भारतीय प्रतिभूति और विनिमय बोर्ड

Securities and Exchange Board of India

# FINANCIAL EDUCATION
## FOR MIDDLE INCOME GROUP

भारतीय प्रतिभूति और विनिमय बोर्ड
Securities and Exchange Board of India

"The content of the book is developed by National Stock Exchange (NSE) under the guidance of the Advisory Committee for the Investor Protection and Education Fund (IPEF) of Securities and Exchange Board of India (SEBI)"

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**Published by:**
Securities and Exchange Board of India, (SEBI)
October 2011

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# TABLE OF CONTENTS

# 1. INTRODUCTION

Financial planning is a must for every household. Financial planning goes beyond savings. It is an investment with a purpose. It is a plan to save and spend future income. It should be carefully budgeted. Financial Planning is the process of meeting your life goals through proper management of your finances. Life goals can include buying a house, saving for your child's higher education or planning for retirement.

Today you find people living beyond their means, having credit card debt, making risky investments and doing things that are irresponsible and against the basic principles of financial planning. Further the proliferation of new and often complex financial products demands more financial expertise. Also turbulent conditions and changing tax laws compound the need for adequate financial planning. Thus it has become inevitable for all to get into financial planning and understanding financial products.

Financial planning envisages both short term and long term savings. A portion of the savings is invested in certain assets. There are various investment options in the form of assets: bank deposits, government saving schemes, shares, mutual funds, insurance, commodities, bonds, debentures, company fixed deposits etc.

Financial planning isn't something that happens by itself. It requires focus and discipline. It is a six step process that helps you take a 'big picture' look at where you are and where you want to be financially

# 2. BASICS OF SAVINGS AND INVESTMENT

Your Parents were right: money doesn't grow on trees. It actually grows on other money – which is where we get the old saying, "It takes money to make money"? Money does have an amazing ability to make more money. The good news is it doesn't take much money to make this happen.

## Savings and Investing

Saving is what people usually do to meet short term goals. Your money is very safe in a savings account and it is usually earning a small amount of interest. It's also easy for you to get to your money when you need.

Investing means you're setting your money aside for long – term goals. There's no guarantee that the money you invest will grow. In fact, it is normal for investments to rise and fall in value over time. But in the long run, investments can earn a lot more than you can usually make in a savings account.

### Why are savings and investing so important to your financial goal?

For one, saving or investing money for your financial goals makes you less tempted to spend it. But the best reason for investing is that your money is actually making money for you. Any interest or investment gains get you that much closer to your financial goals. And you didn't have to do anything for it!

Start saving early and you'll be prepared when you need it, whether you're saving for a home, a child's education, or your retirement. If you start saving in your 20s, you'll be off to a great start. If you don't, you'll play catch-up for the rest of your life. Youngsters have an advantage that older people don't have: time. When they understand this concept and use time in their favour, young people have a much better chance of pursuing their dreams and reaching their financial goals.

### The Price of Procrastination

You know that the more time you have to invest, the more money you are likely to end up having. But the flip side of that is true too. By waiting to invest, you're paying an opportunity cost. It's easy to say that you don't have enough money to start saving and investing now – "I'd rather wait until I have more money." But that decision probably costs you more than you think because the power of compounding works both ways. It costs you because waiting means giving up earning compound interest from even just a small amount of money.

### Ask yourself the following question:-

Could you spend 10 percent less than you do now, still have fun and put that money to work for your future? If you could save 10 percent of your income for future goals, what would those goals be? It takes more than luck to get what you want out of life. People need to know that by "paying yourself first" – making saving a priority – they can do more than just dream about what they want in the future.

Whether one's income is small or large, setting aside some of it for investments requires self-discipline. By maintaining discipline to postpone buying certain things they'd like to have now they can enjoy the longer term benefits of having that money work for them through savings and investments.

## Path to achieve Financial Freedom:

### Setting Goals

List the five goals you have in life:


1.
2.
3.
4.
5.

Goals can be defined as things we want to achieve in life, towards which we direct our efforts. Let us assume that you have a goal of running a marathon. You don't want to start of and run at full speed right at the beginning and later realise that you are unable to finish. Knowing that the distance to be covered is long, you can plan your pace. Also it will help you prepare for the race by training accordingly. Goals can help us be focused and work out a plan to achieve them.

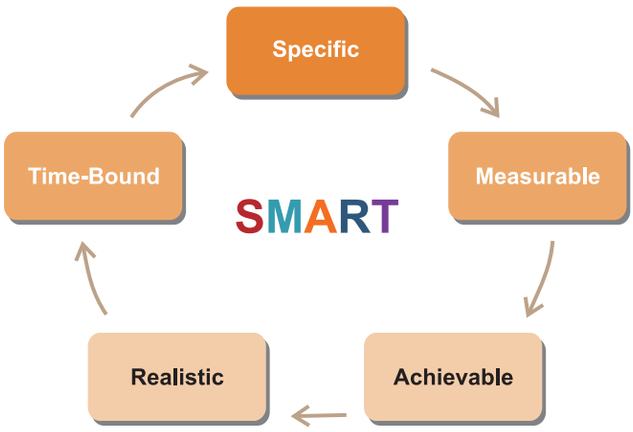
It's rare that anyone has enough money to spend on every single want. Studies show that even multi-millionaires believe that they need about twice what they have to feel worry-free. So everyone has to make choices and set priorities—a good financial plan helps you through that process.

### Goals

**Goals are statements about where you want to end up.** They are what you want to achieve. Goals don't talk about how you will do it. Goals focus on what you want to do.

Goals should be **SMART**

**S**pecific — focused, NOT general.
**M**easurable — you can tell when you've reached them.
**A**chievable — they are possible.
**R**ealistic — based on the resources.
**T**ime bound — there is a deadline.



Goals come from your values. What you believe is important, will lead you to choose certain goals. Finally and most importantly, write down your goals. You are more committed to goals when you write them down. By documenting your goals, you can see and touch them. You can also share them with others. Keep your goals in a visible place, so you'll see them daily. One of the important goals for an individual is planning for his family for the risk of his demise.

## Retirement Planning

**List down the five ways in which retirement planning was being done 30 years back**

1.
2.
3.
4.
5.

**What are the 5 things that you need to do for your retirement planning?**

1.
2.
3.
4.
5.

**How much you should invest to create your retirement fund?**

Let suppose Ram at the age of 30 with monthly expenses of ₹ 10,000 wants to retire at the age of 60 (Life expectancy of 75). What is the corpus he requires for his retirement assuming that he will require 80% of his present expenses? And how much amount he should save every month to build his retirement corpus?

To find the corpus and monthly investment , first of all we have to find that how much he will be spending every month at the age of his retirement, because his current expenses in money value are going to increase in future because of Inflation.

**Step 1:** Value of his expenses at the time of retirement with 5% Inflation?

| No. of years after which you will retire | 5 | 10 | 15 | 20 | 25 | 30 |
|---|---|---|---|---|---|---|
| Amount for expenses you need every month at the time of Retirement | (12,762.82) | (16,288.95) | (20,789.28) | (26,532.98) | (33,863.55) | (43,219.42) |
| Amount for expenses you need every month at the time of Retirement (80% of the requirement) | (10,210.25) | (13,031.16) | (16,631.43) | (21,226.38) | (27,090.84) | (34,575.54) |

**Note: Growth in current expenses after 30 years due to inflation**

Why expenses are less at retirement? (80% in above scenario)

1.

2.

3.

Answer: Ram is retiring after 30 years from now, so his monthly expenses would be ₹ 43, 219 and with 80% it will be ₹ 34,575.

**Step 2:** How much corpus he requires at his retirement to get continuous flow of cash for his monthly expense requirement?

**Assumption: Return on Corpus or investment is 7%.**

| No. of years after Retirement | Expenses of ₹ 10210.25 | Expenses of ₹ 13031.16 | Expenses of ₹ 16631.43 | Expenses of ₹ 21226.38 | Expenses of ₹ 27090.84 | Expenses of ₹ 34575.54 |
|---|---|---|---|---|---|---|
| 5 | 585,130.95 | 746,791.84 | 953,116.66 | 1,216,445.22 | 1,552,526.61 | 1,981,461.08 |
| 10 | 1,117,707.64 | 1,426,509.65 | 1,820,627.96 | 2,323,633.90 | 2,965,611.10 | 3,784,954.77 |
| 15 | 1,602,450.28 | 2,045,177.75 | 2,610,222.66 | 3,331,379.05 | 4,251,777.66 | 5,426,465.43 |
| 20 | 2,043,655.17 | 2,608,279.41 | 3,328,898.92 | 4,248,612.31 | 5,422,425.56 | 6,920,541.77 |
| 25 | 2,445,232.68 | 3,120,805.39 | 3,983,026.38 | 5,083,463.13 | 6,487,930.27 | 8,280,425.78 |
| 30 | 2,810,742.02 | 3,587,298.21 | 4,578,402.57 | 5,843,330.78 | 7,457,735.34 | 9,518,170.11 |

Ram will retire at the age of 60 years and his life expectancy is 75 years that makes his expenses requirement for 15 years (75 years – 60 years).

From the above table we can make out that for 15 years, his required corpus is ₹ 54,26,465.

Step 3: Ram would like to open a Systematic Investment Plan (SIP) where he will invest money every month which grows at 10% annualised over 30 years to build his retirement corpus. How much Ram should invest every month for the corpus?

**Calculations:**

For calculation purpose we are finding out the corpus for ₹ 10 lakhs and after getting the corpus we will multiply it by the required amount:

| Interest / No. of Year | Monthly investment require to build corpus of ₹ 10 Lac | | | | | |
|---|---|---|---|---|---|---|
| | 5 | 10 | 15 | 20 | 25 | 30 |
| 6% | (14,321.72) | (6,125.04) | (3,468.51) | (2,194.69) | (1,471.50) | (1,021.18) |
| 8% | (13,621.38) | (5,516.23) | (2,943.09) | (1,746.24) | (1,093.09) | (705.41) |
| 10% | (12,958.11) | (4,963.82) | (2,489.91) | (1,381.24) | (804.40) | (480.93) |
| 12% | (12,329.91) | (4,463.57) | (2,101.14) | (1,087.13) | (587.47) | (324.57) |
| 15% | (11,449.24) | (3,802.02) | (1,622.41) | (753.54) | (362.77) | (177.56) |

With the above table we can make out that he has to invest ₹ 480/month of ₹ 10 lakhs. Therefore for ₹ 54 lakhs, he has to invest ₹ 2,592 every month = (54/10) x 480 = ₹ 2,592.

**Assignment:**

Calculate the retirement corpus required by you and the monthly investment required to build that corpus based on the tables given below:

1. Your monthly expenses (  )

   (For calculation purpose monthly expenses are given as ₹ 10,000. If your expenses are ₹ 20,000 then multiply the corpus by 2)

2. Your monthly expenses requirement at the time of retirement with inflation rate of 5% _____

| No. of year after which you will retire | 5 | 10 | 15 | 20 | 25 | 30 |
|---|---|---|---|---|---|---|
| Amount for expenses you need every month at the time of Retirement | (12,762.82) | (16,288.95) | (20,789.28) | (26,532.98) | (33,863.55) | (43,219.42) |
| Amount for expenses you need every month at the time of Retirement (80% of the requirement) | (10,210.25) | (13,031.16) | (16,631.43) | (21,226.38) | (27,090.84) | (34,575.54) |

3. Retirement corpus you require for getting regular cash flow _____

| No. of years after Retirement | Expenses of ₹ 10210.25 | Expenses of ₹ 13031.16 | Expenses of ₹ 16631.43 | Expenses of ₹ 21226.38 | Expenses of ₹ 27090.84 | Expenses of ₹ 34575.54 |
|---|---|---|---|---|---|---|
| 5 | 585,130.95 | 746,791.84 | 953,116.66 | 1,216,445.22 | 1,552,526.61 | 1,981,461.08 |
| 10 | 1,117,707.64 | 1,426,509.65 | 1,820,627.96 | 2,323,633.90 | 2,965,611.10 | 3,784,954.77 |
| 15 | 1,602,450.28 | 2,045,177.75 | 2,610,222.66 | 3,331,379.05 | 4,251,777.66 | 5,426,465.43 |
| 20 | 2,043,655.17 | 2,608,279.41 | 3,328,898.92 | 4,248,612.31 | 5,422,425.56 | 6,920,541.77 |
| 25 | 2,445,232.68 | 3,120,805.39 | 3,983,026.38 | 5,083,463.13 | 6,487,930.27 | 8,280,425.78 |
| 30 | 2,810,742.02 | 3,587,298.21 | 4,578,402.57 | 5,843,330.78 | 7,457,735.34 | 9,518,170.11 |

4. Monthly investment you require to build your corpus _____

For calculation purpose, you have to invest regularly to build the corpus of ₹ 10 lakhs. If your requirement is ₹ 20 lakhs, then multiply the monthly investment amount by 2.

| Interest / No. of Year | Monthly investment require to build corpus of ₹ 10 Lac | | | | | |
|---|---|---|---|---|---|---|
| | 5 | 10 | 15 | 20 | 25 | 30 |
| 6% | (14,321.72) | (6,125.04) | (3,468.51) | (2,194.69) | (1,471.50) | (1,021.18) |
| 8% | (13,621.38) | (5,516.23) | (2,943.09) | (1,746.24) | (1,093.09) | (705.41) |
| 10% | (12,958.11) | (4,963.82) | (2,489.91) | (1,381.24) | (804.40) | (480.93) |
| 12% | (12,329.91) | (4,463.57) | (2,101.14) | (1,087.13) | (587.47) | (324.57) |
| 15% | (11,449.24) | (3,802.02) | (1,622.41) | (753.54) | (362.77) | (177.56) |

Please note that higher the return, higher is risk. It is advisable to see your risk taking ability before choosing a financial product.

**Understand your Net worth:**

Please take 5 min to read the data given:

The family of Mr. Dipal shah (34 years) comprises of his wife (30 years) a self-employed professional, son (3 years) and mother around 65 years

## Annual Income / Expenditure Statement

| Item | Self (₹) | Wife (₹) | Gross (₹) |
|---|---|---|---|
| Income (Salary / Professional) | **2,00,000** | **60,000** | **2,60,000** |
| **Expenses** | | | |
| Household Expenses | | | **1,20,000** |
| Misc. Expenses | | | **16,000** |
| Home loan EMI Annualised | | | **60,000** |
| Education | | | **12,000** |
| Personal Loan Repayment | | | **15,000** |
| LIC Premium* (Self & Wife) | | | **7,000** |
| Mediclaim Premium (Self & Family) | | | **10,000** |

| Assets & Liabilities | ₹ |
|---|---|
| ***Shares*** | *40,000* |
| ***Life Insurance Term Plan for Self & Wife*** | *50,000* |
| ***Furniture*** | *30,000* |
| ***Television*** | *10,000* |
| ***Home Appliances*** | *25,000* |
| ***Canteen bill not paid*** | *2,000* |
| ***PF (Self)*** | *85,000* |
| ***Electrical Goods*** | *3,000* |
| Company FD | 25,000 |

| *Assets & Liabilities* | ₹ |
|---|---|
| ***Residential House*** | *6,50,000* |
| ***Bank FD*** | *27,000* |
| ***NSC*** | *50,000* |
| ***Credit card balance*** | *25,000* |
| ***Phone bill not paid*** | *2,000* |
| ***Bank account balance*** | *36,000* |
| ***Home Loan EMI O/s*** | *5,35,000* |
| ***Personal Loan*** | *2,00,000* |
| ***Gold Jewelry*** | *60,000* |
| ***PO MIS*** | *1,00,000* |

***What are the assets owned by the family?***

1._____ 6. _____

2._____ 7. _____

3._____ 8. _____

4._____ 9. _____

5._____10. _____

***How will you classify the assets owned by the family?***

1._____ 6. _____

2._____ 7. _____

3._____ 8. _____

4._____ 9. _____

5._____ 10. _____

***What are the possible assets that can enhance the wealth of the family?***

1._____ 6. _____

2._____ 7. _____

3._____ 8. _____

4._____ 9. _____

5._____ 10. _____

***Learning:*** **The focus of the family should be on accumulating assets that will enhance the wealth of the family.**

List all the liabilities for the family

1._____ 6. _____

2._____ 7. _____

3._____ 8. _____

4._____ 9. _____

5._____ 10. _____

**Calculate the Net worth of Mr. Shah's Family**

**Learning Tracker:**

1. Identify all the income generating assets owned by you

_____

_____

_____

_____

_____

_____

2. Identify all the liabilities you have

_____

_____

_____

_____

_____

3. Calculate your own Net worth as of today.

## Budgeting

The first step in your financial planning is budgeting. Budgeting is a process for tracking, planning and controlling the inflow and outflow of income. It entails identifying all the sources of income and taking into account all current and future expenses, with an aim to meet an individual's financial goals. The primary aim of a budget planner is to ensure savings after the allocation for spending.

**Benefits of budgeting –**

- It puts checks and balances in place in order to prevent overspending at various levels
- Takes into account the unexpected need for funds
- Helps discipline you
- Helps one maintain his/her standard of living post retirement

Steps for budget planning:-

Step 1:- Calculate your income: This should include income from all sources, including your paycheck and interest from any investment

Step 2:- Determine your expense for essentials: List out your essential expenses, which may include rent, grocery, clothing, telephone and electricity bills and fuel and vehicle maintenance. Calculate the amount spent on each.

Step 3:- Note down your total debts, including interest payments on the same.

Step 4:- Determine your expense for non-essentials: Your list of non essentials may include vacations, gifts and trips to restaurants. Calculate the amount spent on each.

Step 5:- Calculate your savings: This is done by subtracting the figure obtained by adding steps 2, 3 and 4 from the figure obtained in step 1.

Realize that unexpected things come up in life. You may have to break your budget plan, or reconstruct it, occasionally. However try to avoid debt to cover the shortage and stick to your budget as much as possible.

## Effects of Inflation on Investments

When you are planning your investment, it is critical that you take into account the effects of inflation on your investments. At its most basic level, inflation is simply a rise in prices. Over time, as the cost of goods and services increase, the value of a rupee is going to go down because you won't be able to purchase as much with those rupees as you could have in the last month or last year.

### How does inflation affect my investment decision?

A Vada pav which used to cost ₹ 2 five years back now the same costs ₹ 7. The cost increase is not as a result of increase in quantity or better quality. The increase is a result of increase in prices of ingredients which have increased as a result of inflation. Change in the prices of some assets:-

| Assets | Price in (2001- 02) | Price in (2009-10) |
|---|---|---|
| Sugar (1 kg) | 16.00 | 40.00 |
| Cooking Oil (5 liters) | 290.00 | 500.00 |
| Gold (10 grams) | 4,474.00 | 17, 138 |
| Silver (1 kg) | 7,868.00 | 28,345.00 |
| Rice (1 kg) | 14.00 | 35.00 |
| Petrol (1 liter) | 33.46 | 48.83 |
| Diesel (1 liter) | 19.88 | 36.74 |

Inflation is greatly feared by investors because it grinds away the value of your investment. Example:- If you invest ₹ 1,000 in a one year fixed deposit that will return 5% over that year, you will be giving up ₹ 1,000 right now for ₹ 1,050 in 1 year. If over the course of that year there is an inflation rate of 6%, your expenses which were ₹ 1,000 in the previous year will increase to ₹ 1,060 at the end of the year. Thus even after investing your money for 1 year you are worse off compared to the previous year because the returns delivered by your investments has been below the inflation rate.

### What are the steps that an investor can take to avoid the adverse effects of inflation?

Try to determine your "real rate of return" which is the return you can expect after factoring in the effects of inflation. In addition to being aware of the current rate of inflation, it is crucial to be aware of what inflation rate the experts are anticipating.

Both the value of current investments and the attractiveness of future investments will change depending on the outlook for inflation. Also remember fixed income investments are particularly vulnerable to the effects of inflation. If you are locked into a particular interest rate and inflation increases, your earnings will not keep up and you will earn a negative return.

## Risk and Return

Risk and investment in hand. Risk can be defined as the chance one takes that all or part of the money put into an investment can be lost. The good news is that investing risk comes with the potential for investing reward – which is what makes the whole process worthwhile.

The basic thing to remember about risk is that it increases as the potential return increases. Essentially the bigger the risk is, the bigger the potential payoff. (Don't forget the two words -"potential payoff". There are no guarantees)

Even seemingly "no-risk" products such as savings accounts and government bonds carry the risk of earning less than the inflation rate. If the return is less than the rate of inflation, the investment has actually lost ground because your earning aren't being maximised as they might have been with a different investment vehicle.

While you stay invested it is crucial that you take necessary measures to manage your risk. Once you invest in any asset class you should monitor your investments and keep yourself updated about various market happenings to avoid any pitfalls. Always check the potential risks when quoted returns are unusually high.

## Power of Compounding

As you pursue your financial planning, the most powerful tool for creating wealth safely and surely is 'the magical power of compounding. Albert Einstein had once remarked, 'The most powerful force in the universe is compound interest'. Compounding is a simple concept that offers astounding returns: if you park your money in an investment with a given return and then reinvest those earnings as you receive them, your investment grows exponentially over time. With simple interest, you earn interest only on the principal (that is, the amount you initially invested); with compounding, you earn interest on the principal and additionally earned interest on the interest.

Consider what the power of compounding does to an investment of ₹ 12,000 a year (that is, an affordable ₹ 1,000 a month) in a scheme that offers a 9 per cent return, over 30 years. The total investment of ₹ 3.6 lacs (principal) grow to ₹ 17.83 lacs over that period.

Compounding rewards disciplined investing and works best over long tenures. In the above example, the first 20 years yield is just ₹ 6.69 lacs. The last 10 years show the multiplier effect of the power of compounding. The longer you leave your money untouched, the faster and bigger it grows. For instance, stretching the above investment pattern to 40 years will give you ₹ 44.20 lacs.

Compounding, thus, is a wonder tool that lets you make the most of small investments made over long periods of time to accumulate phenomenal wealth. It works best if you start investing early and leave the money alone. Compounding is, in fact, the single most important reason for you to start investing right now. Every

day you are invested is a day that your money is working for you, helping to ensure a financially secure and stable future.

### Illustrations: Power of Compounding

Santosh and Sunil are friends and both want to invest ₹ 1 lac @ 10% pa. But Santosh will get compounding interest rate of 10% and Sunil will get Simple interest rate of 10% on their investments

### Now see the power of compounding:

| Year | Compounding @ 10% | Simple interest @ 10% |
|---|---|---|
| 1 | 1,10,000.00 | 1,10,000.00 |
| 2 | 1,21,000.00 | 1,20,000.00 |
| 3 | 1,33,100.00 | 1,30,000.00 |
| 4 | 1,46,410.00 | 1,40,000.00 |
| 5 | 1,61,051.00 | 1,50,000.00 |
| 20 | 6,72,750.00 | 3,00,000.00 |
| 25 | 10,83,470.59 | 3,50,000.00 |
| 30 | 17,44,940.23 | 4,00,000.00 |

1. After one year both will get same amount i.e. ₹ 110, 000
2. After 5 years Santosh will get ₹ 1, 61,051 and Sunil will get ₹ 1, 50,000.
3. After 30 years Santosh will get ₹ 17, 44,940 and Sunil will get ₹ 4, 00, 000,

### A difference of ₹ 13.4 lac in 30 years

**1. Divya invests ₹ 500 today in an account earning 7% p.a interest rate compounded annually. How much will it be worth in?**

a. 5 years?

b. 10 years?

c. 20 years?

**2. Now Divya finds an account that earns 10% p.a interest rate compounded annually. How much will her ₹ 500 be worth at the new rate in:**

a. 5 years?

b. 10 years?

c. 20 years?

## The Rule of 72

You now know that the concept of compounding means that your money is making more money even while you sleep. One way to see how powerful this can be is called the Rule of 72.

Mathematicians say that you can see how long it will take you to double your money simply by dividing 72 by the interest rate. So let's say your grandparents give you ₹ 200 for your birthday and you plan to invest it. If you put the money into an account that earns 6 percent interest a year, how long will it take to grow to ₹ 400?

**72 ÷ 6% interest = 12 years**

So in 12 years, your money will have doubled to ₹ 400. But what if your dad tells you about an account where you could earn 9 percent a year on your money?

**72 ÷ 9% interest = 8 years**

Now you will have that ₹ 400 in only eight years. By earning just a little bit more interest, you reduce the time to double your money by four years. And this doesn't include any additional money that you may put into your account over time, which would only speed up the process.

But what if eight years seems too long to wait and you want that ₹ 400 in four years instead? The Rule of 72 can also tell you the interest rate you need to earn to double your money in a certain amount of time. So for four years it would be:

**72 ÷ 4 years = 18% interest**

You can now see how even a small difference in the interest rate you earn can make a big difference in how quickly your money compounds — earning you more money — over time.

## Time Value of Money

As time passes, you will realise that if 10 years back you could afford to purchase a full lunch for ₹ 10, today you might afford to get a few pieces of vegetables only. This means that the value of a thousand rupee note would be higher today than after five years. Although the note is the same, you can do much more with the money if you have it now because over time. The value of ₹ 1,000 will decrease because of inflation.

At the most basic level the time value of money demonstrates that time literally is money - the value of the money you have now is not the same as it will be in the future and vice versa

## 3. CHOOSING RIGHT INVESTMENT OPTIONS

The choice of the best investment options will depend on personal circumstances as well as general market conditions. An investment for one's objective may not suit the needs of the other. Right investment is a balance of three things: Liquidity, Safety and Return.

### Liquidity

This will cover the ease with which the investment can be converted to cash to meet expenses. Some liquid investments are required to meet exigencies that arise in the normal course or otherwise.

### Safety

This is about the risk factor of the investment. The worst case is losing all the invested money.

The milder case is losing on the income or low income growth or investment growth. Inflation is also a risk, as the purchasing value of money reduces.

### Return

Income generated by investments is another factor to consider. Safe investments offer steady but lower income and risky investments offer high returns or no returns at all.

There are several short-term and long-term financial investment options available, some of which are given hereafter:

Thus, there is a staggering variety of investments to choose from. In the following chapters we will focus on these and explain about them.

## 4. ASSET ALLOCATION STRATEGY

Every Asset class has its own risk and returns. Equity Investments are considered to be risky investments as they might lead to erosion of entire capital invested, whereas government bonds are considered to be risk free as you can be confident that the government will not default on its interest payments.

This is where asset allocation plays a crucial role. Asset allocation is a technique for investing your money into various asset classes that would suit your income and risk appetite.

Asset allocation involves tradeoffs among three important variables:

- Your time frame
- Your risk tolerance
- Your personal circumstances

Depending on your age, lifestyle and family commitments, your financial goals will vary. While allocating your funds to various assets, it is important to see that you distribute your funds across various assets to benefit from diversification.

Normally, in an age based asset allocation, the amount allocated to equities is based on the Investor's age. The premise of using this model is "as the investor gets older, his portfolio should be more conservative". However, as this is just a thumb rule, an investor is the best judge of what suits him the most.

# 5. SELF PORTRAIT

To know exactly where you stand financially, having financial statements compiled is one of the best ways to gain this kind of insight. A key component of a financial statement is a detailed and complete accounting of assets and liabilities associated with the person.

### Identifying Goals

The most important step in financial planning is identifying and understanding what you want to accomplish. Money is merely a tool to be used to satisfy your desires. By understanding what you truly want, it is much easier to plan for how much you need to accomplish your goals.

### Identifying Assets

Once your goals are identified, it is time to assess what assets are available to meet them. Assets need to be categorized according to their liquidity and stability of long term value. The key to identifying and categorizing assets is understanding when and how they generate cash. Make a list of all your assets which include your house, investments in shares, mutual funds, fixed deposits, money lying in the savings bank account etc

### Identifying Liabilities

Identifying your liabilities is as important as identifying the assets available. Ideally, the assets should be more than the liabilities. Planning is required to invest in assets to meet the liabilities and have some assets left over for earning income and investment purposes.

### Likely Future Earnings

When estimating your future earnings you need to make certain assumptions. Some of the assumptions can be as follows:-

If you are a salaried employee it is safe to assume that your salary income will increase at a rate of 8% p.a till retirement.

Rate of return on debt investments can be assumed as 7% p.a. and return on equity index as 12% p.a.

*The aforesaid is only indicative returns. Actual returns may vary depending on market conditions.*

### Likely Future Expenses

Here again you need to make assumption like:-

Long term inflation rate of 5% p.a.

Household and personal living expenses (including entertainment, education, marriage etc.) expenses increase at a rate of 8% p.a (3% more than the rate of inflation)

### Planning

Matching cash inflows from assets to cash outflows for liabilities is the crux of financial planning. In financial planning, goals are considered liabilities due to the fact they generally require cash outflows. This is a multi step approach.

**Example:-**

Suppose your goal is to save enough money for your child's higher education

**Step 1: Determine the no. of years till your child will require higher professional education**

**Step 2: Determine the education cost today. This calculation usually involves taking the current** price of a professional course and multiplying it against an estimated annual rate of inflation

**Step 3: Suppose it costs ₹ 1,00, 000 today for a professional course. ₹ 1,00,000 x 1.05^12 = ₹ 1,79,585** would be the cost 12 years from now, with an expected 5 percent annual inflation rate

**Step 4: The next step is to figure out the present value of that future cash outflow. To do that** you would take the future value of the money and divide it by your expected rate of return.

The future value of ₹ 1,00,000 equals ₹ 1,79,585 as calculated above. The present value of that future value with an estimated annual return of 8 percent for 12 years is ₹ 1,79,585 / 1.08^12, which equals ₹ 71,315. So you need to put ₹ 71,315 today into an asset that will earn you 8 percent annually on average to be able to pay for your child's education in 12 years that costs 100,000 in today's terms.

**Step 5: For every cash outflow you anticipate in the future, you need to calculate the present** value of that outflow and find an asset that can be used to cover the future cost. This process need to be repeated for all your future goals. Calculate your future expenses and start saving for it today so you are in a position to meet all of them.

# 6. SAVINGS AND INVESTMENT RELATED PRODUCTS

## Banks

Bank deposits are safe investments as all bank deposits are insured upto a maximum of ₹ 100,000 under the Deposit Insurance & Credit Guarantee Scheme of India. Banks are subject to control and regulated by the Reserve Bank of India. They offer various types of deposits, depending on the needs of the customer. Bank deposits are preferred more for their liquidity and safety than for the returns thereon. It is possible to get loans up to 75 - 90% of the deposit amount from banks against fixed deposit receipts.

## TYPES OF DEPOSITS AND KEY FEATURES

### Savings Bank Account

- Often the first banking product people use
- Low interest however, highly liquid
- Suitable for inculcating the habit of saving among the customers

### Bank Fixed Deposit (Bank FDs)

- Involves placing funds with the banks for a fixed term (not less than 30 days) for a certain stipulated amount of interest
- The ideal investment time for bank FDs is 6 to 12 months as normally interest on bank for less than 6 months bank FDs is likely to be low
- The time frame assumes importance as early withdrawal may carry penalty

### Recurring Deposit Account

- Some fixed amount is deposited at monthly intervals for a pre-fixed term
- Earns higher interest than Savings Bank Account
- Helps in the saving of a fixed amount every month

### Special Bank Term Deposit Scheme

- This is the Tax Saving Scheme available with banks
- Relief under Section 80C of the Income Tax Act available
- Term deposit of five years maturity in a scheduled bank is mandatory

## GOVERNMENT SCHEMES

### Tax Savings Schemes*

### The Government of India has launched Income Tax Saving Schemes including:

- National Savings Certificate (NSC)
- Public Provident Fund (PPF)
- Post Office Scheme (POS)

Besides, Equity link savings scheme (ELSS) offered by Mutual Funds and

Infrastructure Bonds of Financial Institutions / Banks also offer tax benefit. The incomes from the investment are exempt from Income Tax and the investments in these schemes are deductible subject to certain limits from the taxable income.

### National Savings Certificates (NSC)

- Popular Income Tax Savings scheme, available throughout the year
- Interest rate of 8%
- Minimum investment is ₹ 100/- and with no upper limit
- Maturity period of 6 years
- Transferable and a provision of loan on the basis of this scheme

### Public Provident Fund (PPF)

- Interest rate of 8.6% p.a
- Minimum investment limit is ₹ 500/- and maximum is ₹ 1,00,000/-
- Maturity period of 15 years
- The first loan can be taken in the third financial year from the date of opening of the account, or upto 25% of the amount at credit at the end of the first financial year. Loan amount can be returned in maximum of 36 installments
- A person can withdraw an amount (not more than 50% of the balance) every year from the 7th year onwards

### Post Office Scheme (POS)

- It is one of the best Income Tax Saving Schemes
- It is available throughout the year
- Post Office schemes depends upon the type of investment and maturity period, which can be divided into following categories:
  - Monthly Deposit
  - Saving Deposit
  - Time Deposit
  - Recurring Deposit

### Equity Linked Savings Schemes (ELSS)

- Mirror image of a diversified equity fund, however, with tax benefit U/S 80 C
- Lock in period of three years
- Dividends are also tax free
- On sale of these units, benefit can be obtained of long term capital gains, on which no capital gains tax is to be paid
- Minimum investment is ₹ 500 and then multiples thereof
- Investor can opt for systematic investment plan (SIP)

### Infrastructure Bonds

- Lock in period of three years
- Tax benefit U/S 88 on investments upto ₹ 20,000
- Any redemption prior to maturity nullifies the tax exemption

** Investors are advised to see latest Income tax provisions and other provisions from relevant sources.*

# Bonds

A Bond is a loan given by the buyer to the issuer of the instrument, in return for interest. Bonds can be issued by companies, financial institutions, or even the Government. The buyer receives interest income from the seller and the par value of the bond is receivable by the buyer on the maturity date which is specified.

## TYPES OF BONDS

### Tax-Saving Bonds

Tax-Saving Bonds offer tax exemption up to a specified amount of investment, depending on the scheme the Government notification. Examples are:

- Infrastructure Bonds under Section 88 of the Income Tax Act, 1961
- NABARD/ NHAI/REC Bonds under Section 54EC of the Income Tax Act, 1961
- RBI Tax Relief Bonds

### Regular Income Bonds

Regular-Income Bonds provide a stable source of income at regular, pre-determined intervals. Examples are:

- Double Your Money Bond
- Step-Up Interest Bond
- Retirement Bond
- Encash Bond
- Education Bonds
- Money Multiplier Bonds
- Deep Discount Bonds

### Key Features

- Rated by specialised credit rating agencies like, CRISIL, ICRA, CARE, Fitch etc. The yield on a bond varies inversely with its credit (safety) rating
- Suitable for regular income. Interest is received semi-annually, quarterly or monthly depending on type of bond
- Bonds available in both primary and secondary markets
- Market price depends on yield at maturity, prevailing interest rates, and rating of the issuer
- One can borrow against bonds by pledging the same with a bank
- Minimum investment ranges from ₹ 5,000 to ₹ 10,000
- Duration usually varies between 5 and 7 years
- Can be held in demat form

# Debentures

### Key Features of Debentures

- Fixed interest debt instruments with varying period of maturity, similar to bonds, but are issued by companies
- Either be placed privately or offered for subscription

- May or may not be listed on the stock exchanges. If they are listed on the stock exchanges, they should be rated prior to the listing by any of the credit rating agencies designated by SEBI
- Maturity period normally varies from 3 to 10 years

### Types of debentures

- There are different kinds of debentures, which can be offered. They are as follows:
- Non convertible debentures (NCD) – Total amount redeemed by the issuer
- Partially convertible debentures (PCD) – Part is redeemed and part is converted to equity shares with or without the option to investor.
- Fully convertible debentures (FCD) – Whole value is converted into equity. The conversion price is stated when the instrument is issued

## Company Fixed Deposits

### Key Features

- Fixed deposit scheme offered by a company. Similar to a bank deposit
- Used by companies to borrow from small investors
- The investment period must be selected carefully as most FDs are not encashable prior to their maturity
- Not as safe as a bank deposit. Company deposits are 'unsecured'
- Offer higher returns than bank FDs, since they entail higher risks
- Rating can be guide to their safety

## Mutual Funds

A mutual fund pools money from many investors and invests the money in stocks, bonds, short-term money-market instruments, other securities or assets, or some combination of these investments. The combined holdings the mutual fund owns are known as its portfolio. Each unit represents an investor's proportionate ownership of the fund's holdings and the income those holdings generate.

### Salient Features of Mutual Funds

- Professional Management – Money is invested through fund managers
- Diversification - Diversification is an investing strategy that can be neatly summed up as "Don't put all your eggs in one basket". By owning shares in a mutual fund instead of owning individual stocks or bonds, the risk is spread out
- Economy of Scale - Because a mutual fund buys and sells large amounts of securities at a time, its transaction costs are lower than what an individual would pay for securities transactions
- Liquidity - Just like individual shares, mutual fund units are convertible into money by way of sale in the market
- Simplicity - Buying a mutual fund unit is simple. Many banks have sponsored their own line of mutual funds and the minimum investment amount is small
- Investors should examine each of the above features carefully before investing in mutual funds

## Types of Mutual Funds

Each fund has predetermined investment objectives that tailor the fund's assets, regions of investments and investment strategies. At the fundamental level, there are three varieties of mutual funds:

- Equity funds (stocks)
- Fixed-income funds (bonds)
- Money market funds

All mutual funds are variations of these three asset classes. For example, while equity funds that invest in fast-growing companies are known as growth funds, equity funds that invest only in companies of the same sector or region are known as specialty funds.

Mutual Funds can also be classified as open-ended or closed-end, depending on the maturity date of the fund.

## Open-ended Funds

- An open-ended fund does not have a maturity date
- Investors can buy and sell units of an open-ended fund from / to the Asset Management Company (AMC), at the mutual fund offices or their Investor Service Centre's (ISCs) or through the stock exchange.
- The prices at which purchase and redemption transactions take place in a mutual fund are based on the net asset value (NAV) of the fund

## Closed-end Funds

- Closed-end funds run for a specific period
- On the specified maturity date, all units are redeemed and the scheme comes to a close
- The units shall be listed on a stock exchange to provide liquidity
- Investors buy and sell the units among themselves, at the price prevailing in the stock market

## Money Market Funds

- Invest in extremely short-term fixed income instruments
- The returns may not be very high, but the principal is safe
- These offer better returns than savings account but lower than fixed deposits without compromising liquidity

## Bond/Income Funds

- Purpose is to provide current income on a steady basis
- Invests primarily in government and corporate debt
- While fund holdings may appreciate in value, the primary objective of these funds is to provide a steady cash flow to investors

## Balanced Funds

- Objective is to provide a balanced mixture of safety, income and capital appreciation

- Strategy is to invest in a combination of fixed income and equities

### Equity Funds

- Invest in shares and stocks
- Represent the largest category of mutual funds
- Investment objective is long-term capital growth with some income
- Many different types of equity funds because of the different types of investment objectives

### Foreign/International Funds

- An international fund (or foreign fund) invests in the equity of the companies which are outside the home country

### Sector funds

- These are targeted at specific sectors of the economy such as financial, technology, health, etc.

### Index Funds

- This type of mutual fund replicates the performance of a broad market index such as the SENSEX or NIFTY
- An index fund merely replicates the market return and benefits investors in the form of low fees

## Equity

The ownership interest in a company of holders of the common and preferred stock. A stock market is a public market for the trading of company shares at an agreed price, these are securities listed on a stock exchange.

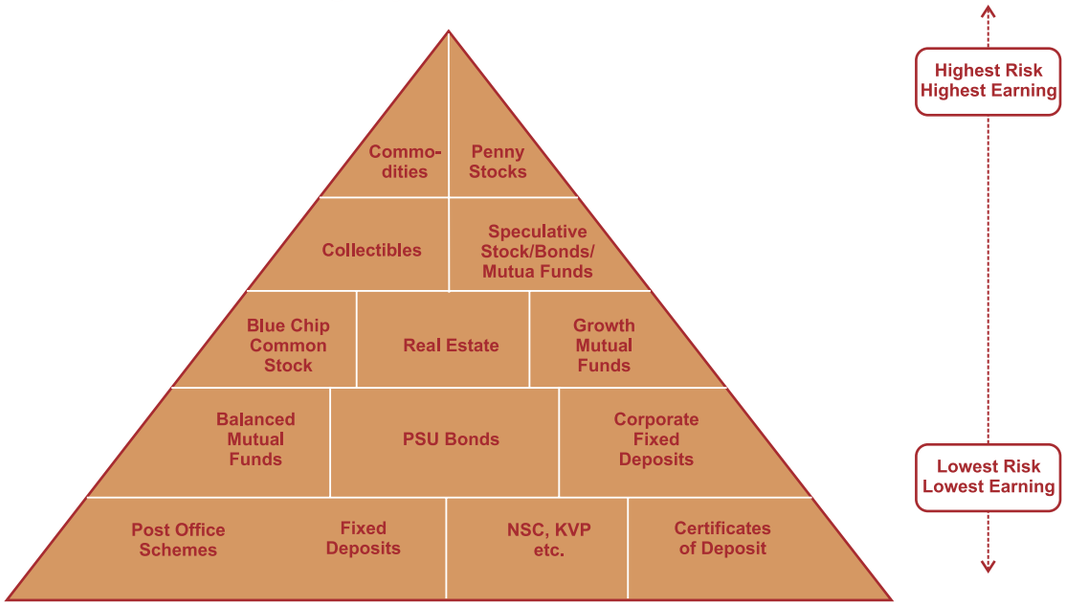
The shares are listed and traded on stock exchanges which facilitate the buying and selling of stocks in the secondary market. The prime stock exchanges in India are The Stock Exchange Mumbai, known as BSE and the National Stock Exchange India ltd known as NSE. The purpose of a stock exchange is to facilitate the trading of securities between buyers and sellers, thus providing a marketplace. Investing in equities is riskier and definitely demands more time than other investments.

### There are two ways in which investment in equities can be made:

- Through the primary market (by applying for shares that are offered to the public)
- Through the secondary market (by buying shares that are listed on the stock exchanges)

Having first understood the markets, it is important to know how to go about selecting a company, a stock and the right price. A little bit of research, some diversification and proper monitoring will ensure that the investor earns good returns.

## Financial Planning Pyramid




The risk/reward trade-off is the key to choosing investments that are right for you, because most people have different ideas about how much risk they should take with their money. Some are conservative and want to keep it someplace safe, like a savings account. Others are more aggressive and are willing to invest it someplace riskier, like the stock market. In the end, you have to decide how comfortable you would be with an investment that could frequently go up and down in price.

Of course, the reward for taking on risk is your return on investment. Return can be made up of income such as ***interest*** or ***dividends*** (which are a share of the profits you receive as a stockholder). Return can also come about from growth stock prices, called ***capital gains.*** If an investor buys a stock and sells it later at a higher price, the difference between the purchase price and the selling price is called a *capital gain.* So if you bought Stock A for ₹ 10 per share in 2000, then sold it for ₹ 25 per share in 2005, your profit, or capital gain, is ₹ 15 per share. If an investor ends up selling a stock at a lower price, the difference is called a ***capital loss.***

When talking about return, people usually cite an investment's ***rate of return*** or rate of interest, which is simply the annual percentage return on an investment. In short, it tells you how fast your money is growing.

## Ponzi scheme

A Ponzi scheme is a fraudulent investment operation that promises high rates at little risk to investors. The scheme generates returns for older investors from their own money or money paid by subsequent investors, rather than any actual profit earned. The perpetuation of the returns that a Ponzi scheme advertises and pays requires an ever-increasing flow of money from investors to keep the scheme going.

The system is destined to collapse because the earnings, if any, are less than the payments to investors. Usually, the scheme is interrupted by legal authorities before it collapses because a Ponzi scheme is suspected or because the promoter is selling unregistered securities. As more investors become involved, the likelihood of the scheme coming to the attention of authorities increases.

## How to Spot one?

The Ponzi scheme usually entices new investors by offering returns other investments cannot guarantee, in the form of short-term returns that are either abnormally high or unusually consistent. In other words it seems too good to be true.

## The ultimate unraveling of a Ponzi scheme

- As more investors become involved, the likelihood of the scheme coming to the attention of authorities increases.
- The promoter will vanish, taking all the remaining investment money
- The scheme will collapse under its own weight as investment slows and the promoter starts having problems paying out the promised returns
- External market forces, such as sharp decline in the economy will cause many investors to withdraw part or all of their funds not due to loss of confidence in the investment, but simply due to underlying market fundamentals.

## DEPOSITORY SYSTEM

In order to invest in shares, it is necessary to understand the term "Dematerialisation of Shares", as almost all shares now are in "Demat" form. Earlier, there used to be physical share certificates issued, which are now converted to Electronic form. For this, an understanding of the depository system becomes essential.

A depository is an organisation which holds securities (like shares, debentures, bonds, government securities, mutual fund units etc.) of investors in electronic form at the request of the investors through a registered Depository Participant. It also provides services related to transactions in securities. It can be compared with a bank, which holds the funds for depositors.

At present two Depositories viz. National Securities Depository Limited (NSDL) and Central Depository Services (India) Limited (CDSL) are registered with SEBI.

A Depository Participant (DP) is an agent of the depository through which it interfaces with the investor and provides depository services. Public financial institutions, scheduled commercial banks, foreign banks operating in India with the approval of the Reserve Bank of India, state financial corporations, custodians, stock-brokers, clearing corporations /clearing houses, NBFCs and Registrar to an Issue or Share Transfer Agent complying with the requirements prescribed by SEBI can be registered as DP. Banking services can be availed through a branch whereas depository services can be availed through a DP.

It is now compulsory for every investor to open a beneficial owner (BO) account to trade in the stock exchange or apply in public issue. Therefore, in view of the convenience as listed below, it is advisable to have a beneficial owner (BO) account.

However to facilitate trading by small investors (Maximum 500 shares, irrespective of their value) in physical mode the stock exchanges provide an additional trading window, which gives one time facility for small investors to sell physical shares which are in compulsory demat list. The buyer of these shares has to demat such shares before further selling.

### Benefits of availing depository services include:

- A safe and convenient way to hold securities
- Immediate transfer of securities
- No stamp duty on transfer of securities
- Elimination of risks associated with physical certificates such as bad delivery, fake securities, delays, thefts etc.
- Reduction in paperwork involved in transfer of securities
- Reduction in transaction cost
- No odd lot problem, even one share can be traded
- Nomination facility
- Change in address recorded with DP gets registered with all companies in which investor holds securities electronically eliminating the need to correspond with each of them separately
- Transmission of securities is done by DP eliminating correspondence with companies
- Automatic credit into demat account of shares, arising out of bonus /split / consolidation /merger etc.
- Holding investments in equity and debt instruments in a single account.

### Points to Remember

- Participants range from small individual stock investors to large fund traders, who can be based anywhere
- One of the most important sources for companies to raise money
- Allows businesses to be publicly traded, or raise additional capital for expansion by selling shares of ownership of the company in a public market
- Stock market is often considered the primary indicator of a country's economic strength and development
- Stock prices fluctuate, in marked contrast to the bank deposits or bonds
- The reasons for investing in equity must also be reviewed periodically to ensure that they are still valid
- Sometimes the market seems to react irrationally to economic or financial news, even if that news is likely to have no real effect on the value of securities itself
- Over the short-term, stocks and other securities can be battered or buoyed by any number of fast market-changing events, making the stock market behaviour difficult to predict.

## Investment Philosophies

- Evaluate risk of every investment
- Have clarity on short term and long term needs of the family
- Decide the investment based on the needs
- Do not invest in any scheme that you do not understand
- Do not invest on trust. Have everything backed up by documents
- Take into account tax implication of every income
- Do not blindly follow market tips and rumours
- Anything that appears unnaturally high or low will have some 'catch' disguised
- Do not follow schemes where you may protect the interest but lose the principal
- Invest with knowledge after understanding the product well.

# 7. PROTECTION RELATED PRODUCTS

## Insurance Policies*

Insurance, as the name suggests is an insurance against future loss. However, although life insurance is most common, there are other schemes that generate regular income and cover other types of losses.

### Life Insurance

Life Insurance is a contract providing for payment of a sum of money to the person assured or, following him to the person entitled to receive the same, on the happening of a certain event. It is a good method to protect your family financially, in case of death, by providing funds for the loss of income.

### Term Life Insurance

- Gaining popularity in India
- Lump sum is paid to the designated beneficiary in case of the death of the insured
- Policies are usually for 5, 10, 15, 20 or 30 years
- Low premium compared to other insurance policies
- Does not carry any cash value.

### Endowment Policies

- Provide for periodic payment of premiums and a lump sum amount either in the event of death of the insured or on the date of expiry of the policy, whichever occurs earlier.

### Annuity / Pension Policies / Funds

- No life insurance cover but only a guaranteed income either for life or a certain period
- Taken so as to get income after the retirement
- Premium can be paid as a single lump sum or through installments paid over certain number of years
- The insured receives back a specific sum periodically from a specified date onwards (can be monthly, half yearly or annual)
- In case of the death, it also offers residual benefit to the nominee.

### Units Linked Insurance Policy (ULIP)

- A ULIP is a life insurance policy which provides a combination of risk cover and investment.
- The dynamics of the capital market have a direct bearing on the performance of the ULIPs.
- The investment risk is generally borne by the investor
- Most insurers offer a wide range of funds to suit one's investment objectives, risk profile and time horizons. Different funds have different risk profiles. The potential for returns also varies from fund to fund
- ULIPs offered by different insurers have varying charge structures. Broadly the different fees and charges include- Premium allocation charges, Mortality charges, fund management fees, policy/administration charges and fund switching charges

### New Pension Scheme, 2009 (NPS)

- Defined contribution scheme open to any Indian Citizen between the age of 18 and 55

- The individual invests a certain amount in a pension scheme till he retires
- At retirement, he is allowed to either withdraw the money that has accumulated or buy an immediate annuity from an insurance company to generate a regular income or do both. A minimum of 40% needs to be used to buy an immediate annuity, a maximum of 60% of the money accumulated can be withdrawn
- Buying an immediate annuity assures a regular payment from the insurance company. This payment can be monthly, quarterly, half yearly or once a year
- The minimum amount that needs to be invested per contribution is ₹ 500. A minimum of four contributions need to be made per year. Other than this, a minimum of ₹ 6,000 needs to be invested per year
- There are no upper limits on the amount of money that can be invested as well as the number of contributions that can be made
- The money you invest in NPS will be managed by professional managers
- You can switch fund managers if you are not satisfied with the performance of your fund manager
- This is a non-withdraw-able account and investments in this keep accumulating till you turn 60. Withdrawal is allowed only in case of death, critical illness or if you are building or buying your first house
- Under Section 80CCD of the Income Tax Act investments of up to ₹ 1 lacs in the NPS can be claimed as tax deductions. Remember that this ₹ 1 lacs limit is not over and above the ₹ 1 lacs limit available under Section 80C
- Also no return is guaranteed as it is in case of PPF. The money you make is dependent on how well the fund managers chosen by you perform.

## Health Insurance

Health Insurance policies insure you against several illnesses and guarantee you stay financially secure should you ever require treatment. They safeguard your peace of mind, eliminate all worries about treatment expenses, and allow you to focus your energy on more important things. There are several health insurance or medical insurance plans in India. These can be divided into the following categories based in the coverage offered:

**Comprehensive health insurance coverage: These plans provide you complete health** coverage through a hospitalisation cover while at the same time also creating a health fund to cover any other healthcare expenses

**Hospitalisation plan: These health insurance plans cover your expenses in case you need to** be hospitalised. Within this category, products may have different payout structures and limits for various heads of expenditure. The hospitalisation coverage may be reimbursement based plans or fixed benefit plans. These plans aim to cover the more frequent medical expenses.

**Critical Illness Plans: These health insurance plans provide you coverage against critical** illness such as heart attack, organ transplant, stroke, and kidney failure among others. These plans aim to cover infrequent and higher ticket size medical expenses.

**Specific Conditions Coverage: These plans are designed specifically to offer health insurance** against certain complications due to diabetes or cancer. They may also include features such as disease management programs which are specific to the condition covered.

** Read latest provisions of schemes carefully as information provided herein may change.*

# 8. BORROWING RELATED PRODUCTS

With today's heightened cost of living, debts become a usual thing. A number of people apply for personal loans, car loans, mortgage loans, and a whole lot of others. There seems to be a loan for everything. Often, financial troubles begin as a result of too large debt.

## DIFFERENT TYPE OF LOANS AVAILABLE

### Personal Loan*

Personal loans are usually taken when you have to meet unexpected needs that are beyond a person's immediate financial means. People often get into financial trouble by taking out personal loans just for the extra money, or to purchase frivolous items, and then find that they can't make the monthly payments required.

#### Key Features

- Be ready for high interest rates of 14-18% p.a, high fees and even higher monthly installments
- The application process can be time consuming, taking weeks to be approved and funds disbursed, quite impractical for those unexpected immediate needs
- Rates and terms of the personal loans can vary tremendously, careful comparison is wise, helping to ensure that the consumer does not pay more than necessary for those emergency funds
- Take your time and do the homework before taking a personal loan
- Not advisable except for emergency requirements

### Housing Loan

A home loan is just another loan with your house as the collateral. If you are buying your first home then it is important to understand the ins and outs of home loans. There are many variations according to the economy and what the market is doing that determines things that are going to apply to your home loan.

#### Key Features

- Banks finance 75-80% of the property value
- Banks have recently started to offer lower fixed 'teaser' rates for a short period of time. Then after some time the interest rates jump up and become variable. Be careful to read the fine print.
- Most housing loans have a minimum lock in period of 3 years or more.
- Heavy penalty charges for pre payment
- Hidden fees include appraisal fees and other charges associated with the loan
- If you want to sell the house the loan becomes payable immediately

### Reverse Mortgage

The whole idea of a reverse mortgage is entirely opposite to the regular mortgage process where a person pays the bank for a mortgaged property. This concept is particularly popular in the western countries.

### Key Features

- A senior citizen who holds a house property, but lacks a regular source of income can put his property on mortgage with a bank or housing finance company. The bank/ housing finance company pays the person a regular payment
- The good thing is that the person who 'reverse mortgages' his property can stay in the house for his life and continue to receive the much needed regular payments. So effectively the property now pays for the owner.
- The way this works is that the bank will have the right to sell off the property after the incumbent passes away or leaves the place, and to recover the loan. It passes on any extra amount to the legal heir.

### Draft Guidelines of reverse mortgage in India prepared by RBI have the following salient features:

- Any house owner over 60 years in eligible
- The maximum loan is upto 60% of the value of residential property
- The maximum period is 15 years
- The borrower can opt for monthly, quarterly, annual or lump sum payments at any point, as per his discretion
- The revaluation of the property has to be undertaken by the Bank or HFC once every 5 years
- The amount received through reverse mortgage is considered as loan and not income
- Reverse mortgage rates can be fixed or floating and hence will vary according to market conditions depending on the interest rate regime chosen by the borrower.

## Loan against Securities

The main purpose of taking loans against shares is to preserve investment, apart from taking care of personal needs. People also resort to such a loan to meet their contingencies and get liquidity without actually selling the shares. It is advisable to take loan against securities only when you are expecting a certain sum of money a few months down the line and you need some funds in the interim.

### Key Features

- RBI allows banks to lend up to 75% of the value of demat shares and 50 per cent of the value of physical shares. However, banks can, and do, fix their own limits with respect to the extent of funding within that range
- Banks have an approved list of securities that they lend against and this list varies from one lender to the other. This list also gets revised from time to time
- Loans against mutual fund units are based on their NAV value
- The amount of loan that you will get depends on the valuation of the security, applicable margin, your ability to service and repay the loan and other conditions
- Interest rates usually range between 14-18%
- Charges vary from bank to bank and usually include processing fees (1-1.5%) and documentation charges
- Only fully paid shares are accepted
- Scrips in the name of corporate, minors, Firms, HUF, and NRIs are not eligible for finance under this scheme.

** Please check latest guidelines / provisions for each loan.*

## Credit Card Debt

Credit card debt is usually resorted to when all other option including personal loans are exhausted. Credit card debt is unsecured therefore it carries very high interest rates. A credit card gives you the power to spend money even when you don't have the funds. Lots of young people misuse it by spending on frivolous things.

Stay away from credit card debt: Lots of people are having problems with credit debt. Paying only the minimum is costly and will ensure that you have debt for a long time. Try to consistently pay as much as you are able to, towards your debts - you will be glad you did.

### Key Features

- Interest rates on credit cards are probably the highest compared to other credit facilities. The interest ranges from 18-36% p.a.
- Debt keeps accumulating via interest and penalties. If you are not paying off you outstanding balance before the interest free period expires then you will be paying a high interest rate. This can make it hard to reduce your credit card debt
- As most credit card limits are low some borrowers tend to neglect the fact that the interest payment is relatively small on a month to month basis. This is a dangerous practice because the amount of interest you pay can quickly jump to exceed the value of your actual debt
- Be very careful of having multiple cards and be very careful of taking up the marketing promotions from credit card providers when they actively try and get you to increase your credit card limit.

## Steps to Avoid Excess Debt

### Set debt limits

- Decide how much you can afford to be in debt. Then, make sure that your total debt is below this amount
- You may also want to set a limit on how much money out of each paycheck you are willing to spend on debts. Having this sort of limit can be very useful in ensuring that you do not overextend your credit.

### Shop carefully for debts

- If you do need a loan, be sure to do your research well. Always understand how much you will pay for your loan in interest and look for the lowest interest rates and the most affordable debt you can find. This will ensure that you do not end up overspending on interest rates
- Once a year, check to make sure that you are still getting the best interest rates and best loan deals possible.

### Don't give into temptation

- Once you show that you can handle some debt, many companies will be eager to offer you more credit. Companies may start sending you credit card offers and your lenders may offer you additional credit products
- While it may be tempting to take out lots of new debt, you need to be wary of doing so. Only take out a loan or credit service when you really need to

### Automatically have money go towards your bills

- Many banks and employers will allow you to have some money automatically deducted from your paycheck
- This can be a great way to ensure that your bills get paid promptly. Plus, since you won't even see the money, you are less likely to miss it.

# 9. ADVANTAGES OF FINANCIAL EDUCATION

The pressing need for financial education comes from two areas.

Firstly is the deterioration of personal finances. Today youngsters resort to living beyond their means, have credit card debt and making risky investments.

Second is the proliferation of new and often complex, financial products that demand more financial expertise of consumers. Turbulent market conditions and changing tax laws compound the need for sound financial education.

Even Government servants are moving to defined contribution regimes from the earlier schemes with defined benefits on retirement. Therefore, retirement planning becomes very important.

**Some advantages of financial education are:-**

- Helps build a secure financial future. Lack of financial knowledge can affect an individual's or family's ability to save for long-term goals and make them vulnerable to severe financial crisis
- Prepared for financial emergencies. By incorporating contingencies in your financial plan you are ready to face unseen circumstances head on
- People who are financially literate are reluctant to buy financial products that they do not understand and thus do not fall for marketing gimmicks
- Feeling a sense of accomplishment. Financial education is effective at moving people closer to their goals
- Makes a more responsible individual with a disciplined approach to money. Helps people from overspending and inculcates a habit of savings and investments
- You become more aware of questionable lending practices adopted by banks and other lenders to sell their products
- Feel like you are setting a good example for your family
- Money management skills can benefit other aspects of your life

# 10. INVESTOR PROTECTION AND GRIEVANCES REDRESSAL MECHANISM

## INVESTOR PROTECTION

- Securities and Exchange Board of India (SEBI) was established with the primary objective of protecting the interest of the investors in the securities market
- SEBI can issue directions to all intermediaries and other persons associated with the securities market in the interest of the investors or for orderly development of the securities market
- SEBI has notified the SEBI (Investor Protection and Education Fund) Regulations, 2009 with a view to strengthening its activities for investor protection. The fund shall be used for the following purposes:-
    - Educational activities including seminars, training, research and publications, aimed at investors
    - Awareness programmes through media - print, electronic, aimed at investors

- Funding investor education and awareness activities of investor associations recognized by the Board
- Aiding investor associations recognized by the Board to undertake legal proceedings in the interest of investors in securities that are listed or proposed to be listed
- Exchanges have set up an Investor Protection Fund (IPF) to meet the claims of investors against defaulter members
- The Exchanges also assist in arbitration process between members and investors and member's inter-se

## INVESTOR GRIEVANCE REDRESSAL MECHANISM

- SEBI and Stock Exchanges have set up investor grievance redressal cells for fast redressal of investor complaints relating to securities markets
- SEBI has directed all the stock exchanges, registered brokers, sub-brokers, depositories and listed companies to make a provision for a special email ID of the grievance redressal division/ compliance officer for the purpose of registering complaints by the investors
- SEBI has set up a mechanism for redressal of investor grievances arising from the securities market
- SEBI provides "walk-in" service at its head office at Mumbai and its regional offices at New Delhi, Chennai, Kolkata and Ahmadabad on all working days. Investors can meet the officials and get guidance relating to the grievances that they may have against issuers. Investors can also meet the higher officials of SEBI on specified working days.

# Notes

# Notes

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Securities and Exchange Board of India

For future financial education programs on any of the following modules:

1. School Children
2. College Students
3. Middle Income groups
4. Executives
5. Retirement Planning
6. Home Makers
7. Self Help groups

OR

Any of the following topics on securities markets namely:

1. How to read an offer document ?
2. How to invest in the primary market through stock exchanges ?
3. How to trade in securities/guide to investors ?
4. De-mat account and depositories
5. Mutual funds-Dos and Don'ts
6. Collective investment schemes- Dos and Don'ts
7. Buy back of securities, delisting of shares
8. Takeover regulations
9. Investor grievances-how to resolve it?

Please write to SEBI at: feprogram@sebi.gov.in

Or

**GENERAL MANAGER**
Investor Awareness Division
**Securities and Exchange Board of India**
SEBI BHAVAN
Plot No. C4-A, G-Block
Bandra Kurla Complex, Bandra (East)
Mumbai - 400 051
Tel: +91-22-26449880

* Investor can lodge their complaints with SEBI at: http://scores.gov.in
* Investor can approach SEBI for any assistance at: asksebi@sebi.gov.in

Contact details of SEBI offices in India

**HEAD OFFICE**

**SEBI BHAVAN**

Plot No. C4-A, G-Block, Bandra Kurla Complex, Bandra (East), Mumbai - 400 051

Tel: +91-22-26449000 / 40459000 / 9114 / Fax: +91-22-26449016-20 / 40459016-20

E-mail: sebi@sebi.gov.in

(Maharashtra, Madhya Pradesh, Chhattisgarh, Goa, Diu, Daman, Dadra and Nagar Haveli)

**SEBI TOLL FREE HELPLINE 1800227575**

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Securities and Exchange Board of India

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