimes.com/articleshow/1168925.cms

ULIP premium already dominates insurance plans sold by private insurance companies. For the 11 months to February 2005, Birla Sun Life, the first private insurer in India to launch a ULIP in 2001, saw its new business income (solely from unit-linked plans) nearly double to Rs 480crore. ICICI Prudential, the largest private insurer, saw its new business premium income from unit-linked plans grow 87 per cent in 2004-05 to Rs 1,130 crore. In fact, the share of unit-linked plans in ICICI Prudential's total annualised premium income has reportedly risen steadily from 51 per cent in 2002-03 to 85 per cent in 2003-04 and to 90 per cent in 2004-05[3].

3. What is a ULIP?

ULIPs are primarily savings oriented products. Unlike traditional insurance products[4], ULIPs offer a lot more flexibility to the policy holder in premiums, sum assured and investment choice amongst various styles of unit funds- equity, balanced, income funds etc. In return, the policyholder bears most of the investment risks. Some ULIPs may offer minimum guarantees on the maturity value of the unit fund.

To meet regulatory norms and conditions for favourable tax treatment, insurance companies include an insurance wrapper[5]. If the policyholder dies before the policy matures, the insurance company will usually pay a death benefit equal to the maximum of the sum assured or the unit value in his account. Some policies pay a death benefit equal to the total of sum assured over and above the unit value in his account. If he survives the term, the policy owner will receive the full value of his unit account, subject to any minimum guarantees. If the policyholder wishes to surrender such a policy during the term, he will be paid a surrender value based on the value of his units, after deducting surrender charges/ penalty. Since the insurer incurs large initial expenses, surrender values may be nil in the first couple of years[6].The policyholder may switch his investments from one unit fund to another, a limited number of times per year, without any additional fee.

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[3] http://www.outlookmoney.com/scripts/IIH021C1.asp?sectionid=11&categoryid=115&articleid=5612
[4] Term, endowment and whole-life insurance products
[5] An insurer wrapper usually has a sum assured which is a very much smaller multiple of annual or single premium compared to a term, whole or even an endowment policy.
[6] IRDA is considering a minimum lock in period for ULIPs, Business Line, Sept 23,2005

A ULIP may deduct an allocation charge from every premium collected and the balance is invested in the funds chosen by the policyholder. The units will be bought at the offer price but worth only a lower bid price. The insurer will thus earn the bid-offer spread on each unit purchased. At any given time, the policyholder owns a given number of units, whose unit value would keep changing depending on the performance of the fund. From the fund account, various other charges (administration charges, mortality charges, investment charges, etc) are deducted periodically as per the policy provisions by cancelling an appropriate number of units held by the policyholder, in favour of the insurer.

4. A Quick Walk-Through on the Mechanics of Operation of a Hypothetical ULIP [7]

Two Types of Accounts

A part of the policy holder benefits (unit fund) is specified in terms of 'units'. These units belong to the policyholder and not the insurer. The value will vary with the net asset value (NAV) of the units. However, the insurer is interested in cash inflows and outflows in his account.

Therefore, such an insurance company has to keep track of two accounts:

- Unit Account
  This belongs to the policyholder. Holdings and accounting are in terms of 'units'. At any point in time, a policyholder owns a given number of units. The unit value (also known as Net Asset Value (NAV)) is computed by dividing the total value of the fund by the number of outstanding units.
- Non-Unit Account or Cash Account
  This belongs to the insurer. All inflows and outflows are accounted for in terms of cash.

An Illustrative Example

Let us assume that Mr. Gopu, 40 yrs old, buys a unit-linked policy for a five-year term. The sum assured is Rs 10,000 payable at the end of the year of death. The annual premium is Rs 3,000. Gopu decides to invest his cash values in 'Growth' units of the

[7] The exact mechanics will vary from scheme to scheme

insurer. The probability of death in each year during the term is assumed to be .005[8]or 0.5%.

Out of the yearly premium of Rs 3000 paid by Gopu, the insurer will invest only a portion, say 85% or Rs 2550, into the unit account. The remaining 15% is the allocation charge which will be paid into the insurer's non-unit account towards meeting the initial and regular expenses and profits of the insurer.

Using the Rs 2550 allocated to the unit account, the insurer will buy the units in the growth fund at the 'offer' price of the unit. However, the policyholder's units are valued only at a lower 'bid' price. The bid-offer spread could be 5%. Let us assume that the offer price was Rs 10/ unit and hence Gopu was allotted 255 units. But these are in fact worth only Rs 2550*0.95 = Rs 2422.5. The balance, Rs 577.50 (i.e., Rs. 3000-2422.5) accrues to the non-unit fund. Thus, Gopu has acquired 255 units of this growth fund whose value will keep fluctuating on the basis of the fund's performance subsequently.

Now assume that Gopu survives the first year and the unit fund earns a 20% return. Gopu's units will be worth Rs. 2906.40 (2422.5*1.20). From this, the insurer will deduct the following charges, as per the sequence below (by assumption)[9]:

'Mortality Charge'[10]	.005*(10000-2906.40)	= Rs. 35.47
'Investment Management Charge' (say, 1.5% of year-end value)	.015*2906.40	= Rs. 43.60
'Administration Charge' (Fixed Rs 100/year)		= Rs.100.00
Total		= Rs.179.07

Please note that the above charges may or may not be equal to the actual expenses incurred by the insurer.

At the end of the year, after these deductions, Gopu's units in the fund would have a bid-value of Rs. 2727.33 (i.e., 2906.40-179.07). The non-unit fund would have earned Rs 577.50 at the beginning of the year and another Rs 179.07 at the end of the year. This

[8] In reality these probabilities will be as per some mortality table. We are assuming a constant .005 here for convenience

[9] The exact periodicity and the sequence in which these charges are successively computed may make a small difference

[10] This is the life insurance element. The insurer would have paid Rs 10000 to any policyholder who died during the year. He has to charge Rs 35.47 on an average from each policyholder to meet this cost.

cycle will repeat every year during the term as long as he survives and continues to invest.

Instead, if Gopu were to unfortunately die during the year, the insurer would have paid Rs 10000 to his beneficiaries. There will be cash outflow of Rs 7272.67 (10000-2727.33) out of the non-unit fund which, along with the bid value of the units of Rs 2727.33 will make up the death benefit of Rs 10000.

If Gopu survives through the entire term of the policy, he will be paid the unit value in his account at maturity. If he surrenders his policy anytime, he will receive his fund value net of any surrender charges.

5. ULIPs- A Consumer Perspective

ULIP is a hybrid, combining insurance with an investment in a mutual fund. As mentioned earlier, it is closer to a mutual fund than a traditional insurance product. Except for a minor life insurance component, the policyholder bears all the investment risks, just like in any mutual fund.

However, against this modest insurance benefit, the policyholder is charged by the insurer under several heads- allocation charges, bid-offer spread, administrative charges and investment charges, apart from the mortality charges for the insurance. These charges are often deducted in complex ways- some as a percentage of annual premium, some on a fixed basis every month, some as insurance charges on a monthly basis, some on a daily basis as a percentage of fund value and so on. In addition, these charges are subject to revision in future periods, with some restrictions. It is very difficult for a buyer to understand the overall impact of these charges on the value of his account, over several years. For example, a small increase in investment charges as a percentage of fund value can have a substantial impact towards later policy years when fund values are likely to be higher. In addition, to recover their high initial acquisition expenses, ULIPs usually levy surrender penalties in the first few years if the policyholder wants to surrender his policy.

Realizing this, the Insurance Regulatory and Development Authority of India (IRDA) requires '… all life insurance companies operating in India to provide official illustrations to their customers. These illustrations are based on the investment rates of return set by the Life Insurance Council (constituted under Section 64C (a) of the Insurance Act 1938). For the Year 2004-05, the two rates of investment return declared by the Life Insurance Council are 6% and 10% per annum'.[11]

The insurers thus have to give illustrated fund values and surrender values at the end of each policy year. These illustrations have to be given at two different assumed rates of annual returns of 6% and 10% of fund value, irrespective of the nature of the unit fund involved.

There is no reason to believe that an insurer can earn a consistently higher return on the funds under ULIP compared to a plain mutual fund of the same type (same risk profile). However, the expenses incurred by an insurer under ULIP and hence the charges levied on the policyholder may be higher or lower compared to that of mutual funds in the same category. It is more likely to be higher as marketing expenses for an insurer are typically higher.

This gives us a simple but effective method of comparing the following two options for a potential buyer of ULIP:

1. Purchase of a ULIP with a given level annual premium and sum assured for a given term of coverage.
2. Purchase of the cheapest term insurance available in the market for the same sum assured and same term; and investing the balance of the annual premium payable under ULIP in a mutual fund of identical style/ risk profile[12].

There are primarily two types of benefits to be compared:

[11] From LIC's Website : http://www.licindia.com/lichome2/plan_140.shtml, as on September 27,2005

[12] This is an example of a general method of 'buy term and invest the difference' for comparing alternative insurance policies. Please see R. Rajagopalan "Comparing Traditional Life Insurance Products in the Indian Market: A Consumer Perspective" TAPMI Working Paper No. 2005/15(mimeo) for an application of this method and the cheapest term insurance available in the Indian market

1. What is the total financial benefit if the policy holder were to die sometime during the term? (Death Benefit)
2. What is the total financial benefit if the policyholder were to terminate his policy either before maturity or on maturity? (Survival Benefit)

For ULIPs, we can directly use the illustrated surrender values and maturity values from the insurers, for the assumed gross returns of 6% or 10%. However, the realizable values from the mutual fund for the same assumed gross returns will depend on the charges levied by the mutual fund. Since there are hundreds of mutual funds to be considered, we took an alternative route: what should be the equivalent annual charge of a mutual fund (as a percentage of fund values) for the realization on maturity to be identical to the illustrated value under ULIP? We can then compare this equivalent charge with the general level of charges by the mutual funds of a given style to asses which accumulation is likely to be more.

For death benefit, we can directly compare the death benefit from ULIP with the death benefit from term insurance plus the fund value under the mutual fund net of equivalent mutual fund charges as above. If the actual charges by mutual funds are lower, the option of term insurance plus mutual fund will be that much better.

As discussed earlier, we have defined an equivalent annual charge for mutual funds so that the maturity value in either case will be the same. However, because of the usually heavy surrender penalties in the first few years, the surrender benefits are likely to be much higher in the case of investment in mutual funds which do not have such heavy surrender penalties

6. Additional Aspects

Tax Treatment of ULIPs

Regular Premiums (other than riders) up to a maximum of 20% the sum assured is eligible for tax rebate under the erstwhile Sec 88. Therefore, if your sum assured is at least five times the annual premium, the entire premium is eligible for tax rebate.

Earnings in unit funds under ULIPs accumulate tax free. Provided the premium in any of the years does not exceed 20% of the sum assured, all death, maturity and full and partial withdrawal benefits are eligible for tax relief under section 10(10D)

Most of the policy documents say that the risk of any changes in tax treatment is to be borne by the policyholders.

Tax Treatment of Mutual Funds

Investments in specified mutual funds, up to a limit of Rs 10000 per year, are eligible for income tax exemption.

As per provisions of Section 10(35) of the Income Tax Act, income received in respect of units of a mutual fund specified under Section 10(23D) of the Act is exempt from income tax in the hands of the recipient unit holders.

Flexibility in contributions

In comparison to ULIPs, the fresh investments in mutual funds and the period before encashment are definitely more flexible.

7. Some Illustrative Comparisons

We consider a policyholder with the following profile:

Age at Entry:	30 yrs, Male of Normal Health
Policy term:	10 yrs
Regular annual premium:	Rs 10000 (or near about, depending on data available)
Sum assured:	Rs 100000 (or near about, depending on data available)

7.1 Case 1: AMP Sanmar's - Kanaka Shree

7.1.1 Policy Highlights[13]

Since this is the first case, we give a fairly detailed account of the policy features. In succeeding cases we will highlight only certain important features.

[13] Source: http://www.ampsanmar.com/products/kanakashree.asp, as on September 27, 2005

Investment Funds and Asset Allocation

Fund Type	Time Horizon	Risk Level	Level of Returns	Asset Allocation	
				Fixed Interest Securities (not less than)	**Equities (not more than)**
Capital Secure	Short	Low	Low	100%	0%
Balanced	Medium	Low-Medium	Medium	80%	20%
Growth	Long	Medium-High	Medium	60%	40%
Equity	Long	High	High	0%	100%

Premiums: Minimum annual premium is Rs 10000, and minimum single premium Rs 25000.

Minimum Policy Term: 5 yrs

Sum Insured: For annual premium, the sum insured has to be a minimum of five times the annual premium or Rs 500000, whichever is lower. For single premium policies, the minimum sum insured is 110% of single premium. While sum insured can be reduced subsequently, subject to the above minimum, any increase will be subject to underwriting.

Allocation Charge: 10% in 1st year & 5% thereafter (for policy term 5-9 yrs), 15% in 1st year & 5% thereafter (policy term 10-14) and 20% in 1st year & 5% thereafter (policy term 15 and more). 2% on single premiums and top up premiums

Administration Charges: Rs 40 will be deducted from the unit account each month .This will vary in line with a suitable consumer price inflation index.

Insurance Charges: This is based on policy holder's attained age and is deducted at the beginning of each month.

Investment Charges: The investment charges are deducted on a daily basis and vary from 1.5% to 1.75% per annum depending on the funds.

Surrender Penalties:

Regular premium

Within one year- 100% of fund value

Between 1-2 yrs- 50% of fund value

Between 2-3 yrs-20% of fund value

Beyond 3 yrs- 0% of fund value

Single premium

Within one year-10% of fund value

Beyond one year- 0% of fund value

Withdrawal Options: From the end of the first policy year to the third year, partial withdrawals can be made if the unit account balance is more than the sum insured. The maximum withdrawal is the difference between the unit account balance and the sum insured. After each withdrawal, unit account balance should be at least Rs 10,000.

7.1.2 Comparison

Table 1 compares the survival and death benefits of the 10-year Kanaka Shree at the assumed annual return of 6%[14], with the alternative of buying a term insurance and investing the balance of the premium in a plain mutual fund achieving the same 6% gross return.

Let us assume that the ULIP has no charges other than an insurance charge equivalent to the cheapest term assurance available for the sum at risk[15] at the beginning of each year. The cheapest annual term insurance premium with a 10-yr term for this policyholder is Rs.204.3 per Rs 100000 sum assured[16]. Using the unit linked insurance premium (Rs.10000) and the cheapest term insurance premium (Rs204.3), we have calculated what should be the fund value at the end of each year[17], as given in Col. 2.

AMP Sanmar provides illustrated policy values net of all their charges. These values are in Col. 3. The difference between Col. 2 and Col. 3, expressed as a % of Col. 2, is the

[14] The data was collected from the website of AMP Sanmar on 27th September 2005.

[15] Sum at Risk = Max (0, Sum assured- Fund value)

[16] Please see R. Rajagopalan, "Comparing Traditional Life Insurance Products in the Indian Market: A Consumer Perspective" TAPMI Working Paper No. 2005/15(mimeo)

[17] Mortality charge = Sum at risk * Premium rate for the cheapest term insurance

cumulative impact of all charges other than insurance charges. This is shown in Col. 4 and is in the range 15-20%. If he were to die before the ninth policy anniversary, he will get a death benefit of Rs 100,000, as the illustrated fund value is less than Rs 100,000. On maturity he will get a survival benefit Rs 112218. Instead, if he were to surrender his policy, he will get the values shown under Col. 5.

Instead, the policyholder can buy a term insurance for a sum assured of Rs 100000 at an annual premium of Rs 204.3 and invest the balance out of Rs 10000 every year in a mutual fund at the same gross return of 6%. To achieve the same maturity value of Rs 112218, he can afford to pay the mutual fund an effective annual charge of 3.34%[18] of the fund value at the end of each year, out of the gross return of 6%.

The actual effective annual charges by mutual funds are likely to be lower than 3.34%. Even assuming this high annual charge of 3.34%, let us compare these benefits with those of the ULIP (ignoring differential tax benefits, if any):

Survival / Surrender Benefits:

The surrender/ survival benefits under the mutual fund option are as in Col. 6. These are more than the surrender values under ULIP (Col. 5) every year till maturity. The maturity values are identical by construction as we have assumed an equivalent annual charge of 3.34% under the mutual fund option. The extra surrender benefits are in Col.7. If the actual annual charge is less than 3.34%, these differentials will in fact grow over years.

Death Benefits

Under the ULIP, this will be Max (Sum assured, Fund Value, i.e. Col.3). Thus, it would be Rs 100000 till Year 9 and 112218 in Year 10. We are assuming that death benefits will be paid at the end of the year of death.

Under the mutual fund option, this will be a sum of Rs 100000 (death benefit under the term insurance) plus the mutual fund value (Col.6). The extra benefit under this option increases over every year, culminating at Rs 100000 in the last year. These extra death

[18]We have used the GOAL SEEK function in Excel to compute this equivalent effective annual charge.

benefits are as shown in Col. 8. If the annual charges are less than 3.34%, these extra benefits will grow at a faster rate.

Table 1
Surrender & Death Benefits @ 6% for 10 Year Term:
Kanaka Shree Vs Term Insurance plus Mutual Fund

(All figures in Rs.)

Policy Year (1)	Unit Value (Net of only insurance charges) (2)	ULIP-Illustrated values (3)	Effective ULIP Charges (%) (4)	ULIP Surrender values (5)	Mutual Fund Value @Equivalent Annual Charges of 3.34%[19] (6)	Extra Surrender Benefits (7)	Extra Death benefits (8)
1	10405	8230	20.90	4115	10036	5921	10036
2	21457	17861	16.76	14288	20319	6030	20319
3	33196	27922	15.89	27922	30854	2932	30854
4	45664	38433	15.84	38433	41649	3216	41649
5	58908	49415	16.12	49415	52708	3293	52708
6	72975	60889	16.56	60889	64039	3150	64039
7	87917	72880	17.10	72880	75649	2769	75649
8	103788	85413	17.70	85413	87544	2131	87544
9	120615	98515	18.32	98515	99731	1216	99731
10	138452	112218	18.95	112218	112218	0	100000

Table 2 compares the survival and death benefits of the 10-year Kanaka Shree at the assumed annual return of 10%, by using the same methods used in Table 1. The difference between illustrated policy values (Col. 2) and the fund value at the end of each year (Col. 3), expressed as a % of Col. 2, is in the range 15-20%. The equivalent annual charge for the mutual fund option now is 3.22%. By assuming an annual charge of 3.22%, let us compare these benefits under the mutual fund option with those of the ULIP (ignoring differential tax benefits, if any):

Survival / Surrender Benefits:

The surrender/ survival benefits under the mutual fund option are as in Col. 6. These are more than the surrender values under ULIP (Col. 5) every year till maturity. The maturity values are identical by construction as we have assumed an equivalent annual charge of

[19] Computed using the GOAL SEEK function in EXCEL so as to equate the last rows in Col. 3 and Col.5

3.22% under the mutual fund option. The extra benefits are in Col.7. If the actual annual charge is less than 3.34%, these differentials will in fact grow over years.

Death Benefits

Under the ULIP, it would be higher than Rs 100000 after the 7th Year. Under the mutual fund option, this will be the sum of Rs 100000 (death benefit under the term insurance) and the mutual fund value (Col.6). The extra benefit under this option increases over every year, culminating at Rs 100000 in the last year. These extra death benefits are as shown in Col. 8. If the annual charges are less than 3.22%, these extra benefits will grow at a faster rate.

Table 2
Surrender & Death Benefits @ 10% for 10 Year Term:
Kanaka Shree Vs Term Insurance plus Mutual Fund

(All figures in Rs.)

Policy Year (1)	Unit value (Net of only insurance charges) (2)	ULIP-Illustrated values (3)	Effective ULIP Charges (%) (4)	ULIP Surrender values (5)	Mutual Fund Value @equivalent Annual Charges of 3.22%[20] (6)	Extra Surrender Benefits (7)	Extra Death benefits (8)
1	10797	8545	20.86	4272	10428	6156	10428
2	22699	18887	16.80	15109	21531	6422	21531
3	35818	30105	15.95	30105	33352	3247	33352
4	50278	42278	15.91	42278	45936	3658	45936
5	66216	55485	16.21	55485	59334	3849	59334
6	83785	69818	16.67	69818	73597	3779	73597
7	103149	85375	17.23	85375	88783	3408	88783
8	124464	102267	17.83	102267	104950	2683	102683
9	147911	120607	18.46	120607	122162	1555	101555
10	173702	140487	19.12	140487	140487	0	100000

[20] Computed using the GOAL SEEK function in EXCEL so as to equate the last rows in Col. 3 and Col.5

7.2 Case 2: Bajaj Allianz's Unit Gain

7.2.1 Policy Features

This plan offers six investment options, namely Equity, Equity Gain, Equity Midcap, Debt, Balanced and Cash fund.

Bid/Offer Spread: 5% of the offer price.

Allocation Charge: 70% in 1st year, 2% in second year, 1% in third year and 0% thereafter.

Fund Administration Charges: 1.25 % per annum of net assets.

Insurance or Mortality Charges: This is based on policy holder's attained age and is deducted on a monthly basis.

Investment Charges: Vary from 1% to 1.5% of annual rate depending on the funds.

Transaction Charges: These are charged between 0.1% and 0.7% depending on the funds. (It is not clear what this charge means!)

Surrender Penalty: 100% for the first three years. After three years, surrender penalty may be a maximum of 10% subject to approval by IRDA. A minimum balance of Rs. 10,000 across funds must be maintained after partial withdrawals.

7.2.2 Comparison

Table 3 compares the benefits of the Unit Gain 10-year policy[21] with the alternative term insurance and mutual fund option at the assumed annual return of 6%. We have used the same methods as in Table 1. Effective annual ULIP charges (Col. 4) is in the range 19-71%. In the early years, the fund values (Col. 3) are much lower than the policy values before charges (Col. 2). The equivalent breakeven annual charge of mutual funds is 3.47%.

[21] Policy values were collected from the website of Bajaj Allianz on 27th September 2005. http://www.bajajallianzlife.co.in/carequotesep/mainsep.asp

Survival / Surrender Benefits:

The surrender/ survival benefits under the mutual fund option are as in Col. 6. These are more than the surrender values under ULIP (Col. 5) every year till maturity. In the first three years, there is no surrender value under the ULIP as the surrender penalty is 100%. The extra benefits under the mutual fund option are as in Col.7. Under this ULIP, a policyholder suffers from very heavy surrender penalties.

Death Benefits

Under the ULIP, this will be Max (Sum assured, Fund Value, i. e, Col.3). Thus, it would be Rs 100000 till Year 9 and Rs. 111363 in Year 10. We are assuming that death benefits will be paid at the end of the year of death.The extra benefit under the mutual fund option increases over every year, culminating at Rs 100000 in the last year. These extra death benefits are as shown in Col. 8.

Table 3
Surrender & Death Benefits @ 6% for 10 Year Term:
Bajaj Allianz Unit Gain Vs Term Insurance plus Mutual Fund

(All figures in Rs.)

Policy Year (1)	Unit value (Net of only insurance charges) (2)	ULIP-Illustrated values (3)	Effective ULIP Charges (%) (4)	ULIP Surrender values (5)	Mutual Fund Value @equivalent Annual Charges of 3.47%[22] (6)	Extra Surrender Benefits (7)	Extra Death benefits (8)
1	10405	2963	71.52	0	10023	10023	10023
2	21457	13084	39.02	0	20278	20278	20278
3	33196	23700	28.61	0	30771	30771	30771
4	45664	34832	23.72	31348	41508	10159	41508
5	58908	46396	21.24	41756	52493	10737	52493
6	72975	58410	19.96	52569	63734	11165	63734
7	87917	70898	19.36	63808	75235	11427	75235
8	103788	83880	19.18	75492	87002	11510	87002
9	120615	97369	19.27	87632	99043	11411	99043
10	138452	111363	19.57	111363	111363	0	100000

[22] Computed using the GOAL SEEK function in EXCEL so as to equate the last rows in Col. 3 and Col.5

Table 4 compares the survival and death benefits at the assumed annual return of 10%, by using the same methods used in Table 3. The difference between illustrated policy values (Col. 2) and the fund value at the end of each year (Col. 3), expressed as a % of Col. 2, is in the range 21-70%. The equivalent breakeven annual charge of mutual funds in this case is 3.63%.

Table 4
Surrender & Death Benefits @ 10% for 10 Year Term:
Bajaj Allianz Unit Gain Vs Term Insurance plus Mutual Fund

(All figures in Rs.)

Policy Year (1)	Unit value (Net of only insurance charges) (2)	ULIP-Illustrated values (3)	Effective ULIP Charges (%) (4)	ULIP Surrender values (5)	Mutual Fund Value @equivalent Annual Charges of 3.63%[23] (6)	Extra Surrender Benefits (7)	Extra Death benefits (8)
1	10797	3070	71.57	0	10384	10384	10384
2	22699	13673	39.77	0	21390	21391	21391
3	35818	25218	29.59	0	33058	33058	33058
4	50278	37778	24.86	34000	45426	11426	45426
5	66216	51327	22.49	46194	58536	12342	58536
6	83785	65944	21.29	59349	72433	13084	72434
7	103149	81715	20.78	73543	87165	13622	87165
8	124464	98736	20.67	88862	102780	13918	102781
9	147911	117097	20.83	105387	119333	13946	102237
10	173702	136880	21.20	136880	136880	0	100000

7.3 Case 3: AVIVA's Life Saver

7.3.1 Policy Features

The minimum annual premium is Rs.3500. Units can be purchased on a single life or joint life. Three funds- secure, growth and balanced funds- are offered by the policy. The sum insured for an annual premium of Rs 10000 is Rs 80000 in the illustration available to us from the insurer.[24]

[23] Computed using the GOAL SEEK function in EXCEL so as to equate the last rows in Col. 3 and Col.5
[24] The data was collected from the website of AVIVA on 27th September 2005.

Bid-Offer Spread: 5% of the offer price.

Allocation Charges:

Too good to believe! Only 1% if premium is less than Rs. 7500. If premium is upto Rs. 10000, allocation charges are 0%. For premiums above Rs 10000, the insurer actually invests more than what you pay (up to 5% extra). However, the bid-offer spread of 5% implies he will never pay anything out of his pocket[25].

Administration Charges:

Rs. 62 per month which shall be adjusted annually for inflation.

Insurance or Mortality Charges:
This is based on policy holder's attained age and is deducted on a monthly basis.

Investment Charges:
The investment charges are 5% per annum for the 'initial' units (those allotted in the first two years) and 1% per annum on both initial and 'accumulation units' (units allotted from third year onwards).

Surrender Values:
During the first two policy years, no surrender values on the policy are payable. The minimum amount you can withdraw in case of partial cash-in of units at any one time is Rs. 5000/-, increasing from time to time (as stipulated by the company). The minimum balance (value of units) in the account after the partial withdrawal at any time should not be less than Rs. 10,000. An early redemption charge will be deducted from the policy value if you surrender your policy fully during the early duration of the policy:

"Early Redemption charges would be equal to [1-1/ (1.05) n] for initial units where,
'n' = (lower of the policy term or 30 years) minus number of years the policy has been in force".

[25] AVIVA's strategy is an example of what is called actuarial funding in ULIPs. Instead of a high upfront allocation charge to meet high initial expenses, the insurer spreads the expense charges on units allotted in the first couple of years through a much higher annual fund management charge over the entire term,

Tables 5 and 6 compare the survival and death benefits of the 10 year Life Saver at the assumed annual returns of 6% and 10% respectively, using the same method as earlier.

The cheapest annual term insurance premium with a 10 yr term for this policyholder Rs.163.44 for Rs 80000 sum assured[26]. Using the unit linked insurance premium (Rs.10000) and the cheapest term insurance premium (Rs.163.44); we have calculated the fund value without charges at the end of each year as given in Col. 2. The equivalent breakeven annual charge of mutual funds in this case is 4.90%. The surrender/ survival benefits under the mutual fund option are as in Col. 6. The extra surrender benefits of the mutual fund option are in Col.7 and the extra death benefits are as shown in Col. 8.

Table 5
Surrender & Death Benefits @ 6% for 10 Year Term:
AVIVA Life Saver Vs Term Insurance plus Mutual Fund

(All figures in Rs.)

Policy Year (1)	Unit value (Net of only insurance charges) (2)	ULIP-Illustrated values (3)	Effective ULIP Charges (%) (4)	ULIP Surrender values (5)	Mutual Fund Value @equivalent Annual Charges of 4.97%[27] (6)	Extra Surrender Benefits (7)	Extra Death benefits (8)
1	10448	8719	16.55	0	9908	9908	9908
2	21546	17351	19.47	0	19888	19888	19888
3	33334	26380	20.86	20853	29940	9087	29940
4	45854	35825	21.87	30986	40066	9080	40066
5	59153	45707	22.73	41587	50265	8678	50265
6	73279	56045	23.52	52677	60539	7862	60539
7	88276	66863	24.26	64281	70887	6606	70887
8	104173	78185	24.95	76425	81311	4886	81311
9	121023	90020	25.62	89121	91810	2689	81790
10	138884	102386	26.28	102386	102386	0	80000

[26] As Sum Assured is 80000 here, we have adjusted proportionately the cheapest term insurance premium of Rs.204.3, for Rs. 100000 Sum Assured.
[27] Computed using the GOAL SEEK function in EXCEL so as to equate the last rows in Col. 3 and Col.5

Table 6
Surrender & Death Benefits @ 10% for 10 Year Term:
AVIVA Life Saver Vs Term Insurance plus Mutual Fund

(All figures in Rs.)

Policy Year (1)	Unit value (Net of only insurance charges) (2)	ULIP-Illustrated values (3)	Effective ULIP Charges (%) (4)	ULIP Surrender values (5)	Mutual Fund Value @equivalent Annual Charges of 4.96%[28] (6)	Extra Surrender Benefits (7)	Extra Death benefits (8)
1	10842	9063	16.41	0	10283	10283	10283
2	22794	18377	19.38	0	21032	21032	21032
3	35967	28453	20.89	22389	32270	9881	32270
4	50487	39356	22.05	33847	44017	10170	44017
5	66492	51160	23.06	46292	56298	10006	56298
6	84133	63943	24.00	59813	69136	9323	69136
7	103547	77793	24.87	74508	82557	8049	82557
8	124902	92788	25.71	90465	96587	6122	83799
9	148392	109018	26.53	107785	111254	3469	82236
10	174231	126587	27.35	126587	126587	0	80000

7.4 Case 4: Birla Sunlife's Flexi Save Plus Endowment Plan

7.4.1 Policy Features

On death during term, this policy pays the sum insured *over and above* the fund value in the unit account. This policy offers a minimum guaranteed return of 3% per annum on the premium net of all policy fees and charges. The meaning is not clear: Is it a return of 3 % on the money invested in the fund after paying out all the fees and charges? Or, is it a net return on the gross premiums paid by the policyholder, after these fees and charges? We think it is the first one. (Not much of a guarantee…!)

[28] Computed using the GOAL SEEK function in EXCEL so as to equate the last rows in Col. 3 and Col.5

Allocation Charge:

	Coverage Paying Period		
Policy Years	5-9 yrs	10-14 yrs	15 or greater
1	29.9%	54.6%	65%
2	5%	7.5%	7.5%
3	5%	7.5%	7.5%
4 and later	5%	5%	5%

Annual Premium: Rs. 10608 (for a sum insured of Rs 100000)[29]

Administration Charges:

Rs. 22 per month and Rs.2.88 per thousand of the life insurance cover face amount will be deducted in the first 10 years except in the second year when it will be Rs 15.24 per thousand. (This is very unique! We think it is just another way of levying a very high allocation charge in the second year also. If we assume a sum insured equal to five times the annual premium, this is equivalent to deducting Rs 15.24 out of an annual premium of Rs 200 or an additional allocation charge of 7.5%) From 11th year onwards annual charges will be increased subject to a maximum of 3.75% per year.

Insurance or Mortality Charges:

This is based on policy holder's attained age and is deducted on a monthly basis.

Investment Charges:

The investment charge will be maximum of 1.5% p.a. Currently, it is 1 % per annum charged on a daily basis.

Switching Charges:

In a year, one switch is free. For every additional switch, a charge of Rs.100 will be levied.

[29] From the website of Birla Sun Life as on 27th September 2005
http://www.birlasunlife.com/insurancenet/index.htm

Surrender Charges:

The surrender charges are levied in the first four years. During the first 24 months of the policy, the charge will be an amount equal to the annualised premium. In the 25th month the charge is 24% of the annual premium. The surrender charge reduces by 1% for every month thereafter up to 48th month. 5th year onwards there is no surrender charges.

Tables 7 and 8 compare the survival and death benefits of the Flexi Save Plus Endowment Plan with the mutual fund option, for the assumed investment returns of 6% and 10% respectively. The equivalent breakeven annual charge of mutual funds is 4.29% in both cases. This policy offers death benefit as face amount plus policy fund value. Thus the extra death benefit (col.8) is comparatively lower and when it reaches the 10th year the illustrated death benefit and the term insurance and mutual fund death benefit are equal.

Table 7
Surrender & Death Benefits @ 6% for 10 Year Term:
Birla Sun Life Flexi Save Plus Endowment Plan Vs Term Insurance plus Mutual Fund

(All figures in Rs.)

Policy Year (1)	Unit value (Net of only insurance charges) (2)	ULIP-Illustrated values (3)	Effective ULIP Charges (%) (4)	ULIP Surrender values (5)	Mutual Fund Value @equivalent Annual Charges of 4.29%[30] (6)	Extra Surrender Benefits (7)	Extra Death benefits (8)
1	11050	0[31]	100.00	0	10554	10554	6285
2	22788	2246	90.14	0	21261	21262	8707
3	35256	20999	40.44	19619	32123	12504	9784
4	48498	34081	29.73	33974	43143	9168	8958
5	62564	45756	26.87	45756	54322	8567	8567
6	77505	57896	25.30	57896	65663	7768	7768
7	93374	70631	24.36	70631	77168	6538	6538
8	110221	83990	23.80	83990	88840	4851	4851
9	128078	98001	23.48	98001	100681	2681	2681
10	147008	112694	23.34	112694	112694	0	0

[30] Computed using the GOAL SEEK function in EXCEL so as to equate the last rows in Col. 3 and Col.5
[31] The company illustrations do not differentiate between illustrated values and surrender values.

Table 8
Surrender & Death Benefits @ 10% for 10 Year Term:
Birla Sun Life Flexi Save Plus Endowment Plan Vs Term Insurance plus Mutual Fund

(All figures in Rs.)

Policy Year (1)	Unit value (Net of only insurance charges) (2)	ULIP-Illustrated values[32] (3)	Effective ULIP Charges (%) (4)	ULIP Surrender values (5)	Mutual Fund Value @equivalent Annual Charges of 4.29%[33] (6)	Extra Surrender Benefits (7)	Extra Death benefits (8)
1	11467	0[34]	100.00	0	10952	10952	6683
2	24108	2246	90.68	0	22481	22482	9927
3	38041	20999	44.80	19619	34618	14999	12279
4	53398	37227	30.28	37120	47395	10275	10065
5	70326	50940	27.57	50940	60846	9906	9906
6	88985	65765	26.09	65765	75005	9241	9241
7	109551	81912	25.23	81912	89911	7999	7999
8	132175	99498	24.72	99498	105602	6105	6105
9	157062	118652	24.46	118652	122121	3470	3470
10	184437	139511	24.36	139511	139511	0	0

7.5 Case 5: LIC's Bima Plus

7.5.1 Policy Features

It has a fixed duration of 10 years.

Death benefit: 30% of sum assured plus cash value of units on death during first 6 months, 60% of sum assured plus cash value of units on death during next 6 months; and from then on full sum assured plus cash value of units thereafter, similar to Case 4.

Maturity benefit:5% of the sum assured along with the cash value of units.

Allocation Charges: Presumably 0% as nothing is mentioned as such in the illustration.

[32] The illustration says 'Surrender/ Maturity Value'
[33] Computed using the GOAL SEEK function in EXCEL so as to equate the last rows in Col. 3 and Col.5
[34] The company illustrations do not differentiate between illustrated values and surrender values.

Bid/Offer spread: A maximum spread of 5%.

Administration Charges: Level annual charge 'depending on the sum assured'.
Insurance or Mortality Charges: This is based on policy holder's attained age and is deducted on a monthly basis.

Fund Management Charges: 1% of the fund per annum charged on a weekly basis.

Switching: Allowed for a maximum of two times during the term with a minimum gap of two years. This is very restrictive compared to other ULIPs.

Surrender values: Possibly the most liberal among all ULIPs; starts at a maximum of 10% and ends with 3% at the end of four years. Nil thereafter.

As we can see, this policy offers much less flexibility to the policyholder. Relaising this, LIC has recently replaced this policy with one which offers more flexibility.The annual premium is Rs.10000 per Rs. 100,000 Sum Assured for a male life currently aged 35[35].

Tables 9 and 10 compare the survival and death benefits of the LIC's Bima Plus with the mutual fund option, for the assumed investment returns of 6% and 10% respectively. The equivalent breakeven annual charges of mutual funds are only 2.19% and 2.26% respectively.

Because of Bima Plus's low death benefit in case of death within the first one year of the policy inception, the additional death benefit under the mutual fund option in such a case is substantial. However, the probability of this event is very small. But for this, the two options are broadly comparable.

[35] Premium was collected from the policy illustration given in the website of LIC on 8th August 2005. The illustration by LIC for ULIP is for 35 years of age. The cheapest term insurance for a male currently aged 35 for the sum assured Rs.100000 is Rs. 255. The comparison is based on these values.

Table 9
Surrender & Death Benefits @ 6% for 10 Year Term:
LIC Bima Plus Vs Term Insurance plus Mutual Fund

(All figures in Rs.)

Policy Year (1)	Unit value (Net of only insurance charges) (2)	ULIP-Illustrated values (3)	Effective ULIP Charges (%) (4)	ULIP Surrender values (5)	Mutual Fund Value @equivalent Annual Charges of 2.19%[36] (6)	Extra Surrender Benefits (7)	Extra Death benefits (8)
1	10356	8214	20.69	7393	10103	2711	100976
2	21362	17583	17.69	16528	20578	4050	1873
3	33059	27463	16.93	26227	31438	5211	2681
4	45488	38127	16.18	36983	42698	5715	3392
5	58697	50377	14.18	50377	54371	3995	3995
6	72735	61995	14.77	61995	66474	4480	4480
7	87652	74187	15.36	74187	79022	4836	4836
8	103505	86983	15.96	86983	92032	5049	5049
9	120315	100411	16.54	100411	105520	5109	5109
10	138134	119504	13.49	119504	119504	0	0

Table 10
Surrender & Death Benefits @ 10% for 10 Year Term:
LIC Bima Plus Vs Term Insurance plus Mutual Fund

(All figures in Rs.)

Policy Year (1)	Unit value (Net of only insurance charges) (2)	ULIP-Illustrated values (3)	Effective ULIP Charges (%) (4)	ULIP Surrender values (5)	Mutual Fund Value @equivalent Annual Charges of 2.26%[37] (6)	Extra Surrender Benefits (7)	Extra Death benefits (8)
1	10747	8524	20.69	7672	10476	2805	101005
2	22600	18599	17.70	17483	21739	4256	1953
3	35670	29623	16.95	28290	33847	5557	2828
4	50085	41955	16.23	40487	46863	6377	3610
5	65982	56576	14.26	56576	60857	4281	4281
6	83513	71086	14.88	71086	75901	4815	4815
7	102846	86887	15.52	86887	92074	5188	5188
8	124130	104096	16.14	104096	109461	5365	5365
9	147543	122838	16.74	122838	128153	5315	5315
10	173298	148248	14.46	148248	148248	0	0

[36] Computed using the GOAL SEEK function in EXCEL so as to equate the last rows in Col. 3 and Col.5
[37] Computed using the GOAL SEEK function in EXCEL so as to equate the last rows in Col. 3 and Col.5

7.6 Case 6: Bajaj Allianz's Unit Gain Plus

7.6.1 Policy Features

This plan offers six investment options, namely Equity Index, Equity Plus, Equity MidCap Plus, Debt Plus, Balanced Plus and Cash Plus fund.

Allocation Charge: 24% in 1st year, 3% from 2nd year onwards.

Fund Administration Charges: Rs. 20 per month charged monthly through cancellation of units.

Insurance or Mortality Charges: This is based on policy holder's attained age and is deducted on a monthly basis.

Investment Charges: Vary from 0.7% to 1.5% of annual rate depending on the funds.

Transaction Charges: These are charged between 0.1% and 0.7% depending on the funds.

Surrender Penalty: 100% for the first three years. After three years, there is no surrender penalty.

7.6.2 Comparison

Table 11 compares the benefits of the Unit Gain Plus 10-year policy[38] with the alternative term insurance and mutual fund option at the assumed annual return of 6%. We have used the same methods as in Table 1. Effective annual ULIP charges (Col. 4) is in the range 12-26%. The equivalent breakeven annual charge of mutual funds is 2.07%.

<u>Survival / Surrender Benefits</u>:

The surrender/ survival benefits under the mutual fund option are as in Col. 6. These are more than the surrender values under ULIP (Col. 5) every year till maturity. In the first

[38] Policy values were collected from the website of Bajaj Allianz on 1st October 2005. Here, minimum premium is Rs.15000 and thus the Sum Assured is Rs.150000. The cheapest term insurance policy value for the same sum assured is Rs. 306.45. http://www.bajajallianzlife.co.in/carequotesep/mainsep.asp

three years, there is no surrender value under the ULIP as the surrender penalty is 100%. The extra benefits under the mutual fund option are as in Col.7.

Table 11
Surrender & Death Benefits @ 6% for 10 Year Term:
Bajaj Allianz Unit Gain Plus Vs Term Insurance plus Mutual Fund

(All figures in Rs.)

Policy Year (1)	Unit value (Net of only insurance charges) (2)	ULIP-Illustrated values (3)	Effective ULIP Charges (%) (4)	ULIP Surrender values (5)	Mutual Fund Value @equivalent Annual Charges of 2.07%[39] (6)	Extra Surrender Benefits (7)	Extra Death benefits (8)
1	15608	11497	26.34	0	15252.39	15252	15252
2	32186	26872	16.51	0	31084.87	31085	31085
3	49794	43024	13.60	0	47519.5	47519	47519
4	68497	59993	12.42	59993	64579.19	4586	64579
5	88363	77822	11.93	77822	82287.7	4466	82288
6	109464	96558	11.79	96558	100669.7	4112	100670
7	131876	116253	11.85	116253	119750.9	3498	119751
8	155682	136953	12.03	136953	139557.7	2605	139558
9	180923	158672	12.30	158672	160117.9	1446	151446
10	207678	181460	12.62	181460	181460	0	150000

Table 12 compares the survival and death benefits at the assumed annual return of 10%, by using the same methods used in table 11. The difference between illustrated policy values (Col. 2) and the fund value at the end of each year (Col. 3), expressed as a % of Col. 2, is in the range 12-27 %. The equivalent breakeven annual charge of mutual funds in this case is 2.10%.

[39] Computed using the GOAL SEEK function in EXCEL so as to equate the last rows in Col. 3 and Col.5

Table 12
Surrender & Death Benefits @ 10% for 10 Year Term:
Bajaj Allianz Unit Gain Plus Vs Term Insurance plus Mutual Fund

(All figures in Rs.)

Policy Year (1)	Unit value (Net of only insurance charges) (2)	ULIP-Illustrated values (3)	Effective ULIP Charges (%) (4)	ULIP Surrender values (5)	Mutual Fund Value @equivalent Annual Charges of 2.10%[40] (6)	Extra Surrender Benefits (7)	Extra Death benefits (8)
1	16197	11905	26.50	0	15823	15823	15823
2	34049	28300	16.89	0	32863	32863	32863
3	53727	46179	14.05	0	51213	51213	51213
4	75417	65676	12.92	65676	70974	5298	70974
5	99325	86940	12.47	86940	92255	5315	92255
6	125678	110133	12.37	110133	115171	5038	115171
7	154724	135437	12.47	135437	139850	4413	139850
8	186697	163039	12.67	163039	166427	3387	153387
9	221867	193108	12.96	193108	195045	1938	151938
10	260553	225866	13.31	225866	225866	0	150000

8. Conclusions

Table 13 summarizes our overall findings. Please note the following:

1. The often hard to assess, cumulative impact of various ULIP charges is generally in the range of 12 to 30% of the cumulative fund value (ignoring exceptionally high upfront charging of initial expenses in cases 2 and 4).
2. For the ULIPs considered in this paper- the break-even annual charge for a mutual fund in our equivalent alternative- of buying term insurance plus investing the difference in a mutual fund- varies tremendously, from a low of around 2% to as high as 5%!
3. Subject to finding a mutual fund with an actual annual charge of around 2-2.5%, this alternative to ULIP seems to offer a better death benefit as well as a better survival benefit.
4. In addition, the mutual fund alternative offers much more flexibility in terms of annual investments and withdrawals.

[40] Computed using the GOAL SEEK function in EXCEL so as to equate the last rows in Col. 3 and Col.5

5. The very high allocation charges and surrender penalties under ULIPs, basically to meet their relatively high initial distribution costs seems to be the major reason.
6. The charging structures of some of the ULIPs are really opaque!

Table 13

ULIPs: Summary Findings

Case	ULIP	Cumulative Impact of ULIP Charges on Fund Value (% of fund value)		Equivalent Annual Charges for Mutual Fund (% of fund value per year)		Does the Term Insurance plus MF option offer better Benefits?	
		6% Return	10% Return	6% Return	10% Return	Survival Benefits	Death Benefits
1	AMP's Kanakashree	15-21	15-21	3.34	3.22	Yes	Yes
2	Bajaj Allianz's Unit Gain	19-72	21-72	3.47	3.63	Yes	Yes
3	Aviva's Life Saver	17-26	16-27	4.97	4.96	Yes	Yes
4	Birla Sun.Life's Flexi save Plus Endowment	23-100[41]	24-100	4.29	4.29	Yes	Yes
5	LIC's Bima Plus	13-21	14-21	2.19	2.26	Yes	Yes
6	Bajaj Allianz's Unit Gain Plus	12-26	12-27	2.07	2.10	Yes	Yes

Can the policyholder find mutual funds with annualized charges less than the breakeven levels worked out by us for each ULIP?

Table 14 is a summary of expense ratios for various categories of mutual funds. As we can see, it should be possible for an investor to find such a low expense passively

[41] The upper range may be incorrect as the company illustrations do not differentiate between illustrated and surrender values

managed mutual fund. There may also be entry or exit load of a maximum of 2% on fresh units purchased. Our illustrative case has an annual saving of Rs 10000, out of which Rs 204.3 goes for a term insurance of Rs 100000. The balance of Rs 9795.7, if invested in a mutual fund with an entry load of 2% and annual expense charge of 2% on closing balance, will accumulate to Rs 119000 at a gross return of 6% annum. If the gross return is 10% instead, the accumulation will be about Rs 148450. This is higher than the accumulations indicated in our tabular comparisons assuming breakeven annualized charges.

Table 14
Expense Ratio of Open-Ended Mutual Fund Schemes (in %of NAV)[42]

No.	Category	Open Ended	
		From	To
1	Balanced	0.96	2.50
2	Debt(LT)	0.60	2.24
3	Debt Liquid	0.18	1.17
4	Debt (ST)	0.37	2.25
5	Equity Basic	2.14	2.68
6	Funds of Fund	0.45	2.50
7	Monthly Income Plans	0.75	2.84
8	Equity Tax Plan	1.00	2.54
9	Equity Diversified	0.02	2.58

Though dividends and long term capital gains from mutual funds are exempted from tax at the hands of the unit holder, the mutual fund pays a 12.5% dividend distribution tax. In contrast, the insurance companies need not pay any tax on investment return on the policyholder funds. Nor are the death / maturity proceeds of ULIPs taxable at the hands of the policyholder.

[42]From http://www.personalfn.com/research-it/mutual-funds/fundarena/expratio.html,collected on 26 September 2005

It is quite clear that at least in the first four cases out of the six ULIPs we have considered, a disproportionate portion of the illustrated gross returns accrues to the insurance companies. This is unfortunate because all the investment risks are being borne by the investor-cum-policy holder. If at all these ULIPs offer a better return to investors, it must be on the back of a tax advantage. But then, is that advantage justified when the insurance wrapper itself is a fig leaf for what is otherwise mainly a savings product?

The insurance companies may defend by pointing out that they have to recover their initial expenses one way or other. Reportedly, the lapse/ surrender rates under ULIPs are very high. However, this may in fact be due to policyholders realising that it is not a suitable savings vehicle. IRDA is reportedly trying to impose a 5-yr lock in period on investments in ULIPs. If so, it may amount to punishing investors who were misled in the first place.

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