ULIP Mis-Selling: Steer Clear of These Common Traps

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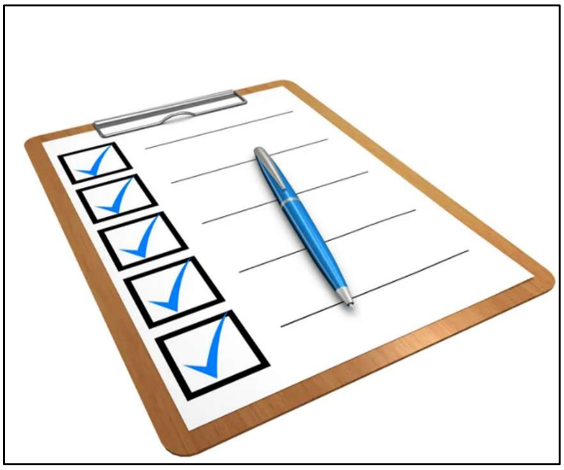
Published on: 12th May 2024



Like any product, every financial product serves a purpose to some people but not for all. For example, a heater has a purpose, but it makes no sense to someone who wants to cool his room. In case a heater is sold to such a person in the guise of something else, it is mis-selling.

Financial products are often mis-sold. But the most mis-sold financial products are Unit Linked Insurance Plans (ULIPs).

ULIPs are nothing but a product that combines investment and insurance. A part of the premiums you pay are used to get you a life cover and the rest is invested in market linked products such as equities or bonds.

ULIPs take the cake as far as mis-selling of financial products is concerned.

The Most Mis-sold Financial Product

'"By nature, ULIPs are 'push" products and there are two major channels by which ULIPs are sold, banking and individual agents and both are commission- driven. Plus, lack of awareness and lastly the way it is trained in the industry are reasons why ULIPs are mis-sold. Its real benefits are rarely getting trained and rather training is done on how to sell, rather than how to know and present suitability," says Viresh Patel, founder and CEO, Financial North, a financial planning firm. In fact, ULIPs can have up to 40 per cent agent's commission in the first year.

Common Mis-selling Spiels

There are various marketing pitches used to mis-sell ULIPs. Here are some of them.

Guaranteed Returns: Since they are linked to the markets, ULIPs do not guarantee returns but its performance is tied to the funds you choose. "Also, recency biases are taken advantage of as the returns in the more recent past could be very good due to equity markets having done well, and thus ULIPs that had more equity could have gained from this in the more recent past. However, investors need to be aware that returns are likely to normalise over a period of time," says Vishal Dhawan, CEO and founder, Plan Ahead Wealth Advisor, and a Securities and Exchange Board of India (Sebi) - registered investment advisor.

Referred To as Mutual Funds: ULIPs are often sold in the guise of mutual funds. "They are often referred to as mutual funds as they also declare a NAV and investors may not understand the difference," says Dhawan. But unlike a mutual fund ULIPs can have high charges and fees. Also, you are paying for life cover, which is best taken through purchase of a term plan.

Not Mentioning the Lock-in Period: ULIPs have a lock-in period of five years. "ULIPs often have lock-in periods, typically of five years, where you cannot withdraw your money without facing significant surrender charges. For example, imagine a senior citizen who is convinced to invest in a ULIP with a high equity allocation, promising high returns," says Tarun Birani Founder and CEO, TBNG Capital Advisors. A senior citizen may be in trouble if he cannot withdraw his investments when required and they are most often victims of ULIP mis-selling.

Efficient Tax Saving Option: "There are some tax advantages of ULIPs, such as a tax-exempt maturity benefit under certain conditions. However, these benefits might be overstated or not applicable to your specific tax bracket or investment horizon," says Birani.

For example, if the total premium you pay for an ULIP is Rs 2.5 lakh or more in any of the previous years or if the total premiums you pay for multiple ULIP policies are more than Rs 2.5 lakh, then it is taxable on maturity. Also, premiums paid for ULIPs are exempt up to Rs 1.5 lakh under section 80C, but if you have other 80C tax savers in place, you cannot claim the entire exemption.

So, even though ULIPs provide tax saving, it may not be suitable to your profile.

Better Than FDs: Yes, ULIPs have the potential to give better returns than fixed deposits (FDs), but there is no guarantee of that. If someone is looking for fixed returns, FDs are a better option.

How to avoid the mis-selling trap

Here are some ways to avoid falling into the ULIP mis-selling trap.

Don't Mix Investment and Insurance: First stay away from any product that mixes insurance and investment and that includes ULIPs.

Ask Questions: "Don't hesitate to ask questions and seek clarifications related to fees, charges, surrender charges, and the risk profile of the ULIP," says Birani. All these should be explained properly before you buy any financial product.

Do Your Research: Don't rely solely on the information provided; independently research the product. Look for information from reliable sources such as the websites of financial regulators or independent financial advisors.

Never Buy for Sake of Buying: Do not buy an ULIP under pressure. "Never buy any insurance (Forget ULIP) from any known or relative, for their target or your relation's sake, especially if they are unprofessional and casual while they are talking about such lifetime important products to you," says Patel.

All in all, stay away from ULIPs unless and until it suits you. Getting a term cover and investing in mutual funds is always a more prudent option.