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Insurance, mutual fund returns aren't comparable

Given the complexity in the cost structure of insurance schemes, it is almost impossible to make an apple-to-apple comparison

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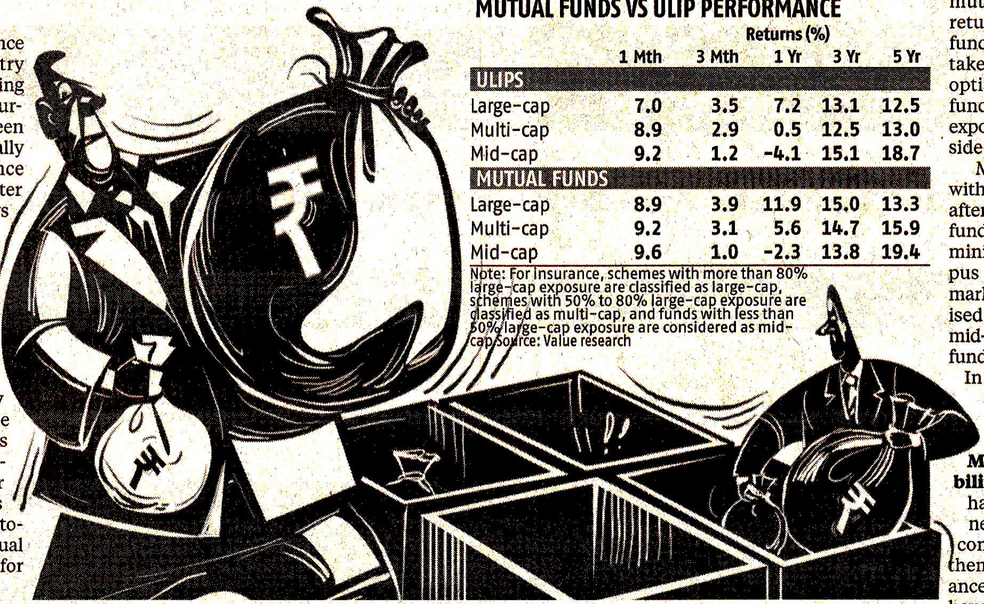
In recent times, many insurance fund managers and industry experts have started comparing returns of mutual funds and insurance schemes. The pitch has been that insurance schemes, especially online unit-linked insurance schemes (Ulips), have given better returns than mutual funds. Says Yashish Dahiya, co-founder and CEO of PolicyBazaar.com: "Over the long term, around 85 per cent of the charges in a financial product consists of fund management charge. Whereas mutual funds charge an annual expense ratio of 2.25-2.5 per cent, online Ulips only charge 1.35 per cent. A difference of one percentage point creates a huge difference over a 10-15-year horizon when you consider compounding." However, it is not possible to do a pure apple-to-apple comparison between mutual funds and insurance schemes for several reasons.



MUTUAL FUNDS VS ULIP PERFORMANCE

	Returns (%) 1 Mth	3 Mth	1 Yr	3 Yr	5 Yr
ULIPS					
Large-cap	7.0	3.5	7.2	13.1	12.5
Multi-cap	8.9	2.9	0.5	12.5	13.0
Mid-cap	9.2	1.2	-4.1	15.1	18.7
MUTUAL FUNDS					
Large-cap	8.9	3.9	11.9	15.0	13.3
Multi-cap	9.2	3.1	5.6	14.7	15.9
Mid-cap	9.6	1.0	-2.3	13.8	19.4

Note: For insurance, schemes with more than 80% large-cap exposure are classified as large-cap, schemes with 50% to 80% large-cap exposure are classified as multi-cap, and funds with less than 50% large-cap exposure are considered as mid-cap Source: Value research

Cost is not the only factor: The new-age online Ulips have done away with policy administration and policy allocation charges. They levy fund management and mortality charges. Some insurers also add 1 per cent of the annual premium to the fund from the fifth year onward, though it's not a significant amount. So, many online Ulips are charging between 1.25 per cent and 1.35 per cent as cost. Mutual funds, on the other hand, are purely transparent. Smaller funds, with a corpus of up to ₹750 crore, are allowed to charge between 2 per cent and 2.25 per cent. However, most of the big schemes (over ₹5,000 crore) cannot charge more than 1.5 per cent annually. Direct plans have even lower charges. And if you are an index fund investor, the expense ratio could be even less than 1 per cent.

Decoding returns: Theoretically, insurance funds have the potential to offer better returns as they receive long-term money. But that's not the case. According to Edelweiss Tokio Life Insurance, the average five-year return of equity large-cap insurance funds is 12.9 per cent annually. For mutual funds, the category average returnof large-cap funds is around 13.2 per cent for the period. According to data from Value Research, the five-year average return from the mid-cap category of insurance funds is 18.7 per cent, whereas for mutual funds it is 19.4 per cent. "It's difficult to say that one product has done better than the other. Both insurance and mutual funds have schemes that are well-managed and have done exceptionally well, and vice versa," says Anup Seth, chief retail officer, Edelweiss Tokio Life Insurance.

What if an investor has to choose between the two, based on performance? "At present, it would not be possible. Only a few insurance companies disclose complete details about their funds. Many only provide limited disclosures as mandated by the insurance regulator," says Kaustubh Belapurkar, director, fund research, Morningstar India.

In mutual funds, performance is the only criterion for selection. But an individual opts for Ulips for various reasons. Some buy it for tax savings, insurance, product features or for long-term investments. "While fund performance is an important criterion in choosing a Ulip, it's not the only reason why someone would opt for it," says Prashant Sharma, chief investment officer (CIO), Aviva Life Insurance.

Similar but with many differences: While insurance funds and mutual funds invest in the same instruments, there's a lot of difference in the regulations that govern their investments. "Insurance companies, for example, need to cap their exposure to banking, financial services and insurance (BFSI) segment to 25 per cent of their total exposure in a fund," says Akhilesh Gupta, CIO, Reliance Nippon Life Insurance Company. Mutual funds only have stock-related restrictions. If there's a rally in the stock market led by the banking sector, mutual funds will give better returns compared to insurance funds. Mutual funds are allowed to take exposure in futures and options (F&O), which insurance funds cannot. In a volatile market, exposure to F&O can protect downside risk.

Mutual funds now need to stay within their mandate all the time after re-categorisation. A mid-cap fund, for instance, needs to have a minimum of 65 per cent of the corpus in mid-cap companies. The market regulator has also standardised the definition of large-caps, mid-caps and small-caps. Insurance funds don't have such restrictions. In times of volatility, mid- and small-cap insurance funds can increase large-cap exposure.

Matter of transparency, flexibility: Many investment advisors have pointed out that insurers need to be more transparent. For competitive reasons, many of them don't disclose the performance of their funds entirely. Some have turned down requests from wealth management companies to meet the fund management teams in order to understand the investment philosophy and processes followed by them. In many Ulips, investors find it difficult to understand how the charges are levied. When an insurer takes premium, some part of the fees, such as policy allocation charges, is deducted upfront. The rest of the money is added to the fund. Then, every month, mortality charges and policy administration charges are adjusted in the net asset value (NAV) of the fund, which makes it difficult for an investor to understand the charges.