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RESEARCH PAPER

ULIPs-A blessing or a curse in disguise

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ABSTRACT

Unit Linked Insurance business forms a significant part of the life insurance business. A Unit Linked Investment Plan (ULIP) is an instrument which combines the security provided by an insurance plan with the opportunities provided by an investment plan. A significant amount of premium of insurance companies comes from this instrument. In this paper author has tried to compare ULIPs with other investment and insurance options available in the market. The purpose of this paper is to study the investor's perception about the ULIPs as an investment option in Indian financial market. The basic thing that an investor keeps in his mind is value orientation. Investor 'balances off' risk, return and cost, means that they want good option with high return but not necessarily too risky and costly, or the less risky and costly which they do not trust in quality and return terms. So, it is just a matter of right balance. Due to SEBI ban on 14 private life insurance companies in India the basic question that comes in the mind is 'how carefully consumer thinks about their investment? Is the investor more concerned with the characteristics (transparency) of investment option to ensure investment is worth or not or the return? Or they believe that the transparency of investment and fewer charges on investment still merit return? This paper investigated investment pattern, attitude and perception of investors about ULIPs as an investment option after SEBI ban on 14 private insurance companies. The result is that investors are losing their trust in ULIPs due to less transparency and less insurance coverage as compared to other options available in market. ULIPs have failed to convince people that the return and coverage is really up to what could be expected for their investment. In these cases investors are attracted towards other option available in market which are more transparent and are giving same return patterns, *i.e.* People want to invest but they do not want to invest at high front-end cost and less transparency.

KEY WORDS : ULIP, Unit linked, Investment plan

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It wasn't too long back when the good old endowment plan was the preferred way to insure oneself against an eventuality and to set aside some savings to meet one's financial objectives. The traditional endowment policies invested funds mainly in fixed interest Government securities and other safe investments to ensure the safety of capital. Thus, the traditional emphasis was always on security of capital rather than yield. However, with the inflationary trend witnessed all over the world, it was observed that savings through life insurance was becoming unattractive and not meeting the aspirations of the policyholders.

The policyholder found that the sum assured guaranteed on maturity had really depreciated in real value because of the depreciation in the value of money. The investor was no longer content with the so called security of capital provided under a policy of life insurance and started showing a preference for higher rate of return on his investments as also for capital appreciation. That was the time, when introduction of such a product was felt which can satisfy expectation of the policy holders. The object was to provide a hedge against the inflation through contract of insurance. Decline of assured return endowment plans and opening of the insurance sector saw the advent of ULIPs on the domestic insurance horizon.

Unit linked insurance plans (ULIPs) are insurance plans that combine the benefit of investment with insurance. They give the investor an option to put a part of their premium in various investment portfolios and derive the benefits depending upon the performance of the funds chosen by them. ULIPs were launched at an opportune time when stock markets had just taken off. Being market- linked, they were

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major beneficiaries of the secular rise in stock markets.

Traditionally, endowment plans have been invested in government securities, corporate bonds and the money market. ULIPs however, have a broader choice. They invest across the board in stocks, government securities, corporate bonds and money market instruments. Of course, with ULIP there are options wherein equity investments are capped. The common types of funds available in ULIPs are bond fund, protector fund, secure fund, balanced fund, growth fund, index fund and enhancer fund. Depending on one's risk appetite one can choose the fund. However the investment risk is borne by the investor.

The common type of charges, fees and deductions in ULIPs are premium allocation charges, mortality charges, fund management charges, policy/administration charges, surrender charges, Fund switching charges and service tax.

Insurance companies are required to declare the NAV of various ULIPs on a daily basis. The movement of NAV enables the policy holder to assess the performance of his investment and accordingly make intervention in the form of switches, withdrawal and top-ups. One big reason behind success of ULIPs was that whatever be your specific financial objective, chances are that there is a ULIP which is just right for you.

Growth scenario:

At present, over 70% of the new business premium for most insurance companies comes from ULIPs, running into thousands, if not lakhs of customers.When the insurance companies started issuing ULIPs about 5-6 years ago, offered huge commissions to insurance agents and flooded the market with these products which nearly mirrored mutual fund (MF) products. ULIPs are products that combine insurance and investment for the insured and are mostly market-linked.

As on (31st March, 2005), the total investments by the insurance industry were Rs.465863.89 crore as against Rs.386699.42 crore in the previous year, recording an increase of 20.47 per cent. While investments by the life insurers increased by 21.5 per cent to Rs.428451.93 crore, the corresponding increase in the case of non-life insurers was 9.79 per cent to Rs.37411.96 crore. While investments by LIC increased by 20.21 per cent, in the case of other life insurers, the increase was 117.84 per cent. Similarly, the increase in the case of public sector non-life companies was 8.17 per cent and for private sector non-life insurers it was 38.11 per cent. Of the total investments, investments from life fund, constituted 85.48 per cent, pension and general annuity (including Group) (12.77 per cent) and Unit Linked Fund (1.76 per cent) as on 31st March, 2005. As against the composition of investments as on 31st March, 2004, were at 87.15: 12.37 and 0.48 per cent, respectively. It may be observed that a shift had taken place in favour of investments from unit linked funds which is reasonable to expect. The shift is more pronounced in the case of private insurers, in whose case the investments out of Unit Linked Funds accounted for 46.92 per cent as against 31.68 per cent in the previous year highlighting the reliance of new insurers on unit linked products to underwrite new business.

In (2006-2007) a significant shift has taken place in favor of investments of unit linked funds since last year. The percentage increased of ULIP funds on year over year on the basis of investment over the last 4 years *vis a vis* traditional funds indicated that the growth in investment pertaining to unit linked business started from 2003-04. Till then, the total investments were only out of premiums towards traditional, group and annuity businesses. The cumulative balances of unit linked investments reported at Rs.1688.31 crore in 2003-04 went up significantly to Rs.25888.14 crore in 2005-06 and further to of Rs.67049 crore in 2006-07. The share of investments of unit linked business in the cumulative life business therefore had gone steeply from 0.47 per cent in the year 2003-04 to 11.09 per cent in 2006-07. On an incremental basis, while the growth of investments during the last 2 years showed a steady pattern in respect of investments pertaining to traditional products, there is a steep increase in respect of investments pertaining to unit linked business. It is the unit linked business which drove the growth of premiums over the last 2-3 years. While the private players have taken the lead in this segment, LIC has also made strong strides in the sale of ULIPs during the last three years. Despite the growing popularity of ULIPs it remains a fact that the policy holders rely heavily on the advice rendered by the distributors. The complicated design of the policies makes them less aware of the product features and chances of mis-selling by agents are high.

In (2007 -2008) the percentage increased of ULIP funds on year over year basis of investment over the last 3 years *vis-a-vis* traditional funds indicated that the growth in investment pertaining to unit linked business started from 2003-04. Till then, the total investments were only out of premiums towards traditional, group and annuity businesses. The cumulative balances of unit linked investments reported at Rs.25888 crore in 2005-06 increased to Rs.67049 crore in 2006-07 and further to of Rs.133382 crore by 2007-08. On an incremental basis, while the growth of investments during the last 2 years shows a steady pattern in respect of investments pertaining to traditional products, there is a steep increase in respect of investments pertaining to Unit Linked business.

As on 31st March 2009, the share of unit linked fund in total investment funds of life insurance companies was 18.85 per cent. Though in nominal terms, the total investments had increased to the growth in 2008-09 at 19.63 per cent was lower than 26.78 per cent recorded for 2007-08.

Both the type of funds (traditional as well as ULIPs) decelerated in 2008-09. While growth in traditional funds was marginally lower, a substantial deceleration was observed in

ULIPs from 98.48 per cent in 2007-08 to 29.82 per cent in 2008-09.

In December 2009 and January 2010, SEBI had issued show cause notices to 14 insurance companies asking them why action should not be initiated against them for issuing investment products without SEBI's permission. SEBI's whole time member Prashant Saran passed the order putting a ban on ULIP products by these 14 insurers. One of the main contentions for Sebi was that although a ULIP is an insurance product which comes under IRDA, part of it is also an investment product which should ideally be regulated by SEBI.

Assessment of various investment and insurance options:

As we all know the number of financial products is increasing in the market. These products can be classified under two categories such as customer beneficial and agent beneficial. Increasing number of products will make the process of buying more complex because it would be very difficult to understand which product is good and which is bad.***:***

ULIPs:

ULIPs are associated with high charges. Almost 20-50% will be deducted from your first annual premium in the form of various charges such as premium allocation charges and mortality charges.Then, why agents aggressively sell this product to people? Well, because this is the only financial product available in the Indian market which gives highest commissions to the agents.

In my opinion, rather than going for ULIPs – Go for term insurance + equity mutual funds or term insurance + equity mutual funds + PPF combination.

Pension plans:

These are also equity linked plans. They are also same like ULIPs means they will give you insurance benefits, tax benefits and investment of your money and they will also give you regular annual pension on maturity for the rest of your life (Maximum age 100).

Again the pension plans are also associated with higher premium allocation and many other kind of charges so rather than giving your money to pension funds to build your retirement corpus, it is advisable to build your own retirement corpus by yourself. Equity mutual funds are the best way to build the retirement corpus in the long run.

Mutual funds:

This is the best financial product. But since SEBI has removed the 2.5% entry load for the mutual funds, the agents have suddenly stop promoting such a nice financial product all over India. This is because now the agents don't get any commissions on selling mutual funds. (Of course, they can get but from customers and not by fund houses. So, if they can convince the customers, they can ask for 2.5% from the customers).

Thus, because of 0% entry load, your 100% of the invested money will go towards the investing and not paying any kind of charges. And that's why mutual funds in India are the superior financial products than ULIPs and pension plans.

So, investors should buy a term insurance plan to cover the life insurance and invest rest of the money in equity diversified mutual funds *via* SIP.

METHODOLOGY

This research is indented to be a questionnaire based exploratory study to investigate the investment pattern and perception of investors about ULIPs and other investment options after SEBI ban on 14 private insurance companies. Frequent investors in Indian financial market were purposively sampled falling in the national capital region (NCR).the frequent investors were only contacted for the purpose of filling of questionnaire as the subject of the study is such that the respondents should have knowledge of financial market and insurance. Even though the questionnaires were administered to 80 investors the usable response was received from 50 respondents, resulting into response rate of around 60 per cent. Interviews were conducted with a well-structured schedule during March 2010 to June 2010.

Investors opinion were obtained on ULIPs mis-selling, agents high commission, high front end cost, way to achieve value orientation, impact of SEBI ban on 14 private insurance companies and so on. Only investors above 21 years were included in study. It initially started with researcher acquaintances and progressively more respondents were added using snow-balling technique. Acquaintances were encouraged to forward the request to their friends. Request to participate in survey were mailed out on frequent investors mailing list or internet groups. The survey was closed after receiving a total of 50 usable responses.

ANALYSIS AND DISCUSSION

The survey received 50 usable responses over 4 month's period. Therefore the total number of analyzed responses was 50.

Demographic information:

The 50 total respondents included 42 men and 8 women. The majority 84% of respondents were male showing that men were more frequent investor then women. The average Indian respondent was 30.7 years old.

Investment pattern:

Most of the respondents indicated that they invest in

ULIPs. Very few respondents had invested in term plan and pension plan. About 30 % respondents had invested in mutual fund (Table 1).

Table 1:Investment pattern	
Responses	Percentage
ULIPs	25 (50%)
Mutual fund	15 (30%)
Pension plan	5 (10%)
Term insurance	5 (10%)
Total	50 (100%)

When respondents were asked about the reason for acquiring a particular fund, most of the respondents indicated that they invested in a particular investment option relying on their agents, some of them invested because their friend made good money from a particular product, other opted for investment to save their taxes, their were very few respondents who invested in a fund after evaluating his investment needs on their own (Table 2).

Table 2 : Highest ranked reason for acquiring a particular investment	
Responses	Percentages
Relying on agents	30 (60%)
Friends reference	12 (24%)
Tax benefit	5 (10%)
Others	3 (6%)
Total	50 (100%)

Respondents were also asked about their satisfaction after investment and achievement of their goals. To our surprise most of the investors were unsatisfied with their investment and return pattern. Only few of them achieved their satisfaction level by their investment (Fig. 1).

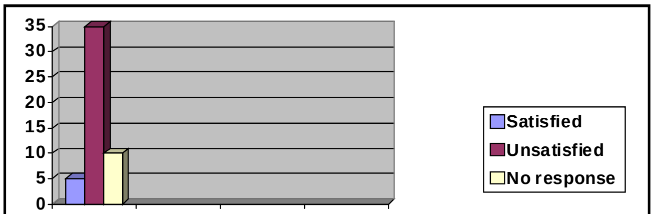

Fig. 1 : Satisfaction level after investment

When respondent were asked that which option they opted for investment, then most of the respondents replied that they opted to invest in one time investment very few respondents opted top-ups option for their investment, reason asked for opting one time investment pattern was shocking that most of the investors were persuaded by their agent for one time investment. As investors were unaware of such persuasion form agents for one time investment but main reason behind it was agents wanted to make money from the high premium of investor (Fig. 2).

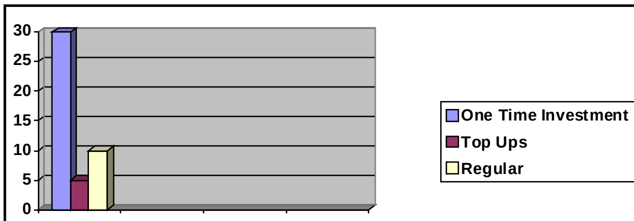

Fig. 2 : Premium structure

Typically they got about 18% of the premium investors pay and it did not stopped at just 18%, every year the agent gots a portion of the premium the investers paid. Typically, it tapered off to 5% in the second year and to 2% in subsequent years, becoming nil in some cases towards the end of the tenure. But till the time you kept paying premiums, the agent keeps making money. His incentive doesn't stop even if he had mis-sold the policy to you.

While the agents have nothing to lose if you opt out, you stand to lose money and your insurance cover if you do so.

Another question which asked to respondents that did they enjoy transparency in their investment. Most of the respondents who had invested in ULIPs were not enjoying transparency in their investment while others were quite satisfied with transparency of their investment product. But to my surprise none of the ULIP holder answered in yes (Table 3).

Table 3 : Are you enjoying transparency in your investment?	
Responses	Percentage
Yes	17 (34%)
No	30 (60%)
Others	3 (6%)
Total	50(100%)

The questionnaire asked to the respondent was what merit the wanted while investing in a particular investment. No clear reaction was gathered from this question as Indian investors are bit confused about their investment and have less financial knowledge. Replies on both the option were almost equal. But still there was large population of respondents who looked for the merit of return over transparency which was the main cause of mis-selling of ULIPs (Table 4).

Respondent were asked that what kind of product they would like to invest in (on what basis) they actually judge that an investment product is good or bad). Most of them were found relying on products which were being sold and

Table 4 : What merit do you want while investing in a particular investment option?	
Responses	Percentage
High returns over transparency and cost	27 (54%)
Low cost and transparency over high returns	23 (46%)
Total	50 (100%)

advertised more intensively. Awfully few of them rely on researching on their own about the investment products (Table 5).

Table 5 : On what factor do you rely while making an investment?	
Responses	Percentage
Products advertised more intensively	35 (70%)
Rely on your own research	15 (30%)
Total	50 (100%)

Respondents were asked that how frequently they got updates and were further adviced after investing by their agents. This question was included in questionnaire to judge whether the agents were working responsibly to their job in giving adequate information about their investment and regular updates about the investors investment or were they just concerned about their commission. Most of the respondents were found unsatisfied with services of their agents. Agents acted like sheep in the skin of wolf before investment but they hardly showed their concern about the hard earned money of the investor after receiveing their commission (Fig. 3).

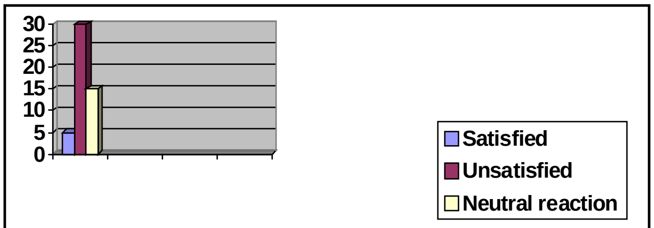

Fig. 3 : After sales services rendered by agents

Respondents were asked that were they aware of various costs attached with their investment and at what percentage their money was invested in a fund. Most of the respondents were found unaware about the loads attached with their fund (Table 6).

Table 6 : Are you aware about the front ended cost attached with your product?	
Responses	Percentage
Yes	10 (20%)
No	25 (50%)
Sort of	15 (30%)
Total	50 (100%)

Respondents were asked question did they think SEBI ban on 14 private insurance companies was in favor of investor or not? Since most of the respondents had already invested in ULIPs and due to terror of loosing their money in SEBI and IRDA tussle, the responses were influenced (Table 7).

Table 7: Is SEBI ban is in favor of investors?	
Responses	Percentage
Yes	20 (40%)
No	30 (60%)
Total	50 (100%)

Last question asked to respondents was that after the ban did they still trust ULIPs and wanted to choose ULIPs as their first choice for investment. Most of the replies were against ULIP even investors who had currently invested in ULIP had lost their trust on ULIPs.but still there were people who trusted ULIP over other investment option this was because Indian investors still rely on products which are sold and advertised more intensively (Table 8).

Table 8 : Do you think ULIPs are good investment option?	
Responses	Percentage
Yes	10 (20%)
No	40 (80%)
Total	50 (100%)

Recommendations:

India's investing public is made up of a large mass of financially illiterate people who obligingly buy whatever is being sold and advertised most intensively. This was the ULIP market, and they had been a rich source of funds for insurance companies and their agents. If the regulatory system is not overhauled, these are the people who will continue to gift away their hard-earned money to the insurance industry.

In India, the long-standing debate over the suitability of Unit Linked Insurance Plan (ULIP) and mutual funds can be resolved better with a proper understanding of the need of the investor. Mutual funds are essentially short to medium term products. ULIPs, in contrast, are positioned as long-term products with an element of life cover. It is pertinent to note that exposure of Indian households to capital markets is limited. It is important for an investor to understand his financial goals and horizon of investment in order to make an informed investment decision.

Product standardization is essential for Ulips. There has to be a way to compare performance, something that the mutual fund industry has successfully done.

Every financial product must explain its costs and risks. Charges, costs and returns are very important because they indicate the tangible benefits of a product.

There should be standardization terms and policy features so that comparisons between products become easier. Policyholders are now being ripped off by life insurers a term insurance policy is a better deal to get a term insurance policy and invest the rest of your money in other avenues such as mutual funds, fixed deposits, etc. Term plans are pure insurance plans in which the nominee of the policyholder gets the amount of the life insurance in case the policy holder dies.

Investors must understand their own profile to make the most of products that are meant to address a financial goal or need.

The product design should be simple and at least the default option should be easy and at low-cost. Only then should a product be allowed in the public domain.

Almost everyone is duly diligent about the mobile he buys, compares features and finally goes to the shop that offers the best discount. But when it comes to buying a financial product, most just say: I signed the document at the marked points.

Investor must consider two important factors: asset allocation and costs incurred to get the best allocation. Also the agents advice must be unbiased. If it is influenced by the company that is represented, it is not as advice but a sale.

The biggest challenge is to explain that they must understand their insurance needs before looking for a product. Often, I come across a consumer who wants a specific product from a specific company. The reason: a friend made good money from it. That this person is 40 and his friend is 25 and that they both had completely different financial needs and risk profiles are not considered.

Conclusion:

After the SEBI tussle with IRDA investors had lost their interest in ULIPs. Even the current investors were afraid of their investments in ULIPs. According to them who so ever win in this tussle they were concerned about safety of their investment.

ULIPs as a product wa not bad. The problem was because they sold as short-term products with a long-term insurance cover. If somebody is buying a ULIP and staying invested in it throughout the year, then it is a very good product. People pay compulsorily in an endowment policy. I would say that ULIPs should be made like an endowment policy. If there is a longer lock-in period, then it is always better for the client.

ULIPs have done an enormous contribution in directing some part of the long-term domestic savings to our capital markets. Even if these investments are coming at a high cost and in some cases without proper risk disclosures, yet this is perhaps one of the very few avenues through which a number of common investors are comfortable taking an exposure to the capital markets. Since capital markets still attract less than 5 per cent of the domestic savings and keeping in mind that a higher contribution from this segment will not only help in stabilizing our financial system but also assist common investors in combating inflation in the long run.

The need of the hour is fine balancing act between stringent regulation on one hand and encouraging investors to increase their insurance cover and putting a proper share of their long-term savings in the capital markets on the other hand.

Also, efforts on increasing investor education and awareness of concepts like financial planning and human life value must be initiated by the regulator in a structured manner very soon. Otherwise despite all good intentions the latest directive will end up harming instead of benefiting investors in the long run.

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