



# KARVY BAZAAR BAATEIN

**A Weekly Investment Newsletter From KARVY**  
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## The Choice between Traditional Policies and ULIPs

The unit linked insurance plans, or ULIPs as they are popularly known as, have been the darling of the insurance companies, intermediaries and importantly the insured population for a good number of years now. The main reason for this popularity lies in the combined twin advantage of the life insurance policy and mutual funds that these plans provide. While the life insurance cover provides the much needed security against the negative financial repercussions of an untimely death of the life assured, the savings component under the policy is able to participate in the capital markets for the creation of wealth over the usually long policy term, through a variety of investment funds available under the policy. Most of the unit linked insurance policy holders have preferred to opt for their savings being invested in the equity linked investment funds for the comparatively faster achievement of the wealth creation objective.

The glitter of ULIPs, where the maturity benefit is not limited or fixed (due to high return and risk potential of equities), has been one of main reasons for the insured or prospective insured to nearly forget about investing in the traditional savings-cum-insurance policies which offer a fixed maturity benefit.

Post January this year, however, the equity markets have been looked at with a sense of fear and contempt by majority of the investor population as the primary benchmark indices, the Nifty (for National Stock Exchange of India) and the Sensex (for Bombay Stock Exchange), in India have continued to lose a major portion of the investors wealth. And, with negative factors such as the slowing down of some of the major world economies, the global credit crisis and associated difficulties outweighing the positive factors, such as strong fundamentals of the Indian

economy being intact, there exist worries if one will ever be able to benefit from the equities again in the near future.

With this background, individuals who are looking at buying an insurance-cum-savings policy, will have a well-founded doubt of whether or not to still choose a unit linked insurance plan, or to go in for a traditional insurance policy with fixed maturity / survival benefits.

In this issue of Karvy Bazaar Baatein, we will look at a brief comparative analysis of these two plans and suggestions for the existing policy holders and the prospective policy holders.

### **ULIPs vs. Traditional Policies**

In this sub-section, we will be discussing some of the points that bring out the difference between ULIPs and traditional policies, which will help the investor form an opinion and thus a selection decision amongst these.

#### **1. Long term perspective:**

The life insurance policies are usually for long term duration and provide the critical life cover. The savings component of the policies (where so provided) aims at achievement of financial objectives of the policy holder either through wealth creation or provision of a regular income or both.

ULIPs look at the creation of wealth over the policy length, particularly on the basis of investments in equities and equity linked avenues.

Traditional policies (with a savings component) aim at the provision of regular income or a moderate capital appreciation through conservative investments aiming at capital preservation / protection.

*We at KARVY wish the readers of Karvy Bazaar Baatein a very happy and prosperous New Year 2009.*

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## 2. Investment Objective:

ULIPs primarily aim at the creation of wealth at a pace at least equivalent to that of the other popular investment avenues (i.e. equity, gold / bullion and real estate), if not more than these. The underlying objective here is the provision of an investment return that outpaces the cost of inflation. In other words, ULIPs aim at provision of a positive real return (gross return less inflation) for purpose of wealth creation.

Traditional policies have safety as the primary concern for investments as well. These policies invest in securities that are low on risk. As such, the rate of return that these policies provide may or may not exceed the inflation, but ensures sufficiency for the provision of regular income or moderate capital appreciation.

## 3. Risk and Return profile:

In case of ULIPs, the risk and return profile gets ascertained based on the investment funds that have been chosen by the policy holder. If the investment funds (as chosen by the policy holder) are predominantly equity oriented, the risk and return profile of the investments will be high. Alternately, if the investments are more debt oriented, this risk and return profile will automatically be low.

In case of traditional policies, the investments are done by insurance company in a conservative manner and mainly in debt oriented investment avenues so as to ensure capital protection. Here, the risk and return profile is low.

## 4. Promised benefits:

As in common knowledge, the benefits available under an insurance policy are available on the happening of a pre-determined event. This event could be an unfortunate one of the death of the life assured during the policy term, or the more optimistic event of the policy holder surviving at the end of the policy term.

In ULIPs, the death benefit could be fixed or variable as usually the higher of the sum assured or the investment fund value, or both of these are payable. The maturity benefit is always variable as it comprises of the investment fund value of the regular premium and the top-up premium (if any).

In traditional policies, the death benefit is fixed in the form of the policy sum assured. The maturity benefit here is also more or less fixed, comprising of the sum assured and terminal / reversionary bonus (if the policy is participating in the profits of the insurance company).

## 5. Charges:

ULIPs are known for a number of charges that are deductible from the premium and the fund value. The usual charges are premium allocation charge, policy administration charge, fund management charge, mortality charge, charges for fund switching / premium re-allocation, etc. (if any). These charges are usually specified in the policy document and prospectus.

In traditional policies, the charges are usually in-built and can be clarified mainly as on account of the provision of the life insurance cover (mortality charge) and policy servicing / administration. The policy document / prospectus, usually does not provide a mention of the specifications of these charges or the manner in which these are deductible.

## 6. Liquidity:

A life insurance policy being a long term contract and requiring a continuous financial commitment from the policy holder in the form of the regular premiums payable, the policy conditions usually provide for an element of financial liquidity to help the policy holder in times of need.

ULIPs usually have the provision of a partial withdrawal facility, wherein usually after the completion of minimum policy tenure, the policy holder can withdraw an amount from the existing investment fund(s), subject to the policy conditions in this regard.

Traditional policies also do provide financial liquidity to the policy holder through the facility of loan that can be availed based on the paid-up value of the policy at a given point of time. The loan is however subject to being made available depending on the policy conditions.

## Possible suggestions

### For existing policy holders:

Individuals who have already bought a unit linked insurance / child / pension plan, should look at continuing with these plans albeit with a slight modification on the investment allocation. At present, equity investments are still lying low and beaten down and at this stage it will not be appropriate to switch the existing (read remaining) investment value in the previously chosen equity linked funds to the safer debt oriented funds. This being so as the switch will result in the booking of losses by redeeming from equity investments at these market levels. As the insurance policies are for a long term period, the policy holder would still have time for the markets to recover the lost levels and the wealth.

Nevertheless, the policy holders can look at minimizing any further losses in equity linked investments by exercising the premium re-direction option and choosing the debt oriented investment funds for the purpose of allocation of the savings component of the future premiums. This premium re-direction option is usually available free-of-charge, subject to a limited number of re-directions in every policy year. With an improvement in the overall performance of the equities and equity based investment avenues, the premium allocation can again be modified to gain from the wealth creation potential of these avenues.

**For prospective policy holders:**

Individuals, who are looking at getting a life insurance policy with a savings component, either for themselves or for their loved ones, could consider the following factors before taking the final decision in this regard:

**(i) Purpose of savings:** If the main purpose for the savings is creation of wealth to provide a lump sum benefit at a future date, investments mostly in equities can be considered, especially when there is a considerable time frame remaining before the deadline for achievement of the wealth creation. For purposes of regular incomes, investments in debt oriented avenues should be looked at.

**(ii) Policy tenure:** Equities have the undisputed power of outperforming the returns from all the other asset classes (i.e. debt, gold, real estate, etc.) over the longer period of time that could be 5 years or more. And as such, equity based investments (through ULIPs) are preferable in the long term. In shorter term durations the equity returns could face great amount of volatility and could even be negative. Hence, short term investments should primarily be done in the debt oriented investments (through traditional policies) as these are more conservative and safe.

**(iii) Capacity to take risks:** The prospective policy holder should also take into consideration his own unique ability and capacity to take risks with respect to investments. The factors that could be considered in determination of this ability include the outstanding liabilities (such as a home loan) that need to be repaid, definite and substantial financial outflows (daughter’s marriage) that will need to be incurred in future and the extent of dependency of family members on the income of the life assured or the head of the family.

**Important:** We will recommend the readers to consult their financial advisors for the exact investment strategies and decisions that will be suited to their respective unique financial profile and requirements.

## Product Showcase – Met Growth

Met Growth is a unit linked insurance policy from MetLife India Insurance Company Limited. The policy aims at the creation of wealth to support the income during the post retirement years as well as provides for the necessary life insurance cover. This is a non-participating policy.

**Unique features**

**Guaranteed loyalty additions:** First year premium under the policy is utilized for the provision of the guaranteed loyalty additions. These additions are expressed as a percentage of the first year premium and are added at the end of the 10th and 15th policy year. At the end of the 10th policy year, the loyalty additions equivalent to 50% of the first year premium will be added to be investment fund(s). At the end of the 15th year, depending on the annualized premium value, the additions will be as per the below table:

Annualized premium value	Guaranteed Loyalty Additions as a % of first year premium value
Silver (Rs.12,000 to Rs.25,000)	55%
Gold (Rs.25,001 to Rs.2,00,000)	60%
Platinum (Rs.2,00,001 & above)	70%

Further, the guaranteed loyalty additions calculated at the rate of 2% of the average fund value\* of the regular premium account are also added at the end of the 20th policy year and every five years thereafter.

\* The average fund value is the average of the fund value of the last 36 monthly anniversaries preceding the due date after monthly deductions preceding the loyalty addition calculation.

The guaranteed loyalty additions would be allocated to the chosen investment funds in the same proportion as the existing premium allocation instruction of the policyholder at the time of additions. The fund value pertaining to top up premiums is not eligible for loyalty additions.

**Top up premium:** Top up premium can be paid to enhance the investment fund value. The minimum top up premium amount is Rs.5,000. The sum assured would also be increased by 125% of the top up premium on each such payment. Any top up premiums paid would not be eligible for partial withdrawals for three years from the date of such payment.

## Policy benefits

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**Death benefit:** In the unfortunate event of death of the life assured during the policy term, the nominee / beneficiary will receive the higher of the fund value or the sum assured (less partial withdrawals as applicable).

If the death of the life assured happens before attaining 7 years of age, and:

(a) If death happens before completion of one policy year, then all the regular premiums received till date of death will be paid back without interest.

(b) If death happens after the first policy anniversary, the death benefit payable will be the fund value plus the amount equal to the regular premium paid in the first policy year.

**Maturity benefit:** At the end of the policy term, the investment fund value including the guaranteed loyalty additions are paid to the policy holder.

The maturity benefit payment can be received by the policy holder as a lump sum amount or in installments ranging to maximum of 5 years from the policy term end under the settlement option.

## Eligibility parameters

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**Age at entry:** minimum – 3 months; maximum – 60 years

**Maximum age at maturity:** minimum – 18 years; maximum – 75 years

**Policy term:** minimum – 15 years; maximum – 30 years

**The policy term options available are:** 15 years, 20 years, 25 years and 30 years

**Sum assured value:** minimum – 5 times the annual premium value; maximum – 20 times the annual premium value. For entry age of 55 years and above, maximum sum assured is only 5 times the annual premium value.

**Premium payment term** is the same as the policy term

**Minimum annual premium amount:** Rs.12,000

**Premium payment frequency:** annual, semi-annual, quarterly and monthly

## Investment fund choice

Policy provides the choice of 5 investment funds. Any one of these or a combination of these two or more of these funds can be opted for to customize the asset allocation under the policy as per ones unique investment requirements. In case of a combination of investment funds, a minimum allocation of 20% is necessary in each of the chosen funds. The allocation in the chosen investment fund(s) starts from the second policy years onwards. The details of the investment funds are:

Fund name	Investment objective	Risk return profile	Asset allocation in				
			Equities	Money market instruments	Long & short term bonds	Government securities	Infrastructure / Social sector securities
Multiplier	To generate long term capital appreciation by investing in diversified equities	Very high	80% to 100%	0% to 40%	0%	0%	0%
Virtue	To generate long term capital appreciation by investing in diversified equities of companies promoting healthy lifestyle and enhancing quality of life.	High	60% to 100%	0% to 40%	0%	0%	0%
Balancer	To generate capital appreciation and current income, through a judicious mix of investments in equities and fixed income securities	High to moderate	35% to 65%	0% to 40%	0% to 60%	10% to 60%	0% to 60%
Protector	To earn regular income by investing in high quality fixed income securities	Low	0%	0% to 40%	0% to 60%	25% to 90%	0% to 60%
Preserver	To generate income at a level consistent with preservation of capital, through investments in securities issued or guaranteed by Central and State Governments	Very low	0%	0% to 40%	0%	80% to 100%	0%

Policy provides the option of re-directing or changing the premium allocation pattern to suit the change in the investment and financial requirements of the policy holder. This re-direction will be subject to condition of minimum allocation of 20% of the premium in each of the funds chosen. One premium re-direction option is available free-of-charge in every policy year. Subsequent re-directions in a policy year will be charged for.

Policy also provides the option of switching the investment value from one fund to the other either partially or fully. There are 12 free-of-charge switches in a policy year. The minimum value of s switch is Rs.5,000.

## Policy charges

The first year premium is utilized towards the provision of the guaranteed loyalty additions. The premium being allocated to the investment fund(s) chosen, from the second year onwards, the policy charges are also levied from the second year. The details of these charges are:

**Premium allocation charge:** This charge is nil and hence results in a 100% allocation of the premium to the chosen investment funds. However, the premium allocation charge for top up premiums is 3.50%.

**Policy administration charge:** This charge is a percentage of the sum assured and would be deducted every month from the fund value from the 2nd year onwards. Policy administration charges will be waived in the first year. This percentage will also depend on the annualized premium value. The details for the charge are:

Annualized premium value	Policy administration charge as a % of the sum assured (S.A.) when S.A. is		
	5 times the annualized premium	10 times the annualized premium	20 times the annualized premium
Silver (Rs.12,000 to Rs.25,000)	0.225%	0.1125%	0.05625%
Gold (Rs.25,001 to Rs.2,00,000)	0.15%	0.075%	0.0375%
Platinum (Rs.2,00,001 & above)	0.10%	0.05%	0.025%

Insurance company reserves the right to increase the charge to 0.33% with prior approval from IRDA.

**Fund management charge:** This charge is levied for the management of the investment fund(s) chosen and are expressed as a percentage of the fund value managed. The details are:

Fund	Multiplier	Virtue	Balancer	Protector	Preserver
Fund management charge	1.75% p.a.	1.75% p.a.	1.50% p.a.	1.25% p.a.	1.25% p.a.

Insurance company reserves the right to increase the charge to 2.50% with prior approval from IRDA.

**Mortality charge:** This charge will be levied, for the provision of the life assurance cover, from the second year onwards. It will be deducted at the beginning of each month by cancellation of an appropriate number of units. No mortality charges are levied in the first policy year. The indicative mortality charge per Rs.1,000 of sum assured is:

Gender	Age of life assured		
	20 years	30 years	40 years
Male	0.134667	0.147542	0.254167
Female	0.124667	0.146875	0.213083

**Surrender charge:** This charge is expressed as a percentage of the annualized premium and is deducted from the fund value to arrive at the surrender value payable. As policy surrender is not permitted during the first three policy years, the surrender charge is not applicable in these first three years.

Number of years for which premium has been paid	Surrender charge as a % of the first year premium	
	In policy year 4	In policy year 5
Less than one	Not applicable	Not applicable
One to less than two	75%	Not applicable
Two to less than three	15%	15%
Three or more	10%	5%

The surrender charge will be nil if the surrender is opted for in the sixth year or later on with three or more years premium having been duly paid.

**Switching charge:** A subsequent switch after 12 free-of-charge switches in a policy year will be charged at the rate of Rs.250 per switch.

Insurance company reserves the right to increase the charge to Rs.750/switch with prior approval from IRDA.

**Partial withdrawal charge:** A subsequent partial withdrawal after first two free-of-charge withdrawals in one policy year will be charged at the rate of Rs.250 per withdrawal.

Insurance company reserves the right to increase the charge to Rs.750/switch with prior approval from IRDA.

**Miscellaneous charge:** The insurance company has the option to charge Rs.250 for alterations like premium redirection (the subsequent one after first free-of-charge redirection in a policy year) and reinstatement of the policy.

Insurance company reserves the right to increase the charge to Rs.750/switch with prior approval from IRDA.

## Policy surrender

Policy surrender can be opted for after the completion of first three policy years. The surrender value is as available after the deduction of the surrender charge detailed in the 'policy charges' section.

## Partial withdrawal

The partial withdrawal facility provides financial liquidity to the policy holder to enable him / her to meet the intermittent financial needs. The facility is available after the life assured attains 18 years of age and after the completion of first three policy years. The minimum amount of a partial withdrawal is Rs.5,000.

The minimum fund value remaining after the partial withdrawal should be equal to 120% of the annualized regular premium. The current limit on the maximum partial withdrawal is restricted to 10% of the fund value in a policy year. This limit shall apply only during the first 15 policy years. First two partial withdrawals are free-of-charge in one policy year.

## Tax benefits

Premium paid under the policy is eligible for deduction under the provisions of Section 80C of the Income Tax Act, 1961. Policy benefits are exempt from tax under Section 10(10D) of the Act.

**Important:** In this policy, the investment risk in the investment portfolio is borne by the policy holder.

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