Business Standard

30 August 2021

Scrutinise costs before investing in Ulips

After the recent run up in equity markets, opt for a mix of equity and debt funds

SANJAY KUMAR SINGH

Demand for unit-linked insurance plans (Ulips) is on the upswing. A recent survey conducted by Bajaj Allianz Life Insurance found increased willingness among respondents to invest in Ulips.

Buoyant market driving demand

The key factor driving demand is the buoyancy in equity markets. "The performance of equity markets over the past months has led to renewed interest in Ulips," says Bharat Kalsi, chief financial officer, Bajaj Allianz Life Insurance. He adds that with interest rates at low levels, investors are looking for alternatives that can beat inflation, and hence have gravitated towards Ulips.

Traditionally, the high charges levied by Ulips had made them unattractive. Starting from October 1, 2013, the insurance regulator capped their charges. Since then, competition has driven these charges even lower. "Today Ulips offer customers a cost-effective route to save systematically for their long-term financial goals," says B Srinivas, head of products, ICICI Prudential Life Insurance.

Ulips allow customers to choose from various types of funds. "The customer can switch from one fund of the insurer to another. The auto-rebalancing feature is also available wherein money is automatically shifted to a debt fund closer to maturity," says Sanjay Tiwari, director-strategy, Exide Life Insurance. He adds that the availability of various types of funds allows investors to have proper asset allocation.

The tax deduction of up to ₹1.5 lakh in a year under Section 80C available on Ulips adds to their attractiveness.

Limited flexibility

While Ulips have become more attractive now than they were earlier, they are less flexible than a combination of term plan and mutual funds. "When you buy a bundled products like Ulip, you don't have the flexibility to change your insurance cover, especially when you wish to reduce it," says Vishal Dhawan, chief financial planner, Plan Ahead Wealth Advisors.

Another issue arises if the fund underperforms. "You can only move from one fund of the insurer to another. Until the five-year lock-in period ends, you can't move to another insurer with better-performing funds," adds Dhawan.

Withdrawal of money before five years is not possible. And if you are unable to contribute the annual premium due to shortage of funds, there are consequences.

Ulips are suited for some

Ulips make sense for certain types of investors. "Some find it difficult to save voluntarily. Ulips are a suitable product for them due to the need to pay the premium compulsorily," says Dhawan.

Even though term plans are best suited for covering the risk of premature demise, some investors are loath to invest in them as they normally don't pay any amount at the end of tenure. Such customers may opt for a Ulip, where they will get some insurance coverage at least.

Pay heed to costs

Two charges were particularly high in Ulips in the past—premium allocation and policy administration. Ensure that these charges are low in the policy you buy. The fund management fee should also not be exorbitant. (Ulip investors also have to bear a mortality charge.)

"The total of all fees in Ulips can range from 1-5 per cent of the premium, so check how much you will pay," says Indraneel Chatterjee, co-founder, Renewbuy.

Adds Dhawan: "Ensure that the sum total of premium allocation, policy administration and fund management fee is in the range of 1-1.5 per cent per annum."

Also be aware that only a certain number of switches may be free in a year.

Besides cost, compare past performance of the funds offered by insurers.

Monitor regularly

Enter Ulips with a horizon of 5-10 years or more. "Returns are healthy when investments are made with a long-term perspective," says Kalsi. Don't stop premium payments before three years. "The policy will only acquire a surrender value if you have paid the premium for three years," says Chatterjee.

Avoid recency bias. Do not extrapolate recent equity market performance into the long run. "After such a run-up, investors will be better off allocating to both equity and debt funds, instead of investing in an equity fund alone," says Dhawan.

Monitor your Ulips regularly. If a fund underperforms, move to a better alternative with the same insurer (most offer several funds). Keep an eye on asset allocation. Whenever the equity market is grossly overvalued, book profits in the equity fund and move to a debt fund.

Around two-three years prior to your investment goal, start moving money from the equity fund to a debt fund, so that a sharp correction in the equity market does not jeopardise your goal.

Finally, when selecting a low-cost Ulip, also evaluate the convenience offered by the digital platform of the life insurer. "You should be able to conduct transactions such as switching from one fund to another, accessing fund value, receiving receipts for premium paid, and even raising a claim digitally," says Srinivas.

HOW ARE ULIPs TAXED

I. If issued on or after Feb 1, 2021
If annual premium doesn't exceed ₹2.5 lakh, Section 10(10D) of IT Act will apply; any sum received is tax exempt, provided premium in any year didn't exceed 10% of sum assured (SA)

II. If issued after Apr 1, 2012 but before Feb 1, 2021
Any sum received is exempt under Section 10(10D), if premium in any year didn't exceed 10% of SA. New premium-related condition doesn't apply

III. If policy is not covered by Section 10(10D)
Taxation will depend on nature of Ulip fund

A. EQUITY-ORIENTED FUND

- At least 65% invested in direct stocks, or at least 90% in indirect equities (equity fund)
- Threshold holding period is 12 months
- Short-term (ST) capital gains: 15% tax rate
- Long-term (LT) capital gains: 10% tax rate, with ₹1 lakh exempted

B. NON-EQUITY FUNDS

- Tax treatment similar to debt funds

Source: RSM India