THE ECONOMIC TIMES

Go for NAV Guarantee Plans if You Can't Digest Fluctuations

Expert Take

Mario Perez
DIRECTOR – SALES, MARKETING & PRODUCTS
Canara HSBC Oriental Bank of Commerce Life Insurance Company

Products with highest NAV guarantee have gained in popularity and have been one of the best-selling Ulip (unit-linked insurance plan) products in recent times. Such products have been available for three years and several life insurers have offered or are offering some form of NAV-guarantee (NAVG) Ulips. However, these products are relatively less understood than regular Ulips.

Unit-linked products with guarantees, such as NAV guarantee plans, are suited for investors who are aware and understand the concepts of units, net asset value (NAV) and the nature of investment funds. Typically, such customers have the experience of investing in mutual funds, equity or other Ulips and are aware of the risk-return tradeoff in such products.

Customers who have invested in pure equity funds and are aware of the fluctuations of NAVs sometimes prefer NAVG funds/products in their portfolio because such products guarantee the highest NAV achieved. It also mitigates to some extent the risk of volatile fund NAV impacting the maturity value of the product. One has to keep in mind that the highest NAV of such products is not the same as that of a pure equity fund. NAV guarantee Ulips typically invest in a mix of equity and debt and, hence, their NAVs are similar to those of a balanced fund rather than of a pure equity fund.

How can guarantees be provided on investment funds? Typically, any form of investment guarantee in the Indian market is provided only on funds that have some component of risk-free (ie, debt) assets in the fund, and not on a pure risky asset (eg, equity), which can theoretically have any unit price depending on the market price of the asset.

In any NAV guarantee product, the guarantee is only applicable at the maturity of the policy, typically 10 years from inception. The highest NAV achieved during the tracking period (which could be say 7 to 10 years) from the inception is computed and if this is higher than the maturity NAV, then the highest NAV is used to determine the maturity amount.

How does this work? At any point of time, the company invests in a mix of debt and equity according to an algorithm. The algorithm ensures that the ratio of the risk-free asset and the risky asset at any point is such that the maturity guarantee amount (which is the highest NAV reached so far) can be delivered to the customer using the debt portion – assuming the equity investments fluctuate within some limits. So, as long as the equity market fluctuation is within limits, the model will continue to tweak the balance of equity and debt to help deliver the maturity guarantee.

What happens in case there is a very sharp fall in the equity market or a very sharp decrease in bond yields? In such cases, it is possible that to safeguard the guaranteed maturity amount, the fund may need to shift completely to debt and it may then not be able to invest in equity again. In such a "lock-out" situation, the guarantee will still be delivered but the fund will no longer participate in the equity market.

Hence, such products provide a mix of both worlds – they allow for an upside to the investment through participation in equity, while ensuring that the NAV achieved by the fund is 'locked in' for maturity return.

So, the final actual return in such a fund depends on the proportion of the equity and debt components as per the algorithm used by the company, and also on the way the risky asset (equity) has moved during this period. So far, none of these funds has reached maturity, so it is difficult to use past performance as a barometer.

This fund may be appropriate for you if:

- You are comfortable investing in equity and debt funds and understand NAV.
- Understand the risk-returns of these asset classes but are concerned about volatility.
- You are looking for a tenure of at least 10 years.
- You are willing to live with reduced potential upside from pure equity, in return for having the guarantee of the highest NAV of a fund that would perhaps move similar to a balanced fund.