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UNIT – I

Personal Financial Management

Every woman is doing cash budgeting or capital expenditure in her lifetime and every man is doing business or investment in his life. Still there is a lack of awareness about personal financial management. Even if there is some awareness, there is a lack of will to follow the personal financial management process. Because of this, people might fail to take better and efficient personal financial decisions. Financial illiteracy is impacting financial decision making.

Finance is an integral part of everyone's life and financial principles are based on pure and simple common sense. The ability to take financially intelligent decisions is financial management. Financial management is the ability to understand the impact of every financial decision on net worth and to ensure that all those actions should be undertaken that will strengthen it and do nothing that weakens it.

Managing personal finances is essential to one's financial wellbeing. Money management is a critical function in self-management. It aims to give the power and the knowledge to take control of the money. It provides the means to keep track of personal expenses, personal debt and subsequently helps in calculation and enhancement of personal net worth.

Personal financial management can be defined as the management of the finances of an individual, in order to achieve his/her financial goals including long-term financial security. It is concerned with procurement and utilization of funds for an individual. It is concerned with efficient planning and controlling of the financial affairs, budgeting,

financial forecasting, cash management, credit administration, investment analysis, and fund management and so on. It helps individuals determine the past performance, predict future performance, and assess the capability of generating future cash flows.

Twelve Principles of Personal Financial

1. **Know Your Take-Home (Net) Pay** - Before committing to significant expenditures, estimate how much income is likely to be available to you after all mandatory deductions.
2. **Pay Yourself First** - Before paying bills and other financial obligations, set aside an affordable amount each month in accounts designated for long-range goals and unexpected emergencies.
3. **Start Saving Young** - Recognize that your total savings are determined both by the interest you earn on savings and the time period over which you save.
4. **Compare Interest Rates** - Obtain rate information from multiple financial services firms to get the best value for your money.
5. **Don't Borrow What You Can't Repay** - Be a responsible borrower who repays as promised, showing that you are worthy of getting credit in the future. Before you borrow, compare your total payment obligations with income that you will have available to make these payments.
6. **Budget Your Money** - Create an annual budget to identify expected income and expenses. Including savings. This will serve as a guide to help you live within your income.
7. **Money Doubles By "The Rule of 72"** - To determine how long it will take your money to double, divide the interest rate into 72. For example, an account earning 6% interest will double in twelve years (72 divided by 6 equals 12).
8. **High Returns Equal High Risks** - Recognize that no one will pay you high interest rates on a sure thing. In most cases, the higher the interest rate offered, the higher the risk of losing some, or all, of the money you invest. Diversification is the best hedge against investment risk.
9. **Don't Expect Something for Nothing** - Be leery of advertisements, sales people, or other sources of financial offers promising anything free or guaranteed investment returns. Like non financial opportunities, "if it sounds too good to be true, it probably is."

10. **Map Your Financial Future** - Take time to list your financial goals, with a specific time deadline and dollar cost, and develop a realistic plan for achieving them.
11. **Your Credit Past Is Your Credit Future** - Be aware that credit bureaus maintain credit reports, which record borrowers' histories of repaying loans. Negative information in credit reports can affect your ability to borrow at a later point.
12. **Stay Insured** - Purchase insurance to avoid being wiped out by a financial loss, such as an illness or accident. An insurance plan should be part of every personal financial plan.

Time Value of Money (TVM)

The time value of money (TVM) is the concept that money available at the present time is worth more than the identical sum in the future due to its potential earning capacity. This core principle of finance holds that provided money can earn interest, any amount of money is worth more the sooner it is received. TVM is also sometimes referred to as present discounted value.

The time value of money draws from the idea that rational investors prefer to receive money today rather than the same amount of money in the future because of money's potential to grow in value over a given period of time. For example, money deposited into a savings account earns a certain interest rate and is therefore said to be compounding in value.

KEY TAKEAWAYS

- Time value of money is based on the idea that people would rather have money today than in the future.
- Given that money can earn compound interest, it is more valuable in the present rather than the future.
- The formula for computing time value of money considers the payment now, the future value, the interest rate, and the time frame.
- The number of compounding periods during each time frame is an important determinant in the time value of money formula as well.

Time Value of Money Formula

Depending on the exact situation in question, the time value of money formula may change slightly. For example, in the case of annuity or perpetuity payments, the generalized formula has additional or less factors. But in general, the most fundamental TVM formula takes into account the following variables:

- FV = Future value of money
- PV = Present value of money
- i = interest rate
- n = number of compounding periods per year
- t = number of years

Why Personal Finance

The main purpose of personal finance education is to positively influence financial behaviour. It has been observed that such education is delivered more effectively to younger children than to their older counterparts. Knowledge of personal finance is beneficial for everyone in many ways.

Make your own financial decisions

An understanding of personal finance helps you take informed decisions about your financial situation. When you spend money on a particular thing you are giving up something else. For example, if you purchase a book for `. 500/- you are sacrificing maybe, a video game of the same amount or you could have saved that money for the future. There are various alternatives which you could have considered and you have to choose one and forgo the others. What you give up as a result of your buying decision is what we call opportunity cost.

Evaluate the advice of financial advisors

You may have come across various insurance agents, trying to sell policies or agents for different mutual funds. If you are aware of financial matters then it becomes easy to assess the various alternatives given by financial advisors. Financial advisors usually give you advice and guide you on your savings and investment. They may sometimes make false claims and guarantee high returns on particular investments. Your understanding of personal finance will enable you to determine whether their advice is in your best interests or theirs.

Become a financial advisor

There are many people who do not understand financial matters or are not interested in taking financial decisions at all. At times, many employees go on paying high taxes because they do not know that by investing in certain securities or contributing to their provident funds they may save on taxes. There is a demand for financial advisors and a course in personal finance or other finance related courses can help you pursue a career as a financial advisor. They usually charge a commission on the amount of investment made from the source of the securities, for example, the post office or the company connected with the mutual funds. At a later stage, if they are enterprising and have a good understanding of financial matters they get paid for their specialised knowledge.

Instilling Financial Discipline

All of us need to be disciplined when it comes to spending money. If you have to live with a limited income your expenses have to be regulated. Same is true for your pocket money; you have to make sure your money lasts through the whole month. Parents have to make sure that the money is not misused and is judiciously spent.

Preparing a financial plan - PRACTICAL CONSIDERATIONS

Each individual or family is different so will have their own financial plans. One cannot expect to have same financial plan as another even if two people are earning the same salary. This is because financial situations and risk taking ability are different. Suppose a person already has to pay a housing loan instalment (EMI) and take care of other personal responsibilities, then his risk taking ability would be much lower than a person who does not have to repay a loan.

How exactly do you go about preparing a financial plan?

- Assess your finances. Make a list of your bank accounts, investments, fixed deposits, mutual funds, shares etc.
- What are your expenses per month? How much do you spend on rents or instalments (EMIs), your kids' education, monthly kitchen expenses and so on. You will be able to understand where you are with respect to your income, expenses and savings.
- Now the next step would be to list down your goals which could be short term, medium term or long term.

  Your short-term goals could be buying a car or going on a vacation, let us presume in the next 5 years.

  Your medium-term goals could be your child's education, buying a house, or setting up your own business. This could be planned for may be 10-15 years.

  For long-term goals you could plan for 20 years after and think of retirement, clearing all loans and keeping some money aside for emergency.
- There are three parameters which you have to consider –time, money you can save and the rate of return.
- Based on your goals and your risk taking ability, you can diversify your money among different asset categories such as shares, bonds, fixed deposit and cash.

Source: The Economic Times

Components of a Financial Plan

In a financial plan there are personal finance decisions related to six major areas.

i) Budgeting

ii) Managing your money

iii) Financing large purchases

iv) Protecting assets

v) Investing money

vi) Planning your retirement

vii) Tax Planning

Budgeting

We have heard people say that spending is going out of our budget. What is a budget? A budget is a statement of your income, expenses and saving. Budgeting therefore, is the process of forecasting future income and expenses for a given period. The surplus shown in your budget would be savings. Savings may be less or more depending upon how much you spend. Budgeting can therefore help you estimate how much of your income is required for monthly expenses and how much you will be able to save each month. You may use your saving for investing in bank deposits or in the financial markets or purchasing an asset such as a car or paying off your loan. Budgeting is a process where you evaluate your current financial position by assessing your income, expenses, assets and liabilities. Your budget is influenced by your income because you can only spend what you earn. Then the next step in the budgeting process is to estimate your expenses to be incurred every month. If you are able keep current expenditure levels low, your savings will be higher and you will be able to accumulate wealth in the future. Budget is the foundation of your financial plan, as it provides a base for making personal financial decisions.

Managing your money

You need cash to meet your daily expenses. Cash is required for daily minor expenses as well as major contingencies like repairs or medical treatment etc. For all this access to funds is necessary to cover any short-term cash needs. Your liquidity position is basically

determined by how much cash you have in hand or what can be accessed immediately. Money management and credit management are two techniques to enhance your liquidity position. Money management involves decisions regarding how much money to carry in liquid form and how much to allocate to short-term investment. Credit management involves decisions about how much credit you need to support your spending and the sources of credit to use. If you fall short of money then what other sources can you fall back on? Can you go to a bank, friends, employer or credit card facility? Credit card facilities should be used less as interest rates are exorbitant. It is normally used to cover expenses that cannot be covered by current income.

Financing large purchases

Huge expenditures like purchase of a car or a house often are financed by a loan. How much loan to take will depend upon your savings and the purchase price of the assets. The capacity to repay the loan is also an important consideration. Loans are available in easy instalment of monthly, six monthly or annual system of repayment. The interest rate charged also is different for different schemes of loan and its repayment. There are, therefore, four things to consider: (i) how much loan to take, (ii) Maturity or length of the loan (iii) Interest rate and (iv) Instalment plan.

Protecting assets

Insurance plans are available to protect your assets. Insurance companies offer different types of insurance policies with varying amounts of premium to be paid depending on the risk associated. Car insurance, house insurance, health insurance are some of the popular policies for different amounts.

Investing money

The extra funds which you have can be invested in shares, bonds, mutual funds and property to earn a higher return. You may invest your saving in bank deposits for different periods with varied rates of interest if you wish to opt for a safe investment. Or if you are willing to take risk you may invest in the capital market, i.e., in shares or bonds

or mutual funds. A risk return analysis may be done and funds may be invested according to your requirement.

Planning your retirement

After retirement you do not get a fixed amount as salary, therefore a certain amount must be set aside and invested so that some return is assured at a later stage. This type of planning could be done well in advance so that sufficient money is accumulated to support yourself and your family. For example, you may be investing in provident funds, public provident fund, national saving certificate, etc., which can give you an income after retirement.

Tax Planning

Taxes are an essential component of financial plan. Whatever you earn, part of it has to be paid to the Government in the form of taxes. However, tax planning enables you to plan your investment in such a way so as to minimise your tax.

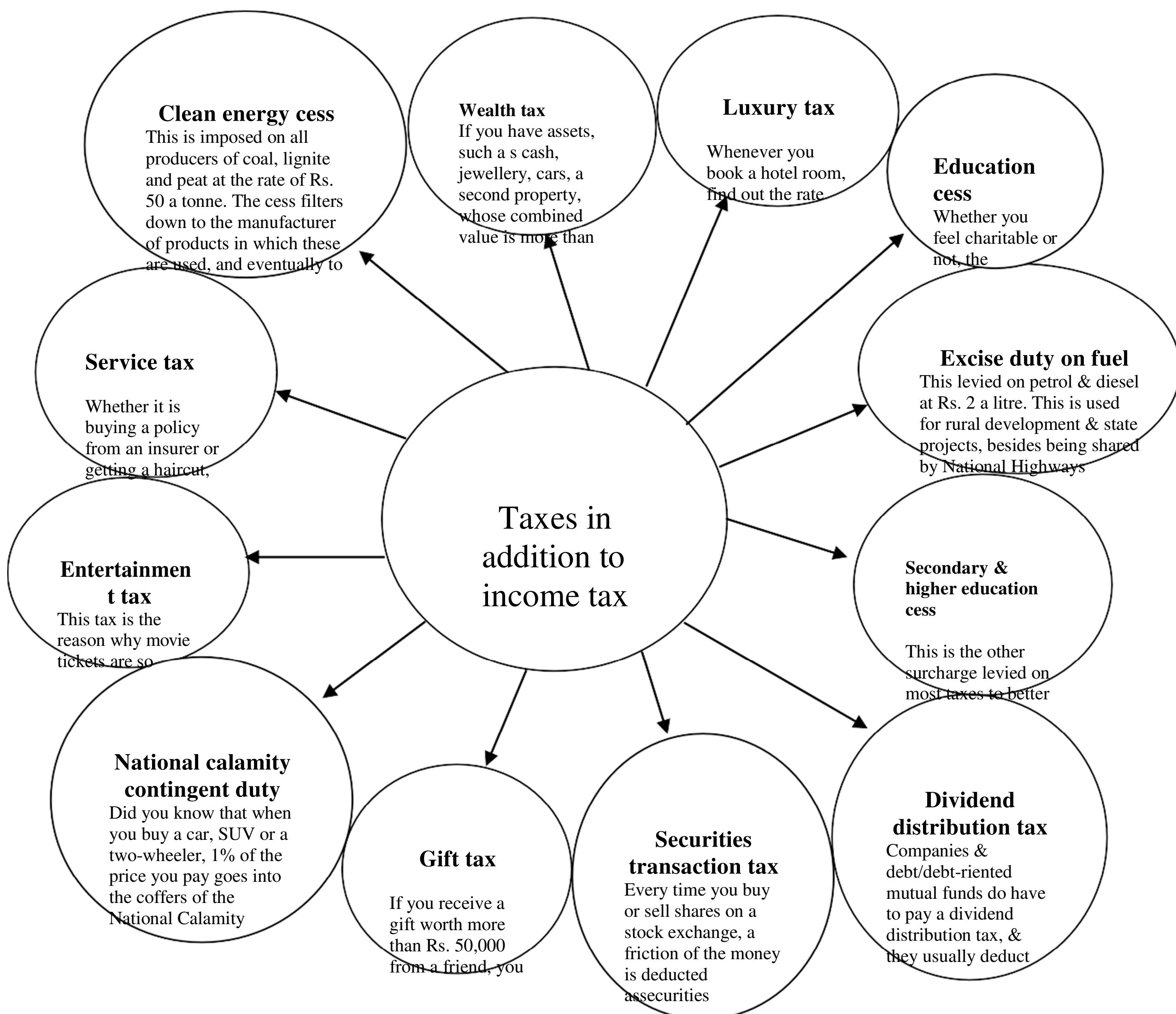
Financial planning

1. **Income:** It's possible to manage income more effectively through planning. Managing income helps you understand how much money you'll need for tax payments, other monthly expenditures and savings.
2. **Cash Flow:** Increase cash flows by carefully monitoring your spending patterns and expenses. Tax planning, prudent spending and careful budgeting will help you keep more of your hard earned cash.
3. **Capital:** An increase in cash flow, can lead to an increase in capital. Allowing you to consider investments to improve your overall financial well-being.
4. **Family Security:** Providing for your family's financial security is an important part of the financial planning process. Having the proper insurance coverage and policies in place can provide peace of mind for you and your loved ones.
5. **Investment:** A proper financial plan considers your personal circumstances, objectives and risk tolerance. It acts as a guide in helping choose the right types of investments to fit your needs, personality, and goals.

6. **Standard of Living:** The savings created from good planning can prove beneficial in difficult times. For example, you can make sure there is enough insurance coverage to replace any lost income should a family bread winner become unable to work.
7. **Financial Understanding:** Better financial understanding can be achieved when measurable financial goals are set, the effects of decisions understood, and results reviewed. Giving you a whole new approach to your budget and improving control over your financial lifestyle.
8. **Assets:** A nice 'cushion' in the form of assets is desirable. But many assets come with liabilities attached. So, it becomes important to determine the real value of an asset. The knowledge of settling or canceling the liabilities, comes with the understanding of your finances. The overall process helps build assets that don't become a burden in the future.
9. **Savings:** It used to be called saving for a rainy day. But sudden financial changes can still throw you off track. It is good to have some investments with high liquidity. These investments can be utilized in times of emergency or for educational purposes.
10. **Ongoing Advice:** Establishing a relationship with a financial advisor you can trust is critical to achieving your goals. Your financial advisor will meet with you to assess your current financial circumstances and develop a comprehensive plan customized for you.

UNIT – II

Have you ever wondered how the government runs its offices or pays the salaries of the police department, army, air force and navy employees? The government requires money for all these and a variety of other essential services such as electricity, water provided to you. The government collects money from the general public in the form of taxes which it uses for different developmental schemes and functioning of the economy. The general public may comprise salaried people, business people, industrialists and many other service providers. All these people pay taxes with the expectation that the government would function efficiently.



In your lifetime, you definitely have to pay taxes, in fact, you have probably already paid sales tax. Have you wondered or questioned why you had to pay more at times? The prices that we pay when we buy things in the market, is inclusive of taxes that have been charged on them. We bear taxes when we spend money and also when we earn money. Not many of us willingly part with their hard earned money for taxes. You must have often heard your elders' say, "what do we get that we should pay taxes?" Payment of taxes is not only the duty of every citizen but an essential requirement for existence of our country as a prosperous, secure, stable and a just nation-state.

You know that government spends money for providing many public services, like, highways, police, defence, etc., and basic facilities such as schools and hospitals to the poor and underprivileged thus creating an egalitarian society. It is also used for funding developmental programmes and services. Government gets money from taxes and therefore it is vital for all its citizens to pay taxes. However, at the same time it is important for us to learn to be wise and smart so that all taxes that we legally owe are paid – and not a rupee more.

Did you know?

How taxes affect our economy?

Taxes, the main source of revenue are used by the rulers or the government to carry out many functions. No government in the world can run its administrative offices without funds and it has no such system incorporated in itself to generate profit from its functioning. Therefore, it can be well understood that the purpose of taxation is very simple and obvious for proper functioning of a state. The expenditures of the government include providing economic infrastructure (roads, railways, etc.), public services (education systems, health care systems, public transportation, etc.), public utilities (energy, water and waste management, etc.) for the enforcement of law and order, to meet expenditures on defence, and the operation of government itself. The money is also utilized for relief and rehabilitation in case of natural disasters such as floods, earthquakes, tsunamis, etc. Space programme, missile programme and nuclear programme are also funded from the revenue collected as tax.

Taxes, apart from being a source of revenue to government also are used to influence the functioning of the economy (the government's strategy for doing this is called fiscal policy), or to modify patterns of consumption or employment within an economy. It influences

the economy by affecting resource allocation, consumer behaviour and even the nation's productivity and growth. To reallocate its scarce resources for ensuring welfare, government may tax highly some commodities (say luxuries). It regulates consumption of some commodities (tobacco is taxed, for example, to discourage smoking, and other injurious commodities like alcohol, etc). To ensure long-term growth it may impose taxes on production of consumer goods and give concession for production of capital goods. Apart from interest rates, the deductions allowed in taxes for the savings also inspire people to save. The provision of exemptions of income that have been diverted into various saving schemes results in increased saving in the economy. Taxes also help in redistribution. Normally, this means transferring wealth from the richer sections of society to poorer sections, thereby reducing inequality in the income levels. When government imposes taxes on the richer section and uses it for the welfare of it citizens, it is transferring wealth from few high income groups to low income groups. Taxes also make the government accountable. The government tax citizens, and citizens in turn demand accountability from their government.

Tax planning implies minimization of taxes-- pay as little as possible by saving and investing wisely. The goal is to arrange financial affairs so as to minimize taxes. How can we do this? The key lies in prudent and effective tax planning. It is important to plan for taxes as it affects your personal budget-- your savings, expenditure and consumption so dearly. Tax planning means devising strategies all the year round so as to minimize the liability of tax that one owes to the government. You have to plan sensibly so as to pay less money to the government as tax thereby reducing your tax burden. As a result save more money for yourself. Planning taxes reduces the burden of tax on a person and also helps him to make savings by investing in various saving schemes.

India has a well-developed taxation structure. The tax system in India is mainly a three-tier system, comprising the Central government, State Governments and the local government's organizations which include panchayats and municipalities.

History of taxation:

Taxation dates back to earliest recorded history. In the beginning, in all societies, the most common way to collect taxes was in kind. Taxes were paid in the form of gold-coins, cattle, grains, raw materials and even by rendering personal service. As economies became money based, countries started collecting taxes in cash. In addition to the revenues from land, tax on the basis of ownership of immovable properties also became prevalent. Evidence show that all historical leaders and head countrymen collected taxes to run its authority.

In India, the tradition of taxation has a long history. Archeological findings indicate a taxation system as old as about 6000 years ago at a place called Lagash. It finds its references in many ancient books like 'Manu Smriti' and 'Arthasastra'. Manu, the sage and lawgiver in Vedic times, stated in his ‘Manu Smriti’ that the king could levy tax and advised that taxes should be related to the profession, income and expenditure of the person. With the coming on of the Mughals in India, the country witnessed a sea of change in the taxation system of India. Although, they also practised the same norm of taxation but it was more homogeneous in structure and collection.

The period of British rule in India witnessed some remarkable change in the taxation system of India. The objectives of taxation were designed to protect and enlarge the economic and strategic interests of the East India Company and the Crown. After the revolt of 1857, the first formal income-tax on traders and professionals became operative in 1860. Setting up of administrative system and taxation system was first done in the history of taxation system in India in 1922. Independent India brought out changes in the nature and objectives of taxation, which became directly linked with national programmes for citizens’ welfare. Nowadays taxation is seen as an instrument not only to augment finance of the government but also to fulfill certain social objective, both being interlinked.

Taxes are collected from a number of sources. The government raises revenue from a variety of taxes -- taxes on income (like, individual income tax, corporate income tax) taxes on property (like, wealth tax, estate taxes, death duties, property taxes), taxes on commodities (like, sales tax, excise duties, customs duties) and other taxes (like service taxes, entertainment taxes).

Different taxes that we pay

> ***In this world nothing is certain but death and taxes***
>
> **-Benjamin Franklin**

As said earlier we pay different types of taxes to the government, which can be classified as direct and indirect. Direct taxes are those that are imposed and paid by the tax payer directly to the government (like, taxes on income and wealth) Indirect taxes are those taxes that we pay indirectly to the government (like, taxes on commodities). An understanding of these taxes is necessary for us to be aware of the payments that we have to make.

Income tax

When you start earning incomes beyond the exemption limit, you will have to pay taxes which are progressive, meaning that the more you earn, the more you pay. Income tax is levied on the income of individuals or on the profits earned by companies and businesses. Personal income tax and corporate income tax together contribute towards a major share of tax revenue to central government. The Income Tax Act was incorporated in India in1860. Income taxes are imposed by the Government of India on taxable income of Hindu Undivided Families (HUFs), companies, individuals, firms, co-operative societies and trusts (which are identified as a body of individuals and association of persons). Even the gifts that you receive from persons other than relatives come under the purview of income tax and are included in your income.

> **Did you Know?**
>
> *For all financial transactions (be it investing, purchasing, etc.) that you make above a certain limit, it is now mandatory to quote your* ***Permanent Account Number (PAN)****. This makes it easier for taxman to trace all your investment/savings. This number is mandatory for filing income tax returns, opening a depository account, buying or selling property, large cash transaction- You need a PAN for many things that affect your life.*

Corporate Tax

When a company earns profit, corporate tax has to be paid. Corporate tax is the tax charged on the profits earned by associations and companies by several jurisdictions. The excess of earnings that a company makes over the expenses incurred (cost of production) will be your profit. On this profit, the company has to pay corporate tax according to rules. This corporate tax also applies to foreign corporations that have economic bases in India (e.g, Microsoft,

Agro-tech, Hewlett-Packard). It applies to all people working for a corporation, including income for work done in a foreign country and work done for a corporation that is situated in a foreign country. The rate of corporate tax in India depends on whether the profits have been passed on to the shareholders or not.

Capital Gains Tax

Did you know that you will have to pay taxes on all your capital gains that you receive upon the sale of assets? A capital gain is any income generated by selling a capital investment (business stocks, paintings, houses, family business, farmhouse, etc.). The 'gain' here is the difference between the price originally paid for the investment and money received upon selling it, and is taxable.

Wealth Tax

The wealth that you possess also entails you to contribute towards the tax exchequer. Wealth tax is levied on the property owned depending on the market value of it. If you possess net wealth over a certain exemption limit (now `. 30 lakh) other than ownership of one residential property it is mandatory to pay wealth tax and file a return to avoid tax collector knocking at your door.

Excise Duty

You pay taxes to the government while purchasing commodities. One among the indirect tax is the excise duty which is one of the most well known forms of taxation in India. Excise duties are imposed on goods at the time of production. It is paid to the government by the factory itself, but in reality the burden of the tax falls on those who buy the goods. The producer increases the prices of goods they sell to cover the amount that they have paid in form of excise duties. The rates of excise duties vary depending on the nature of commodity. Excise tax also serves various purposes of price control, adequate supply of essential commodities, promotion of small-scale industries and industrial growth.

Customs Duty

During your visits to the market you might have come across foreign brand products varying from toys, chocolates to stationary and consumable items and probably wanted to purchase it but felt hesitant seeing the price tag. They are highly priced because of the foreign exchange rate (the value of Indian rupee compared to the foreign currency) and also it includes the customs duty imposed on them. Government imposes customs duty not just with the intention

of earning revenue but also to control the commodities moving out and moving in the country. Customs duties are charged on those commodities which we bring in from other countries (import duties) and which we export to other countries (export duties). Usually, the goods that are imported to the country are charged customs duty along with educational cess. The customs duty is evaluated on the value of the transaction of the goods. The Central Board of Excise and Customs under the Ministry of Finance manages the customs duty process in the country.

Types of state taxes

Apart from the central taxes, we also pay certain taxes on various goods and services to the state government. Let us see which these taxes are:

Sales Tax/VAT

Probably this is one of the taxes that you have been paying indirectly to the government. When you purchase commodities or when you eat at a restaurant your bills are inclusive of the sales/VAT taxes. The state governments in India impose sales tax which is paid by the dealer or shopkeeper and this amount is later added to the price of the good. The taxes range in percentages according to the type of goods. Essential commodities such as food, room and board are not taxed. Petroleum, tobacco and liquor are taxed, but the percentage varies from region to region, as the state governments have regulatory control. In most cases, sales taxes are charged on the sale of movable goods. The sales taxes have been replaced with Value Added Tax (VAT). This is the tax that a manufacturer needs to pay while purchasing raw materials and a trader needs to pay while purchasing goods. VAT is eventually expected to replace sales tax. All goods and services provided by business individuals and companies come under the ambit of VAT. The VAT rates of petroleum, tobacco, liquor and so on are higher and differ from state to state.

Goods and Service Tax (GST)

Proposals are being carried out to combine tax on goods as well as services such as VAT, excise duties, service tax and replace them with a single GST. All financial contribution made in the distribution chain will therefore be taxed under GST.

Other taxes:

In addition, there are some other state and local taxes that are applicable. They are:

- Octroi/entry tax
- Stamp duty on asset transfer
- Property/building tax
- Agriculture income tax

Tax Planning

Usually tax planning is in the air during the month Feb-March when you hear and see advertisements for everything from tax saving bonds, insurance products to tax saving mutual funds. Many of the tax saving avenues are not touched upon as we do not give due time and thought to understand and evaluate different options that are specific to the financial situation and usually end within the conventional tax saving techniques. However, if you are to think of tax planning not just as a tax saving exercise instead as a part of overall investment strategy then you have to smarten up the tax-planning exercise. The tax-saving investment that you choose can eventually play a significant part in achieving your financial goals.

How to plan for taxes

Arranging transactions helps in optimizing our tax liability. An understanding of the tax process and tax strategies will help to lower your taxes taking full advantage of the tax benefits. For this, the provisions of the Income Tax Act: all accessible allowances, exemptions, deductions, etc., are to be used judiciously.

Know the Tax process: Basics of income tax	
WHO?	All residents in India, whose total income level is more than the maximum exemption limit, are under the domain of chargeable income tax. The payment of the income tax is to be calculated on the total income of the last year in the relevant financial assessment year.
WHEN?	The return has to be filed by 30th September of the assessment year if the individual, being a sole proprietor, has his accounts subjected to tax audit or is a partner of a partnership firm whose accounts are subject to tax audit and by 31st July of the assessment year for any other assessee.
HOW?	The income tax payments are paid in the sort of tax deducted at source (TDS), tax collected at source (TCS), and advance tax before the last due date of March 31st.
WHY?	Government earns revenue through taxes so as to provide basic services and certain amenities to its people in the national interest.

Exemptions: Income tax

Exemptions refer to specified income, which are earned but not taxable. It means that at the time of calculating annual income, this type of income will not come under the purview of tax. These include agriculture income, dividend income, gratuity, and receipt in respect of commutation of pension, leave encashment, proceeds from an insurance company, LTA rules, etc. There are certain expenses that you incur that get you tax benefits. School fees paid for two children, the principal amount repaid of housing loan and the medical insurances premium paid for self, family and parents, expenditure on treatment cost of chronic illness of your dependant can be deducted from your taxable income. Interest paid on educational loans

> ***Tax tip:*** *You can claim a deduction of rent paid even if you are not getting house rent allowance (HRA). If you are staying with your parents pay them the rent and avail deduction in your tax.*

> ***Tax tip:*** *Buying medical insurance for your parents not only ensures better treatment for them but also will help you to get an additional deduction in taxes.*

> ***Tax tip:*** *Chronic illness of a dependant and disabilities can be used to save on taxes. Avail tax deductions for the expenses.*

is also deducted from the taxable income and is now available even to the parent or spouse of the borrower. Availing a home loan helps to claim exemptions for the interest payments of up to `. 1,50,000 in case of a self-occupied house. The claim can be made even on loans taken for repair, renewal or reconstruction of an existing property. The taxpayers also can claim exemption for the house rent paid. An investment in the medical insurance scheme ensures not only insurance benefits, but also helps to avail tax exemptions. The donations made to particular funds/institutions and contributions made to the recognized political parties are also exempted from taxes.

Deductions:

Deductions refer to those investments or payments which will be deducted from the total income. There are various deductions provided by the Indian Income Tax Act. The tax deductions help to deduct an amount from the taxable income and save tax.

The maximum reduction available for investing in Provident Fund, Public Provident Fund, accrued interest on National Saving Certificate, Life Insurance Premium, National Saving

Evergreen favorites that lighten tax burden

The most preferred investment tax-saving avenues are:

- ***Life insurance policy***: It has three benefits- covers risk, save tax and also is an investment strategy.
- ***Public Provident Fund***: A long-term investment instrument with assured interest rate and contributions and the interest earned thereon is wholly exempt from tax.
- ***Fixed deposit scheme***: Fixed deposits with banks having a lock-in period of 5 years earn tax exemption but the interest earned shall be taxed.
- ***National Saving Certificates***: Safest investment option as it is backed by the government with a maturity period of six years. The interest earned is taxable.
- ***Home loans***: The principal amount repaid, stamp duty and registration charges are eligible for deduction.
- ***Children's tuition fees***: Amount paid towards tuition fees of any two children of an individual is eligible for deduction.

- ***Equity Linked Saving Schemes (ELSS):*** As these are investments in equity, they carry an inherent risk. An investor who can take on risk in the quest for high returns, should be investing in ELSS schemes through Systematic Investment Plan (SIP) as it is the best solution to counter the volatility in markets.

Certificate, tuition fees paid for children's education (maximum 2 children), principal component of home loan repayment, 5-year fixed deposits with banks and Post Office and Equity Linked Savings Schemes (ELSS) is `. 1,00,000. Choices from these tax-saving avenues should be made in terms of the risk-return trade-off. Investments have to be planned in such a way that the post-tax yield is the highest possible and keeping in view the vital parameters of safety and liquidity. Investment in employment provident fund is a compulsory contribution and will give you an amount at the time of retirement. Public Provident Fund and National Savings Certificate turn out to be attractive in terms of assured returns and safety of capital. Choice between PPF and NSC depends whether you are saving to provide for a long-term need or you prefer to make lump sum investment and have a shorter investment horizon. In the former situation PPF would be a better option and in case of latter, the option may be NSC with duration of 6 years or fixed deposits with banks for 5 years. These tax saving measures provide assured rates return, however, offer only negative real returns in an inflationary scenario.

Deductions are also available on various insurance schemes. But the choice of an insurance scheme should be made without tax saving benefits taking precedence over the insurance aspect. Investment in the insurance schemes should have the best insurance cover and not just tax sops. The tax deductions help to deduct an amount from the taxable income and therefore save tax. Whereas, investment in equities through ELSS scheme will help to beat inflation and have the lowest lock-in period of 3 years. However, after the direct tax code comes into effect ELSS will cease to be a tax saving option. Tax reliefs are also available on investments in long-term infrastructure bonds of specified companies. The interest rates of these bonds are not as high as that offered by the

Tax tip: *Charity is good not only for the receiver, but the giver as well. You can avail deductions the charitable expenditure and contribution to recognized political parties.*

banks on fixed deposits, but still as it is offered as an additional tax shield they turn out to be worth investing.

UNIT - III

Can you manage risk in life?

When any individual buys insurance, he/she transfers a portion of risk for compensation to the insurance company. The company in turn provides him/ her protection at a price, but it's a fraction of recurring expense borne by you annually. It is true that events cannot be predicted but the probability of events occurring can be calculated on the basis of past experience. Henceforth, steps need to be taken to reduce the chance or extent of loss to one's health and property. For example, the use of seat belt in the car can reduce the chance of auto injuries and deaths. Therefore, we buy an insurance policy and we transfer the risk to the insurance company in exchange for a fee called premium.

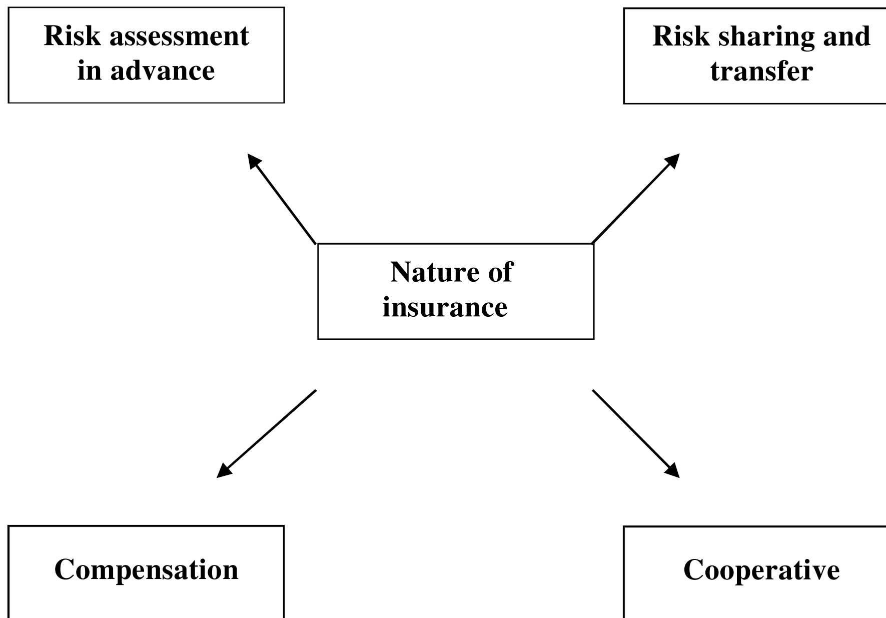
Nature of Insurance

Insurance is a cooperative device under which a group of persons who agree to share the financial loss to either of them may be brought together voluntarily by a registered company. These companies are called insurers and are the risk bearers. They provide insurance to the customer / client who are called the insured. The risk is evaluated by the insurer and an amount is charged from the insured. This amount is called the premium. The insurance companies provide insurance policies. These policies are legally binding contracts between the insurer and the insured. The insured or the policy holders pay insurance premium to the insurance company for sharing the risk.

Insurance provides security and safety to an individual and guarantees payment in the time of loss. It ensures compensation for losses suffered due to the incident on unanticipated events.

It has two fundamental characteristics:

- Transferability or shifting of risk from an individual to a group
- Sharing of loss, equally by all the members of the group



Elements of Insurable Risks

It is not feasible for an insurance company to ensure all kinds of loss, rather few elements of loss can be insured at a reasonable price. In fact, insurers are not willing to accept all the risk that client may wish to transfer to them. Certain characteristics should exist to be considered as a proper subject for insurance. For example:

(i) The loss produced by the risk must be definite and measurable

(ii) The loss must be fortuitous or accidental

(iii) The loss must not be catastrophic

What the customer expects?

The customer expects information on different products, i.e., policies, their terms and conditions (grace, waiting periods, and exclusions). The customer may desire that particular insurance policy should be linked to her needs. For example, a parent who is worried about the future of her child would prefer educational loan to retirement policy.

There should be active involvement of the company at the times of settlement of claims. There should also be regular contact with the company to dispatch payment to the customer when policy matures or to ensure payments in times of emergency. The company should make effort to instantly dispatch policy document, health card and other claim settlements.

Functions of Insurance

The purpose of insurance is generally to protect the insured against uncertainties.

Certainty

Insurers reduce the uncertainty of loss and the insured is given guarantee of payment at the time of loss or damage.

Protection

The insured is assured of protection from probable chance of accident or loss.

Assist in capital formation

The accumulated funds in the form of premium are invested in various income generating schemes.

Prevention of loss

Insurance does not eliminate or decrease the uncertainty for the individual as to whether or not the event will occur, but it will reduce the extent of financial loss connected with the event.

Insurance provides security and safety

The insurance provides safety and security against the premature death of a family member or payment at the time of old age. Similarly, the property can also be insured so as to provide security to the owner against damage or loss in a fire.

Peace of mind

It ensures peace of mind against uncertainties like fire, automobile accidents, deaths and other contingencies which are beyond human control.

Elimination of dependency

What happens to other family members when one of its earning member expires? The insurance company assists the family and provides adequate amount of financial assistance at the time of suffering or unforeseen accident.

Timeline of insurance companies in India

	Date of Registration	Name of the company
1	23-10-2000	HDFC Standard Life Insurance Co. Ltd
2	15-11-2000	Max New York Life Insurance Co. Ltd
3	24-11-2000	ICICI Prudential Life Insurance Co. Ltd
4	10-01-2001	Kotak Mahindra Old Mutual Life Insurance Ltd
5	31-01-2001	Birla Sun Insurance Company Limited
6	23-10-2001	Reliance Life Insurance Co. Ltd
7	30-03-2001	Tata AIG Life Insurance Co. Ltd
8	02-08-2001	ING Vysya Life Insurance Co.Ltd
9	03-08-2001	Bajaj Allianz Life Insurance Co.Ltd
10	06-08-2001	Metlife India Insurance Co.Pvt Ltd
11	14-05-2002	Aviva Life Insurance Co. India Pvt Ltd
12	06-02-2004	Sahara India Insurance Co. Ltd
13	30-07-2006	Bharti Axa Life Insurance Co. Ltd
14	3-01-2007	Shriram Life Insurance Co. Ltd
15	4-09-2007	Future General India Life Insurance Co. ltd
16	30-03-2001	SBI Life Insurance Co. Ltd
17	19-12-2007	IDBI Fortis Life Insurance Co.

How much should you insure?

One way to deal with risk is to purchase an insurance policy. The amount of the policy will depend upon a number of factors.

Need for minimum protection

The amount of insurance that any client should purchase depends upon the analysis of the needs that would have to be met by dependents when the family earner dies. In this case there is a need to follow three steps – first to identify the basic needs that would have to be met after the death of an individual. Second, resources available to meet these needs must be sorted out. Last, the difference between the existing needs and available resources which needs to be fulfilled has to be identified.

Current income level

Payment of premium results in an outflow of disposable income. While deciding for insurance, one should keep in the mind the regular payment of insurance premium.

Tax benefits

The tax benefits under Section 80 C can be availed on purchase of different insurance policies. Individuals can avail tax benefits by paying life insurance premium according to the provisions of the Income Tax Act.

Specific schemes

An insurance scheme can be bought for a special scheme like education and wedding of children. There is provision for acquiring a property through a loan under the various insurance schemes.

Annuities for regular income during retirement

Investment made for retirement purpose will not create any undue financial worries.

Present age

Life insurance requires a periodical review based on individual needs in order to ensure that the coverage is adequate. One can buy more insurance policies for the same premium at a younger age than at an older age.

A guideline for purchase of insurance policies in different age groups

Age	Life Insurance	Non-Life insurance
Young 20's adult	Buy only if you have dependants	Buy accident and health insurance, requisite asset cover
Young 30's family	Subtract existing assets from future expenses, and cover the difference	Extend health insurance to family; continue accident and asset covers
Mature 40's family	Maintain cover to balance the shortfall in the existing assets	Same as above
Matured 50's family	Maintain cover till you are earning	Top up health cover for self and spouse; continue asset cover
Retired and over 60	No life cover needed,	Continue health insurance

	unless you have dependants	for self and spouse; continue asset cover

At a younger age you can undertake risks since you have ample time to check your decision. The payment of premium is spread over a longer duration of time compared to policies opted at later stage in life. However, at this stage you should minimise the risk and opt for safe policies.

Principal function of the Insurance Regulatory and Development Authority

IRDA was set up by the Parliament in 1999 to regulate, promote and ensure orderly growth of the insurance business.

Section 14 of IRDA Act, 1999 specified the composition of the authority consisting of 10 members.

The authority is a ten-member committee consisting of:

a) Chairman b) five whole-time members c) four part-time members

It was formed with the following objectives:

to set up capital adequacy, solvency and other prudential norms for insurance companies;

to decide on granting licences for conducting insurance business and to function as a registered authority;

to set standards for insurance products, to monitor and modify their rates, terms and conditions;

to ensure compliance with prescribed ceilings for management expenses of insurers and agency commissions;

to monitor the quality and performance of inward and outward reinsurances;

to ensure maintenance of adequate technical reserves by the insurers;

to review insurers' asset distribution and management and to monitor compliance with prescribed potential prudential norms and patterns of investments;

to detect sickness in the industry and to take suitable corrective actions;

to act as a dispute resolution forum for consumer grievances;

to prepare and publish an annual report on the state of the insurance industry; and

to ensure, set and monitor accounting standards and transparency of reporting of accounts, to scrutinize and accept annual accounts, valuation reports and solvency margin statements.

Ombudsman

New legislation came into force in 2013 wherein the insurers can ask questions about any matters that could be used as an excuse for not paying a claim. On investigation, the ombudsman can find out whether the facts were withheld which cause difficulties in taking decisions.

How and When to Approach the Ombudsman

1. Write to the grievance cell if the insurance claim is rejected.
2. In case of unsatisfactory answer or no response, write to the insurance ombudsman.
3. One should complain within one year of the rejection of claim. The matter should not be pending in any court, consumer forum or with an arbiter.
4. Any complain can be submitted personally or through the post.
5 All the relevant documents should be attached with the complaints.
6 One should also give written consent to the ombudsman for acting as a mediator
7. In case the recommendation is acceptable to you, write within 15 days to the ombudsman, who will then pass an award within three months of the date of complaint.
8. The final award is binding on insurance companies, but you can approach a consumer forum or a civil court.
9. You can get in touch with the Insurance Regulatory and Development Authority's Grievance Redressal cell through a **toll free number 155255**
10. Complaints relating to conduct of agents can be taken up by IRDA's Grievance Redressal Cell
11. No outsourcing: Ensure that you send your complaint personally and not involve lawyer or agents.

Types of insurance: Life Insurance, Health, Home and Auto

There are many types of insurance such as life insurance, health, home and auto insurance. Life insurance covers the risk of unexpected death. Health insurance meets the need of expensive medical treatment. Similarly, home insurance covers the risk on burning of the house or when there is robbery in the house. In the same fashion car insurance covers the risk of an accident.

Whole- life Policies

A whole-life policy is one that covers the insured for almost all his life. Under this type of policy, the premium is payable throughout the life of the insured person. The policy amount is paid to the beneficiary upon the death of the policy holder. Due to its long duration, the premiums may be low. The policy matures after a fixed period since the insurance cover ceases to exist and the insured amount is then paid to the policy holder.

Life insurance is also considered an investment. However, before opting for a policy some factors like

The company's financial strength and integrity, terms and conditions of the policy needs to be carefully looked into. One may choose from a variety of policies to suit one's needs.

As an investor in life insurance policy how much would you like to invest? What other factors would you consider before opting for a policy?

Stages of life	Needs	Assets
Initial stage. No responsibility	Premature death leads to minimal needs	No worthwhile assets
Married, with children	Premature death leads to financial hardships	Growing assets
Empty nest	The needs decline once children are settled	Strong asset base

Source; Yasaswy N.J (2010)

Life insurance: How to estimate your insurance needs ?

In the event of any misfortune, a policy can save the family from financial hardships. Therefore, it becomes essential to estimate the amount of life insurance required to meet exigencies.

Guidelines to estimate insurance needs

Income Rule

It states that individual cover should be around six to eight times of the customer's gross annual income. For example, a person earning a gross annual income of `. 1,00,000 should have between `. 6,00,000 (6 × 1,00,000) or `. 8,00,000 (8 × 1,00,000) in life insurance cover.

Income plus Expenses Rule

This rule indicates that individual insurance need to be equal to five times your gross annual income plus the total of basic expenses like housing or car loans, personal debt, child's education, etc.

Premiums as Percentage of Income

In this case, payment of insurance premiums depends on disposable income. One should decide the quantum of insurance after meeting the regular outflows from the salary.

Family Need Approach

Under this rule, one has to divide family needs into two main categories: immediate needs at death (cash needs), and ongoing needs (net income needs). The amount of insurance should cover the immediate and ongoing needs of the family.

An agent should not influence your decision since you are already aware of how to calculate the amount of insurance required. Your agent may try and convince you that an insurance scheme has the feature of a saving plan as well as an investment plan. However, since the rate of return on a policy is generally low, it cannot be compared with a saving scheme of a bank or any investment plan. A saving or investment plan may fetch you much higher returns than what you would get on an insurance policy. The purpose of insurance is only to assure your life, health or property against risks.

Some Dos and Don'ts related to policies

Do not over insure or underinsure

Pay the premia promptly

Keep the premium receipts

Opt for group schemes

Do not switch from one policy to another frequently

Can take loan on your policy

Keep your parents well informed regarding policies

Surrender your policy at the right time

Buy adequate personal accident insurance

Health Insurance Schemes

It is also called accident insurance, sickness insurance and disability insurance. It provides risk coverage against unforeseen health expenses that may result in financial hardship. Health insurance schemes also cover outpatient department (OPD) expenses for illness, injuries and women during pregnancy and childbirth.

Health insurance is a critical component of financial planning. It means an individual or group is purchasing health care coverage in advance by paying a fee called 'premium'. It is an arrangement that helps to defer, delay, reduce or altogether avoid payment for health care incurred by individuals and households. It is expensive but at the same time necessary. It ensures medical care and limits potential liabilities. Its need is felt more in old age. People's lifespan in general, has increased, partly due to effective health care and medical facilities available. This facility is provided by both private insurance companies as well as by the government.

The existing health schemes can be categorized as:

a) Voluntary health insurance scheme or private-for-profit schemes
b) Employer-based schemes
c) Insurance offered by NGO's/ community based health insurance
d) Mandatory health insurance schemes or government run schemes (namely ESIS, CGHS)

An example of Community-based Health insurance Scheme

This scheme was established in 1992, provides health, life and assets insurance to women working in the informal sector and their families. The scheme operates in collaboration with the National Insurance Corporation (NIC). Under SEWA's (Self Employed Women's Association) there is a policy which has a low premium per individual and is paid by the women for life, health and assets insurance. At an

additional payment, her husband too can be covered. In addition, some amount per member is also paid to the National Insurance Corporation (NIC) which provides coverage to a maximum of `. 2000 per person per year for hospitalization. After being hospitalized at a hospital of one's choice (public or private), the insurance claim is submitted to SEWA. The responsibility for enrolment of members, for processing and approving of claims rests with SEWA. NIC in turn receives premium from SEWA annually and pays them a lumpsome on a monthly basis for all claims reimbursed.

Social Insurance or Mandatory Health Insurance Scheme or Government Run Schemes (namely, ESIS, CGHS)

Social insurance is an earmarked fund set up by the government with explicit benefits in return for payment. It is usually compulsory for certain groups in the population and the premiums are determined by income (and hence ability to pay) rather than related to health risk. The benefits packages are standardized and contributions are earmarked for spending on health services. The government run schemes include the Central Government Health scheme (CGHS) and the Employer State Insurance Scheme (ESIS).

Queries raised when considering health care insurance policies

Questions regarding costs

- Monthly premium
- Deductible expense
- Limits on coverage
- Other major expenses not borne by the company

Questions regarding the doctors/ health care providers

- How many doctors are in the plan?
- Who are the doctors in the plan?
- Doctors and their specialization.
- Where are the doctors located?
- What heath services do the doctors provide?
- What hospitals/labs/diagnostic centres are in the plan?

General questions

- Is access to specialists only allowed with a referral from primary care physicians?
- What coverage is provided if the patient receives out of the primary network?
- If a physician is accessed outside of the plan, are there out-of- network benefits?

Contents of Health Care Insurance policies

Identification of insured person

A health insurance contract identifies the insured person.

Location

The health insurance benefits may be confined to a particular area.

Pre-existing condition

A policy may exclude coverage for pre-existing conditions, which existed with the individual prior to the grant of policy.

Cancellation operation

A health insurance contract may allow the insurance company to cancel the contract at any time. Other contracts guarantee continuous coverage as long as the policy holders pay premium on time.

Medical claim

It provides for reimbursement of hospitalisation expenses incurred for illness/ diseases or injury sustained.

Disability Insurance

The disability insurance policy will provide benefits if you are unable to do the duties required of your occupation.

Types of Disability Insurance

Individual disability insurance

The insurance premium varies with the type of job. For example, workers employed in any steel plants are more at risk than any individual working in office building.

Employer disability insurance

Employers at some firms are either provided the insurance free (fee borne by the firm) or participate in a plan by paying for the coverage.

Insurance from Worker's compensation

In case of disability, one may receive workman's compensation from the company or organization.

Home owner's insurance

One of the easier ways of acquiring a house property is through a loan provided under various insurance schemes, where a life insurance policy is accepted as a collateral security. The proceeds of the policy can be adjusted towards the housing loan.

It ensures protection in case of theft, damage to the property, personal liability relating to home ownership. Financial loss to the ownership of a house can also occur from a wide variety of adverse events like flood and earthquake. In case of damage or loss of the property, the insured has to produce proof of the loss. Therefore, the insured must notify the loss to the police and register a first information report (FIR).

The insurance company under the India Home Insurance policies, provides its customers with instant home insurance quotes. Some of the factors which cover home insurance include area of the house (sq. ft), location of property, approximate rate of construction (`./sq. ft) and type of construction (only pukka/ permanent). However, 50 years and above old properties are exempt from insurance cover. According to the sum insured the customer has to pay the premium for every month/quarter/six months. Home insurance policies offer different policies to suit the needs of the customer.

Home Insurance policy covers broadly two things

Building structure

Insurance covers for a building structure includes compensation paid for losses due to fire, storm, tempest, flood, riot, strike, lightning, explosion and implosion, landslides and rockslides, bursting or overflowing of water tanks, apparatus and pipes, earthquake and damages to the structures due to acts of terrorism. The market value of the house is not under the coverage, whereas, the cost of the land is included within the price of the house. This land cannot be insured. The insurance price is only for covering the construction cost of the building.

Contents inside the Home

The coverage is for the loss or damage of the valuables inside the building like the

electronics and electrical goods, furniture, clothing, jewellery and any other precious contents. The contents are covered on the market value of the items and in case of a loss the insurance claim is paid on the value of purchasing a similar new item exempting the depreciating value.

Do you have adequate insurance to protect your wealth?

How much insurance should you plan to have in the future?

Home Inventory	**Item description**	**Model/ registration No**	**Date acquired**	**Estimated cost**	**Estimated replacement cost**
Electronics					
Laptop					
Computer/ Mobile					
Camera					
Major Appliances					
Refrigerator					
Gas/stove					
Blender					
Clothing and Accessories					
Belt, Ties					
Dresses					
Jewellery					
Watches					
Furniture					
Living Room					
Bedroom					

Try to complete the above table of home inventory and find answers to the following questions:

1.Based on your inventory how much personal property coverage should you have?

2.How will you estimate the replacement cost?

3.Have you seen the copies of sale receipt and purchase contracts in your house?

Replacement Cost Coverage

Personal property replacement cost coverage depends upon its estimated cost**.** As indicated in the table, home owner's policies also cover assets for their cash value. For example, if any home entertainment system is priced at `. 5,000 and is assumed to have a life of five years. Let us assume it has been used for half of its life. Based on this amount of depreciation, the insurer will pay the cash value of `. 2500.

After completing the table, you can take pictures of individual items or audiotape/ videotape all the items for further documentation if you wish to insure you assets.

Factors that affect home/house owner's insurance premiums

Value of insured house

Since the value of the house is taken into account, therefore, premium is higher for expensive ones.

Deductible

A higher deductible reduces the amount of coverage provided by the home/house owner's insurance, and therefore results in lower insurance premium.

Location

The chances of damage vary from area to area. It is high for coastal areas than for the houses located in the plains.

Degree of protection

Protection against natural calamities like flood or earthquake require a higher premium.

Discounts

Discounts are provided to the insurer if other insurance (such as auto, health) is purchased from the same insurance company.

Other Home Insurance Related Points

Hut Insurance

This insurance applies to those huts used for dwellings and constructed in rural areas with financial assistance from banking/cooperative/ government institutions.

The scope of cover of this policy is against loss or damage due to fire, including fire resulting from explosion and short circuiting) lighting, explosion of boiler or gas used for domestic purpose, earthquake, flood, and other allied perils.

Fire Insurance

A fire insurance is a contract whereby the insurer undertakes to compensate for any loss or damage caused by fire during any specified period. This policy is applicable for one year and has to be renewed from time to time. A claim for loss by fire should satisfy the following conditions:

i) There must be actual loss and not just wear and tear of the asset.

ii) Fire must be actual and non-intentional.

Insurable Interest

Insurable interest is an important component of the insurance contract. The insurance company only allows persons having insurable interest in the subject matter to opt for a fire insurance policy.

i) A person has insurable interest in the property he owns.

ii) A businessman has insurable interest in his stock, plant and machinery and building.

iii) Partner has insurable interest in the property of partnership firm.

iv) Mortgage has insurable interest in the property, which is mortgaged.

It is important to define insurable interest since the company has to pay compensation to the policy holder.

Motor Insurance

Motor insurance has been classified according to types of vehicles i.e., scooter/motor cycles, private cars, commercial vehicles and other vehicles. No motor vehicle can run in a public place unless it is insured against third party liability.

Motor insurance is a mandatory requirement for all vehicles owners whether needed for personal and commercial uses. The premium varies from car to car like costly car has high premium and cheap car has lesser rate of the premium.

The claims offered by the car insurance company in India can be categorized as

a) Accidental claims, b) theft or burglary claims and c) third party claims.

Auto insurance provides protection against damage to an automobile and expenses associated with accidents. The policy specifies the coverage provided by an insurance company for a particular individual or a vehicle. In this way, it protects the vehicle

and also limits potential liabilities (expenses due to accidents). The rates of premium vary substantially among locations, insurance companies and even among the policy holders

Factors that affect motor insurance premium

Insurance policy is determined by the claims an insurer submits to the company. An auto insurance premium will be higher for a policy that specifies a greater amount of liability coverage and lower deductible.

Coverage offered by motor insurance companies in India

In case of motor insurance the liability incurred is in respect of :

- Death or personal injury to owner of the goods or his authorised representative in goods vehicle.
- Liability insured in respect of death or bodily injury of any passenger of a public service vehicle.
- Liability arising under Workman Compensation Act, 1923 in respect of death or bodily injury of:

i) Paid driver in a vehicle

ii) Conductor or ticket examiner in a public service vehicle

iii) Workers carried in a goods vehicle

- Liability in respect of death/ injury to passengers who are carried for hire or by reason of or in pursuance of contract of employment.

The risk covered by the Third Party policy includes death or injury to a third party and damage to a third party property. Liability in the case of death or injury is unlimited.

Auto Insurance Coverage will not cover the following:

When car is used beyond the geographical territory.

Depreciation, consequential damage, electrical and mechanical breakdown, snag or breakage, Intoxicated driving.

Characteristics of your car

Value of car determines the amount of premium. Insurance premium is high for new cars. In addition, the premium is high for expensive cars.

If You Are In an Auto Accident

In case of an auto accident, contact the police immediately. You may also note down licence plate numbers from witnesses, if the other driver leaves before the arrival of the police. If possible take pictures of any evidence that may prove that you are not at fault. Write down the details of the accident. After the arrival of police ask for the police report.

File a complaint with the insurance company immediately. The company will examine the police report and may also contact the witnesses. An agent employed by the insurance company may investigate the details of the accident. He will survey the site and the automobile and assess the damages to determine the amount of compensation paid by the insurance company.

Hit-and-run accidents

In hit-and-run accidents the insurance companies are not held liable since the vehicle which has hit the victim cannot be traced. The victim can be compensated by the solatium fund established by the government. The comprehensive auto insurance policy provides for damage caused to the vehicle due to man-made or natural calamities.

Renewal of Auto Insurance

If a vehicle's auto insurance policy is not renewed, driving that vehicle is illegal. Also if the vehicle meets an accident the insurance company will not pay any claims. No claim bonus will be forfeited. Auto insurance can be renewed with another insurer, including the bonus at your earlier insurer.

Insurance sector plays a vital role in the process of economic development of the country also. The process of capital formation is encouraged by the insurance services. The sector acts as mobiliser of savings, as financial intermediary, as promoter of investment activities, as stabilizer of financial market, and as risk manager. Insurance services lead to efficient and productive allocation of capital resources, prevent the losses to the firms by encouraging loss preventive measures, facilitate growth of trade and commerce, complement government social security programmes and assist the individual and firms in efficient management of the risks. In turn, economic development also facilitates reach of insurance both in terms of its dispersion and concentration.

UNIT – IV

In the chapter on managing your money, you have read about fixed deposits in banks on which you are assured a fixed return in the form of interest. These are considered safe investments as returns are guaranteed by the bank. Other safe investments are provident fund, public provident fund, saving schemes in post offices, etc.

There are many other avenues for investment which may give higher returns than banks. Of course, the risks will also increase as higher returns are expected. For this, you may invest in shares and debentures of a company, mutual funds, bonds and other investment plans. These are generally known as financial products. Mutual funds are of various types and investment in them can be tailored to suit your requirements. We shall learn about this and other financial products in this section.

Why Invest?

When we have surplus money, we think about investing it in something which gives us good return. We may start on our business if we are enterprising, and willing to undertake risk. In this case, we are using our surplus money or funding a business and expect to earn a good return.

In case we are not willing to start our business, we may invest our money in other companies through shares or debentures. If we do not have enough information about the stock exchange operations then we may consult a financial advisor for investment in other financial products like government bonds, mutual funds, etc.

Saving money in an almirah is not an investment. However, saving money in a bank is an investment as it assures some return on your investment. Investor buys the shares of a particular company in expectation of earning a better return in terms of appreciation in the market price of the share. Similarly, when an investor subscribes to the debentures of a company, he expects a fixed interest return for a given period. When a person invests in a house he either plans for his own stay or to earn some rental income. Investment in insurance assures security as well as minimum return to the insurers.

The basic objective of any investment is to minimize risk and maximize the expected returns besides ensuring stability, liquidity and tax benefits. Today managing one's investment has become challenging and complex. Due to new economic and political situations, stock markets across the globe witness unprecedented volatility. Domestic markets, too, have been integrated with the global markets ever since the boom in technology. Therefore, investment in different types of products in one's portfolio at this juncture would be beneficial to any individual in many ways.

Investors in general spend a lot of time deciding about a financial product. In India, investors prefer to invest in secured debt products that guarantees return from it. Therefore, banks fixed deposits or saving deposits form one of the biggest components of investment. Be it a share or a mutual fund, they are looking for returns and checking whether it is beating the benchmark indices. This kind of haphazard investment is not recommended. A financial advisor would want investors to set their goals and accordingly decide the different products/assets to include in their portfolio.

How can Varmas benefit by diversifying their investment portfolio

Rohit Varma decides to invest in real estate. He thinks that it is the best investment option. Rohit is a director in a private company and brings home an impressive six digit salary of `. 1.5 lakh every month. He is married to 33-year-old Ritika who, too, is an executive in a private company. They have three-year-old daughter and two-year-old son.

On analysing Rohit's investment plan, it has been found that they had heavy bias towards investment in real estate. The couple had been investing money in two bulky loans undertaken to purchase a house. Their investment approach has not only jeopardized the fulfilment of their financial goal but also indicates concentration of funds in one asset, i.e., real estate.

There is no dearth of funds with the family. Insufficient surplus is not the issue rather the couple needs to be apprised regarding diversification or allocation of assets. The financial planner never advises to put all the eggs in one basket. Investment in different assets is based on the notion that even when there is a fluctuation in some assets (in terms of up and down movement in an economy) one is assured of consistent average return from one's portfolio. It is, therefore, advisable to distribute one's investment in other forms of assets like gold, mutual fund, equity, real estate and so on. In this case we find the couple has no investment in equities. Apart from

mandatory employee provident fund, they have no debt cushion. What will happen if there is burst in the price of real estate? The volatility in interest rate may reduce the credibility of real estate. Further, real estate is a highly illiquid asset and there is maintenance costs associated with it.

The couple also feels the need of saving for the education of their children. Nevertheless, they want to stock an ample amount of money for their kids' future needs also. They plan to have some investment in health cover also.

Let us analyse Varma's investment decisions in real estate

Advantages associated with Varma's investment	Disadvantages associated with Varma's investment
Investment in real estate	No investment in equities
Investment at an early stage	No debt cushion
	No insurance policies

Relevance of allocation in different assets: Why are we investing in particular financial products. What are our expectations from that investment?

Safety

A well functioning system helps people reduce their exposure to risks. For example, you expect to earn 15% rate of return on your investment but in actual you earn only 12% thus you fail to minimize your risk. Safety is an important factor to consider while allocating funds to assets.

Liquidity

Liquidity is conversion of your assets into cash. Investment of funds in some securities may provide high return after a fixed period of time. In the meantime if you need cash, buyers may not be available as they may be infrequently traded shares. Here you may have to compromise by selling at a lower price. We see, that this share was not easily converted into cash and hence not so liquid. However, there are other assets which are considered to be more liquid and may be converted into cash when required. Thus, our portfolio should consist of different kinds of assets.

Tax Benefits

Investors plan their investment in such a way so that they can avail tax incentives on the given investment opportunities. For example., if an investor invests his money in National Saving Certificate (NSC), he would be entitled for tax rebate u/s 80-c of the Income tax Act, 1961. Likewise investment in insurance policies and mutual funds also provides tax rebates under the same section.

Purchasing power stability or hedge against inflation

The investor ensures that the return earned on his investment shall be greater than the inflation rate. For example, if an investor invests `. 200 at the rate of 10% per annum therefore, he will get `. 210 after one year. If the price of the commodity increases by more than `. 210 then the very purpose of investment gets defeated.

Why investment is encouraged at an early age?

The effect of compounding can work better in early years. It is one of the effective ways of making the money multiply for you. It is also necessary that we stay on track of committed and disciplined investor. Let us understand with the example of Uday and Rajesh. They both entered the job market at the age of 23. Uday decides to keep aside `. 25,000 every year from the age of 25 until he turned 30, that is, for a period of five years. After 30, he did not touch his investment that is he neither added nor withdrew anything from his capital till he turned 60.

Rajesh, on the other hand decided to start saving only when he turned 35. From then on till he turned 65, that is, for the next 30 years, he kept aside `. 25,000 every year.

Guess who saved more?

At 65, Uday's investment of `. 1.5 lakh was equivalent to `. 54.2 lakh, while Rajesh's savings of `. 7.5 lakh yielded `. 45.23 lakh.

Source: *Layman's Guide to Retirement Planning*.

Five steps to help to avoid investment blunders

At the beginning of every month chalk out how much you intend to save and invest every month in different assets. Then spread out this amount as per your convenience.

Determine your financial goal like child's education, retirement and insurance cover or a house to dwell in. On the basis of your plan invest in a tax saving option.

Automate your investment to ensure even if you forget to invest every month, banks can make your payment.

In case of insurance do not commit yourself to multi-year payments. Purchase of insurance assessing its features. Buy health insurance after careful considerations of its features and clauses.

Be cautious against your deductions. Take into account deductions such as tuition fees of children and home loan repayment while estimating saving needed under section 80c

Rajiv and his new project

Rajiv after completing his course in management has opted for a new project which requires him to stay abroad for three years. He got married recently to Seema who happened to be his friend in college. His posting in a new place along with new project may provide him opportunity to earn additional income.

How do you think Rajiv, after covering major expenses, should invest his surplus which he has earned abroad?

Where to invest the surplus?

His parents advised him to buy a house in Bangalore, where he is likely to return after his posting. His wife thinks of investment in gold jewellery. His uncle thinks he should invest the saving in safe instruments such as bank deposits.

The additional income that Rajiv will earn from his new project provides him good opportunity to build some assets. His prime consideration should be liquidity of his assets depending upon his needs. Another objective that should determine his choice is growth in the value of his assets. Let us critically analyse the various options available to Rajiv for investment. Buying a house would be an attractive option as it would ensure roof and value would appreciate over a period of time. However, the disadvantage erupts when he is transferred to other place or he undertakes

some other projects abroad. At a time when his career needs flexibility, the house would be an inflexible investment.

Investment in gold too would be limiting his choice since it may turn out to be an illiquid investment. Selling gold may not give a lucrative return and a tough decision considering his wife's passion for jewellery.

Bank deposits are no doubt a safe option, but the rate of interest is very low and does not ensure growth over a period of years.

It would be optimum for Rajiv to opt for mix of investments in different assets. He can make small investment in a house, a proportion in jewels and some amount may be invested in bank deposit and mutual funds to ensure liquidity and higher flexibility.

In fact, the growing number of investment avenues has also made investment decisions difficult. According to Association of Mutual Funds in India (AMFI), the number of mutual funds has grown considerably since 1964 when US-64 was launched by erstwhile UTI. When it comes to investing in shares, an investor like Rajiv has an option of choosing from over 5000 different types of securities.

Investment in shares

Investment in the equity of a company involves buying shares of private and public companies. It is one of the most rewarding and at the same time volatile instruments for investing. When you invest in shares of a company, you become part owner of the company and, hence, share both the profit and losses that the companies make. They can be brought from either the primary market--directly from the company during a public offering--or the secondary market, i.e., the stock exchange. Stock market deals with trading of shares and their prices fluctuate on a daily basis. Let us assume Rajiv has brought 10 shares of company X for `. 1000. After five days share prices increase to `. 1500, that means Rajiv can make a profit of `. 500. However, if the price falls to `. 500, then he makes a loss of `. 500.

A return on investment in shares is obtained through dividends and share price appreciation. The market price of the share depends on the number of buyers and sellers of the share. In addition, the demand and supply of the share for sale is also influenced by the firm's business performance, as measured by its earnings and other characteristics. When the firm performs well, its stocks become more desirable for the investors. Conversely, when a firm has negative

earning, its market value declines. Some firms distribute quarterly income to their shareholders in the form of dividends rather than reinvest the earnings in the firm's operations.

Some individual investors called day traders buy stock and then sell them on the same day. They hope to earn a return on a very short term movement in share prices. Day trading is not recommended for most investors. Moreover, this type of investment is risky because the stock prices of even best managed firms periodically decline.

Where do you think Rajiv should invest?

There are certain sunrise industries like biotechnology, and sunset industries like jute. There are high-tech industries (instrumentation), and low tech industries (solvent extraction). Then there are capital-intensive industries like petrochemicals, and labour-intensive like textiles. Thus, industries can be classified into several types. Each industry goes through a certain life cycle from a small beginning to massive growth, to stagnation and eventual decline. Thus, Rajiv has to take a decision on the basis of the information he collects about various companies.

Bonds

Bonds are issued to raise funds in the same way an individual borrows funds from banks. An individual has to hypothecate its assets with the bank as security in proportion to the demand for the loan. In case of failure of an individual to refund the money, the bank has the right to sell off these assets to recover its dues. On similar lines, a corporate can borrow funds from the general public. Here the sole borrower is a company and there are many moneylenders in the form of individual investors. Since a company cannot pledge or mortgage its assets separately with each individual, it pledges its assets with a trust constituted for this purpose. The trustee is conferred with the power to dispose of the assets of the company in case of failure to meet the commitment of individual investors. A company issues certificates to bond holders while borrowing funds from the individual investors. This is known as bond certificate.

National Saving Certificates

National Saving Certificates are bonds issued by the central government with tenure of six years and sold through post offices. Individuals including minors and trusts can invest in NSCs. They are issued in denominations ranging from `. 100 to 10,000. They offer interest rate of 8% compounded half yearly. The accumulated amount is paid on maturity. Premature encashment

can be done after a period of three years after deducting some amount. It is eligible for tax rebate under section 80c.

Take A SIP (Systematic Investment Plan) to Grow Your Wealth

A SIP helps you invest small amounts on a regular basis. You can invest in equity, debt or balanced scheme using a SIP.

You should continue with your SIPs irrespective of stock market conditions. Never close your SIP even if the economy faces depression.

SIPs offer you dual benefits of averaging and compounding through market cycles.

You can choose a date of your SIP based on your cash flow.

You can invest in SIPs by using the electronic clearing service or post- dated cheques.

Do remember that SIPs do not ensure assured returns or safety of principal.

Mutual funds

Investors who desire to invest their funds in corporate securities lack information regarding profiles of companies. Such investors can invest their funds in corporate securities through mutual funds. The pooled funds are invested by expert portfolio managers. They help the clients to invest in SIPs. Since mutual funds allow investment in numerous stocks, it enables investors to achieve broad diversification with an investment as low as `. 500. Unit Trust of India was the first mutual fund set up in 1964. The main objective of the UTI was to mobilize the savings of the household sector.

A mutual fund can generate a capital gain for individual investors, since the price at which investors sell their shares can be higher than the price at which they purchased their shares. However, the price of the mutual fund’s share may decline over time, which would result in a capital loss.

Mutual Funds

Check out the asset allocation schemes from mutual funds. These funds will help you in allocating money across different asset classes depending on your investment goals and risk taking ability. The fund first defines the asset allocation and then identifies a basket of different

funds in which it will invest. There are good options for an investor looking for expert advice to invest based on asset allocation.

It is the risk profile and life stage of the investor that will decide which of the options he or she will choose. Franklin Templeton AMC has come out with plans with life stages, e.g., a twenty-five-year-old person can choose to invest in FT India Life Stage Fund 20's plan. This fund has defined the asset allocation as 80% for equity and 20% for debt. Money is invested in Franklin India Blue Chip Fund (50%), Franklin India Prima Fund (15%), Templeton India Growth Fund (15%), Templeton India Income Builder Fund (10%), and Templeton India Income Fund (10%). This makes the investment process much easier for investors and the inbuilt rebalancing features help in maintaining the target asset allocation, which could go awry due to market movements.

The best part of investing in asset allocation fund is that you will get access to a basket of funds with different investment styles that will invest according to your asset allocation plan. It saves time needed for investing in multiple schemes and tracking them.

Source: ***Economic Survey?***

Debt

Fixed Deposits

One of the oldest investment avenues in India is bank fixed deposits. It gives a returns of 6%-8% per annum depending on the tenure. It is a safe investment device for those who do not have a risk appetite and have traditionally put their money in them.

Insurance

It is an investment-cum-risk management instrument. The objective of insuring one's life is to provide financial security to oneself and to the family members. The details of this policy have been discussed in the next chapter. A policy can be opted after evaluating one's needs.

Other investment avenues for Rajiv

Investment in agricultural land

Income from agricultural land may be in various forms like land rent and sale proceeds of agricultural produce. The value of agricultural lands has been highly appreciating in some parts of the country.

Farmhouse

Income can be generated by investment in farmhouses by giving them on rent or by selling the produce of the agricultural land. A farmhouse is any building owned or occupied by a cultivator.

Urban land

Due to increasing pressure of population on land, land prices have gone up all over the world. Investment in urban land can also be profitable.

Gold

It lends stability to the portfolio and acts as a hedge against inflation and is highly liquid.

Bars, coins and biscuits

Bars and coins can be purchased from jewellers or bullion traders. In the past few years, banks have started retailing 24 carat gold biscuits. It retains its purity and comes in tamper proof covers. An individual can gain by selling the bars, coins and biscuits when there is hike in gold prices

Gold Electronically Traded Funds(ETFs)

It is equivalent to 1 gram of gold, are held electronically in the demat form and traded on exchanges. They offer investors the advantage of security, convenience and liquidity. These products are regulated by SEBI and the risk is lower. Income from ETFs is treated as long-term capital gains and taxed at lower rate if the holding period exceeds one year compared with three years as in the case of physical gold. Unlike physical gold, investors are assured transparency in pricing as there are no making charges or premium involved and units are traded on the exchange.

E-gold

E-gold offers liquidity more than most of the gold. Each unit of e-gold is equivalent to one gram of physical gold and is held in the demat account. It is the only form of paper gold that allows conversion to physical gold, or rematerialisation. Offered by the National Spot Exchange Limited (NSEL), e-gold can be bought by setting up a trading account.

Individual Investors and Institutional Investors

Investing money requires considerable expertise since there are so many avenues of investment as discussed. Individual investors, like us, may wish to invest directly in shares and the stock market, if we are willing to take risk. However, if we do not have adequate information about the stock market, we may prefer safe investments like fixed deposits in banks. Or, we may decide to invest in mutual funds.

As an investor you can do it on your own or seek help of **institutional investors**. Institutional investors are professionals employed by financial institutions who are responsible for managing money of clients like Rajiv. They advise the client to invest in different kinds of mutual funds and other securities. They select shares and securities of different companies so that investors get a reasonable return on their investment. The employees of financial institutions who make investment decisions for clients are also referred to as portfolio managers.

Like institutional investors, **individual investors** invest a portion of their money to earn a reasonable return on their investment. Individual investors may hold their stock for more than a year. These investors usually analyse the changes in share prices regularly and accordingly take decision to buy or sell different shares. Some stocks may promise a higher return but an individual should keep his capacity for risk bearing intact. An investor should not get swayed by ups and downs in the market. This kind of investor needs to patiently watch the market rather than change decisions on a weekly basis.

Unit – V

Retirement planning is a part of overall financial planning process. It is an attempt to figure out how much money you need to save each month in order to have a comfortable retirement and be financially secure by making best of the accumulated retirement assets. Planning for retirement acquires added importance because, normally, people over-estimate what they have and under-estimate how much they would need for their post-retirement. At the verge of retirement, your needs will rapidly be changing. You will be asking the big questions – what does retirement mean to me, and will I have enough? How can I be better off? As our lives change, our financial needs and priorities change too.

Whether you are a salaried person employed with a government organisation or a private sector organisation or a self-employed person, the fact remains that you have to retire one day. The benefit with the person employed with any government organisation is that there is a provision for a pension scheme which serves as a regular income to the retired person to support his/her monthly expenses in the post-retirement years. But, the people outside the pension scheme coverage need to take concrete steps to plan for their post-retirement income and earnings.

Why do you need to save?

You have to retire one day. You can choose the age but cannot postpone it indefinitely. The biggest question is, when the time of retirement arrives, will you have enough income to continue the lifestyle you were enjoying before retirement. The amount of pension alone will not be sufficient for most of us. Remember, the average life expectancy is improving with the advancement in the health care sector. The average person who retires at the age of 58-60 looks forward to another 20 years of life. For this it becomes imperative to save enough funds in your 30-35 working life.

Thus, in order to be comfortable in the post-retirement years, there is a need to start planning from today itself. The sooner you start investing, the better it is. You can then experience the **effect of compounding**. Let us take an example: Yogesh, who is now 25 years of age in 2011, starts investing `. 10,000 every month. If his investments grow by 6% p.a., he will end up with `. 1.38 crore in 2046 when he attains the age of 60. If he puts off this exercise for next 10 years, that is, till 2021, he will end up with `. 67.95 lakh.

Did you notice that this amount is less than half the amount that he would have if he had began investing early? It is crucial to stay on track, that is, remain committed and disciplined. If you give up the habit of saving and investing midway, it will not yield the expected returns and affect the financial plan for retirement.

In order to know how much you need to save, you first need to ascertain how much funds you will need after retirement. This involves calculating your monthly earnings (from occupation, interest, dividends, pension or any other investment that you might have). Here, it is necessary to take into account the **rate of inflation**.

Inflation is a widespread and sustained increase in the general price level of goods and services. Economists say that when prices go up 3 per cent or more a year, the country is in a state of inflation. While just about everyone gets hurt by inflation, people who live on fixed incomes may feel the crunch more than others because prices rise but their income doesn't. That's why it makes sense to build-in inflation into your retirement plans.

For example, Sunitha would like to retire in 10 years. She expects inflation to be at an average of 6% throughout the period. After retirement she wants to maintain the same level of living standard which she is presently enjoying. At present she is spending `. 10,000 p.m. To calculate how much she should save today will depend how much she would need 10 years from now. With inflation of 6%, the worth of `. 10,000 p.m. today would approximately be `. 17,900 p.m.[1], i.e., `. 2,14,800 p.a.

What you can do to achieve your retirement goals

The retirement is a new chapter in one's life and the life is not over by any means at the time of retirement. The people either decide to start another job to spend the time or they choose to spend their time with the family and friends. It does not matter what you choose, what matters is that you live a happy life once you have retired.

1. Define your need and financial objectives.
2. Diversification and optimal asset allocation in accordance with one's risk appetite is a key to successful financial and retirement planning.
3. If you start early, you can build large corpus for retirement. It is a myth, that one should start planning for retirement when you are 40+. Remember the power of compounding.

This chapter will help you understand how much you need to grow your wealth before you retire and how to plan for it.

Tools for Planning

Financial Independence

Financial independence is the goal of retirement planning. It is not something that can be done in a day, a week, or even in a month. It is not an event but rather a recursive and cyclical process. The key aspect of retirement planning is to choose the right investment vehicles which will help you reaching your financial goals.

Portfolio planning/Asset allocation

A good retirement planning depends on asset allocation rather than confining oneself to a single investment. For this reason, it is good to spread your investment capital around and understand the income and growth objectives for future performance. You should not put all your eggs in the same basket. What is required is a portfolio with right combination of

assets. You may have various financial assets, namely, shares, debentures, bonds, life insurance, annuities, mutual funds, fixed deposit, company deposits, PPF, monthly income schemes, national savings certificates, etc., in your portfolio. In addition to this, it may also contain tangible assets that can take the form of gold, silver jewellery, precious stones like diamonds, real estate, painting, carvings, etc., and other collectibles. Apart from providing good hedge against inflation, they also emerge as an attractive alternative investment avenue. You may also have some insurance to cover risk.

What assets?

Primarily, all assets are divided into two categories:

i. Real assets
ii. Financial assets

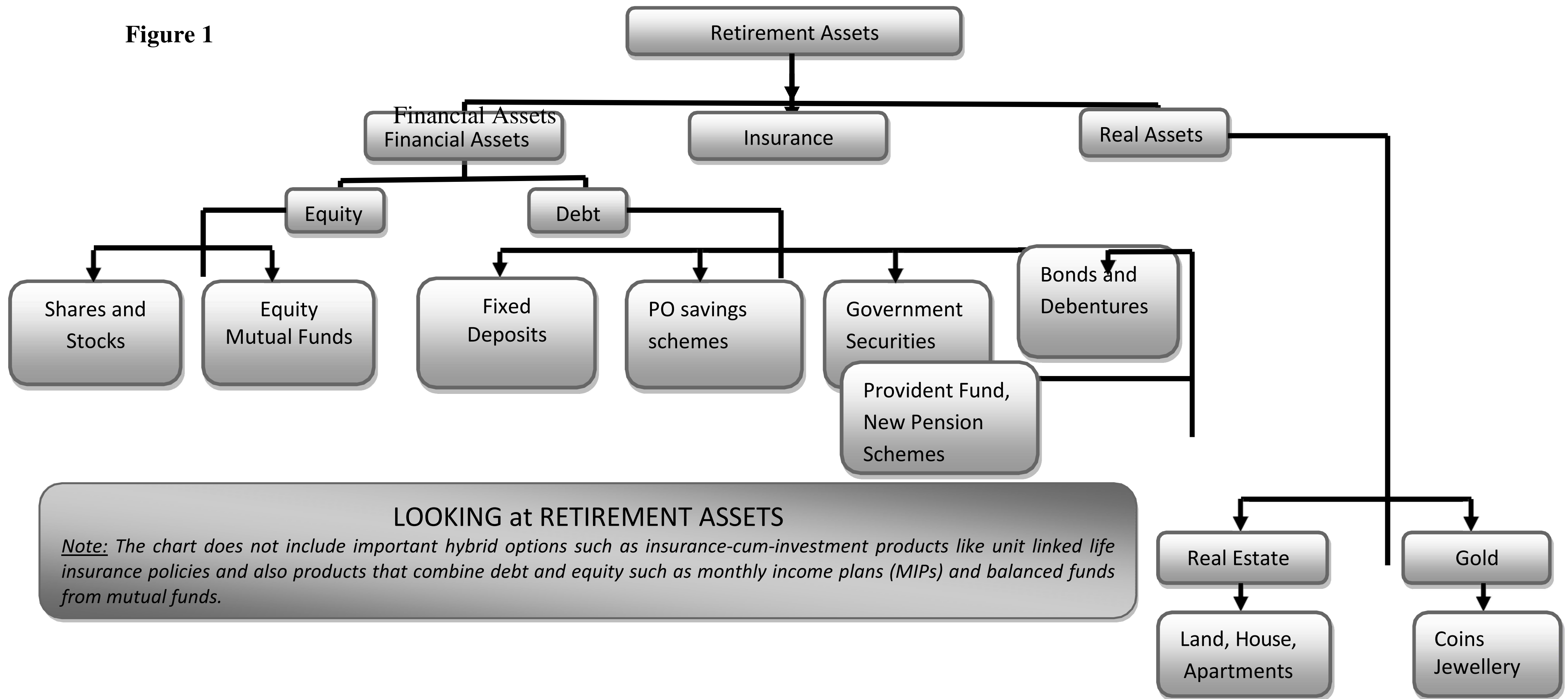
Your *real assets* are the physical assets that you own and are tangible. It means investing in immovable property such as a house, a flat, a plot of land or a commercial space. The other item under real asset is *gold* and other precious stones. However, investment in gold jewellery is mostly done with the intention of safe keeping rather than for sale-resale purposes. The positive side of investing in gold is its high liquidity value.

Financial assets are the claims on real assets and can be converted into cash easily. Depending on the nature of investment, financial assets are of two types: equity and debt.

Equity implies investing in stocks and mutual funds. Investment in stocks involves buying shares of public and private companies. When you buy shares of a company, you become a part owner of the company and share the company's profit and bear losses. Shares can be bought from both primary market (public offering) and secondary market (stock exchange). Shares are traded in the stock exchange and their prices fluctuate on daily basis. Investment in share market should be a purely long-term investment. Mutual funds are essentially a pooling of small resources of individuals which are handed over to a professional fund manager who invests this money in the stock exchange and according to the objectives of the scheme.

Debt: Bank fixed deposits is one of the very popular investment avenues in India. This investment is commonly done by the people who have a very low risk taking aptitude and wish to make safe investment in banks. Similar to the bank fixed deposits, the postal saving_schemes continue to be one of the most popular fixed income instruments in India. The post office small saving schemes like Kisan Vikas Patra , Monthly Income Scheme, Public Provident Fund, Time Deposit Scheme, Recurring Deposit, National Saving Scheme and Senior Citizen Scheme are backed by sovereign guarantee and are zero risk investments. These schemes, however, have a lock-in period between 1-15 years (refer Figure 2). The services of the post office has been successfully tapped into the rural savings market by offering higher rate of return than that extended by scheduled banks. Nearly all post office schemes give returns of about 8% p.a.

Figure 1



Benefits of investing in post office schemes
• These schemes are offered by Government of India. • Safe, secure and risk-free investment options. • No tax deduction at source. • Nomination facility is available. • Nomination can be changed any time. • The instruments are transferable to any post office anywhere in India. • Attractive rate of interest.

Other debt instruments

In addition to these, government securities (G-secs.) issued by Reserve Bank of India, in lieu of the central government borrowings programme, bonds and debentures issued by companies, financial institutions or even by governments are also available for the public as debt instruments. Over and above the scheduled interest payments, the par value of the instrument is received at a specified maturity date. The risk in these instruments is almost nil.

Pension Schemes

Further, the new pension schemes introduced by the government to give people a way to get a pension during their old age. Employees of the government sector already get a pension, so this scheme is introduced as a security measure that enables people from the unorganised sector to draw a pension as well. The working mechanism is simple. You contribute a certain sum every month during your working years, which is then invested according to your preference. You can then withdraw the money when you retire which is currently at 60 years. NPS is meant to be a pension scheme , so it is geared towards giving you a steady stream of income on your retirement.

Figure 2	
Post office Small Savings Schemes	
Kisan Vikas Patra	• Money doubles in 8 years 7 months. • No limit on investment. • Available in the denomination of `. 100, 500, 1000, 5000 , 10,000 and 50,000 in all head post offices

Monthly Income Scheme	• 8% p.a. payable monthly. • Minimum `. 6000, Maximum `. 3 lakh in single account and 6 lakh in joint account. • Maturity period 6 years
15-year Public Provident Account	• 8% p.a. compounded yearly. • Minimum `. 500 maximum `. 70,000 in a financial year. • Deposits can be made in lump sum or 12 monthly instalments. • Interest is completely tax free. • Withdrawal is permissible from the 7th year.
Post office Time Deposit Account	• Interest payable annually but calculated quarterly. • Minimum `. 50 maximum no limit
5-year post office recurring deposit account	• Minimum `. 10 per month any amount in maximum limit. • One withdrawal up to 50% of the balance allowed in the multiple of `. 5 after 3 years.
Post office savings account	• Minimum of `. 50 and maximum of `.1,00,000 for an individual account. • `. 2,00,000 for joint account. • No limit on group, institutional or official capacity accounts.
National Savings Certificate	• Interest compounded six monthly payable at maturity. • Certificate can be purchased by an adult or on the behalf of a minor.
Deposit Scheme for Retiring Govt. Employees	• 8% p.a. payable half yearly. • Minimum `. 1000 maximum not exceeding the total retirement benefits.

But, how can you be sure that your portfolio has all the components adequate enough to cover all your retirement needs? There are certain investments which every individual ought to make though their relative priority changes with age as illustrated below:

	Young (25-35 years of age)	Middle aged (35-45 years of age)	Senior (45-60 years of age)	Retired 60 + age
Life insurance	Medium	Medium	Low	Nil
Medical Insurance	Low	Medium	High	High
House/Flat	Medium	High	High	High
Tax oriented savings schemes	Low	Medium	Medium	Low
Mutual Funds	Medium	High	High	High
Debt Instruments	Low	Medium	Medium	High

Also, savings bank accounts have to be maintained by all of us for meeting ongoing liquidity needs. Each type of investment has distinct advantages and disadvantages, which tends to behave differently in different types of economic mood and swings. Your retirement portfolio should broadly be diversified and well balanced.

Estimating the Retirement Expenses

Let us now review various factors that you should consider while building your retirement portfolio.

Align your Assets

Creating a regular income

It is always better that you align your assets as one portfolio. Your assets or your investments need to be arranged in such a manner that there is a regular flow of income at different intervals. Though the reasons for your investment may be different, you must see your portfolio as one. This will enable you to review your investment in different assets.

In your portfolio you must reallocate these assets from time to time to optimise their returns. Whatever the amount of corpus you have, you must have a mode of regular income in the form of dividends, interests or systematic withdrawals. Hence, you must create an *income ladder* with manageable diversified portfolio to suit your needs and requirements.

One of the best options to get a regular income is *annuities*. Annuities are monthly payments you receive from a financial institution after you invest a lump sum in it. The returns from these investments along with a part of principal form the monthly payment accruing to you. You can buy an annuity plan from a life insurance company or a mutual fund. A regular income can also be generated from a variety of investment instruments such as National Savings Certificates or deep discount bonds that give you a pre-determined lump sum on maturity. If you invest in these at regular intervals your investments will mature at regular intervals in your retirement years creating a regular income flow.

Creating a Lump Sum Income

Besides a regular income, you will also require lump sum amount in your post-retirement years. Your requirements may relate to the higher education of your children, children's marriage or a sudden illness, etc. In this case, the needs are classified as :

Future needs: These needs are known and can be listed in terms of the amount required as and when they arise. You have two alternatives: (a) Invest the lump sum (large amount) and receive a lump sum on maturity. You may opt for infrastructure bonds with a suitable tenure. Other options available are NSC's and Government of India Savings Bonds (RBI bonds), Kisan Vikas Patra and fixed maturity plans which mutual fund companies launch regularly and (b) invest a fix amount regularly and receive a lump sum on maturity. If you choose to save regularly, a mutual fund SIP or post office and bank recurring deposits will be most suitable for you

Unforeseen needs:

Needs may arise due to sudden illness requiring prolonged hospitalisation. You need to keep certain reserves for such contingencies.

Tax Planning

Taxes are levied on your retirement funds. Therefore proper tax planning is required before you retire if you wish to take advantage of your retirement benefits. Your investment in mutual funds, shares, real estate and other assets need to be reallocated so that you are not burdened with tax after retirement

Managing Risk

If you want your investment to be 100% safe, bank fixed deposit can be your choice. But there is some risk involved in other types of investment whether it is debt or equity. In equity funds you are subject to market risks and in debt funds there is the risk of inflation. At times you would like to keep your funds handy for emergencies, meaning thereby you want liquidity. This kind of liquid money earns higher returns. People in general fear that they have not saved enough for the future and therefore they need to manage their retirement funds carefully. Taxes are another unplanned expense which has to be taken care of.