

# Assure returns on insurance products?

## It helps mis-selling of insurance products

**T**WO or three products in the market recently were such that they offered a minimum NAV of par (Rs 10) at the end of the term and promised to lock in the highest unit price observed over the first 84 months on the equity markets. Another product gave a guaranteed tax-free return compounded at 7.2% p.a. A third product gave a guarantee of 9% or 10% for a five or ten year terms, respectively.

All of these products, along with some others with similar guarantees, seem to be catering to the need of the moment — i.e., to give comfort and safety of principal along with guarantees. After the recent bloodbath that investors experienced in equity markets, such guarantees seem god-sent. This option seems even more lucrative if we factor in the fact that proceeds from insurance are tax-free. Since these are insurance policies, there is a life cover also attached to the policy. These features seem almost too good to be true. A serious concern, however, is the moral hazard of positioning an insurance product as an investment product since it opens doors to mis-selling. It is comparatively easier for an insurance advisor to pitch tax-free returns with added insurance compared to plain vanilla insurance product. Besides, an investment-oriented insurance policy such as a unit linked insurance policy (ULIP) affords a higher commission to the insurance advisor as well.

The critical point to debate is: who is providing the guarantee? Is it the insurance company or Insurance Regulatory and Development Authority (IRDA) or the insurance company under IRDA guidelines? Besides, what happens if despite the mandated solvency margins that insurance companies are required to maintain, it goes belly up? In such a situation, who would guarantee the payment returns to the investor which forms a part of the policy terms?

In a nutshell, by developing such guaranteed return products, insurance companies are able to charge a higher expense, thus adding to the bottom line of the firm, the insurance advisor is happy because his commission rates are higher, the customer is also happy especially in the present times of equity unrest. So no one's complaining except the author who believes this to be a moral and ethical dilemma.

*(The writer heads Wealth Management Solutions)*

## Current economic environment demands it

**S**OME of the recent guaranteed return products have evoked mixed response from stakeholders. Customers have welcomed the move as they are assured of some return on investments. Companies realise that guarantees are expensive and risky in a volatile economy, but out of regard for customer preference have gone for such products. Regulators have always frowned on any kind of guarantees as these have been the undoing of many financial institutions.

Why should there be guarantees at all? Can one be absolutely clinical about it and say let the market forces decide the safety of capital and returns? To find an answer one needs to look at the Indian economic environment and cultural ethos of strong family bonding, heavy social expenditure that even lower and middle-class families are obliged to provide for and high inflation rate. There is complete absence of any social security system, with nearly 90% of population being without any pension coverage. The cost of guarantees can be quite significant but any cost benefit analysis has to be done keeping in view these factors.

The current economic environment has also to be factored in. Investors have suffered loss of capital and low or negative returns in the past one year. The flow of retail savings in mutual funds and financial sector have dried up. People have become risk averse. Life insurance companies have been less impacted because of regulatory oversight, long-term nature of products and strong capital to support liabilities. Little sop to retail investors in terms of guaranteed products can bring the retail investor to the fold of life insurance and other players in the financial market. However, guarantees have to be low and not extend beyond a certain term, say for five years or so. This initiative of life insurers would only supplement the efforts of the government to revive the economy. Notwithstanding the above, guarantees certainly can not be a long-term solution and have to be eased out gradually.

One can not also ignore the fact that the guaranteed products are more tax efficient for insurance companies. To sum up, some guarantees may not be out of place in the current savings environment with effective monitoring by the regulator. *(Views are personal)*

## FACE-OFF



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